

FEDERAL TAX INCENTIVES

Tax incentives make food donation more cost effective and economically beneficial. The federal government recognizes the importance of food donation and provides tax incentives to incentivize businesses to donate food. These federal incentives have been extraordinarily successful in motivating food donation. After the incentives were temporarily expanded to cover more businesses in 2005, food donations across the country rose by 137% in 2006. With the passage of the Protecting Americans from Tax Hikes (PATH) Act² in December 2015, all businesses — including C-corporations, S-corporations, limited liability corporations (LLCs), partnerships, and sole proprietorships — are eligible for an enhanced tax deduction for donations that meet certain eligibility criteria. If the donated food does not meet the criteria, they can still claim a general tax deduction in the amount of the property's basis.

HOW ARE THE TAX INCENTIVES CALCULATED?

General (non-enhanced) tax deduction: Businesses that donate inventory may claim a tax deduction in the amount of the property's basis, which is usually its cost to the business and is often lower than the fair market value, which is the value at which goods can be sold. Businesses other than C-corporations — including S-corporations, sole proprietorships, and some LLCs — cannot deduct more than 30% of the business' total taxable income each year. C-corporations generally cannot deduct more than 10% of their taxable income for the year.

Enhanced tax deduction: The enhanced tax deduction provides an extra incentive for donation by allowing the donating business to deduct the lesser of (a) twice the basis value of the donated food or (b) the basis value of the donated food plus one-half of the food's expected profit margin (if the food were sold at its fair market value). Under the enhanced deduction, all businesses may deduct up to 15% of their taxable income for food donations.

Example: A grocery store donates potatoes with a fair market value of \$100. The basis value of these potatoes was \$30. The expected profit margin is the fair market value minus the basis value (\$100-\$30), which is \$70. Under the enhanced deduction, the grocery store is eligible to deduct the smaller of:

$$1. \text{Basis Value} \times 2 = \$30 \times 2 = \$60$$

or

$$2. \text{Basis Value} + (\text{expected profit margin}/2) = \$30 + (\$70/2) = \$65$$

The enhanced deduction would be \$60, which is substantially higher than the general deduction (the \$30 basis value).

Businesses that do not account for inventories and are not required to capitalize indirect costs have the option to calculate the basis value at 25% of the products' fair market value.

Businesses also have the option to calculate the fair market value of certain products — i.e., those that cannot be sold because of failure to meet internal standards, lack of a market, or similar reasons — by using the price of the same or substantially similar, saleable food items.

HOW CAN A DONATING BUSINESS KNOW IF IT IS ELIGIBLE FOR A TAX DEDUCTION?

General tax deduction requirements: In order for a charitable contribution to qualify for a federal tax deduction, the donation must be used for charitable purposes and given to a qualified organization as laid out under section 170 of the Internal Revenue Code (IRC).

Enhanced tax deduction requirements: In order to qualify for the enhanced tax deduction, donated food must meet the following criteria:

- The recipient must be a qualified 501(c)(3) not-for-profit as defined by the IRC;
- The recipient must use the donated food in a manner consistent with the purpose constituting that organization's exempt status under IRC 501(c)(3), which means that the donated food must be used exclusively for charitable purposes;
- The food must be used for the care of the ill, needy, or infants;
- The food may not be transferred by the recipient organization in exchange for money, other property, or services; however, the recipient organization may charge another organization a nominal amount for "administrative, warehousing, or other similar costs."

Example: If a business donates food to a food bank (the recipient organization), the food bank may not charge a soup kitchen for the donated food, and the soup kitchen may not charge the individuals eating at the soup kitchen. The food bank can, however, charge the soup kitchen a nominal fee for reimbursement of the costs of storing the food in a warehouse;

- The donating business must receive a written statement from the recipient organization. The statement must describe the contributed property and represent that the property will be used in compliance with the requirements outlined above; and
- The donated property must satisfy the requirements of the Federal Food, Drug, and Cosmetic Act (FDCA) at the time of donation and for the preceding 180 days. For food that did not exist for 180 days prior to donation, this requirement is satisfied if the food was in compliance with the FDCA for the period of its existence and at donation, and any similar property held by the donor during the 180 days prior to donation was also held in compliance with the FDCA.

More information about whether a food donor is eligible to receive the enhanced deduction can be found in the Federal Enhanced Tax Deduction for Food Donation: A Legal Guide¹³, created by the Harvard Law School Food Law and Policy Clinic and the Food Recovery Project at University of Arkansas School of Law.

RECOMMENDATIONS FOR STRENGTHENING FEDERAL POLICY

The 2015 changes to the enhanced tax deduction took a significant step to incentivize donations, but there are additional ways to further improve the federal tax incentives available for food donations. The suggestions put forth by Natural Resources Defense Council and the Harvard Law School Food Law and Policy Clinic would require Congressional action.

- 1. Federal tax incentives should be expanded to include an alternative tax credit that can be used by low-margin businesses, like many farms, in lieu of the enhanced deduction.**
- 2. Federal tax incentives should be strengthened by adding a deduction or credit specifically to cover the cost of transporting donated food.**
- 3. Congress should foster the development of innovative, sustainable food recovery models by repealing the “no-charge” provision that does not allow the enhanced deduction to be claimed if donated food is “transferred by the donee in exchange for money, other property, or services.”**
- 4. Congress should amend the enhanced deduction to only require compliance with safety standards and safety-related labeling Food, Drug, and Cosmetic Act requirements.**

RESOURCES

Harvard Law School’s Food Law and Policy Clinic and the University of Arkansas School of Law’s LL.M. Program in Agricultural & Food Law published the Federal Enhanced Tax Deduction for Food Donation, A Legal Guide (<http://www.chlpi.org/wp-content/uploads/2013/12/Food-Donation-Fed-Tax-Guide-for-Pub-2.pdf>), which provides an in-depth guide to the federal enhanced tax deduction.