APPEALS
INDUSTRY SPECIALIZATION PROGRAM
COORDINATED ISSUE PAPER

INDUSTRY: Food

ISSUE: Charitable Contributions of Surplus Food

COORDINATOR: Clifford Jackson

TELEPHONE: (312) 886-1046

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<u> /s/ John F. Eckert   </u>   <u> 9/4/92 </u>
for   **Regional Director of Appeals   Date**
       Midwest Region

<u> /s/ James J. Casimir   </u>   <u> 9/20/92 </u>
National Director of Appeals   Date

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ISSUE

Whether the charitable contribution of Surplus Food (Inventory) by a corporation qualifies for an increased deduction under Section 170(e)(3) of the Internal Revenue Code in an amount equal to the basis plus fifty percent of the unrealized appreciation in the property at the time of contribution.

EXAMINATION DIVISION'S POSITION

That taxpayer is limited to a deduction in the amount of its basis (usually cost) in that the donated food is not salable at normal price and often not salable at cost.

DISCUSSION

Internal Revenue Code section 170(e)(3) and Regulation section 1.170A-4A(b) specify what a qualified contribution of inventory and other property consists of and the amount to be deducted by the qualifying C corporation (S corporations do not qualify).

Code section 170(e)(3) and its Regulations define a qualified contribution as follows:

1. The property is to be donated to an organization qualifying under Code section 501(c)(3) and to be used solely for the care of the ill, the needy or infants.

2. The property is not to be transferred by the donee in exchange for money, property or services.

3. The taxpayer receives from the donee a written statement representing that its use and disposition of the property will be in accordance with the provisions of 1 and 2 above.

4. In the case where property is subject to the regulations under the Federal Food, Drug and Cosmetic Act, as amended, such property must fully satisfy the applicable requirements of such Act and regulations on the date of transfer and for one hundred and eighty (180) days prior.

The deduction allowed under I.R.C.§ 170(e)(3) for qualified contributions is equal to the basis of the property, plus one-half of the property's unrealized appreciation. However, in no event may the deduction exceed twice the property's basis.

A problem arose with the original regulations where the basis of the contributed property exceeded the fair market value. The entire basis of the contributed property is removed from cost of goods sold, while the charitable contribution was limited to the property's fair market value. In such a case, it would be more advantageous for the taxpayer to destroy the property rather than contribute it. This was not the intent of the statute.

Therefore, regulations were amended to provide that the taxpayer's cost of goods sold will be reduced by the lesser of the fair market value or the basis of the contributed property. So, the reduction in cost of goods sold can never be more than the charitable contribution amount. The Regulation states:

Section 1.70A-4A(c)(3) Adjustment to Cost of Goods Sold.   Notwithstanding the rules of Section 1.170A-1(c)(4), the donor   of the property which is inventory contributed under this   section must make a corresponding adjustment to cost of goods   sold by decreasing the cost of goods sold by the lesser of the   fair market value of the contributed item or the amount of   basis determined under paragraph (c)(2) of this section.

Revenue Ruling 85-8 1985-1 CB 59, states that where a corporation donates products to a charitable organization shortly before their expiration date, the amount allowable as a charitable contribution deduction is equal to the the corporation's basis in the product plus one-half of the unrealized appreciation, not to exceed twice the taxpayer's basis in such property.

Regulations 1.170A-1(c)(2) states in part that the usual market of manufacturer or other producer consists of a wholesaler or other distributors to or through whom he customarily sells, but if he sells only at retail the usual market consists of his retail customers.