Every company has excess inventory from time to time. It may have become obsolete, it may be a second, or it may have resulted from overproduction.

The likelihood is that it could be of use to some party but is not saleable or there is no known buyer for the inventory.

All companies want to take steps to minimize their tax liability. Meanwhile, there are charitable organizations that have needs. Fortunately, these problems can come together for a solution that will benefit everyone.

The Internal Revenue Code allows a company to get a charitable contribution deduction for donations of excess inventory.

**Who can receive charitable contributions?**

To be deductible, a charitable contribution must be made to a qualified charitable organization.

The IRS maintains a list of qualified organizations, which may be accessed through their website or by calling the IRS for verification. Additionally, the organization may be able to provide a copy of its tax-exempt letter from the IRS.

A deductible contribution normally may be made to any 501(c)(3) organization. Note that simply because an organization is a nonprofit does not mean that it is an IRS-qualified charitable organization.

**What can be donated?**

A business can donate virtually any property that it owns. This may include inventory and equipment or intangibles such as a patent, copyright or trademark.

Different rules apply to different types of property donated. Our focus here, though, is on inventory items. It is important to note that the donated items must have value, and the company must have basis in those items in order to receive a deduction.

**When can a contribution be deducted?**

Normally, a charitable contribution is deductible in the year in which the contribution is actually made.

However, there is an exception for corporations. A corporation using the accrual method of accounting may deduct the contribution in the year it is accrued if the board of directors authorizes the contribution and the contribution is made by the 15th day of the third month after the end of the accrual year.
A copy of the resolution by the board must be attached to the tax return.

**What amount of deduction can be taken?**

The amount of the charitable contribution that is allowed for donations of property is the lesser of fair market value (FMV) or cost, with some exceptions.

There are two important implications of this definition. First, if the property is worthless because of obsolesce or other reason, no deduction can be taken.

Secondly, if the company does not include the cost in beginning inventory, the cost basis will be zero and no deduction is allowed.

There is a special rule that applies to certain donations allowing the corporation to take a larger deduction.

If this rule applies, the deduction is equal to the FMV plus one-half of the excess of the property’s FMV over its adjusted basis. This is limited to twice the property’s adjusted basis.

This rule applies to inventory that:

1. Is related to the recipient’s exempt functions and is used solely for the care of ill, elderly, or infants;
2. Is not transferred to the recipient in exchange for money, other property or services; and
3. The donor receives a statement from the recipient that the above conditions will be complied with.

There is a similar rule in place for donations of scientific research property given to a college, university or tax-exempt research organization. The inventory must be used by the organization within two years of the property being created.

Once the amount of the deduction is determined, the corporation must consider limitations and substantiation requirements. Corporations may not deduct more than 10 percent of its adjusted taxable income for all charitable contributions. Any excess may be carried forward for five years.

(There are times when making a charitable contribution can be unfavorable to the taxpayer, and scrapping the inventory will give a 100 percent deduction.)

If the amount of deduction exceeds $500, the corporation must include a description of the property on its tax return. If more than $5,000, the corporation must obtain an appraisal. If the deduction exceeds $500,000, the appraisal must be attached to the return. On occasion, a corporation may sell inventory to a charitable organization for a price far below FMV. This is referred to as a bargain sale, and may give rise to a charitable contribution deduction.

If the sale was for less than FMV or basis, the difference between the sale price and lower of FMV or basis will be the amount of the deduction.
Collaborations between corporations and not-for-profit organizations can be beneficial to all concerned. Making good use of excess or obsolete inventory can reap benefits for the corporation, the charitable organization, and for society at large.