JOHN DUNHAM & ASSOCIATES

Memorandum

To: Dawson Hobbs
From: John Dunham
Date: January 10, 2025
Re: IRS Section 199A Impact on Wine and Spirits Distribution Industry

Under the provisions of the Tax Cuts and Jobs Act of 2017, Congress included a deduction for individuals receiving "pass-through" income from partnerships and Subchapter S corporations. This provision, known as Section 199A, allows eligible business owners to deduct up to 20 percent of their qualified business income (QBI) in determining their personal tax liability. This reduces effective tax rates for business profits by up to 20 percent. This deduction expires in 2025.[1]

Nearly all American, family-owned wine and spirits wholesaler companies operate as partnerships and S-corporations, meaning that partners and shareholders of these entities utilize this critical provision in the tax code. This allows them to realize the same after-tax income while taking smaller distributions from the companies, effectively providing more capital for reinvestment and operational purposes.

Wine & Spirits Wholesalers of America (WSWA) asked John Dunham & Associates (JDA) to calculate the support to local facility operations, and capital investments, that accrued since 2017 as a result of this tax provision based on both government and survey data.

Expected Impact of 199A Provisions

In the context of the 199A provision, a reduction in the tax on income from partnerships and Subchapter S corporations should encourage more investment in qualified entities. While it is difficult to determine the specific impact of the 199A provision, there has been a sizable increase in capital investment in non-durable goods wholesaling following the enactment of 199A.[2] The US Department of Commerce, Bureau of Economic Analysis tracks capital investment across industry sectors.[3] While wine and spirits wholesaling is not broken out directly, non-durable goods wholesaling is. These data track new investment in the sector for: Structures (such as warehouses or certain types of equipment like elevators), equipment (packaging machinery, conveyers), intellectual property (software, books, R&D); other fixed assets (desks, trucks, etc.). Based on these data, there was a sizable jump in investment (in real 2004 terms) following the implementation of 199A. Table 1 on the following page shows these data.

As the table shows, growth was most rapid for equipment and intellectual property, though in recent years, investment in new structures has been particularly strong. Only in the case of other fixed assets, which would include items such as furniture or trucks, have investments fallen, though this has likely been in response to the COVID-19 virus.

1 Guenther, Gary, *The Section 199A Deduction: How It Works and Illustrative Examples*, Congressional Research Service, Report R46402, June 10, 2020, at: https://crsreports.congress.gov/product/pdf/R/R46402.

2 Wine and spirits wholesaling falls under the non-durable goods category. More detailed data are not available from the Federal government.

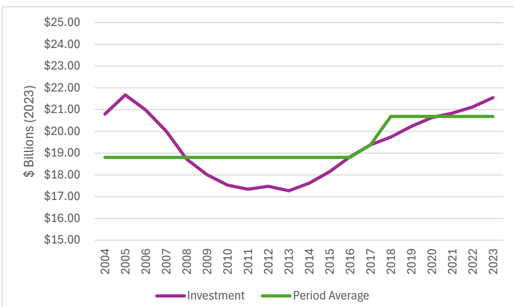
3 National Data, Fixed Assets Accounts Tables, US Department of Commerce, Bureau of Economic Analysis, at: https://apps.bea.gov/iTable/?ReqID=10&step=2. Accessed December 26, 2024.

Table 1
Investment in Fixed Assets in the Non-Durable Goods Wholesaling Sector ($2004)

($2004 Billion)	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Structures	$ 3.94	$ 3.80	$ 3.65	$ 3.52	$ 3.48	$ 3.73	$ 3.97	$ 4.11	$ 4.17	$ 4.21	$ 4.31	$ 4.40	$ 4.56	$ 4.76
Equipment	$ 4.96	$ 4.94	$ 5.07	$ 5.08	$ 5.21	$ 5.33	$ 5.44	$ 5.91	$ 6.28	$ 6.70	$ 6.95	$ 7.10	$ 7.24	$ 7.43
Intellectual Property	$ 3.32	$ 3.34	$ 3.46	$ 3.51	$ 3.72	$ 3.92	$ 4.21	$ 4.51	$ 4.77	$ 5.08	$ 5.37	$ 5.57	$ 5.75	$ 5.96
Other Fixed Assetx	$ 5.32	$ 5.25	$ 5.29	$ 5.16	$ 5.21	$ 5.18	$ 5.22	$ 4.84	$ 4.52	$ 4.24	$ 4.00	$ 3.77	$ 3.57	$ 3.40
Total	$ 17.53	$ 17.34	$ 17.48	$ 17.27	$ 17.62	$ 18.15	$ 18.83	$ 19.38	$ 19.74	$ 20.23	$ 20.63	$ 20.84	$ 21.12	$ 21.55

Going back to 2004, the earliest year available, and examining the percentage change in investment, it is easy to see that prior to 2017, there were lower levels of investment growth than after 2017. Figure 1 below shows the total and average investment over three periods (2014-2016, 2017, and 2018-2023) in real 2004 dollars. As the figure shows, there was a substantial increase in average real capital investments in the sector following the implementation of the 199A credit. This change was nearly $1.9 billion per year, or 10.0 percent.[4]

Figure 1
Total and Average Capital Investment by Period ($2004)



While data are too limited to determine if this increase in investment is solely due to the 199A provisions, it is important to note that investment tracked the economy prior to 2017, but did not fall during the 2020-2021 COVID-19 recession, nor has it tapered off as the economy remained soft in 2022 and 2023.

Extrapolation to the Wine and Spirits Wholesaling Industry

These data reflect all capital investments by non-durable goods wholesalers, of which wine and spirits wholesalers account for a small proportion. The most recent comprehensive data on the scope and operations of wine and spirits distributors is available from the 2024 Economic Impact Analysis of the Wine and Spirits Industry.[5] According to this analysis, nearly 97,800 full-time-equivalent (FTE) jobs were directly created by wine and spirits wholesalers in 2024, along with nearly $40.8 billion in direct economic output. There were 4,176 facilities wholesaling beverage alcohol in 2024. Of the 97,800 jobs, about 7,850 are classified as "proprietors." These would be everything from sole proprietors, members of Limited Liability Corporations (LLCs), owners of Subchapter S corporations, etc.[6] This means that about 7.1 percent of all employees are proprietors, and they receive about $663.5 million in distributions.

According to the Bureau of Labor Statistics, there were a total of 2,217,840 employees in the non-durable

4 $1,882,000,000 in $2004.
5 *The Wine and Spirits Industry Economic Impact Study: 2024*, John Dunham & Associates, prepared for the Wine and Spirits Wholesalers of America, December 2024. Dollars in current $2024.
6 Anyone receiving K-1 income from a company is considered a proprietor.

goods wholesaling sector as of June 2024.[7] These workers received $48.9 billion in wages. This suggests that wine and spirits wholesaling accounts for 4.1 percent of the total sector in terms of employment but 17.7 percent of wages, meaning that employees in this sector are particularly well compensated.

Keeping ratios similar for proprietors would mean that there are a total of 187,470 proprietors in the non-durable wholesaling sector of the economy. Table 2 below shows the totals for the wine, spirits, wine and spirits and non-durable goods wholesaling sectors.

Table 2
Employment, Income and Estimated Proprietors and Proprietor Income Across Sectors

Sector	Workers	Proprietor	Wage Income	Proprietor Income	Wage/emp.	Income/Prop.
Spirits	42,269	3,583	$ 4,061,691,045	$ 311,062,791	$ 96,092	$ 86,806
Wine	47,887	4,060	$ 4,601,493,465	$ 352,403,317	$ 96,092	$ 86,806
Wine And Spirits	90,155	7,643	$ 8,663,184,510	$ 663,466,108	$ 96,092	$ 86,806
Non-Durable Goods	2,217,843	187,467	$ 48,911,428,000	$ 3,726,524,671	$ 22,054	$ 19,878

Based on a linear projection of the capital spending data, total spending in 2024 (again in inflation adjusted 2004 dollars) would be $21.88 billion, or about $9,864 per worker.[8] Inflating this to current (2024) dollars would equal $17,671 in investments per employee for the non-durable goods wholesaling sector. Of this, about $2,485 per employee is potentially due to the 199A deduction. Multiplying this by the number of wine and spirits wholesaling employees gives an estimate of $224.0 million in increased annual capital spending due to the 199A deduction, or approximately $1.57 billion over the 7-year period.[9]

Tax Based Modeling Approach

Another way to look at the potential impact of the 199A provision is through the estimation of tax savings that could be made available for capital investments. The 199A provision provides for a 20 percent deduction of qualified business income. According to the economic impact analysis, proprietors in the wine and spirits wholesaling sector received about $663.5 million in qualified business income in 2024, meaning that the total deduction would be $132.7 million in current dollars, leading to a tax savings of $44,200,100, assuming the highest tax rate of 33.31 percent.[10]

An alternative calculation is produced by multiplying the $663.5 million in qualified business income by 25 percent. When an owner's taxable income exceeds the upper income threshold: in this case the deduction cannot exceed the greater of 50 percent of the owner's share of W-2 wages for a business, or 25 percent of those wages plus 2.5 percent of the owner's share of the unadjusted basis of qualified property used in the business.[11] The 25 percent figure is used as a conservative cap on the amount of income that can be deducted. This would total just under $55.3 million in tax savings.

7 Quarterly Census of Employment and Wages, US Department of Labor, Bureau of Labor Statistics, at: https://www.bls.gov/cew/data.htm. Accessed December 28, 2024.
8 $21,877,000,000 in $2004.
9 $1,568,000,000 in $2024.
10 2024 Calculation of Effective Tax Rate. Kraft CPAs, at: https://www.kraftcpas.com/production/site/web/assets/2024/02/2024-Effective-Federal-Tax-Rate-Chart.pdf.
11 Op. cit., Guenther, Gary.

Assuming owners keep an average profit margin of 1.63 percent,[12] the amounts that could be potentially reinvested would be between $43.5 million and $54.3 million each year, or between $304.4 million and $380.5 million in current ($2024) over the 7-year period.

Table 3
Calculation of Available Capital From Tax Savings ($2024)

	Scenario 1	Scenario 2
Pass through income	$ 663,466,108	$ 663,466,108
199A Deduction	20%	25%
Deduction $	$ 132,693,222	$ 165,866,527
Effective Tax Rate	33.31%	33.31%
Savings	$ 44,200,112.11	$ 55,250,140.14
Owner's Margin	0.0163	0.0163
Total $ Available	$ 43,479,650	$ 54,349,563
Employees	90,155	90,155
$ Per Employee Available for Investment	$ 482	$ 603

Data from Wine and Spirits Wholesalers

In late 2024, WSWA conducted a survey of its members to determine the amount and nature of capital spending in the industry since 2017.[13] The results were limited, with data collected from 11 companies and locations in 29 states. Based on these data, and estimated company employment by state from the 2024 Economic Impact Analysis of the Wine and Spirits Industry, an average of $66,320 per person was spent on capital improvements over the 7-year period, or roughly $9,475 per worker per year. The median spending was smaller, just $48,632, indicating that the distribution was skewed to the lower end.

While this figure is significantly lower than the non-durable goods sector as a whole ($9,475 vs. $17,671), it should be remembered that the companies in the survey tended to be larger, more established firms, and most capital spending in the distribution sector would be made by newer entrants. Even so, $9,470 per worker would equal $854.2 million per year, of which $120.1 million would likely be due to the 199A provisions.[14]

Investment Breakdown

While different businesses reinvest tax savings in different ways, the WSWA survey also broke the spending by category. Again, results were limited, but based on averages, the annualized capital investments made by wine and spirits wholesalers would equal about $3.0 billion, of which the majority (57.9 percent) would be in the form of construction expenses for new and expanded warehouses. The next largest segment was operational investments which accounted for 36.9 percent. Table 4 below outlines the spending reported by the survey.[15]

12 IMPLAN® model, 2022 Data, using inputs provided by the user and IMPLAN Group LLC, IMPLAN System (2024), 16905 Northcross Dr., Suite 120, Huntersville, NC 28078, www.IMPLAN.com.

13 Raw survey data provided to John Dunham & Associates by the WSWA. JDA did not have access to the survey frame and therefore cannot determine the statistical significance of the results.

14 Based on the 90,155 workers in wine and spirits wholesaling from the 2024 Economic Impact Analysis (Note 4).

15 Note that per person figures were based on employment estimates for company facilities from the 2024 Economic Impact Analysis (note: 4). Categories were extrapolated from survey questions as provided to JDA. Specific investments were outlined in only a few cases.

Table 4
Estimated Capital Spending by Type Based on WSWA Survey

	Avg Per Person	Estimate	Percent
Upgrades	$ 9,475	$ 854,192,277	4.0%
Construction	$ 126,434	$ 11,398,681,346	53.9%
Sustainability	$ 2,587	$ 233,272,135	1.1%
IT	$ 2,551	$ 230,022,939	1.1%
Talent Development	$ 2,631	$ 237,223,009	1.1%
Operational	$ 86,542	$ 7,802,228,015	36.9%
Transportation	$ 4,283	$ 386,172,267	1.8%
Total	$ 234,504	$ 21,141,791,988	100.0%
Annualized	$ 33,501	$ 3,020,255,998	

Based on the analysis of overall capital spending in the non-durable goods wholesaling industry between 14.4 percent and 18.0 percent of capital spending is likely a result of the 199A provisions. This means that between $434.9 million and $534.6 million in capital spending by the wine and spirits wholesaling industry has resulted from the 199A provisions (or between $62.1 and $77.7 million per year), equal to between $104,150 and $130,180 for each of the 4,176 facilities across the country.

Conclusion

The IRS Section 199A provision from the Tax Cuts and Jobs Act of 2017 help to encourage investments into the operations of companies operating as partnerships and S-corporations. Many of these are smaller, family businesses, including most of the nation's wine and spirits wholesalers. Each year, between $43.5 million and $54.3 million is made available through the 199A tax deduction to invest in growing and improving wine and spirits distribution operations across America.[16] Over 90 percent of this is invested in new facilities and equipment that helps to improve industry productivity and ensure that legal adult consumers have access to a wide variety of wine and spirits products sold through responsible retailers.

These operations lead to the collection of as much as $14.8 billion worth of federal income, excise, payroll, customs and other taxes each and every year.[17]

[16] For a total of between or between $304.4 million and $380.5 million in current ($2024) over the 7-year period.
[17] Op. cit. Footnote 4.