



*Addressing the Accounting,
Tax and Business Needs
of Food & Beverage
Industry Executives*

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Taxing Thoughts: California's Onerous Taxing Environment

During our 2nd Annual Food & Beverage Industry Forum in September 2013, the difficulties surrounding doing business in California were recurring themes in the panel discussion. The conversation prompted this issue's topic where we will be discussing the high tax climate in California. Food and beverage owners and executives are looking for guidance on how to address these taxing issues. Akash Sehgal, Director of State and Local Tax at Green Hasson Janks, will shed light on the tax implications for California food and beverage companies.

From complex labor laws and workers compensation, to healthcare costs, food and beverage companies continue to deal with the "high cost" of doing business in California. This has never been more apparent than in the state and local tax area where California continues to pass and retain legislation designed to further burden businesses and their owners that operate and expand in California.

California specifically:

1. Imposes the highest personal income tax rates in the country. The highest marginal tax rate is currently 12.3% with an additional 1% for individuals with \$1 million or more of California source income.
2. Has one of the highest corporate income tax rates in the country at 8.84%.
3. Imposes an entity level income tax on S Corporations at 1.5%. Most states do not impose an entity level tax on S Corporations.
4. Imposes a minimum tax of \$800 on all legal entities doing business in California. Most states that impose a minimum tax do so at a substantially lower amount.
5. Imposes a fee on limited liability companies doing business in California based on gross receipts. The fee can be as high as \$11,790 per year.

6. Provides virtually no tax credits to companies in the food and beverage industry. In fact, California recently repealed the State Enterprise Zone Credit, which was the most lucrative tax credit in the country and which benefitted many food and beverage companies.
7. Taxes California food and beverage companies on sales of product destined to other states to the extent the business is not subject to tax in the destination state (“throwback rule”).
8. Has complex and onerous city business taxes that cannot be passed through to customers and are in addition to state level taxes described above
9. Has some of the highest property taxes for businesses in the country.

Many California based businesses are looking to expand or relocate to other states and it's important that these businesses understand what tax benefits may be received by doing so

Take for example, a typical food and beverage company set up as an S Corporation with two California resident shareholders that has its main distribution facility in California. The company ships products to all fifty states but is taxable only in California. If this company generated \$5 million in net income, it would pay an S Corporation level tax of \$75,000 and the shareholders would pay tax on the \$5 million of net income at 13.3% equating to a California personal income tax liability of \$665,000. In addition, the business would be subject to local business taxes and high personal property taxes depending on where in California it operates. Further, this business would receive virtually no state or local tax credits.

Now let's say this business operated its main distribution facility in Arizona with its two shareholders as Arizona residents. Arizona does not impose an entity level tax on S Corporations, so no tax liability would be incurred at the S Corporation level. Arizona's highest marginal

individual income tax rate is currently 4.54%, so the Arizona resident shareholders would pay Arizona individual income tax of \$227,000. Additionally, Arizona does not generally impose onerous local business taxes and has relatively modest personal property taxes. Further, Arizona does provide tax credits for newly hired employees that can further reduce the tax burden at the shareholder level. Based on this scenario, the business and shareholders would save approximately \$513,000 of state income tax by operating its main distribution facility and residing in Arizona as opposed to California.

Granted, tax implications are one of many different factors that a business considers when determining where to operate. The above example was designed to give an idea as to what California based businesses face from a tax perspective compared to business located or operating in other states. Many other states have recently enacted legislation to reduce the tax impact on

businesses and individuals. For example, many southern US states, have relatively low corporate and personal income tax rates, do not have “throwback rules” and have lucrative tax credits and incentives that can be utilized at both the business and personal income tax level. Many California based businesses are looking to expand or relocate to other states and it's important that these businesses understand what tax benefits may be received by doing so.

All hope is not lost in California as the state recently enacted a new hiring credit and sales/use tax exemption that may benefit food and beverage manufacturers and distributors. The new hiring credit is an income tax credit that can be as high as \$56,000 per eligible employee. The eligible criteria is much more stringent than under the prior Enterprise Zone Credit and many food and beverages companies may find that a majority of their employees who otherwise qualified for the Enterprise Zone

Recap: 2nd Annual Food and Beverage Industry Forum

On September 26, 2013, Green Hasson Janks hosted its 2nd Annual Food and Beverage Industry Forum in downtown Los Angeles. The event was designed for business owners and executives in the food and beverage industry and was attended by over 150 people. Attendees heard highlights from our 2013 Food and Beverage Survey, including growth areas, pricing competition, challenges such as raw materials and labor costs, M&A, succession planning, social media and other benchmarking studies. Our keynote speaker, Alexia Howard, senior analyst at Bernstein, highlighted the hot topics in the food and beverage industry from the national perspective. Following Alexia, we had a panel discussion of food executives, including, Jan Berk of San Miguel Produce, Jack Hook of Bodega Latina, John Dutton of the Arlon Group and Antonio DeCardenas of the DeCardenas Law Group and shareholder of Cacique, Inc. The panel discussion covered a myriad of topics, including the local perspective of the food and beverage industry and there was a great deal of discussion revolving around the difficulties of conducting business in California. To view highlights from our Food and Beverage Industry Forum, [click here](#).



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Credit do not qualify for the new hiring credit. Food manufacturers may be able to take advantage of a new partial sales tax exemption on qualified manufacturing equipment that is used in California. The partial sales/use tax exemption can be as high as 45% of the statutory sales/use tax that would otherwise apply. To view our recent State and Local Tax alert on the partial sales/use tax exemption and its implications, [click here](#).

In the meantime, California based food and beverage companies should continue to lobby for more favorable taxing schemes in California given the importance of operating in California for this industry. These businesses should also discuss the applicability of the new hiring credit, the partial sales/use tax exemption and potential tax credit and incentives opportunities in other states with their respective tax advisors. &

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