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Restaurant Companies: It's Not Too Late to Save on Taxes

Restaurant companies have plenty of tax ideas to incorporate into their 2019 tax returns. With the help of our friends at Plante Moran, Robert Shefferly III and Brett Bissonnette, and my colleague Brian Tunis, we've compiled some of the best ideas for 2019 and 2020.

1. Depreciation. Make sure you're taking advantage of bonus and Section 179 depreciation. The unique aspect of 179 is its application to used equipment and to leasehold improvements with a 15-year life. It's not too late to do a cost segregation study for real estate acquired in 2019.

2. Gift Cards. You should consider the new rules for gift cards, especially for when you bring gift cards into income. Certain businesses that have "applicable financial statements" (audited financial statements) are now required to include sales of gift cards into income in the year of sale. The effect of this is to accelerate income requiring businesses to pay income taxes sooner rather than later. Other businesses may continue to follow the existing deferral rules.

3. Interest Expense. The deduction for interest expense is limited to 30% of adjusted taxable income. However, there are a couple of exceptions. First, small businesses under $25 million in average annual receipts for the prior three taxable years are not subject to the limitation. Further, a real estate company which does not otherwise fall under the small business exception may make an irrevocable election to avoid the interest limitation rule. If a company makes this election, the trade-off is they must depreciate their real property under the "alternative depreciation system," which extends the depreciation period for this property.

4. Flow-Through Deductions. Flow-through-entity owners are allowed a 20% qualified business income deduction. While this deduction may be limited based upon wages and historic cost basis, certain related businesses may combine these limitations. For example, suppose a restaurant owner operates a business through an S corporation and owns the restaurant building individually. If the S corporation doesn't have enough income to qualify for the qualified business income deduction but has enough wages, and the rental activity has enough income to qualify but doesn't have any wages, the owner can elect to combine his or her share of income and wages of both entities into a single activity.

5. Use of a C Corporation. One planning tool we've been focusing on is the use of multiple entities, particularly C corporations, because of the lower corporate tax rate. If you are servicing significant debt, then a C corporation may be in your future. This is particularly relevant if you can isolate the debt in the C corp and move income out of the C corporation through management agreements or rent or other types of arm's-length business arrangements.

6. Deduction of Investment-Related Expenses. While investment expenses and custodial fees used to be freely deductible to the extent they exceeded 2% of the taxpayer's adjusted gross income ("AGI"), they are no longer deductible. There is a workaround to be able to deduct investment expenses, that is running the investment expenses through an active trade or business. Investment expenses are generally a deductible business expense and not subject to any AGI floor.

7. Meals and Entertainment. No deduction is allowed for food and beverage unless it falls under one of the exceptions. The exceptions are recreational, social, or similar activities primarily for the benefit of employees. Private employee parties are great for restaurants. Also allowed is a deduction for 50% of food and beverage expenses related to employee, stockholder, agent or director business meetings.

8. R& D. One of the things that is sometimes overlooked is that restaurateurs often engage in research and development, particularly when developing new restaurants, new types of service or even new technology. If the records of such activities are maintained and a base period is established, this can generate tax credits. Record keeping is essential to capture the information for your accountants to make accurate calculations.

9. FICA Tip Credit. The FICA tip credit is still a great tool for limiting taxes. More importantly, you have the option of taking it as a deduction, or as a credit. If for some reason you can't utilize the credit, it is certainly a deduction which may offset income, or create a carryover loss.

10. Smallwares. Restaurants or taverns are permitted to expense applicable smallwares in the same way that materials and supplies are expensed.

11. Cash Basis. Because of their size, restaurants, even though they have minimal inventory, may be able to use the cash basis for tax purposes. The receipt of credit cards, for instance, may allow some deferral.

12. State and Local Tax. Don't forget state and local tax planning. For example, consider payments to other entities, such as management fees to a management company located in a lower-tax state. Or set up an intellectual property holding company located in a lower-tax state and then collect reasonable licensing fees from operating entities in higher-tax states.

These are just a few ideas, and I hope they help. It's never too late to plan.

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