



# **Agricultural Quarantine and Inspection User Fees - Effects on Taxable Corporate Income**

October 2024

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## Executive Summary

Cost of goods sold (COGS) is a cost of doing business and is deducted from revenue to calculate gross profit and gross margin and this value changes depending on the accounting methods used in the calculation. COGS is recorded as a business expense on the income statements and calculated by adding up the various direct costs required to generate a company's revenue. These costs reduce businesses taxable income and increase tax deductions which lower the amount of taxes owed.

Commercial vessels, trucks, trucks (transponder), railroad cars and aircraft companies may include COGS on business tax returns as a calculation of inventory valued in beginning and end of year and costs for making products, storing, and shipping them. COGS is an important part of the tax return as it captures production costs that would not be included otherwise. Such costs reduce business taxable income.

Operating expenses are the cost of running a business that are common and accepted in the trade as ordinary and necessary. Operating expenses can be deducted in the year they are incurred or paid depending on the accounting method and reduce corporate income and tax liability. The administrative processes of collecting, holding, and remitting AQI user fees are expenses which could be considered operating expenses. Operating expenses are not included in the direct costs of production or costs of goods sold and include all non-production costs.

International air and cruise passenger AQI user fees are costs that are passed through directly to their passengers. The administrative costs of collecting, storing, and remitting these fees to the Secretary may be calculated as an operational expense. These expenses are incurred through normal business operations and can be deducted from business income if the business operates to earn profits. According to the IRS, operating expenses must be ordinary and necessary. An entity is allowed to deduct operating expenses for the year which the expenses are incurred. AQI user fees are potentially deductible as a COGS or operating expense.

## Background

The collection of taxes relies on the government's sovereign power to compel payment. User fees provide a dedicated source of funding and can bring diversity to government revenue streams. User fees are costs expended by entities in the ordinary course of business. Though user fees are not compulsory, they must be paid to carry out business activities. Every business tracks such expenses through the year for tax purposes. Business expenses are subtracted from revenue to arrive at a company's taxable net income. AQI User fees may fall primarily into two business deduction categories: **cost of goods sold** and **operational expenses**.

## Cost of Goods Sold

Various costs may have tax treatments that allow the cost to be deducted and generate a tax benefit to the taxpayer. This offset thereby reduces the economic cost of the transaction. In a manufacturing, merchandising, or mining business, “gross income” means the total sales, less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources.<sup>1</sup> In certain circumstances, AQI User Fees may reduce taxable income as part of cost of goods sold (COGS).

Cost of goods sold (COGS) is the method the Internal Revenue Service (IRS) uses to define the cost a business invested to produce new inventory for sale during the tax year. AQI user fees connected specifically to the import of products to be used in manufacturing or resale would be considered parts of the cost of goods sold. For example, treatment fees or specific carriers’ fees for the transport of goods are part of the cost of freight. Commercial vessels, trucks, railroad cars and aircraft (carriers) would deduct the cost of the AQI user fees as part of COGS.

AQI user fees incurred by international air passenger and cruise ship (sea passenger) users would be deductible as COGS if these users have inventory. If not, then COGS would not be used but may be deducted as an operational business expense (see “*Business/Operational Expense*”). Where user fees are collected on behalf of the Secretary by a taxpaying entity, such as in the case of air and sea passenger services related to AQI inspections, fees are held in trust for the United States and remitted to the Secretary at the time prescribed.<sup>2</sup> These fees are collected by the carriers on behalf of the Secretary and are not considered business income; therefore, cannot directly be used to offset tax obligations.

COGS refers to the direct costs of producing the goods sold by a company. These amounts include the cost of the materials and labor directly related to the production of goods, such as raw materials. COGS is used to capture the total costs of products sold and therefore calculate the total net income of all inventories sold as part of a business’ reportable income.

## Business/Operational Expenses

Indirect costs are associated with the operating expenses of a company unlike direct costs which are usually associated with COGS and affect a company’s gross profit and gross profit margin. Indirect costs affect a company’s operating profit and the operating profit margin and are not associated with the manufacturing or resale of a product. Indirect costs include administrative and marketing expenses.

Business expenses are usually deductible if the business is operated to make a profit.<sup>3</sup> Under APHIS’ rule and regulations 7 CFR Part 354.3, AQI fees collected for air or cruise passengers must be collected and remitted to APHIS for services provided in connection with the AQI Program. The AQI user fees are applied to tickets purchased by passengers and held in trust until remittance to APHIS. AQI user fees are currently remitted no later than 31 days after the close of the calendar quarter in which the AQI user fees were collected.

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<sup>1</sup> [26 CFR § 1.61-3 - Gross income derived from business. | Electronic Code of Federal Regulations \(e-CFR\) | US Law | LII / Legal Information Institute \(cornell.edu\)](#)

<sup>2</sup> [21 U.S. Code § 136a - Collection of fees for inspection services | U.S. Code | US Law | LII / Legal Information Institute \(cornell.edu\)](#)

<sup>3</sup> Pub535, Chapter 1 ([2022 Publication 535 \(irs.gov\)](#))

As compensation for collecting, handling, and remitting the AQI user fees for international passengers, the person holding such user fees are entitled to any interest or other investment return earned on the user fees between the time of collection and the time the user fees are remitted to APHIS under this section.<sup>4</sup> Interest income is a separately reported income item on tax returns, and you should consult a licensed, certified or otherwise credentialed tax professional on appropriate treatment.

## Conclusion

Please note that you cannot deduct fines or penalties paid to the government in violation of the law.<sup>5</sup> Fine or penalties including tax penalties are not deductible. For more information, please contact the IRS - [Telephone Assistance | Internal Revenue Service \(irs.gov\)](#).

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<sup>4</sup> [eCFR :: 7 CFR 354.3 -- User fees for certain international services.](#)

<sup>5</sup> [Publication 529 \(Rev. December 2020\) \(irs.gov\)](#)