Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Thurmond, et al.	Analyst:	Jessica Deitchman	Bill Number:	AB 2768
Related Bills:	See Legislative History	Telephone:	845-6310	Introduced Date:	February 19, 2016
		Attorney:	Bruce Langston	Sponsor	

SUBJECT: Prepackaged Food, Unspoiled Fruit & Vegetable Donations of Trade or Business to Exempt Organization 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.

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, 2017, and before January 1, 2023.

FEDERAL/STATE LAW

Federal Law

Charitable Contributions in General

Under federal law, 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. In the case of an individual, the deduction for charitable contributions is limited to various percentages of the contribution base, depending on the donee and the property contributed. In the case of a corporation, the deduction generally is limited to ten percent of the taxable income (with modifications). Contributions in excess of these limitations may be carried forward for up to five taxable years.

Contributions of Inventory

A taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically, cost) in the inventory, or, if less, the fair market value of the inventory. However, for certain contributions of inventory, a C corporation may claim an enhanced deduction 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. To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer and must be contributed to a charitable organization described in IRC section 501(c)(3)[1] (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.

Contributions of Food Inventory

Any taxpayer engaged in a trade or business, whether or not a C corporation, is eligible to claim the enhanced deduction for donations of food inventory. For taxpayers other than C corporations, the total deduction for donations of food inventory in a taxable year generally may not exceed 15 percent of the taxpayer's net income for such taxable year from all sole proprietorships, S corporations, or partnerships (or other non C corporations) from which contributions of apparently wholesome food are made.[2] For C corporations, these contributions are subject to a limitation of 15 percent of taxable income. The enhanced federal deduction for food inventory is available only for food that qualifies as "apparently wholesome food."[3]

State Law

California law does not conform to or adopt the federal enhanced deduction for donations of food inventory, but allows a temporary credit for donated fresh fruits and vegetables, as described below.

Under the PITL, California generally conforms to the federal rules relating to charitable contributions as of the "specified date" of January 1, 2015, but specifically does not conform to the enhanced deduction for a contribution of food inventory; thus, the deduction under the PITL for charitable contributions of inventory, including food inventory, is limited to the taxpayer's basis in the inventory, generally its cost, subject to the general federal contribution-base and carryover limitations. Under the CTL, the deduction for contributions of inventory, including food inventory, is limited to the taxpayer's basis in the inventory (generally its cost), may not exceed ten percent of the corporation's net income, and any excess may be carried over for five years.

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[1] Organizations that qualify for exemption from federal (and state) income tax that are organized and operated exclusively for one or more of the following purposes: religion, charitable, scientific, testing for public safety, literary, educational, fostering national or international sports competition, and the prevention of cruelty to children or animals.

[2] For example, if a taxpayer is a sole proprietor, a shareholder in an S corporation, and a partner in a partnership, and each business makes charitable contributions of food inventory, the taxpayer's deduction for donations of food inventory is limited to 15 percent of the taxpayer's net income from the sole proprietorship and the taxpayer's interests in the S corporation and partnership. However, if only the sole proprietorship and the S corporation made charitable contributions of food inventory, the taxpayer's deduction would be limited to 15 percent of the net income from the trade or business of the sole proprietorship and the taxpayer's interest in the S corporation, but not the taxpayer's interest in the partnership.

[3] For this purpose, apparently wholesome food is defined 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.

For tax years beginning on or after January 1, 2012, and before January 1, 2017, California law provides a Donated Fresh Fruits and Vegetable Credit (under the PITL and the CTL), which generally allows a credit equal to 10 percent of the qualified donation of fresh fruits and vegetables made to a qualified nonprofit made by a qualified taxpayer.

THIS BILL

For taxable years beginning on or after January 1, 2017, and before January 1, 2023, this bill would, under the PITL and the CTL, allow a tax credit for a taxpayer who donates qualified food of its trade or business to an organization located in California that is exempt from federal income taxation as an organization described in Section 501(c)(3) of the Internal Revenue Code.

The credit would be equal to 10 percent of the fair market value of the contribution for a taxpayer subject to the PTL and 15 percent for a taxpayer subject to the CTL.

"Qualified food" would mean prepackaged food, as defined in Section 113876 of Health and Safety Code,[4] and food prepared for immediate human consumption, including unspoiled fruits and vegetables.

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

The credit may be carried over for nine years, or until exhausted.

This credit would be repealed on December 1, 2023.

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 "qualified food" is very broad, and would allow the donation of almost any food product that is packaged. If this is contrary to the author's intention, this bill should be amended.

The bill would allow a credit for donated food valued at "fair market value." However, the bill fails to specify how the fair market value of the contribution would be determined. To avoid disputes between taxpayers and the department, it is recommended the bill be amended to specify how fair market value should be calculated for clarity.

This bill uses phrases that are undefined, i.e., "food prepared for immediate human consumption", and food "of its trade or business." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this bill.

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[4] "Prepackaged food" means any properly labeled processed food, prepackaged to prevent any direct human contact with the food product upon distribution from the manufacturer, a food facility, or other approved source.

For clarity and ease of administration, it is recommended that the bill be amended to provide a definition for these phrases.

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 of these products, which would make it difficult for the department to verify the date, amount, and types of food products donated. It is recommended the bill be amended to require the non-profit to provide a receipt to the taxpayer specifying the date of donation, a description of the products donated, and the value of products.

TECHNICAL CONSIDERATIONS

This bill uses the phrase "for amounts taken into account", however, "reduced by the amount of credit allowed" or similar wording is the customary phrase used within a franchise or income tax credit statute. This phrase has the benefit of past usage and common understanding within the context of a tax credit statute and for consistency and harmony with other tax credit language should be used in this bill. It is recommended that this bill be amended to reference the correct phrase for franchise and income tax purposes.

LEGISLATIVE HISTORY

AB 1577 (Eggman et al., 2015/2016) would recast the donated fresh fruits or vegetables credit as an agricultural product or processed foods donation. AB 1577 is currently in the Assembly Revenue and Taxation Committee.

AB 515 (Eggman, 2015/2016) would have recast the donated fresh fruits or vegetables credit as an agricultural product or processed foods donation. AB 515 was vetoed by Governor Brown because “despite strong revenue performance over the past few years, the states’ budget has remained precariously balanced due to unexpected costs and the provision of new services. Now, without the extension of the managed care organization tax that I called for in special session, the next year’s budget faces the prospect of over $1 billion in cuts. Given these financial uncertainties, I cannot support providing additional tax credits that will make balancing the state’s budget even more difficult. Tax credits, like new spending on programs, need to be considered comprehensively as part of the budget deliberations.”

AB 1255 (Thurmond, 2015/2016) similar to this bill, would have provided a credit for the donation of apparently wholesome foods to a nonprofit entity. AB 1255 failed to pass out of the house of origin by the constitutional deadline.

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

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2768 As Introduced February 19, 2016 Assumed Enactment After June 30, 2016 ($ in Millions)		
2016-17	2017-18	2018-19
- $55	- $160	- $200

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 qualified taxpayers made $1 billion in qualified donations in 2015. This amount was increased to bring the wholesale value up to the fair market value, and account for the additional incentive to donate because taxpayers would receive a tax credit. This amount was then grown to arrive at an estimated $1.5 billion in qualified donations in 2017. It is estimated that 30 percent of this value would be made by personal income taxpayers and 70 percent by corporate taxpayers. Applying the credit rate of 10 and 15 percent, for PIT and corporate taxpayers respectively, 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 is estimated that 75 percent of the credit would be used in the year generated and the remaining 25 percent would be used over the next nine years, resulting in a $150 million loss in 2017. The tax year estimates are converted to fiscal year estimates, and then rounded to arrive at the estimates shown in the above table.

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.

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