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Harvard Food Law and Policy Clinic
A Division of the Center for Health Law and Policy Innovation

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.

http://www.chlpi.org/FLPC
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food recovery project
UNIVERSITY OF ARKANSAS

Affiliated with the University of Arkansas School of Law’s LLM 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.

http://law.uark.edu/foodrecovery
@ConserveFood
Introduction

An estimated 40 percent of food produced in the United States goes uneaten. American consumers waste 160 billion pounds of food each year; food is also wasted on farms and in stores, schools, and restaurants. At the same time, almost 15 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. Under current federal law, businesses that donate property, including food, may claim a general tax deduction in the amount of the property’s basis. One type of business, C corporations, may claim an enhanced tax deduction that exceeds the property’s basis for donating certain property, including food.

Those businesses eligible for the enhanced tax deduction must meet certain requirements to receive the enhanced deduction that are not necessary to receive the general tax deduction. This guide first provides an overview of federal tax deductions available for businesses that donate food, and then explains the additional requirements that C corporations must meet to receive the 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, 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. The basis is the amount the business paid for the product or the cost of producing the product. The basis is generally lower than the fair market value of the product. With very limited exceptions, a donating business’ total annual charitable deductions cannot exceed 10% of the business’ taxable income for the year.
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 (I.R.C.) 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. 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. This provision is included in I.R.C 170(e)(3) as a permanent part of the tax code, meaning it does not need to be reauthorized by Congress.

Within the food industry, C corporations are generally retailers, restaurants, and food manufacturers; many small businesses choose not to incorporate as C corporations.

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. Congress extended this broader eligibility multiple times after KETRA but the most recent extension expired on December 31, 2014. While at the time of this publication the enhanced tax deduction is only available to C corporations, Congress could retroactively reauthorize this extension as it has done in the past. Further, some members of Congress have made efforts to make this broadened eligibility a permanent part of the tax code.

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). Private non-operating foundations are not qualified recipients.

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.
(3) The recipient organization may not use or transfer the food “in exchange for money, other property, or services.” 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.” 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:

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 Food, Drug, and Cosmetic Act (FDCA) at the time the contribution is made as well as for 180 days before the contribution. For example, food may not be adulterated or misbranded. 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.

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.

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. An eligible business’ total annual charitable deductions cannot exceed 10% of the business’ taxable income for the year.

Example: A grocery store donates potatoes with a fair market value (FMV) of $100. The basis value of these potatoes, or the cost that the grocery store paid to acquire them, was $30. The expected profit margin is the FMV 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  
(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.
Conclusion

The enhanced tax deduction provides important financial incentives for food donation, encouraging eligible businesses to donate surplus food rather than dispose of it. Currently, only C corporations are eligible for the enhanced tax deduction, while other businesses are only eligible for a general tax deduction. Yet businesses other than C corporations should stay abreast of actions by Congress that could retroactively extend the enhanced deduction to all businesses, or make this extension a permanent part of the tax code. 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 consistent quality standards for their donated 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 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.

This publication is for information only; it does not contain legal advice. It is not intended to create, and receipt of it does not constitute, a lawyer-client relationship. Please consult an attorney licensed in your jurisdiction for advice regarding the subject matter addressed herein.
Endnotes


x. FOWLER & HENCHEY, supra note iv, at 2.


xiv. FOWLER & HENCHEY, supra note iv, at 1.


Endnotes, continued


FEDERAL ENHANCED TAX DEDUCTION FOR FOOD DONATION

a legal guide