Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Thurmond	Analyst:	Jessica Deitchman	Bill Number:	AB 1255
Related Bills:	See Legislative History	Telephone:	845-6310	Amended Date:	March 26, 2015
		Attorney:	Bruce Langston	Sponsor	

SUBJECT:	Apparently Wholesome Food Donation Credit

SUMMARY

This bill would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), create a tax credit for food donations made to nonprofit entities.

RECOMMENDATION

No position.

Summary of Amendments

The March 26, 2015, amendments removed language that would have made a nonsubstantive, technical change to the PITL, and replaced it with the provisions discussed in this analysis. This is the department's first analysis of the bill.

Summary of Suggested Amendments

Technical amendments are provided for clarity.

REASON FOR THE BILL

The reason for the bill is to encourage donations of food to nonprofit entities.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective upon enactment and specifically operative for taxable years beginning on or after January 1, 2015.

FEDERAL/STATE LAW

Under current federal law, in general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. The amount of any deduction generally equals the fair market value of the contributed property on the date of the contribution.

Under a federal special temporary provision,[1] for charitable contributions of food inventory made after December 31, 2009, and before January 1, 2014, a taxpayer engaged in a trade or business

[1] Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 Public Law 111-312, Sec.740, December 17, 2010.

Board Position:						Executive Officer	Date
	S		NA	X	NP	Selvi Stanislaus	5/6/15
	SA		O		NAR		
	N		OUA				

was eligible to claim an enhanced deduction for donations of food inventory.[2] In general, the total deduction for donations of food inventory in a taxable year may not exceed 10 percent of the taxpayer's net income for such taxable year.

The enhanced federal deduction for food is available only for food that qualifies as "apparently wholesome food". Section 170 of Title 26 of the United States Code defines "apparently wholesome food" as food intended for human consumption that meets all quality and labeling standards imposed by federal, state, and local laws and regulations even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions.

A donor making a charitable contribution of inventory must make a corresponding adjustment to the cost of goods sold by decreasing the cost of goods sold by the lesser of the fair market value of the property or the donor's basis with respect to the inventory. Accordingly, if the allowable charitable deduction for inventory is the fair market value of the inventory, the donor reduces its cost of goods sold by such value, with the result that the difference between the fair market value and the donor's basis may still be recovered by the donor as a business deduction other than as a charitable contribution. To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis. The valuation of food inventory has been the subject of disputes between taxpayers and the IRS.

California's PITL generally conforms to the federal rules relating to charitable contributions as of the specified date of January 1, 2009,[3] but specifically does not conform to the enhanced deduction for a contribution of food inventory.[4] The deduction under the PITL for charitable contributions of inventory is limited to the taxpayer's basis in the inventory, generally its cost. Additionally, California's CTL does not adopt the general federal rules that allow enhanced deductions for C-corporation contributions of inventory, and does not adopt the enhanced deduction for a contribution of food inventory. The deduction under the CTL for contributions of inventory is limited to the taxpayer's basis in the inventory (generally its cost), and may not exceed ten percent of the corporation's net income. Any excess may be carried forward for up to five years.

[2] To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer, contributed to a charitable organization described in Internal Revenue Code (IRC) section 501(c)(3) (except for private non-operating foundations), and the donee must: (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants; (2) not transfer the property in exchange for money, other property, or services; and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. In the case of contributed property subject to the Federal Food, Drug, and Cosmetic Act, as amended, the property must satisfy the applicable requirements of such Act on the date of transfer and for 180 days prior to the transfer. The enhanced deduction is equal to the lesser of: (1) basis plus one-half of the item's appreciation (i.e., basis plus one-half of fair market value in excess of basis); or (2) two times basis. IRC section 170(e)(3)(C).
[3] For taxable years beginning on or after January 1, 2010, Revenue and Taxation Code (R&TC) section 17201 conforms to IRC section 170, relating to charitable contributions and gifts, as of the specified date of January 1, 2009, with modifications.
[4] R&TC section 17275.2.

Current state law's Donated Fresh Fruits and Vegetable Credit allows a credit equal to 10 percent[5] of the qualified donation of fresh fruits and vegetables made to a qualified nonprofit made by a qualified taxpayer,[6] as defined.

THIS BILL

For taxable years beginning on or after January 1, 2015, this bill would, under the PITL and CTL, allow a tax credit for a taxpayer who donates "apparently wholesome food" from any trade or business of the taxpayer to an organization located in California that is exempt from federal income tax as an organization described in Section 501(c)(3) of the Internal Revenue Code.

The credit would be equal to 15 percent of the fair market value of the contribution.

"Apparently wholesome food" would have the same meaning as the term in Section 170 of Title 26 of the United States Code, as of January 1, 2015.

No deduction would be allowed for amounts taken into account in calculating the credit.

Section 41[7] would be inapplicable to the credit this bill would allow.

IMPLEMENTATION CONSIDERATIONS

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

The definition of "apparently wholesome food" is very broad, and would allow the donation of almost any food product, even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions. If this is contrary to the author's intention, this bill should be amended.

Because the bill fails to specify otherwise, the Franchise Tax Board (FTB) would be subject to the rulemaking procedures required under the Administrative Procedures Act (APA).[8] Following these procedures may delay the immediate implementation of this bill. To prevent any delay, it is recommended that the author add a provision exempting the FTB from the APA when the FTB is prescribing rules, guideline, or procedures necessary or appropriate to carry out the purpose of this bill.

[5] Of the cost that would otherwise be included in inventory costs under Section 263A of the Internal Revenue Code, or that would be required to be included in inventory costs under Section 263A of the Internal Revenue Code.
[6] Qualified taxpayer means the person responsible for planting a crop, managing a crop, and harvesting the crop from the land.
[7] Revenue and Taxation Code section 41 requires that tax credits contain specified goals, purposes, and objectives that the tax credit will achieve and detailed performance indicators, including data collection requirements as specified, to measure whether the credit is meeting those goals, purposes, and objectives.

[8] Government Code section 11340 et seq.

This bill would allow taxpayers to donate apparently wholesome foods to any entity that is located in California and is exempt from federal income tax as an organization described in Section 501(c)(3) of the IRC. The bill lacks language that would require the non-profit to accept, confirm, and certify receipt to these products. Lack of confirmation and certification may lead to taxpayers being able to take a credit for items that non-profits may not want or need. It is recommended the bill be amended to specify that a donation must be accepted by the non-profit.

TECHNICAL CONSIDERATIONS

For clarity, the following two technical amendments are provided:

1. On page 2, line 08, after “contribution” insert “on the date of the donation”
2. On page 2, line 26, after “contribution” insert “on the date of the donation”

Additionally, it is recommended the bill be amended to specify that the donation must occur within that taxpayer’s taxable year.

LEGISLATIVE HISTORY

AB 515 (Eggman, 2015/2016) would recast the donated fresh fruits or vegetables credit as an agricultural product or processed foods donation. AB 515 is currently before the Assembly Revenue and Taxation Committee.

AB 152 (Fuentes, et al., Chapter 503, statutes of 2011) created the donated fresh fruits or vegetables credit under the PITL and the CTL. The credit is calculated as 10 percent of donations of fresh fruits and vegetables made to a qualified nonprofit entity.

OTHER STATES’ INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states lack 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

The department’s costs to implement this bill have yet to be determined. As the bill moves through the legislative process and the implementation concerns are resolved, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 1255 As Amended March 26, 2015 Assumed Enactment After June 30, 2015 ($ in Millions)		
2015-16	2016-17	2017-18
- $210	- $180	- $180

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

Revenue Discussion:

Using data on food donations to food banks, soup kitchens, and other charitable organizations it was estimated that taxpayers would make $1 billion in apparently wholesome food donations in 2014. This amount was increased to bring the wholesale value up to the fair market value, and account for the additional incentive to the taxpayer to donate because they would be getting a tax credit. This number was then grown by the Department of Finance's growth rate bringing the total amount of donations to $1.3 billion in 2015. Applying the credit rate of 15 percent results in estimated credits generated of $200 million. Because the bill would disallow a deduction for qualified donations used to generate the credit, an offsetting gain is applied to account for the decrease in the taxpayer's deduction. It was estimated that 75 percent of the credit would be used in the year generated and because there is no carryover provision the remaining 25 percent would expire, resulting in a $150 million loss in 2015. The tax year estimates are split between personal income taxpayers and corporate taxpayers, converted to fiscal year estimates, and then rounded to arrive at the estimates shown in the table above.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that this bill would provide the incentive needed for businesses to donate to needy non-profits in California.

Opponents: Some may argue that providing a credit this broad in scope would lead to manipulation by the donors and would not help nonprofits.

POLICY CONCERNS

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

This bill lacks carryover language. As a result, any unused credit would be lost if the taxpayer is unable to use the entire credit amount in the year claimed. The author may wish to add language allowing a limited carryover period.

This bill would allow taxpayers in certain circumstances to claim both the Donated Fresh Fruits and Vegetables Credit and the credit discussed in this analysis, thus providing multiple tax credit benefits for the same item of expense.

LEGISLATIVE STAFF CONTACT

Jessica Deitchman	Jame Eiserman	Gail Hall
Legislative Analyst, FTB	Revenue Manager, FTB	Legislative Director, FTB
(916) 845-6310	(916) 845-7484	(916) 845-6333
jessica.deitchman@ftb.ca.gov	jame.eiserman@ftb.ca.gov	gail.hall@ftb.ca.gov