

DONATIONS OF INVENTORY BY BUSINESSES

Preferable Tax Deduction for Contributions of Inventory

A special rule contained in Section 170(e)(3) of the Internal Revenue Code of 1986 offers regular (“C”) corporations substantial tax benefits for contributions of inventory to a Section 501(c)(3) organization to be used “solely for the care of the ill, the needy, or infants.” As explained in detail in Treasury Regulations § 1.170A-04A, this rule allows a corporation to take a tax deduction for qualified contributions of inventory equal to as much as 200% of the corporation’s basis in the inventory, e.g., the corporation’s cost for such inventory.

Restrictions and Requirements

To realize the benefits of this favorable charitable deduction the following requirements must be met:

- The contributing corporation must be a Chapter “C” corporation, and not a Subchapter “S” corporation.
- The donated property must be inventory held primarily for sale to customers in the contributing corporation’s trade or business (e.g., pharmaceuticals, equipment, food, books, etc.).
- The 501(c)(3) organization receiving the inventory must be a public charity or a private operating foundation, but not a private foundation.
- Use of the property by the 501(c)(3) organization must be related to its tax-exempt activities.
- Property contributed must be used for the care of the ill, the needy or infants (including all minor children).
- Neither the 501(c)(3) organization nor any transferee of the 501(c)(3) organization may receive any money or property in exchange for the use of the property.
- The 501(c)(3) organization receiving the property must provide the donate corporation with a written statement regarding the property’s use which complies with the requirements of Treasury Regulations § 1.170A-4(b)(4).

Determining the Amount of the Tax Deduction

The corporation making a qualified contribution of inventory may take a deduction equal to the lesser of (i) the cost of the contributed inventory, as carried on the corporation’s books, plus one-half the difference between the cost and the fair market value of the property, or (ii) twice the cost of the contributed property.

Example: If an item of donated inventory was carried on the contributing corporation's books at a cost of \$200.00 and it has an established fair market value of \$500.00, the donating corporation would be allowed a tax deduction of \$350.00 [$\$200.00 + (\frac{1}{2} (\$500.00 - \$200.00))$]. If, however, the item was carried at a cost of \$100.00 and it had a fair market value of \$500.00, the donating corporation would be entitled to a tax deduction of \$200.00 (e.g., twice the corporation's cost for the donated property).

Reduction in Donor's Cost of Goods Sold

A corporation taking advantage of this deduction must decrease its cost of goods sold for the year of contribution by the lesser of the fair market value of the contributed property or its cost to the contributing corporation (e.g., a \$200 or \$100 reduction, respectively, in the above example).

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