







Food Donations Benefit Both Donor and Donee

Your company can make a measurable impact through charitable giving of food to hunger-relief organizations. The contribution of food may also result in an enhanced tax deduction for your company, which may change the return on investment analysis for contributions vs. other methods of disposition.

This brochure describes the tax impact of the enhanced deduction for donations of food inventory for tax years beginning after December 31, 2017.

Benefits for Taxpayers that Donate Food

General rule

The Internal Revenue Code ("IRC") generally allows taxpayers a deduction for charitable contributions equal to the lesser of the donor's adjusted tax basis ("ATB") in the food or the fair market value ("FMV") of such food. The ATB is the inventoriable carrying cost assigned to the donated food, generally meaning the direct costs plus any indirect costs required to be allocated to the food. The FMV is generally the price that the taxpayer would have received if the food was sold in the usual market.

Enhanced deduction

A special rule allows an enhanced charitable contribution deduction for donations of food to a qualified organization for the care of the ill, the needy, or infants. The amount of this enhanced deduction is equal to the ATB of the food plus one-half of the built-in gain (i.e., the difference between the ATB and the FMV of the contributed food), but the total deduction may not exceed twice the ATB of the food.

For example, a food manufacturer has excess food with an ATB of \$30 and a FMV of \$50. The manufacturer has the opportunity to donate the food to a qualified domestic charity. The manufacturer would be entitled to an enhanced charitable contribution deduction of \$40 (\$10 of which would be a permanent difference between book and tax), calculated as follows:

Donation of Food

FMV	50
ATB	30
Enhanced Deduction	40
Blended Federal & State Tax Rate	x 25%
After-Tax Value of Charitable Deduction	10

Percentage Limitations

In general, C corporations are allowed to deduct charitable contributions to the extent they do not exceed 10 percent of the corporation's taxable income for the year. Individuals generally are limited to 50 percent of their adjusted gross income for certain charitable contributions made to qualified public charities during the year.

For tax years beginning after December 31, 2015, charitable contributions of food are subject to an increased limitation of 15 percent of taxable income for C corporations and 15 percent of aggregate net income from all trades or business from which such charitable contributions of food were made for individuals through direct ownership of the trade or business, or through an investment in a partnership and/or S corporations.

The general limitations for contributions of non-food inventory are reduced by the amount of charitable contributions of food. If the aggregate amount of the charitable contribution exceeds the limitation, the excess is treated as a charitable contribution in each of the five succeeding taxable years.

FMV Safe Harbor

If a taxpayer donates “apparently wholesome food” that it otherwise would not sell by reason of its own internal standards, lack of market, or similar circumstances, the FMV of that food can be determined by taking into account the price at which the same or substantially the same food items are sold by the taxpayer at the time of the contribution (or, if not sold at such time, in the recent past).

ATB Safe Harbor

For charitable contributions of food inventory, if the taxpayer does not account for inventories under I.R.C. § 471 and is not required to capitalize costs of inventory under I.R.C. § 263A which would otherwise provide the taxpayer with an identifiable ATB, the taxpayer may elect to treat the ATB as 25 percent of the FMV of the “apparently wholesome food.”

Considerations for the Retail/Grocery/
Food Service Industry

Appropriate Valuation of Donated Food
Valuation of food requires special consideration as food may naturally spoil and deteriorate with time. As a general rule, the FMV of donated food is the price that the taxpayer would have received if the food had been sold in the market the taxpayer customarily sells the food (at the time and in the place and quantity contributed). However, if a contribution is made of food for which the taxpayer could not reasonably have expected to realize its usual selling price, the donated food must be valued in light of any restriction or conditions limiting its marketability.

Timing Considerations

Consideration should be given to the effect of timing on the FMV. A short delay in the timing of a donation could have a substantial impact on after-tax cash value if the FMV of the food declines. It is advantageous for companies to donate in the present food that they know will go unsold, rather than waiting until just before the expiration date, thereby taking advantage of the higher current FMV for purposes of computing their enhanced deductions, rather than the reduced FMV of the food if donated just before expiration.

Choice of Charitable Deduction Under
General Rules or Enhanced Deduction

There may be circumstances where it is advantageous to apply the general rules for charitable contributions of inventory instead of the special enhanced deduction rules. For example, a corporation donating food produced during the current year with a FMV less than its ATB is allowed to recover the ATB of the food as cost of goods sold under the general rules without regard to the 15 percent limitation. In contrast, under the enhanced deduction rules, the corporation would recover the FMV of the food as an I.R.C. § 170 deduction subject to the 15 percent limitation and would recover the built-in loss as cost of goods sold. IRS Notice 2008–90 allows a taxpayer to choose which set of rules to apply on a contribution-by-contribution basis.

Other Considerations

In addition, the decision to sell, donate, or dispose of food may be influenced by other factors, including avoiding costs such as:

- Storage costs: The occupancy and overhead associated with storing food.
- Selling costs: The costs incurred in the process of selling food, including marketing and promotional costs.
- Transportation costs: The costs incurred to ship the food to customers. Many charitable organizations are able to pick up donations at the business site.
- Disposal costs: The costs incurred to dispose of food, for example, at landfills.

Considerations for the Produce/
Agriculture Industry

Farmers often are on the cash receipts and disbursements method of accounting for tax and, therefore, do not account for inventory. Under the ATB Safe Harbor, such farmers can now claim an enhanced deduction, illustrated as follows:

Donation by Cash Basis Farmer	
FMV	40
ATB	10
Enhanced Deduction	20
Blended Federal and State Tax Rate	x 25%
After Tax Value of Charitable Deduction	5



Considerations for the Manufacturing Industry

Enhanced Deduction for Off-Spec Food

Before 2016, a taxpayer donating “off-spec” food, or food that qualifies as apparently wholesome food but is not held for sale in the ordinary course of business, usually due to internal quality standards, had difficulty determining FMV due to a lack of substantial sales of the product. Further, without a FMV, it was also difficult for the taxpayer to determine ATB. Without FMV or ATB, it was difficult to calculate an enhanced deduction.

A new FMV Safe Harbor provides a method for determining the FMV of off-spec food without needing substantial sales and, therefore, a taxpayer may be able to use the joint product method of accounting to attribute an ATB to the food, thereby qualifying the donated food for the enhanced charitable contribution deduction. It is recommended that a taxpayer file an advanced consent Form 3115, Application for Change in Accounting Method, to change its method of accounting for inventory to allow for the joint product method.

The following examples highlight these different inventory costing accounting methods:

Byproduct Costing Method			
Primary Product Sold		Off-Spec Product Donated	
FMV	100	FMV	50
ATB	(60)	ATB	0
Taxable Income	40	Enhanced Deduction	0
Tax (25% Rate)	(10)	Tax Saved (25% Rate)	0
Income After Taxes	30	Income After Taxes	0
Total Income After Tax			30

Joint Product Costing Method

Primary Product Sold		Off-Spec Product Donated	
FMV	100	FMV	50
ATB	(40)	ATB	(20)
Taxable Income	60		
		Enhanced Deduction	35
Net Taxable Income (60–35)			25
Tax (25% Rate)			(6.25)
Total Income After Tax*			33.75

*The Joint Product Costing Method results in an additional after tax benefit of \$3.75 compared to the Byproduct Costing Method (\$33.75 vs. \$30.00).

Substantiation Requirements

Companies making a donation of food should maintain the following supporting documentation:

- Name and address of donee organization;
- A detailed description of the food;
- Date of charitable contribution;
- FMV of the food on the date the charitable contribution was made;
- The method used in determining FMV; and
- ATB of the food (direct and indirect costs)

To claim the enhanced deduction, taxpayers are required to obtain from the donee organization a written statement representing that the donated food will be used solely for the care of the ill, the needy, or infants. This written statement must be obtained by the donor no later than the date the taxpayer is required to file its federal income tax return for the year in which the contribution is made.

Part Sale & Part Donation

A charity may be willing to pay taxpayers an amount necessary to make up a portion of the difference between the revenue that a taxpayer would receive on the secondary market and the value of any tax deduction available to the taxpayer upon the charitable contribution of the food. A charity may also be willing to pay taxpayers the processing costs to enable the food to be donated.

The taxpayer will still be eligible for the enhanced charitable contribution deduction in these situations; however, the taxpayer's charitable contribution deduction would be reduced, because a portion of the transaction would be treated as a bargain sale. Effectively, the transaction is treated as two transactions: (1) the sale or exchange of a portion of the food, and (2) a charitable contribution of a portion of the food, as illustrated by the following example:

Part Sale/Part Donation			
Portion Treated as Sale (10%)		Portion Treated as Donation (90%)	
FMV	10	FMV	90
ATB*	(6)	ATB*	(54)
Sale Revenue	10		
COGS Deduction	(6)		
		Enhanced Deduction	(72)
Taxable Income	4	Taxable Income	(72)
Tax (25% Rate)	(1)	Tax Saved (25% Rate)	18
Total Income After Tax (10–1)	9	Total Income After Tax	18
Total Income After Tax (Taking Into Account Both the Sale and the Donation)			27

*For purposes of this example, we assumed the \$60 of ATB incurred was a sunk cost that does not factor into the Total Income After Tax.

Executive Summary

Key Concept	Current Law
Calculation of the enhanced deduction for charitable contributions of food	ATB (defined below) of the food plus one-half of the difference between FMV (defined below) and the ATB; but the total deduction may not exceed twice the ATB of the food.
Limitation on the enhanced deduction for charitable contributions of food	For C corporations, may not exceed 15% of taxable income. For taxpayers other than a C corporation, may not exceed 15% of aggregate net income.
Fair Market Value ("FMV")	The price that the taxpayer would have received if the food was sold in the usual market. For food which is not sold by the taxpayer due to internal standards, the price at which the same or substantially the same food is sold by the taxpayer at the time of the charitable contribution or in the recent past.
Adjusted Tax Basis ("ATB")	The inventoriable carrying cost of the donated food at the time of the charitable contribution. If the taxpayer does not account for inventories and is not required to capitalize indirect costs to the food, the taxpayer may elect to treat the ATB of donated food as 25% of the FMV.
Part Sale/Part Donation	If a taxpayer receives a partial payment for a donation, the transaction needs to be bifurcated with a portion treated as a donation and a portion treated as a sale.

Contacts

Michael E. Fincher

Deloitte Tax LLP
+1 612 397 4144
mfincher@deloitte.com

Steve Howard

Deloitte Tax LLP
+1 612 692 7128
stehoward@deloitte.com

Anna Borden

Deloitte Tax LLP
+1 612 659 2671
aborden@deloitte.com







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