Statement
On behalf of the
National Restaurant Association
&
Colorado Restaurant Association

ON: BURIED IN PAPERWORK: A 1099 UPDATE

TO: U.S. HOUSE OF REPRESENTATIVES, COMMITTEE ON SMALL BUSINESS

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Buried in Paperwork: A 1099 Update
Before the
U.S. House of Representatives, Committee on Small Business
By
John "Mark" Eagleton, Franchisee, The Egg & I, Arvada, Colorado
On behalf of the
National Restaurant Association and the Colorado Restaurant Association
February 9, 2011

Chairman Graves, Ranking Member Velázquez, Colorado Congressman Scott Tipton, my Colorado Representative Mike Coffman, and members of the House Committee on Small Business, thank you for this opportunity to testify before you today on behalf of the National Restaurant Association and the Colorado Restaurant Association.

My name is Mark Eagleton. I am a franchisee owner of the Egg & I restaurant in Arvada, Colorado, a northwest suburb of Denver. We are a 133-seat restaurant open every day from 6 a.m. to 2 p.m., serving breakfast and lunch.

I'm here today to ask Congress to repeal the expanded 1099 reporting provision passed in Section 9006 of the Patient Protection and Affordable Care Act (PL 111-148) and to explain the burden this requirement will have on small businesses like mine. In addition, there are fundamental problems with PPACA that must also be addressed by Congress.

The 1099 provision specifically requires me to report all business transactions, for both services and materials, with a vendor valued at more than $600 aggregated annually. If this requirement is not repealed it will create a new hardship, particularly on small businesses, at a time that many of us are attempting to survive under the current weak economy.

I have been in the business since I began as a busboy at age 14. I was with Arby's® for 21 years, eventually serving as COO of The Bailey Company LLP, Colorado's largest Arby's franchisee. When I left Arby's, my wife, Sandy, and I decided to take a chance. We leveraged everything we had and we opened our own business in 2005. Our location is one of 42 Egg & I restaurants. The company is headquartered in Lone Tree, Colorado, and franchises restaurants in eight states.

The Restaurant Industry Is Primarily Composed Of Small Businesses

The National Restaurant Association is the leading business association for the restaurant and foodservice industry. The Colorado Restaurant Association is the leading business association for the restaurant and foodservice industry in Colorado.

The Associations' missions are to help our members build customer loyalty, rewarding careers and financial success. Nationally, the industry is comprised of 960,000 restaurant and foodservice outlets employing 12.8 million people. We serve more than 130,000 million guests per day.[1] Despite being an industry of predominately small businesses, the restaurant industry is the nation's second-largest private-sector employer.

We are a unique industry. First, we are dominated by small businesses. More than seven in 10 eating and drinking establishments are single-unit operations. The restaurant industry also operates under relatively low profit margins – roughly 4 to 6 percent <u>before taxes</u>, according to the National Restaurant Association's Restaurant Industry Operations Report. Labor costs are one of the most significant line items for restaurants.

Many of these small businesses do not have a large administrative staff to handle recordkeeping and reporting responsibilities. In addition to the 1099 reporting requirements, these responsibilities include a myriad of requirements mandated by federal, state and local governments.

THE COST OF COMPLIANCE WITH THE NEW 1099 REQUIREMENTS COULD TAKE ME AND OTHER EMPLOYERS OUT OF BUSINESS

The expanded 1099 rules would force small businesses to collect taxpayer identification information from most, if not all, vendors, contractors and other business partners, as well as make their own tax identification number more easily accessible by customers.

The Treasury Department proposed a regulation in 2010 to exempt credit card transactions from the expanded 1099 mandate. That was a step in the right direction that is much appreciated by the restaurant industry. However, more needs to be done to reduce the expected paperwork burden from the new reporting requirements. My industry believes that Congress must act to repeal this section of the law.

I took every dime I had from anywhere I could get it to open our restaurant. I cashed out my 401(k). I emptied my savings. We took out a second mortgage on our home. My best friend became a limited partner. We received an SBA 7(a) loan. In short, I leveraged the family's entire future to open this restaurant. All we have is at risk and will be lost if this venture fails.

We are now in our sixth year, and I am very proud of what we have built. We have 26 employees, including my wife, two sons, and our adopted daughter. My son John Paul is a server/trainer. My son Dustin is our assistant kitchen manager. My special-needs daughter, Natasha, washes dishes.

I mentioned that profit margins in our business are slim. I fell way below the typical profit margin for a full-service restaurant last year. My sales in 2010 were $944,504. That may sound good, but my cash flow for the year, after debt service, was a negative $591.

As I ended 2010, the total amount of money in all my personal and business savings, checking and investment accounts – as well as lines of credit, and credit available on

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[1] *2011 Restaurant Industry Forecast*, National Restaurant Association (2011).

credit cards – added up to a little more than $1,000. My family, employees, their families and I live and operate on the edge of success and failure. The following table displays my sales, cash flow and net income since I have opened:

The Egg & I® Sales, Cash Flow and Net Income Table:

Eagleton Ventures dba The Egg & I Restaurant in Arvada, Colorado			
Year	**Annual Sales**	**Cash Flow** (After Debt Service)	**Net Income** (After Depreciation and Amortization)
2010	$944,504	($591)	($20,109)
2009	$968,012	$22,617	($9,472)
2008	$987,509	$30,766	($11,916)
2007	$922,816	($4,634)	($74,404)
2006	$978,872	($4,836)	($71,905)
2005	$779,188	($8,009)	($38,387)

We've invested everything we have in this business. Any variable can tip the balance from my restaurant being a going concern to another failed business. If sales fall or costs rise and I cannot cover the increased expenses, my business will close very quickly. My family and I will lose our life savings and 22 other employees will lose their jobs and their livelihood.

The added 1099 reporting requirements sound simple to comply with, hardly more than the requirement to provide year-end W-2s. W-2s cost me over $800 a year to input, track, print, mail and file with the IRS.

Providing 1099s for essentially all business to business transactions may be a simple edict, but it could put me out of business. The requirement that I track all vendors from whom I purchase at least $600 in products or services annually and issue 1099s will be significant, in both time and money.

In this case, I have two choices: Do it myself, or pay someone else to do it. Where am I going to come up with the money? I don't have spare assets to put into play to make this happen. I can raise prices, but I compete in a marketplace where my customers can easily go to my competitor.

The practical consequences of the expanded 1099 requirements are staggering for a business like mine. I work with 200 to 300 vendors each year. Not all will reach the $600 threshold, but since I don't know who will, I will need to record all the purchases I make. I must buy, install and learn new software; track down each vendor's taxpayer identification number and address; key in information for 200 to 300 vendors; compile data onto 1099s; and print and mail forms to vendors and the IRS if my purchases to any one vendor total more than $600 for the calendar year.

If I can't get a taxpayer ID number for a vendor, I will need to withhold federal income taxes from my payments to them. I will do as much of this as I can myself, but will need to go outside for help – just like I need to do for my annual W-2 forms.

I worry about accuracy. I don't want to send my vendors erroneous information. I feel obligated to hire someone to double-check me. What if my books don't agree with a vendor's records? How will we reconcile disagreements? How much time will I spend answering questions from vendors? Will I face penalties from the IRS for failing to file proper 1099s?

To list just a few examples of the reporting this law will trigger:

- We like to use fresh produce in our salads. Everyday I cross the street to the local grocery store to buy a head of fresh Romaine lettuce to add to our salad mix. The lettuce costs me $1.79 per day. I generally pay in cash, and do so for the 363 days a year we are open. My spending for fresh lettuce will exceed the $600 threshold.
- Each spring, I spend at least $600 a year on seasonal outdoor plants at my local nursery.
- I visit my neighborhood hardware store frequently when an electrical cord is frayed, when I need nuts and bolts to hang a picture on the wall, and for all sorts of other reasons. These nickel-and-dime purchases easily add up to $600 a year.
- I stop by my local dollar store to buy light bulbs, picture frames, bandages, vacuum cleaner bags, and other items totaling more than $600 a year.

These incidental, day-to-day costs of running a business are business payments I never had to worry about reporting to the IRS or companies before. How much time will I spend keying in data for 1099s?

Does that compliance burden justify the extra revenues the IRS expects to receive as a result of this law? What happens when I go out of business? The government loses all the revenue in that case.

Restaurateurs have another concern. Almost every week, a local business-networking group spends $80 for a meal at my restaurant. Once a month, a department of employees from a local business comes in for a business lunch and spends $60 while they discuss workplace issues. They often pay in cash or check.

Will these guests need to collect data from me so they can issue me a 1099 at year's end? Will they continue to patronize my restaurant if they need to track purchases and send me a 1099?

It is clear that there is bipartisan support for repeal of Section 9006. This shows that Congress is listening to the nation's job-creating small businesses. I hope this Committee can help convey our concerns to your colleagues and work to repeal this section of the law as soon as possible.

There Are Other Fundamental Problems With PPACA From The Perspective Of The Restaurant Industry

Beyond the 1099 provision, there are some important fundamental problems with PPACA from the perspective of the restaurant industry. The early feedback from our industry on PPACA is not encouraging. So far, PPACA is failing to constrain rising health care and coverage costs, while imposing unsustainable costs and job burdens on the restaurant industry.

My business has provided health insurance to the same four people since 2005. In seven years, my annual premiums have risen 278 percent, from $11,456 in 2005 to $31,919 in 2011. Since the healthcare reform bill was enacted last March, my health insurance premiums have continued to rise. They haven't declined, as promised.

PPACA will have an enormous impact on the U.S. restaurant industry. Our employee demographics, our distinctively labor-intensive business models and a historically low voluntary enrollment rate in health insurance offerings will lead the U.S. restaurant industry to take the brunt of this act.

Restaurateurs will be predominantly affected by the burdens found in PPACA in a number of ways. First, the law defines a full-time employee as one working an average of 30 hours per week. This is vastly different than current practice in the restaurant industry – generally 40 hours per week.

This will create confusion and will mean employees' hours will be even more closely managed throughout the industry. Due to the higher costs, it is entirely rational to expect some employees' work hours will be cut even further in order to fall below the 30-hour-per-week threshold. We also expect to see less hiring of full-time employees overall. Because the restaurant industry is distinctively labor-dependent and constrained by thin profit margins, these changes to the business model might be the only way to remain profitable.

For front-of-the-house employees, the number of hours worked directly affects their income. Thus, the changes businesses will make because of PPACA would have another unintended negative consequence that has not fully been taken into consideration. We also fully expect less development and growth for existing restaurants, and we expect some restaurants operating with marginal profits to have to close their doors altogether.

The employer mandate and accompanying penalties that take effect in 2014 will impose a great burden on employers with 50 or more full-time employees or full-time equivalents who fail to offer qualifying coverage. The penalty is $2,000 per full-time employee (defined as 30 hours or more per week) after the first 30 employees.

What's more, a restaurant could provide qualifying coverage to full-time employees and still be penalized for any subsidy-recipient full-time employees if the cost to one full-time employee exceeds 9.5 percent of that employee's household income and the employee receives subsidized coverage. This penalty is $3,000 per subsidy-eligible employee up to a maximum of $2,000 times every full-time employee, after the first 30 employees.

The employment-based exemptions found in PPACA place direct pressure on employers to cut jobs in order to remain below the exemption level. The employment-based exemptions also do nothing to test whether the employer has the ability to absorb the additional costs. Thus, some in our industry are calling for an exemption based on a "profit-per-employee" (PPE) test. The PPE is calculated by dividing a business's net profit by their number of employees.

A recent study from the University of Tennessee's Center for Business and Economic Research concluded that PPE would be better than total employment for exempting employers because it is a better proxy for ability to pay.[2] Most restaurants already offer health care options to their employees. However, a PPE-based exemption would allow small and low-margin restaurants the flexibility to provide benefits at levels that allow them to remain profitable – helping preserve and create jobs, particularly important in this economic climate.

Finally, I worry about the fine print of this law – the rules that define a full-time employee as one who works 30 hours a week or 35 hours for discrimination testing, or a small business as one with fewer than 50 full-time equivalent employees. In our labor-intensive restaurants, 50 full-time equivalent employees isn't a lot. Limiting the maximum contribution by employees to 9.5% of his/her salary or wage is too low.

In my opinion, a full-time employee's weekly hourly threshold should be raised to 40 hours per week. It is my own opinion, as a small business owner, that the small business threshold should be greater than 250 employees. I understand that the National Restaurant Association is willing to support either a smaller number to reach consensus among the different policy makers or a different threshold, such as profit-per-employee. I also believe that employee contributions for health care should be raised to 50 percent of the health care premium.

For example, under the new law, if I have a server who is married and they have one child, health care premiums would be $1,000 a month (using round numbers). Let's say a typical server for me makes $24,000 a year working 32 hours a week (including tips). Health care premiums would equal 50 percent of his/ her annual wages.

The employee contribution would be $2,280 (9.5 percent of wages) and I, the employer, would have to pay $9,720 for that one employee. I do not make that much profit in a year! If I had to pay that for even half my employees, it would total $106,920 annually. How can I generate that much in new sales? I would have to generate an additional $300,000 in sales annually just to generate the additional $106,920. How? If I knew how to do that, I'd be doing that already!

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[2] Bruce, Donald (Ph.D.), "An Economic Analysis of Business Exemptions from Public Policies," Center for Business and Economic Research, The University of Tennessee, Knoxville, TN, August 2010.

Let Us Work Together To Find A Solution That Both Lowers Health Care Costs And Provides Better Benefits Without Bankrupting Small Businesses

Since enactment of PPACA, the National Restaurant Association has been attempting to constructively shape the regulations, including those covering mini-med policies. Nevertheless, there are limits to the scope of change we can achieve through regulations, particularly if those charged with their drafting choose to ignore the industry's comments. Ultimately, PPACA itself needs to be repealed or changed to mitigate the most harmful effects on the restaurant industry.

The National Restaurant Association will continue to be active in urging Congress to either repeal or pass major legislative changes to PPACA because some of the fundamental problems cannot be fixed through regulations alone. Our highest priority will continue to be eliminating the employer-mandate penalties.

In the meantime, other important changes are needed to ease the administration of benefits without constraining benefit offerings. These include the elimination of the auto-enrollment provision, the expansion of the limits on waiting periods, the modification in the definition of full-time employee, and other changes. The National Restaurant Association looks forward to working with this Committee and all of Congress on these and other important issues to improve health care for our employees without sacrificing their jobs in the process.

Thank you for this opportunity to explain the added burden the expanded 1099 information reporting provision included in PPACA will impose on small businesses like mine. The restaurant industry appreciates the steps this committee is taking to highlight the burdens small businesses will face if Congress does not repeal Section 9006 of the law. However, more must be done to address the other fundamental problems we see with this law. The industry looks forward to working with this Committee and Congress to eliminate the paperwork burdens of the expanded 1099 requirements and also on the fundamental problems with the law that impact so many of America's job creators.