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Charitable Deduction vs. Advertising/Business Expense

In general, no deduction is allowed as an ordinary and necessary business expense for any contribution or gift to charity that is allowed as a charitable deduction under Sec. 170. However, a donation to a charitable organization that bears a direct relationship to the taxpayer's business and is made with a reasonable expectation of a commensurate financial return may be allowed as a business expense rather than as a charitable donation.

The IRS Chief Counsel provided guidance on charitable donation programs of a business. A taxpayer was allowed a business deduction for amounts given to charities and other non-profit entities under an advertised program in which the taxpayer would donate a percentage of its sales proceeds to various non-profit organizations. The IRS ruling noted that the taxpayer appeared to have acted with the reasonable belief that the program of donating a percentage of its sales to charity would enhance and increase its business. The ruling also noted that these "donations" were deductible as business expenses even when made to non-profits that were not qualified charitable contribution entities. However, the IRS noted that if any of these organizations sent the business a notice under Sec. 6033(e) that a portion of the donation related to nondeductible lobbying, that portion of the expenditure would not be deductible as a business ex-

pense under Sec. 162(e). That section denies a deduction for any amount paid in connection with lobbying or political campaigns.

Businesses that advertise either regularly or in a special promotion that a percentage of sales will be donated to specific non-profit causes should maintain documentation of their expectation of increased business sales if they intend to deduct the donated amounts as business expenses rather than charitable contributions. Business expense treatment is particularly valuable to pass-through entities that otherwise must report charitable contributions to individual owners as itemized deductions, as well as to C corporations that are subject to the 10% of taxable income charitable limitation.

This is a good item to keep in mind when you are working with your clients, especially if they have a significant amount recorded as charitable dona-

tions. As noted above, there are certain limitations to charitable donations, and not all taxpayers may receive a tax benefit from them depending on their individual tax situation. Properly reclassifying some of these charitable donations as advertising or general business expenses can provide a greater tax benefit to the taxpayer.

As a reminder, the IRS requires donors claiming a deduction of \$250 or more to obtain and keep a contemporaneous written acknowledgement for a charitable contribution. To be contemporaneous the written acknowledgement must generally be obtained by the donor from the recipient organization no later than the date the donor files the return for the year the contribution is made. The acknowledgement must state if the donee provided any goods or services in consideration for the contribution.



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