THE MAIN DISH

Summer 2015

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National Restaurant Association Executive Study Group Synopsis

By Brian Campbell, CPA

I was happy to spend a few days in San Diego this year (the week of June 15th as Phoenix was heating up to over 110 degrees) for the National Restaurant Association's (NRA) Financial Officers and Tax Executives Study Group. As I have said in previous year's newsletters, this is a great conference and I encourage those of you that are responsible for the accounting and/or tax aspects of a restaurant to attend in future years.

Restaurant Owners' Top Concerns

Last year was the year of food costs and this year is the year of government regulations and recruiting of employees. In a May 2015 survey by the NRA, 24% of those who responded cited government regulation as their main concern compared to 16% in the prior year. Recruiting employees came in second with 16% of those responding having concern with hiring and retaining employees being a focus for 2015. Food costs are stabilizing and the prices of cheese, dairy and beef are expected to start decreasing in 2016 and 2017 as cattle numbers in Texas and the South start to increase with drought conditions no longer being a concern.

Restaurant Food Dollars vs. Grocery Store Spending

On the brighter side, for the first time ever, restaurant food dollars spent by households have surpassed dollars spent for food at grocery stores. Consumer confidence in the economy continues to rise at a slow pace, gas prices are lower than in the prior year, household incomes are up and these conditions result in people going out to eat more often than in the prior year. Menu prices are expected to rise around 3% in 2015 resulting in the industry projecting just over a 3% increase in sales for 2015. Arizona and Florida will be leading the way in sales growth for the nation at 4.9%. The restaurant industry over the past year has added approximately 355,000 jobs. Over the next ten years, Arizona is projected to lead all states in employment growth in the restaurant industry at 23.8%.

Gift Cards

Gift cards are still a hot topic when it comes to breakage and states pursuing unclaimed property as a result of breakage and unredeemed gift cards. The toughest state out there is still Delaware. So, those of you incorporated in Delaware, if you have not been approached by the state, plan on it. Breakage on gift cards is ranging from 6% - 10%. Keep in mind – the home state for gift cards is the state where the buyer of the gift card resides. If you have individual contact information for the person who purchased the gift card, then that is the home state. If no contact information is kept for the purchaser, then the home state defaults back to the company's state of incorporation.

Restaurant Valuations

Valuations for restaurants are at an all-time high, especially in the public markets as seen by some recent IPO's. Ten percent growth is the new benchmark to try to achieve as set by Chipotle at around 12% growth. Franchising continues to be a big growth area for restaurants and for private equity firms looking to buy restaurants, as it is a quick way for restaurants to grow and can result in great returns on investments. There will continue to be more focus placed on efficiently managing overhead costs, labor and vendor relationships to help increase bottom line net income. Technology is, and will continue to be, a big factor in the future in helping to manage restaurant operations, especially labor as costs continue to increase in this area.

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Tappas

Do you want to bolster your bottom line through lower turnover, higher guest satisfaction and other positive outcomes? Then you'll want to have a well-thought out and reinforced company culture. That's according to a panel of training experts at the National Restaurant Association's Hotel-Motel Show. They recommend beginning to establish a culture by defining what it means to your company.

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The FDA has officially removed partially hydrogenated oils, the main contributor of artificial trans fat in the food supply, from its list of generally recognized as safe ingredients. The Arizona Restaurant Association reports that companies, including restaurants, have until June 18, 2018 to stop serving or producing foods with artificial trans fat.

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EMV Chip Technology

The new EMV chip technology in credit cards has finally made it to the US. The technology has been present in other countries for over 20 years. Later in 2015, there will be some regulations that come into play regarding these cards that businesses need to be aware of as there will be potential shifts in liability to the business due to fraudulent transactions occurring. If you have not discussed this with your credit card processor, you will want to do so sooner than later. One last thing to point out on the EMV front, the EMV technology does not equate to being PCI compliant, so do not mistake the two.

GAAP Updates

For all of you who are producing GAAP basis financial statements, there are a few updates you need to know about.

- **Leases** - The FASB is still working on the new lease pronouncements and it is unknown as to when this new standard will be issued. It will result in current existing operating leases being capitalized on the balance sheet. There will be a difference between type A leases and type B leases and how they are amortized/expensed to the income statement. Just keep in mind, if you are negotiating new loans with your bank, you may want to try to work on your loan covenants and discuss with the bank how this will be addressed when it becomes effective. The banks will work with you on your loan covenants, so be proactive as you do not want to ask for loan covenant violation waivers after the fact.

- **New Revenue Recognition Standards** - The new revenue recognition standards will become effective in 2019 for nonpublic entities. The main impact on the restaurant industry will be with franchisors and those of you that have reward cards with your customers. The new standards will require franchise fees to be recognized over the life of the franchise agreement versus the opening of a franchise location. This will be a major impact on franchisors, so if you fall into this category, start working with you CPA on the impact to your financial statements. In regards to reward cards, a portion of the original sale that generates an award will need to be deferred based on the fair value of the points awarded and expected to be used by your customer. Current practice involves recording a liability and cost of sale for awards earned. When effective, this will no longer be allowed for GAAP basis financial statements.

Millennials

The Millennials continue to be a focus for restaurant owners. Restaurants are continuing to educate themselves on how to best market to and retain customers from this generation. Mobile technology, social media and reward programs are big for Millennials. Restaurant owners need to continue to focus on these areas for growth within this generation. In a recent survey of Millennials, 70% of them will not be loyal to a restaurant without a rewards program. Starbucks is still the leader in rewards programs and is setting the standards in this area.

The restaurant industry continues to be a growth industry for our economy and is expected to remain in this position for at least the next two years. I am excited to be a part of this industry and excited about the opportunities it provides me to help restaurant operators achieve success. If you have questions regarding any of the above items, please do not hesitate to contact myself or one of our restaurant professionals.

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



Tappas

Restaurant industry sales are projected to increase 5.3% in 2015. According to Technomic, the projection represents a 1.5% increase over a 3.8% growth rate in 2014. Last year, restaurant industry sales totaled $466 million.

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The Huffington Post is taking a look at how websites and online marketing have evolved in the restaurant industry and what restaurants can do to promote their business and increase sales. Suggestions include optimizing your website with keywords if you are locally focused so that your restaurant appears in searches done regarding your area. You can also bring your menu to life by having your most popular dishes professionally photographed and placing the pictures on your website so customers can easily explore them.

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Tax Musings from the NRA's Tax & Finance Executive Roundtable

By Bradley Dimond, CPA

I thought I would try something a bit different this year. Rather than marching through the various tax topics/updates, I will present bite-sized tidbits, if you will, structured as good news-bad news.

Good News: The current run of positive growth for the industry continues.

Bad News: The growth is only moderate and industry valuations are at historic highs, which could be a signal that the four to five year run of moderate growth is coming to an end (a year or two out).

Good News: Technology improvements (mobile ordering apps, electronic payments, loyalty programs, stored value/rechargeable value cards, etc.) play a large part in this growth.

Bad News: Cyber security is increasing in importance and the threat of a data breach is growing as more hackers and organized crime move into this space. Rewards programs are a natural target because of the wealth of personal information contained in such programs and they usually are not as well "guarded".

Good News: The IRS has tried to use technology (such as obtaining transcripts online) to increase efficiency and improve taxpayers' experience.

Bad News: You may have heard – the IRS was hacked and account information for approximately 100,000 taxpayers was obtained. I predict a slowdown in taxpayers' ability to interact with the IRS electronically.

Good News: Congress acted late last year to retroactively extend a number of industry-favorable tax provisions such as enhanced Section 179 expensing, bonus depreciation, Work Opportunity Tax Credit (WOTC), Research and Development (R&D) Tax Credit, and 15 year amortization of restaurant leasehold improvements.

Bad News: These provisions all expired (again) on December 31, 2014 and it looks like it will be a last minute Congressional decision as to whether these "extenders" are yet extended again. This could affect decisions regarding capital spending and hiring.

Good News: Fundamental Tax Reform, i.e., simplification and improved "fairness", continues to be a hot topic and momentum for such is gaining steam. Everyone agrees that the current system is "broken".

Bad News: Most insiders believe that such reform, while sorely needed, is still several years away as we need to work through the next presidential election cycle. Also, there is no consensus on what the goals of Tax Reform should be.

Good News: Some recent guidance has made the R&D credit more available to the food industry as well as if you develop software for internal use.

Bad News: As mentioned above, the R&D credit expired at the end of 2014 and we won't know until later in the year if it will be brought back again.

Good News: Should Tax Reform happen, it will likely lead to a more simplified and fair tax code (trying not to snicker).

Bad News: There will be "winners and losers". The restaurant industry appears to be a "loser". The FICA Tip Credit (Section 45B) is on the chopping block. This long standing provision which has led to greater compliance could be a victim of technology. With most transactions captured electronically, the need to capture tip amounts through employee reporting may no longer be necessary.

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Tappas

A new app is tackling food waste by connecting retailers, producers and suppliers to nearby nonprofits so the companies can sell or donate their surplus inventory. According to Food Dive, the Spoiler Alert app aims to remove barriers and streamline the process of donating food. When the products are no longer edible, the app connects users to companies that make fertilizer and animal feed. That way the extra food still doesn't go to waste. A three month pilot program involving eight organizations saw about 10,000 pounds of food donated through the app, sometimes in just a few minutes.

Bad News: Other items on the chopping block: accelerated depreciation (Why is this a problem? It's all timing), immediate deductions for advertising, and the R&D and WOTC credits.

Good News: The IRS has re-written and simplified the instructions for the annual tip reporting Form 8027.

Bad News: The revised instructions are not yet published. I understand the revisions have been completed for a while but are apparently caught up in the approval process. They may not be available for a couple more years. The IRS uses these forms as one way to select companies for audit. In addition, the IRS believes that only 75% of companies that should be filing this form are actually filing it and that most of the forms that are filed are incorrect. So, no hurry on those revised instructions.

Good News: After years of struggling with the new "capitalization" regulations, final regulations came out, which, for the most part, provide some additional opportunities for the industry, particularly in the remodel area. If you have significant amounts invested in a building or build-outs, for example, you may benefit from a cost segregation study.

Bad News: These opportunities are probably more prevalent for larger companies. The people who write these regulations tend to come from the global accounting and law firms and are used to dealing with the largest companies. So, these rules end up being too complex for most of the country's businesses and increase the cost of compliance.

Good News: Many employers provide employees with discounted meals, gift cards for their own locations as well as other concepts, along with other incentives. Many of these incentives are allowed as non-taxable fringe benefits. For example, regulations actually provide that "soft drinks and donuts" may be provided without worry that the value of such should be included in wages.

Bad News: The IRS is aggressively challenging on audit that many of these incentives, particularly gift cards for other retailers, should be included in wages rather than treated as a non-taxable fringe benefit! Also, we heard one horror story of an IRS examiner asserting that providing bagels to employees each week should be included in wages because bagels were not "donuts" (I am not making this stuff up).

Good News: It looks as though the IRS budget will be cut again. This means that the IRS resources available for enforcement will be down.

Bad News: It looks as though the IRS budget will be cut again. Seriously, if you need to deal with the IRS for any reason, which I need to do regularly, service is already abysmal. Wait times on the IRS Practitioner hotline regularly time-out after two hour waits. Have any of you ever received an IRS notice asserting an underpayment of tax issued in error? It happens all the time. In addition, the IRS and Treasury put increased pressure on yours truly and all tax professionals to keep our clients in line by threatening us with a beefed up Office of Professional Responsibility.

Breaking News: (I won't label this as good news or bad news for fear of offending someone out there.) The Supreme Court just decided another challenge to Obamacare by upholding that premium tax credits are available to individuals who purchase insurance on an exchange in a state that has not created its own exchange but allows the federal exchange. The law provides that credits are available to those who purchase insurance on an exchange established by the State. Pundits agree that if the case had gone the other way, the entire system would have come crashing down without additional legislative action – which would have been interesting given a Republican Congress.

Not News: Without commenting on whether the ACA is the best way to tackle our country's issues with health insurance, I can say that this makes most companies' and CPAs' lives much more complicated.

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