REPRESENTING THE RESTAURANT INDUSTRY
The Cornerstone of the Economy, Career Opportunities and Community Involvement

Written Testimony

of

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for the hearing

Examining Expiring Tax Incentives
and the Needs of Small Businesses

before the

U.S. House of Representatives
Committee on Small Business

on behalf of the

National Restaurant Association

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Chairwoman Velazquez, Ranking member Chabot, members of the House Committee on Small Business; thank you for the opportunity to testify before you today of behalf of the National Restaurant Association. My name is Joe Clements of Clements Management, LLC and I am a Burger King franchisee in Louisiana. I am also a Certified Public Accountant by training and education, so I know how much taxes can impact small businesses like mine. I'm here today to urge Congress and this Committee to extend and include 15-year depreciation schedules for new restaurant construction and improvements in this year's tax extenders package.

I have been in the restaurant business for 13 years. I initially entered the business by acquiring 6 Burger King restaurants from an existing franchisee who happened to be a client of mine. I currently own and operate 9 Burger King restaurants in 6 cities. Prior to my entry into the restaurant business, I practiced public accounting for 19 years where my firm provided services to many small business clients. During my years in public practice, the tax laws became more and more complex, and the burden on small businesses, my clients, became greater and greater.

I am proud to be a part of an industry that plays such a significant role in this nation's economy. There are 945,000 restaurant/foodservice outlets in this country. Seven out of ten restaurants are single-unit operators. The restaurant industry is an industry of small businesses.

This year the restaurant industry is estimated to generate $558 billion in sales, with an overall economic impact of $1.3 trillion. Every dollar spent dining out generates $2.34 in business for other industries.

We are the nation's second largest employer outside the government, employing more than 13.1 million people, representing more than 9 percent of the job-base. We are truly the cornerstone of this nation's economy.

On any given day 133 million individuals are patrons of a food establishment. Given the industry's contributions to the economy, we strongly urge the Congress to include 15-year restaurant depreciation for new restaurants and improvements to the 2008 tax extenders legislation.

More Accurate Depreciation Schedules Should Be Included in Tax Extenders

Depreciation schedules for commercial real estate, including restaurant buildings, have not been significantly revised since they were established decades ago. It is time these schedules more accurately reflect the life of the property. According to the tax code, commercial real estate generally has a 39 1/2-year depreciable life for the original building and for any subsequent renovations or improvements to the building. Restaurants have gained some temporary relief for improvements before, but not for new construction and not reliable relief that will encourage longer term investment and planning.

Restaurants operate on industry average margins of four to six percent and every penny counts, especially for small businesses and franchisees like me. Depreciating property over a shorter amount of time has a direct impact on a restaurant's bottom line by allowing a restaurateur the immediate cash flow to reinvest in their business.

Changes have been made that allow certain industries that directly compete with restaurants to benefit from shorter schedules. These schedules range from seven years for food outlets located in amusement parks to 15 years for convenience stores attached to gas stations. This favorable depreciation schedule has allowed convenience stores to expand and improve their foodservice options – a direct competitor to quick service restaurant operators.

Restaurant Building Depreciation
Past changes to the depreciation schedule for certain industries and the exclusion of the new restaurant construction provision have placed certain businesses at an economic disadvantage. The tax code should not pick winners and losers in the restaurant industry; it should allow a level playing field on which all can compete.

Within the retail industry, restaurants have a unique case for accelerated depreciation schedules. As mentioned earlier, 133 million individuals are patrons of the industry on a daily basis. Restaurants must constantly make changes to keep up with the daily structural and cosmetic wear and tear caused by customers and employees. Restaurants get more customer traffic than other commercial businesses. Many are open 24 hours a day, seven days a week. This heavy use accelerates deterioration of a restaurant building's entrance, lobbies, flooring, restrooms, and interior walls. Restaurant building structures therefore experience a daily human "assault" unlike that borne by any other types of buildings in the retail industry.

Most restaurants remodel and update their building structures every six to eight years – a much shorter timeframe than is reflected in the current depreciation schedule. Many of these refurbishments are not treated as improvements under the tax code, but as new construction because these remodeling projects require changes to structural walls. Thus creating layer upon layer of depreciation schedules for every periodic update or new construction.

Also, many franchise agreements contractually require the evaluation of the location, and quality and configuration of the restaurant structures routinely. As for me, Burger King requires a remodel of the facility at 10 year and a complete renovation at 20 years. Franchisees are small business owners and they bear the cost of updating their buildings or completing scrape and re-build projects. While these scrape and re-build projects may be considered renovations in their agreements, the tax code treats these as new construction. Thus, they currently are depreciated over 39 ½ years.

The above-mentioned renovations and structural improvements made to restaurants every six to eight years come at an average cost of $250,000 - $400,000. This year alone, the restaurant industry is expected to spend in excess of $5.5 billion on capital expenditures for building construction and renovations. The restaurant industry is projected to spend over $70 billion over the next ten years for building construction and renovations. These more-than-modest expenditures in turn have a significant economic impact on businesses performing these renovations. Like the restaurant industry, growth in the construction industry will reverberate throughout the economy. According to the Bureau of Economic Analysis, every dollar spent in the construction industry generates an additional $2.39 in spending in the rest of the economy, while every $1 million spent in the construction industry creates more than 28 jobs in the overall economy.

If there is any question whether shortened deprecation schedules would spur economic activity consider the fact that after Congress enacted the restaurant improvement provisions in 2004, the restaurant industry spent more than $7.4 billion on new structures and building improvements in 2005 – a 42 percent increase over the $5.2 billion spent in 2004 (according to the U.S. Census Bureau).

The additional spending – fueled by a shorter depreciation schedule – created thousands of jobs in construction-related industries across the country. With more predictability in the tax code and the inclusion of new restaurant construction on a 15-year schedule, we anticipate that these spending numbers will grow as restaurateurs have the ability to plan new building and improvement projects farther out than one or two years.

Legislative History of Accelerated Restaurant Depreciation

The economic stimulus package passed in the 107th Congress, allowed for 30 percent bonus depreciation for certain assets, (such as assets depreciated over a 20 year schedule or less). As part of the 9/11 economic stimulus package, this provision was expanded to include any leasehold improvements (currently depreciated over a 39 ½ year schedule). However, owner-occupied properties were not included.

The American Jobs Creation Act of 2004 established that restaurants could depreciate qualified restaurant building improvement costs over 15 years for property in place by the end of 2005. This provision applied to both leased and owner-occupied buildings. The Tax Relief and Health Care Act of 2006 extended the existing provision through the end of 2007.

The Minimum Wage/Small Business Tax Relief bill (H.R. 2) that passed the Senate on February 1, 2007 contained a provision which would have extended the improvement piece through March 31, 2008, and would also have added 15-year depreciation for new restaurant construction from the date of enactment through March 31, 2008. A subsequent Senate Finance Committee package included the extension of qualified leasehold and restaurant improvements through December 31, 2008 and added new construction from the date of enactment through December 31, 2008. However, all depreciation provisions were removed from the final package that was enacted into law.

As of January 1, 2008 all schedules reverted back to 39 1/2 years, including improvements made to restaurant structures both leased and owner-occupied. When Congress passed and the President signed the Economic Stimulus Act of 2008, the legislation included a bonus depreciation tax provision as well as increased Sec. 179 small business expensing. However, the restaurant industry can not take advantage of the bonus depreciation provision for even the improvements we had previously because the provision only applies to property on a 20 year or less depreciation schedule. As a result, the positive impact of the economic stimulus package was not as great as it could have been for the restaurant industry and our communities.

Several 2008 tax extenders proposals include a 15-year depreciation provision for improvements and newly constructed restaurants. We urge Congress to extend the improvements provision and include new restaurant construction as qualified property in the final tax package.

There is broad support for the idea that restaurant improvements and new construction should be on a 15 year schedule. There are currently two bipartisan bills in the 110th Congress which address restaurant depreciation for new construction and improvements. H.R. 3622, championed by Congressmen Kendrick Meek (D-FL-17th) and Patrick Tiberi (R-OH-12th), would make permanent a 15 year depreciation schedule for newly constructed restaurants as well as restaurant improvements. The bill currently enjoys the bipartisan support with 161 cosponsors, including 18 members of this committee. Senators Kay Bailey Hutchison (R-TX) and Jon Kyl (R-AZ) introduced companion legislation, S. 2170, which also enjoys bipartisan support in the Senate.

Conclusion

We urge Congress to consider this information as evidence of the need to keep the restaurant industry strong in order to help the nation's overall economy. The House Small Business Committee has been a staunch advocate of tax relief for the country's small businesses, including restaurants. We encourage the committee to continue to support H.R. 3622 and push for inclusion of 15-year depreciation schedules for new restaurant construction and improvements in the 2008 tax extenders bill.

Thank you.