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Money-Saving Tax Strategies for Craft Breweries

Ongoing deliberation by Congress on excise tax for beer has been top of mind recently for many craft breweries in the U.S. Whatever the outcome, it will have a significant impact on craft brewery financials. However, excise tax is just one tax topic breweries should consider.

Legislation activity has increased on other issues as well, and many can substantially increase or decrease a company's tax burden. However, there's no "right answer" for all breweries; each brewery is unique, and each tax strategy will work better for some than for others. Those listed below offer a sampling of the areas craft brewery financial officers and their tax advisors should examine.

R&D Tax Credit

The research and development (R&D) tax credit allows companies to deduct expenses related to developing new processes, efficiencies, or initiatives that eliminate uncertainty within the business. R&D activities must employ the scientific method and must be documented. Examples of the many processes that may qualify include, but are not limited to, developing new recipes, creating ideas to reduce power use, improving brewing/packaging processes, and making test batches.

Cost Segregation Studies

Breweries that are expanding into new facilities or expanding current operations can use cost segregation to reduce their tax burdens. For example, rather than applying a standard 39-year depreciation to a brewhouse and everything attached to it, a brewery may apply a shorter schedule to certain specialty items. The determination of which items are eligible for cost segregation requires an engineering-based study, which identifies building parts that can be depreciated over a shorter lifespan. The cost segregation study is typically initiated after purchase, construction, or renovation of a building. Accelerated depreciation allows you to take tax deductions over the shorter more realistic asset lives, which saves cash flow in the short term instead of having to slowly recognize those deductions over the 39-year life.

Section 199 Deduction

Section 199 of the Internal Revenue Code describes the Domestic Production Activities Deduction (DPAD), which allows companies that manufacture within the U.S. to deduct 9% of the lesser of (1) taxable income or (2) qualified production activity income (QPAI), which is equivalent to domestic production gross receipts (DPGR) less allocable cost of goods sold and other deductions. Many breweries and even some manufacturing-focused tax professionals overlook this deduction, but it can potentially save profitable breweries significant sums.

Accelerated Depreciation

Enhanced Code 179 allows taxpayers to immediately deduct, rather than gradually depreciate, the cost of qualified assets, subject to certain limitations. This type of depreciation reduces the amount of taxable income early in the life of an asset, so tax liabilities are deferred. Method changes may be required or preferable under the new repair and capitalization regulations, so brewery executives should consult with tax professionals to ensure filing is being done correctly. Bonus depreciation allows taxpayers to claim an additional first-year depreciation deduction; although currently expired, this benefit may be extended for 2015. Currently, the level of Code 179 deduction has not been finalized and will not be known until Congress finalizes tax regulation for 2015. For the 2014 fiscal year, the determination did not happen until late in December 2014.

Entity Structure

The business structure selected by a brewery will have certain consequences. For example, a C corporation is generally not tax efficient because the corporation is taxed on income, and owners can be taxed again on distributions of available income. However, this structure may be preferred by certain investors. With an S corporation, there are limits to who can be an owner and to the number of owners. With an LLC, income allocations are usually supported by tax distributions, which can impact cash flow. The decision about which structure to use can have implications far into the future, and the process of changing from one structure to another can be complex, so breweries should consider options carefully.

Another tax strategy not specific to a particular entity type is an Employee Stock Ownership Plan (ESOP). An ESOP can be set up by companies of any entity type and is an increasingly popular option for breweries because it can incentivize employees, save money, and defer taxes due.

State-Specific Considerations

States offer various tax incentives, and breweries should investigate them before starting or expanding operations in a new state. Breweries are manufacturing entities, and most states currently offer some level incentives to manufacturing entities because of the large benefits that flow through to the states from the employees of such entities. Incentives may be granted for business activity within Economic Empowerment Zones or Enterprise Zones, hiring veterans or displaced youth, starting or expanding manufacturing-based businesses, and other business activities. Companies can negotiate with states to get additional benefits, especially if they're creating new jobs. Additionally, expansion into different states may affect income tax nexus or create new sales tax compliance requirements. As breweries expand into other states, they should explore all of these issues. Department of revenue websites for each state can provide critical information, and industry-experienced tax advisors can help determine how individual breweries should put it to use.

Conclusion

A variety of tax-related strategies, including deductions, credits, and incentives, can be used by breweries to minimize their tax burdens; however, to ensure all the strategies available are used to their best advantage, breweries must do a bit of digging to understand how various activities, such as engaging in research and development, purchasing property and other assets, or doing business in a particular state, can impact them. The effort is well worth the savings, but most brewery executives have limited time and may want to consider enlisting the help of tax professionals to examine their options.

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Serving several of the largest craft breweries in Colorado and across the country for more than 15 years, EKS&H offers 25 professionals with industry expertise. Our commitment to these breweries includes membership in the Brewers Association and the Colorado Brewers Guild. To learn more about how we can help your craft brewery leverage all potential credits, incentives, and deductions, please contact John DeVore at 303-448-7000 or jdevore@eksh.com or Mike Madden at 303-740-9400 or mmadden@eksh.com.