Good Deeds and Good Business

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By Lou Vlahos

Many successful business people are also community-minded. They have done well for themselves and their business and, at some point, they seek to share some of their success with the communities they serve and in which they operate, and with the communities in which their employees live and work. This charitable inclination reflects, more often than not, the philosophy of the owner and chief executive of the business, and he or she often wishes to pass this philosophy along to those members of his or her family who will succeed the owner in the business.

Businesses approach charitable giving and community service in many different ways. Some donate cash and/or products; others organize a "day of service" by their employees, or encourage their key employees to serve on charity boards or committees.

A recent IRS ruling considered a variant on one such matching program. The company, which already had a matching program, proposed to establish its own tax-exempt charitable organization. The company would be the charity's sole contributor, the charity would be treated as a private foundation for tax purposes, and the company and charity would share the same officers and directors.

It was proposed that the charity assume the company's role of matching employee gifts. This "assumption" would be prospective only; the charity would not take on any existing obligation of the company or release the company of any financial burden. In conjunction therewith, and in addition to the criteria set forth above, the charity represented that it would not match contributions to any organization which the charity or any "disqualified person" controlled. In general, disqualified persons as to the charity would include (among others) a substantial contributor like the company, the officers and directors of the company, and the owners of the company.

The IRS ruling focused primarily on the issue of self-dealing; specifically, the question of whether the charity's assets were to be used by or for the benefit of a disqualified person; specifically, the company. If a disqualified person is found to have engaged in an act of self-dealing with a private foundation, the IRS will impose a penalty tax upon the disqualified person, as well as on certain foundation managers.

The ruling notes that the public recognition that a person may receive, arising from the charitable activities of a private foundation to which such person is a substantial contributor, does not in itself result in an act of self-dealing since, generally, the benefit to such person is "incidental and tenuous." For example, the naming of a "public" facility (the construction of which was funded by the foundation) after the substantial contributor of a foundation will not be an act of self-dealing – the benefit to the disqualified person is deemed to be only incidental.

Thus, the IRS ruled, the benefit derived by the company from the payments made by the charity – in the form of goodwill in the community, and increased loyalty and morale among the employees – was incidental and tenuous, and did not constitute self-dealing.

A company-sponsored foundation is only one way by which a closely held business may support charitable activities within its community. Such a foundation, however, may, also serve as a vehicle through which the owners may instill the family's values in its younger members, familiarize these family members with the company's workforce and customers, and train them in the management of a "business" endeavor before getting them directly involved in the company's actual business.