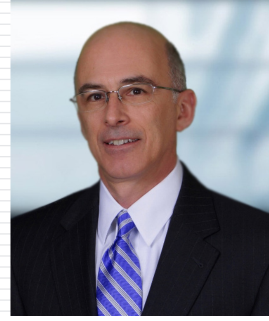
The MWE Advisor

mwe
Margolin, Winer & Evens LLP
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

www.mwellp.com

Two Big Tax Changes Will Affect Food-and-Beverage Businesses

By Lance Christensen, CPA and Joseph Pizzimenti, Esq.



The food-and-beverage industry knows well that customers' tastes are dynamic and constantly changing. So is the tax realm.

Recent tax law changes and a decision by the Supreme Court have added complicated twists to current tax law that will affect businesses such as restaurants, distributors, and manufacturers on two fronts: the deductions they can claim if structured as pass-throughs, and the extent to which they must now pay state sales tax, even if they're out-of-state entities.

Businesses across these industries will need to get current on these changes or risk seeing their tax posture go stale.

Claiming the 20 Percent Deduction

By now, the tax law's main provisions are widely known. The corporate tax rate was lowered to 21 percent, and the law allows qualifying pass-throughs a 20 percent deduction between now and 2025, when the provision sunsets. Businesses face limitations on capturing this deduction, however, based on the definition of "qualified business income." Given this consideration, businesses should revisit:

Structuring Arrangements
For entities with taxable income above a certain threshold, the deduction is calculated based on W-2 limitations. The amount that qualifies for the deduction can't exceed 50 percent of an entity's W-2 wages, or the sum of 25 percent of wages plus 2.5 percent of the cost of the property used by the business. It hasn't been entirely clear if the limitation could be calculated for a single entity or could be calculated in the aggregate. Recent IRS guidance suggests the latter.

That's good news for a company with multiple S-corporations with different product lines in one or several states. It would also favor a single shareholder with shares in several S-corporations in various states, each offering the same product or service, such as distributing food products under centralized management. (However, the guidance is less clear where two different shareholders are involved, even if there's centralized management.)

The deduction does apply to companies owning real estate through a separate partnership that generates profit from an affiliated food distributing company that's an S-corporation. It's still not clear, however, if the deduction applies to a lease with an unrelated company, particularly in cases with a triple-net lease.

In light of these factors, businesses should analyze the current or future business structure being considered to assess whether they qualify for the deduction.

Revenue from 'Intangibles'
The 20 percent deduction generally is off-limits to a "specified service trade or business." Service sector entities such as law, health, and accounting firms usually were understood to fall under this deduction exclusion. Also disqualified are companies whose business is primarily driven by name or reputation. The recent IRS guidance provides guidance to this last type of disqualified type of business.

While this narrower definition should not adversely affect companies in the food-and-beverage industry, there's still ambiguity depending on where a business licenses its name or trademark. In such cases, it may not qualify for the 20 percent deduction. Given the potential lack of deductions, it makes sense to revisit whether licensing net revenue is accurately classified.

Don't Forget Wayfair

With all the attention paid this year to federal tax reform, it is possible to have overlooked the significant sales tax compliance repercussions of the determination in South Dakota v. Wayfair on companies in the food industry. But Wayfair's adoption of an "economic" standard in its landmark redefinition of the minimum presence in a state necessary to subject an out-of-state company to its sales tax rules, or nexus, has broad potential ramifications.

Prior to Wayfair, a company needed physical presence in a state in order for a state to constitutionally require a company to comply with its sales tax provisions. Wayfair found that companies don't need a physical presence in a state to be subject to the state's sales tax compliance requirements.

Based on the findings of Wayfair, a state that has adopted a Wayfair-type economic nexus standard may require any company that has $100,000 or more in sales or 200 or more transactions with customers in the state to comply with that state's sales tax laws.

It's important to note that while Wayfair has received extensive coverage of its ramifications regarding internet retailers, this decision doesn't simply apply to internet-only vendors. Wayfair potentially casts its wide nexus net over the food-and-beverage industry as well. Wayfair can apply to food companies that have customers located in states in which they do not presently have physical operations or physical presence and are not registered for sales tax.

Wayfair could require food companies to register and comply with such state's sale tax provisions. This would include registering as a vendor, collection of sales tax or exemptions, and filing periodic sales tax returns with such states.

What should a company do in the post-Wayfair era?

Time for a Nexus Review
First, they should review their sales tax nexus to identify if the company has sufficient sales or transactions in those states that have adopted Wayfair-type economic nexus provisions for sales tax. This is most efficiently accomplished through an analysis of company sales by destination compared to the states in which the company is presently filing sales tax returns.

Register As a Vendor?
Depending on the results of a company's nexus review, the company should consider whether to immediately register in the state as a sales tax vendor. This will be determined on a company- and state-specific basis, including an analysis of the effective/enforcement date of each Wayfair state's economic sales tax provision. For those Wayfair states whose effective or enforcement date has passed, a company may wish to consider if such state has any remediation or special procedures to effect registration while limiting past liability; i.e., a voluntary disclosure agreement.

A number of states have adopted provisions that establish their Wayfair effective/enforcement date as of October 1, 2018. For such states, companies should immediately review whether they have met the economic nexus threshold in such states. If they do have nexus in such state(s), the company should register and undertake the complex process involved with complying with such state's sales tax provisions.

First, that company should determine the taxability of all of its revenue streams as soon as possible. Also, such affected companies should identify if they are required to collect exemption certificates from their customers in such states to exempt some or all of their sales. If yes, a business should commence getting those appropriate exemptions as soon as possible.

Wait—Wayfair Can have Use Tax Considerations Too
There's another potential pitfall to navigate: Perhaps a company has been buying from various out-of-state vendors that weren't previously required to charge it sales tax because such vendors did not have sales tax nexus in the company's state. Thus, the company has correctly been self-accruing use tax. After the Wayfair ruling, however, some of these out-of-state vendors may now have sales tax nexus in the company's state and may start charging the company sales tax.

If the company's use tax accrual procedure is determined based on the vendor and not on whether an invoice has sales tax charged, the company may be accruing use tax on purchases from such out-of-state vendors that are now charging sales tax. This may result in an over-accrual of use tax. Therefore, companies should also consider reviewing their use tax accrual procedures in light of the Wayfair decision.

What Now?

In the case of federal provisions, there is no slowing down its impact because it's the law of the land. With respect to sales tax nexus, companies should review their sales tax nexus footprint as soon as possible. In either case, a food-and-beverage business should promptly address

issues with a trusted tax advisor, or risk facing serious heartburn.

About Lance Christensen, CPA

Lance is a Partner serving in the Tax Department. He brings outstanding credentials to MWE as an experienced Tax Partner with strong business and professional relationships. Over the course of his career he has developed an extensive business and tax background in a broad range of industries and subjects. Lance's experience extends to both public and privately held companies which he serves with respect to a wide range of tax planning, compliance and consulting matters. Lance can be reached at **lchristensen@mwellp.com.**

About Joseph Pizzimenti, Esq.

Joe is a Tax Director specializing in State and Local Tax Services. He joined MWE in February 2012. Prior to joining the firm, Joe was the Multistate Tax Coordinator for Deloitte Growth Enterprise Services ("DGES"). His practice at Deloitte focused on providing Multistate Tax Consulting and Planning services to Deloitte's DGES clients in the New York Tri-State area. Joe's tax career includes significant experience with respect to rendering complex Federal tax consulting services to Multinational and Fortune 1000 corporations.

Joe has extensive experience in providing multistate tax advisory services with respect to mergers and acquisitions, FAS 109 and FIN 48/ASC 740. His area of expertise includes substantial income/franchise and sales/use tax controversy representation for corporate clients. Joe has extensive sub-specialty knowledge with respect to sales and use tax issues affecting the e-commerce and consumer product industries.

Joe is admitted to the Bar in the State of New York. He is a member of the New York State Bar and American Bar Associations. Joe can be reached at ***jpizzimenti@mwellp.com.***

About Margolin, Winer & Evens LLP

Margolin, Winer & Evens LLP is widely recognized as one of the most respected business advisory firms in the Northeast and is consistently ranked among the top accounting firms nationwide. MWE has developed a portfolio of distinct practice groups in response to its clients' changing needs and growth objectives and is committed to help clients meet the challenges of today's technology-driven, global business environment. MWE has offices in New York City and Garden City, New York. For more information, visit ***www.mwellp.com.***

Margolin, Winer & Evens LLP

CERTIFIED PUBLIC ACCOUNTANTS
AND BUSINESS ADVISORS

LONG ISLAND
400 Garden City Plaza, Garden City, NY 11530
516-747-2000

NEW YORK
757 Third Avenue, New York, NY 10017
212-973-1000

GRAND CAYMAN
27 Hospital Road, P.O. Box 1748GT
George Town, Grand Cayman, Cayman Islands, B.W.I.

www.mwellp.com