

S Corporation Tax Deduction Dilemma

S corporations face a dilemma about whether they can take the tax deduction for donating food inventory. The Pension Protection Act of 2006 (H.R. 4) allows all business entities to take the enhanced tax deduction for donation of wholesome surplus food. It removes the C corporation restriction. However, individual S corporation shareholders may not be able to take the deduction for the donation of food inventory, depending on their basis in the corporation.

In working with restaurants structured as S corporations we have learned the following:

- S corporation income is distributed to each shareholder based on each shareholder's ownership percentage and therefore the deductibility of the deduction depends on each shareholder having sufficient basis (i.e. IRS at risk rule) in the company to permit deduction at the individual level.
- Many S corporations make ongoing distributions to shareholders rather than retain excess funds in the company and therefore most S corporation shareholders have no basis (i.e. distributions reduce basis).
- As a result, S corporations' shareholders do not believe they are entitled to a tax deduction and do not benefit from recent tax law changes and are therefore not motivated to donate.

FDC provided technical tax comments to the House Ways & Means Committee in October, 2006 to recommend a solution to the S corporation dilemma. The attached file and the URL link below contain the comments.

<http://waysandmeans.house.gov/hearings.asp?formmode=view&id=5336>

While the S corporation dilemma is crucial, the Good Samaritan Hunger Relief Tax Incentive Extension Act of 2007 must be signed into law this year in order for any non C corporation to take advantage of the special tax deduction for the donation of surplus food beyond 2007.

For further information contact:

Jim Larson
Program Development Director
(800) 206-3952 Direct Line
(800) 831-8161 Harvest Support Center
Jim.Larson@foodtodonate.com

Food Donation Connection
PO Box 22787
Knoxville, TN 37933-0787
www.foodtodonate.com