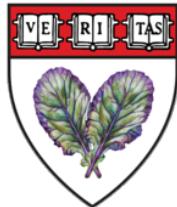


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TAX DEDUCTION FOR food DONATION *a legal guide*



Harvard
Food Law and Policy Clinic

A Division of the Center for Health Law and Policy Innovation

food
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APRIL 2016

This guide was written by attorneys in the Harvard Food Law & Policy Clinic (FLPC), including Kelliann Blazek, Ona Balkus, & Emily Broad Leib, Director of the FLPC; Nicole Civita, Director of the Food Recovery Project at University of Arkansas School of Law; & Michelle Maley, Kelly Nuckolls & Susan Zhu, law students in the FLPC.



A division of the Center for Health Law & Policy Innovation, the Food Law and Policy Clinic is an experiential teaching program of Harvard Law School that links law students with opportunities to serve clients & communities working on various food law & policy issues. The Clinic strives to increase access to healthy foods, assist small and sustainable farmers in breaking into new commercial markets, and reduce waste of healthy, wholesome food.

[@HarvardFLPC](http://www.chlpi.org/flpc)

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Affiliated with the University of Arkansas School of Law's LL.M. Program in Agricultural & Food Law, the Food Recovery Project translates the laws pertaining to food recovery into understandable & actionable terms & educates diverse stakeholders on low-risk, high benefit ways to reduce food waste. The FRP also promotes the development of food conservation policy through careful analysis of existing laws, practices, and norms.

[@ConserveFood](http://law.uark.edu/foodrecovery)



This updated version of this guide reflects significant changes to federal tax law enacted in December 2015. The initial version of this guide was published in November 2015 and is now out-of-date.

Introduction

An estimated 40 percent of food produced in the United States goes uneaten.¹ American consumers waste 160 billion pounds of food each year;² food is also wasted on farms and in stores, schools, and restaurants.³ At the same time, 14 percent of U.S. households are food insecure at some point during the year. Diverting a fraction of the wholesome food that currently goes to waste in this country could effectively end food insecurity for all Americans. Farms and food businesses can play a key role by donating more food to organizations that serve those in need.

The federal government has recognized the importance of food donation and provides tax deductions to incentivize businesses to donate food.⁴ As of December 2015, all businesses—including C-corporations, S-corporations, limited liability corporations (LLCs), partnerships, and sole proprietorships—are eligible for an enhanced tax deduction that exceeds the property's basis for donated food.⁵ Businesses that are eligible for the enhanced tax deduction must meet certain requirements to receive the enhanced deduction. Businesses that do not meet these requirements, and therefore cannot claim the enhanced deduction, can still claim a general tax deduction for donating property, including food, in the amount of the property's basis.⁶

This guide provides an overview of the general federal tax deductions available for businesses that donate food, explains how the enhanced deduction is calculated, and reviews the additional requirements for businesses to receive this enhanced tax deduction.

Who can receive federal tax incentives for food donations?

U.S. taxpayers can receive a variety of tax incentives in the form of tax credits or tax deductions. While a tax credit is a direct reduction in the amount of taxes owed, a tax deduction is a reduction of the taxpayer's taxable income,⁷ which is used to calculate the amount of taxes owed.

Since the 1969 Tax Reform Act, taxpayers who donated ordinary income property (property that could have provided additional income to the donor, such as food products) can file for a tax deduction in the amount of the property's basis.⁸ The basis is the amount the business paid for the product or the cost of producing it and is generally lower than the fair market value of the product.⁹ A donating business' total annual

charitable deductions are capped at different rates, depending on what type of business makes the donation. C-corporations generally cannot deduct more than 10% of their taxable income for the year.¹⁰ Businesses that are not C-corporations—including S-corporations,¹¹ sole proprietorships,¹² and certain LLCs¹³—generally cannot deduct more than 30% of the business' total taxable income each year.¹⁴



In order for a charitable contribution to qualify for a general 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 (I.R.C.).¹⁵ In 1976, Congress amended the Tax Reform Act to give C-corporations an enhanced tax deduction for certain contributions, including food donations, made to public charities.¹⁶

As described in more detail below, the enhanced deduction allows a donor to value the donation at the lesser of either (a) twice the basis or (b) the basis plus one-half the expected profit margin of the donated food, either of which is generally significantly higher than the property's basis. In the wake of Hurricane Katrina in 2005, Congress passed the Katrina Emergency Tax Relief Act (KETRA), broadening eligibility for enhanced tax deductions for food donations to all businesses regardless of corporate form, rather than limiting it to C-corporations.¹⁷ Congress temporarily extended this broader eligibility multiple times after KETRA,¹⁸ but the most recent extension expired on December 31, 2014.¹⁹ However, after a decade of temporary extensions to non-C-corporations, the enhanced deduction was permanently expanded to include all businesses in December 2015.²⁰



Where should an eligible business donate food in order to receive the enhanced tax deduction?



To receive the enhanced tax deduction, an eligible business must meet three main requirements:

(1) The donor organization must donate food to qualified domestic 501(c)(3) nonprofit organizations that use the food solely for the care of the ill (those requiring medical care), the needy (those lacking necessities of life as a result of poverty or temporary distress), or infants (a minor child, as determined by local law).²¹ Private non-operating foundations are not qualified recipients.²²

(2) The recipient organization must use the donated food in a manner consistent with the purpose constituting that organization's exempt 501(c)(3) status, which means that the donated food must be used exclusively for one of the three authorized charitable purposes.²³

(3) The recipient organization may not use or transfer the food “in exchange for money, other property, or services.”²⁴ There is an exception to this requirement if the recipient organization charges another organization an amount that is “small or nominal in relation to the value of the transferred property and is not determined by this value” and “designed to reimburse the [recipient] organization for its administrative, warehousing, or other similar costs.”²⁵ For instance, a food bank is allowed to charge a soup kitchen a nominal fee to cover the costs of storing the food in the food bank’s warehouse or transporting it to the soup kitchen. Notably, this exception does not apply when an organization is distributing food to low-income individuals; those individuals cannot pay even a nominal fee for the food.



What does an eligible business need to receive from the recipient organization to claim the enhanced tax deduction?

Businesses claiming the enhanced tax deduction for donating food must receive a written statement from the recipient organization. This statement must include:²⁶

- (1) A description of the contributed property, including the date of its receipt;
- (2) A statement that the property will be used in compliance with the requirements of I.R.C. 170(e)(3) as described above;
- (3) A statement that the recipient organization is recognized as exempt from federal income tax under I.R.C. 501(c)(3); and
- (4) A statement that adequate books and records will be maintained and made available to the Internal Revenue Service upon request.



What food quality standards must an eligible business meet to receive the enhanced tax deduction for its donation?

Food donations must satisfy all applicable requirements of the federal Food, Drug & Cosmetic Act (FDCA) at the time the contribution was made, as well as for 180 days preceding the contribution.²⁷

For example, food may not be adulterated or misbranded.²⁸ 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 the time of donation, and any similar food held by the donor during the 180 days prior to donation was held in compliance with the FDCA.²⁹

Example: A grocery store donates 12 crates of orange juice cartons that were stored in the grocery store two weeks before the time of donation. These orange juice cartons must have been in compliance with the FDCA during those two weeks and at the time of donation, and all of the orange juice cartons in stock at the grocery store during the previous 180 days must have been in compliance with the FDCA.³⁰



How is the enhanced tax deduction calculated?

The enhanced tax deduction allows eligible businesses 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 (i.e., the profit margin the donor would expect to capture if the food were sold at its fair market value).³¹

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. Basis Value x 2 = $\$30 \times 2 = \60
or
2. Basis Value + (expected profit margin/2) = $\$30 + (\$70/2) = \$65$

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

Beginning in 2016, businesses that do not account for inventories and are not required to capitalize indirect costs³² have the option to calculate the basis value at 25% of the products' fair market value, which is the value at which goods can be sold.³³ This allowance makes it easier for a broader range of businesses to take advantage of the enhanced deduction. For example, if a farm (that met both requirements above) donated apples with a fair market value of \$100, the farmer could choose to calculate the basis value of the apples at \$25 (\$100 x .25).

Also beginning in 2016, businesses have the option to calculate the fair market value of certain products that cannot or will not be sold by using the price of the same or substantially similar food items that are being sold by the business.³⁴ This provision includes:

- Products that do not meet internal standards, such as cosmetic blemishes or shape variations;
- Products where there is a lack of market, such as holiday items once the holiday has passed, and similar circumstances; and
- Products where the business produced the product exclusively for the purposes of donation.³⁵

This clarification makes it easier for businesses to calculate the value of their food donations and claim the enhanced deduction.



Examples: (1) If a grocery store had cranberries with a fair market value of \$100 the day before Thanksgiving, the grocery store could donate these cranberries the day after Thanksgiving and still calculate their fair market value as \$100. (2) If a farm grew an acre of crooked carrots that did not meet its distributor's cosmetic standards, they could donate those carrots and calculate their fair market value as \$150, provided that the fair market value for the same amount of straight carrots is \$150.

Lastly, beginning in 2016, the cap on the enhanced deduction will be increased. Going forward, an eligible business' total annual charitable deductions for food donations cannot exceed 15% of the business' taxable income for the year.³⁶ Businesses also may carry forward any excess donations beyond the 15% income limitation for up to five years,³⁷ such that businesses can receive future financial incentives if they max out on the deduction limit in a given year.

Note, however, that a non-C-corporation business can receive a total charitable deduction (for all food and other eligible donations) up to 30% of the business' taxable income for the year.³⁸ In contrast, a C-corporation's charitable deduction cannot exceed 10% of its taxable income, except when the corporation has donated food that can increase its deduction to up to 15%.³⁹

Example: If a C-corporation has made non-food charitable donations that earn a deduction of 10% of its taxable income, and food donations that earn a deduction of 7% of its taxable income, the corporation can only receive a deduction in the amount of 15% of its taxable income because it has exceeded the cap. In this example, the corporation could choose to carry forward the extra deduction of 2% (17%-15%) of its taxable income to the next year, and claim this deduction if it does not exceed the cap in that year.



Conclusion

The enhanced tax deduction provides important financial incentives for food donation, encouraging all eligible businesses to donate surplus food rather than dispose of it. As of December 2015, all businesses—including C-corporations, S-corporations, LLCs, partnerships, sole proprietorships, and other business entities—are eligible to receive an enhanced tax deduction for food donations.

To receive the enhanced deduction, eligible businesses should ensure that they are following all of the requirements described in this guide, including donating to charitable organizations and maintaining federal quality standards for their donated food.

In addition, a general tax deduction is available for those businesses not eligible for the enhanced deduction that donate food. In addition to federal tax deductions, food businesses should research tax incentives for food donation in their states. Several U.S. states provide additional tax incentives for food donation above the federal tax incentives. These can take the form of either tax deductions or tax credits, and they can provide additional economic support for food donation.

Businesses should be sure to understand the eligibility criteria for state tax incentives, as these might differ from the federal requirements outlined in this guide.

Endnotes

1. Dana Gunders, WASTED: HOW AMERICA IS LOSING UP TO 40% OF ITS FOOD FROM FARM TO FORK TO LANDFILL, NAT. RES. DEF. COUNCIL 6-14 (2012), available at <http://www.nrdc.org/food/files/wasted-food-ip.pdf>.
2. THE DATING GAME: HOW CONFUSING FOOD DATE LABELS LEAD TO FOOD WASTE IN AMERICA, HARVARD FOOD LAW AND POL'Y CLINIC & NAT. RES. DEF. COUNCIL 5 (2013), available at <http://www.chlpi.org/wp-content/uploads/2013/12/dating-game-report.pdf>.
3. Household Food Security in the United States in 2014, U.S. DEPT OF AGRIC. ECON. RESEARCH SERV. (last updated September 2015), <http://www.ers.usda.gov/publications/err-economic-research-report/err194.aspx>
4. Ronald Fowler & Amy Henchey, EXEMPT ORGANIZATIONS – CONTINUING PROFESSIONAL EDUCATION ARTICLES: IN-KIND CONTRIBUTIONS, INTERNAL REVENUE SERV. (1994), available at <http://www.irs.gov/pub/irs-tege/eotopic94.pdf>.
5. H.R. 2029, 114th Cong. § 113 (2015) (to be codified at I.R.C. § 170(e)(3)(C) (2016)).
6. I.R.C. § 170(e)(1) (2015), <http://www.law.cornell.edu/uscode/text/26/170>; Fowler & Henchey, supra note 4, at 2.
7. Elizabeth Rosen, Tax Credits v. Tax Deductions, U.S TAX CTR. (Aug. 28, 2013), <http://www.irs.com/articles/tax-credits-vs-tax-deductions>.
8. 26 C.F.R. 1.170A-4A(c)(2) (2016), available at <http://www.law.cornell.edu/cfr/text/26/1.170A-4A>.
9. Id. § 170(b)(2)(A).
10. Fowler & Henchey, supra note 4, at 2.
11. I.R.C. §§ 170(b)(1)(B)(i) 1363(b).
12. I.R.S., Sole Proprietorships, <https://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Sole-Proprietorships> (last visited Jan. 8, 2016); Id. § 170(b)(1)(B)(i).
13. I.R.S., Single Member Limited Liability Companies, <https://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Single-Member-Limited-Liability-Companies> (last visited Jan. 8, 2016). Whether an LLC will be treated as an individual for tax purposes—and hence be subject to the 30% total charitable contribution cap—depends on the number of members in the LLC. Id.
14. I.R.C. § 170(b)(1)(B)(i).
15. I.R.C. § 170(b), (c), (e)(3) (2015), <http://www.law.cornell.edu/uscode/text/26/170>.
16. I.R.C. § 170(e)(3) (2015), <http://www.law.cornell.edu/uscode/text/26/170>.
17. Katrina Emergency Tax Relief Act of 2005, Pub. L. No. 109-73, § 305, 119 Stat. 2016, 2025 (originally codified at I.R.C. § 170(e)(3)(C)).



Endnotes, continued

18. P.L. 109-280 § 1202 (Pension Protection Act of 2006 extended the deduction through December 31, 2007); Pub. L. 110-343 § 323 (Emergency Economic Stabilization Act of 2008 extended the deduction through December 31, 2009); Pub. L. 111-312 § 740 (Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended deduction through December 31, 2011); Pub. L. 112-240 § 314 (Taxpayer Relief Act of 2012 extended the deduction through December 31, 2013); Pub. L. 113-295 § 126 (Tax Increase Prevention Act of 2014 extended the deduction through January 1, 2015).

19. I.R.C. § 170(e)(3) (2015), <http://www.law.cornell.edu/uscode/text/26/170>.

20. H.R. 2029, 114th Cong. § 113 (2015) (to be codified at I.R.C. § 170(e)(3)(C) (2016))

21. I.R.C. § 170(e)(3)(A) (2015), <http://www.law.cornell.edu/uscode/text/26/170>; 26 C.F.R. 1.170A-4A(b)(2)(i) (2016), <http://www.law.cornell.edu/cfr/text/26/1.170A-4A>; see Fowler & Henchey, *supra* note 4, at 4.

22. 26 U.S.C.A. § 509(a) (West 2016) and 26 U.S.C.A. § 4942(j)(3) (West 2016), <http://uscode.house.gov/browse.xhtml>.

23. I.R.C. § 170(e)(3) (2014), available at <http://www.law.cornell.edu/uscode/text/26/170> (“... the property is to be used by the donee solely for the care of the ill, the needy, or infants.”)

24. 26 C.F.R. 1.170A-4A(b)(2)(i) (2016), <http://www.law.cornell.edu/cfr/text/26/1.170A-4A>; see I.R.C. § 170(e)(3) (2015), <http://www.law.cornell.edu/uscode/text/26/170> (“... the property is to be used by the donee solely for the care of the ill, the needy, or infants.”)

25. I.R.C. § 170(e)(3) (2015), <http://www.law.cornell.edu/uscode/text/26/170>; see also 26 C.F.R. 1.170A-4A(b)(4) (2016), <http://www.law.cornell.edu/cfr/text/26/1.170A-4A>.

26. 26 C.F.R. § 1.170A-4A(b)(4) (2016), <http://www.law.cornell.edu/cfr/text/26/1.170A-4A>.

27. *Id.*

28. Fowler & Henchey, *supra* note 4, at 5; I.R.C. § 170(e)(3)(A)(iv) (2015), <http://www.law.cornell.edu/uscode/text/26/170>.

29. See 21 U.S.C.A. § 331 (West 2016), <http://uscode.house.gov/browse.xhtml>.

30. 26 C.F.R. 1.170A-4A(b)(5)(i) (2016), <http://www.law.cornell.edu/cfr/text/26/1.170A-4A>.

31. 26 C.F.R. 1.170A-4A(b)(5)(i) (2016), <http://www.law.cornell.edu/cfr/text/26/1.170A-4A>.

32. I.R.C. § 170(e)(3)(B) (2015), <http://www.law.cornell.edu/uscode/text/26/170>.

33. *Id.* (to be codified at I.R.C. § 170(e)(3)(C)(iv)(I), (II) (2016)).

34. *Id.* (to be codified at I.R.C. § 170(e)(3)(C)(iv) (2016)).

35. See H.R. 2029, 114th Cong. § 113 (2015) (to be codified at I.R.C. § 170(e)(3)(C)(v) (2016)).

36. *Id.*

37. H.R. 2029, 114th Cong. § 113 (2015) (to be codified at I.R.C. § 170(e)(3)(C)(ii)(I) (2016)); An eligible business’ charitable deduction for food donations made prior to 2016 cannot exceed 10% of the business’ taxable income for the year.

38. H.R. 2029, 114th Cong. § 113 (2015) (to be codified at I.R.C. § 170(e)(3)(C)(iii)(I) (2016)).

39. I.R.C. § 170(b)(1)(B)(i) (2015), <http://www.law.cornell.edu/uscode/text/26/170>.





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