ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author:	Fuentes	Analyst:	Jahna Alvarado	Bill Number:	AB 152
Related Bills:	See Legislative History	Telephone:	845-5683	Introduced Date:	January 18, 2011
				Amended Date:	March 15, 2011
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Agricultural Product Donation To Food Bank Credit/Emergency Food Assistance Program Fund

SUMMARY

This bill would create an income tax credit for donations of fresh fruits or vegetables to a California food bank.

This analysis will not address the bill's changes to the Health and Safety Code or Welfare and Institutions Code, as they do not impact the department or state income tax revenue.

RECOMMENDATION AND SUPPORTING ARGUMENTS

No position.

SUMMARY OF AMENDMENTS

The March 15, 2011, amendments do the following:

1. Replace the phrase “donations of agricultural products” with the phrase “donations of fresh fruits or vegetables,” for purposes of the income tax credit; and
2. Eliminate the restriction on the use of Emergency Food Assistance Program funds received by emergency food assistance programs.

Summary of Suggested Amendments

Amendments 1 and 2 would eliminate language that is declarative of existing law.

PURPOSE OF THE BILL

According to the author’s office, the purpose of this bill is to increase access to fresh produce for families that are “food insecure[1].”

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[1] Food insecurity is strongly associated with household income. It is, by definition, a condition that arises from a lack of enough income and other resources for food. Thirty-five percent of poor households had difficulty putting enough food on the table at times during the year compared with 8 percent of households with incomes above the poverty line. Source: U.S. Dept. of Agriculture Economic Research Service at http://www.ers.usda.gov/AmberWaves/April05/DataFeature/

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EFFECTIVE/OPERATIVE DATE

This bill would become effective January 1, 2012. The credit would be specifically operative for taxable years beginning on or after January 1, 2012.

ANALYSIS

Under current federal and state laws, in general, all ordinary and necessary expenses of a trade or business are deductible. For taxpayers, including farmers, that are required to use an inventory method of accounting, certain business expenses are capitalized and, upon the sale of the underlying inventory, are deducted as "costs of goods sold." Inventories include all goods that are held for sale in the ordinary course of business or that are to become a physical part of goods for sale to customers in the ordinary course of business.

There are four methods farmers use to value inventory: (1) the cost method; (2) the lower-of-cost-or-market method; (3) the farm price method; and (4) the unit-livestock-price method. The two most commonly recognized methods of valuing inventories are cost and the lower-of-cost-or-market, whichever is lower. Costs of goods on hand at the start of an accounting period are the amount at which they were valued in the closing inventory of the prior period. Costs of goods ordinarily purchased are the invoice price minus trade or other discounts. Costs of goods produced by the taxpayer include raw materials and supplies entering into or consumed in manufacturing, regular and overtime direct labor costs, and certain required indirect costs.

<u>FEDERAL/STATE LAW</u>

Under current federal and state laws, a taxpayer may claim a deduction for charitable contributions made to qualified organizations. A charitable contribution is a gift given to or for the use of a qualified organization. It may be in the form of money or property, or unreimbursed out-of-pocket expenses incurred by the taxpayer for services rendered to the organization. For corporations, in general, the deduction is limited to 10 percent of net income. Contributions that exceed these limits may be carried over for five years.

There are special rules for contributions of food inventory. The amount of a charitable contribution for a donation of food inventory would be calculated as the property's fair market value (FMV) reduced by one half the amount of the ordinary income or short-term capital gain that would have been recognized if the food inventory had been sold by the donor for its FMV. The resulting amount is subject to a further limitation of twice the basis of the donated food inventory. The charitable contribution deduction for donations of food inventory is limited to 10 percent of a taxpayer's net income. [2]

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[2] During 1978 corporation X, a calendar year taxpayer, makes a qualified contribution of oranges. The fair market value of the property at the date of contribution is $1,000, and the basis of the property is $200. The amount of the charitable contribution that would be taken into account under section 170(a) is the fair market value ($1,000). The amount of gain which would not have been long-term capital gain if the property had been sold is $800 ($1,000 − $200). The amount of the contribution is reduced by one-half the amount that would not have been capital gain if the property had been sold ($800/2 = $400).

After this reduction, the amount of the contribution that may be taken into account is $600 ($1,000 − $400). A second reduction is made in the amount of the charitable contribution because this amount (as first reduced to $600) is more than $400 which is an amount equal to twice the basis of the property. The amount of the further reduction is $200 [$600 − (2 × $200)], and the amount of the contribution as finally reduced is $400 [$1,000 − ($400 + $200)]. The $400 amount would be subject to the net income limitation of 10 percent of X's net income. X would also have to decrease its cost of goods sold for the year of contribution by $200.

Current state law also provides a credit equal to 50 percent of the transportation costs paid or incurred for transporting any donated agricultural product to a nonprofit charitable organization.

Under the Food and Agriculture Code, a person engaged in the business of processing, distributing, or selling agricultural products may donate food to a nonprofit charitable organization. Agricultural products include fowl, animal, vegetable, or other stuff, product, or article that is customary or proper food for human beings. (Please note that the Food and Agricultural Code does not specify a benefit for the donation. However, if the donee was a qualified organization for federal and state tax purposes, a donor that is an individual could take an itemized deduction for the contribution under federal and state tax laws.)

THIS BILL

This bill would establish a tax credit for taxable years beginning on or after January 1, 2012, equal to 10 percent of the cost, as specified, of fresh fruits or vegetables donated to a California food bank, as specified.

The cost of donated fresh fruits or vegetables would be the cost of those products that would be included in inventory costs as specified in Internal Revenue Code (IRC) section 263A without regard to the exception for farming businesses. Generally, inventory costs would include both the direct costs and the allocated indirect costs required to produce the fresh fruits or vegetables.

The donee organization would be required to provide a certificate to the donor that would include: (1) a statement signed and dated by an authorized organization representative that the donation is made under the Food and Agricultural Code; (2) the type and quantity of fresh fruits or vegetables donated; (3) the name(s) of the donor(s); and (4) the name and address of the donee. A taxpayer reporting the credit would be required to provide a copy of the certification to the FTB upon request.

A married couple or domestic partners would be allowed only one credit under the terms of the bill. If filing separately, the credit may be taken by either individual or equally divided between them. Except for a married couple or domestic partners, if two or more taxpayers share in expenses eligible for this credit, each taxpayer would receive the tax credit in proportion to his or her respective share of the expense paid or incurred. In the case of a partnership, the tax credit may be divided according to a written partnership agreement, as specified.

This bill would require that any deduction for the cost of donated products otherwise allowed would be reduced by the amount of the credit and

Any unused credit would be allowed to be carried forward up to seven years.

The FTB would be required to provide an annual report regarding the utilization of the credit to the Legislature “to the extent that data are available.” The reporting requirement would become inoperative on January 1, 2016.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is working with the author's office to resolve these and other concerns that may be identified.

It is unclear whether the credit would be based on the cost of the donated items, or whether a donation would qualify a taxpayer for a credit of 10 percent of the taxpayer's total inventory cost. If it is the author's intention that the credit would be 10 percent of the cost of the donated items, this bill should be amended.

This bill uses the undefined term, "fresh fruits or vegetables." The absence of a definition to clarify this term could lead to disputes with taxpayers and would complicate the administration of this credit. For example, because fruits would be required to be fresh, donations of canned fruits would be excluded from the credit while donations of canned vegetables would be considered eligible for the credit. Additionally, it is unclear what "fresh" is intended to mean. For example would the following items be considered fresh: pre-packaged, sliced apples, pre-packaged salad greens, fruits or vegetables that have been flash frozen? The author may wish to amend this bill to clarify the donations that would be eligible for this credit.

This bill is silent on the date that the required annual report would be due to the Legislature. The author may wish to consider amending this bill to specify that the credit utilization information be included in the department's Tax Expenditure Report.[3]

TECHNICAL CONSIDERATIONS

The language in subdivision (b) discussing the treatment of the credit by husbands and wives, persons that share expenses, and domestic partners is declarative of existing law and should be deleted. Amendments 1 and 2 are provided.

LEGISLATIVE HISTORY

AB 727 (Correa, et al., 2001/2002) would have created a tax credit equal to 10 percent of the normal inventory costs for the donation of an agricultural product made to a food bank located in Fresno County, Orange County, or Santa Cruz County. This bill would allow a similar credit for donations made to a food bank located in California. AB 727 failed to pass out of the Senate Revenue and Taxation Committee by the Constitutional deadline.

AB 287 (Strickland, 1999/2000) would have created a tax credit equal to 10 percent of the wholesale value of agricultural products donated by a taxpayer to a nonprofit charitable organization or food bank. AB 287 failed to pass out of its house of origin by the Constitutional deadline.

AB 196 (Thomson, 1997/1998) would have created a tax credit equal to 20 percent of the cost of agricultural products donated to a nonprofit charitable organization. AB 196 failed passage out of the Senate Appropriations Committee.

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[3] The most recent version of the Tax Expenditure Report may be accessed at http://www.ftb.ca.gov/aboutftb/Tax_Expenditure_Report_2010.pdf.

AB 364 (Cannella, 1995/1996) would have, among other things, created a tax credit equal to 10 percent of the cost of food donated to nonprofit charitable organizations. AB 364 failed passage out of the Senate Appropriations Committee.

AB 2346 (Kelley, Stats. 1989, Ch. 1248) created a tax credit for the donation of agricultural products to certain nonprofit charitable organizations. The credit this bill would create is substantially similar to the credit authorized by AB 2346. AB 2346 was repealed by its own terms effective December 1, 1992.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states do not offer a credit similar to the credit proposed in this bill. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

This bill would require a calculation for the credit that would require a new form or worksheet to be developed and could result in some existing forms expanding from 2 to 3 pages. Additionally, the credit would require additional information to be keyed, monitored, and reported. As a result, this bill would impact the department's systems, and printing, processing and storage costs for tax returns. The additional costs have not been determined at this time. As the bill continues to move through the legislative process, costs will be identified, and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Estimated Revenue Impact of AB 152 (As Amended March 15, 2011) For Taxable Years Beginning On or After January 1, 2012 Enactment Assumed After June 30, 2011 ($ in Millions)			
2011-12	2012-13	2013-14	2014-15
-$0.3	-$0.8	-$0.8	-$0.8

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

SUPPORT/OPPOSITION

Support: None identified to date.

Opposition: None identified to date.

ARGUMENTS

Pro: Increased access to fresh fruits and vegetables could reduce the demand for medical care provided at state expense by preventing or managing the chronic health problems stemming from poor nutrition.

Con: It could be argued that the credit this bill would provide is overly narrow in scope and should be expanded beyond the donation of fresh fruits and vegetables.

POLICY CONSIDERATIONS

Although farmers would generally be required to use the inventory cost method as set forth in IRC section 263A, an election to opt out of the inventory cost method is available to certain farmers. For example, sole proprietorships that are not required to use the accrual method of accounting could be allowed to elect out of the application of IRC section 263A. Because these farmers would be required to recalculate the cost of the donated agricultural product in order to report the credit, some targeted taxpayers may choose not to claim this credit.

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of a credit by the Legislature.

LEGISLATIVE STAFF CONTACT

Jahna Alvarado	Patrice Gau-Johnson
Legislative Analyst, FTB	Asst. Legislative Director, FTB
(916) 845-5683	(916) 845-5521
jahna.alvarado@ftb.ca.gov	patrice.gau-johnson@ftb.ca.gov

Analyst	Jahna Alvarado
Telephone #	(916) 845-5683
Attorney	Pat Kusiak

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 152
AS INTRODUCED JANUARY 18, 2011

AMENDMENT 1

On page 5, delete lines 25 through 37, and redesignate remaining subdivisions accordingly.

AMENDMENT 2

On page 7, delete lines 22 through 30, and redesignate remaining subdivisions accordingly.