

ENCOURAGE INCREASED CHARITABLE CONTRIBUTIONS
DURING THE COVID-19 PANDEMIC

It is often more financially beneficial for companies to destroy inventory than to donate it to charity, particularly when the inventory is subject to high duty rates, like clothing and footwear. This is because destruction of product qualifies for duty drawback while donating to charity does not. Congress should address this unfortunate reality by amending 19 USC 1313 to allow duty drawback if a product is donated to a qualified charity and the charity is prohibited from reselling the product.

In addition, Congress added §170(e)(3) to the Code in 1976 to provide an incentive for increased donations of food, clothing, medical equipment, and supplies to charities that assist the needy and disaster victims. Section 170(e)(3) should be amended to expand the class of charities that are eligible to receive donations (e.g., to be able to donate compression leggings to frontline hospital workers) and to change valuation rules to allow taxpayers to deduct an amount greater than cost for an inventory donation.

Duty Drawback expanded to charitable donations

19 USC 1313 includes multiple references to allowing duty drawback upon “exportation or destruction” of imported merchandise. This language should be amended to read “exportation, destruction or donation to a qualified charity”. It can also include a prohibition that the charity may not resell the merchandise so as to prevent it from entering a marketplace environment.

Expanding drawback would allow a company to recoup the duties it paid on merchandise that it donates to charity while ensuring that the product does not enter a marketplace environment. For example, Old Navy recently [announced a donation of \\$30M](#) (value based on cost) in clothes to needy families across America. If drawback were expanded to allow the donation to qualify, then the drawback claim would be based on the actual duties paid on the merchandise. As an example, the average duty rate on apparel in 2019 was 14.5%. Using that average, then the duties paid and drawback claim would be \$4.35M (\$30M* 14.5%).

Charitable donee requirements relaxed

Existing requirements permit a deduction only if the donation is made to a limited class of charities that in turn must use the inventory for specific purposes. The proposal relaxes existing requirements for the use of inventory contributions – for example, by allowing donations of clothing, medical equipment, and other supplies to be provided to health care workers. See **proposed section 170I(3)(C)(i)**, attached.

Gross Profit Percentage to determine fair market value

To incentivize charitable donations in response to COVID-19, a corporation’s prior year gross profit percentage, as defined, would be used to determine the fair market value of contributed inventory property during a major disaster or emergency. This approach is particularly appropriate when markets have been disrupted due to a major disaster or emergency because the proposal provides that the value of contributed inventory would be based on margins from the sale of similar goods under normal market conditions. The determination of margin would be objective because it would be based on margins reflected on prior year tax returns.

A charitable deduction would be based on a company's prior year profit margin on donated inventory. For example, Old Navy recently [announced a donation of \\$30M](#) (value based on cost) in clothes to needy families across America. If the prior year's profit margin is 35%, then the charitable deduction would be \$10.5M ($\$30M \times 35\%$) and the tax benefit would be \$2.2M (assuming a 21% corporate tax rate).

See **proposed section 170(e)(3)(C)(ii)**, attached.

Limitations on deductions based on taxable income would not apply

The existing limitation on corporate charitable contributions (based on a percentage of taxable income) would not be applied to a contribution of inventory property in the case of a major disaster or emergency. This would allow corporate taxpayers to deduct the full amount of their inventory contributions when computing taxable income in 2020. See **proposed section 170(e)(3)(C)(iii)**, attached.

Proposed Changes to Section 170(e)(3)

(3) Special rule for certain contributions of inventory and other property.

(A) Qualified contributions. For purposes of this paragraph, a qualified contribution shall mean a charitable contribution of property described in paragraph (1) or (2) of section 1221(a), by a corporation (other than a corporation which is an S corporation) to an organization which is described in section 501(c)(3) and is exempt under section 501(a) (other than a private foundation, as defined in section 509(a), which is not an operating foundation, as defined in section 4942(j)(3)), but only if—

- (i) the use of the property by the donee is related to the purpose or function constituting the basis for its exemption under section 501 and the property is to be used by the donee solely for the care of the ill, the needy, or infants;
- (ii) the property is not transferred by the donee in exchange for money, other property, or services;
- (iii) 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 clauses (i) and (ii); and
- (iv) in the case where the property is subject to regulation under the Federal Food, Drug, and Cosmetic Act, as amended, such property must fully satisfy the applicable requirements of such Act and regulations promulgated thereunder on the date of transfer and for one hundred and eighty days prior thereto.

(B) Amount of reduction. The reduction under paragraph (1)(A) for any qualified contribution (as defined in subparagraph (A)) shall be no greater than the sum of—

- (i) one-half of the amount computed under paragraph (1)(A) (computed without regard to this paragraph), and
- (ii) the amount (if any) by which the charitable contribution deduction under this section for any qualified contribution (computed by taking into account the amount determined in clause (i), but without regard to this clause) exceeds twice the basis of such property.

(C) Emergencies and disasters. In the case of major disasters or emergencies declared in a State --

(i) clauses (i) and (ii) of subparagraph (A) are replaced by the following for contributions made to donees operating in that State—

(i) the use of the property by the donee is related to the purpose or function constituting the basis for its exemption under section 501;

(ii) the property is not transferred by the donee in exchange for money, other property, or services.

(ii) The fair market value of a qualified contribution under paragraph (1)(A) is the sum of –

(I) the basis of the property, and

(II) the product of the basis of the property multiplied by the corporation's gross profit percentage.

A corporation's gross profit percentage shall be determined under section 132(c)(2), with the following modifications:

(I) "employer" is replaced by "corporation" in clause (i) of subparagraph (A);

(II) clause (i) of subparagraph (B) is replaced by "(i) all property offered to customers in the ordinary course of the line of business of the corporation (or a reasonable classification of property selected by the corporation);"

(III) "employer's" is replaced by "corporation's" in clause (i) of subparagraph (A); and

(IV) for purposes of clause (ii) of subparagraph (B), a representative period shall include, but is not limited to, the taxable year preceding the year of the corporation's qualified contribution.

(iii) Subsections (b)(2)(A) and (e)(1)(A) shall not apply to qualified contributions described in this subparagraph.

(D) For purposes of subparagraph (C)—

(i) *Major disaster* means a major disaster as declared by the President under section 401 of the Stafford Act, 42 U.S.C. § 5170; and

(ii) *Emergency* means an emergency as declared by the President under section 501 of the Stafford Act, 42 U.S.C. § 5170.