Anchin Alert

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Tax Cuts and Jobs Act Will Greatly Impact Food & Beverage Companies

The Tax Cuts and Jobs Act (TCJA), which was signed into law on December 22, brings many changes to the tax landscape that emerging brands operate in. Here are the most important changes in the new law that will impact your business.

New corporate tax rate

The TCJA substantially reduces the federal income tax rate on C corporations to 21%. This could have an impact on entity choice for emerging food and beverage companies which will be discussed in another article on that topic. Broadly, this reduces the value of Net Operating Loss carryovers as they will now shelter income taxed at only 21% compared to the prior 35%. The choice between C corporation and pass-through status will be more complex.

Net Operating Losses

For C Corporations with Net Operating Losses (NOLs) that arise in tax years ending after December 31, 2017, the maximum amount of future annual taxable income that can be offset with NOL deductions in a given year is generally reduced from 100% to 80%. Affected NOLs can be carried forward indefinitely under the TCJA as opposed to a limit of 20 years under the prior law. This will also impact the value of NOL carryovers.

New deduction for pass-through businesses

Under prior law, net taxable income from pass-through business entities (such as sole proprietorships, partnerships, S corporations and LLCs) was simply passed through to owners. It was then taxed at the owner's tax rates.

For tax years beginning in 2018, the TCJA establishes a new deduction from income based on a non-corporate owner's qualified business income (QBI). This new tax break is available to individuals, estates and trusts that own interests in pass-through business entities. The deduction generally equals 20% of QBI.

Because QBI does not include reasonable compensation paid to an owner for services rendered to the business or any guaranteed payments to a partner or LLC member, it may be time to reassess those compensation levels to maximize the QBI deduction for profitable pass-through entities. It should be noted that there are limitations on the QBI deduction based on the company's W-2 wages or the cost of property and equipment invested in by the company.

Accelerated depreciation and Section 179

The TCJA increased the amount a business or taxpayer may expense under bonus depreciation from 50% to 100% for property placed in service after September 27, **2017** and before January 1, 2023. The amount allowed as bonus depreciation after 2022 will be reduced by 20% until it is fully phased out in 2027. Property purchases prior to September 28, 2017 and placed in service will still be eligible for the 50% bonus depreciation.

Beginning 2018 the amount a business may claim as an immediate deduction under Section 179 will increase from $500,000 to $1 million. Also the phase out threshold that eliminates the Section 179 deduction is increased to $2.5 million.

New limits on business interest deductions

Subject to some restrictions and exceptions, prior law stated that interest paid or accrued by a business generally is fully deductible. Under the TCJA, affected businesses generally cannot deduct interest expense in excess of 30% of "adjusted taxable income," starting with tax years in and after 2018.

For S corporations, partnerships and LLCs that are treated as partnerships for tax purposes, this limit is applied at the entity level rather than at the owner level.

Taxpayers with average annual gross receipts of $25 million or less for the three previous tax years are exempt from the interest deduction limitation. Certain other taxpayers are also exempt.

Business interest expense that's disallowed under this limitation is treated as business interest arising in the following taxable year. Amounts that cannot be deducted in the current year can generally be carried forward indefinitely.

Excess loss limitation

A new limitation applies to deductions for "excess business losses" incurred by noncorporate taxpayers. The TCJA defines an Excess Loss as an amount in excess of $250,000 or $500,000 for a married taxpayer filing joint. This will impact the potential value of pass-through losses to individual investors. Losses that are disallowed under this rule are carried forward to later tax years and can then be deducted under the rules that apply to NOLs. This new limit kicks in after applying the passive activity loss rules. Unlike the business interest limitation this limit is calculated at the taxpayer level and not the entity level.

Reduced or eliminated employer deductions for business-related meals and entertainment

Prior to the TCJA, taxpayers generally could deduct 50% of expenses for business-related meals and entertainment. Meals provided to an employee for the convenience of the employer on the employer's business premises were 100% deductible by the employer and tax-free to the recipient employee. Various other employer-provided fringe benefits were also deductible by the employer and tax-free to the recipient employee. Under the new law, for amounts paid or incurred after December 31, 2017, deductions for business-related entertainment expenses are disallowed. Meal expenses incurred while traveling on business are still 50% deductible, but the 50% disallowance rule will now also apply to meals provided via an on-premises cafeteria or otherwise on the employer's premises for the convenience of the employer. After 2025, the cost of meals provided through an on-premises cafeteria or otherwise on the employer's premises will be fully nondeductible. Entertainment expenses are now fully non deductible.

Carried Interest

A watered down version of the long awaited carried interest legislation was part of the TCJA. In order to receive long term capital gain treatment the allocation of income that a partner receives for services performed to a partnership will now be subject to a three year holding period instead of the normal one year holding period. This could have an impact on the time horizon certain investors will look for in new investment opportunities.

What's Next?

The TCJA is the largest overhaul of the tax code in more than 30 years, and we've covered only the highlights of the food and beverage-related tax provisions here. If you would like to discuss these changes, planning opportunities or have any specific questions, please contact James Ferrara or John Ingrassia, Tax Partners in Anchin's Food and Beverage Practice, Food and Beverage Leader Greg Wank, or your Anchin Relationship Partner at 212.840.3456.

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