

April 15, 2015

The Honorable John Thune
The Honorable Benjamin L. Cardin
Co-Chairs, Business Working Group
Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Michael B. Enzi
The Honorable Charles E. Grassley
The Honorable Debbie Stabenow
Co-Chairs, Individual Working Group
219 Dirksen Senate Office Building
Washington, D.C. 20510

Submitted via: Business@finance.senate.gov
Individual@finance.senate.gov

Dear Co-Chairs Thune, Cardin, Enzi, Grassley and Stabenow:

On behalf of the National Restaurant Association (NRA), we would like to share our thoughts on tax reform and particular issues affecting the restaurant and food service industry for your consideration. As you know, on March 11, 2015, Senate Finance Committee Chairman Hatch and Ranking Member Wyden announced a bipartisan effort to solicit ideas from interested members of the public on how best to overhaul the nation's broken tax code to make it simpler, fairer, and more efficient. We are submitting for your consideration comments regarding tax policies that are important to our industry.

Currently, the tax law presents taxpayers with a great deal of complexity, unpredictability, and compliance burdens. The NRA believes tax reform offers an opportunity to provide taxpayers with certainty, simplicity, and fairness, while also encouraging economic growth and job creation. If 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.

The NRA 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 Congress moves forward with crafting reform legislation, the NRA would like to highlight several provisions of particular importance to the restaurant and 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 is consistent 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 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 ordinary and necessary 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 2015, the restaurant industry is expected to reach a record high of \$709.2 billion in sales, representing four 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 14 million people in 2015, representing nearly ten percent of the U.S. workforce. The restaurant industry is expected to add 1.7 million jobs over the next decade reaching 15.7 million by 2025. The restaurant industry job growth outpaced the overall economy in 15 consecutive years, from 2000 to 2014. Average sales in 2012 were \$875,000 at a full-service restaurant and \$803,000 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 1 million 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 Congress undertakes its review of the tax code, the NRA 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.

As mentioned above, there are several specific provisions contained in the tax code that directly affect the restaurant and food service industry and are a priority for the NRA. We hope you will take these comments into consideration as the deliberations on tax reform 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 costs 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, NRA 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.

Moreover, a 15-year depreciation schedule reduces the cost of capital expenditures and increases cash flow. As demonstrated in Figure 1 below, 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 *Tax Increase Prevention Act of 2014* retroactive to the beginning of 2014 and through December 31, 2014. Consequently, the provision is currently lapsed. The 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 NRA 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 14 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 than 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 *Tax Increase Prevention Act of 2014* retroactive to the beginning of 2014 and through December 31, 2014. Consequently, the provision has again lapsed. Allowing this provision to expire again at a time of persistent unemployment is 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.

Retention of the FICA Tax Tip Credit

The FICA Tax Tip Credit, codified in Section 45B of the tax code, is a reimbursement for the food and beverage 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. Most importantly, by encouraging employers to capture employees' tip income more accurately, the credit promotes better Social Security earnings records for tipped employees and ensures they receive maximum benefits at retirement.

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. FICA taxes are a Federal payroll tax imposed on both the employees and employers to fund Social Security and Medicare. Employers withhold and deposit employees' FICA taxes on all regular wages and reported tip income. Employers also pay upfront the employer share of FICA taxes on employees' wages and tip income, even though tips are a third-party transaction between the guest and the tipped employee dependent solely on the level of service.

The credit for employer-paid FICA taxes on tips originated with the *Omnibus Budget Reconciliation Act of 1993* (P.L. 101-508). 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."

It is difficult to know exactly how much tip reporting would fall absent the credit, but tracking the impact of the enactment of Section 45B in 1993 showed it clearly led to greater tip reporting at the source and better tax compliance. Total tip income reported to the IRS increased substantially, from \$8.5 billion in 1994 to \$14.3 billion in 1999. In March 2013, the Social Security Chief Actuary estimated the effect of repealing the FICA Tax Tip Credit on the Social Security and Medicare trust funds. In a letter to Congress, the Chief Actuary projected that repeal would cause a 15-percent reduction in reported cash tips and a two

percent reduction in reported credit card tips. Overall, this would mean a reduction of about five percent in reported tips.

Because the 45B tax credit has been successful in boosting tax compliance, the NRA strongly urges its retention. Proposals to repeal the tax credit would ultimately hurt the Social Security and Medicare trust funds as well as reduce the accurate reporting of tip income.

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, one of which is through food donation. According to NRA 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 *Tax Increase Prevention Act of 2014*. 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 NRA 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.

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 allowed for C-corporations.

Restoring the Business Meals Deduction

The NRA supports tax reform that would restore the full tax deduction for business meals and entertainment expenses. By way of background, business meals previously were fully deductible. In 1986, the Congress reduced the allowable tax deduction for business meals and entertainment from 100 percent to 80 percent. 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 ordinary and necessary business expenses should be fully deductible. Increasing the limitation to at least the previous level of 80 percent would better align the provision with these objectives.

More importantly, at a time when the Nation 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 the business meals to conduct business. Small companies 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.

In addition, the effects on the overall economy would be significant. Research has shown that increasing the business meal deduction to 80 percent would increase business meal sales by \$6.3 billion and increase the number of jobs by 213,000, while fully restoring the deduction would increase business meal sales by \$11.2 billion and increase jobs by 378,000. Moreover, restaurants service more than 130 million guests every day. Every dollar spent dining out generates \$2.05 in business to other industries, totaling more than \$2 trillion in overall economic impact.

Conclusion

On behalf of the NRA, thank you for the opportunity to share our views on tax reform. We applaud the commitment of policy makers to make the tax code more certain, fairer, simpler while encouraging economic growth and job creation. As the Congress forward with its deliberations, we look forward to working with you and would be pleased to serve as a resource. If you have any questions, please feel free to contact me.

Sincerely,

A handwritten signature in black ink that reads "David G. Koenig".

David G. Koenig
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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