THE MAIN DISH

Summer 2016

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Musings from the 2016 National Restaurant Association's Tax and Finance Executive Study Group

By Bradley Dimond, CPA

I recently attended my 6th consecutive NRA Tax and Finance Executive Study Group in Denver. It is always an interesting conference and this year was no exception.

Something is missing …

The conference differed in that there were fewer tax and finance-specific "breakout" sessions. In addition, conspicuously missing from the proceedings were representatives from the IRS, which had been present in the past (if not in person, then at least by teleconference). These had always been informative sessions which gave indications of areas of concern in the Service as well as future guidance that was of particular interest to the hospitality industry. Also, there was always a representative from the IRS specific to the area of tips. Apparently the IRS was invited to speak but declined. Not sure what sort of conclusion to be drawn here; we will be diplomatic and surmise that it was not within the IRS budget.

Also missing this year was a lively and informative session with labor attorney Marianna Dyson dealing with tax-related updates in the area of wages and benefits. In her place, my running mate this year, Jonathan Poppel, is debriefing a presentation from attorneys from another firm regarding new information on reporting standards coming online.

Tax matters

On the tax side of the house, we reviewed past year developments. Of course, the biggest development was the December passage of the PATH Act (Protecting Americans from Tax Hikes). The bill made many of the so-called "extenders" permanent. Others were extended for 5 years and some for 2 years. This provides more certainty in terms of planning than we have had for a number of years. Things of interest to the industry include the extension of favorable Section 179 expensing, $500,000 per year if less than $2 million in assets is placed in service during the year (permanent and indexed for inflation); 15 year write-off for leasehold improvements for restaurants and retail including more favorable rules regarding application with respect to leasehold (permanent); R&D credit (permanent); extension of the 50% immediate bonus depreciation write-off for new equipment and leasehold improvements (5 year extension); continued and enhanced Work Opportunity Tax Credit (WOTC) (5 years); and finally, the extension of energy efficient building deductions under Section 179D (2 years). There were numerous other favorable extensions not necessarily industry-specific that are beyond the scope of our word limit and probably your attention span as well.

R&D credit. With respect to the R&D credit, favorable guidance related to potential application to internal use software which the IRS had regularly challenged in the past came out. This could be of particular interest to operators who work to develop internal systems for tracking performance and/or managing costs.

Safe harbor elections. There was favorable guidance released which provides that restaurants and other retailers that regularly need to "refresh" their space can make certain safe harbor elections regarding amounts of such costs deducted versus what needs to be capitalized and depreciated.

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Tappas

When it comes to the cleanliness of your restaurant, restaurantnews.com highlights ten areas customers pay extra attention to: floors, silverware, tabletops, dusty décor, bathrooms, ceiling fans, glasses, condiments, bugs and trash areas. Keeping these areas clean will keep your customers coming back.

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Phoenicians are spending more at restaurants. According to the JPMorgan Chase Institute, in March 2016, spending at restaurants in Phoenix increased 3.84% year over year.

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The top 5 restaurant chains for the 2016 Consumer Picks survey from Nation's Restaurant News are: Morton's the Steakhouse, Ruth's Chris Steak House, The Capital Grille, Fleming's Prime Steakhouse & Wine Bar and McCormick & Schmick's.

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The good news is that operators can deduct 75% of such costs and must capitalize only 25%. Costs such as new flooring, painting, reconfiguring space, etc., which the IRS may have argued in past years needed to be capitalized as leasehold improvements or worse yet, as building, can now be mostly deductible. Of course, there are very complex rules regarding what type of costs are "qualified". As well, there is always some bad news with the good news (for those of you who might recall my debriefing from last year's conference). The bad news is that in order to take advantage of these rules, an owner must have an "applicable financial statement" or AFS as we geeks refer to it. This means, basically, audited financial statements. Since most of my clients do not want to incur the cost of getting audited statements, we will not have the certainty that the safe harbor provides. This also once again highlights the bias or lack of understanding the people who write the rules (read people who come from global accounting and law firms and are used to dealing with global, public companies) have against most of the companies we deal with.

Tax reform. As in past years, the most interesting presentation centered on tax reform (I really need to get a new life). In most proposals that have come out, the Section 45B tax credit (the FICA Tip Credit) is on the chopping block. This is not news; however, the National Restaurant Association is working hard to educate the lawmakers on the continued need for the credit. Obviously, the result of the upcoming election cycle will determine the direction tax reform will take. We can be pretty certain, however, that the discussion will not begin in earnest until 2017. Many factors will induce the outcome of tax reform including simplification, dealing with the international aspects and U.S. competitiveness, integration of corporate and individual/flow through entities as well as fairness and whether the goal of reform is to raise revenue or be revenue neutral.

Interchange fees. One topic covered which has been in the news quite a bit lately is the question of interchange fees. You may recall that this was a big topic a number of years ago and Congress worked a deal to limit the swipe charges (interchange fees) on transactions. There is a movement to do away with these limits and allow banks/processors to raise the fees. This would do particular damage to those that handle many smaller transactions (read QSR concepts). Data suggests that 30% of these transactions are for less than $10. The presentation at the conference discussed whether the current fee structure made economic sense and the conclusion drawn by the speaker was that processing costs have come down in the years since the limit was introduced (one estimate had the reduction in costs at 42%). So, it appears that the banks/processors are looking to make even more money. This all runs contrary to the Fed's goal of driving more transactions to be electronic rather than in currency.

Sharing economy. Finally, there was a presentation on the effect the "sharing" economy (e.g., Uber, Airbnb) was having on the industry. More and more people are comfortable with peer to peer transactions. There are several new apps which connect diners with people who want to provide "home cooked" meals and pick up a little money too. Of course, this affects the hospitality industry which is subject to regulation and taxation (similar to what taxis and hotels had been subject to) that could escape such regulation and taxation in a sharing economy situation. At this point, none of these apps has approached the wide appeal of ride sharing and home sharing, but the industry is keeping a close eye on them.

Unfortunately, I have run out of space. I am looking forward to next year's conference. If any readers out there are interested in attending or sending a representative to the conference, please do not hesitate to contact us. We would love to increase the Valley presence at the conference.

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



Tappas

The new Uber Eats app has launched in Phoenix. According to the Phoenix Business Journal, it allows users to order food from a number of Phoenix restaurants. To build the app, Uber used Thrillist ratings, Yelp reviews and other articles on the top restaurants in the Valley.

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Researchers are working on a new way to prevent food-borne illness and food waste. According to phys.org, they're looking into a special new coating that's more resistant to bacteria and other food microbes. The Department of Food Science at Cornell University has designed polymer coatings that resist microbial adhesion and can actually inactivate any microbes that do adhere. This would prevent them from growing and contaminating food supply. They may be commercially available in a few years.

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Highlights from the National Restaurant Association's Tax and Finance Executive Study Group

By Jonathan Poppel, CPA

Summertime is upon us once again and the annual National Restaurant Association's Tax and Finance Executive Study Group is in the books. I had the pleasure of attending this years' conference in Denver, CO and want to share some of the highlights.

Restaurant Spending

Restaurant spending is projected to increase again for 2016. States along the East and West Coast, along with the Southeastern U.S., are expected to have 5% or higher growth in restaurant sales for 2016. Midwest states, however, are expected to not be as fruitful in additional sales, with less than 5% increase expected for 2016. As noted during last year's conference, restaurant spending surpassed grocery store spending for the first time ever. A large driver of this for 2015 was due to reduced gas prices. It is estimated that consumers spent 20% of their gas savings on restaurant dining. Continued lower gas prices compared to historical levels will bode well for restaurant sales.

Minimum Wage Increases

One hot topic across the United States is recent or pending legislation to minimum wage rates for both tipped and non-tipped employees. Certain states and, to a further extent, certain municipalities have recently enacted legislation to substantially increase the minimum wage rates in those jurisdictions. Furthermore, many states have current or proposed legislation which may lead to additional minimum wage increases. There is an overall concern that minimum wage increases will hurt restaurant operators' bottom line, as related menu price changes can't be made to fully absorb the labor cost changes without sacrificing lost customers. Profit forecasting for multi-state operators will become more difficult due to the wide ranging pending legislation. Furthermore, changes in minimum wage rates are expected to negatively impact restaurant operators from expanding into certain states or municipalities.

Technology Trends

Technology continues to permeate restaurant operations as Millennials and Gen Z become a larger customer base. Online order and pay, digital menu boards, in-store kiosks, and tableside tablets are becoming more commonplace in the industry. Third party online ordering and delivery services are changing the landscape in how people get their food from restaurants. Furthermore, Millennials and Gen Z diners value customer loyalty programs. As a result, there continues to be the need for larger spends for technology related items for restaurants in order to keep up with diner expectations.

Real Estate

As the real estate market has heated back up, there is an overall shortage of "A" locations for new restaurant openings, which have driven the growth in "B" locations. This creates a more competitive environment, which increases rental rates all around. Many restaurant operators are increasing their focus on remodeling existing restaurants to give them a facelift and keep new and fresh in the eyes of the consumer.

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Tappas

A new survey by Datassential for the Alaska Seafood Marketing Institute finds that many Americans would like to see more seafood on restaurant menus. The reason? More of those surveyed cited taste as the main reason versus being healthful. Consumers would also rather the seafood be wild than farm-raised.

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A new app aiming to cut down on food waste made its debut at the Democratic National Convention. The mission of Food Connect is to help restaurants, caterers and event venues donate any excess food that does not get served because they ordered too much or it just didn't get eaten. The food goes to places in need such as food banks and pantries. Businesses can schedule pickups and volunteer drivers shuttle the extra food around. Food Connect will remain in business in Philadelphia even though the convention is over.

Gift Card Breakage

The recent revenue recognition accounting standards updates issued by the FASB have provided specific treatment for the recognition of revenue associated with gift card breakage. Starting in 2019 for nonpublic companies, gift card breakage income will need to be recognized in proportion to the amounts redeemed on the originally issued gift card. For example, if a $100 gift card is expected to have $8 of breakage (unused balance), and $70 is redeemed in a reporting period, the restaurant will recognize $6.09 of breakage income on the card during the reporting period as follows: $70 amount redeemed divided by $92 expected total redemption amount on the card multiplied by $8 of expected breakage income. However, if the gift card is subject to any state unclaimed property law, a restaurant is precluded from recognizing gift card breakage in income and will need to maintain a liability for the unclaimed property due to the state.

Food Safety

Diners have an increased desire for locally-sourced food. However, this also creates larger risk related to food safety. Furthermore, recent food safety issues experienced by Chipotle and the related negative publicity have brought food safety concerns to the front of people's minds. Restaurant operators are encouraged to develop an action plan for handling any potential food safety issues. This may include the need for a crisis response team. If you don't have it already, it is recommended that you get the necessary insurance coverage for any potential food safety or recall issues. Also, review the company's communication on how it promotes food safety. This is becoming increasingly important in the eyes of consumers and they are more likely to patronize a restaurant that has practices and a commitment to the highest in food safety.

Pay Equity

Pay equity has become a greater risk for employers and potential new reporting requirements by the Equal Employment Opportunity Commission ("EEOC") in 2017 may create an additional burden on employers. The EEOC has proposed revisions to the Employer Information Report (EEO-1), which will require all employers with more than 100 employees to submit compensation data and hours worked to the EEOC broken down by employee race/ethnicity and sex in each of ten job categories. Currently, the form just requires the number of employees by race/ethnicity and sex in each of the categories listed. There is genuine concern over the additional administrative burden the proposed reporting requirement would entail, especially considering that the reporting period would not be on a calendar year. The EEOC's proposal was put out for public comment, which ended in April 2016. It will be interesting to see what comes out of this proposal based upon the feedback received. If the proposed revisions as provided by the EEOC are approved, companies will need to work with their payroll providers or payroll system providers to determine how to comply with the requirements.

These are just a few highlights to a variety of topics that are discussed during the conference. As always, if you work in key accounting and tax positions for a restaurant, this is a great conference to plan on attending as part of your summer routine.

If you have questions, Jonathan can be reached at (480) 839-4900 or JonathanP@hhcpa.com.

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