



INVENTORY AND PROPERTY DONATIONS

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Congress has provided a special rule under the federal tax law to encourage corporations to donate certain kinds of property to charitable organizations to be used "for the care of the ill, the needy, or infants." Gifts In Kind International can assist corporations in qualifying for this special tax benefit by distributing the donated products for the charitable purposes specified by the tax law.

What tax benefit is provided?

In general, a donor may deduct the full fair market value (FMV) of a gift to a public charity. However, the charitable contribution deduction allowed for donations of ordinary income property (property that, if sold, would not result in long-term capital gain) is generally limited to the lesser of the donor's adjusted tax basis in the donated property or the FMV of the property. To encourage donations by corporations of food, medicine, clothing, medical equipment, supplies, etc., to charities that serve the ill, the needy, or minor children, a special rule effectively doubles the maximum available tax benefit by providing a deduction of up to twice the donor's basis in the property. This special tax benefit was enacted as Section 170(e)(3) of the Internal Revenue Code.

What types of property must be donated to qualify for the special tax benefit under Section 170(e)(3)?

The types of property eligible for the special tax rule include: (1) stock-in-trade or other property includible in a donor's inventory; (2) property held for sale by the donor to customers in the ordinary course of its trade or business; (3) depreciable property used in the donor's trade or business; and (4) real property used in the donor's trade or business.

Property subject to regulation under the Federal Food, Drug, and Cosmetic Act is eligible for the special charitable deduction only if the items meet the requirements of that law on the date of transfer and for the preceding 180 days.

How is the tax benefit calculated?

The starting point in calculating the deduction for a donation of property that qualifies for this special rule is the property's FMV on the date of contribution. Generally speaking, FMV is the price at which the property would sell in its customary market. The determination of FMV is specific to the facts and circumstances with respect to the particular products at the time contributed.

The special deduction for qualified contributions of property equals the lesser of two amounts:

- (1) The donor's tax basis in the property, increased by one-half the difference between fair market value and basis;
- (2) Twice the donor's tax basis.

This computation is illustrated by the following examples.

Example 1: During 1994, a manufacturer donates products it manufactures to Gifts In Kind International with a FMV of \$40,000. The company's basis in the products is \$28,000. The charitable deduction equals the lesser of--



- (1) \$34,000, computed by adding basis (\$28,000) plus \$6,000, which is one-half the difference between FMV (\$40,000) and basis (\$28,000), or
- (2) \$56,000 (twice basis).

Thus, the manufacturer's charitable deduction in Example 1 is \$34,000. If instead the manufacturer had made a donation of products that did not qualify under the special tax rule, the deduction would have been \$28,000.

Example 2: During 1994, a retailer donates merchandise to Gifts In Kind International with a FMV of \$40,000. The retailer's basis in the property is \$12,000. The charitable deduction equals the lesser of--

- (1) \$26,000, computed by adding basis (\$12,000) plus \$14,000, which is one-half the difference between FMV (\$40,000) and basis (\$12,000), or
- (2) \$24,000 (twice basis).

Thus, the retailer's charitable deduction in Example 2 is \$24,000. If instead the retailer had made a donation of goods that did not qualify under the special tax rule, the deduction would have been \$12,000.

In calculating the deduction, a donor's basis in the property must be determined under the donor's method of accounting for income tax purposes. For inventory, the donor must use as basis the inventoriable carrying cost assigned to any similar item not included in closing inventory. To prevent the same amount from being deducted twice, the tax law requires the donor to decrease its cost of goods sold by the lesser of the FMV of the donated item or its tax basis.

Special rules apply with respect to donations of property when any gain on the sale of the property would be subject to "recapture" as ordinary income. In effect, these recapture amounts are not eligible for the charitable deduction.

Can any donor qualify for the special tax rule?

The special deduction for qualified contributions of property is available to any corporation other than an electing small business corporation (generally known as an "S" corporation).

Can any charity receive the donated property?

To qualify for the special deduction, a gift must be made to a public charity described in sections 509(a)(1), (2) or (3) of the Internal Revenue Code, or to a private operating foundation described in section 4942(j)(3). Since 1984, Gifts In Kind International has been recognized by the Internal Revenue Service as a public charity.

Are there restrictions on the use of the donated property?

Under the regulations, a wide range of uses of the donated property is permitted. For example, the donated property may be used to assist individuals who are physically or mentally ill, handicapped, incapable of self-care due to old age, or homeless; victims of disasters, crimes of violence, or spousal abuse; and immigrants with language, cultural, or financial difficulties. Qualified charitable purposes also include providing for physical, mental, and emotional needs of minor children. An "intermediary" charitable donee (such as Gifts In Kind International) may distribute the donated property to other qualified charities that in turn use the items for the care of the ill, needy, or minor children.



The special charitable deduction under Section 170(e)(3) is not available if the donee charity sells the donated items.

What IRS Form should a donor file?

A corporation generally must file IRS Form 8283 ("Noncash Charitable Contributions") with its tax return if the amount it claims as a deduction for all noncash gifts is over \$5,000. A corporation that is a closely held corporation, a personal service corporation, or an "S" corporation must file Form 8283 with its tax return if the amount it claims as a deduction for all noncash gifts is over \$500.

A written "qualified appraisal" is not required for donations of property by "C" corporations (including closely held corporations and personal service corporations) that qualify for the special deduction under Section 170(e)(3). A qualified appraisal is required for a donation of property by an "S" corporation if the deduction claimed exceeds \$5,000.

The charity receiving the property must complete the donee acknowledgment portion of Form 8283 for noncash gifts exceeding \$5,000. Gifts In Kind International can assist donors in preparing Forms 8283.

What other documentation is needed?

A donor must obtain from the donee charity a written statement representing that the donee's use and disposition of the property will meet the requirements for the special charitable deduction (*i.e.*, will be used by the charity for the care of the ill, the needy, or minor children). Gifts In Kind International will furnish this statement to the donor, which should maintain the statement with its tax records.

In addition, any donor making a contribution (in cash or property) of \$250 or more must obtain, before filing its tax return, a written acknowledgment of the donation from the donee charity meeting certain requirements. Gifts In Kind International will furnish the required written acknowledgment to each donor. The donor should maintain this written acknowledgment with its tax records.

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About Gifts In Kind International

The world's leading charity in product philanthropy, Gifts In Kind International is ranked as one of the most cost-efficient charities in the world, operating at less than .05 percent of the value of products, goods and services contributed annually. In 2006 alone, Gifts In Kind International and its 300-plus global affiliates distributed nearly \$900 million in quality products to a network of more than 150,000 charitable nonprofits around the globe. Gifts In Kind International is a registered 501(c)(3) U.S. nonprofit charitable organization, www.giftsinkind.org.

For more information about the benefits of product donations, please contact Barbara Florence, Vice President, Gifts In Kind International at (703) 299-7570 or via email at bflorence@giftsinkind.org, or visit our website at www.giftsinkind.org.