

Legal Fact Sheet for Food Donation in Tennessee: Tax Incentives

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Tax incentives make food donation more cost effective and economically beneficial for donors. Federal tax incentives have been highly successful in motivating food donation. For instance, prior to 2015, federal tax incentives for food donations were limited to C-corporations.¹ After the incentives were temporarily expanded to cover more businesses in 2005 in response to Hurricane Katrina, food donations across the country rose by 137% in 2006.² Congress subsequently made the expansion permanent in 2015,³ providing all businesses with added incentive to increase food donations and prevent food waste. That includes many independent restaurants, small grocery chains, smaller farms and other businesses that are not C-corporations.

While some states have enacted state-level tax incentives,⁴ Tennessee has no such state-level policy. Therefore, Tennessee businesses are only eligible for federal tax incentives, which are available in the form of general and enhanced tax deductions. This legal fact sheet discusses both types of deductions.

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 cost basis, which is usually its cost to the business and is often lower than the fair market value,⁵ which is the value at which goods can be sold.⁶ Businesses other than C-corporations—including S-corporations,⁷ sole proprietorships,⁸ and some LLCs⁹—cannot deduct more than either 30% or 50% of the business' total taxable income each year, depending on the type of organization to which the business is donating.¹⁰ C-corporations generally cannot deduct more than 10% of their taxable income for the year.¹¹

Enhanced tax deduction: The enhanced tax deduction provides an extra incentive for donation of food 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).¹² Under the enhanced deduction, all businesses may deduct up to 15% of their taxable income for food donations.¹³

Example: A grocery store donates potatoes with a fair market value of \$100. The basis value of these potatoes was \$30. The expected profit from selling the food 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) $\text{Basis Value} \times 2 = \$30 \times 2 = \$60$, *or*
- (b) $\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 costs¹⁴ have the option to calculate the basis value at 25% of the products' fair market value.¹⁵ Businesses also have the option to calculate the fair market value of certain products—e.g., 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.¹⁶ This approach is often most appropriate for farms and other smaller businesses that are not using the cost method of accounting.

How can a donating business know if they are 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).¹⁷

Enhanced tax deduction requirements: In order to qualify for the enhanced tax deduction, a business must donate to a recipient organization that meets the following criteria:¹⁸

- 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."¹⁹

*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 or transporting it.*²⁰

- 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
- The donated food 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 the date of donation. In addition, if the donating business owns any other food during the 180-day period that is comparable with the contributed food, that food must also be FDCA compliant.

Conclusion

There is no Tennessee state-level tax incentive for food donation. However, Tennessee businesses are eligible for federal tax incentives. As of 2015, all businesses are eligible for the general and enhanced tax deductions for food donations.

¹ See I.R.C. § 170(e)(3)(C) (2016), <https://www.law.cornell.edu/uscode/text/26/170>.

² *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>.

³ See H.R. 2029, 114th Cong. § 113 (2015) (to be codified at I.R.C. § 170(e)(3)(C) (2017)).

⁴ States with tax incentives for food donation include: Arizona, see *Ariz. Rev. Stat. Ann.* §§ 42-5074, 43-1025 (West 2016); California, see *Cal. Rev. & Tax Code* §§ 17053.12, 17053.88 (West 2016); Colorado, see *Colo. Rev. Stat. Ann.* § 39-22-301 (West 2016); Iowa, see *Iowa Code* §§ 190B.101–190B.106, 422.33(30) (West 2016); Maryland, see *Md. Tax-Gen. Code Ann.* § 10-745 (West 2018); Missouri, see *Mo. Rev. Stat.* § 135.647 (West 2016); New York, see *N.Y. Tax* § 210-B(52) (McKinney 2018); Oregon, see *Or. Rev. Stat.* §§ 315.154, 315.156 (West 2016); South Carolina, see *S.C. Code Ann.* § 12-6-3750 (West 2016); Virginia, see *Va. Code Ann.* § 58.1-439.12:12 (West 2016); and West Virginia, see *W. Va. Code* § 11-13DD (West 2017). 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 (2016).

⁵ 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).

⁶ 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>.

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

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)(A).

¹¹ *Id.* § 170(b)(2)(A).

¹² See *id.* § 170(e)(3)(B); 26 C.F.R. § 1.170A-4A(b)(4) (2017).

¹³ I.R.C. § 170(e)(3)(C)(ii) (2016).

¹⁴ *Id.* § 170(e)(3)(C)(iv)(I), (II).

¹⁵ *Id.* § 170(e)(3)(C)(iv).

¹⁶ *Id.* § 170(e)(3)(C)(v).

¹⁷ See I.R.C. § 170(b)(c), (e)(3)(c).

¹⁸ I.R.C. § 170(b)(c), (e)(3)(c); 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).