Adler v. Commissioner, T. C. Memo. 1994-324

Property donated to charity is not subject to the ordinary income limitation if it would not have been considered inventory if sold.

Summary

In Adler v. Commissioner, the Tax Court addressed whether the charitable contribution deduction for donated Christmas cards should be limited to the donors' cost basis under section 170(e)(1)(A). The petitioners purchased 180,000 Christmas cards at a U. S. Customs auction and donated them to Catholic Charities. The court held that if the cards had been sold, the gain would have been long-term capital gain, not ordinary income, because the cards were not held primarily for sale to customers in the ordinary course of business. This ruling allowed the petitioners to deduct the full fair market value of the cards at the time of donation, as opposed to being limited to their cost basis.

Facts

Barry Adler attended a U. S. Customs auction to buy medical equipment and noticed Christmas cards with gold medallions. He purchased 180,000 of these cards for $30,000, stored them for over a year, and then donated them to Catholic Charities. The cards were valued at $10. 50 each by Customs, totaling $1,890,000. Petitioners claimed charitable contribution deductions based on this value but held the cards for more than a year before donation.

Procedural History

The IRS disallowed the deductions, claiming the cards should be treated as ordinary income property under section 170(e)(1)(A). The Tax Court consolidated the cases of multiple petitioners and heard them together. The court's decision was based on the determination of whether the cards would have been considered ordinary income property if sold.

Issue(s)

1. Whether the Christmas cards, if sold by the petitioners, would have produced ordinary income or long-term capital gain?

Holding

1. No, because the Christmas cards were not held primarily for sale to customers in the ordinary course of business, thus the gain would have been long-term capital gain if sold.

Court's Reasoning

The Tax Court applied section 1221(1) to determine whether the Christmas cards were held primarily for sale to customers. It considered several factors including the frequency and continuity of sales, the purpose of acquisition, the duration of ownership, and promotional activities. The court found that petitioners made only one contribution of cards and had not engaged in frequent sales of similar property. Although the cards were bought to donate, not for appreciation, the lack of improvements or promotional efforts weighed in favor of the petitioners. The court concluded that the cards would not have been considered inventory if sold, hence the gain would have been long-term capital gain. The court distinguished this case from revenue rulings cited by the IRS, emphasizing the fact-specific nature of the analysis.

Practical Implications

This decision clarifies that a one-time charitable contribution of property not typically associated with the donor's business activities will generally not be treated as ordinary income property. Legal practitioners advising clients on charitable contributions should assess the donor's involvement in the type of property donated and the frequency of such contributions. The ruling impacts how tax deductions for charitable contributions are calculated, particularly in cases involving unique or one-off donations. It also informs future cases involving the classification of donated property, potentially affecting tax planning strategies for donors.

