CURRENT TAX LAWS AND THE FULFILLMENT OF CORPORATE FOUNDATIONS' SOCIAL FUNCTIONS: EVIDENCE FROM 990-RETURNS OF PRIVATE FOUNDATIONS

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ABSTRACT

This study analyzes the relationship between the current tax laws and the fulfillment of corporate foundations' social functions. The particular social functions of private foundations such as corporate sponsored foundations are theorized to provide alternative solutions to social issues by supporting research and public policy studies. The findings of this study suggest if current tax laws do not facilitate foundations to fulfill their social functions, amendments to tax provisions for private foundations appear to be desirable.

INTRODUCTION

Partially due to favorable tax treatments, business corporations are believed to be more proactive in managing their charitable giving agenda (Werbel and Carter, 2002). Many corporations use corporate (company-sponsored) foundations to handle their donations (Himmelstein, 1997). The purpose of this study is twofold. First, this study investigates the relationship between the current tax laws and the fulfillment of corporate foundations' social functions. Theoretically, private foundations are expected to fund leading research that may bring alternative solutions to social issues (Andrews, 1965; Heifetz, et al., 2004). Current tax laws, however, neither distinguish the functions between private foundations and charities nor require or provide any incentive for foundations to fund research. This lack of differentiation is an important public policy issue because if current tax laws do not facilitate foundations to fulfill their social functions, amendments to tax provisions for private foundations appear to be needed. Second, this study examines whether the giving behavior of corporate foundations is motivated primarily by the tax advantage or by a desire to strategically manage their parent company's business environment.

THEORETICAL DEVELOPMENT AND RESEARCH QUESTIONS

Although private foundations are funded by charitable contributions, the social expectation of a private foundation is somewhat different from traditional charities. Roelofs (2003) states the distinction between foundation grant-making and charitable giving is in the "root cause" metaphor. Whereas the purpose of traditional charities is to provide relief to the poor, the distressed or the underprivileged, and to lessen the burdens of government, the purpose of foundations is to do something about the deeper causes that lead to suffering and inequality in the first place. For instance, the research on and discovery of vaccine treatment is aimed at preventing the suffering that accompanies epidemics. Furthermore, Andrews (1965, p.5) emphasizes that the purpose of foundations "is not relief or even cure, it is prevention, research, and discovery." Heifetz et al. (2004) argue that if foundations are to achieve their social role, they are well positioned to do so through imaginative and even controversial leadership.

Even though corporate foundations are legally separated from the funding organizations, the grant-making behaviors of foundations are likely to be influenced by the giving policies and social interests of the parent company because foundations are financially and administratively controlled by the sponsoring corporations (Himmelstein, 1997). In a capitalistic society, business entities are believed to be more concerned with their economic benefits as long as the pursuits of their business interest are within the provisions of laws. The current tax provisions neither request nor provide any incentive for corporate foundations to support public policy studies; grant monies given to traditional charities and policy research receives the same tax treatment. Consequently, corporate foundations operating in a capitalistic society are theorized to have a preference to provide funding to traditional charities rather than social issue research. It is because funding traditional charities not only helps organizations enjoy the same degree of tax benefits, and perhaps the same amount of name recognition, but also prevents many criticisms. Thus:

> Hypothesis 1: Corporate sponsored foundations will give a significantly higher amount of grant monies to traditional charities than they will give to research and public policy studies.

The literature suggests two possible rationales - tax advantage and strategic management of corporate environment– that may explain why so many corporate foundations come into being and persist indefinitely. Many researchers (Clotfelter, 1985; Webb, 1992) argue the most important reasons for using a corporate foundation have to do with the tax code. If the characteristics of corporate foundations are similar to other nonprofit organizations, tax benefit plays an important role in their reporting and giving behaviors. For instance, Yetman (2001) documents that nonprofit organizations allocate expenses from their tax-exempt to their taxable activities to reduce their tax liabilities. Moreover, Sansing and Yetman (2002) find that large and professionally managed foundations have a tendency to minimize their payouts. Thus, the tax advantage hypothesis is postulated:

> Hypothesis 2a: The annual amount of contributions given by a corporate foundation does not significantly exceed its minimum payout requirement.

Still, others (Neiheisel, 1994; Williams and Barrett, 2000) argue that managing the sponsoring corporation's business environment is the most important reason to set up a corporate foundation. Neiheisel (1994) argues that corporations use their foundation as an extended arm to administer their public affairs, which may reduce government interference and special interest group criticism. William and Barrett (2000) document that corporate charitable giving mitigates unfavorable corporate reputations caused by environmental violations. Moreover, as documented by Chen and Roberts (2005), corporations that receive poorer social performance evaluation scores tend to make more donations then corporations that receive better evaluation scores. In order to control the influence of their parent company's legitimacy need in corporate foundation's payout behavior, the unfavorable social performance scores of a foundation's sponsoring corporation should be accounted for. Thus, the strategic management hypothesis suggests that: Hypothesis 2b: The annual amount of contribution given by corporate foundations significantly exceeds the minimum payout requirement after controlling for the legitimacy need of the parent company.

RESEARCH DESIGN AND FINDINGS

181 sample corporate foundations were selected to test hypothesis 1. Among the 181 sample, 108 foundations' parent company have reported KLD social performance scores, and were used to test hypotheses 2a and 2b. Hypothesis one was measured by the difference between the amount of grant

money donated to support traditional charities and the amount donated to support research and public policies studies. The amount of foundation giving and required minimum payout are obtained from Forms 990-PF (Return of Private Foundation). KLD concern scores are the control variables. The results indicate that the current tax laws do not provide incentives for foundations to support research and public policy studies. The research findings also reveal that corporate foundation giving is motivated more by a desire for strategic management than tax benefits. However, this study does not exclude tax advantage as one of the motivations of corporate foundation giving.

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