Theories of the Corporation and the Tax Treatment of Corporate Philanthropy Symposium: Corporate Philanthropy Law, Culture, Education, and Politics

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THEORIES OF THE CORPORATION
AND THE TAX TREATMENT OF CORPORATE PHILANTHROPY

LINDA SUGIN*

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  Fisch, Abner Greene, Tracy Higgins, Faith Stevelman Kahn, Lily Kahng, James Kainen,
  Nancy Knauer, Mark Patterson, Daniel Shaviro and William Treanor for comments on
  earlier drafts, and to Antonia Giuliana for excellent research assistance. The research for
  this project was supported by a summer research grant from Fordham University School
  of Law.
The Internal Revenue Code\(^1\) has fossilized a conception of the corporation as a "real entity."\(^2\) It generally treats that entity like any other taxable person, but it presumes that the entity is "the classic profit maximizer in collective form."\(^3\) According to the tax law, a corporation earns its own income and pays its own tax.\(^4\) Treating the corporation as a real entity serves important practical goals: it eases administration and allows form to control the tax consequences of many corporate transactions, thereby improving predictability for taxpayers.

Developments in corporate theory, however, challenge this conception of the corporation. Accordingly, tax policymakers should reconsider the Code's real-entity approach. In particular, the Code's model of the corporation does not accurately describe the multi-functioned, politically powerful, and internally conflicted publicly held corporations that dominate the economic landscape. In its treatment of corporate philanthropy, the Code adopts an anthropomorphic conception of the corporate entity that is at odds with the profit-maximizing conception prevalent throughout the rest

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1. All references are to the Internal Revenue Code of 1986, as amended [hereinafter the "Code"].


   For purposes of this essay, the important characteristic of the real entity theory of the corporation is that it treats the corporation as a thing that exists, separate and apart from the people who make it up. While ethical theorists and corporate law scholars have defined the attributes of the entity differently, for clarity of analysis, this essay distinguishes two models of the corporate entity: an anthropomorphic entity, see infra Part I.B.2.a, and a limited entity, see infra Part I.B.2.b. The aggregate notion of the corporation, which is implicit in the nexus-of-contracts model, is presented here as the opposite of the entity model, although conceptions of the corporation fall along a continuum. See infra Part II.


4. All references to corporations are to corporations taxed under subchapter C of the Code. This essay assumes that integration of the corporate and individual income tax is not an option, and takes no position on the desirability of an integrated tax. Although some closely held corporations are taxed under subchapter C, the issues discussed in this essay are primarily relevant only for widely held corporations.
of the Code.\textsuperscript{5} It is also inconsistent with treating the corporation as an entity that is limited by its purposes and consequently not entitled to the rights and powers that humans possess.\textsuperscript{6} By treating the corporation as a person who can act charitably, the Code has legitimized the power of management to spend the shareholders’ money for charitable purposes,\textsuperscript{7} and has undermined the justification for using a tax expenditure model for the individual charitable deduction.\textsuperscript{8}

Although corporate theory has not entirely resolved the issues that arise in explaining and analyzing how corporations work and what their role in society should be, the corporate-law literature has seriously questioned the formalistic entity theory of the corporation embodied in the Code. Recent corporate theory has moved away from an entity model toward an aggregate model of the corporation, which considers the corporation as its constituent parts. While changing conceptions of the corporation reflected in corporate theory may not provide sufficient reason to alter the legal regime for taxing corporations,\textsuperscript{9} at the very least, tax policymakers should share corporate theorists’ inquiries into the nature of the corporation and consider the normative baggage being carried by the tax law’s model.\textsuperscript{10} The tax law, by unreflectively adhering to the entity concept, has failed to grapple with the tax relevance of these ideas.

In keeping with recent attempts to remedy tax theory’s isolation from more general social theory\textsuperscript{11} or from legal theory in related disciplines,\textsuperscript{12} this essay considers the implications of corporate-law theories about the nature of the corporation for the tax treatment of corporate philanthropy. In discussing corporate philanthropy, this essay is concerned with

\textsuperscript{5} See infra Part I.B.1.
\textsuperscript{6} See infra Part I.B.2.
\textsuperscript{7} See infra Part I.B.3.b.
\textsuperscript{8} See infra Part I.B.3.c.
\textsuperscript{9} Corporate theory has not produced a complete change in state corporate law, either. See William T. Allen, Our Schizophrenic Conception of the Business Corporation, 14 CARDOZO L. REV. 261 (1992).
\textsuperscript{10} Considerations of tax administration, revenue collection and politics often outweigh theoretical consistency. See, e.g., I.R.C. § 1014 (allowing appreciation in assets held by decedent to permanently escape income taxation while allowing relatively easy date-of-death basis determination); I.R.C. § 67 (instituting a 2% floor for deductibility of certain expenses clearly incurred in the production of income, and thereby encouraging use of the standard deduction).
corporate contributions that are not profit-driven. Application of corporate theory to corporate-tax issues can help to illuminate biases that are hidden behind the Code’s veneer of neutrality.

The subject of corporate philanthropy invites this kind of analysis because the tax law’s treatment of corporate philanthropy is so dependent on treating the corporation as a real entity. Once the real entity notion of the corporation is relaxed or questioned, the tax law’s treatment of corporate philanthropy is no longer obvious, and the deduction for corporate giving demands a more explicitly normative explanation. In addition, because the tax law’s legitimation of corporate philanthropy is largely responsible for the corporate law’s acceptance of it, application of corporate analysis creates a dynamic relationship that can potentially improve both the tax law and the corporate law.

This essay is organized as follows: Part I describes the entity model of the corporation as developed in corporate and ethical theory, showing how that model is embodied in the Code and how variations in that model produce different conclusions about the legitimacy of the charitable contribution deduction for corporations. It discusses some issues that arise when corporate philanthropy is considered in the context of the entity theory and how the tax law might respond to those issues.

Part II explains how the nexus-of-contracts conception of the corporation, applied as an analytical tool, challenges the tax law’s treatment of corporate philanthropy. This more contemporary model of the corporation deconstructs the corporate entity and suggests the possibility that taxpayers other than the corporation, such as shareholders, managers, and employees, might more appropriately claim the charitable contribution deduction for corporate giving. By reconsidering the taxation of corporate philanthropy, this essay concludes that the Code, by allowing a deduction at the corporate level for charitable donations financed from the corporation’s coffers, contains behavioral biases that encourage giving by corporations rather than by the individuals who make up corporations. It suggests that changes to current law might better allocate income among taxpayers, neutralize those biases, and reconcile some concerns of both corporate and tax policy.

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13. See infra notes 48-52 and accompanying text.

I. THE TAX LAW TREATS THE CORPORATION AS A REAL ENTITY

The entity theory is convenient for explaining the charitable deduction for corporations because, at its most extreme, it allows projection of human characteristics onto corporate entities and consequently, the imputation of moral agency onto corporate organizations. If corporations are just like individuals, then they must have the same capacity for charity as human persons, and the Code should treat them the same. However, the Code's invocation of an entity model does not necessarily justify a charitable deduction for corporations because the entity model, standing alone, does not imply that corporations are just like people; a particularly anthropomorphic conception of the corporate entity, which the Code fails to adopt as a general matter, must underlie any conclusion that a corporation is a person which can itself be charitable.

A. The Emergence of an Entity Theory

In corporate theory, the conception of the corporation as a "real entity" that exists separate and apart from the individuals who make it up, or as an "aggregate" of individuals, has evolved over time. The earliest conception of the corporation, adopted from British law, was based on a government "concession" theory that treated the corporation as an entity, and also solely as a creature of law. During this period, corporations received individual charters from the state to carry out particular purposes, and, consequently, were more clearly identified with the public sector.

After the enactment of general corporation laws, which provided widespread availability of the corporate form, the state's role weakened. While some argued that general availability of the corporate form undermined the entity notion because any group of individuals could privately create their own corporation, others still viewed the corporation

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15. Moral agents can act intentionally and take moral responsibility for their actions. See infra notes 63-69 and accompanying text; see also SHAME, RESPONSIBILITY AND THE CORPORATION 4-5 (H. Curtler ed., 1986).


17. See Bratton, The New Economic Theory of the Firm, supra note 2, at 1484; see also Millon, supra note 2, at 206. The public nature of the chartered corporation was taken for granted and judicial intervention was necessary to protect any private attributes of corporations. See Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819).

18. See Horwitz, supra note 2, at 204.
as an entity. In the late nineteenth century, there was a debate between individualists, who adopted a contractual model of the corporation that treated the corporation as an aggregation of shareholders along the partnership model, and "corporate realists," who adopted the entity model. In the early twentieth century, the entity conception seemed to have triumphed, and much was written about the personality of that entity, for example, as an organic or inevitable institution.

The debate about the nature of the corporation in the scholarly literature quieted from the 1920s until the 1980s, during which time corporate realism, which treated the corporation as a real entity, was the dominant paradigm, and the corporation was generally envisioned as a hierarchical structure with management in power. While Berle and Means can be read to have introduced a contractual concept into the corporation, the corporation did not lose its real-entity existence in the literature until economic theories were adopted by corporate-law theories.

19. See Bratton, The New Economic Theory of the Firm, supra note 2, at 1486; Millon, supra note 2, at 211 ("The conception of the corporation as an artificial creation entirely dependent on the state for its powers gradually gave way to the view that corporations are the natural products of individual initiative and possess powers conferred by their constituent shareholders.").

20. See Bratton, The New Economic Theory of the Firm, supra note 2, at 1489-90. The corporate realists continued to be influential in the scholarly literature through at least the 1920s. See id. at 1491.

21. See Horwitz, supra note 2, at 214.

22. See id. at 220.


24. Corporations were treated as having ontological status, or reality apart from the people who participated in them.


Throughout its history, the tax law has taken the legal-person fiction very literally, adopting as strong a version of the independent corporate person as any of the corporate theorists.\textsuperscript{28} If Congress has been ambivalent about treating corporations like people, that ambivalence is rarely apparent in the Code's provisions for corporations. The corporate tax\textsuperscript{29} is imposed on corporations as independent taxpaying persons, regardless of who the corporation's shareholders are, or what their taxpaying ability is,\textsuperscript{30} even though tax equity is often judged by reference to a taxpayer's ability to pay.\textsuperscript{31} Only if corporations are people can they have their own abilities to pay tax; and it is clear that individuals bear the ultimate burden of the corporate tax, even though economists do not agree about who those individuals are.\textsuperscript{32} Whoever bears the economic burden of the corporate tax bears it at the corporate rate, regardless of that person's individual marginal rate, so the corporate tax, by design, is not related to the taxpaying ability of any of the individuals who might bear it.

Despite the corporate tax's failure to impose the tax burden based on ability to pay, the Code continues to adhere to a strict separate entity treatment for subchapter C corporations. Under this treatment, corporate and individual income taxes are not integrated, despite the fact that virtually all tax policy theorists advocate integration,\textsuperscript{33} and the 1986 Act

\textit{Fischel, 89 Colum. L. Rev. 1449, 1449 (1989).}

\textsuperscript{28} See Arthur W. Machen, \textit{Corporate Personality}, 24 Harv. L. Rev. 253, 261-62 (1911) (claiming that the corporation is a real and natural entity).

\textsuperscript{29} This refers to the corporate income tax imposed on corporations that are subject to subchapter C of the Code.


strengthened the corporate tax, which, in the past, taxpayers had successfully self-integrated, through the use of leverage, for example. The text of the Code therefore continues to reflect an unflinching legislative adherence to the concept of separate corporate personhood, suggesting, in error, that taxing corporations as entities can be part of a system that fairly distributes the tax burden.

In addition, the tax law’s wholesale adoption of the corporate person fiction is well illustrated by the current rate schedule applicable to corporations. Under § 11 of the Code, corporations are subject to increasing marginal rates of tax, depending on their income. This is a curious phenomenon, given that the income of a corporate taxpayer is not related to the taxpaying ability of the people who bear the burden of the corporate tax. Arguments about the desirability and justification for progressive taxation are simply inapplicable to the income of a


35. Some have argued that the tax on income from capital is an effective way to increase the Code’s progressivity, and operates as a second-best wealth tax. Cf. Alvin C. Warren, Jr., Fairness and a Consumption-Type or Cash Flow Personal Income Tax, 88 HARV. L. REV. 931-46 (1975). This distributional justification for the corporate income tax obviously depends on the incidence of that tax falling on holders of capital, a premise that may not hold. Moreover, it is not at all clear that Congress understands the corporate tax in this way.

Outside the corporate context, the tax law does recognize that some legal entities are made up of individuals, but has refused to apply any general aggregate notion for widely held corporations. S corporations, which are taxed as pass-through entities, are limited to 75 shareholders. See I.R.C. § 1361(b)(1)(A). Publicly traded partnerships are taxed as corporations. See I.R.C. § 7704(a). The Code has created a structural division between C corporations, subject to their own tax, and partnerships, which are taxed as pass-throughs. Partial pass-through regimes, such as PFICs and personal service corporations, stand in between.

While courts sometimes ignore the separate existence of a corporation for tax purposes, those cases bolster the separate entity treatment of widely held corporations by preventing taxpayers from manipulating the corporate form in closely held entities. For example, where the court determines that the corporation is simply a vehicle for tax avoidance, it may disregard the separate existence of the corporation. See BITTKER & EUSTICE, supra note 30, ¶¶1.05[1][a] & 2.07. By ignoring the corporation where there is ambiguity about where the corporation ends and the shareholders begin, the courts have strengthened the notion of the corporation as a real and separate entity.

36. The Office of Management and Budget has recognized the uncomfortable fit of the graduated-rate structure in the corporate tax by designating it a tax expenditure and quantifying the expenditure by reference to the top corporate rate. OFFICE OF MANAGEMENT AND BUDGET, ANALYTICAL PERSPECTIVES: BUDGET OF THE UNITED STATES GOVERNMENT 44 (fiscal 1996) (estimating revenue loss from the graduated corporate income tax rate at $4,120,000,000 in 1996).
corporation; progressive taxation is about the relative distribution of the
tax burden among the individuals who bear that burden.\textsuperscript{37} The importation
of a graduated-rate structure into the corporate tax implies that there is
decaying marginal utility of corporate income, a conclusion that cannot be
reached without identifying the individual circumstances of the people who
would otherwise receive that income. The adoption of that concept into
the corporate tax shows Congress's adherence to the idea that a
corporation is a person when the corporate tax is at issue.

Similarly, the regulations that define corporations for tax
purposes—and distinguish corporations from other business
entities—support the conception of the corporation as an entity. For
example, the regulations treat "continuity of life" as a distinguishing
corporate characteristic\textsuperscript{38} an attribute that can only attach to something
that exists.\textsuperscript{39} Limited liability is another corporate characteristic under the
regulations,\textsuperscript{40} one that Professor Horwitz has argued flows directly from
the entity notion.\textsuperscript{41}

\textbf{B. The Entity Theory and the Charitable Deduction}

The real-entity model of the corporation embedded in the tax law has
allowed the Code to treat the income of the corporation as belonging to the
entity, rather than to any individual. Accordingly, as long as corporate
income belongs to the entity, charitable contributions from the corporate
coffers may be made by the entity. Conventional analysis would therefore
conclude, as the tax law does, that the corporation is the taxpayer entitled
to the deduction associated with the contribution. In this way, the entity
theory of the corporation adopted by the Code seems to mandate the
charitable deduction for corporations.

There are three problems with this analysis, one internal to the tax law
and the others resulting from the interplay of corporate theory and tax law.
First, as a matter of the Code's internal consistency, the corporate

\textsuperscript{37} There is significant literature debating progressive taxation. \emph{See}, \textit{e.g.}, Joseph
Progressive Taxation}, 75 \textit{CAL. L. REV.} 1905 (1987); Walter Blum & Harry Kalven, \textit{The
Uneasy Case for Progressive Taxation}, 19 \textit{U. CHI. L. REV} 417 (1952); Marjorie E.
Kornhauser, \textit{The Rhetoric of the Anti-Progressive Income Tax Movement: A Typical

\textsuperscript{38} \textit{See} Treas. Reg. § 301.7701-2(b) (1993).

\textsuperscript{39} The regulation states: "A corporation . . . has a continuing identity which is
detached from the relationship between its stockholders." Treas. Reg. § 301.7701-2(b)(2)
(1993).

\textsuperscript{40} \textit{See} Treas. Reg. § 301.7701-2(d) (1993).

\textsuperscript{41} \textit{See} Horwitz, \textit{supra} note 2, at 185.
charitable deduction is incompatible with the Code's general treatment of the corporation as a purely profit-maximizing entity.\textsuperscript{42} Second, adoption of an entity theory for the corporation alone does not establish that corporations have the moral capacity for charity, which seems to be a prerequisite for the individual deduction.\textsuperscript{43} Therefore, assuming that the corporation is an entity does not require parallel taxation for corporations and individuals, and does not necessarily support a charitable contribution deduction for the entity.\textsuperscript{44} Corporations should only be entitled to the charitable deduction if they can, in fact, act charitably.\textsuperscript{45} Finally, if the corporation is to be treated as an entity, the entity's acts must be distinguished from the individual acts of the people who make up the corporation. In determining what constitutes legitimate corporate action, the existence of conflicts among the individuals associated with the corporation, particularly owners and managers, must be recognized and addressed.\textsuperscript{46} The tax law has ignored the issues raised by the separation of ownership and control in large corporations by generally presuming that corporations are operated in the single-minded pursuit of profit. Thus, the profit-maximizing, entity notion is problematic, whether analyzing the tax law from within or without.

1. Inconsistency in the Code

In addition to treating the corporation as an entity, the Code treats that entity as having certain characteristics. One overwhelming characteristic is that corporations are operated for profit.\textsuperscript{47} In fact, the Code essentially presumes that all expenses incurred by a corporation are expenditures incurred in the production of income,\textsuperscript{48} and corporations are therefore generally spared the burden of proving that their expenditures are, in fact, connected to their businesses.

Against this presumption stands the corporate charitable deduction, which uniquely contemplates (and subsidizes) expenditures that are not

\begin{itemize}
  \item \textsuperscript{42} See infra Part I.B.1.
  \item \textsuperscript{43} See infra Part I.B.2.
  \item \textsuperscript{44} Outside the charitable contribution context, the Code recognizes that the corporate person is fundamentally different from the individual taxpayer by explicitly exempting corporations from certain limitations that are applied to individuals. See, e.g., I.R.C. §§ 183, 465, 469. See infra notes 63-87 and accompanying text.
  \item \textsuperscript{45} See infra Part I.B.3.
  \item \textsuperscript{46} See Treas. Reg. § 301.7701-2(a) (1993) (providing that all organizations taxed as corporations must have "an objective to carry on business and divide the gains therefrom").
  \item \textsuperscript{47} See BITTKER & EUSTICE, supra note 30, ¶ 5.03[1].
\end{itemize}
profit-maximizing for the corporation. Of course, some expenditures that are commonly called corporate philanthropy are, in fact, profit-oriented, and they fit well within the Code's approach to taxing corporations. Those expenditures are not the subject of this paper.49

Some corporate philanthropy is not profit-oriented,50 or at least, we must assume that it is not51 in order to consider fully the legal regime that permits corporate philanthropy and the deduction allowed for it. Because the statutory structure of both state and federal law are so clear, it is important to consider the implications of corporate giving that is not profit-maximizing: the state statutes expressly permit such giving52 and the Code clearly contemplates, even encourages, it.53 Thus, there is explicit authority and significant incentive for corporations to make profit-reducing expenditures to charity. From the simple perspective of statutory coherence, allowance of a charitable deduction for any profit-reducing expense undermines the Code's broader approach to corporations because

49. The issues raised by profit-maximizing philanthropy and wealth-reducing philanthropy are somewhat different, so it is useful to analyze these two types of corporate expenditures independently of one another. Professor Knauer has thoroughly examined the tax implications of profit-maximizing corporate philanthropy. See Nancy J. Knauer, The Paradox of Corporate Giving: Tax Expenditures, the Nature of the Corporation, and the Social Construction of Charity, 44 DEPAUL L. REV. 1 (1994).


51. Some would argue that profit-maximizing philanthropy is not properly regarded as philanthropy at all. See David L. Engel, An Approach to Corporate Social Responsibility, 32 STAN. L. REV. 1, 6-9 (1979). This essay takes no position in the definitional debate.

52. See, e.g., Del. Gen. Corp. Law § 122(9) (1991) (“Every corporation . . . shall have power to . . . [m]ake donations for the public welfare or for charitable, scientific or educational purposes”); N.Y. Bus. Corp. Law § 202(a)(12) (1986) (“Each corporation . . . shall have power . . . [t]o make donations, irrespective of corporate benefit, for the public welfare or for community fund, hospital, charitable, educational, civic or similar purposes”) (emphasis added).

53. Section 170’s corporate deduction would otherwise be superfluous because corporate philanthropy would be deductible under I.R.C. § 162. Where donations to charity are in the nature of capital expenditures, a deduction under I.R.C. § 170 is more advantageous than a business deduction, which would be deferred by I.R.C. §§ 263 and 263A.
it is inconsistent with the Code’s overall profit-oriented presumption applicable to corporations.54

2. Corporations and Charitable Intent

While there is some debate about what requirements a donor must satisfy to claim the charitable-contribution deduction,55 two of the three tests that courts have applied require some discernible intent on the part of the donor, and the entity theory of the corporation does not automatically imbue the corporation with the capacity to have any charitable intent of its own. The three tests, each of which has been offered as the interpretation of a single statutory provision, can be summarized as follows: (1) the donor makes a qualifying contribution or gift as long as she receives no direct quid pro quo for her transfer;56 (2) the donor makes a qualifying contribution or gift if she receives no quid pro quo for her transfer and has no expectation of any return benefit;57 and (3) the donor makes a qualifying contribution or gift if she receives no quid pro quo and makes her transfer out of detached and disinterested generosity.58

The first is the only test that can be analyzed purely objectively, while the other two tests have varying levels of subjective inquiry. The requirements of “detached and disinterested” generosity and lack of a quid pro quo dictate that business transfers and charitable transfers be separable.59 Profit-maximizing philanthropy would fail to satisfy any of the three tests because it involves an economic return to the donor.60 For

54. Part I.B.3 discusses some of the implications of this presumption.
55. These requirements are an interpretation of the “contribution or gift” requirement in I.R.C. § 170, and therefore, apply to all taxpayers claiming charitable deductions.
56. See Crosby Valve and Gage Co. v. Commissioner, 380 F.2d 146 (1st Cir. 1967).
57. See Singer Co. v. United States, 449 F.2d 413 (Ct. Cl. 1971).
58. See DeJong v. Commissioner, 309 F.2d 373 (9th Cir. 1962).
59. See I.R.C. § 162(b) (disallowing business deduction for charitable gifts, and thereby requiring particular expenditure to be placed within § 162 or § 170). The two intent tests require courts to distinguish business motives from charitable motives. See Rusoff v. Commissioner, 65 T.C. 459 (1979) (deduction disallowed where transfer of property not accompanied by donative intent and taxpayer had expectation of "astronomical profits" that never materialized).
60. The law does not require that the quid pro quo come directly from the charitable recipient. See Singer, 449 F.2d at 423-24 (no deduction allowed for donation of sewing machines to schools because donations were intended to induce students to buy Singer machines); Gen. Couns. Mem. 39,877 (Aug.27, 1992) (deduction disallowed where corporation donated to charities selected by employees, and employees, in exchange,
purposes of this essay, the third test, which clearly requires emotive capacity on the part of the donor, is assumed to apply because it is the most consistent with the body of cases concerning the charitable deduction, and it is necessary to prevent the deduction from applying in cases in which transfers are clearly not charitable, such as in the case of "bad bargains" in sales of property, and fines paid to exempt organizations. Even without such an assumption, I contend, in Part 2b below, that the entity theory provides a weak justification for the corporate charitable deduction.

a. The Anthropomorphic Corporation

The corporate entity concept does not demand that any particular human characteristics be projected onto the corporation. Therefore, within the confines of the entity concept, the tax law is left to personify the entity to various degrees. The Code seems to reflect the choice to give corporations the human capacity for altruism by allowing them a charitable deduction in the context of a statute that recognizes charitable motives. On the other hand, the tax law has refused to allow corporations the human capacity for consumption by generally recharacterizing corporate consumption expenditures as consumption that is taxable to individuals.

61. A full discussion of this issue is beyond the scope of this essay. For further discussion see Richard D. Hobbet, Charitable Contributions -- How Charitable Must They Be?, 11 SETON HALL L. REV. 1 (1980) (both arguing that the detached and disinterested requirement is a necessary part of the statute); Joseph V. Sliskovich, Charitable Contributions or Gifts: A Contemporaneous Look Back to the Future, 57 UMKC L. REV. 437, 486 (1989). But see James W. Colliton, The Meaning of 'Contribution or Gift' for Charitable Contribution Deduction Purposes, 41 OHIO ST. L. J. 973 (1980) (arguing that there should not be any motive requirement); Knauer, supra note 49, at 39 (implying that the subjective element has been rejected by the Supreme Court).

62. Consumption-type expenditures financed by corporate payments are generally recharacterized as the taxable consumption of individual shareholders or employees. See, e.g., Botany Worsted Mills v. United States, 278 U.S. 282 (1929) (excessive payments to corporate directors not deductible as business expenses, but characterized as profit distributions); P.R. Farms, Inc. v. Commissioner, 820 F.2d 1084 (9th Cir. 1987) (gratuitous payments to third party characterized as constructive dividends); Inland Asphalt Co. v. Commissioner, 756 F.2d 1425 (9th Cir. 1985) (corporate payments of shareholder's personal tax liability were constructive dividends); Jack's Maintenance Contractors, Inc. v. Commissioner, 703 F.2d 154 (5th Cir. 1983) (corporate payments for shareholder's criminal defense were constructive dividends). For the rent free use of a corporation's apartment see Dean v. Commissioner, 187 F.2d 1019 (3d Cir. 1951); Chandler v. Commissioner, 41 B.T.A. 165 (1940), aff'd 119 F.2d 623 (3d Cir. 1941); Reynard Corp. v. Commissioner, 30 B.T.A. 451 (1934); Frueauf v. Commissioner, 30 B.T.A. 449 (1934); Dean v. Commissioner, 9 T.C. 256 (1947).
The strongest theoretical support for the altruistic capacity of corporations, and justification for the deduction that subsidizes altruistic actions, can be drawn from the work of the ethicist Peter French, who contends that “corporations can be full-fledged moral persons with whatever privileges, rights and duties are accorded to moral persons.” In his view, moral personhood requires the abilities to engage in intentional decision-making and to change conduct in response to moral criticism, and he suggests that corporations can do these things. If they can, then they can act intentionally in the same way that humans act intentionally and, therefore, it follows that they can have the intent to be charitable.

63. See also Paul B. Thompson, Why Do We Need a Theory of Corporate Responsibility?, in SHAME, RESPONSIBILITY AND THE CORPORATION, supra note 15, at 113 (explaining and defending French’s position).


65. See id. at 213-14; PETER A. FRENCH, COLLECTIVE AND CORPORATE RESPONSIBILITY 166 (1984). Ethicists disagree about whether behaving intentionally and responding to moral evaluation are sufficient conditions for moral personhood. See Thomas Donaldson, Personalizing Corporate Ontology: The French Way, in SHAME, RESPONSIBILITY AND THE CORPORATION, supra note 15, at 99, 108-09 (arguing that the ability to sympathize with others is a necessary condition for moral personhood).

The philosophical literature about the personhood of corporations has focused, to some extent, on the specific question of responsibility for harm and the problem of punishment. Whether corporations can have the intent to cause harm is a crucial part of that inquiry, and that is why this literature is relevant to the subject at hand: corporations need the capacity for charitable intent in order to be charitable. Some of the literature on harm has explicitly related the analysis to social good. See Richard T. DeGeorge, Corporations and Morality, in SHAME, RESPONSIBILITY AND THE CORPORATION, supra note 15, at 57, 71.

The legal implications of corporate personhood, beyond the treatment of corporate philanthropy and criminal liability, should not be overlooked. If corporations are just like humans, then they not only have the capacity for charity, but they should have all the rights that other people have under the law as well. Treating corporations as persons affects the relative power of corporations and individuals in society. See John Ladd, Persons and Responsibility: Ethical Concepts and Impertinent Analogies, in SHAME, RESPONSIBILITY AND THE CORPORATION, supra note 15, at 87 (“Some of the legal consequences of taking corporations to be persons are, it seems to me, morally objectionable. They may be summed up in the legal doctrine that a corporation is a person within the protection of the 14th amendment.”); Donaldson, supra, at 102; DeGeorge, supra, at 61.

charitable; giving because of commitment\textsuperscript{67} that reduces their well-being.\textsuperscript{68} As long as the corporation has its own income and gives it away with generous motives, then the charitable contribution deduction is appropriate for the corporate entity because the corporation is the taxpayer who satisfies both the economic and motive requirements for charitable giving.\textsuperscript{69}

b. The Limited Corporate Entity

Peter French's critics have disputed the capacity of organizations to act as he describes.\textsuperscript{70} Thomas Donaldson has pointed out that corporations have no "heart."\textsuperscript{71} John Ladd has argued that French's extension of personhood to corporations "reduces the ethical content of 'person' and 'responsibility' virtually to zero."\textsuperscript{72} Some have claimed that nobody is

\begin{itemize}
  \item \textsuperscript{68} This description of charitable intent borrows from the literature concerning individual giving. Some have argued that all charitable giving is essentially consumption, which is utility maximizing, implying that there is no uniquely charitable intent. See Mark G. Kelman, \textit{Personal Deductions Revisited: Why They Fit Poorly in an "Ideal" Income Tax and Why They Fit Worse in a Far From Ideal World}, 31 STAN. L. REV. 831, 845-54 (1979). Others have considered the possibility of altruism. See Mark P. Gergen, \textit{The Case For a Charitable Contributions Deduction}, 74 VA. L. REV. 1393, 1442 (1988) (evaluating the equitable arguments for the charitable deduction by looking to whether the contribution is "self-abnegating" or welfare-reducing for the donor); see also Engel, \textit{supra} note 51, at 59 ("the distinctive trait of altruism is that the giver's lot is depreciated -- by his or her own voluntary act").
  \item \textsuperscript{69} While he did not discuss the moral-person issues of concern to Peter French, it is possible to interpret E. Merrick Dodd's use of an entity theory to argue for corporate philanthropy as adopting an anthropomorphic conception of the corporation. See E. Merrick Dodd, Jr., \textit{For Whom Are Corporate Managers Trustees?}, 45 HARV. L. REV. 1145, 1160-61 (1932).
    If we think of [the corporation] as an institution which differs in the nature of things from the individuals who compose it, we may then readily conceive of it as a person, which like other persons engaged in business, is affected not only by the laws which regulate business but by the attitude of public and business opinion as to the social obligations of business. \textit{Id}.
  \item \textsuperscript{70} See, e.g., DeGeorge, \textit{supra} note 65, at 62 (Human beings have emotions which should not be treated as the emotions of the corporation because to do so "stretches our normal use of language beyond recognition."); Manuel G. Velasquez, \textit{Why Corporations are Not Morally Responsible for Anything They Do}, BUS. & PROF. ETHICS J., Spring 1983, at 7.
  \item \textsuperscript{71} Donaldson, \textit{supra} note 65, at 109.
  \item \textsuperscript{72} Ladd, \textit{supra} note 65, at 77-79.
\end{itemize}
responsible when bureaucracies act, and others have argued for a revised conception of individual responsibility in the organizational setting to ensure that individuals are responsible for corporate acts. Ladd stated, “In the final analysis . . . the only way to bring corporations under the scope of morality is to identify what they do (corporate actions) in one way or another with what individual human beings connected with them . . . do.”

Some philosophers have chosen a middle ground between French’s view that groups are full moral persons in their own right, and the view of those who claim that groups do not exist as independent actors at all. “A middle position is developed in which social groups are conceived as individuals in relationships[.] . . . when there is action or intent that occurs in the group which could not occur outside of the group.” Larry May believes that this middle ground is better supported by psychological and sociological evidence than either of the more extreme views. Any notion of moral agency in the corporation that relies on individuals reflects a much weaker anthropomorphization of the corporate entity than contemplated by French, even though the corporation can still be conceived, for some purposes, as an entity that exists independent of any individual participants; it is simply a more limited entity.

These theorists, who have concluded that corporations have some restricted existence, characterize corporations as means to ends, while

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74. See id. at 2382-90; Ladd, supra note 65, at 91.

75. Ladd, supra note 65, at 91.

76. See infra notes 135-39 and accompanying text.


78. Although May explicitly states that he adopts a middle view, his ideas are much closer to French’s than many of the other theorists who seem to adopt a conception of a limited entity. May treats groups (including corporations) as existing only to the extent a collection of individuals have “common interests,” which suggests a limited conception. MAY, supra note 77, at 10. At the same time, he believes that the corporate entity makes decisions when corporate decision-making procedures “change and combine the intentions among . . . individuals” in a way that “cannot be fully explained by reference to the intentions of individual, isolated people.” Id. at 66. In this way, he gives the corporation a great deal of independence from the individuals who make it up.
human persons are ends in themselves. As means, corporations are established for limited purposes, and the theme of common purpose seems to be the guiding principle for determining the boundaries of this conception of a corporate entity. Ladd has defined the sphere of corporate activity (as distinguished from individual activity) as only those actions that are within the stated goals of the corporation.

Some legal thinkers have adopted this philosophical approach in describing the corporation as an entity with a limited and artificial construction: "The firm, like other institutions, retains a meaningful existence as a separate entity because it carries on while individuals, with their narrower interests and whims, come and go. This reified entity receives separate substantive content from the 'common purpose' of its participants." Like the more anthropomorphic entity notion, this limited-entity concept allows for some independent action on the part of the corporation. Since corporations possess legal rights and obligations, recognition of legal personhood for corporations is instrumental, even if corporations lack moral personhood.

The limited-entity concept recognizes that there are actions that are best characterized as actions of corporations, while recognizing that individuals are necessary at every stage of corporate activity. If, for example, a corporation is organized to provide certain goods or services in the most efficient manner possible, then the corporation itself can take action in pursuing those goals, in a theoretical as well as a legal sense, and can be held responsible for wrongdoing committed in that pursuit. Corporate criminal liability seems to follow this model.

79. See DeGeorge, supra note 65, at 62-63; Ladd, supra note 65, at 94 (citing Kant's categorical imperative).
80. See DeGeorge, supra note 65, at 62.
81. John Ladd, Morality and the Ideal of Rationality in Formal Organizations, 54 MONIST 488, 493-97 (1970) ("The decisions are made for the organization, with a view to its objectives and not on the basis of the personal interests or convictions of the individual official who makes the decision. This is the theory of organizational decision-making.").
82. Bratton, The Nexus of Contracts Corporation, supra note 2, at 425-26 (footnotes omitted). In the philosophy literature, "reification" means the attribution of reality to something that exists only in the mind, as opposed to "ontological," which means that something really exists. See SHAME, RESPONSIBILITY, AND THE CORPORATION, supra note 15, at 15.
83. Corporations can be held criminally liable for acts of employees that are within the scope of their employment, see NewYork Cent. & Hudson River R.R. Co. v. United States, 212 U.S. 481, 493 (1909), and that they perform with the intent to benefit the corporation, see United States v. Paccione, 949 F.2d 1183, 1200 (2d Cir. 1991). For crimes that require a certain mental state, a corporation can be held liable if any agent had the requisite mental state, even if the person with the intent is very low in the corporate
Nevertheless, a concept of limited corporate personhood that respects
the separateness of the corporation in certain spheres, while rejecting the
conclusion that corporations have all the attributes of individuals, provides
less support than French's personification for the notion of a charitable
corporation and the consequent deduction for corporate giving. Many of
the socially responsible activities of corporations fit nicely within the
common-purpose rubric, and can therefore be considered to be actions of
the corporate entity, even where the corporation is conceived as a limited
construction. However, under this limited-entity view, beyond the
common purpose of the corporation's participants, the corporation's acts
are not its own. This is where corporate philanthropy, as opposed to
corporate criminal liability and profit-oriented social responsibility,
becomes problematic as a theoretical matter, even though it may be
permitted as a legal matter.

Treating employees well, refusing to pollute the environment in the
community in which the business is located, and assuring consumer
satisfaction and safety are all examples of corporate social responsibility
that may fit under the corporate-entity umbrella as actions of the entity,
even under a limited theoretical construction. But these examples of
corporate citizenship may be incomparable to corporate philanthropy in the
sense described here, which is definitionally wealth-reducing, and
therefore, cannot be related to the aims of the business. To the extent that
corporate philanthropy is not advertising and does not otherwise inure to
the benefit of the business—i.e., the kind of philanthropy contemplated by
§ 170—any connection to corporate purpose is tenuous.

hierarchy. See United States v. Twentieth Century Fox Film Corp., 882 F.2d 656, 660
(2d Cir. 1989).

84. [A]ny considerations that are not related to the aims or goals of the
organization are automatically excluded as irrelevant to the
organizational decision-making process . . . [D]ecisions and actions
of individual officers that are unrelated to the organization's aims or
goals are construed, instead, as actions of those individuals rather
than of the organization. . . . [T]he concept of a social decision or
action is bound up logically with the notion of an organizational aim.
The consequence of this co-implication of action and aim is that the
notion of an action or decision taken by an organization that is not
related to one of its aims makes no sense.

Ladd, supra note 81, at 496-97 (emphasis added).

85. There is some ambiguity in the meaning of "corporate social responsibility."
See Engel, supra note 51, at 3.

86. See supra notes 49-54 and accompanying text.

87. Some corporations, under state law, have as their purpose the provision of
charity. These corporations are not taxed under subchapter C of the Code, and are not
the subject of this paper.
Assuming that corporate philanthropy is wealth-reducing for the corporation, the limited-entity notion cannot justify it, even though the income of the corporation given away is appropriately taxed to the entity under the model. This is so because the limited corporation cannot look to the common purpose of its participants to resolve: (1) a conflict between the goals of producing good for society and profits for shareholders; and (2) a conflict between competing charitable recipients and their distinct conceptions of social good.

Despite these shortcomings, some who have argued for corporate philanthropy seem to have adopted this more limited conception of the corporate entity, suggesting the possibility of a generous corporation without treating the corporation like a human person. This approach requires the projection of generosity onto the corporation. Some rely upon the “moral conscience” of the shareholders to give legitimacy to the actions taken by the managers on behalf of the corporate entity, and others argue that corporations can be morally responsible by allowing managers to project their own values onto the corporation. While turning to the shareholders may be feasible if the corporation is small, or if a matter is closely related to the shareholder’s interest as a shareholder, it is absurd to talk about a “collective moral conscience” of the shareholders of a publicly traded corporation, who are not only numerous, but geographically, religiously, and politically diverse. There can be no collective charitable choices made on behalf of the corporation that satisfy

88. Richard DeGeorge treats the limited nature of corporations as an explanation for why charity is inapplicable to corporations. DeGeorge, supra note 65, at 62.

89. This is a conflict that arises in other contexts as well. See Allen, supra note 9, at 275.


91. Shaw & Post, supra note 50, at 747 (“[I]t is essential that corporate management, acting for the collective moral conscience of the corporate stakeholders, seize the leadership in advancing ‘the greatest good for the greatest number’”).

92. See Goodpaster & Matthews, supra note 90, at 139.

93. In addition to adopting the limited-entity conception of the corporation, Shaw and Post also adopt a utilitarian ethic as the conception of the good that the corporation should be active in bringing about. The simple adoption of a utilitarian ethic, even aside from the necessarily controversial assignment of utility values to various states of affairs, is likely to be repugnant to a significant number of shareholders, who may adopt some other theory of justice. For example, a Rawlsian shareholder may prefer that the most good is provided to the least well off members of society, while a Nozickian shareholder may prefer that corporations refrain from any redistributive activities. See ROBERT NOZICK, ANARCHY, STATE AND UTOPIA 149-64 (1974) (describing the “entitlement theory”); JOHN RAWLS, A THEORY OF JUSTICE 75-80 (1971) (describing the “difference principle”).
the parameter of collective shareholder moral conscience, and therefore, the limited-entity model fails to justify corporate giving if it relies on a collective moral conscience in which all shareholders join.

Whether projecting from shareholders or managers, the decisional agency of identifiable individuals becomes part of the corporation's operating mechanism in the limited-entity conception of the corporation. Therefore, unlike the anthropomorphic corporation, the limited-entity model does not itself imply that the corporation should be entitled to a deduction for such giving for tax purposes; a connection between the individuals and the corporation must be established, and additionally, the corporation must be chosen as the proper taxpayer. If the guiding force of individuals is recognized as an integral part of corporate philanthropy, and there is no link that connects the action of that individual to the corporation, then the Code must inquire whether the relevant taxpayer is that individual. If the charitable intent is personal to the managers, and the money comes out of the corporation's residual earnings, then there is no taxpayer—corporate or individual—who satisfies both the economic and intent prongs of the deduction provision, and a complete disallowance of the deduction might be appropriate.

In addition, if the gift is not connected to the common purpose of the corporation, then, as an economic matter, it must come out of the residual profits of the corporation. While use of the residual profits within the corporate business may keep them tied to the corporate entity, thereby legitimating any use to which the corporation puts them, once they are paid out of the corporation, the shareholders' interests are affected since shareholders are ordinarily entitled to distributed residual profits. On this analysis, the limited-entity corporation fails to satisfy even the economic requirement for the deduction. Because failure to connect philanthropy with corporate purpose places corporate giving outside the defined parameters of corporate acts, it is thus possible to see corporate philanthropy as dividends foregone by the shareholders, even where there is some respect for the separateness of the corporation.

For these reasons, application of the limited-entity concept of the corporation to the tax law fits best with limiting deductibility of corporate giving to activities connected with the business of the corporation. But the tax law's adherence to this image of the corporation and of corporate charitable giving would make § 170's inclusion of corporations

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94. This is what distinguishes the corporate criminal liability issue from the corporate philanthropy issue, as well as distinguishing among different aspects of corporate social responsibility.

95. Resolution of this issue follows the same analysis as the nexus-of-contracts challenge. See infra Part II.

96. See infra note 177.
inappropriate, because all legitimate corporate philanthropy would fit within the business deduction of § 162. No provision would be necessary to govern non-business related corporate giving. The limited-entity notion fails to identify the corporation as the taxpayer entitled to claim a deduction for corporate giving. Thus, it makes clear that a limited-entity model is insufficient, and an anthropomorphic entity concept is necessary to give corporations the characteristics necessary to rationalize the corporate charitable deduction in its current form.

3. The Code's Role in Exacerbating the Conflict Between Managers and Shareholders

In addition to the problem of corporate intent just described, adoption of a limited-entity model in which individual judgments are acknowledged creates difficulties for that model that are absent in the anthropomorphic model of the corporation. Once it is recognized that the generous impulses of individuals may be fulfilled by the disbursement of corporate funds, tensions between distinct corporate constituencies are highlighted. This is particularly true in the case of the large, modern corporation, which can be seen as a hierarchical entity in which management holds all the power. The legitimation of managerial power, independent of shareholder action, solidified the entity theory of the corporation, but also undermined the notion that the corporation simply embodied the unanimous will of the shareholders. The shareholders were thereby transformed into passive investors. While creating certain efficiencies, this structure of the

97. The immediate deductibility of charitable giving, as for any business expense, would be limited by the capitalization rules of I.R.C. §§ 263 and 263A.


99. See Berle & Means, supra note 16, at 124. While Berle and Means recognized certain contractual aspects of the corporation, their focus on the disempowerment of shareholders and the centralization of power in managers is more consistent with an entity theory of the corporation: "What we have here been observing is the corporation in transition. From a tight organization analogous to an overgrown partnership it has emerged into a tremendous unit whose major preoccupation is distinctly not with the interests of its shareholders." Id. at 152.

100. Changes in state corporate law that allowed fundamental corporate changes without shareholder unanimity presented one of the greatest challenges to the theory of the corporation, and seemed to support the entity theory in the late nineteenth century. See Horwitz, supra note 2, at 202. However, rejection of unanimity can also be consistent with the aggregate notion of the corporation where it is understood as a method for reducing transaction costs.
corporation tempted managers to use their control in their own interests, rather than in the interests of the investors whose capital they managed.

a. The Code Privileges Corporate Philanthropy Compared to Shareholder Philanthropy

In adopting the charitable contribution deduction for corporations, Congress ignored these tensions, despite their prior exposition by Berle and Means.\textsuperscript{101} By instituting an incentive for the corporate entity to give away the residual profits of the corporation,\textsuperscript{102} the 1935 Congress explicitly legitimated the power of corporate management to reduce corporate wealth. In fact, because of the classical system of corporate taxation, which taxes corporate income to the entity and again on its distribution to shareholders, the charitable deduction for corporations created a preference for corporate giving over individual shareholder giving.\textsuperscript{103}

\textsuperscript{101} It has been claimed that the 1918 Congress, which considered and rejected a deduction for corporate philanthropy, was concerned about the conflict between shareholders and managers. See Kenneth B. Davis, Jr., \textit{Discretion of Corporate Management to Do Good at the Expense of Shareholder Gain -- A Survey of, and Comment on, the U.S. Corporate Law}, 13 \textit{CANDA-U.S. L.J.} 7, 60 (1988). The legislative history, however, does not support such a reading. When Congress argued about corporations “breaking a law in order to give away some other person’s money,” it was concerned about the \textit{ultra vires} nature of corporate giving and the taxpayers’ subsidy of deductible giving. There is no indication that the 1918 Congress believed that the managers gave away the shareholders’ money without their consent, particularly because the debate enumerates three methods of corporate giving, each of which required some affirmative act on the part of the shareholders. See 56 \textit{CONG. REC.} 10,427-28 (1918). The Red Cross dividend program, which was initiated during World War I, and with which Congress was likely to be familiar in 1918, required shareholder authorization for corporate gifts. See Knauer, supra note 49, at 18. Therefore, it did not raise the issue of conflict between managers and shareholders raised by manager-controlled contributions.

\textsuperscript{102} In describing the powers of managers to route corporate earnings, nothing that Berle and Means described rises to the level of giving them away. See BERLE & MEANS, supra note 16, at 189-206.

\textsuperscript{103} In the simplest case, the deduction at the corporate level allows the charitable gift to be larger, by an amount in proportion to the tax rate that applies to the corporation, than a gift that could be made after a distribution of the same earnings to the shareholders. For example, if the corporation has $100 cash (tax-paid) to devote to philanthropy and is in the 35\% tax bracket, then it can make a gift to charity of $154, with the extra $54 financed by the tax savings attributable to the deduction. On the other hand, if the corporation takes the $100 and distributes it to its shareholders, then the corporation may not claim a deduction, so the distribution is limited to the $100 available funds. If the corporation has a sole shareholder in the 40\% tax bracket, then the
This preference for corporate philanthropy is particularly significant because the tax law, and not state corporate law, established the normative basis for corporate philanthropy. When Congress adopted the charitable contribution deduction for corporations, charitable giving was still *ultra vires* in most states, and therefore usually prohibited, as a matter of state corporate law. The states followed the tax law’s lead in authorizing corporate giving, and to this day, the state law standards for corporate giving are still principally constructed on the basis of the tax law definitions. Therefore, the Code’s subsidy for corporate giving must be recognized as the most important legitimating factor for corporate philanthropy.

If that legitimation is grounded in the assumption that the corporation is a limited-entity entitled to its own deductions, then it is on shaky ground in light of the fact that the deduction is for an expenditure that has no integral connection to any common purpose that defines the entity’s parameters. By authorizing corporations to deduct their charitable contributions, the tax law was operating on the realist vision without contending with the internal conflicts. Today, even more than in 1935, shareholder must pay $40 tax on the distribution. If, however, the shareholder contributes the dividend to charity, then the tax at the shareholder level disappears because the shareholder is entitled to a deduction that fully offsets the inclusion of the dividend, and can therefore contribute the entire $100 in cash. Thus, without affecting the residual earnings of the corporation available to the shareholders, the decision to make a contribution at the corporate level increases the gift by $54, which is wholly tax-financed, as compared to the gift at the shareholder level.

104. See Kahn, supra note 14, at 594-609 (discussing early state laws governing corporate philanthropy).

105. Some of the early state statutes either referred to the Code or parroted its language. See, e.g., IND. ANN. STAT. §25-211(b) (Burns Supp. 1951).

106. The leading Delaware case, *Theodora Holding Corp. v. Henderson*, 257 A.2d 398 (Del. Ch. 1969), which established that corporate contributions have to be reasonable in both amount and purpose, looked to the Code’s percentage limitations and qualifying recipients to decide what is reasonable.


108. See supra Part I.B.2.b.

109. The corporate deduction was adopted shortly after E. Merrick Dodd, Jr. wrote his article contending that corporations should be socially responsible, so it is possible that Congress was responding to this development, and adopting Dodd’s position. Professor Knauer interprets the legislative history that way. See Knauer, supra note 49, at 28-29. By treating the managers as agents of the corporate entity, rather than agents of the shareholders, Dodd argued that the managers could act for the benefit of constituencies...
the question of corporate philanthropy, even by a corporate "entity," is inextricably tied to the separation of ownership and control because corporate giving is primarily the domain of large corporations.  

b. The Code Legitimates the Power of Management

The Code has perpetuated the idea that managers can be considered to be carrying out the corporate agenda without conflict, by adopting the assumption that corporations are operated solely for profit. That assumption implies that corporations only make expenditures in the production of income. In other words, the Code presumes that management operates the corporation in the interest of the shareholders—a presumption that makes the classic conflict between managers and shareholders disappear. The existence of this presumption bolsters the legitimacy of all expenses that are explicitly deductible. Therefore, the statutory provision authorizing the charitable deduction implies that management's choices about corporate philanthropy are part of the corporation's trade or business, despite the fact that they are allowed to be wealth-reducing for the corporation. Thus, in addition to the Code's internal inconsistency in including the corporate deduction in a scheme that generally denies corporations the capacity to make wealth-reducing other than shareholders. See Dodd, supra note 69. Adolf Berle responded that managers would thereby be virtually unaccountable in their "absolute powers." See Adolf A. Berle, Jr., Corporate Powers as Powers in Trust, 44 HARV. L. REV. 1049, 1050 (1931); Adolf A. Berle, Jr., For Whom Corporate Managers are Trustees: a Note, 45 HARV. L. REV. 1365 (1932).

110. Less than a quarter of the 2.2 million companies make any contribution, and only 7.5 percent provide more than $500 per year. Of the nation's 1,127 corporations whose assets exceeded $0.5 billion in 1977, more than 80 percent made contributions...[and] the total value of their contributions constituted 50 percent of all corporate gifts. As in most areas of corporate social and political activity, discussion of corporate philanthropy is thus primarily a consideration of the practices of large corporations.


111. A curious exception seems to be I.R.C. § 162(m), adopted in the Omnibus Reconciliation Act of 1993, Pub. L. No. 103-66 § 3211(a), which prevents public corporations from deducting certain executive compensation in excess of $1 million. While it is possible to read this provision as a protection for shareholders from overreaching management, the limitations and exceptions in the statute make it seem more like a political placebo than true regulation of executive compensation.

112. See supra notes 47-48 and accompanying text.
expenditures,¹¹³ that inclusion itself supports the argument that charitable giving is a normal corporate activity.

c. The Tax-Expenditure Method of Government Subsidy is Inconsistent with Concentration of Power in the Hands of Corporate Management

A related stumbling block in the discussion of corporate philanthropy within legal scholarship is the assumption that all charity is good, and therefore, anything that supports it is desirable.¹¹⁴ If that were so,¹¹⁵ then it could be argued that the conflict between managers and shareholders is unimportant, because any corporate charity is better than none. But the legal definition of charitable organizations is so broad¹¹⁶ that there is plenty of room for shareholders to believe that some organizations, though within


¹¹⁴. This seems to have been the most common argument in favor of extending the deduction to corporations. See 61 CONG. REC. 5,295 (1921) (House floor debate); 56 CONG. REC. 10,426-28 (1918) (House floor debate); H. R. REP. No. 1681, 74th Cong., Sess., reprinted in Seidman’s Legislative History, 1938-1861, 286.

¹¹⁵. There are numerous problems with this position. For example, depending on the elasticity of charitable giving, the deduction may be inefficient so that a dollar of tax subsidy may not produce in excess of a dollar for the recipient organization. See CHARLES T. CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING, 206-21 (1985) (reviewing econometric studies of price elasticity of corporate giving). Even if elasticities are high, the deduction may not necessarily be efficient because high elasticity is consistent with waste. See Gergen, supra note 68, at 1439. Furthermore, corporate giving may reduce individual giving. For analyses of crowding-out effects, see Burton N. Abrams & Mark D. Schmitz, The Crowding Out Effect of Governmental Transfers on Private Charitable Contributions, and Susan Rose-Ackerman, Do Government Grants to Charity Reduce Private Donations?, both in THE ECONOMICS OF NONPROFIT INSTITUTIONS: STUDIES IN STRUCTURE AND POLICY (S. Rose-Ackerman ed., 1986).

In addition, it is important to isolate the deduction for corporations from the separate issues of charitable deductions for individuals and government support for charities. Objections to the corporate deduction do not imply anything about these other issues, and therefore, the corporate deduction requires independent normative justification.

¹¹⁶. The latest statistics show that there are approximately half a million nonprofit charitable organizations that have been recognized by the Service as exempt under § 501(c)(3), which includes all of the following as exempt purposes: religious, charitable, scientific, testing for public safety, literary, educational, fostering sports competition, and preventing cruelty to children or animals. While other classifications of organizations are also eligible to receive tax-deductible contributions, I.R.C. § 501(c)(3) organizations receive the largest share. See Cecilia Hilgert, Charities and Other Tax-Exempt Organizations, 1991, in INTERNAL REVENUE SERVICE, STATISTICS OF INCOME BULLETIN 26 (1995).
§ 501(c)(3), are distinctly bad. The specific content of what is socially desirable is bound to be a subject of much dispute, even if there is agreement on the general goal that corporations should act responsibly for the good of society.

The methods by which a pluralistic society reaches consensus on any particular social issue is a political matter of importance. If corporations operated by unanimous consent of all interested persons, or even like democratic polities—with constitutional limits, mechanisms for separation of power and meaningful suffrage—then the decisions of corporations on moral issues might reflect some shared conception of the good. However, the current structure and operation of corporations give no comfort that decisions about what is good for society are decisions that any critical mass of people with an interest in the corporation would believe are good. Reorienting corporate management toward the political sphere, as suggested by Jeffrey Nesteruk, assigns too much weight to the social preferences of the individuals holding those positions.

Furthermore, reorienting corporate management, and legitimating greater power in management to carry out their own visions of the good, is inconsistent with the policies embedded in the tax expenditure model for funding charitable organizations. One justification for the charitable contribution deduction is the promotion of pluralism. By funding charitable organizations through tax expenditures rather than direct

117. Shareholders may believe that I.R.C. § 501(c)(3) organizations are bad for myriad reasons. For example, they may disagree with the purposes of an organization, or believe that the organization is not worthy of a tax subsidy because it does not produce as much social good as cost. Mark Gergen has recognized this issue by stating that the existence of people who are “radically disinterested” prevent the charitable contribution deduction from being a Pareto improvement. Gergen, supra note 68, at 1412.

118. Of course, there is not agreement as to whether corporations should act for the good of society. See, e.g., Milton Friedman, The Social Responsibility of Business is to Increase Its Profits, N.Y. TIMES, Sept. 13, 1970, at 32.


120. See Allen, supra note 9, at 268-69.

121. See Nesteruk, supra note 119, at 467.

government spending, individuals can implement their diverse views about what is deserving of funding.\textsuperscript{123} The tax expenditure method respects eclectic individual values because it allows any goal favored by a small minority of taxpayers\textsuperscript{124} to get some amount of government funding, regardless of the will of the majority.\textsuperscript{125} The pluralism argument contends that placing power over public funds (the subsidy to charitable giving that the tax expenditure model treats as coming from foregone revenue) in the hands of individuals who are willing to pay for part\textsuperscript{126} of an organization's work counteracts the tendencies of democratic institutions to take too mainstream and narrow a view of the projects worthy of support.\textsuperscript{127} Significant indirect public support of endeavors through the charitable contribution deduction, if accompanied by private funding, appears to lack the stigma that attaches to direct public funding of controversial charitable works that some consider distasteful.\textsuperscript{128} It has been argued that the tax-

\begin{footnotesize}
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\item[124.] Or even an individual, in the case of private foundations.
\item[125.] Milton Friedman has praised the market along similar lines, as a way for individuals to make diverse choices. MILTON FRIEDMAN, CAPITALISM AND FREEDOM 15 (1962). \textit{But see} McDaniel, \textit{supra} note 122, at 390 (arguing that the charitable deduction in its current form does not, in fact, promote pluralism because the upside-down nature of the subsidy favors the wealthy).
\item[126.] Part because the charitable contribution deduction makes the government a co-payer to the extent of the taxpayer's marginal rate. \textit{See} OFFICE OF MANAGEMENT AND BUDGET, \textit{supra} note 36 (quantifying the costs to government of foregone revenue for tax expenditures).
\item[127.] Empirical evidence may prove the pluralism rationale to be flawed because donors prefer to support large, prestigious organizations even more than does government. This is certainly true of corporate donors. \textit{See} Useem, \textit{supra} note 110, at 342.
\item[128.] There was tremendous public debate about the National Endowment for the Arts' support of a Robert Mapplethorpe exhibit that some considered obscene. \textit{See, e.g.,} Kathleen M. Sullivan, A Free Society Doesn't Dictate to Artists, N.Y. TIMES, May 18, 1990, at A31; William Safire, Stop Subsidizing The Arts, N.Y. TIMES, May 18, 1990, at A31. There was no suggestion that the institution that sponsored the exhibit should lose its I.R.C. §501(c)(3) status, though it was indicted (and acquitted) on obscenity charges. \textit{See} Isabel Wilkerson, Cincinnati Jury Acquits Museum In Mapplethorpe Obscenity Case, N.Y. TIMES, Oct. 6, 1990, at 1.
\end{enumerate}
\end{footnotesize}
expenditure model of funding charitable works has been a necessary factor in producing positive results in our society.\textsuperscript{129} Against this defense of the charitable contribution deduction itself, one must consider the effects of extending the deduction to corporations, and most particularly, the desirability of centralizing power over the particular charitable destination of public and private funds in large corporations, which undermines the pluralistic goals of the deduction.\textsuperscript{130} Even increasing the input of individual shareholders into the corporate decision-making structure, or increasing the power of management to take representative social positions, is at odds with the policy of disaggregation of charitable decision-making and government funding of charitable works that has justified the charitable deduction itself. If the government is a poor institution for making choices about the public good, it seems that large corporations are at least as bad;\textsuperscript{131} there is no reason to believe that corporations are better at prioritizing different charitable purposes, determining appropriate levels of support for diverse needs, or resisting the temptation to support conventional tastes than either the government or individuals. In addition, the concentration of charitable funding from corporations inevitably leads to the exertion of power by those corporations over the charitable institutions,\textsuperscript{132} while the individual deduction is more likely to produce small gifts that fail to buy influence.\textsuperscript{133}

\textsuperscript{129} It has encouraged “experimental people and dissenting voices [that] have to be financed, at least in the early stages, out of a single financial pocket, or a very few.” John G. Simon, \textit{Charity and Dynasty Under the Federal Tax System}, in \textit{The Economics of Nonprofit Institutions: Studies in Structure and Policy} 254 (S. Rose-Ackerman ed., 1986). Simon attributes discovery of the polio vaccine to a single $15,000 gift to Jonas Salk from the Scaife Foundation.

\textsuperscript{130} \textit{See} Bayless Manning, \textit{Book Review}, 67 \textit{Yale L.J.} 1477, 1494 (1958) (reviewing \textit{J.A. Livingston, The American Stockholder} (1958)) (noting that corporate giving may conflict with pluralism); Engel, \textit{supra} note 51, at 23 n.66 (“it seems peculiar to perceive an increase in pluralism from anything that augments the power of for-profit corporations in our social decisional process”). Employee matching grants prevent this centralization of decision-making in management, and therefore, are more consistent with the pluralistic policies of the charitable deduction.

\textsuperscript{131} \textit{But see} Nesteruk, \textit{supra} note 119, at 466-75 (arguing that corporate management should make the choices of citizens that the shareholders of corporations resemble since they are merely beneficiaries of the corporation, rather than owners or investors).

\textsuperscript{132} \textit{See} Engel, \textit{supra} note 51, at 63.

\textsuperscript{133} Of course, rich individuals are crucial sources of support for many exempt organizations, and their large gifts influence the organizations as well. John Simon has argued that this anti-democratic aspect of the charitable contribution deduction is acceptable because it advances important social goals. \textit{See} Simon, \textit{supra} note 129, at 249-52 (applying a Rawlsian analysis to the upside-down subsidy).
In sum, the real-entity theory of the corporation can support the expansive corporate deduction of § 170, but only on the most anthropomorphic interpretation of the corporate entity. While any entity notion can support the economic underpinning of the charitable deduction, which requires that the corporation give away its money without receiving anything in return, only an entity with human characteristics can act by virtue of its own generosity.\textsuperscript{134} The anthropomorphic conception of the corporation is an inadequate model for the Code because it fails to appreciate the differences between human persons and corporate persons. Ethical theorists have largely resisted, and generally, the Code has rejected the notion of an anthropomorphic corporation. The differences between humans and corporations demand that the corporate charitable deduction be justified, independent of the individual deduction, taking into account the special nature of the corporation and the unique issues that arise in corporate giving.

The limited-entity conception of the corporation, which recognizes that corporate persons are not interchangeable with human persons, is too weak to explain the corporate charitable deduction because it fails to include profit-reducing philanthropy within the legitimate sphere of corporate activity. Therefore, a tax system built on that conception would have a more limited notion of taxable income and allowable deductions, and would have no place for a deduction for philanthropy not connected to corporate purposes.

Furthermore, the limited-entity model of the corporation recognizes internal conflicts and the significance of individuals within the corporate sphere. By authorizing the corporate charitable deduction, without addressing the special issues that are intertwined with the limited-entity model, the Code has legitimated the power of management to make charitable choices on behalf of the people involved in the corporate entity, and has undermined the pluralistic values embedded in the deduction for individuals. This legitimation is dangerous from an agency-cost perspective, but more importantly, from the perspective of concentrating political power in corporate management over the destination of public funds, which is inimical to both the democratic process and the policies underlying the tax-expenditure model for charitable giving.

\textsuperscript{134} Any version of the real-entity theory, which allows a corporation to have its own income, supports the corporate charitable contribution if the deduction allowance requires only that the donor make a payment without receiving a quid pro quo.
II. THE NEXUS-OF-CONTRACTS CHALLENGE TO THE TAX LAW'S TREATMENT OF CORPORATE GIVING

The nexus-of-contracts approach treats the corporation as a connecting point for the actions of individuals in their various capacities of production. The participants in the firm are part of a web of relationships in which no group is privileged as a matter of structure, and the rights and obligations of the various participants are governed by markets that affect and largely define their interests.¹³⁵ Within the understandings or contracts that arise from these markets, some terms are expressly negotiated, some dictated by either managers or investors and negotiated as to price, others fixed and accepted at the market price, and others implied by courts or legislatures choosing terms that would have been chosen if people had addressed the issue.¹³⁶

Within the most radical reading, the contractualized corporation ceases to exist as a separate institution at all.¹³⁷ A less radical interpretation of the theory, but still consistent with the nexus-of-contracts approach, treats the corporation as an institution that can be a contracting party.¹³⁸ However, unlike in the real-entity theory, the corporation can never be treated as an anthropomorphic being, but remains solely the product of the aggregated market-based understandings of the constituent parties.¹³⁹

A. The Corporation as an Aggregate

The crucial element of the nexus-of-contracts model for application to the tax law is the aggregate conception of the corporation. If the Code

¹³⁶. See id. at 14. See also Kornhauser, supra note 27, at 1451 (“the nexus of contracts approach constructs an agreement out of the interests of the relevant parties”) (emphasis in original).
¹³⁷. See Phillips, supra note 2, at 1061-62 (describing the ascendancy of the nexus-of-contracts approach and the decline of the real-entity theory of the corporation). Philosophical underpinnings for this approach can be found in the work of J.W.N. Watkins, proponent of “methodological individualism.” See MAY, supra note 77, at 14-17 (discussing methodological individualism).
¹³⁹. Although I have tried to distinguish the anthropomorphic entity, the limited entity and nexus-of-contracts entity from one another for ease of discussion, the different conceptions of the corporation are not so clearly delineated. The corporate entity that exists as a contracting party is along a continuum with the more robust conceptions of the corporate entity discussed in Part I.
were to contemplate the corporation as an aggregate of contracting parties, then the tax treatment of corporate philanthropy would have to be reconsidered, and could be redefined in terms consistent with the Code's general framework for taxing corporations and charitable giving.\(^{140}\)

In contrast with the anthropomorphic model necessary for the Code's charitable deduction for corporations, the nexus-of-contracts approach to the corporation has generally been thought to support the idea that corporations cannot act as independent moral persons.\(^{141}\) This position does not necessarily imply that philanthropy is illegitimate as a matter of corporate governance within the model. Frank Easterbrook and Daniel Fischel, strong proponents of the corporate-contract model, have argued that corporate philanthropy should generally be a matter for contracting, like other terms, but that "[f]or most firms the expectation is that the residual risk bearers have contracted for a promise to maximize long-run profits of the firm, which in turn maximizes the value of their stock."\(^{142}\) However, it is possible that corporate philanthropy is justifiable under the nexus-of-contracts approach, as a term that forms part of the bargain defining the corporation.\(^{143}\)

140. While the aggregate notion of the corporation may support integration of the corporate and individual tax, this essay does not consider that possibility and integration is beyond the scope of this discussion. This essay identifies corporate giving as a special problem for an aggregate conception of the corporation, even if complete integration is not a necessary corollary of the aggregate approach. Reconceptualizing the corporation as an aggregate for tax purposes can be consistent with a separate corporate tax if, for example, the separation of ownership and control in the corporation is significant for tax purposes, or if the corporate tax is a second-best wealth tax. The corporate tax could also be reduced to reduce agency costs in the nexus-of-contracts model. See Lily Kahng, Resurrecting the General Utilities Doctrine (manuscript on file with author).


142. Easterbrook & Fischel, supra note 135, at 39. Professor Brudney has pointed out the empirical problems with the nexus-of-contracts approach generally, and the lack of actual or implicit consent of the contracting parties. See Brudney, supra note 138, at 1405-06, 1414-15. Models of contracting depend on information, and the failure of the securities laws to require disclosure of corporate philanthropy may undermine any contractual argument concerning corporate giving. See Kahn, supra note 14, at 605 n.99.

143. See Millon, supra note 2, at 236-37. Although the nexus-of-contracts approach has generally been used to support the notion of a shareholder-centered corporation, and the pivotal role of profit maximization, those conclusions do not necessarily follow from the model. The aggregate conception can also support a broader picture of contracting parties that includes employees, creditors, customers and even the community at large. Therefore, there is no clear prescription about corporate philanthropy that necessarily grows out of the conception of the corporation as a nexus of contracts, and the nexus-of-contracts approach is indeterminate in legitimating corporate philanthropy in general.
Regardless of the normative implications for corporate law, for the tax treatment of corporate giving to be consistent with the nexus-of-contracts theory, the tax law should account for that giving as a contractual term for which some participant in the venture bargained and paid. In keeping with this approach, the deduction for corporate philanthropy might better attach to the contracting parties who act charitably, rather than the corporation itself. If corporate philanthropy is the carrying out of individual philanthropy through the corporate nexus, then income and deductions might better flow to the individual. Thus, where corporate giving as a wealth-reducing term for the shareholders is properly priced in the market as a term of the corporate contract, the nexus-of-contracts approach applied to tax theory suggests the possibility that the corporation may not be the proper taxpayer to claim a deduction for corporate giving. If the corporation is not the proper taxpayer, then from the perspective of taxpayers, there are people who are overtaxed or undertaxed by assigning the deduction at the corporate level, and, more

Similarly, no clear prescription for corporate giving follows as a necessary attribute of the real-entity model of the corporation. See Berle-Dodd debate, discussed supra note 109 and accompanying text; Millon, supra note 2, at 248.

144. The indeterminate nature of normative content in theories of the corporation was argued by John Dewey in 1926. See generally John Dewey, The Historical Background of Corporate Legal Personality, 35 YALE L.J. 655 (1926). Dewey's article may have been responsible for the sudden end of debate on the issue, and some scholars disagree with his conclusions. See Horwitz, supra note 2, at 175.

145. Some commentators have recognized that corporate contributions may be substitutes for individual giving by shareholders or managers. See Knauer, supra note 49, at 45-48; Davis, supra note 101, at 13-15, 65-67.

The IRS has adopted the constructive dividend model for charitable giving only in cases in which significant benefits are received by shareholders of closely held corporations. See Rev. Rul. 79-9, 1979-1 C.B. 125.

146. This is not necessarily an accurate description of reality. See Brudney, supra note 158.

147. If the market price of the stock and managerial compensation are affected by corporate philanthropy, then the price adjustments may also reflect capitalization of the tax savings of that philanthropy. It may not, however, due to the indeterminate incidence of the corporate tax.

148. Because of the uncertain incidence of the corporate tax, it is arguable that the corporation is never the proper taxpayer because it is impossible to allocate the tax burden among individuals through the corporate tax. If, however, corporations are to continue to be taxpayers, as this essay assumes, then there must be some assignment of income and deductions to the corporation that best measures the nexus-of-contracts corporation's net income. In that context, there can be a misallocation of income and deductions to a corporation. See infra notes 164-67 and accompanying text.
significantly, from the perspective of the fisc, there may be a net undercollection or overcollection of total tax.\textsuperscript{149}

Conceiving the corporation as an aggregate of contracting parties demands identification of the individual interests served by the corporate action. The theory allows the characterization of corporate giving as a product of contracting between shareholders and managers, or broader constituencies, and can represent explicitly delegated authority to management or decision-making reserved to other groups.\textsuperscript{150} In using the nexus-of-contracts approach as an analytical tool that locates corporate philanthropy as individual moral choices,\textsuperscript{151} one must ask what contract would have been entered into freely, with sufficient knowledge of material facts.\textsuperscript{152} The nexus-of-contracts approach suggests that corporate philanthropy be parsed out as the product of individual charitable intent carried out through the corporate nexus.

B. Adjusting the Model to Allow Charity

Application of the nexus-of-contracts approach here neither endorses it as a positive or normative theory, nor criticizes it. The purpose of this application is to suggest an alternative approach that the tax law can take to the question of deductions for corporate philanthropy. With this purpose in mind, it is necessary to modify some elements of the neoclassical version of the nexus-of-contracts model to make it more conducive to an analysis of charitable giving.

Writers in the neoclassical economic tradition assume that the contracting parties are rational economic actors, maximizing value for themselves,\textsuperscript{153} and living in a Hobbesian world.\textsuperscript{154} In this vision of human

\textsuperscript{149} The corporation's ability to deduct what is actually a dividend reduces the tax base.

\textsuperscript{150} For example, Berkshire Hathaway allows its shareholders to exercise power over individual philanthropic choices. \textit{See} Letter from Warren E. Buffett, Chairman of the Board, Berkshire Hathaway, Inc., to Shareholders (Sept. 15, 1995) (on file with author). Employee matching grant programs give the same power to employees.

\textsuperscript{151} The assumption that contracting parties are "rationally ignorant" is problematic. \textit{See} Alan Wolfe, \textit{The Modern Corporation: Private Agent or Public Actor?}, 50 WASH. & LEE L. REV. 1673, 1685 (1993).

\textsuperscript{152} This uses the contract idea in the tradition of John Rawls, as a way to evaluate arrangements, rather than to describe them as actual contracts, as Easterbrook and Fischel do. \textit{See} RAWLS, supra note 93; Wolfe, supra note 151, at 1680; EASTERBROOK AND FISCHEL, supra note 135, at 16 (arguing that, unlike the social contract, the corporate contract is real). Because there is no required disclosure of corporate philanthropy, it is hard to see how the market accounts for it. \textit{See} Kahn, supra note 14.

\textsuperscript{153} \textit{See} Bratton, \textit{The Nexus of Contracts Corporation}, supra note 2, at 417.
nature, there is no room for welfare-reducing altruism that allows charity, in the sense described here, to exist. The neoclassical model does not account for the non-utility maximizing acts of the individual contracting parties. Because real human beings have the capacity to be charitable, and because the contracting model is being applied here in order to identify the individual inputs that produce corporate philanthropy, that aspect of human nature must be part of the analysis of philanthropy.

In analyzing the corporation as an aggregate, there is no compelling reason to limit the contracting parties to single-minded profit-maximizers. Indeed, one of the virtues of the nexus-of-contracts approach is that it permits a more complex understanding of the choices and motives of actors within the corporation. Individuals, who retain the capacity for human emotion even as they become part of institutions, can cause those institutions to carry out their welfare-reducing wishes.

C. Who Is Charitable When a Corporation Engages in Philanthropy?

The task then becomes identifying the individuals for whom the corporation carries out philanthropic activities. If the contracting parties include the charitable organizations themselves and the community-at-

154. See Wolfe, supra note 151, at 1687 ("The literature spawned by the economic theory of the firm clearly is individualistic, but what is more important is the kind of individuals it envisions. These individuals are not people as most of liberal political theory has always understood them.").

155. See Sen, supra note 67. Any charitable acts would have to be recharacterized as welfare increasing on some reciprocal-expectation model. See Wolfe, supra note 151, at 1682 ("The notion that what seems to be altruism is really self-interest is a way of arguing that what seems to be real is not really real at all -- hardly a position compatible with taking the world as it is.").

156. See Bratton, The Nexus of Contracts Corporation, supra note 2, at 417.


158. An "institutional" version of nexus-of-contracts allows for broader human traits, and is therefore a more appropriate model for considering philanthropy. See Bratton, The Nexus of Contracts Corporation, supra note 2, at 421 (referring to the work of Oliver Williamson as embodying the institutionalist approach).

Alan Wolfe, a sociologist and political scientist, has argued that the pure contractarian theorists do not allow for actual individual decision-making and that the individuals in their models are "not responsible selves in the way many liberal theorists imagined human beings." Wolfe, supra note 151, at 1685. See also Brudney, supra note 138, at 1405-06, 1414-15.

159. Daniel Fischel has acknowledged that human beings do have moral obligations and social responsibilities, even as he argues that the corporation cannot. See Fischel, supra note 141.
large, then identifying actions with constituencies becomes difficult, and
regulating the contracting becomes impossible. Corporate law has never
had the ambitious agenda of regulating all the relationships implicated by
corporate activity,¹⁶⁰ and the tax law is even more limited as a potential
moderator of corporate activity because it can regulate only by adjusting
its subsidy for charitable giving.

In keeping with the Code's requirements for a charitable deduction,
it makes sense to limit the relevant contracting parties to persons who can
fulfill the requirements for charitable giving: charitable intent and
economic burden.¹⁶¹ That means that the relevant parties include only
individuals who are capable of acting generously, and who may also bear
the ultimate financial burden for corporate giving in the pricing
adjustments that the nexus-of-contracts model assumes the markets can
make. The choices seem to be shareholders, employees, and managers.¹⁶²

1. Shareholders

The shareholders are the most obvious choice for the people whose
generous impulses and financial resources may produce corporate
philanthropy. On the simplest analysis, corporate philanthropy is the
giving away of the shareholders' money.¹⁶³ One premise of corporate law

¹⁶⁰ "If . . . one is also concerned about consumers or the general public, to redraw
the boundary of the corporation broadly enough to encompass these constituencies
threatens to dissolve the line between the corporation and the rest of the world. The
normative implications are then ambiguous." Millon, supra note 2, at 259.

¹⁶¹ See supra notes 56-58 and accompanying text. In United States v. American
Bar Endowment, 477 U.S. 105, 117 (1986), the Supreme Court adopted the following
standard: "First, the payment is deductible only if and to the extent it exceeds the market
value of the benefit received. Second, the excess payment must be 'made with the

¹⁶² Absent from the analysis that follows are consumers. While it has been
suggested that customers bear the economic burden of corporate social responsibility that
does not inure to the benefit of the business, the shift to customers depends upon an
increase in the marginal cost of products. See Engel, supra note 51, at 25. This can
readily happen with socially responsible corporate activity related to its business, such as
pollution control, but is unlikely to happen with respect to corporate philanthropy.

¹⁶³ While the government subsidizes corporate giving by allowing the corporation
to take a tax deduction, the deduction is not an incentive that is costless for the
shareholders. If the applicable corporate-tax rate is 35%, then the corporation is out-of-
pocket 65 cents for every dollar contributed to charity. While greater tax subsidies are
available for the contribution of appreciated property, see I.R.C. § 170(e), current
empirical research shows that corporations predominantly give cash to charity. See
Useem, supra note 110, at 341. Gifts of cash are only tax-favored to the extent of the
donor's marginal rate.
is that shareholders are entitled to the residual profits of the corporation in return for the risks they assume, while managers, creditors, and employees are entitled to fixed returns for their inputs.\(^\text{164}\) Therefore, the financial burden of corporate contributions is on the shareholders to the extent of the non-tax-subsidized portion.\(^\text{165}\) This is so because the assumption that the expenditure is not income-producing means that costs cannot be shifted from holders of the residual interest in the corporation to other participants in the corporate venture. If the expenditure is not income producing, then it must come out of the earnings of the corporation, which represents the shareholders' residual return on capital.\(^\text{166}\)

As for the portion financed by the tax subsidy, the deduction provides an economic benefit to whomever bears the corporate tax, and the tax savings may not benefit the same persons who are burdened by the out-of-pocket cost of the contribution. If the tax-subsidy from the government alleviates a tax burden on equity holders, it reduces the cost of the charitable contribution for them.\(^\text{167}\) If, however, the corporate tax is borne by people other than shareholders, then the deduction for charitable giving produces a tax reduction for those people, and can be seen as a wealth transfer from shareholders, who bear the burden of the philanthropic donation, to the group that benefits from the deduction.

2. Employees

Another potentially generous constituency, which may cause the corporation to give on its behalf, is the corporate workforce. Consider employee matching-grant programs: both requirements for deductible giving—cost and intent—attach to the employees in that case. The economic cost of corporate giving falls on the employees, in keeping with the nexus-of-contracts model, when the contribution of corporate funds to

\(^\text{164}\) See Brudney, supra note 138, at 1436; Easterbrook & Fischel, supra note 135, at 10-11.

\(^\text{165}\) The non-tax-subsidized portion is the actual out-of-pocket cost of a charitable contribution, while the tax-subsidized portion is the cost that is financed through tax savings.

\(^\text{166}\) If the contribution is income-producing, then it becomes a cost of the corporation similar to all other business costs, and can have various real incidences, or economic burdens, depending on how the market adjusts to the costs.

\(^\text{167}\) Economists have not been able to pinpoint the incidence of the corporate tax because the market may adjust in various ways so that the tax is either borne by holders of capital, or shifted to labor or consumers, or some combination. See Musgrave & Musgrave, supra note 32, at 269; see generally Joseph A. Pechman, Brookings Inst., Who Paid the Taxes 1968-1985 (1985).
the objects of the employees' affections is priced in the market as a fringe benefit to the employees of the corporation. The nexus-of-contracts model of the corporation implies that this method of corporate giving is taken into account in the market for employee wages. Matching grant programs are reasonably seen as employee fringe benefits because directing funds to the employee's favorite charity is a benefit to the employee similar to other non-cash benefits, such as health insurance, that cost the corporation money and would otherwise have to be purchased by the employee with cash. The tax law clearly recognizes the compensatory equivalence of fringe benefits and ordinary salary by generally taxing fringe benefits like cash compensation. In the contract model, matching-grant programs are one of the perquisites of employment, which might have been traded in the bargaining process (actual or implied) for more direct employee compensation.

3. Managers

A narrower group of people for whom corporate contributions may represent additional compensation is the managers. While the bargaining process looks different for managers than for employees, the characterization for tax purposes is essentially the same. Managers who retain the prerogative to use corporate funds to enrich the charities they favor are garnering the corporate profits for the objects of their affection, and therefore, are receiving a benefit in the nature of extra compensation. Whether this amount is termed an "agency cost," as the literature does when managers take perquisites for themselves instead of maximizing firm value, or simply part of the negotiated fringe-benefit package of

168. The corporate-contract model accounts for implicit, as well as explicit, contracting because markets price the implicit terms of the corporate governance contract. See Easterbrook & Fischel, supra note 135, at 17.

Of course, it is possible that the market fails to account for employee matching grants as a type of fringe benefit, in which case the economic burden of the matching-grant program remains on the shareholders because they would otherwise be entitled to the residual profits of the firm. From a corporate governance perspective, the allocation of control to employees over shareholder funds is problematic because the corporate workforce has an even more tenuous agency relationship with the shareholders than the elected management. From a tax perspective, it is less troublesome. See infra notes 181-84 and accompanying text.


170. See Jenson & Meckling, supra note 27, at 308-10.
management\textsuperscript{171} that leads to a reduction in other salary paid, the arrangement clearly mirrors that of the employees.

4. Identifying the Donor

A practical problem that follows from disaggregating the corporation is choosing the various contracting parties accurately, particularly if tax consequences to individuals are to follow from those choices. This is not a significant problem if applying corporate theory to the Code is intended to illuminate biases and provide perspective, as this essay suggests, rather than to direct specific statutory changes.

In the case of corporate philanthropy, it might be hard to determine on which constituency's behalf the corporation gives. Nevertheless, it seems reasonable to impute certain contributions to certain constituencies depending on some formal requirements for corporate giving. Corporations can clearly identify particular charitable contributions with employees through matching grant programs, and therefore, employees should not be the identified donors in other cases. Similarly, Berkshire Hathaway has demonstrated that shareholder designation is possible, and shareholders should be treated as the donors through those programs. Short of shareholder designation, it would be reasonable to treat corporate giving as shareholder giving only if choices about corporate giving are made through an effective mechanism for shareholder democracy. However, it is hard to imagine a widely held corporation, under the current proxy system, achieving that goal.

Since the most recent evidence suggests that corporate giving is managerialism\textsuperscript{172} and because treating it as such in the default case might produce the greatest reduction in agency costs and the least concentration of political power in the hands of corporate management, it would be reasonable to treat the managers as the donors wherever the other explanations are inapposite. Of course, where corporate giving is, in fact, profit-maximizing for the corporation, then it need not be characterized as charitable giving at all.

D. Recharacterizing Corporate Philanthropy for Tax Purposes

This analysis is a challenge to the tax law because it suggests that the charity for which the Code allows a deduction may be identified with

\textsuperscript{171} Management compensation can come in a wide variety of forms. Some have argued that the fruits of insider trading should be treated as managerial compensation. See Dennis W. Carlton & Daniel R. Fischel, The Regulation of Insider Trading, 35 STAN. L. REV. 857, 870-73 (1983); EASTERBROOK & FISCHEL, supra note 135, at 258.

\textsuperscript{172} See Boatsman & Gupta, supra note 50.
various taxpayers other than the corporation. Once the aggregate conception of the corporation underlying the nexus-of-contracts model is introduced, the idea of a generous corporate entity becomes impossible. If managers are generous with the shareholders' money, then there is no single taxpayer who makes a charitable gift that merits the deduction. One response to this observation might be that the charitable deduction for corporate philanthropy is simply indefensible and should be repealed so that corporate philanthropy ceases to be tax-subsidized. But the aggregate conception of the corporation does not necessarily lead to that conclusion; it is possible to search for generosity and cost, in the tax sense, somewhere in the aggregate.

The very limited conception of the corporate entity within the nexus-of-contracts notion undermines the legal and theoretical predicates for the existence of corporate philanthropy except as an extension of the charitable impulses of contracting parties. The choice of the corporate taxpayer for allowance of the deduction, as opposed to the individual taxpayers, is therefore not an obvious one, and instead of requiring repeal of the deduction, the aggregate model may disperse the tax consequences away from the entity to the individuals.

1. Allocation of Income and Deductions

If the Code were to follow through with the recharacterization of corporate philanthropy as the projected generosity of individuals described above, then the deduction for corporations under § 170 would be inappropriate. By repealing the deduction at the corporate level, the Code would become more internally consistent with its own presumption that corporations incur expenses only in the production of income, and there

173. From a tax perspective, cost depends on the inclusion of an amount in income. Therefore, a taxpayer can incur a cost based on amounts she never has in hand, if those amounts have been taxed to her. For example, an employee has "tax cost" for the full fair-market value when she purchases her employer's stock for less than that value and includes the discount in income. See I.R.C. § 83. For an explanation of the special concept of "cost" in the tax law, see MARVIN A. CHIRELSTEIN, FEDERAL INCOME TAXATION: A GUIDE TO THE LEADING CASES AND CONCEPTS 13 (7th ed. 1994).

174. Corporate income may still exist because the nexus of contracts may coalesce around corporate business. Nevertheless, the nexus-of-contracts conception of the corporation can clearly be used to argue for integration of the corporate and individual income taxes.

175. See supra Part I.B.1.
would be no need to fit corporations into a deductibility provision that only comfortably suits individuals.\textsuperscript{176}

At the same time, the incentive and subsidy in current law for corporate giving would not be abolished by a reconfiguration of the corporate deduction because individuals would still be entitled to deduct the charitable gifts made by corporations on their behalf. For tax purposes, the various corporate constituencies, in keeping with the aggregate approach to the corporation, could be treated as having income and deductions more consistent with the corporate-contract model than reflected in current law.\textsuperscript{177}

\textsuperscript{176} Courts have recognized that the intent requirement is problematic for corporations, and the inclusion of corporations in the statute has led some courts to question the intent requirement. \textit{See} United States v. Transamerica, 392 F.2d 522, 524 (9th Cir. 1968).

\textsuperscript{177} Aside from the question of who should be entitled to the deduction for charitable giving from corporate coffers, the aggregate paradigm presents a challenge to the availability of any charitable deduction in some cases of corporate philanthropy. Wherever the two requirements of charitable giving—generous impulse and economic burden—are separated from one another because different taxpayers satisfy each of the requirements, it may be more appropriate to disallow any deduction, rather than to assign the deduction to one taxpayer who fails to fully satisfy the requirements. One example of such separation may be in the context of cause-related marketing, in which a corporation promises to give some part of the proceeds from the sale of a product to charity. If the price of the product does not change as a result of the charitable gift, the consumer bears no economic burden for the gift. However, the consumer may be induced to purchase the product because of the diversion of funds from the corporate coffers to the charity, so the consumer may be acting out of charitable impulses in entering into the transaction. At the same time, the shareholders may suffer some loss of residual profits by the payment of the promised percentage to the charity, and therefore, the promotion may cost the shareholders money. However, the arrangement is likely to have been devised as a promotion that would produce greater profits for the corporation (by inducing consumers to buy the product), so any loss occasioned by the transfer to charity cannot be characterized as motivated by charitable impulses of either the shareholders or the managers. Because of the immediate advertising value of cause-related marketing, it is easy for corporations to fit such costs within I.R.C. § 162.

Separation of charitable intent from economic burden is an unresolved (and unrecognized) issue outside the corporate context as well. In a recent private ruling, the Service held that credit-card holders would be entitled to charitable-contribution deductions for percentages of their credit-card purchases that were destined for charitable organizations pursuant to arrangements with the credit card companies. \textit{See} Priv. Ltr. Rul. 96-23-035 (March 8, 1996). These cards present a questionable case for the identity of the taxpayer, as well as the general availability of any deduction. The cardholder has control over who receives the funds, but hardly acts with charitable intent when simply purchasing items with a credit card. In addition, the card-holder does not pay any extra for the goods by virtue of using the card—cash or noncharitable credit cards would produce the same price for goods, so the cardholder bears no economic burden for
Where gifts are made on behalf of shareholders, the Code would treat the gifts as distributions paid to the shareholders from the corporation, followed by charitable gifts by those shareholders. This makes sense because the residual profits of the corporation, when paid directly to the favorite charities of the shareholders, are indistinguishable from shareholder contributions paid out of dividend funds. Such a characterization would produce taxable income to the individual shareholders, offset by a charitable contribution deduction. The major difference from current law that this recharacterization would produce would be the taxation of the corporation, which would no longer be entitled to a deduction because distributions to shareholders, as opposed to charitable contributions, are not deductible by corporations.

In the case of matching gifts made on behalf of employees, the gifts would be included by the employees as compensation income, offset by

the gift. The economic burden may be borne by the shopkeepers, who agree to accept this card, rather than requiring cash, to induce consumers to shop at their store. That's a profit-seeking motivation. On the other hand, if shopkeepers pay the same percentage to this credit card company as to other companies whose cards they accept, then the shopkeepers don't even bear any economic burden for the transfers to charity. Finally, if the credit card company accepts less than the market requires because of the percentage to charity, then one can argue that the credit card company bears the burden of the charitable transfer. But, for them, this is simply cause-related marketing, which is business, not charity.

178. See I.R.C. § 301.

179. This would produce a wash for the shareholders unless they exceed the statutory limitations for charitable contributions of I.R.C. § 170(d), in which case the shareholders would carry excess contributions over to a future taxable year. It is also possible that some shareholders would receive no tax benefit from the deduction because they do not itemize their deductions. This is a particular problem for employees. See infra notes 192-94 and accompanying text.

180. See I.R.C. § 311. Contrary to this analysis, in the private letter ruling that was apparently issued to Berkshire Hathaway, the Service stated that shareholder-designated contributions would be deductible by the corporation under I.R.C. § 170, and not taxed to the shareholders. Priv. Ltr. Rul. 81-52-094 (Sept. 30, 1981).

181. See I.R.C. § 61. It is conceivable that Congress would want to provide an exclusion, as it has for so many other fringe benefits that do not personally enrich employees with cash, particularly in light of the fact that most rank and file employees are likely to claim the standard deduction and would therefore have income with no offsetting deduction. See, e.g., I.R.C. § 119 (exclusion for meals on the business premises that are provided for the convenience of the employer), § 132(c) (exclusion for certain employee discounts on products ordinarily offered for sale in employer's business).

Statutory exclusion of employee matching grants from income, particularly in the context of the general disaggregation scheme described here, would create a bias towards corporate philanthropy in that form. While there are some advantages to the matching
charitable contribution deductions. The gifts would also be deductible to the corporation as compensation expense, rather than a charitable contribution. Assuming that the employees can benefit from the charitable contribution deduction, this produces the same result as current law because there is a net deduction at the corporate level and no tax consequences at the employee level.

From a tax perspective, gifts on behalf of management employees are indistinguishable from gifts on behalf of other employees. Therefore, they could be taxed the same as employee matching grants, i.e., producing a compensation deduction for the corporation, and an income inclusion and charitable deduction for the managers. Such a recharacterization would likely produce some tax burden for managers, who would be subject to the limitations on charitable contributions in § 170 and, as high-income taxpayers, some disallowance for itemized deductions under § 68. This allocation of income and deduction for managers follows the aggregate model in deconstructing the corporate transaction into its constituent parts, finding the individual and producing tax cost for the deduction by requiring an income inclusion.

Alternatively, the nexus-of-contracts approach might support distinguishing managerial compensation from employee compensation because of that model's concern with minimizing agency costs, a concern with respect to management, but not with respect to the regular work force. If application of the nexus-of-contracts approach to the Code means that the Code should be used as an agency-cost reduction tool, then where corporate philanthropy is managerialism, the corporate deduction should be disallowed without any tax consequences to the individual managers. This treatment cuts off the tax subsidy that current law provides for corporate philanthropy and alters the trade-off calculation that managers

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182. The tax consequences to the individual employees would therefore mirror the consequences to the shareholders.

183. See I.R.C. § 162.

184. Under current law, this is a big if because the charitable contribution deduction is currently allowed only to taxpayers who itemize their deductions. See I.R.C. § 63. From 1982 until 1986, non-itemizers were entitled to claim a deduction for charitable contributions. See former I.R.C. § 63(b), repealed by the Tax Reform Act of 1986, Pub. L. No. 99-514 § 102(a).

185. I am indebted to Lily Kahng for this idea.

grant model in terms of pluralism and dissipation of managerial power, if the employees are giving away the shareholders' money, the matching grant model offers little improvement over the managerialist model. Tax cost fails to create economic cost. I am indebted to Jill Fisch for this observation.

182. The tax consequences to the individual employees would therefore mirror the consequences to the shareholders.

183. See I.R.C. § 162.

184. Under current law, this is a big if because the charitable contribution deduction is currently allowed only to taxpayers who itemize their deductions. See I.R.C. § 63. From 1982 until 1986, non-itemizers were entitled to claim a deduction for charitable contributions. See former I.R.C. § 63(b), repealed by the Tax Reform Act of 1986, Pub. L. No. 99-514 § 102(a).

185. I am indebted to Lily Kahng for this idea.
must make between contributions and profits, making contributions less attractive.186

2. Advantages of Recharacterization

Numerous advantages would flow from these recharacterizations of corporate philanthropy as individual philanthropy. First, by explicitly assigning charitable giving to shareholders, corporate management would have to acknowledge the economic burden that corporate contributions place on shareholders. This tax treatment could lead to greater accountability to shareholders with respect to corporate giving.187 At the very least, the tax reporting requirements that would be necessary to accurately tax the shareholders would mean that shareholders be informed about the philanthropic choices made by management on behalf of the corporation. The requirement that corporations provide information could lead to more shareholder input in philanthropic choices,188 or at least better monitoring of management abuse in charitable giving.189

Second, this recharacterization would neutralize the bias of current law that favors charitable giving at the corporate level, as opposed to the shareholder level. As mentioned above, because of the structure of the classical system of taxation, which taxes corporate income at both the corporate and shareholder levels, the corporate deduction makes charitable giving at the corporate level more attractive than distributions to shareholders followed by charitable giving at the individual level.190 Recharacterization removes the extra tax incentive to give at the corporate level, compared to the shareholder level, which could lead to greater actual

186. In a world in which charitable contributions of corporations are deductible and the marginal rate of tax paid by corporations is 35%, managers must decide whether to trade the utility of $1 of charitable contribution for $0.65 of profit for the corporation. If the corporate-level deduction is abolished, then utility-maximizing managers will have less incentive to substitute contributions for profits. See Boatsman & Gupta, supra note 50, at 197 (relying on OLIVER WILLIAMSON, THE ECONOMICS OF DISCRETIONARY BEHAVIOR: MANAGERIAL OBJECTIVES IN A THEORY OF THE FIRM (1967)).

187. Of course, it might also lead to less corporate giving. This essay takes no position about a desirable level of corporate philanthropy.

188. It could lead to the adoption of programs similar to Berkshire Hathaway’s. According to that company's controller, administration of the shareholder-designated contributions program is not burdensome. Telephone Interview of Julie Min and Dan Jaksich (July 30, 1996). In 1995, Berkshire-Hathaway gave over $11 million to 3,600 charities. BERKSHIRE HATHAWAY INC., 1995 ANNUAL REPORT 55 (1996).

189. See Kahn, supra note 14, at 624-25.

190. See supra note 103 and accompanying text.
distributions and more individual shareholder determination concerning charitable giving.  

Third, with respect to employee matching grants, this recharacterization will highlight the upside-down nature of the subsidy provided by the charitable contribution deduction generally, and possibly induce Congress to return to a more generous deduction for non-itemizing taxpayers. Under current law, because the corporation deducts employee matching grants, rather than the employees themselves, nondeductible charitable giving of lower income people is minimized.

Finally, with respect to managerial compensation, both suggested tax treatments would reduce the agency costs of management. Treating corporate giving just like managerial compensation would make the agency costs of managerial discretion explicit, and would include those costs in taxable income. To the extent that corporate giving is a managerial perquisite, it should be taxed to management, and subject to the limitations

191. Of course, it would also reduce the total tax subsidy for private giving because there would be an increased tax at the corporate level. But the reduced subsidy for private giving would then be available for direct public support of charities.

192. The charitable-contribution deduction is an "upside-down" subsidy because it provides a greater government subsidy for charitable giving of taxpayers in higher tax brackets than lower tax brackets. See Stanley S. Surrey & Paul R. McDaniel, Tax Expenditures 103 (1986). Some have challenged the significance of the upside-down subsidy. See Thomas D. Griffith, Theories of Personal Deductions in the Income Tax, 40 Hastings L.J. 343, 355 (1989) (disputing that the proper comparison between taxpayers is absolute amounts of tax paid, and arguing that relative amounts of tax paid and after-tax distribution of income are better ways to evaluate deduction provisions).

193. The corporate deduction might not be in the nature of an upside-down subsidy, depending upon the incidence of the corporate tax. See supra note 167 and accompanying text.

194. Under current law, taxpayers who choose the standard deduction may not claim any deduction for charitable contributions that they make. See supra note 184. Therefore, tax subsidies for charitable giving depend not only on whether taxpayers make contributions to charitable causes, but also on completely irrelevant factors such as whether they also incur home-mortgage interest. This is so because the aggregate of all itemized deductions must exceed the standard deduction in order for the taxpayer to itemize. Any policy justification for subsidizing charitable giving is compromised when arbitrary factors determine whether a taxpayer benefits from tax savings as a result of charitable giving. See McDaniel, supra note 122, at 384.

195. See Kahn, supra note 14, at 620-25.
on individual contributions196 and managerial compensation197 found in the Code. Taxing such items as compensation and disclosing these expenditures as managerial compensation would reduce the incentive of managers to direct corporate assets toward themselves in this manner. On the other hand, disallowance of any deduction at the corporate level might more effectively reduce agency costs of management. However, it would also impose a unique tax on corporate giving on behalf of managers, compared to corporate giving on behalf of other employees and individual giving of managers.

3. Conclusion

This essay has attempted to expose the problems presented by the charitable contribution deduction for corporations in light of various theoretical models of the corporation. It has argued that the deduction for corporations cannot be justified by analogy to the deduction for individuals. The proposal to allocate the deduction for corporate giving in response to the nexus-of-contracts model of the corporation is not necessarily a proposal for legislative action. Instead, it is intended to help inform the debate about the corporate charitable contribution, and to consider the deduction in light of developments in corporate theory, while assuming that the Code will continue to adhere to the classical system of taxation.

Even if charitable giving is the province of individuals and not corporations, we may still believe in the corporate-level deduction as a matter of social policy. After this symposium, I plan to continue exploring the corporate contribution deduction and to consider whether it is possible to: (1) reconcile a tax policy that includes a corporate tax and a corporate policy that values minimizing agency costs; and (2) resolve conflicting directives of tax and corporate policy analysis where they overlap.

196. I.R.C. § 170(b)(1) limits deductibility of individual contributions to 50% of a taxpayer's adjusted gross income. While this limitation is not currently significant for most taxpayers, it might be if corporate contributions were recharacterized in this context.

197. Such as the requirement that salaries be reasonable, in I.R.C. § 162(a)(1), and the $1 million limitation of I.R.C. § 162(m).