Shareholder-Designated Charitable Contributions: A Practical Response to Critics of Corporate Charitable Contributions

DAVID E. SPIRO
Blake, Cassels & Graydon, Barristers and Solicitors, Toronto

In the summer of 1989, a provocative article appeared in the *Globe and Mail* entitled "Three Good Reasons Why Firms Shouldn't Support Good Causes".[1] In that piece, Terence Corcoran of the *Report on Business* concluded that corporations should not donate to charity. This article provoked angry reactions in Canada's charitable community and gave rise to the publication of several vigorous responses.[2]

What led to this controversy? First, Mr. Corcoran argued, it is not management's money to give, as the corporate assets ultimately belong to the shareholders. If a corporation has surplus funds that cannot be profitably reinvested, it should pay money to its shareholders as dividends. Second, assigning the role of philanthropist to corporate managers involves delegating power to a self-appointed stratum of society that has no business influencing the social and cultural direction of our nation through philanthropy. Third, corporations exist only for one purpose: to make money. Giving away money does not further that goal.

This third argument is that of American economist Milton Friedman and it is difficult to dismiss in a short article. It will, therefore, not be dealt with here. However, the solution described below, devised and implemented by one United States corporation, responds eloquently to Mr. Corcoran's first and second arguments. This program will appeal to all corporations which are currently donating to charitable causes.

The program in question has been implemented by Berkshire Hathaway Inc. The British weekly, *The Economist*, recently described the company in the following terms:

> Omaha is home to a company called Berkshire Hathaway, and its chairman, Mr. Warren Buffett. If an undergraduate were asked to describe the company in a few words, he would say that it invests in various companies and its own shares are quoted on the New York Stock Exchange. That description is accurate, and completely misses the point.

> Mr. Buffett treats all of Berkshire's shareholders as partners, and almost all the company's investments as long-term ownership commitments. His strategy is to invest only in American companies, not out of nationalism but because, for companies half a world away, he cannot behave like an owner. Some of his proudest investments are in Omaha itself.... Since Mr. Buffett took over Berkshire, $10,000 invested in its shares has grown to be worth about $1.5m, a compound rate of growth of 23% a year... The company's assets are valued at over $7 billion, and its annual report declares, in what is virtually a footnote, that "Berkshire has not declared a cash dividend since 1967".[3]

Under the program, shareholders are given the opportunity to designate the charities to which the corporation's donations are to be given. The amount of corporate funds eligible to be designated by each shareholder is calculated on the basis of the number of shares owned by that shareholder.

Only tax-exempt qualified charities may be nominated by shareholders (these are the Canadian equivalents of "registered charities"). There are no tax consequences to the shareholders from contributions pursuant to this program. So long as the contribution does not fulfil a charitable pledge or other obligation of shareholders or their families, the shareholder will not be deemed to have received any income and, likewise, the shareholder will not be entitled to a deduction for a charitable contribution. Berkshire Hathaway is entitled to the tax deduction for the contribution. However, the charity will be advised that the contribution from Berkshire Hathaway has been made because of the shareholder's designation (unless the shareholder chooses anonymity).

It is possible for one shareholder to designate up to three charities to benefit from the donation. However, shareholders are free to designate their private foundations, which may later distribute their funds to many charities.

As the company makes the donations at the corporate level, the charities receive more than if the funds were paid out as dividends and donated by the shareholders. Under this system, the funds are not taxed as dividends in the hands of the shareholders; therefore, more money is available for distribution by the corporation.

Why was this program implemented? Warren Buffett, President of Berkshire Hathaway, was disturbed that most corporate charitable gifts are based more on who does the asking and how corporate peers are responding than on an objective evaluation of the recipients' activities. A common result is the use of the shareholder's money to implement the charitable preferences of the corporate manager, who is usually heavily

influenced by specific social pressures. Frequently, there is an added incongruity; many corporate managers deplore governmental allocation of the shareholder's dollar. Mr. Buffet refers to this phenomenon as the "father-knows-best" school of corporate governance.

Just as Mr. Buffett would not want his shareholders to implement their personal judgments by writing cheques on his bank account for charities of their choice, he believes it is inappropriate to write cheques on the shareholders' "bank account" for charities of *his* choice.

In each annual report, Mr. Buffett discusses the results of his shareholder-designated charitable contributions program. In 1981, its first year of operation, the specified amount per share was $2 and the total contribution by the corporation was $1,783,654 which was disbursed to 675 charities. In 1989, the specified amount per share was $6 and the total contributed was $5,867,254 which was disbursed to 2,500 charities. It should be noted that shares of Berkshire Hathaway have recently traded in the $7,000–$8,000 (U.S.) range. Therefore, a person with $100,000 (U.S.) to invest could purchase about 13 shares and designate $78 in charitable contributions.

In 1984, Berkshire Hathaway sent shareholders a questionnaire asking whether they favoured discontinuation of the program, continuation of the program at the same rate (then $3), at a higher ($4–$7) rate, or at a lower ($1–$2) rate. Those in favour of discontinuation numbered 3.2 per cent, 52.7 per cent were in favour of continuation at the same rate, 39 per cent were in favour of a higher rate, and 3.4 per cent were in favour of a lower rate. Each year, approximately 95 per cent of the eligible shares participate in the program, demonstrating that the shareholders are overwhelmingly in favour of the program.

In a recent annual report, Mr. Buffett noted that no Berkshire Hathaway shareholders had sent in designation forms with instructions that the officers of Berkshire Hathaway—in their superior wisdom, of course—make the decision to allocate the donation attributable to the shareholder's shares.

This is an exceptional example of a corporation which takes it shareholders, and its charitable obligations, seriously. Berkshire Hathaway recognizes that its officers and directors owe a responsibility to their shareholders for the allocation of corporate funds donated to charity. All Canadian corporations currently making charitable contributions should consider adopting such a program.

Postscript

In an article entitled "Business of being charitable not up to managers" ("Report on Business", *Globe and Mail*, Saturday, June 16, 1990), Terence Corcoran again discussed the matter of corporate donations. In essence, he indicated that shareholders, not managers, should dictate both the amount and the recipients of corporate charitable donations.

His views, however, differ somewhat from those of Berkshire Hathaway. First, he suggests that shareholders should be free to decide that their corporations will not make any charitable donations at all. This could not occur under the Berkshire Hathaway plan as Berkshire Hathaway chooses the recipient if the shareholder does not; the decision about *whether* to give is not up to the shareholders.

Second, under the Berkshire Hathaway plan, the decision about *how much* to give is made by management, not shareholders.

However, shareholders under both the Berkshire Hathaway plan and Mr. Corcoran's proposal share one important point—the right to decide *who* receives the corporation's charitable dollars.

FOOTNOTES

1. Terence Corcoran, "Three Good Reasons Why Firms Shouldn't Support Good Causes", *The Globe & Mail*, August 19, 1989, p. B2.
2. See, for example, Sean Moore, "Corporate World's Time for Shelling Out Has Come", *The Globe & Mail*, August 24, 1989, p. A7.
3. "There Are Other Ways", *The Economist*, May 5, 1990, "A Survey of Capitalism: Punters or Proprietors", p. 15.