

Navigating the New 1 Percent Floor On Corporate Charitable Deductions

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In this article, Quesenberry and Tucker review the background of section 170, the mechanics of its new 1 percent floor, and options for corporations that will allow them to avoid suffering permanent disallowances of deductions equal to 1 percent of their taxable income every year.

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The One Big Beautiful Bill Act (P.L. 119-21) imposed a 1 percent floor on deductions for charitable contributions made by corporations.¹ Under this provision, in tax years beginning after 2025, a corporation will be able to claim a deduction under section 170 for charitable contributions only if, and to the extent that, the aggregate of these contributions exceeds 1 percent of the corporation's taxable income. Without planning, this provision could result in corporations suffering a permanent deduction disallowance equal to 1 percent of their taxable income every year. Corporations that make contributions to charities do, however, have several options at their disposal to avoid that result. After reviewing the background of section 170 and the mechanics of its 1 percent floor, this article will review those options.

¹ OBBBA section 70426.

I. Background on Section 170 Deductions for Corporations

Corporations may take a federal income tax deduction under section 170 for their contributions or gifts to U.S. charities, governmental entities, and other organizations described in section 170(c). A corporation's charitable deductions in any tax year are generally limited to 10 percent of its taxable income.² For purposes of this 10 percent limit, taxable income is computed without regard to charitable deductions, the dividends received deduction and other special deductions for corporations under sections 241 to 250 (other than section 248), and capital loss carrybacks to the tax year under section 1212(a)(1).³

If a corporation's charitable contributions in a tax year exceed the 10 percent limit, section 170(d)(2) provides for a carryover. Charitable contributions made in the current year are deducted and applied against the 10 percent limit first. If the current-year contributions are less than the 10 percent limit, carryover contributions from prior years are considered in the order in which they arose (that is, on a first-in, first-out basis). The

² Section 170(b)(2)(A). As noted below, section 170 contains several higher limitations for specific kinds of contributions. Congress has also temporarily increased the limitation for certain contributions made for relief efforts in qualified disaster areas on numerous occasions.

³ The adjustments to taxable income for purposes of the 10 percent limit are set forth in section 170(b)(2)(D). Taxable income for purposes of the 10 percent limit is also computed without regard to any net operating loss carryback to the tax year. Section 170(b)(2)(D)(iii). But this adjustment should generally not be relevant for tax years beginning in 2021 and later, except for some insurance companies (other than life insurance companies) and farming businesses. See section 172(b)(1)(B) and (C)(i). The passthrough deduction allowed to specified agricultural or horticultural cooperatives under section 199A(g) and the deduction for contributions made by a Native American corporation to a settlement trust (as defined in section 646(h)) are also disregarded. Section 170(b)(2)(D)(ii), (v).

maximum carryover period for charitable contributions is five tax years.

Most of these general principles continue to apply post-OBBA, though the OBBA both adds a 1 percent floor and amends the statutory language in several other respects.

II. How the 1 Percent Floor Works

The OBBA amended section 170(b)(2)(A) to allow corporations to take charitable contribution deductions “only to the extent that the aggregate of such contributions (i) exceeds 1 percent of the taxpayer’s taxable income for the taxable year, and (ii) does not exceed 10 percent of the taxpayer’s taxable income for the taxable year.” For these purposes, taxable income is computed with the same adjustments for both the 10 percent limit and the 1 percent floor (and any reference to taxable income hereinafter should be understood to include those adjustments unless otherwise noted).

This new statutory language makes clear that if a corporation’s charitable contributions in a tax year⁴ do not exceed 1 percent of its taxable income for that year, no charitable deduction is allowed. What is less clear is how the 10 percent limit applies once the 1 percent floor is crossed. One interpretation is that aggregate contributions in a tax year in excess of the 1 percent floor may be deducted up to 10 percent of taxable income in that tax year. Under this interpretation, a corporation is still allowed a deduction for charitable contributions up to 10 percent of taxable income; it would just have to contribute an additional 1 percent of taxable income (11 percent of taxable income total) to do so. In other words, the 1 percent floor may apply to some contributions, and the 10 percent limit may separately apply to additional contributions not disallowed by the 1 percent floor to permit a deduction of up to 10 percent of taxable income if aggregate charitable contributions in the tax year total at least 11 percent of taxable income.

⁴ Any references to charitable contributions in a tax year should generally be understood to include not only contributions made in that tax year but also contribution carryovers from prior years that are available to be deducted in the tax year. That said, as discussed below, there remains a question as to whether the 1 percent floor applies to charitable contribution carryovers from years beginning before 2026.

As an example of how the 1 percent floor would work under this interpretation, if a corporation has \$10 million in taxable income in its 2026 tax year with no charitable contribution carryovers to that year, it would not be able to take any deduction under section 170 in that year unless it has aggregate charitable contributions exceeding \$100,000 (the 1 percent floor amount). Once the \$100,000 threshold is crossed, however, every additional dollar in charitable contributions would count toward the 10 percent limit, for a maximum total deduction of \$1 million. In other words, the corporation would have to make \$1.1 million in charitable contributions (11 percent of taxable income) to take a deduction of \$1 million (10 percent of taxable income).

Another possible interpretation is that a corporation is allowed a deduction only for those charitable contributions that are both above the 1 percent floor and below the 10 percent ceiling. Under this interpretation, the 1 percent floor and the 10 percent limit would simultaneously and jointly apply to the charitable contributions under consideration, such that a deduction would be allowed only to the extent of the difference between the 1 percent floor and the 10-percent-of-taxable income limit. Pursuant to this understanding the 1 percent floor would effectively reduce the limit on deductions to 9 percent of taxable income. Applying this reading to the prior example, the corporation with \$10 million in taxable income in 2026 would be able to take a maximum charitable deduction of only \$900,000 if it donated \$1 million or more.

Unfortunately, the legislative history provides relatively little elucidation as to which interpretation Congress intended.⁵ While both interpretations seem to be reasonable readings of the statutory language, we must choose one for purposes of the examples in the remainder of this article, so we will select the second interpretation (though this is not intended to indicate a preference for that interpretation). We will also continue to use the phrase “10 percent limit” to refer to the upper bound on charitable deductions, though note that under the second

⁵ The Joint Committee on Taxation’s general explanation of the OBBA, commonly known as the blue book, had not been released as of this writing.

interpretation the limit on deductions would effectively be reduced to 9 percent of taxable income.

III. How Carryovers Are Generated With the 1 Percent Floor

If a corporation's charitable contributions in a tax year do not exceed the 10 percent limit, there is no carryover of charitable deductions, and the charitable contribution deductions disallowed by the 1 percent floor are permanently lost.

However, if a corporation's charitable contributions in a tax year do exceed the 10 percent limit, section 170(d)(2), as amended by the OBBBA, provides that the corporation may carry over both the amount exceeding the 10 percent limit and the amount disallowed by the 1 percent floor.⁶

To return to the example of a corporation with \$10 million in taxable income for its 2026 tax year, if the corporation were to have more than \$1 million in charitable contributions in the tax year, it would generate a charitable contribution carryover that would include not only the excess over \$1 million but also the \$100,000 disallowed by the 1 percent floor. Thus, if the corporation had \$1.1 million in charitable contributions in 2026, it would have a \$900,000 deduction and a carryover equal to \$200,000.

By contrast, if the corporation had \$1 million or less in charitable contributions in 2026, it would have no carryover and the \$100,000 disallowed by the 1 percent floor would be permanently lost.

IV. How the 1 Percent Floor Applies to Carryovers

Under section 170(d)(2)(A), as amended by the OBBBA, charitable contributions exceeding the 10 percent limit are "taken into account as a charitable contribution for the succeeding taxable year," except that contributions in that succeeding

tax year are "taken into account under [section 170](b)(2)(A) before any contribution taken into account" as a carryover.⁷ Because section 170(b)(2)(A) includes the 1 percent floor beginning in 2026, carryovers from a tax year beginning in 2026 or later to a subsequent tax year are subject to the 1 percent floor under section 170(b)(2)(A) just as contributions made in that subsequent tax year are.

The situation is slightly less clear regarding carryovers from a tax year beginning before 2026 to a tax year beginning after 2025. Section 170(d)(2)(A), as in effect before the OBBBA, says that charitable contributions exceeding the 10 percent limit are "deductible for each of the 5 succeeding taxable years in order of time, but only to the extent" of "the excess of the *maximum amount deductible for such succeeding taxable year* under [section 170](b)(2)(A) over the sum of the contributions made in such year plus the aggregate of" carryovers from prior years available to be deducted in the succeeding tax year (emphasis added).⁸ There is a reasonable argument to be made that the phrase "maximum amount deductible" here refers only to the 10 percent limit in section 170(b)(2)(A) and does not pick up the 1 percent floor that has been added to that paragraph. The counterargument would be that, in tax years beginning after 2025, the maximum amount deductible is determined by both the 1 percent floor and the 10 percent limit.

For any carryover that is potentially subject to a 1 percent floor in a subsequent year, another question is whether current-year contributions in that subsequent year are taken into account for purposes of the 1 percent floor before the carryover. The answer appears to be "yes," because section 170(d)(2)(A), as amended by the OBBBA, expressly says that current-year contributions are taken into account "under [section 170](b)(2)(A) before any contribution taken into account" as a carryover. Section

⁶ Section 170(d)(2)(C), as in effect for tax years beginning after December 31, 2025. See also H. Rep. No. 119-106, at 1749 ("The amount of charitable contributions disallowed under the one-percent floor may be carried forward only from years in which the taxpayer's charitable contributions exceed the 10-percent limit."). Note that under the first interpretation of how the 1 percent floor works described above, one would need to contribute 1 percent of one's taxable income and then more than an additional 10 percent of taxable income — that is, more than a total of 11 percent — to exceed the 10 percent limit and generate a carryover of the amount disallowed by the 1 percent floor.

⁷ Section 170(d)(2)(A) as in effect for tax years beginning after December 31, 2025. Section 170(d)(2)(B) then provides that no "charitable contribution may be carried forward under" section 170(d)(2)(A) "to any taxable year following the fifth taxable year after the taxable year" of the contribution, and that "contributions shall be treated as allowed on a first-in first-out basis."

⁸ Section 170(d)(2)(A) as in effect for tax years beginning before January 1, 2026.

Table 1. Applying the 1 Percent Floor to Carryovers

	2026	2027	2028	2029	2030	2031
Taxable income	\$10 million	\$10 million	\$10 million	\$10 million	\$10 million	\$10 million
Contributions made in year	\$1,000,001	\$900,000	\$900,000	\$900,000	\$900,000	\$900,000
Disallowed by 1% floor	\$100,000	\$100,000	\$100,000	\$100,000	\$100,000	\$100,000
Deduction	\$900,000	\$900,000	\$900,000	\$900,000	\$900,000	\$900,000
Carryover to the next year	\$100,001	\$100,001	\$100,001	\$100,001	\$100,001	\$0

170(b)(2)(A) includes both the 1 percent floor and the 10 percent limit. Accordingly, it appears that current-year contributions are applied to and disallowed by the 1 percent floor before any charitable contribution carryovers are taken into account.⁹

If that is correct, this ordering could have favorable consequences when a combination of current-year contributions and carryovers from prior years results in a carryover to the subsequent year that includes the amount disallowed by the 1 percent floor. If current-year contributions are disallowed by the 1 percent floor in these circumstances, then arguably the portion of the carryover to the subsequent tax year that consists of the amount disallowed by the 1 percent floor is a current-year contribution rather than a carryover from an earlier year. This is beneficial, since a current-year contribution being carried over has five subsequent tax years before it expires, whereas a carryover from a prior year will expire sooner.

This point may be illustrated by returning to our example of a corporation with \$10 million of taxable income in 2026 with no carryover from prior tax years. Assume this corporation has taxable income of \$10 million in 2027 through 2031, as well. If it contributes \$1,000,001 in 2026 and then \$900,000 in each of 2027 through 2031, it

will generate a \$100,001 carryover each year until 2031, as shown in Table 1.

In this example, if the amount disallowed by the 1 percent floor is a current-year contribution and that contribution is carried over to a later year, \$100,000 of the \$100,001 carried over from 2027 to 2028 would be from 2027 (the amount disallowed by the 1 percent floor in that year), with only \$1 being carried over from 2026. Similarly, \$100,000 of the \$100,001 carried over from 2028 to 2029 would be from 2028, with only \$1 being carried over from 2026, and so on. Thus, the corporation could continue generating \$100,001 in carryovers with \$900,000 in contributions each year until 2031, when the \$1 carryover from 2026 would finally expire. To keep the pattern going, the corporation would need to contribute only \$1 more — \$900,001 — in 2031.

V. How the 1 Percent Floor Affects Other Corporate Contributions

While the general limit for corporate charitable deductions is 10 percent of taxable income, section 170 contains several higher limitations for specific kinds of contributions, such as certain food inventory contributions (15 percent) and qualified conservation contributions by certain corporate farmers, ranchers, and native-owned corporations (100 percent).¹⁰ Regarding the latter, section 170(b)(2)(A) (both before and after the OBBBA's amendments) expressly says that section 170(b)(2)(A) (which

⁹ The legislative history also supports this conclusion. See H. Rep. No. 119-106, pt. 2, at 1749 ("Any carryforward is applied after contributions made in the current taxable year for the purposes of the one-percent floor and 10-percent limit."); Senate Finance Committee section-by-section summary of the provisions in Title VII of the OBBBA, as signed into law on July 4, 2025, section 70426, at 30 (same).

¹⁰ Section 170(b)(2)(B)-(C) and (e)(3)(C)(ii)(II).

now includes the 1 percent floor) does not apply to these contributions.

By contrast, section 170(b)(2)(A) itself does not directly reference the 15 percent limit for certain food inventory contributions (and never has). Rather, that limit is imposed in an entirely separate paragraph of section 170: section 170(e)(3)(C). Section 170(e)(3)(C) was not amended to incorporate a 1 percent floor for food inventory contributions subject to the 15 percent limit.

Section 170(e)(3)(C) addresses the coordination with section 170(b)(2)(A) — the provision that has historically contained the 10 percent limit and now also contains the 1 percent floor — saying that section 170(b)(2)(A) “shall not apply” to food inventory contributions subject to the 15 percent limit.¹¹ Because this language expressly says that section 170(b)(2)(A) does not apply to food inventory contributions subject to the 15 percent limit and section 170(b)(2)(A) contains the 1 percent limit, a reasonable argument may be made that the 1 percent limit does not apply to food inventory contributions subject to the 15 percent limit.

Another limitation on charitable contribution deductions applies only to tax-exempt corporations and the deductions they may take against unrelated business taxable income. Section 512(b)(10) says that, in the case of a tax-exempt corporation with UBTI, “the deduction allowed by section 170 . . . shall not exceed 10 percent of the [UBTI] computed without the benefit of this paragraph.” This language was not amended to include a 1 percent floor and contains no cross-reference to section 170(b)(2). Moreover, nothing in the OBBBA or the legislative history thereof indicates any congressional intent for the 1 percent floor in section 170(b)(2)(A) to apply to tax-exempt corporations. Accordingly, one could argue that the 1 percent floor does not apply to the charitable contribution deduction taken against UBTI by tax-exempt corporations. This argument would be based on an interpretation of the phrase “but shall not exceed 10 percent of the [UBTI]” in section 512(b)(10) as supplanting section

170(b)(2)(A), which has historically contained the 10 percent limit and now also contains the 1 percent floor. That interpretation is supported by the regulations under section 512(b)(10), which say unequivocally that the “provisions of section 170(b)(2) are not applicable to contributions by” organizations subject to the unrelated business income tax.¹² Accordingly, a reasonable argument may be made that the 1 percent floor that now appears in section 170(b)(2) is not applicable to tax-exempt corporations subject to UBIT.

VI. Interplay With Other Deduction Limitation Provisions

The 10 percent limit is not the only deduction limitation in the code based on taxable income. For example, section 172 imposes a limit on deductions for certain net operating loss carryforwards equal to 80 percent of taxable income (as defined in section 172(a)(2)(B)(ii)), and section 163(j) imposes a limit on interest deductions equal to 30 percent of adjusted taxable income (as defined in section 163(j)(8)). For corporations that face more than one of these limitations based on taxable income, neither the code nor any guidance provided by the IRS provides any ordering rules that taxpayers can use in taking deductions to determine taxable income for purposes of the limitations. In the absence of ordering rules, numerous commentators have noted that simultaneous equations are the technically correct way to determine the various limitations.¹³

Unfortunately, the new 1 percent floor on charitable contribution deductions is also based on taxable income. Thus, simultaneous equations may be necessary to determine this floor when other limitations based on taxable income are at

¹² Reg. section 1.512(b)-1(g)(1) (“The provisions of section 170(b)(2) are not applicable to contributions by the organizations described in section 511(a)(2).”). Thanks to Nathan Doane for this observation.

¹³ See, e.g., Preston J. Quesenberry, Maury I. Passman, and Tom Greenaway, “The Post-TCJA Interplay Between NOLs and Charitable Deductions,” *Tax Notes Federal*, May 30, 2022, p. 1367; Libin Zhang, “Simultaneous Equations: The Statute Strikes Back,” *Tax Notes Federal*, Sept. 21, 2020, p. 2211; Zhang, “Simultaneous Equations for Simpler Tax Analysis,” *Tax Notes*, Oct. 29, 2018, p. 571; Chris Pollock, Bela Unell, and Maury Passman, “‘After You.’ ‘No, After You.’ The Case for Simultaneous Linear Equations With Competing Deductions,” KPMG, June 18, 2018.

¹¹ Section 170(e)(3)(C)(iii)(II). The provision further says the 10 percent limit is “reduced (but not below zero)” by the aggregate amount of food inventory contributions applied against the 15 percent limit.

play, making an already untenably complex situation worse.

The use of simultaneous equations is best explained with an example. Suppose a corporation with charitable contributions in a tax year also has NOL carryovers available to be used in that tax year that arose in tax years beginning after December 31, 2017 (post-2017 NOLs), and will be subject to the 80 percent limit under section 172. Suppose further that x represents charitable deductions that will be permitted after application of the 1 percent floor, y represents permissible post-2017 NOL deductions, CC represents actual charitable contributions made in or carried over to the tax year potentially subject to the 1 percent floor, and T is the taxable income in the tax year without regard to either charitable deductions or post-2017 NOL deductions. Further, assume that none of the other differences in the definitions of taxable income in sections 170(d)(2)(D) and 172(a)(2)(B)(ii) apply and that no other deductions will potentially be subject to a limit based on taxable income. In that case, the two simultaneous equations would be as follows:

$$\begin{aligned}x &= CC - 0.01(T - y) \\y &= 0.8(T - x)\end{aligned}$$

One can reduce the first equation to one variable by substituting the definition of the second variable in the second equation for the same variable in the first equation, as follows:

$$\begin{aligned}x &= CC - 0.01(T - y) \\x &= CC - 0.01(T - 0.8(T - x)) \\x &= CC - 0.01(T - 0.8T + 0.8x) \\x &= CC - 0.01T + 0.008T - 0.008x \\1.008x &= CC - 0.002T \\x &= (CC - 0.002T)/1.008\end{aligned}$$

Accordingly, the permissible charitable contribution deduction above the 1 percent floor in the tax year is going to equal $(CC - 0.002T)/1.008$.¹⁴ (If $(CC - 0.002T)/1.008$ is zero or less than zero, no charitable contribution deduction would be permitted.)

Employing the same simultaneous equation approach (and assuming the 10 percent limit actually limits deductions to 9 percent of taxable

income), one can also determine that charitable contribution deductions would be subject to a 10 percent limit of $(0.018/0.928) * T$.¹⁵

Permissible charitable contribution deductions would then equal the lesser of $(CC - 0.002T)/1.008$ (if not less than zero) or $(0.018/0.928) * T$.

The corporation could then subtract the permissible charitable deductions from T and take 80 percent of that to figure out the 80 percent limit on post-2017 NOL deductions.

Matters get significantly more complicated when other taxable-income-based limitations come into play, such as the limitation on interest deductions under section 163(j) and relevant differences in the definitions of taxable income.

VII. Strategies to Minimize the Impact of the 1 Percent Floor

Fortunately, corporations may employ a number of strategies to minimize the impact of the 1 percent floor. Perhaps most obviously, to prevent the floor from applying and disallowing deductions every year, a corporation could choose to make several years' worth of contributions in one year and then not make contributions in several subsequent years, such that the 1 percent floor would apply only in the first year.

For example, rather than donate around 1 percent of its taxable income every year and have the 1 percent floor disallow deductions each year, a corporation could donate an amount equal to 5 percent of its taxable income (or the sum of 1 percent of its estimated taxable income in the current and next four tax years, if materially different) in 2026 and then not make any donations from 2027 to 2030. In this scenario, the 1 percent floor would only apply once to disallow a deduction, and deductions that might otherwise be disallowed if taken in future years could be taken in the year of the contribution.

Even better, if this strategy is employed in a tax year beginning in 2025 — before the 1 percent

¹⁴ As discussed above, there remains a question as to whether the 1 percent floor applies to charitable contribution carryovers from tax years beginning before 2026.

¹⁵ To see this simultaneous equation (albeit one in which the charitable deduction is limited to 10 percent of taxable income rather than 9 percent), see Quesenberry, Passman, and Greenaway, *supra* note 13. If charitable deductions are limited to 10 percent of taxable income, the equation is $(0.02/0.92) * T$.

Table 2. Bunching Contributions With a Carryover

	2026	2027	2028	2029
Taxable income	\$10 million	\$10 million	\$10 million	\$10 million
Contributions made	\$3 million	\$0	\$0	\$0
Deduction	\$900,000	\$900,000	\$900,000	\$200,000
Carryover used	N/A	\$900,000	\$900,000	\$300,000 (incl. 1% floor)
Carryover to next year	\$2.1 million	\$1.2 million	\$300,000	\$0

floor is in effect — the 1 percent floor would not even apply in the first year.

Corporations that want to spread their distributions to operating charities over several years may contribute to a donor-advised fund or their company foundation. Note that although the corporation would arguably lose the time value of money by contributing a larger amount upfront to be paid out over several years, the amounts contributed to a DAF or foundation could earn returns on a (largely) tax-free basis.¹⁶

To the extent that the amounts contributed up front are large enough to generate a significant carryover, the result can still minimize the extent to which the 1 percent floor disallows deductions and actually delay the disallowance, as shown in Table 2.

In this case, the \$100,000 loss in a deduction occurs only once — in 2029 — such that the corporation's \$3 million contribution results in \$2.9 million in deductions over four years. By contrast, if the corporation contributed \$1 million each year for three years, the 1 percent floor would apply every year without being carried over, and the corporation would take only \$2.7 million in deductions over the three-year period.

Of course, taxable income will not always be the same year after year, and corporations that want to maximize the benefits of a bunching strategy will need to forecast future taxable income and model the results as best they can.

VIII. Exceeding the 10 Percent Limit Every Year

Corporations that donate enough to routinely approach the 10 percent limit will want to make sure to donate at least enough to generate a carryover such that amounts below the 1 percent floor may be carried over rather than permanently disallowed. Once it generates a carryover to a subsequent tax year, the corporation may generate a carryover again in that subsequent year with a contribution of less than 10 percent of taxable income; how much less will depend on the amounts of the carryover and taxable income in that year. Revisiting the simplified example shown above in which a corporation has \$10 million in taxable income each year between 2026 and 2031, one sees that a corporation could contribute just in excess of 10 percent one time and thereafter be able to contribute only 9 percent of taxable income every year to generate both a deduction equal to 9 percent of taxable income and a carryover every year. (See Table 3.)

Again, although Table 3 shows \$0 being carried over to 2032, the corporation in the example would only need to contribute an additional \$1 in 2031 to keep this pattern going (assuming the amount disallowed by the 1 percent floor each year and subsequently carried over is a current-year contribution).

Corporations reporting on an accrual basis that want to pinpoint their taxable income each year for purposes of ensuring that they generate a carryover to the subsequent tax year can benefit from section 170(a)(2). This provision allows an accrual-basis corporation's board of directors to authorize contributions equal to 10 percent of taxable income and deduct the amount authorized in a tax year but actually make the contributions by their Form 1120's original due

¹⁶ Foundations are subject to an excise tax on their net investment income at a 1.39 percent rate, so the returns would not be entirely tax free. See section 4940. Note also that sponsoring organizations of DAFs typically claim some portion of a DAF account for administrative or investment management fees.

Table 3. Contributing Just Over 10 Percent One Year and Less in Subsequent Years

	2026	2027	2028	2029	2030	2031
Taxable income	\$10 million	\$10 million	\$10 million	\$10 million	\$10 million	\$10 million
Contributions made in year	\$1,000,001	\$900,000	\$900,000	\$900,000	\$900,000	\$900,000
Disallowed by 1% floor	\$100,000	\$100,000	\$100,000	\$100,000	\$100,000	\$100,000
Deduction	\$900,000	\$900,000	\$900,000	\$900,000	\$900,000	\$900,000
Carryover to the next year	\$100,001	\$100,001	\$100,001	\$100,001	\$100,001	\$0

date (without extensions) in the following tax year (for example, by April 15, 2027, for a calendar-year corporation authorizing contributions for 2026). This election gives corporations time to determine taxable income with more precision before making charitable contributions.

IX. Taking a Business Expense Deduction for Contributions to Charities

Corporations should also take a close look at their payments to charities to determine whether they are actually ordinary and necessary business expenses rather than charitable contributions.

Corporations contemplating treating their contributions to charities as ordinary and necessary business expenses do not generally have a choice between deducting a given contribution under section 170 or section 162.¹⁷ Rather, whether a payment is a contribution or gift within the ambit of section 170 or an ordinary and necessary business expense deductible under section 162 is a determination based on the specific facts and circumstances of the contribution.¹⁸ To the extent that a corporation has

made a payment to a charity with no intent or expectation of receiving, and no actual receipt of, any commensurate return benefit (and otherwise meets the many requirements of section 170), a section 170 deduction is appropriate and a section 162 deduction will not be allowed. Conversely, to the extent that a corporation has made a payment or transfer to a charity “with a reasonable expectation of financial return commensurate with the amount of the payment or transfer” and that “bears a direct relationship to” the corporation’s trade or business, the regulations under section 162 make clear that the payment or transfer constitutes “an allowable deduction as a trade or business expense rather than a charitable contribution deduction under section 170.”¹⁹

As the IRS has recognized, “determining expected benefit or financial return often can be difficult.”²⁰ This is especially true of “expenditures for institutional or ‘good will’ advertising which keeps the taxpayer’s name before the public,” which the regulations under section 162 provide are “generally deductible as ordinary and necessary business expenses provided the expenditures are related to the patronage the taxpayer might reasonably expect in the future.”²¹ The IRS has acknowledged that this general rule regarding institutional or goodwill advertising “applies even if the payment is made to a section 501(c)(3) organization.”²²

¹⁷ One arguable exception applies to contributions of current-year inventory that qualified for the so-called enhanced deduction under section 170(e)(3). Corporations making these contributions have a choice between leaving the costs incurred in relation to that inventory in costs of goods sold for the year or taking the enhanced deduction under section 170(e)(3) and backing the costs out of COGS. *See generally* Notice 2008-90, 2008-43 IRB 1000. Costs incurred in relation to current year inventory, the charitable contribution of which do not qualify for the enhanced deduction, are left in COGS pursuant to the regulations. Reg. section 1.170-1(c)(4).

¹⁸ Rev. Rul. 72-293, 1972-1 C.B. 95 (saying that whether a payment is “a ‘contribution or gift’ within the ambit of section 170(c)(1) of the Code or an ordinary and necessary business expense deductible under section 162(a) of the Code is a determination that must be made on the basis of all the facts and circumstances in each case”).

¹⁹ Reg. section 1.162-15(a)(1).

²⁰ Rev. Rul. 97-52, 1997-2 C.B. 61.

²¹ Reg. section 1.162-20(a)(2).

²² INFO 2016-0063.

One example of payments to charities that the IRS has repeatedly recognized as deductible under section 162 because of the generation of a “significant degree of name recognition and goodwill” are contributions made in accordance with a promoted program under which the business agrees to donate a percentage of its sales to charity as part of its efforts to generate business (for example, commercial co-venturing arrangements).²³ The regulations under section 162 also recognize as a deductible business expense a business’s payment to a local church for a half-page advertisement in the church’s program for a concert²⁴ and, much less specifically, expenses that keep “the taxpayer’s name before the public in connection with encouraging contributions to” charities.²⁵ In addition, while not as conventional of a marketing activity, a court determined that a sewing machine manufacturer had an expectation and purpose of enlarging its future potential market for sewing machines (and thus was denied a section 170 deduction) when it sold its sewing machines at a discount to schools so they would encourage and teach students to sew.²⁶

On the other hand, a court denied a section 162 deduction to a linen supply and service company for contributions to Christian Science churches even though the company received all the Christian Science business in its area of operation. Among other reasons, the court

determined that a section 162 deduction was not justified because the company could not demonstrate that the churches’ membership was aware that the contributions had been made.²⁷

These authorities do not begin to cover the full scope of business payments to charitable organizations that can be expected to generate at least some degree of name recognition and goodwill²⁸ among a business’s potential customer base. As a result, for many situations, corporations will not have directly analogous authorities to inform them of when the courts and the IRS might find the expected name recognition and goodwill (and its potential connection to revenue increases) from a donation to be significant enough to justify a section 162 deduction. If a corporation does want to take the position that a payment to a charity is deductible under section 162 as a marketing expense, though, it should contemporaneously document that its purpose in making the payment is to get its name before the public and thereby increase its volume of business. It should also document all the ways in which its name did, in fact, get before the public because of the contribution and a reasoned explanation of how this specific exposure could be expected to increase sales.

Other benefits to businesses resulting from contributions to charities that the courts and IRS have recognized as justifying a section 162 deduction include contributions to please current or potential customers;²⁹ contributions to improve

²³ See, e.g., reg. section 1.162-15(a)(2), Example 2 (supermarket chain that operates a promotional program in which it sets aside the proceeds from 1 percent of its sales each year, which it gives to one or more charities); Rev. Rul. 72-314, 1972-1 C.B. 44 (stock brokerage corporation advertised extensively that 6 percent of its commissions would be paid to a local charity); Rev. Rul. 63-73, 1963-1 C.B. 35 (manufacturer made an agreement with a charitable organization under which it would pay the charity a certain amount on each unit of a specified product manufactured by it for which a label was mailed to the charity by the purchaser); Rev. Rul. 55-514, 1955-2 C.B. 55 (payments to charities to redeem coupons forwarded to them by the taxpayer’s customers); Rev. Rul. 54-3, 1954-1 C.B. 67 (newspaper’s payments to a charity of a percentage of its subscription receipts); ILM 201543013 (company made donations to charities recommended by purchasers in accordance with an advertised program); LTR 200236027 (insurance company would pay, as a policy benefit, an amount generally equal to 1 percent of the face amount of a life insurance policy to a charitable organization designated by the policy owner); LTR 9309006 (a company that operated a chain of supermarkets instituted a promotional program in which it set aside the proceeds from 1 percent of its sales each year for donation to various public interests in the cities where the sales occurred).

²⁴ Reg. section 1.162(a)-15(a)(2), Example 1.

²⁵ Reg. section 1.162(a)-20(a)(2).

²⁶ *Singer Co. v. United States*, 449 F.2d 413 (Ct. Cl. 1971).

²⁷ *Hartless Linen Service Co. v. Commissioner*, 32 T.C. 1026 (1959).

²⁸ Reg. section 1.162(a)-15(a)(2), Example 2.

²⁹ *Willcuts v. Minnesota Tribune Co.*, 103 F.2d 947 (8th Cir. 1939) (a newspaper publisher’s donation to help retire a college’s debt, where the college was an advertising customer of the publisher and the donation was made to retain this source of income, was deductible under section 162); *Marquis v. Commissioner*, 49 T.C. 695 (1968) (contributions by a travel agency that did 57 percent of its business with charitable organizations, where the contributions were geared to the amount and profitability of the business they gave and the potential for future business, were deductible under section 162); *Marcell v. United States*, 8 A.F.T.R.2d (RIA) 5344 (D. Vt. 1961) (a contribution to a hospital, where the chair of the fundraising drive was the owner of a company that was an actual or potential client, was deductible under section 162). On the other hand, cash payments to hospital building funds by a seller of surgical and hospital supplies were found to be charitable contributions, not business expenses. *William T. Stover Co. Inc. v. Commissioner*, 27 T.C. 434 (1956).

business conditions in a business's area of operations;³⁰ contributions that help with the

attraction, retention, and morale of employees;³¹ and contributions that help the company obtain necessary licensing or regulatory approvals.³² Regarding all these potential business benefits, authorities exist in which the courts or the IRS recognize the contributions to charities as either deductible or nondeductible under section 162.³³ The answer depends on the facts and circumstances of each case. And, as with advertising, the more direct a relationship between the contributions and the corporation's business that can be established, and the more significant and concrete the benefits that the corporation can reasonably expect, the higher the likelihood is that a section 162 deduction will be upheld. The key, again, is the level of contemporaneous documentation that the corporation can produce to demonstrate its business purpose in making the contribution, its associated actions consistent with

³⁰ Reg. section 1.162-15(b) (saying that "a transit company may donate a sum of money to an organization intending to hold a convention in the city in which it operates, with a reasonable expectation that the holding of such convention will augment its income through a greater number of people using its transportation facilities"); Rev. Rul. 79-283, 1979-2 C.B. 80 (voluntary contributions by members of a savings and loan association league with the sole purpose of assisting victims of natural disasters who had property mortgaged with members of the league at the time of a disaster were deductible under section 162, since the purpose was to protect mortgagors from defaulting); Rev. Rul. 73-113, 1973-1 C.B. 65 (voluntary contributions to a city's special oil pollution control fund used for research, beautification, and advertising to recover tourist business lost because of oil pollution were deductible as business expenses by a corporation conducting a retail business in the city, as they were reasonably calculated to improve the taxpayer's future business); LTR 8515014 (a developer's contribution to an exempt organization that was formed for the purpose of "assisting and/or taking a leader role in the promotion of the long-term economic stability and growth of the region" in which the developer did business was a deductible business expense). *But see* Rev. Rul. 69-90, 1969-1 C.B. 63 (voluntary payments by merchants and property owners to a city to provide unrestricted public parking facilities in the general area of the contributors were charitable contributions where the facilities were not limited to, and the parking spaces were not reserved for, the contributors or the tenants or customers of the contributors and the amount of the contributions was not based on proximity or probable use); LTR 8145020 (a newspaper's contributions to fund a first grade reading program, which it characterized as an effort to improve literacy and reading habits of the region's populace and enhance the newspaper's marketability, was not deductible as a business expense because the benefit was too tenuous and indirect).

³¹ *Jefferson Mills Inc. v. United States*, 259 F. Supp. 305 (N.D. Ga. 1965), *aff'd* 367 F.2d 392 (5th Cir. 1966) (a textile mill's payment to the board of education in its city in accordance with an obligation to improve the city's schools was deductible under section 162 because it would attract and keep employees by providing adequate education for their children and also result in desirable prospective employees); *Weil Clothing Co. v. Commissioner*, 13 T.C. 873 (1949) (permitting a business deduction for contributions to an employee-established and -controlled nonprofit employee aid association in order to improve and maintain the morale and loyalty of its employees). *But see* *McDonnell Aircraft Corp. v. Commissioner*, 16 T.C. 189 (1951) (an aircraft manufacturer's contribution to a local university on the condition that "an aeronautical engineering course is included in the courses of study offered by the school" was a charitable contribution, not a business expense). Employee morale was also noted in Rev. Rul. 62-156, 1962-2 C.B. 47, in which the IRS concluded that an employer's expenses incurred in maintaining a voluntary payroll deduction plan to encourage employees to contribute to political campaigns of their choice and in granting time off with pay to register and vote was deductible under section 162 because it was not "unreasonable for the taxpayer to expect that such expenditures would improve employee morale and ultimately improve its business" and would enhance the employer's reputation.

³² *See South End Italian Independent Club Inc. v. IRS*, 87 T.C. 168 (1986) (holding that contributions of net proceeds of beano games to charities were deductible under section 162 because state law provided that the taxpayer's beano gaming license could be revoked if the proceeds were not donated for charitable, religious, or educational uses); Rev. Rul. 77-124, 1977-1 C.B. 39 (concluding that a parimutuel racetrack's contributions to charities of profits earned on conducting races on additional "charity days" were deductible under section 162 when the racetrack believed that if it failed to conduct these charity days, the state licensing agency might select less favorable racing days or the local citizens might recall the taxpayer's license); LTR 201437004 (annual contributions to charities made to satisfy conditions of a certificate necessary to operate under state law were deductible under section 162); LTR 8749020 (contributions to charities that were required to be made quarterly for a station to operate under an interim F.C.C. order were deductible under section 162). *But see* Rev. Rul. 72-542, 1972-2 C.B. 37 (no business deduction was allowed when a racetrack voluntarily conducted charity days and donated the net proceeds without any goal of retaining its license or getting more favorable racing days).

³³ *See supra* notes 29-32.

this purpose, and, if possible, the expected results in achieving this purpose.

X. Possible Downsides of Payments Not Being a Charitable Contribution

While payments to charities that are business expenses are not subject to the 1 percent floor or the 10 percent limit, they can have disadvantages in certain circumstances. These include (1) the possibility that those payments are not ordinary and necessary business expenses, but rather are subject to capitalization (and potential amortization or depreciation);³⁴ (2) that, in the case of asset transfers, the corporation's deduction may be limited to the asset's cost rather than its fair market value; and (3) the risk of excise taxes when contributions are made to private foundations or DAFs.

A. Capitalization

Even when a corporation can establish that a contribution to a charitable organization described in section 170(c) bears a direct relationship to the corporation's business and is made with a reasonable expectation of a commensurate financial return benefit, the associated expenditures may have to be capitalized to the basis of the property acquired or created (potentially subject to amortization or depreciation) rather than be immediately deductible under section 162. Sections 263(a) and 263A govern the rules for determining whether costs paid or incurred by a taxpayer are immediately deductible or must be capitalized (and potentially recovered through depreciation, amortization, or cost of goods sold). In the case of intangible property, reg. section 1.263(a)-4 generally requires taxpayers to capitalize amounts paid to acquire or create (or facilitate the acquisition or creation of) certain intangible assets that confer rights or benefits over an extended period of time (such as, for example, amounts paid by a taxpayer to a governmental agency to

obtain, renew, renegotiate, or upgrade its rights under a license, permit, or other similar right granted by that agency (as well as amounts that facilitate the acquisition or creation of that right)).³⁵ For example, if a corporation pays a university an amount and in return receives naming rights regarding the university's athletics stadium for a period of 20 years, the payment will generally have to be capitalized to the basis of the intangible of the naming rights and amortized over the 20-year period.³⁶

Similarly, a corporation generally must capitalize an amount paid for real property that is relinquished to another party (such as a charity or governmental entity) without consideration, or to produce or improve real property that is owned by another party without being compensated, when the real property can reasonably be expected to produce significant future economic benefits for the corporation.³⁷ These amounts that are subject to capitalization may generally be amortized either over the period of the expected future benefit or a 25-year safe harbor period.³⁸ For example, if a corporation operating a quarry makes a contribution to the city in which it operates to help defray the cost of constructing a publicly owned bridge capable of accommodating the corporation's trucks, that amount generally must be capitalized (subject to amortization, as previously noted).³⁹

Corporations are also required to capitalize direct and indirect costs allocable to real and tangible property they self-produce. Accordingly, if a real estate developer makes a contribution to a governmental entity in order to obtain regulatory approval for a real estate development, the cost of that contribution may have to be capitalized to the basis of the development property produced under section 263A (which requires the

³⁵ Note that under the so-called 12-month rule of reg. section 1.263(a)-4(f), a taxpayer may deduct amounts paid to create, or facilitate the creation of, any right or benefit that does not extend beyond the earlier of (i) 12 months after the first date on which the taxpayer realizes the right or benefit, or (ii) the end of the tax year following the tax year in which payment is made.

³⁶ See reg. sections 1.263(a)-4 and 1.167(a)-3.

³⁷ See reg. section 1.263(a)-4(d)(8). This rule does not apply to impact fees and the costs of dedicated improvements subject to capitalization under section 263A and the regulations thereunder.

³⁸ See reg. section 1.167(a)-3.

³⁹ Reg. section 1.263(a)-4(d)(8)(v), Example 1.

³⁴ See, e.g., sections 263(a) and 263A.

capitalization of direct and indirect costs allocable to property produced by a taxpayer).⁴⁰

B. Noncash Property

One advantage of making a charitable contribution of noncash appreciated property to a charity is that the donor may be able to take a deduction equal to the property's FMV without having to recognize any of the property's built-in gain.⁴¹ When a corporation transfers appreciated property with the expectation of commensurate financial return benefit, however, such a result is not so clear. Rather, the transfer could be a realization event that results in gain being recognized, depending on the value of what is received in return and/or could result in the net deduction being limited to the corporation's basis.⁴²

C. Potential Exposure to Excise Taxes

Corporations contributing to company foundations or DAFs should be mindful of the excise tax rules that govern the potential receipt of benefits from these donees. In the case of a private foundation, any use of its income or assets for the benefit of a disqualified person (which will usually include the company, in the case of a company foundation) is generally considered self-dealing and subject to an excise tax under

section 4941 unless the benefit can be shown to be incidental or tenuous. Regarding a DAF, any distribution from it that provides a more than incidental benefit to the donor or donor adviser is subject to an excise tax under section 4967.

The IRS has consistently deemed "the public recognition a person may receive, arising from the charitable activities of a private foundation" to be incidental for purposes of section 4941.⁴³ Nonetheless, corporations should carefully consider whether they can credibly argue both that (1) they are entitled to a section 162 deduction for a contribution to their company foundation or a DAF because they expect to receive a commensurate financial return benefit, and (2) any benefit they derive from the foundation or a distribution from a DAF is incidental for purposes of sections 4941 and 4967. Corporations should also consider whether they may, for purposes of section 162, take into account financial return benefits expected not from their own contributions to a foundation or DAF but from subsequent distributions by the foundation or sponsoring organization of the DAF (both of which are separate entities with their own fiduciary obligations and discretion and control), possibly over an extended period of time.

XI. Conclusion

There is no bright side for corporations when it comes to the 1 percent floor. It is a deduction disallowance that the Joint Committee on Taxation estimates will cost corporations about \$16.6 billion over the next nine years.⁴⁴ That said, corporations can employ strategies to minimize the cost of the 1 percent floor. First, they should closely examine all their payments to charities to determine if any may be more properly characterized as ordinary and necessary business expenses rather than charitable contributions. For those payments that are true charitable

⁴⁰ See reg. section 1.263A-1(e). See also *Triumph Mixed Use Investments III LLC v. Commissioner*, T.C. Memo. 2018-65 (holding that a real estate developer could not claim a charitable contribution deduction for the transfer of land to a city in exchange for the city's approval of the taxpayer's development plan); *Von-Lusk v. Commissioner*, 104 T.C. 207 (1995) (holding that the costs of obtaining building permits and zoning variances, negotiating permit fees, and similar activities incurred by a real estate developer before actual physical work began on undeveloped land were indirect costs of production and thus capitalizable under section 263A); Rev. Rul. 2002-9, 2002-1 C.B. 614 (holding that the costs of impact fees required to be paid by a developer were capitalizable under section 263A); and reg. section 1.263(a)-4(d)(8)(v), Example 3.

⁴¹ See, e.g., *Campbell v. Prothro*, 209 F.2d 331 (5th Cir. 1954); Rev. Rul. 68-292, 1968-1 C.B. 359; Rev. Rul. 57-506, 1957-2 C.B. 65; Rev. Rul. 55-410, 1955-1 C.B. 297; LTR 201122007 ("In general, a gift or other transfer without reciprocal consideration is not treated as a sale or exchange or as a distribution of property that results in a realization of income by the donor."), citing reg. section 1.1001-1(e) (illustrating that the gift portion of a transfer is not treated as gain realized). Note that the deduction would be reduced by the amount of any gain that would not be long-term capital gain if the donor sold the property and may have to be further reduced for other kinds of contributions. See generally section 170(e)(1).

⁴² See, e.g., *United States v. General Shoe Corp.*, 282 F.2d 9 (1960); *International Freighting Corp. Inc. v. Commissioner*, 135 F.2d 310 (2d Cir. 1943); section 83; reg. section 1.83-6; Rev. Rul. 69-181, 1969-1 C.B. 196; Rev. Rul. 62-217, 1962-2 C.B. 59.

⁴³ See reg. section 53.4941(d)-2(f)(2).

⁴⁴ JCT, "Estimated Revenue Effects Relative to the Current Policy Baseline of the Tax Provisions in 'Title VII — Finance' of the Substitute Legislation as Passed by the Senate to Provide for Reconciliation of the Fiscal Year 2025 Budget," JCX-34-25 (July 1, 2025); and JCT, "Estimated Revenue Effects Relative to the Present Law Baseline of the Tax Provisions in 'Title VII — Finance' of the Substitute Legislation as Passed by the Senate to Provide for Reconciliation of the Fiscal Year 2025 Budget," JCX-35-25 (July 2, 2025).

contributions, corporations can explore bunching several years' worth of them into one year such that they are only hit with the 1 percent floor once (in the bunching year) rather than every year. This strategy can be especially fruitful in the tax year beginning in 2025, when the 1 percent floor is not yet in effect and when corporations can argue that carryovers generated are not subject to the 1 percent floor in subsequent years. For corporations that more routinely donate close to the 10 percent limit, donating just enough to exceed that limit can ensure that the 1 percent floor is carried forward rather than permanently disallowed. While they may not turn the 1 percent floor "lemon" into lemonade, these strategies can help make the 1 percent floor taste considerably less sour.⁴⁵ ■

⁴⁵ The foregoing information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the authors only and does not necessarily represent the views or professional advice of KPMG LLP.

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