Statement for the Record

of

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National Restaurant Association

on

"Reforming the Internal Revenue Code"

for the

Committee on Ways and Means
U.S. House of Representatives

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NATIONAL RESTAURANT ASSOCIATION

Chairman Camp, Ranking Member Levin, and members of the House Ways and Means Committee, thank you for the opportunity to submit this statement on tax reform for the record on behalf of the National Restaurant Association ("The Association"). We applaud the Chairman, Ranking Member, and Committee for undertaking the complex challenge of developing reform legislation that would move the Internal Revenue Code into the 21st Century.

Currently, the tax law presents taxpayers with a great deal of complexity, unpredictability and compliance burdens. Looking ahead, tax reform offers an opportunity to provide taxpayers with certainty, simplicity, and fairness, while encouraging economic growth and job creation. Done properly, a comprehensive and nuanced review of the tax system would eliminate those tax policies that detract from these objectives, while promoting those that advance them.

We applaud the Committee for the open and transparent process by which it is approaching tax reform. The association has been working for the past several years to make the case for fair reforms that take the restaurant industry's organizational diversity into account. We believe that marginal tax rates for both individuals and corporations should be reduced as much as possible. We also believe it is important for Congress to examine corporate and individual tax reform simultaneously due to the variety of smaller pass-through entities that make up the majority of restaurant businesses. Moreover, as the Committee moves forward with crafting reform legislation, we would like to bring to your attention several provisions of particular importance to the food service industry. Specifically, we strongly support:

1) Making permanent the 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements. This temporary provision clearly comports with the tax reform policy that cost recovery reflect the economic useful life of the taxpayer's investment.
2) Making permanent the Work Opportunity Tax Credit ("WOTC"). WOTC has been very effective helping targeted group members find gainful employment.
3) Retention of the FICA Tax Tip Credit Reimbursement which has been instrumental to enhancing compliance and the accurate reporting of tip income.
4) Making permanent for all restaurant businesses the enhanced charitable deduction for donations of food inventory, which has helped alleviate hunger in the U.S.
5) Restoring the business meal deduction to better reflect the basic principle that business expenses should be fully deductible.

Restaurants: An Industry with a Large Impact on Our Nation's Economy

The restaurant industry plays a significant role in our nation's economy. In 2013, the restaurant industry is expected to reach a record high of $660.5 billion in sales, representing 4 percent of the U.S. gross domestic product. Every dollar spent in restaurants generates an additional $2.05 spent in our nation's economy. The restaurant industry is one of the nation's largest private job creators and is expected to employ approximately 13.1 million people in 2013, representing nearly ten percent of the U.S. workforce. The restaurant industry is expected to add

1.3 million jobs over the next decade reaching 14.4 million by 2023. The restaurant industry job growth outpaced the overall economy in 13 consecutive years, from 2000 to 2012. Average sales in 2010 were $849,000 at a full-service restaurant and $753,000 at a quick-service restaurant. We are truly one of the cornerstones of this nation's economy.

It is also important to stress that the restaurant industry is an industry of small businesses. There are 980,000 restaurant and foodservice outlets in this country. Ninety-three percent of eating and drinking place businesses have fewer than 50 employees and more than seven out of 10 are single-unit operations. In addition, restaurants serve as the conference rooms for many of the self-employed and other small businesses.

Accordingly, as the Committee undertakes its review of the tax code, the association believes it is important to examine corporate and individual tax reform simultaneously due to the restaurant industry's organizational diversity. Since a variety of smaller pass-through entities make up a majority of restaurant businesses, only through comprehensive reform can a truly fair outcome be achieved.

Comments Regarding the Committee Chairman's Small Business and Pass-Through Discussion Draft

On March 12, Committee Chairman Camp released a discussion draft that proposes options for simplifying the tax rules that apply to a wide range of business entities including partnerships, limited liability companies, S corporations and sole proprietorships. While we continue to review many of the framework's proposals, we applaud the Chairman's commitment to reforming the taxation of small businesses.

We believe some of the specific proposals contained in the framework would go a long way toward simplification and reducing taxpayer burden. For example, the discussion draft would make permanent the expensing thresholds under IRC section 179. Specifically, the draft makes permanent the election to deduct the cost of certain property placed in service for the year rather than depreciate those costs over time. The draft sets the maximum dollar amount that may be deducted at $250,000 and the amount at which the deduction phases-out at $850,000, indexed for inflation.

The Chairman's proposal to make the increased limits permanent, to index the amounts for inflation, and to include certain qualified real property in the definition of qualified property furthers simplification, provides predictability and merits serious consideration. We would note that for taxable years before 2014 the limits were set at $500,000 and $2 million. These higher limits were very beneficial to many small businesses in terms of simplification and investment decisions. We are very pleased that the proposal retains the expanded definition of qualified property includes qualified leasehold improvements and qualified restaurant and retail property.

We will continue to review the small business and pass-through discussion draft and gather input from our members, particularly regarding the two separate options designed to achieve greater uniformity between S corporations and partnerships. In the meantime, we want to bring to your attention several provisions contained in the tax code that directly affect the food service industry and are a priority for the restaurant industry. We hope you will take these comments into consideration as your deliberations continue.

Permanence of the 15-year Depreciation Schedule for Leasehold Improvements, Restaurant Improvements and New Construction, and Retail Improvements

One principle of the tax code is that the cost of assets are allocated over the period in which they are used. Assets with longer expected lives are depreciated over a longer period of time, while assets with shorter lives are depreciated over a shorter period of time. As a reflection of this principle, the tax code contains a provision under which leasehold improvements, restaurant improvements and new restaurant construction, and retail improvements can be depreciated over 15 years rather than a 39-year recovery period that would otherwise apply to nonresidential real property.

With more than 130 million Americans patronizing restaurants each day, restaurant building structures experience daily structural and cosmetic wear and tear caused by customers and employees. Moreover, National Restaurant Association research shows that most franchise contracts require restaurant owners to remodel and update their building structures every six to eight years. Consequently, 15 years is a more accurate timeframe for recovering the cost of investments in restaurant buildings and improvements than is 39 years.

Moreover, a 15-year depreciation schedule reduces the cost of capital expenditures and increases cash flow. As demonstrated in Figure (see next page), the annual tax savings and corresponding additional cash flow realized by restaurateurs from a 15-year, rather than a 39-year, depreciation schedule are considerable. For example, a restaurateur's annual tax liability would increase by nearly $10,000 if the recovery period for a $1 million investment were increased from 15 years to 39 years. A more accurate recovery period frees resources to expand business either through new hires or further capital expenditures.

Figure 1.

Sample Calculations for 15-Year versus 39-Year Depreciation

Total Capital Expenditure on Eligible Property	Annual Depreciation Based on 39-year Schedule	Annual Tax Savings from Depreciation	Annual Depreciation Based on 15-year Schedule	Annual Tax Savings from Depreciation	Annual Difference in Tax Savings Between 15- & 39-year Schedules
$100,000	$2,532	$608	$6,667	$1,600	$992
$250,000	$6,329	$1,519	$16,667	$4,000	$2,481
$500,000	$12,658	$3,038	$33,333	$8,000	$4,962
$700,000	$17,722	$4,253	$46,667	$11,200	$6,947
$1,000,000	$25,316	$6,076	$66,667	$16,000	$9,924
$1,500,000	$37,975	$9,114	$100,000	$24,000	$14,886
$2,000,000	$50,633	$12,152	$133,333	$32,000	$19,848

Note: Figures are based on a 24 percent effective marginal tax rate

Additionally, when restaurants invest in construction and renovations, the impact spreads throughout the economy. Figure 2 (attached at the end of statement) provides state-by-state estimates of the additional spending on restaurant improvements and new construction that would result from an extension of the 15-year depreciation provision in 2013, as well as the overall economic and employment impact within each state.

However, the 15-year depreciation schedule is temporary and must be extended annually. Most recently, it was extended by the *American Taxpayer Relief Act of 2012* retroactive to the beginning of 2012 and through the end of 2013. Consequently, the provision will expire again at the end of this year unless Congress takes action. This piecemeal and temporary approach to the 15-year depreciation schedule, requiring extension every couple of years, presents taxpayers with unnecessary uncertainty and complexity.

In March 2012, the association surveyed a sample of nearly 600 restaurant operators who took advantage of the 15-year depreciation provisions between 2005 and 2011. The survey revealed that 30 percent of restaurant operators said they put projects on hold in 2012 when the provision lapsed because of the uncertainty surrounding the extension of the 15-year depreciation provision. With single-unit restaurant operators reporting an average expected project cost of $40,000, and multi-unit operators reporting an average expected project cost of $500,000, the additional construction activity from these restaurant projects put on hold would have exceeded $7 billion in 2012. Based on economic multipliers from the Bureau of Economic Analysis, the overall economic impact of these restaurant construction projects would have exceeded $23 billion, with a total employment impact of nearly 200,000 additional jobs across all U.S. industries.

Using tax reform to make permanent the 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements would address this problem, providing taxpayers with predictability, simplicity, and fairness. The ability to plan for these expenditures and know what the tax treatment will be in the future is important to those who are making business decisions in today's economy.

Permanence of the Work Opportunity Tax Credit

Another important provision in the tax code is WOTC, a tax credit provided to employers who hire individuals from several targeted groups who face significant barriers to employment. Examples of WOTC-targeted employee groups include veterans who either are Supplemental Nutrition Assistance Program ("SNAP", formerly food stamps) recipients or are unemployed and suffering a service-connected disability, former felons, disconnected youth, and members of families receiving benefits under the Temporary Assistance for Needy Families Program ("TANF").

The restaurant industry employs over 13 million people, many of whom may not have been hired if WOTC had not been in place. WOTC encourages employers to hire certain categories of individuals with barriers to employment, enabling these workers to move into self-sufficiency as they earn a steady income and become contributing taxpayers. Through WOTC, more long-term welfare recipients – the most difficult cases – are being employed in the private sector and seven out of 10 welfare recipients are using WOTC to help find private sector jobs. A 2011 study by Peter Cappelli of the Wharton Business School at the University of Pennsylvania found that individuals hired under WOTC go on to become productive employees who are no longer dependent on public assistance.

Further, WOTC works. In 2011, more that 1.1 million workers found jobs through WOTC, at an average cost of approximately $1,300 based on Joint Committee on Taxation data. It is important to note that this figure does not reflect any offsetting savings from lower welfare, disability, and social security payments. The Cappelli study found that WOTC is one of the most successful and cost effective federal employment programs.

WOTC was most recently extended by the *American Taxpayer Relief Act of 2012* retroactive to the beginning of 2012 and through the end of 2013. Consequently, the provision will expire again at the end of this year unless Congress takes action. Allowing this provision to expire again at a time of intransigent unemployment would be a significant setback for job creation. Congress should make WOTC permanent, since it has proven to be an efficient incentive for businesses to provide jobs for workers who might otherwise fall through the cracks. Doing so would further provide taxpayers with predictability and certainty in the tax code.

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Retention of the FICA Tax Tip Credit Reimbursement

The FICA Tax Tip Credit Reimbursement, codified in Section 45B of the tax code, is a reimbursement available to food and beverage companies for the employers' portion of FICA taxes on reported tip income above the minimum wage. That reimbursement is, in effect, an intermediary fee for encouraging tip reporting and helping the IRS collect employment and income taxes owed by employees on their tips. Employers who choose to take the Section 45B reimbursement put processes and systems in place to capture tip data including new-hire training, point of sale system prompts, manager reviews of tip reports and continuing employee education. Today's successful tip reporting regime has been developed with the IRS over the last 20 years, and maintaining the FICA Tax Tip Credit Reimbursement is an integral part of current compliance and enforcement strategies

As background, restaurant servers and bartenders are required to report tips to their employers. The employers in turn base income tax withholding and payment of FICA taxes on this information. Employers withhold and deposit employees' FICA taxes on all regular wages and reported tip income. But in addition to paying the employer's share of FICA taxes on regular wages, employers also pay employer FICA taxes on employees' tip income. At the end of the year, in exchange for actively encouraging tip reporting, withholding taxes and transmitting that information to the IRS, food and beverage establishments can claim the Section 45B nonrefundable credit to reimburse the portion of FICA taxes on tip income above the federal minimum wage.

The credit for employer-paid FICA taxes on tips originated with the *Omnibus Budget Reconciliation Act of 1993* (P.L. 101-508). It serves two purposes: it helps close the tax gap, and it ensures that tipped restaurant employees are maximizing their retirement benefits. Former Ways and Means Committee Chairman Bill Archer (R-TX), who was on the Committee when the reimbursement was created, explained that "the FICA tax tip credit is unique from other credits – rather than a subsidy, it is an integrated component of the requirement that employers pay FICA taxes on deemed employee tip income." Section 45B does double duty by encouraging accurate reporting of tips for both FICA tax and income tax purposes and helps to ensure accurate Social Security benefits for tipped workers.

Former Ways and Means Committee Member Barbara Kennelly (D-CT), also on the Committee when the reimbursement was created, said, "with so many seniors dependent on the system, it is critical that low-income workers, such as Food and Beverage workers, fully pay into Social Security during their working years."

Economist Don Bruce, Ph.D., of the University of Tennessee, produced an economic analysis of the FICA Tax Tip Credit Reimbursement in February 2012. He similarly reports that repealing Section 45B could have significant negative consequences. Dr. Bruce found that if tip reporting fell between 18 and 23 percent following repeal of Section 45B, then repeal would in fact lose revenue for the government.

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The Section 45B reimbursement is not just another tax expenditure. It is distinguishable from other credits and deductions because it provides a positive return on investment to the government. It incentivizes complete and accurate tip reporting, which means additional income tax revenue for the Treasury and additional FICA taxes for the Social Security and Medicare trust funds.

Permanence for the Deduction for Charitable Donations of Food Inventory for Small Businesses

Each day, 35 million Americans are at risk of hunger. At the same time, billions of pounds of food are wasted each year. America's restaurants give back to their communities in major ways, the most significant of which is through food donation. According to National Restaurant Association research, 73 percent of restaurants donate food to individuals or charities.

The deduction for charitable donation of food inventory is a critical tool in alleviating hunger. Without the provision, taxpayers get the same tax treatment for throwing out surplus food as they do for giving it to charity. The enhanced deduction instead encourages donating the food to charity, by helping to offset the costs associated with storing and transporting the extra food. Absent the enhanced deduction for the charitable donation of food inventory, these charities would be hard-pressed to meet critical demands, putting our nation's most vulnerable families at risk for hunger.

However, the impact of the deduction could be improved. For nearly 30 years since its inception in 1976, the tax deduction for contributions of food inventory was limited to C corporations. In 2005, the provision was temporarily expanded to include pass-through entities (i.e., Subchapter S corporations, limited liability companies) and has been extended on subsequent occasions; most recently it was part of the *American Taxpayer Relief Act of 2012*. Making permanent the now-temporary component of the deduction would make it more effective, while advancing the objectives of providing taxpayers with simplicity and predictability.

The National Restaurant Association strongly encourages its members to donate more food and has partnered with Food Donation Connection ("FDC") to strengthen this effort. Founded by a former restaurant executive, FDC serves as the liaison between the restaurants interested in donating food and the social service agencies adept at getting that food to people in need. FDC helps restaurants develop and implement programs designed to provide an alternative to discarding surplus food while capitalizing on the economic benefits of those donations through the tax savings. Since 1992, FDC has helped facilitate the donation of over 210 million pounds of food to non-profit, hunger-relief agencies.

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We urge the retention of the enhanced deduction for donations of food inventory. We also urge Congress to make permanent the temporary provision allowing unincorporated small businesses the same enhanced deduction for food donations.

Restoring the Business Meal Deduction

Under current law, the business meal and entertainment deduction is limited to only 50 percent of costs incurred. By way of background, business meals previously were fully deductible. In 1986, the deduction was reduced to 80 percent and, in 1993,the deduction was further reduced to its current level of 50 percent.

The business meal deduction should be reformed to better reflect the basic principle that business expenses should be fully deductible. Full deductibility would appropriately bring the business meal deduction in line with other ordinary and necessary business expenses, but even increasing the limitation back to 80 percent would better align the provision with these objectives.

According to National Restaurant Association research, increasing the business meal deduction to 100 percent would increase business meal sales by $14.2 billion and create an additional 352,000 jobs. Increasing the business meal deduction to 80 percent would increase business meal sales by $7.9 billion and create an additional 195,000 jobs. Moreover, restaurants service more than 130 million guests every day and the overall impact to the economy of full deductibility or a return to 80 percent deductibility of business meals would be significant. Each dollar spent dining out generates $2.05 in business to other industries, totaling more than $1.7 trillion in overall economic impact.

More importantly, at a time when the country is getting back on stronger economic footing, this reform measure is particularly critical especially for the small businesses and self-employed individuals that depend so heavily on business meals to conduct business. Small businesses often use restaurants as “conference space” to conduct meetings or close deals. Meals are their best, and sometimes only, marketing tool. Certainly, an increase in the meal and entertainment deduction would have a significant impact on a small business’s bottom line.

Conclusion

Thank you for the opportunity to submit this statement on behalf of the National Restaurant Association. Again, we applaud the Committee for its work to date and commitment to make the tax code more certain, fairer, simpler while also encouraging economic growth and job creation. As the Committee moves forward with its deliberations, we would be pleased to serve as a resource.

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Figure 2.

Estimated Impact of Extending 15-Year Restaurant Depreciation Provision Through 2013

State	Increase in Spending on Restaurant Improvements & New Construction (in millions)	Total Economic Impact Within the State (in millions)	Total Employment Impact Within the State (total jobs in all industries)
Alabama	$78	$170	1,591
Alaska	$21	$37	263
Arizona	$113	$233	1,913
Arkansas	$53	$104	961
California	$851	$1,953	13,122
Colorado	$130	$293	2,264
Connecticut	$101	$192	1,250
Delaware	$22	$41	269
District of Columbia	$26	$31	42
Florida	$380	$785	7,054
Georgia	$194	$441	3,818
Hawaii	$42	$80	609
Idaho	$40	$71	718
Illinois	$312	$728	4,870
Indiana	$134	$294	2,381
Iowa	$81	$144	1,293
Kansas	$60	$115	900
Kentucky	$75	$161	1,406
Louisiana	$87	$182	1,518
Maine	$42	$82	834
Maryland	$129	$250	1,758
Massachusetts	$193	$382	2,474
Michigan	$224	$482	4,051
Minnesota	$118	$251	1,957
Mississippi	$47	$94	872
Missouri	$127	$275	2,145
Montana	$39	$73	748
Nebraska	$48	$80	723
Nevada	$58	$109	801
New Hampshire	$39	$78	586
New Jersey	$254	$550	3,468
New Mexico	$37	$71	659
New York	$595	$1,075	7,049
North Carolina	$190	$391	3,665
North Dakota	$22	$38	307
Ohio	$254	$584	4,840
Oklahoma	$70	$150	1,424
Oregon	$117	$241	2,018
Pennsylvania	$330	$781	5,728
Rhode Island	$39	$71	539
South Carolina	$98	$214	2,016
South Dakota	$25	$42	416
Tennessee	$109	$246	2,035
Texas	$427	$1,068	8,210
Utah	$48	$112	1,012
Vermont	$21	$39	384
Virginia	$166	$345	2,645
Washington	$187	$408	3,010
West Virginia	$38	$73	627
Wisconsin	$173	$362	3,036
Wyoming	$17	$29	241
United States	$7,081	$23,944	199,830

Source: National Restaurant Association estimates, with economic and employment impact based on BEA multipliers
Note: State impact figures do not sum to the U.S. total, because they only include inputs within each state.