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New Opportunity for Contributions of Food Inventory

The recent "extender" legislation made permanent the provision allowing an above-basis deduction for contributions of food inventory to charities that use it for the care of the ill, needy or infants. But it also opened a new opportunity for cash method growers who previously were unable to use the provision because they have a zero tax basis in their inventories.

Background

Normally, when ordinary income property such as inventory is given to a charity, the deduction is limited to the taxpayer's basis in the property. This is in contrast to long-term capital gain property given to charity; in that case, the donor claims a deduction for the fair market value (FMV) of the property.

But a special rule applies to several categories of inventory contributions, allowing a charitable deduction in excess of basis. One of the privileged inventory categories is a contribution of food inventory by a business [Sec. 170(e)(3)(C)]. The food must meet a definition of "apparently wholesome food," meaning that it is food inventory intended for human consumption that has met all quality and labeling standards imposed by governmental regulations, even though it may not be marketable due to appearance, age, freshness, surplus or other conditions. The deduction is limited to the lower of two amounts:

- The basis of the inventory plus one-half of the ordinary income that would have been recognized if the property were sold at FMV; or
- Twice the basis of the inventory.

In the case of a cash method grower or producer of edible food products with a zero basis in raised inventory, the second limitation meant that no charitable deduction was allowed (twice a basis of zero would be the lower amount in the preceding formula and no deduction would be permitted).

Extender Act Changes

The recent extender legislation, enacted on December 18, 2015, made several enhancements to the special rule allowing an enhanced charitable deduction for the contribution of food inventory:

1. 15% of income limitation

Previously, the food inventory contributions were limited to 10% of taxable income, whether made by a C corporation or by any other business. For tax years beginning after 2015, the taxable income limit increases to 15%. For taxpayers other than C corporations, however, the 15% limit is based upon the trade or business income from the activity from which the contributions were made. If the contribution exceeds the limitation, the excess becomes a carryforward for up to five tax years. However, as with all charitable contributions, the current year contributions are applied first, and then the carryovers are applied on a FIFO basis [Sec. 170(e)(3)(C)(ii) and (iii)].

2. FMV Definition

The legislation also defines the FMV definition for contributions of food inventory. In the case of food which cannot be sold by reason of internal standards, lack of market or similar circumstances, or by reason of being produced solely for purposes of the charitable contribution, the FMV is to be determined without those circumstances and by taking into account the price at which substantially similar food items are sold by the taxpayer [Sec. 170(e)(3))C)(v)].

Commentary: This new definition eliminates arguments for a lower FMV of donated inventories that are surplus or nearing the end of their "shelf life."

3. Deemed Basis Election

If a taxpayer does not account for inventories under Sec. 471 (full absorption costing) or under Sec. 263A (UNICAP rules), the taxpayer may elect to treat the basis of donated food inventory as equal to 25% of the FMV of the food inventory. The effect of this rule is to allow an electing taxpayer with zero basis raised inventory to claim a charitable deduction of 50% of the FMV of the donated food inventory, based on the formula allowing a deduction of twice the basis of the property.

Commentary: As noted earlier, cash method producers with zero basis inventory have not been able to use the enhanced deduction for contributions of food inventory because of the two-times basis limit. But with an elective deemed basis election of 25% of FMV for tax years beginning after 2015, ag producers that sell consumable food products and donate those inventories to charities that use them in their exempt purpose are allowed a deduction equal to 50% of FMV. Examples of producers who may qualify include cash basis grower-packers who have inventories of bags of onions, apples, potatoes, etc. that meet the standards for sale to retailers. Those who sell produce at farmers' markets or who conduct CSA (community supported agriculture) activities may also have surplus inventory that could be donated to food shelters or similar qualifying charities.

Implementation

Tax practitioners with ag clients producing food products that are consumable by humans and that meet any governmental standards for quality and labeling should notify those clients of this new opportunity. Those clients should be advised to keep record of the FMV of any inventory donations to charities. Also, the client should be advised to secure a written statement from the charity stating that its use and disposition of the food inventory will be in accordance with its exempt purpose and solely for the care of the ill, the needy, or infants, and that the inventory was not transferred to the charity in exchange for money, other property or services from the charity.