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INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

SEP 30 1998

Index (UIL) Numbers: 170.05-00; 267.00-00; 1366.00-00.
CASE MIS Number: TAM-107661-98

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Years Involved:
Date of Conference:

LEGEND:

Taxpayer =

Foundation =

A =

B =

C =

D =

Year X =

Year Y =

$3Z =

ISSUES:

(1) Is the income tax deduction for a charitable contribution provided for an accrual-basis corporation under § 170(a)(2) subject to the § 267(a)(2) related

taxpayer attribution rules, and, as a result, does § 267 defer the deduction of a charitable contribution made to a related party § 501(c)(3) organization?

(2) Can an accrual-basis S corporation properly accrue a deduction for a charitable contribution made before the 15th day of the third month following the close of its taxable year under § 170(a)(2) or is the charitable deduction properly taken when paid under § 170(a)(1)?

CONCLUSIONS:

(1) The income tax deduction for a charitable contribution provided under § 170(a)(2) is not subject to the § 267(a)(2) related taxpayer attribution rules because § 501(c)(3) organizations do not have gross income with respect to charitable contributions to them. Section 267 therefore does not defer the deduction of a charitable contribution under § 170(a)(2) made to a related party § 501(c)(3) organization.

(2) The special rule for charitable deductions by accrual-basis corporations does not apply to S corporations because charitable deductions by S corporations are not allowed to the S corporation but are passed through to shareholders. The deduction for a charitable contribution made by an S corporation is properly passed through to shareholders and taken in the year that the contribution is actually paid.

FACTS:

Taxpayer is an accrual-basis subchapter S corporation with a fiscal year ending March 31. Prior to the end of its Year X tax year, Taxpayer's Board of Directors authorized a $3Z charitable contribution to Foundation, a qualified donee under § 170(c)(2) and an organization described under § 501(c)(3) of the Internal Revenue Code. Taxpayer actually paid the contribution to Foundation in May, Year Y.

Taxpayer elected under § 170(a)(2) to treat the charitable contribution as actually paid in its tax year ending March 31, Year X. Thus, Taxpayer accrued the charitable contribution to Foundation as a payable on its books and reported it as a charitable contribution on its tax return for its fiscal year ending March 31, Year X. The contribution passed through to Taxpayer's shareholders and was deducted on their individual returns for the Year X calendar year.

A and B own 100 percent of the stock of Taxpayer and are two of the four trustees of Foundation. C and D, the children of A and B, are the other trustees of Foundation.

LAW AND ANALYSIS:

SECTION 170

Section 170(a) of the Internal Revenue Code allows as a deduction any charitable contribution (as defined in § 170(c)) the payment of which is made within the taxable year. Under § 170(b)(1), the percentage limitation on charitable contributions for an individual is 50%, 30%, or 20% of the taxpayer's contribution base (generally adjusted gross income) for the taxable year depending generally on the type of property and the type of qualified donee. Under § 170(b)(2), the percentage limitation on charitable contributions by a corporation is 10% of the taxpayer's taxable income with certain adjustments.

Under § 170(a)(2), however, a corporation reporting its taxable income on the accrual basis may elect to deduct a charitable contribution in the year in which the board of directors authorizes the contribution, if the payment is made by the 15th day of the third month following the close of the taxable year. The election may be made only at the time of the filing of the return for such taxable year and is made by reporting the contribution on the return. § 1.170A-11(b)(2). (The regulations require the taxpayer to attach to the return: (1) a written declaration, made under the penalties of perjury, by an officer authorized to sign the return, stating that the resolution authorizing the contribution was adopted by the board of directors during the taxable year; and (2) a copy of the resolution by the board of directors.)

The legislative history to § 170(a)(2) provides that the exception for accrual basis corporations was desirable because corporations intending to make the maximum charitable contribution allowable as a deduction had experienced difficulty in determining before the end of the taxable year what constituted 5 percent of their net income [the § 170(b) gross income limitation for corporations at the time of enactment]. S. Rep. No. 831, 81st Cong, 1st Sess., 1949-2 C.B. 289.

SECTION 267

Section 267(b)(9) provides that a person and an organization to which § 501 applies are related for purposes of § 267 if the person controls the foundation directly or indirectly. Under § 7701(a)(1) the term "person" includes a corporation.

Treasury Regulation 1.267(b)-1(a)(3) provides that control of a § 501 organization includes any kind of control, direct or indirect, by means of which a person in fact controls a § 501 organization, whether or not the control is legally enforceable and regardless of the method by which the control is exercised or exercisable. See also Nationwide Corp. v. Commissioner, 73-1 USTC 9269 (6th Cir. 1973).

Accordingly it is clear that Taxpayer and Foundation are related parties for purposes of § 267 because A and B, who may be brothers, and their children control both Taxpayer and Foundation. Taxpayer therefore would be considered to indirectly control Foundation.

The issue in this case, however, is whether § 267(a)(2) applies to charitable contributions.

Section 267(a)(2) provides, for related parties, that if by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not (unless paid) includible in the gross income of the payee, and at the close of the taxable year of the taxpayer for which (but for § 267) the amount would be deductible the payor and the payee are § 267 related parties, then any deduction shall be allowable as of the day as of which such amount is includible in the gross income of the payee.

In the present case, Taxpayer is on an accrual method of accounting and therefore, absent § 267, would accrue the charitable contribution in its tax year ended March 31, Year X. Foundation, on the other hand, is on the cash method of accounting and would not include the contribution in its "gross income" until the amount was paid in May of Year X, which is in the next fiscal year.

Section 267, however, does not apply to charitable contributions because § 501(c)(3) organizations do not have gross income with respect to charitable contributions. The matching between payor deductions and payee income that § 267 seeks to achieve has no relevance to charitable contributions.

We therefore conclude that § 267 does not defer the deduction of a charitable contribution made to a related party § 501 organization because a § 501 organization does not have gross income with respect to charitable contributions and therefore matching of deductions and income is not applicable.

SECTION 1366

Section 1363(b)(2) states that the taxable income of an S corporation is computed in the same manner as in the case of an individual with certain exceptions, among which is an exception that the deductions referred to in § 703(a)(2), including the deduction for charitable contributions provided in § 170, are not allowed to the corporation.

Section 1366(a)(1)(A) provides that in determining the tax of a shareholder, each shareholder takes into account the shareholder's pro rata share of the corporation's items of income (including tax-exempt income), loss, deduction or credit the separate treatment of which could affect the liability for tax of any shareholder. Section 1366(a)(1) provides further that the items referred to in § 1366(a)(1)(A) include amounts described in § 702(a)(4). Section 702(a)(4) refers to charitable contributions (as defined in § 170(c)).

The legislative history of § 1366 provides that the corporate limitation on charitable contributions will no longer apply. Instead, charitable contributions by S corporations will pass through to the shareholders and be subject to the individual limitations on deductibility. See H.R. Rep. No. 826, 97th Cong., 2d Sess. 14 (1982); S. Rep. No. 640, 97th Cong., 2d Sess. 16 (1982).

Under § 1363(b), an S corporation computes its taxable income in the same manner as an individual. The election in § 170(a)(2) is not available to an individual. An individual taxpayer may deduct a charitable contribution only in the year in which payment is actually made to the charitable organization.

Accordingly, in this case, Taxpayer must report the charitable contribution on its tax return for the year in which it actually paid the charitable contribution, fiscal year ending March 31, Year Y, and the shareholders cannot deduct the contribution until the Year Y calendar year.

CAVEAT(S)

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.