THE MAIN DISH

Summer 2013

ABOUT US

Henry & Horne, LLP is one of the leading accounting firms in Arizona with offices in Tempe, Scottsdale and Casa Grande. We combine the knowledge and expertise of a premier consulting firm with the personal attention of a local CPA, meaning unmatched service to you. Our services include: daily, monthly and annual bookkeeping and accounting; audit, review and compilation of company financial statements; audits of 401(k) plans; tax planning and compliance; tip reporting and compliance; cost segregation studies; internal control reviews; estate, trust & gift services; real estate appraisal and consulting; and valuation and litigation support services.

Your Restaurant Team:

Brian Campbell, CPA, Partner

Brad Dimond, CPA, Partner

Kelly Lynch, CPA, Manager

Dan Mace, CPA, Manager

HENRY & HORNE, LLP

Certified Public Accountants

National Restaurant Association Finance Study Group Synopsis

By Brian Campbell, CPA

During the week of June 17th, I had the opportunity to attend the National Restaurant Association's Tax and Finance Executive Study Group Meeting. It was a great meeting filled with very useful information. I will summarize some key takeaway points from the finance side of the meeting and my tax partner, Brad Dimond, will be discussing some key takeaway points from the tax side of the meeting.

• Projected 2013 sales for the industry are expected to be at $660 billion up 3.8% over 2012; however, taking inflation out of the equation the gain will be about 0.8%.

• According to a May 2013 survey, the top challenges facing restaurant operators are as follows:
  o Government – this entails healthcare and the restoration of the 2% payroll tax reduction.
  o Economy – according to an April 2013 survey – 9 out of 10 operators see the economy as fair to poor.
  o Food cost – projected to be up 2.7% for 2013.
  o Sales volume – due to the slow economy, sales growth over the past few years has been extremely low in the restaurant industry and continues.
  o Recruiting – it is difficult to recruit great people.

• iPad's are being used more by operators as a virtual menu, resulting in operators being able to change menu prices throughout the day based on traffic in the restaurant. Prices can be reduced and/or specials ran when there is typically less traffic to help spur increased sales volume during these times of day.

• A CFO forum was held as a session and included CFOs from 3 different sized restaurant categories- small (less than 10 locations) to large (thousands of locations). During the CFO forum, healthcare was discussed and I took away the following:
  o Projected 25-30% of employees will enroll in insurance provided by their employer.
  o Employees are not aware of the fact that the insurance being offered by employers is not free to themselves.
  o Cost may range from a slight increase to an increase of 3-4% of sales.

• The CFOs in the CFO forum also discussed the issues that keep them up at night:
  o Healthcare.
  o Tight labor market in regards to finding qualified and dedicated staff.
  o Finding the liquidity to grow.
  o Lack of sales growth, as a result of job losses in the Midwestern part of the United States.

Continued on Back...

• For those of you that keep your financial statements on a GAAP basis (Generally Accepted Accounting Principles). The few takeaways I had from the GAAP update session were as follows:

- o Revenue recognition – final standard is expected in 2013 and could have a major impact on franchisors.
- o Lease accounting – standards are still moving towards capitalizing leases on the balance sheet. Guidance has been re-exposed to the public and as a result there probably won't be any changes required until after 2016. However, you still should be discussing these changes with your bankers to ensure covenants are structured adequately to ensure compliance.
- o The Private Company Council (PCC) was setup a little over a year ago to discuss accounting guidance for non-public companies. The following items that have come out of the PCC, and endorsed by FASB, that may be in a future exposure draft for feedback from the public prior to implementation are:
    - • Recognition of intangibles, in business combinations, will be separately recognized when a legal contract exists that will allow separate recognition of these items. The remaining dollar amount of consideration will all be allocated to goodwill. This eliminates the need to have a business valuation to allocate the purchase price to separately identified intangible assets acquired.
    - • Accounting for goodwill will include an election to amortize the goodwill over ten years. Impairment testing of goodwill will be at the entity level versus the reporting level.
    - • Interest rate swaps would be recorded as one instrument with the debt. The termination value would be disclosed only and not recorded on the balance sheet.
    - • Rules regarding variable interest entities which require consolidation would be simplified and scope exceptions may be more prevalent to limit the amount of consolidations being performed.

• In a session with lenders from three different financial institutions, the lending environment as of 2013 and beyond was discussed. The following key items were noted:

- o Lending has increased over the past 18 months; however, independents still seem to struggle with obtaining financing.
- o Lenders are seeing around 6-7 times EBITDA being paid for growth restaurants.
- o As today is a borrower's market, this will not last for an extended period of time. Bond rates have started to increase over the past few weeks, which in turn, has an impact on interest rates in the lending market.

• An outside attorney and gift card consultant discussed what they were seeing in the gift card area including unclaimed property laws under various states. They seemed to focus a lot of attention on changes recently made in the state of Delaware. Delaware is becoming very active in pursuing unclaimed property as it relates to gift cards and this includes challenging special purpose entities that house only gift cards. Letters are being sent out to companies regarding potential unclaimed property for unredeemed gift cards and these letters should not be ignored as it will probably lead to a future audit. Delaware has created a VDA (volunteer disclosure agreement) program that companies can enter into and this is a very friendly program from a liability standpoint to consider if you do receive a letter from Delaware.

I know this article contains a lot of information, with not a lot of detail; however, if there are any specific areas above that peaked your interest, do not hesitate to reach out to me and I would be happy to discuss any of these topics in more detail.

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



Tappas

According to Nation's Restaurant News, 70% of menus on GrubHub misspell the word fettuccine. 40% misspell caesar and 10% misspell dessert.

~

According to Nation's Restaurant News, 61 billion Americans went to restaurants in 2012 and delivery accounted 1.6 billion of those occasions, or less than 2.7%.

~

According to the NPD Group, the consumer's idea of a snack has changed. Restaurants are changing their menus to replace combo meals with individual items because consumers are either on the run or they are trying to keep their checks down.

HENRY & HORNE, LLP
Certified Public Accountants

National Restaurant Association Tax Study Group Synopsis

By Bradley Dimond, CPA

It's time for our annual debrief from the National Restaurant Association's Tax and Financial Executive Study Group conference recently held in San Francisco. It was an eventful conference (both professionally and personally but we'll keep it professional unless anyone out there wants to buy me a beverage!) and we have much information to share so let's get to it.

There was a significant amount of time devoted to Health Care and rightly so since there was a fast approaching January 1, 2014 drop date. However, this past Tuesday (post-conference), the Obama administration announced to delay the employer mandate for one year. This means that businesses with more than 50 full-time employees will now have until January 1, 2015 to offer health insurance coverage to their workers. With that said, the banter around the conference was that most of the large restaurant operators (think large national chains), after working with brokers, consultants and insurance companies, concluded it was not going to be as bad (read: costly) as operators had feared. There still is a great deal of concern and uncertainty among smaller operators and a great deal that is still unknown. Scan the QR code on the next page to find an outline of an implementation timeline, as space does not permit here. Operators need to understand that implementing ObamaCare must be a coordinated effort between the tax, accounting/finance, and HR functions. Employers should get their arms around the number of full time employees, full time equivalent employees, employees' census information (age, years of service), work history, and their W-2 income (more on that in a moment) etc. Bottom line, the law is here to stay so hire a consultant, broker, or adviser to determine how you need (or don't need) to implement it and what it might cost. In response to the delay in offering health insurance, the NRA said it "strongly encourages employers to voluntarily report information in respect to the health care coverage offered to full-time employees, in preparation for the full implementation in 2015."

There were a couple of presentations dealing with the view from the IRS and tip reporting. Due to the IRS's current "struggles" (Tea Party, Anaheim, sequestration, and budget issues/work force cuts), the IRS will be challenged to deal with all the guidance that is needed on health care as well as the other items on their business plan such as getting the final "Repair" regulations issued. Clearly, the IRS is going to have to figure how to do more with less…such as continuing the recent trend of putting more onus on taxpayers and their tax preparers to disclose questionable positions so the IRS knows who to challenge.

The tip reporting session was interesting as the IRS is working to engineer a systemic approach to tip reporting – which I understood to mean that they are looking to remove the voluntary reporting aspect so that the information is gathered and reported automatically. There are big concerns in the Service that cash tips reported (whether through payroll tax examinations or reported by operators on the required 8027 reporting) always lag well behind credit card tips. Of course, there could be many explanations for that (e.g., expense account spending). The IRS is working on reengineering the Form 8027 (part of the systemic approach mentioned above) so look for that for next filing season. As reported in previous issues, the IRS still believes that there are many non-filers of Form 8027 that should be reporting tip information on that form. Expect more IRS scrutiny of revenues reported on tax returns and, if revenues appear to warrant an establishment with the requisite number of employees, then the IRS will raise questions if there is not a Form 8027 from that taxpayer.

Continued on Back...



While the subject of cash tips is still fresh, let's circle back to ObamaCare for a moment. One requirement of the law is that large employers must provide "affordable" coverage to full time employees (average > 30 hours per week). "Affordable" = 9.5% of the employees W-2 (as a proxy for "household income") and must provide certain minimum benefits. Let's say you have a full time server who receives a large amount of cash tips. I am sure no one would be too surprised if there was some doubt about the veracity of reported cash tips.

Now consider the employee who over-reports cash tips (don't laugh – there are valid reasons that could happen). Correspondingly, stop and consider the server who under-reports cash tips…in either case, this could have a major impact on an employer on whether they might be subject to the potentially more expensive ObamaCare penalty provisions, which is the failure to provide affordable care. Not sure there is an answer to this one yet, but it is something to look out for.

Scan here to download the PPACA Implementation Timeline

Service Charges/Auto-gratuities are not "tips" per the IRS – thus, not eligible for the Section 45B tax credit, although the IRS has delayed enforcement as we have previously reported. The reason for the delayed enforcement is the many practical issues and education that need to occur. For example, you may need to have your POS reprogrammed by the start of your 2014 tax year. Many operators, unless their staffs revolt, are doing away with service charges or looking at creative ways to "suggest" various tip amounts. Please consider carefully before making these changes. Finally, you need to make sure that you or your payroll service provider is "stacking" payroll correctly. This is important from a state withholding point of view and appears to be an issue where many payroll providers are not doing this correctly and, on audit, an operator could be liable for state withholdings.

Finally, let's end with some planning ideas as well as the notion of playing defense (avoiding potential traps). First a trap: the IRS believes that the Section 263A rules ("uniform capitalization") apply to restaurants. This means that operators need to capitalize some general and administrative costs to inventory…essentially the loss of current deductions to become deductions in the future, particularly if you carry substantial inventories. If you are growing, that future where the deductions come your way becomes pretty far away.

A few opportunities: aside from the Section 45B tax credit, many restaurants, particularly those that have some turnover and are constantly hiring might benefit from WOTC (Work Opportunity Tax Credit) which was retroactively reinstated from 2012 through 2013. Advance qualification procedures are needed, but folks, there is real money here. The minimum WOTC is $2,400 and it could be as high as $9,000. Many operators might also benefit from the research and development credit. Although "taste" is not a factor which gives rise to the credit, food must be edible. To the extent you are developing new products or menus, there could be the factors necessary to claim research credits. Remember, credits, as opposed to deductions, reduce your tax liability dollar for dollar (of course, there are always exceptions to this and alternative minimum tax could play a role). Many operators also produce food for wholesale distribution through grocery stores and other outlets. If so, these production processes could also generate research and development credits. In addition, if you are wholesaling products, you could also be allowed a 9% additional deduction known as the Domestic Production Activities Deduction. The aforementioned tax credits are what's become known as "extenders". This means they tend to expire on an annual or bi-annual basis and Congress, after the obligatory bickering, must "extend" these credits, often retroactively.

Well, I have come to the end of my allotted space (actually, we blew up this issue to twice its normal length already) and we left too many tidbits on the table, so to speak. Please do not hesitate to contact us with questions and don't forget to scan the QR code to the left for an outline of the implementation timeline.

HENRY & HORNE, LLP
Certified Public Accountants

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