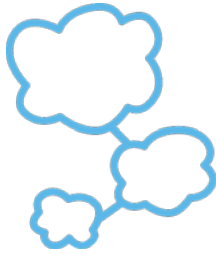


Year-End Tax Planning for Restaurants



Connect the thoughts.



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- I. Depreciation review and overview – 2011 and 2012
- II. Tax credits
- III. Calculation of tip credit and supporting documentation
- IV. Discussion of KFC Corp. decision and its effects
- V. Analyzing the complex gift card tax rules
- VI. Unclaimed property

Depreciation review and overview – 2011 and 2012

100% bonus depreciation



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- > Available for qualified property placed into service in 2011.
- > Qualified property is **new** (not used) property with a maximum 15-year tax life
- > A taxpayer may elect out of 100% bonus depreciation.

NOTE THAT THE DEPRECIATION GUIDELINES DISCUSSED TODAY ARE GOOD AS OF DECEMBER 8, 2011 AND MAY CHANGE DUE TO LEGISLATION.

50% bonus depreciation



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- > Available for qualified property placed into service in **2012**.
- > Qualified property is the same as that which qualifies for 100% bonus depreciation (see previous slide).
- > A taxpayer may elect out of 50% bonus depreciation.

Section 179



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- > For **2011**, a taxpayer can take up to \$500,000 of Section 179, of which \$250,000 can be a combination of Qualified Leasehold Improvements, Qualified Retail Improvements, and Qualified Restaurant Property (each to be explained in upcoming slides).
- > For **2012**, a taxpayer can take up to \$125,000 of Section 179, but only for personal property.

- > A leasehold improvement is treated as a Qualified Leasehold Improvement (QLI) if it is placed into service in **2011** and if it meets all of the following tests:
 - The improvement is to an interior portion of a building,
 - the building is nonresidential real property,
 - the improvement is made pursuant to a lease by either the lessee, sublessee, or by the lessor to property to be occupied exclusively by the lessee or sublessee,
 - the improvement is placed into service more than three years after the date the building was first placed into service, and
 - the lease is not between related parties.

- > An improvement is treated as a Qualified Retail Improvement (QRI) if it is placed into service in **2011** and if it meets all of the following tests:
 - The improvement is to an interior portion of a building,
 - the building is nonresidential real property,
 - the improved interior portion of the building is open to the general public and is used in the retail trade or business of selling tangible personal property to the general public, and
 - the improvement is placed in service more than three years after the date the building was first placed in service.

- > Property is treated as Qualified Restaurant Property (QRP) if it is placed into service in **2011** and if it meets all of the following tests:
 - The property is a building or an improvement to a building, and
 - more than 50% of the building's square footage is devoted to preparation of, and seating for, on-premise consumption of prepared meals.

Repairs & Maintenance final regulations pending [Reg 1.263(a)-3]



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- > These regulations provide guidance on capitalizing versus expensing various repairs and improvements.
- > Most common areas for opportunities (prior to these final regulations being issued) were remodeling projects and repairs to large assets (ex. repairs for which less than 50% of the asset was replaced/repaired such as the compressor on a walk in cooler).
- > The impact of the final regulations is currently unknown; however, practitioners believe changes are likely to be significant and the expectation is that many taxpayers will be adversely affected by the final regulations.

Tax credits

Small business health care tax credit



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- > For tax years beginning 2010-2013, the credit is 35%
- > For tax years beginning 2014-2015, the credit is 50%
- > Requirements:
 - Must pay premiums for employee health insurance.
 - Have fewer than 25 full-time equivalent employees (FTEs) for the tax year.
 - Paid average annual wages for the tax year of less than \$50,000 per FTE.
 - Full amount of credit only available for 10 or fewer FTEs and employees paid an average annual FTE wages of less than \$25,000.

HIRE retention credit



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- > Credit of up to \$1,000 per employee
- > Available for qualified employees hired after February 3, 2010 and before January 1, 2011.
- > Employed by the employer for at least 52 consecutive weeks.
- > Wages in the second 26 weeks of the period must be at least 80% of the wages in the first 26 weeks of the period.

Tax provisions in the proposed American Jobs Act of 2011



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- > Temporary payroll tax cut for employers and employees
 - For calendar year 2012, the bill would reduce the social security portion of the payroll tax from 4.2 percent to 3.1 percent
 - Also would reduce the portion of the tax that is paid by employers from 6.2 percent to 3.1 percent

- > Tax credit for increased payroll
 - For the last quarter of 2011 and for calendar year 2012, the payroll tax credit fully offsets the employer Social Security tax on increased wages from prior period

Tax provisions in the proposed American Jobs Act of 2011 (cont.)



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> Returning Heroes/Wounded Warriors

- The bill would increase the maximum credit for employers that hire veterans who have been unemployed for at least 6 months and have a service-connected disability from \$4,800 to \$9,600.
- Introduction of 2 new credits:
 - » \$2,400 credit for employers that hire veterans who have been unemployed for at least 4 weeks.
 - » \$5,600 credit for veterans who have been unemployed for at least 6 months.

> Long term unemployed workers

- Maximum tax credit of \$4,000 if they hire individuals who have been unemployed for at least 6 months.

Calculation of tip credit and supporting documentation

Employee record keeping and reporting requirements



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- > The law requires employees to report 100% of their tip income via credit charges or cash.

- > All tips are subject to federal income tax.

- > Employees must keep a daily record or other equally reliable documentation evidence to substantiate their tip income.
 - Date of each entry

 - Employee name and address

 - Employer and establishment name

Employee record keeping and reporting requirements (cont.)



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- > Employees must keep a daily record or other equally reliable documentation evidence to substantiate their tip income. (cont.)
 - Amount of cash and charge tips received each work day
 - Amount of tips paid, if any, through sharing arrangements, and the name of those employees in the arrangement.

- > Employees who receive > \$20 cash tips in one month must report these tips to their employer on or before the 10th day of the following month.

Income tax withholding

- > Calculated as if the tips are supplemental wages.
- > Employers may treat reported tips as regular wages instead of supplemental wages.
- > Employer has no withholding obligation if the employee fails to submit a written statement of taxable tips to the employer.
- > Employer must withhold and deposit income tax on reported tips.

Employment taxes

- > Employer must withhold from wages, not tips, FICA tax.
- > If an employee fails to report tips, the employer is not liable for its portion of FICA until it receives notice and demand from the IRS.

Employer's annual information return of tip income and allocated tips



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- > A large food or beverage establishment must file Form 8027.

- > What is a large food or beverage establishment?
 - The establishment is a food or beverage operation,
 - the tipping of food or beverage employees is customary, and
 - the food or beverage operation normally employed more than 10 employees on a typical business day during the preceding calendar year.

- > The IRS has begun to increase its efforts to find unreported income taxes and FICA taxes within the hospitality industry.

- > Food and beverage employers are allowed a business income credit for social security and Medicare taxes (FICA) on its employees' tip income.

- > No credit is given for tips used to meet the federal minimum wage rate.
 - Federal minimum wage \$7.25 per hour

 - Base wage minimum of \$2.13 per hour

- > States have their own minimum hourly wage laws specific to tipped employees; however, the federal minimum hourly wage should be used in the computation of the credit.

FICA tip credit basics (cont.)



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- > No deduction is allowed for any amount taken in determining the tip credit.
- > Employers who pay tipped employees a base wage of \$7.25 or more can compute the credit from Form 8027.
- > If employers pay tipped employees less than the minimum hourly wage, employees must figure each employee's hourly tip rate to compute the credit.
- > No deduction is allowed for any amount taken in determining the tip credit.
- > Taxpayers can elect out of the credit for any tax year.

FICA tip credit basics (cont.)



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- > Credit is reported on Form 8846.
- > The tip credit flows to the owners of a partnership or an S Corporation.
- > FICA tax credit on tips can be used to offset 100% of alternative minimum tax (AMT) for tax years beginning after 2006.
- > Even though the employee's portion of social security taxes was reduced by 2% in 2011, the employer rate was not reduced; therefore the FICA credit remains at 7.65% in 2011.

Tip credit calculation – example 1



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> Facts

- Base wage of \$7.25
- 1,600 hours worked
- Tip income \$16,000

> Calculation:

Employee hourly base wage (up to federal minimum wage)	\$5.15
Plus hourly rate for tipped income ($\$16,000/1,600$ hours)	\$10.00
Less hourly federal minimum wage	(5.15)
Hourly tip income in excess of federal minimum wage	\$10
Annual tip income in excess federal minimum hourly wage (1,600 hours*\$10)	\$16,000
FICA tax credit ($\$16,000*7.65\%$)	\$1,224

Tip credit calculation – example 2



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> Facts

- Base wage of \$2.13
- 1,600 hours worked
- Tip income \$16,000

> Calculation:

Employee hourly base wage (up to federal minimum wage)	\$2.13
Plus hourly rate for tipped income ($\$16,000/1,600$ hours)	\$10.00
Less hourly federal minimum wage	(5.15)
Hourly tip income in excess of federal minimum wage	\$6.98
Annual tip income in excess federal minimum hourly wage (1,600 hours*\$6.98)	\$11,168
FICA tax credit ($\$11,168*7.65\%$)	\$854.35

New requirements of employer related to tip credit



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- > Employer must provide the following information to a tipped employee before the employer may use the tip credit:
 - Amount of cash wage the employer is paying a tipped employer, which must be at least \$2.13 per hour
 - Additional amount claimed by the employer as a tip credit, which cannot exceed \$5.12 (the difference between the minimum required cash wage of \$2.13 and the current federal minimum wage of \$7.25)
 - Tip credit claimed by the employer cannot exceed the amount of tips actually received by the tipped employee
 - All tips received by the tipped employee are to be retained by the employee except for a valid tip pooling agreement limited to employees who customarily and regularly receive tips
 - Tip credit will not apply to any tipped employee unless the employee has been informed of these tip credit provisions.

New requirements of employer related to tip credit (cont.)



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- > Employers may provide oral or written notice of those 5 items to its tipped employees.
- > Failure to provide the required information, prohibits the employer from using the tip credit provisions and must then pay the tipped employee at least federal minimum wage of \$7.25 per hour in wages and allow the tipped employee to keep all tips received.

Suggestions



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- > Review tip reporting procedures.
- > Educate employees about proper tip reporting.
- > Discuss with your payroll provider the supporting documentation required for computation of the credit.
- > Notify employees in writing about the 5 elements.

Discussion of KFC Corp. decision and its effects

- > In 2001, Iowa Department of Revenue issued to KFC an assessment of \$284K

- > KFC Corp
 - headquarters in Louisville, KY
 - Primary business is ownership and licensing of the KFC trademark and related system
 - KFC owns no restaurant properties in Iowa
 - KFC has no employees in Iowa

- > Physical presence not necessary when intellectual property generates income
 - Physical presence can be obtained through independent franchisees
- > KFC's royalty income based on with Iowa customers
 - Made possible by Iowa's infrastructure and legal protection of the Iowa marketplace.

- > In Quill the US Supreme Court held that a use tax could not be imposed on a foreign corp. that had no physical contact with the taxing state.
- > In Quill it was not stated that its holding was limited to use tax collection obligations.
- > Iowa could not constitutionally impose the income tax because KFC lacked property "located or having a situs in this state."

KFC Corp v. IDOR Timeline



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- > June 2009 - Iowa District Court upheld the state's imposition of tax
 - KFC appealed the decision to the Iowa Supreme Court
- > May 2010 - The Iowa Supreme Court heard oral arguments
- > December 2010 - Iowa Supreme Court upheld the state's imposition of tax
- > Why are we still talking about this a year later?

- > KFC appealed the case to the US Supreme Court
- > On October 3, 2011 the US Supreme Court refused to hear the case
- > Iowa Supreme Court's decision will stand

How will *KFC* impact franchisors with franchisees in Iowa?



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- > Franchisors with franchisees located in Iowa
 - Will likely face enforcement actions by the state to collect income taxes from prior years.

- > If a franchisor with franchisees in Iowa has not filed income tax returns in Iowa
 - It could potentially be liable for taxes in all previous years the franchisor has had franchisees within the state.

What should a franchisor do in response to *KFC*?



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Contact Iowa's Voluntary Disclosure Program, or wait to see if the state contacts them

- > Generally, participation in the program will limit a franchisor's liability
- > Program is not available to franchisors once they have been contacted by the department.

How will *KFC* impact franchisors with franchisees in other states?



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- > We expect that the *KFC* case will have an impact far beyond Iowa.

- > States looking for ways to generate additional revenue
 - Franchisors have already seen states taking more aggressive actions against franchisors in recent years.
 - » Washington enacted a new statute that imposes its B&O tax
 - » New reporting requirements in New York
 - » Aggressive collection actions by California

Analyzing the complex gift card tax rules

Why should we care?



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- > The purchase and use of gift cards has dramatically increased in popularity and the IRS knows it.
- > Taxation of gift cards is a Tier II issue under the IRS Industry Focus program, which reflects it is an area of potential high non-compliance and/or significant compliance risk to the IRS.
- > The IRS has issued Revenue Procedures in 2011 to clear up some confusion that brought gift cards to the level of Tier II, yet non-compliance risk still remains.

Are gift card revenues taxable income?



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- > General rule -- Income is "income from whatever source derived."
- > Exception -- Income does not include funds over which a taxpayer lacks "complete dominion and control," such as a deposit.
- > So -- If a gift card can be redeemed for a cash refund, it seems to be a deposit and is therefore not a taxable "advance payment."
- > But -- Most gift cards do not allow for cash redemption; therefore, gift card revenues are generally taxable income.

When does gift card revenue become taxable income?



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- > Cash basis taxpayers -- Amounts received by cash basis taxpayers for the sale of gift cards must be included in gross income in the year of receipt.

- > Accrual basis taxpayers -- Amounts received by accrual basis taxpayers for the sale of gift cards must be included in gross income in the year of receipt, unless a proper deferral method is in place.

- > Available accounting methods for accrual basis taxpayers selling gift cards:
 - Full Inclusion Method
 - Rev. Proc. 2004-34 ("One Year Deferral")
 - Treas. Reg. 1.451-5 ("Two Year Deferral")

- > Not surprisingly, the IRS is ok if accrual basis taxpayers includes the full amount of gift card revenues into taxable income in the year of receipt (so no deferral of income).

- > This is true:
 - Regardless of whether the taxpayer recognizes the full amount of gift card revenues for that taxable year for financial reporting purposes.

 - Regardless of whether the taxpayer earns the full amount of advance payments in that taxable year.

- > Gift card revenues are taxable income in the year of receipt to the extent they are recognized into income for the taxpayer's financial statement in the year of receipt, or if the taxpayer does not have financial statements, then to the extent it is earned in the year of receipt.
- > The remaining gift card revenues (so the unredeemed gift cards) may be deferred to the taxable year subsequent to the year of receipt, but no further.
- > Example: ABC Company is a calendar year accrual basis taxpayer
 - Sells \$100 in gift cards in 2011

	Amount redeemed	Recognized
2011	\$40	\$40
2012	\$35	\$60
2013	\$10	
2014	\$15	

Rev. Proc. 2004-34 (“one year deferral”) (cont.)



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- > The taxpayer must be able to determine the extent to which gift card revenues are earned (redeemed) in the year of receipt.
- > If the taxpayer is unable to determine the extent to which gift card revenues are earned in the year of receipt, the taxpayer may determine that amount on a statistical basis. Otherwise, the revenues must be included into taxable income in the year of receipt.

Treas. Reg. 1.451-5 (“two year deferral”)



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- > Gift card revenues are taxable income in the year of receipt, or the first subsequent taxable year, to the extent they are recognized into income for the taxpayer's financial statement in the year of receipt or the first subsequent taxable year, respectively, or if the taxpayer does not have financial statements, then to the extent it is earned in the year of receipt or subsequent taxable year, respectively. (So, just like Rev. Proc. 2004-34, but adding a year in between receipt and the maximum deferral year)
- > The remaining gift card revenues may be deferred to the second taxable year subsequent to the year of receipt (so two years after receipt), but no further.

Treas. Reg. 1.451-5 (“two year deferral”) (cont.)



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- > Example: ABC Company is a calendar year accrual basis taxpayer
 - sells \$100 in gift cards in 2011

	Amount redeemed	Recognized
2011	\$40	\$40
2012	\$35	\$35
2013	\$10	\$25
2014	\$15	

- > However, the gift card must be redeemable for goods (not services) included in inventory by the taxpayer AND the taxpayer must have sufficient inventory on hand or available through its normal sources of supply to satisfy all outstanding gift cards.

Treas. Reg. 1.451-5 (“two year deferral”) (cont.)



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- > Gift cards redeemable for services are not eligible for two year deferral unless:
 - Services are integral to the sale of goods OR
 - Services constitute less than 5% of the total price of the gift card.

- > If the two year deferral method is being claimed, the taxpayer must attach to the income tax return an annual information schedule providing specific information on payments received from sales of gift cards.

- > To use the two year deferral method, you may not estimate or use statistical analysis. Rather, each gift card must be tracked.

How to adopt a gift card method



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- > With the filing of the company's *initial* income tax return, a method can be adopted without approval or special election. Just simply start following the method properly.

- > To change methods, whether using an incorrect or correct method currently, file Form 3115, Application for Change in Accounting Method:
 - To change to the Full Inclusion Method or one year deferral method under Rev. Proc. 2004-34 -- generally, an automatic change can be made by filing Form 3115 with the income tax return.

 - To change to the two year deferral method under Treas. Reg. 1.451-5 -- advance consent is required from the IRS, which requires a user fee and is required to be filed before the end of the taxable year for which the change is to be applied.

Rev. Proc. 2011-18

- > Previously, the IRS position was that the one year deferral method under Rev. Proc. 2004-34 was not available for the sale of gift cards redeemable by entities other than the taxpayer.

- > Now, one year deferral under Rev. Proc. 2004-34 is available for gift cards redeemable by other entities than the taxpayer if:
 - The taxpayer is primarily liable to the customer for the value of the card until redemption or expiration AND
 - The gift card is redeemable by the taxpayer or any other party that is legally obligated to the taxpayer to accept the gift card for redemption.

- > To change to this accounting method, an automatic change can be made by filing Form 3115 with the income tax return.

Rev. Proc. 2011-17

- > This ruling addresses the income tax consequences of issuing gift cards in exchange for returned merchandise.

- > Taxpayer may consider the issuance of a gift card in exchange for returned goods as:
 - The payment of a cash refund (so an immediate reduction in income) in the amount of the gift card, and

 - the sale of a new gift card, which may be subject to the deferral rules under Rev. Proc. 2004-34 and Treas. Reg. 1.451-5.

- > To change to this accounting method, an automatic change can be made by filing Form 3115 with the income tax return.

Unclaimed property

What is unclaimed property?



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- > After a stated inactivity period every state has laws which declare money, property, and other assets to be abandoned.
- > Time period of inactivity typically is 3 to 5 years.
- > Unclaimed property can include expired gift cards or gift certificates.

What am I required to do if I have unclaimed property?



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- > Every state has varying unclaimed property laws, so check with your state laws.
- > Gift cards and certificates are normally required to be turned over as unclaimed property if they have expiration dates or services fees.
- > If gift cards specify an expiration date, the balance on the card may be presumed abandoned x-number of years from the date of purchase.
- > Once the abandonment period begins, companies are required to return the property its owner.

What am I required to do if I have unclaimed property? (cont.)



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- > If the company is unsuccessful, the property must be turned over to the state's unclaimed property office.
- > Annual filing may be required whether a business actually has unclaimed property or not.
- > Noncompliance may result in potential penalties and interest.

Why should you be concerned?



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- > States have begun to audit unclaimed property more seriously than they have in the past.
- > Generally there is no statute of limitation.
- > Unclaimed property will have to be remitted to the state with attached penalties and interest can be incurred.

What do you need to do?



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Since reporting requirement varies from state to state,
check your local states for reporting requirements.

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