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Making Money With Your Employees

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In last month's issue, when considering the employment issues likely to arise for restaurant operators, we discussed ways to avoid costs and minimize your losses. Now, let's look at a few ideas that can actually help not only minimize cash costs but create revenue benefits.

Use of the FICA Tax Credit

Most operators can take advantage of the tax credit for the employer portion of FICA paid on tips. You do have to offset your tax deduction for wage expenses by the amount of wages you take as a credit. Many times, operators who have losses and carryovers elect not to use the credit and take the deduction instead. In most situations, we think this is shortsighted. It is important to weigh all factors when trying to minimize income taxes. This FICA tax credit is a very good tax-savings provision.

Research and Development Credit

Another credit that you might consider, which I have seen used by restaurant companies, is the research and development credit. Many times, restaurant companies develop proprietary software or systems, or receive patents for equipment developed or processes for new food techniques. These are all items that qualify for this type of credit. It is based on an initial year of dollars spent on research and development, and the credit is equal to the incremental dollars spent over the base period.

Use of Empowerment Zone Tax Credit

Each restaurant operator also should be aware of the Empowerment Zone tax credit, which provides businesses with an incentive for both the business and the employees in a designated zone. The tax credit is equal to 20 percent of the first $15,000 of wages if the employees both live and work in the empowerment zone. Curiously enough, this does not just include inner-city locations. Many zones include small-to-middle-size rural communities. The key to taking advantage of this credit is accurate recordkeeping and certification of where the employee lives and that the business is also in the empowerment zone.

Regarding the above credits, there is one caveat: We really do not know what will happen when the final tax bill is released. As of the time of this article, these are still available.

Now, let's look at ideas that can actually help not just minimize costs, but actually create some revenue benefits.

Stock Appreciation Rights

Stock Appreciation Rights are considered "phantom ownership," which is where the employee shares in the theoretical increase in the value of the company or even individual stores from an original start date to the date of termination, retirement, or sale of the business. These are great ways to provide incentives to the employees to grow the company, and it is something that can be easily implemented. Unfortunately, for GAAP purposes, the liability associated with these has to be accrued, even though it hasn't been paid, and there is also no deductibility for the accrued benefits until they are paid.

Profits Interests

One effective technique to incentivize employees as well as receive some tax benefits is what is known as profits interests. These interests provide key employees with an interest in the profit of the company, so that, when filing the tax return, the employee is allocated a certain percentage of the taxable profits. A real incentive for the employees is provided, while also allowing the tax burden for profitability to be spread among these individuals. The key is that these employees have a right to profit and cash distribution. Normally, profit investments do not have a participation in the business' equity interest, therefore the employees would not benefit from the sale of the company.

Restricted Stock Ownership

Another form of employee benefits is what is known as Restricted Stock Ownership. This is where the employees are granted, either with or without a purchase, an interest in the company or individual stores. The beauty of this approach is that in most cases it is real ownership. It may not carry a voting interest but it is true economic interest, which is beneficial for the current earnings and future sales. This approach may have some immediate tax implications; however, these can be mitigated through a Section 83B election. Thanks to this incentive, the employee will definitely feel a part of the ownership.

In summary, last month we discussed ways to save on the cost of employee issues. This is always going to be a primary concern, and successful companies track all employee issues and the costs related to them. In this article, we have tried to feature ways to incentivize employees and make employees the true assets that they are. Another caveat to the above ideas is certain provisions of the proposed tax bill may significantly alter their current tax treatment. However, we still hope that implementing these techniques will alleviate the issues we discussed in the previous article.

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