Rev. Rul. 68-296, 1968-1 C.B. 105

Amounts transferred without consideration by a taxable corporation to its sole stockholer, an organization exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954, are distributions constituting dividends to the extent provided in section 316(a) of the Code and are not deductible as charitable contributions under section 170 of the Code.

Advice has been requested whether transfers made without consideration by a taxable corporation to its sole stockholder, an organization exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954, are distributions constituting dividends to the extent provided in section 316(a) of the Code or are deductible as charitable contributions under section 170 of the Code.

In 1966, Y, a taxable corporation, paid dividends to its sole stockholder, Z, an organization exempt under section 501(c)(3) of the Code as a charitable organization. In addition, Y transferred a sum to Z without consideration for which Y claimed a deduction as a charitable contribution under section 170 of the Code. Y's earnings and profits exceeded the sum of both amounts paid to Z.

The term 'dividend' is defined in section 316(a) of the Code as any distribution of property made by a corporation to its shareholders out of earnings and profits accumulated after February 28, 1913, or out of its earnings and profits of the taxable year.

The term 'charitable contribution' is defined in section 170(c) of the Code as including a contribution or gift to or for the use of a corporation, trust, community chest, fund, or foundation created or organized in the United States, which is organized and operated exclusively for religious, charitable, scientific or educational purposes, and no part of the net earnings of which inures to the benefit of any private shareholder or individual and no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation.

In Crosby Valve and Gage Company v. Commissioner, 380 F.2d 146 (1967), affirming 46 T.C. 641 (1966), certiorari denied, 389 U.S. 976 (1967), the petitioner, a business corporation wholly owned by a charitable foundation, deducted as a charitable contribution property distributed without consideration to its parent. The court concluded that the transfer of property was not deductible as a charitable contribution under section 170 of the Code but was a dividend under section 316(a) of the Code. It reasoned that (1) in enacting sections 511 and 512 of the Code Congress sought to treat exempt organizations having unrelated business income the same as their noncharitable competitors; (2)

to allow a subsidiary of an exempt organization a charitable deduction for amounts distributed to its exempt parent would permit the exempt organization to receive a greater return on its investment in its business (conducted indirectly through its subsidiary) than a non-exempt organization; and (3) it is from this competitive advantage that Congress intended to protect competing businesses not linked to an exempt organization by taxing unrelated business income of exempt organizations and by limiting an exempt organization's charitable contribution deduction from unrelated business income to contributions made to other exempt organizations. The court then concluded that a contribution made by a subsidiary to its exempt parent is not a contribution considered to be made to another exempt organization and therefore the benefits of section 170 of the Code are not available to it for such transfers of property.

In United States v. Knapp Brothers Shoe Manufacturing Corporation, 384 F.2d 692 (1967), certiorari denied, 390 U.S. 989 (1968), the taxpayer, a taxable corporation that was organized for the specific purpose of benefiting a university, was held not entitled to charitable contribution deductions under section 170 of the Code for amounts given the university out of earnings and profits that were labeled 'contributions.' Although the university was not a shareholder of and exercised no control over the taxpayer, the business property and profits of the taxpayer were distributable only to the university which was therefore deemed to be the beneficial owner of the taxpayer. Thus, pursuant to the rationale of Crosby Valve and Gage Company v. Commissioner the amounts given to the university were held to be dividends under section 316(a) of the Code.

Applying the rationale of these decisions a business corporation that is wholly owned, whether actually or beneficially, by an organization exempt under section 501(c)(3) of the Code as a charitable organization, is not entitled to a charitable contribution deduction for property transferred without consideration to its sole shareholder or beneficial owner.

Accordingly, the amounts transferred by Y, a taxable corporation, to its sole stockholder, Z, an organization exempt from Federal income tax under section 501(c)(3) of the Code as a charitable organization, are distributions defined as dividends in section 316(a) of the Code and are not deductible as charitable contributions under section 170 of the Code.