

# TO TAX OR NOT TO TAX SOCIAL ENTERPRISES

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## I. INTRODUCTION

Social enterprises have proliferated in recent years.<sup>1</sup> Yet, the federal income tax law relating to tax-exempt organizations has remained relatively static since its inception more than a hundred years ago.<sup>2</sup> Depending how a social enterprise is organized and operated, it can be either tax-exempt or taxable. But organizations that operate with a dual purpose of conducting both a charity and a commercial business for non-charitable purposes cannot qualify as tax-exempt.

Notwithstanding the current state of the federal tax law, this Essay explores the question of whether social enterprises *should be* given tax breaks—namely an exemption from federal income tax—for their charitable activities.<sup>3</sup> To the extent social enterprises provide public goods or services, the prevailing justification for tax exemption provides some basis to answer that question in the affirmative. But without additional

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<sup>1</sup> There are thousands of social enterprises in existence, operating as benefit corporations or L3Cs. InterSector Partners, L3C puts the count of active L3Cs as of August 1, 2018, at 1,531. INTERSECTOR PARTNERS, L3C, <https://www.intersectorl3c.com/l3c> (last visited Oct. 6, 2018). See also Frederick H. Alexander, Next Phase for Benefit Corporation Governance Begins, Thomson Reuters Westlaw, at 2 (Dec. 11, 2017) and Ellen Berrey, How Many Benefit Corporations Are There?, <http://ssrn.com/abstract=2602781> (May 5, 2015). B Lab maintains a list of benefit corporations at <http://benefitcorp.net/businesses/find-a-benefit-corp>. B Lab is a non-profit corporation that seeks to “harness the power of business to help address society’s greatest challenges.” <https://bcorporation.net/about-b-lab>. Among other things, B Lab bestows B Corp certifications on businesses to presumably signal their commitment to social enterprise. *Id.* See generally David E. Pozen, *We Are All Entrepreneurs Now*, 43 WAKE FOREST L. REV. 283, 294-300 (2008) (examining the uptick in social entrepreneurship).

<sup>2</sup> BITTKER & LOKKEN, FED’L TAX’N INCOME EST. & GIFTS, ¶ 100.1.1 (2011 Edition) (tracing federal tax-exemption to the Revenue Act of 1894 and noting its “surprising consistency” since then).

<sup>3</sup> Other scholars who have studied this issue in far greater detail than this Essay include: Lloyd Hitoshi Mayer & Joseph H. Ganahi, *Taxing Social Enterprise*, 66 STAN. L. REV. 387 (2014) (not in favor of extending tax exemption to social enterprises); Susannah Camic Tahk, *Crossing the Tax Code’s For-Profit/Nonprofit Border*, 118 PENN ST. L. REV. 489 (2014) (in favor of extending tax breaks to social enterprises); Benjamin Moses Leff, *The Case Against For-Profit Charity*, 42 SETON HALL L. REV. 819 (2012); Anup Malani & Eric A. Posner, *The Case for For-Profit Charities*, 93 VA. L. REV. 2017, 2029 (2007).

rules to guard against abuse and overreach, the risk of inappropriate revenue leakage looms large. The likelihood that social entrepreneurs would be amenable to mitigating this risk seems unlikely if doing so infringes on the ways in which they do business. Social enterprises are still businesses seeking a profit even if that profit is directed toward social good. Nonetheless, all hope is not lost. Although federal tax law does not—nor should it—grant a partial tax exemption to for-profit social enterprises, similar tax results may be achieved through the existing law.

## II. THE CURRENT ENVIRONMENT

This section explores the meaning of “social enterprises” as well as their taxation under federal income tax law.

### *A. Scope of Social Enterprises*

There is no uniform definition of the term “social enterprise.”<sup>4</sup> The Good Trade reserves the label for “cause-driven business[es] whose primary reason for being is to improve social objectives and serve the common good.”<sup>5</sup> Under this definition, the purpose of generating profits is to sustain the firm’s social mission. The Social Enterprise Alliance defines social enterprises as “[o]rganizations that address a basic unmet need or solve a social or environmental problem through a market-driven approach.”<sup>6</sup> This Essay uses the term to mean organizations that have a dual mission of using a commercial enterprise to make a profit while also addressing a social need.

A social enterprise can be operated through a variety of organizations whose governing statutes expressly consider the organization’s social objectives. For example, the Tennessee Business Corporation Act permits for-profit public benefit corporations.<sup>7</sup> The corporation’s charter must include the public benefits that the corporation intends to pursue.<sup>8</sup> “Public benefit” means “a positive effect or reduction of negative effects on one . . . or more categories of persons, entities, communities, or interests, other than shareholders in their capacities as

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<sup>4</sup> Dana Brakman Riser, *Theorizing Forms for Social Enterprise*, 62 EMORY L.J. 681, 681 (2013) (noting that, “Social enterprise is a hotly contested term.”).

<sup>5</sup> Amyann Cadwell, *What is a Social Enterprise? Simple Definition & 3 Example*, THE GOOD TRADE SOCIAL IMPACT, <https://www.thegoodtrade.com/features/what-is-a-social-enterprise>.

<sup>6</sup> SOCIAL ENTERPRISE: WHAT IS SOCIAL ENTERPRISE?, <https://socialenterprise.us/about/social-enterprise/>.

<sup>7</sup> TENN. CODE ANN. § 48-28-103 (2016).

<sup>8</sup> *Id.* at § 48-28-104(e).

shareholders.”<sup>9</sup> Tennessee for-profit public benefit corporations must report to their shareholders every year the extent to which they pursued and achieved their public benefit purpose.<sup>10</sup> Alternatively to the extent authorized in the relevant jurisdiction, a social enterprise could be organized as a low-profit limited liability company, or L3C, or a benefit limited liability company. Both are state-law LLCs that seek to accomplish one or more charitable purposes.<sup>11</sup> Despite the rise of special-purpose entities, even traditional corporations or limited liability companies might serve as appropriate vehicles for social enterprises.<sup>12</sup>

### *B. Taxation of Social Enterprises Under Current Federal Income Tax Law*

The federal income tax law takes a binary approach to the taxability of organizations.<sup>13</sup> Those that satisfy statutory requirements imposed by section 501 of the Internal Revenue Code (the “Code”) and the accompanying regulations are exempt from federal income tax.<sup>14</sup> Organizations that fail to satisfy all the legal requirements are subject to tax. Thus, notwithstanding the expansion of entity choices within the states, federal tax exemption generally does not depend on the organizational vehicle used.<sup>15</sup> Even traditional corporations or limited liability companies could qualify for tax exemption if they satisfy all of the

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<sup>9</sup> *Id.* at § 48-28-103(3).

<sup>10</sup> *Id.* at § 48-28-107(b)(2).

<sup>11</sup> *See, e.g.*, 805 ILCS § 180/1-26 (“A low-profit limited liability company shall at all times significantly further the accomplishment of one or more charitable . . . purposes, . . . and would not have been formed but for the relationship to the accomplishment of such charitable . . . purposes.”). The Tennessee legislature considered but did not enact L3C legislation. *See also* Md. Code § 4A-1201(b) (defining “benefit limited liability company”). *See generally* J. Haskell Murray, *The Social Enterprise Law Market*, 75 MD. L. REV. 541 (2016) (cataloguing social enterprise forms).

<sup>12</sup> *See* Joan MacLeod Heminway, *Let’s Not Give Up on Traditional For-Profit Corporations for Sustainable Social Enterprise*, 86 UMKC L. REV. 779 (2018).

<sup>13</sup> There are organizations that are primarily tax-exempt but partially taxable under the unrelated business income tax regime. *See infra* notes 42–43 and accompanying text. But in general, organizations fit into either a taxable or tax-exempt regime.

<sup>14</sup> I.R.C. § 501(a). Unless otherwise noted, section references are to the Internal Revenue Code of 1986, as amended. In addition to exempting the organization from income tax, donors are entitled to deduct from their own taxes any contributions made to tax-exempt organizations. I.R.C. § 170(c)(2).

<sup>15</sup> I.R.C. § 501(c)(3) seems to limit tax exemption to “corporations, and any community chest, fund, or foundation,” but state-law unincorporated entities such as LLCs are permissible. *See* Treas. Reg. § 301.7701-3(c)(1)(v)(A).

statutory and regulatory requirements.<sup>16</sup> Otherwise, state-law corporations, whether a traditional corporation or a public benefit corporation, are classified as fully taxable C corporations unless a valid S election is made.<sup>17</sup> Likewise, a multi-member limited liability company, whether a traditional LLC, an L3C, or a benefit LLC, is classified as a partnership under subchapter K of the Code unless a check-the-box election is made to classify the state-law LLC as a corporation for federal tax purposes.<sup>18</sup>

There are various types of tax-exempt organizations, but the focus here is on organizations exempt under Code section 501(c)(3), which are the prototypical tax-exempt organizations with which people are most acquainted. The federal tax law imposes several requirements on organizations that desire to obtain and maintain tax-exempt status. First, Code section 501(c)(3) exempts from federal income tax only organizations that are “organized and operated” for one or more statutorily-enumerated purposes, including charitable purposes.<sup>19</sup> To satisfy the organizational test, the firm’s organizational document must limit its purpose to one or more of the permissible purposes specified in section 501(c)(3).<sup>20</sup>

Even if the organization’s purpose is appropriately limited, the operational test also has to be met. To satisfy the operational test, the charity must engage “primarily in activities which accomplish one or more of [the] exempt purposes specified in section 501(c)(3).”<sup>21</sup> The organization fails the operational test “if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.”<sup>22</sup> The

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<sup>16</sup> See Bloomberg BNA Tax Portfolio 489, Social Enterprise by Non-Profits and Hybrid Organizations, n.277.

<sup>17</sup> Treas. Reg. § 301.7701-2(a) and (b) (defining business entities and corporations), 301.7701-3(a) (corporations cannot elect their federal tax classification); I.R.C. § 1361 (defining S corporation).

<sup>18</sup> Treas. Reg. § 301.7701-3(a). The L3C model was created to permit private foundations to make program-related investments and thereby avoid triggering certain excise taxes in section 4944(c). BISHOP & KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW, 1.09[4]. The IRS has not expressly approved of this approach. *Id.*

<sup>19</sup> I.R.C. § 501(c)(3). Other permitted purposes include “religious, . . . scientific, . . . literary, or educational purposes . . . or for the prevention of cruelty to children or animals. . . .” *Id.*

<sup>20</sup> Treas. Reg. § 1.501(c)(3)-1(b).

<sup>21</sup> *Id.* § 1.501(c)(3)-1(c)(1).

<sup>22</sup> *Id.*

purpose toward which the activity is directed, rather than the nature of the activity itself, determines whether the operational test is satisfied. Thus, the fact that an organization's activity constitutes a trade or business does not, in itself, disqualify an organization from section 501(c)(3).

As an illustration of the operational test, consider *New Faith, Inc. v. Commissioner*, which involved a California non-profit public benefit corporation that operated lunch trucks.<sup>23</sup> The Tax Court affirmed the revocation of the corporation's section 501(c)(3) designation because the taxpayer could not show that the lunch truck activities furthered the claimed exempt purpose of helping poor people.<sup>24</sup> The operational test was flunked, not because the corporation engaged in a commercial enterprise of operating lunch trucks, but because it failed to demonstrate that it engaged in that activity to further its tax-exempt purpose of relieving poverty.<sup>25</sup>

In addition to the organizational and operational requirements, the no-private-benefit and non-distribution requirements are a significant impediment for social enterprises desiring tax-exempt status. The Treasury regulations provide that organizations cannot be organized or operated for the benefit of private interests.<sup>26</sup> The non-distribution constraint prohibits a charity's net earnings from inuring "to the benefit of any private shareholder or individual."<sup>27</sup> These prohibitions are intended to ensure that the organization serves public, not private, interests.

The very thing that might make a social enterprise attractive to entrepreneurs and investors, namely the dual mission of addressing a social need while engaged in a commercial enterprise, is in tension with the tax law regarding tax-exempt organizations. In particular, social enterprises with dual commercial and charitable purposes cannot satisfy the organizational test. They will also flunk the operational test unless the commercial purpose furthers the charitable purpose. Finally, social

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<sup>23</sup> *New Faith, Inc. v. Comm'r*, 64 T.C.M (CCH) 1050 (1992).

<sup>24</sup> *Id.* at \*3–4.

<sup>25</sup> *Id.* at \*3; *See also* I.R.S. Priv. Ltr. Rul. 201702042 (2016) (clothing manufacturer that intended to give away a shirt for every shirt sold and use its profits for charitable purposes did not satisfy the operational test because it failed to show that it operated its business to assist the poor despite its stated charitable purpose).

<sup>26</sup> Treas. Reg. § 1.501(c)(3)–1(d)(1)(ii).

<sup>27</sup> I.R.C. § 501(c)(3).

enterprises that seek to serve both public and private interests cannot satisfy the private benefit and non-distribution requirements.

### III. SHOULD TAX BREAKS BE EXTENDED TO SOCIAL ENTERPRISES?

This section considers whether the prevailing explanation for tax exemption can reasonably be extended to social enterprises and whether providing them partial tax exemption can be justified from a policy perspective.

#### *A. Prevailing Justification for Tax-Exemption*

Charities have been tax-exempt from the inception of the Code.<sup>28</sup> Yet, Congress has provided no clear justification as to why charitable organizations should be exempt from paying federal income tax.<sup>29</sup> Early on, the House Ways and Means Committee articulated the following rationale:

[T]he exemption from taxation of money and property devoted to charitable and other purposes is based on the theory that the Government is compensated for the loss of revenue by its relief from financial burdens which would otherwise have to be met by appropriations from other public funds, and by the benefits resulting from the promotion of the general welfare.<sup>30</sup>

This justification has come to be known as the Public Goods Theory (“PGT”). The PGT justifies tax benefits for charities to incentivize the private sector to provide public goods or services that the government would otherwise have to provide.<sup>31</sup> A prominent example is goods or services for the poor. Academics have endorsed the PGT as the prevailing justification for tax exemption.<sup>32</sup> The United States Supreme

<sup>28</sup> BITTKER & LOKKEN, FED’L TAX’N INCOME EST. & GIFTS, 100.1.1.

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> See, e.g., Bloomberg BNA Tax Portfolio 450, Tax-Exempt Organizations: Organizational Requirements, VII.B. (“Exemption under § 501(c)(3) is usually intended to encourage such organizations to undertake tasks that the government would otherwise have to perform itself.”). [editor’s note: I have no clue what kind of source this is – not sure if it is a book or if I should cite as a periodical or what]

<sup>32</sup> See, e.g., Thomas Lee Hazen & Lisa Love Hazen, *Punctilios and Nonprofit Corporate Governance—A Comprehensive Look at Nonprofit Directors’ Fiduciary Duties*, 14 U. PA. J. BUS. L. 347, 365–66 (2012) (PGT is “[t]he long-lived justification for exemption from federal

Court in *Bob Jones University v. United States* has also recognized the role of public benefit to justify the federal tax exemption under section 501(c)(3).<sup>33</sup> Bob Jones University had a policy of prohibiting interracial dating and marriage.<sup>34</sup> In a companion case, Goldsboro Christian Schools “for the most part accepted only Caucasians” at its school.<sup>35</sup> The Court affirmed the IRS’s practice of denying section 501(c)(3) status to private schools that employ racially discriminatory practices.<sup>36</sup> It did so by noting that “[c]haritable exemptions are justified on the basis that the exempt entity confers a public benefit—a benefit which the society or the community may not itself choose or be able to provide, or which supplements and advances the work of public institutions already supported by tax revenues.”<sup>37</sup> The Court found that educational institutions that engage in racial discrimination confer no public benefit.<sup>38</sup>

### B. *Partial Tax-Exemption for Social Enterprises?*

To the extent the PGT persuasively justifies tax exemption, it arguably should also provide justification for *partially* exempting a *for-profit* business’s charitable activities. Scholars have made this argument, most notably University of Chicago Law School professors Anup Malani and Eric Posner.<sup>39</sup> Malani and Posner, in *The Case for For-Profit Charities*, assert that there is “no reason to condition the tax subsidy for charitable activities on organizational form.”<sup>40</sup> In their view, the PGT does not justify limiting tax exemption solely to non-profit organizations.<sup>41</sup>

There is an intuitive appeal to want to give tax breaks to social enterprises to the extent they are providing public goods or services. And it would seem this should be true even if the social enterprise is organized as a for-profit organization. There are existing analogs for hybrid tax and tax-exempt organizations. For example, an organization may meet the

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tax”); Malani & Posner, *supra* note 3, at 2029 (recognizing the PGT as a “prominent view”).

<sup>33</sup> *Bob Jones Univ. v. United States*, 461 U.S. 574 (1983).

<sup>34</sup> *Id.* at 580–81.

<sup>35</sup> *Id.* at 583.

<sup>36</sup> The IRS’s position is set forth in Rev. Rul. 71-447, 1971-2 C.B. 230.

<sup>37</sup> *Bob Jones Univ.*, 461 U.S. at 591.

<sup>38</sup> *Id.* at 595–96.

<sup>39</sup> Malani and Posner, *supra* note 3.

<sup>40</sup> *Id.* at 2023.

<sup>41</sup> *See id.* at 2029–31.

requirements of section 501(c)(3) even if it operates a trade or business as a substantial part of its activities.<sup>42</sup> Importantly, however, the operation of the trade or business must be in furtherance of the organization's exempt purpose or purposes and the organization cannot be organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513.<sup>43</sup> Treasury Regulation section 1.501(c)(3)-1(e) provides that “[i]n determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes.” Thus, a tax-exempt organization can operate a trade or business without jeopardizing its tax exemption if the trade or business furthers the organization’s tax-exempt purpose. But if the trade or business is unrelated to the organization’s exempt purpose, those activities would be subject to unrelated business income tax (“UBIT”).

### C. Defining Charity

While it reasonably may be argued that for-profit social enterprises should receive a partial tax exemption for their charitable activities, there remain many unanswered questions. Chief among them is how to define charity. The government defines the term “charitable” in section 501(c)(3) by reference to “its generally accepted [common law] sense.”<sup>44</sup> At common law, “charitable” means the conferral of “benefit upon the public in general,” as opposed to private benefit.<sup>45</sup> At a minimum, the term “charity” in section 501(c)(3) includes “[r]elief of the poor and distressed or of the underprivileged” and “lessening of the burdens of Government.”<sup>46</sup>

Whether organizations that currently are classified as tax-exempt are actually promoting the public good can be debatable. Tax-exempt hospitals whose activities are virtually indistinguishable from their for-profit counterparts is one prominent example that comes to mind.<sup>47</sup>

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<sup>42</sup> Treas. Reg. § 1.501(c)(3)-1(e)(1) (as amended in 2017).

<sup>43</sup> *Id.*

<sup>44</sup> Treas. Reg. § 1.501(c)(3)-1(d)(2) (2017).

<sup>45</sup> BNA 451, IV.A.

<sup>46</sup> Treas. Reg. § 1.501(c)(3)-1(d)(2) (2017).

<sup>47</sup> See, e.g., Suja Amir & Steve Dubb, *Will Nonprofit Hospitals Have to Defend Their Tax Exemptions Next?*, NONPROFIT QUARTERLY (Dec. 5, 2017), <https://nonprofitquarterly.org/2017/12/05/will-nonprofit-hospitals-defend-tax-exemptions-next/>; John Carreyrou and Margaret Martinez, *Nonprofit Hospitals, Once for the Poor, Strike it Rich*, WALL ST. J. (Apr. 4, 2008), <https://www.wsj.com/articles/SB120726201815287955>.

Historically, tax-exempt hospitals had to provide free or reduced-fee services to patients who could not otherwise afford those services.<sup>48</sup> Beginning in 1969, the charity-care standard was broadened to permit tax-exempt hospitals to count activities that benefit the communities they serve in lieu of charity care.<sup>49</sup> Congress conducted hearings in 2005 and 2006 to examine the policy of granting tax-exempt status to hospitals.<sup>50</sup> In 2010, Congress imposed additional requirements on hospitals desiring tax-exempt status under section 501(c)(3).<sup>51</sup>

A report from Rob Reich, Lacey Dom, and Stefanie Sutton of the Stanford University Center on Philanthropy and Civil Society underscores the lack of clarity as to what constitutes a charity. They found that the IRS denied just .74% of federal tax-exemption applications in 1998.<sup>52</sup> The denial rate had increased to just 2.17% by 2008.<sup>53</sup> Those findings led them to conclude that “when it comes to oversight of the application process to become a public charity, nearly anything goes.”<sup>54</sup> They characterized the approval process as “weak, bordering on non-existent.”<sup>55</sup> The lack of a precise definition of charity almost certainly contributes to this outcome.

The apparent lack of rigor in approving tax-exemption applications results in uncertainty about whether organizations are providing sufficient public benefit to justify the tax advantages given to them. Organizations must submit a detailed narrative of their proposed activities and financial statements or a proposed budget with their tax-exemption applications.<sup>56</sup> But no one seems to be seriously questioning

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<sup>48</sup> See Rev. Rul. 56-185, 1956-1 C.B. 202.

<sup>49</sup> See Rev. Rul. 69-545, 1969-2 C.B. 117.

<sup>50</sup> Taking the Pulse of Charitable Care and Community Benefits at Nonprofit Hospitals: Hearing Before the S. Fin. Comm. 109th Cong. (2006); The Tax-Exempt Hospital Sector, Hearing Before the H. Comm. on Ways and Means, 109th Cong. (2005).

<sup>51</sup> Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 9007, 124 Stat. 119 (2010) (enacting I.R.C. § 501(r)).

<sup>52</sup> ROB REICH ET AL., *Anything Goes: Approval of Nonprofit Status by the IRS*, Stanford University Center on Philanthropy and Civil Society (Oct. 2009), at 8, <https://pacscenter.stanford.edu/wp-content/uploads/2015/08/Anything-Goes-PACS-11-09.pdf>.

<sup>53</sup> *Id.*

<sup>54</sup> *Id.* at 4.

<sup>55</sup> *Id.* at 3.

<sup>56</sup> IRS Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code. Certain applicants are permitted to file a simplified form, Form 1023-EZ, Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code. Organizations using the simplified form need

whether organization are likely to achieve their charitable purposes, much less whether they can do so efficiently and effectively. Nonetheless, the non-distribution constraint acts as a backstop of sorts. The non-distribution constraint prohibits a charity's net earnings from benefiting any private interests, including founders or owners.<sup>57</sup> The non-distribution constraint is a way to help ensure that tax-exempt organizations are serving a public purpose. The government can be less concerned about what constitutes a public benefit if the organization cannot distribute its profits to private individuals. On the other hand, the desire to maximize profits and the ability to distribute them to investors could introduce skepticism about the organization's altruistic motives. Without the non-distribution constraint, which for-profit social enterprises presumably would not want to be subject to, the law would have to do a better job of defining what a public benefit is. Attention would have to be given to the development of rules that, on the one hand, are flexible enough to benefit social enterprises and yet guard against abuse and overreach. Even more fundamentally, would social enterprises be willing to trade off flexibility for oversight?

#### D. *Second-Best Solutions*

Although the current federal income tax law does not permit for-profit social enterprises a partial federal tax exemption, similar tax results may be achieved through the existing law. Expenses for social enterprise conducted by a taxable entity would be 100% deductible under section 162 if the expenses were incurred to further a trade or business.<sup>58</sup> Like a tax exemption, a deduction reduces taxable income. For example, suppose corporation A has \$100,000 of gross income and \$10,000 of business deductions and corporation B has \$100,000 of income, but \$10,000 is exempt from tax. Both corporations would have \$90,000 of taxable income and would owe \$18,900 of tax.<sup>59</sup>

Amazon recently announced that it was raising the hourly pay of its employees to a minimum \$15, which is more than double the federal minimum wage.<sup>60</sup> This move was, at least in part, a response to criticism

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only check a box to attest that they will be organized and operated for permissible purposes.

<sup>57</sup> I.R.C. § 501(c)(3); Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

<sup>58</sup> I.R.C. § 162(a).

<sup>59</sup> I.R.C. § 11(b) (the tax rate on C corporations is a flat 21%).

<sup>60</sup> Bill Chappel & Laurel Wamsley, *Amazon Sets \$15 Minimum Wage for U.S. Workers, Including Temps*, NPR (Oct. 2, 2018), <https://www.npr.org/2018/10/02/653597466/amazon-sets-15-minimum-wage-for-u-s-employees-including-temps>.

leveled at the company after it revealed that the median annual pay of its workers was just over \$28,000.<sup>61</sup> Perhaps contributing to the company's decision, earlier in the year it was reported that Amazon workers disproportionately rely on the Supplemental Nutritional Assistance Program, which is more popularly known as food stamps.<sup>62</sup> Whether the move was motivated by criticism, a tight labor market, or altruism, these employee wages should be fully deductible as trade or business expenses under section 162 assuming the amounts are otherwise reasonable.<sup>63</sup>

Even companies who are more clearly philanthropic might incur deductible section 162 expenses. Consider companies like TOMS and Warby Parker that use the buy-one give-one business model to give away a pair of socks or eyeglasses (or matching funds) through nonprofit partner organizations to persons in need for every pair bought.<sup>64</sup> Expenses associated with the buy-one give-one model could be deductible as ordinary trade or business expenses under section 162 if payment is made for some business purpose such as building brand loyalty or increasing sales.<sup>65</sup> If, on the other hand, payment is made to a qualifying charity with donative intent, then the payment should qualify as a section 170 charitable deduction.<sup>66</sup> Charitable contribution deductions are less

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<sup>61</sup> *Id.* (this revelation was made pursuant to the SEC's mandated pay ratio disclosure). See SEC Press Release, SEC Adopts Rule for Pay Ratio Disclosure (Aug. 5, 2015), <https://www.sec.gov/news/pressrelease/2015-160.html>.

<sup>62</sup> Claire Brown, *Amazon Gets Tax Breaks While its Employees Rely on Food Stamps, New Data Shows, The Intercept* (Apr. 19, 2018), <https://theintercept.com/2018/04/19/amazon-snap-subsidies-warehousing-wages/>.

<sup>63</sup> I.R.C. § 162(a)(1) (“a reasonable allowance for salaries” paid or incurred is a deductible trade or business expense).

<sup>64</sup> See generally Christopher Marquis & Andrew Park, *Inside the Buy-One Give-One Model*, STAN. SOC. INNOVATION REV. (Winter 2014) (for a discussion of the buy-one give-one model).

<sup>65</sup> IRS Gen. Info. Letter IR-2016-0063 (June 2, 2016), <https://www.irs.gov/pub/irs-wd/16-0063.pdf>; Rev. Rul. 72-314, 1972-1 C.B. 44 (“Whether payments ... are ‘contributions or gifts,’ within the meaning of section 170 of the Code, or are deductible as ordinary and necessary business expenses under section 162 of the Code depends upon whether such payments are completely gratuitous or whether they bear a direct relationship to the taxpayers’ business and are made with a reasonable expectation of a financial return commensurate with the amount of the payment.”).

<sup>66</sup> IRS Gen. Info. Letter IR-2016-0063; see also I.R.C. § 162(b) (providing that “[n]o deduction shall be allowed under [section 162(a)] for any contribution or gift which would be allowable as a deduction under section 170 were it not for the percentage limitations, dollar limitations, or the requirements as to the time of payment, set forth in such section”).

valuable to corporations because they are limited to 10% of the corporation's taxable income though unused amounts may be carried forward for 15 years.<sup>67</sup>

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<sup>67</sup> I.R.C. § 170(b)(2).