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Taxation of Charity-PAC Contribution Matching Programs

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This is in response to your request for a General Counsel Memorandum on the question of certain matching contributions made to charities by corporations.

ISSUES

(1) Is a corporation's contribution to a charity designated by its employee deductible by the corporation under section 170 if the contribution is made under a program to match the employee's contribution to the corporation's political action committee?

(2) Should the transaction be recharacterized as a payment of compensation to the employee, and a subsequent contribution by the employee to the charity?

CONCLUSIONS

(1) No. The charitable contribution is not deductible by the corporation under section 170 because the corporation is receiving a quid pro quo in the form of a contribution to the political action committee.

(2) No. The amount paid to the charity designated by the employee is not a payment for services performed by the employee. Furthermore, the employee does not receive either property or an economic benefit as a result of the contribution.

FACTS

Charity - PAC matching programs have been described in several opinions issued by the Federal Election Commission (see e.g., Federal Election Commission Advisory Opinion 1989-7, June 30, 1989). Typically, such a program allows corporate employees to designate a section 501(c)(3) organization as the recipient of a contribution equal to the sum of the contributions that the employee made to the corporation's PAC the previous year. Such a program generally excludes all section 501(c)(3) organizations that provide any benefits in return for contributions. Several FEC opinions conclude that the matching of a PAC contribution with a charitable donation is not a means of exchanging treasury monies for a voluntary contribution, which is prohibited by 11 CFR 114.5(b), but is rather a permissible solicitation expense under 2 U.S.C. 44lb(b)(2).

ANALYSIS

The charity - PAC matching program raises two key income tax issues. First, is the corporation permitted a charitable contribution deduction under section 170 of the Internal Revenue Code? Second, should the matching charitable contribution be characterized as compensation to the employee, and a subsequent payment by the employee to the charitable organization?

Issue (1): Corporation Not Entitled to Charitable Deduction

Section 170(a) states that a deduction is allowed for any charitable contribution payment of which is made within the taxable year. Charitable contribution is defined as a contribution or gift to or for the use of a charitable donee. it is settled that a transfer does not qualify as a contribution or gift unless it is made without receipt or expectation of a financial or economic benefit commensurate with the money or property transferred. See, e.g., Rev. Rul. 67-246, 1967-2 C.B. 104; Rev. Rul. 76-185, 1976-1 C.B. 60. This principle has been recently reaffirmed by the Supreme Court in two opinions, U.S. v. American Bar Endowment, 477 U.S. 105 (1986), and Hernandez v. Commissioner, 109 S.Ct. 2136 (1989). In U.S. v. American Bar Endowment, the Supreme Court noted that "[a] payment of money generally cannot constitute a charitable contribution if the contributor expects a substantial benefit in return." 477 U.S. at 116. The Court applied a test in which a contribution was deductible (1) to the extent that the contribution exceeds the market value of the benefit received, and (2) if it was made with the intention of making a gift.

The same principle was applied in Hernandez. In Hernandez, the Court held that payments to the Church of Scientology were not eligible for a charitable deduction under section 170 because there was a quid pro quo for the contribution. In determining that a quid pro quo existed, the Court focused strongly on the external features of the transaction. The Court noted that looking to external factors had the advantage of obviating the need to determine the motivations of individual taxpayers. The external features indicating a quid pro quo included the existence of an identifiable benefit, fixed price schedules calibrated to sessions of particular lengths or sophistication, and the fact that the church barred provision of benefits for free.

A PAC is organized to promote the interests of its corporate sponsor, A major role of a PAC is to make contributions to political candidates. The corporate sponsor is prohibited by law from making such contributions. Therefore, a contribution to a corporation's PAC is a benefit to that corporation. This benefit is received in return for the charitable contribution the corporation agrees to make to its employee's designated charities. Furthermore, as in Hernandez, the external features of the transaction also indicate the existence of a quid_pro quo: there is an identifiable benefit, and the benefit received fixed and increases or decreases depending on the amount of the contribution. Applying the principles of American Bar Endowment and Hernandez to the case at hand, we conclude that corporations making charitable contributions in return for PAC contributions receive a substantial benefit in return.

It might be argued that American Bar Endowment and Hernandez do not apply because in those cases the return benefit was provided by the charitable recipient, while in the case at hand, the return benefit is provided by a third party (the employee that makes the PAC donation). However, it has been held that the return benefit or quid pro quo need not be provided by the charitable donee; it may be an indirect result of the gift. For example, in Singer v. U.S., 449 F.2d 413 (1971), cited by the Supreme Court n American Bar Endowment, the Singer Co. donated sewing machines to public and parochial schools at discounts of 45 percent of their fair market value. The Claims Court held that the company could not take a charitable deduction for the amount of the discount because the company's predominant reason for granting the discount was not charitable. The court found that the predominant reason for the discount was to "develop prospective purchasers" on the theory that students that learned to sew on Singer machines would buy them. The return benefit in Singer, product identification for future buyers of Singer sewing machines, was not provided directly by the charitable recipients; the return benefit was nevertheless sufficient to disallow a deduction for the discount.

Issue (2): Transaction Not Recharacterized as a Payment of Compensation to the Employee and a Subsequent Payment by the Employee to the Charitable Organization.

In Revenue Ruling 79-121, 1979-1 C.B. 61, a government official received an honorarium for making a speech to a professional society. The ruling concludes that the payment must be included in the official's gross income, even though the official requested that the payment be transferred to a charitable organization. The ruling also holds that the official, rather than the professional society, is entitled to a deduction under section 170 with respect to that amount.

However, under Revenue Ruling 67-137, 1967-1 C.B. 63, the right of certain employees to designate charitable organizations to which their employer will make charitable contributions is not income to the employee. Furthermore, the contribution is deductible by the corporation to the extent provided by section 170. The rationale for not treating the employees' right to designate charitable recipients as compensation is that "[t]he employees are merely performing administrative duties for the corporation by suggesting specific qualified recipient organizations."

In a related area, Revenue Ruling 79-9, 1979-1 C.B. 125, which explains the acquiescence of the Service in Knott v. Commissioner, 67 T.C. 681 (1977), holds that a charitable contribution by a corporation is not taxable as a dividend to the corporation's controlling shareholders (in spite of shareholder control over the selection of the charitable donee) unless property or an economic benefit 2 is received by the controlling shareholders or their families.

The conclusion we draw from a comparison of these rulings is that when a charitable organization is designated to be the recipient of a payment by a person providing services for the payor, the payment is not treated as compensation unless it is in return for specific and identifiable services, so that the payment represents a mere assignment of income. In Revenue Ruling 79-121, the amount paid to the charitable organization was clearly payment for specific and identifiable services. Therefore, the ruling was correct in treating that amount as having been paid to the service provider and then transferred to the charitable organization. However, in Revenue Ruling 67-137 the amount paid to the charitable organization by designation of the employees was not payment for services performed by the employees. Furthermore, the employees received no economic benefit as a result of the payment to the charitable organization.

We believe that the facts and circumstances of the charitable-PAC match program described are more similar to the circumstances of Revenue Ruling 67-137 and Revenue Ruling 79-9 than to the circumstances of Revenue Ruling 79-121. The amount paid to the charitable organization designated by the employee is not a payment for services performed by the employee. Furthermore, the employees do not receive either property or an economic benefit as a result of the contribution.

Therefore, we conclude that a charity-PAC matching program should not be recharacterized as payment of compensation to the employee, and a subsequent payment by the employee to the charitable organization.

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FN1 Although the Supreme Court has not defined "substantial benefit", the Service position is that the full amount of a contribution is deductible under section 170 only where the return benefit is "inconsequential or insubstantial." Rev. Proc. 90-12, 1990-1 C.B. 471. Clearly, there is more than an inconsequential or insubstantial return benefit to the corporation here.

FN2 That ruling revoked two previous rulings, Revenue Rulings 68-658 and 75-335, which held that such a contribution constituted a dividend to the corporation's controlling shareholders if the contribution served only the personal interests of the shareholder. The conclusion in the two revoked rulings was based in part on the fact that controlling shareholders of a closely held corporation controlled the selection of the charitable donee and the size of the gift. The position of the Service in Revenue Rulings 68-658 and 75-335 was rejected by the Tax Court in Knott v. Commissioner, 67 T.C. 681 (1977).