

Legal Fact Sheet for Massachusetts Food Donation: Tax Incentives for Businesses – January 2016

Federal tax incentives provide important financial incentives that make food donation more cost-effective and economically beneficial. These tax incentives have been extraordinarily successful in motivating food donation; after federal tax incentives for food donations were temporarily expanded to cover more businesses in 2005, food donations across the country rose by 137% in 2006.¹ At the end of 2015, Congress made the expansion permanent,² providing all businesses with an added incentive to increase food donations and prevent food waste.

While federal tax incentives may be augmented by state-level tax incentives in some states,³ Massachusetts has no such state-level policy. Therefore, Massachusetts businesses are only eligible for federal tax incentives, which are available in the form of a general or enhanced tax deduction. This guide will discuss both types of tax incentives.

How are the tax incentives calculated?

General (non-enhanced) tax deduction: In general, 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 of the property,⁴ which is the value at which goods can be sold.⁵ C-corporations generally cannot deduct more than 10% of their taxable income for the year.⁶ Businesses that are not C-corporations—including S-corporations,⁷ sole proprietorships,⁸ and some LLCs⁹—cannot deduct more than 30% of the business' total taxable income each year.¹⁰

Enhanced tax deduction: The enhanced tax deduction allows 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 (i.e., the profit margin the donor would expect to capture if the food were sold at its fair market value).¹¹ Under the enhanced deduction, all businesses may deduct up to 15% of their taxable income for food donations.¹²

Beginning in 2016, businesses that do not account for inventories and are not required to capitalize indirect costs¹³ have the option to calculate the basis value at 25% of the products' fair market value.¹⁴ 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.¹⁵

¹ *Feeding America Urges Swift Vote On Expired Tax Provisions*, FEEDING AM. (June 8, 2012), <http://www.feedingamerica.org/hunger-in-america/news-and-updates/press-room/press-releases/feeding-america-urges-swift-vote-on-expired-tax-provisions.html>.

² See H.R. 2029, 114th Cong. § 113 (2015) (to be codified at I.R.C. § 170(e)(3)(C) (2016)).

³ Arizona, California, Colorado, Iowa, Kentucky, Missouri, and Oregon have tax incentives specifically for food donation. California law also provides a tax credit for 50% of the costs of transporting donated food. See, e.g., Cal. Rev. & Tax. Code § 17053.12 (2015). South Carolina provides a tax credit for licensed meat packers, butchers, or processing plants that contract with charitable organizations to process deer for eventual donation to needy clients. See S.C. Code Ann. § 12-6-3750 (2015).

⁴ See I.R.C. § 170(e)(1); *Charitable Contributions: For Use in Preparing 2014 Tax Returns*, I.R.S., DEP'T OF THE TREASURY, Jan. 13, 2015, at 11, <http://www.irs.gov/pub/irs-pdf/p526.pdf> (noting the amount of the deduction is the fair market value minus the amount of income gained had the product been sold at fair market value).

⁵ RONALD FOWLER & AMY HENCHEY, EXEMPT ORGANIZATIONS – CONTINUING PROFESSIONAL EDUCATION ARTICLES: IN-KIND CONTRIBUTIONS, INTERNAL REVENUE SERV. 8 (1994), <http://www.irs.gov/pub/irs-tege/eotopice94.pdf>.

⁶ I.R.C. § 170(b)(2)(A) (2015), <https://www.law.cornell.edu/uscode/text/26/170>.

⁷ See I.R.C. §§ 1363(b), 170(b)(1)(B)(i).

⁸ 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).

⁹ 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.*

¹⁰ I.R.C. § 170(b)(1)(B)(i).

¹¹ See *id.* § 170(e)(3)(B); 26 C.F.R. § 1.170A-4A(b)(4) (2015).

¹² H.R. 2029, 114th Cong. § 113 (to be codified at I.R.C. § 170(e)(3)(C)(ii) (2016)).

¹³ See *id.* (to be codified at I.R.C. § 170(e)(3)(C)(iv)(I), (II) (2016)).

¹⁴ See *id.* (to be codified at I.R.C. § 170(e)(3)(C)(iv) (2016)).

¹⁵ See *id.* (to be codified at I.R.C. § 170(e)(3)(C)(v) (2016)).

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:

- (a) *Basis Value x 2 = \$30 x 2 = \$60, or*
- (b) *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.

What restrictions and requirements are there on tax deductions for food donations?

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).¹⁶

Enhanced tax deduction requirements: In order to qualify for the enhanced tax deduction, a business must donate to a recipient organization that meets several criteria. First, the recipient must be a qualified 501(c)(3) not-for-profit as defined by the IRC.¹⁷ Additionally, the donor and recipient must adhere to the following guidelines:¹⁸

(A) 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;

(B) The food must be used for the care of the ill, needy, or infants;

(C) 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."¹⁹ For 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;²⁰

(D) The donating business must receive a written statement from the recipient organization.²¹ The statement must describe the contributed property and represent that the property will be used in compliance with the requirements outlined above;²² and

(E) 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.²³ 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.²⁴

Conclusion

There is no Massachusetts tax incentive for food donations; however, Massachusetts businesses are eligible for federal incentives. As of 2015, all businesses are eligible for the general and enhanced tax deductions for food donations.

¹⁶ See I.R.C. § 170(b),(c), (e)(3)(c).

¹⁷ See *id.* § 170(e)(3).

¹⁸ 26 C.F.R. § 1.170A-4A(b).

¹⁹ *Id.* § 1.170A-4A(b)(3).

²⁰ *Id.*

²¹ I.R.C. § 170(e)(3)(iii).

²² *Id.*

²³ *Id.* § 170(e)(3)(iv).

²⁴ 26 C.F.R. § 1.170A-4A(b)(5).