The Main Dish

Winter 2019

Business tax reform: restaurant industry impact
By Austin Bradley, CPA

The Tax Cuts and Jobs Act brought with it many drastic changes to the tax law. Arguably the most important (and complex) of which is the 20% deduction allowable for pass-through income. However, that's not the only business tax change to come from the new law. As you prepare to file your taxes, let's look at the major provisions impacting you and your restaurant.

Section 199A: pass-through income deduction

Pass-through income is earnings generated by partnerships and S Corporations, which are subsequently "passed-through" to the owners of the business. The owners then pay the tax on this income, rather than the entity paying the tax. Under TCJA, this income is eligible for an up to 20% deduction on the individual's tax return. Assuming a taxpayer receives the full 20% deduction and is in the highest applicable tax bracket, this reduces the effective rate on their pass-through income from 37% to 29.6%. However, there are numerous variables that determine how much, if any, of the 20% deduction you're entitled to.

The first question you need to answer is whether the entity generating pass-through income constitutes a "specialized service trade or business." Income generated by an SSTB is subject to stricter rules when calculating the deduction. Fortunately, restaurants are not among the industries which will generally be subject to SSTB restrictions, but there are still several factors you must consider to determine the allowable deduction.

To illustrate a basic scenario, as long as taxable income for a married taxpayer is below $315,000, he or she will receive the full 20% deduction. Once the $315,000 threshold is crossed, however, the calculation becomes more complicated. At this point, the amount of the deduction is based on the amount of wages paid to employees and on the amount of depreciable property owned by the entity. Specifically, the deduction is limited to the greater of 50% of W-2 wages paid, or 25% of W-2 wages paid plus 2.5% of the unadjusted basis of depreciable property owned. Not confusing enough? This limitation only applies in full once taxable income exceeds $415,000. Between taxable income of $315,000 and $415,000, the wage and property limitation is only partially in effect – it is phased in gradually as income increases between the two thresholds.

While the limitations may seem a little scary, the good news for restaurant owners is that you operate in an industry which typically pays significant wages as part of regular operations and also employs significant depreciable assets, such as leasehold improvements and kitchen equipment. All this adds up to a higher likelihood of receiving the maximum pass-through deduction possible.

Despite being known as a pass-through deduction, there are other situations in which you can take advantage of the 20% deduction. Sole-proprietor restaurant owners reporting income and expenses directly on Schedule C of their individual tax return are eligible for the deduction – however, income limitation rules still apply.

Section 179

The Section 179 deduction allows you to deduct all or part of the cost of equipment and other tangible assets

Fast Facts

- Founded 1957
- 18 Partners
- 150+ team members
- 50% are CPAs
- Arizona's largest locally owned accounting firm
- Your money stays local
- Arizona Restaurant Association member
- National Restaurant Association member

The Main Dish

in the year the property is placed in service. Instead of having to spread out depreciation deductions over years, your business can receive immediate income tax benefits by using Section 179 to expense large costs in a single tax year. As part of TCJA, Section 179 limits were expanded from a maximum available deduction of $500,000 to $1 million. The deduction begins phasing out if total assets purchased during the tax year exceed $2.5 million and is completely phased out at $3.5 million of asset additions.

Bonus depreciation

Bonus depreciation was also significantly expanded by TCJA. Under the old law, assets eligible for bonus depreciation could be written off 50% in the year placed in service, with the remaining 50% depreciated over the asset's appropriate class life. Now, assets eligible for bonus depreciation can be written off 100% in the year placed in service, with no applicable phase-outs.

In addition to furniture, equipment and the like, you would expect that bonus depreciation could be applied to "qualified improvement property" – defined as any improvement to an interior portion of a building that is nonresidential real property if such improvement is placed in service after the date such building was first placed in service. Additionally, QIP does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator or the internal structural framework of the building. Essentially, QIP would include most buildout, remodel and refresh costs. However, there is a caveat.

When TCJA was drafted by Congress, qualified improvement property was left off the list of property eligible for 15-year class life depreciation; so, it reverts to the default class life of 39 years, which is ineligible for bonus depreciation. Many believe this was an oversight – a simple mistake due to the rushed nature of the bill – and that a technical correction would be issued. At the time of this article, no such correction has been published.

Business meals + entertainment

Significant changes enacted by TCJA impact the deductibility of business meals and entertainment. Before, you could deduct 50% of the expenses incurred for any food or beverages and for any activity generally considered entertainment, amusement or recreation, as well as for the facility used in connection with such activity. TCJA completely repeals the deduction for entertainment expenses; business meals remain 50% deductible.

If you incur expenses that are comprised partially of meals and partially of entertainment, make sure the facility separately states the meals portion of the bill and that you account for these expenses correctly in your bookkeeping software. Lumping all the expenses into one account called "meals and entertainment" will no longer be sufficient for recordkeeping, as they must be separately stated in order to determine their deductibility. Accounting for business meals can become complex, particularly when employees are involved.

If you have questions about how all this impacts your business, be sure to reach out to your Henry+Horne tax advisor. For a more in-depth look at the impact of tax reform on the restaurant industry, visit **www.hhcpa.com/restaurant** to download our new e-Book.

If you have any questions, Austin can be reached at (480) 483-1170 or AustinB@hhcpa.com.

"

Henry+Horne has performed several audits of our annual financial statements, and each year they have submitted the reports on or before deadline. All members of the engagement team are very knowledgeable, extremely responsive and professional.