Tax considerations for PE-backed businesses in the restaurant sector

It's been a difficult couple of years for the restaurant sector, dealing with the Pandemic, labour market and supply chain challenges and adapting to the changing needs of customers. But … demand has bounced back and M&A activity in the sector is expected to increase in 2022, so businesses are turning their attention back to creating value as well as mitigating risk.

Here at PwC we have a dedicated team of specialist tax professionals who have significant experience in advising Private Equity backed businesses across the restaurant sector, from international restaurant chains to domestic 'food to go' groups. So whether it is supporting you in:

- maximising tax relief for capital expenditure on site roll-outs or refurbs
- securing grants for R&D spend or improving sustainability
- optimising your VAT position through our retail VAT best practice reviews
- implementing a tronc
- helping you comply with NMW and CJRS rules
- maximising efficiency of your international operations
- guiding you through the tax implications of lease re-negotiations, or
- supporting you through a successful exit

Our team is here to help!

We've summarised over the next few pages some of the key areas we are currently focussing on with our restaurant clients and would welcome the opportunity to discuss these with you and highlight how our advice can add real value to your business.

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Employment taxes are a commonly raised risk area on exit diligence - is your business compliant?

Employment taxes are one of the main taxes paid and borne by businesses and account for more that 50% of Government revenues. HMRC estimate PAYE is annually underpaid by £3.4bn. To address this, industry specialists have been appointed as Employment Tax Champions to reduce the tax gap. With responsibility for employment taxes often sitting between Finance and HR functions it can be difficult to ensure compliance.

The consequences of getting things wrong can be considerable and, with HMRC taking an increasingly hard line on penalties, it is now more important than ever to get the right controls and processes in place.

National Minimum Wage ('NMW')

Businesses need to comply with the NMW and pay employees at or above the published rate. This sounds straightforward, but in practice there are a number of complexities which can catch employers.

Do you pay your chefs the time it takes them to change into chef's whites? Does your uniform policy stipulate employees must wear 'black footwear, trousers, skirts'? Do you hold unpaid staff briefings? Are employees required to be ready for shift 5 mins before it starts? Are employees subject to any deductions, such as salary sacrifice schemes that could bring them below the NMW rates? Use of Time Off In Lieu ("TOIL")?

Any one of the above could mean that you breach NMW regulations.

A breach, identified by HMRC, would result in having to compensate current employees and all former employees, uplifted to current rates going back 6 years; a penalty of typically 100% of the underpayment and your business "named and shamed" by the Dept of Business damaging reputation and company value. In order to avoid this reputational and financial damage, we can help review your policies, payments and processes to ensure NMW compliance.

Should we identify any areas of non-compliance then provided this is recorded and payments made to the employees prior to a HMRC review, this should avoid any penalties and dangers of reputational damage.

We have lots of practical experience helping businesses, across multiple industries, review their NMW compliance and then helping ensure that they are compliant going forward.

Gratuities – are you losing out?

Under plans unveiled by the Government on 24 September 2021, legislation will be put in place to overhaul "tipping" practices, which will have a particular impact across the Hospitality and Leisure industry. The Government estimates that the change is set to help approximately 2 million workers across the sector.

At present, it is common practice for the Hospitality and Leisure industry to add a discretionary service charge to bills (usually between 10% -12.5%), however these may not always be shared with the workers, or may be collected and distributed via the payroll. The change is to ensure that all tips (tip/gratuity or service charges) paid will have to be passed onto workers, and not retained by the business.

Under a tronc, the responsibility for distributing the tips rests with an individual (or 'troncmaster') as such, whilst income tax applies, NIC does not, this therefore creates an immediate 13.8% saving for the business, and a 12% saving for the employee. However, there are very strict guidelines for the operation of a tronc that employers need to have the processes to manage.

If your business does not operate a tronc we would be very happy to discuss how to implement one and model the savings that can be achieved.

Coronavirus Job Retention Scheme ("CJRS") - have you checked your claims?

CJRS is a complex area and the Guidance was adapted throughout the claims period. Many restaurants were severely affected by the COVID-19 pandemic and did make claims under CJRS. However, following the submission of claims, employers may not have re-reviewed the calculations to ensure that they are in line with the Guidance

Minimum Furlough Pay

Where an employer identifies an under-claim, steps should be taken to correct any underpayment made to the employee. Failure to pay a minimum of 80% of 'reference pay' would lead to the claim for that employee being invalidated.

Penalties and errors

HMRC have provided a CJRS-specific fact sheet which confirms that they will not charge a 'failure to notify' penalty if an employer did not know they had over claimed a CJRS grant when it was received (or at the point when they subsequently ceased to be entitled) provided it is paid back by 12 months from the end of the accounting period in which the over claim arose (or 31 January 2022 for an employer who is an individual or a partner).

An employer who, on review of their claim identifies a mistake, should therefore be able to avoid penalties for late notification provided that they repay any over-claim within the time limit.

HMRC's view is that employers have ample opportunity to reduce the penalty amount to nil, provided that the failure is 'non-deliberate' in nature.

Furthermore, where the failure is non-deliberate, the penalty can be reduced to nil where the employer has a reasonable excuse and acts without unreasonable delay after the excuse has ended.

Offsetting

HMRC have updated their guidance to confirm that where errors have resulted in both under-claims on some employees and over-claims on others within a given claim period it is possible to net those errors off. Only any resulting over-claim needs to be repaid.

It is important to appreciate that no such offsetting is permitted if the errors arose in different claim periods.

Next Steps

We would recommend that reviews are undertaken as soon as reasonably practicable in order to meet HMRC's deadline to mitigate any penalties and ensure that all claims are accurate.

We have extensive experience, across multiple industries, in helping employers ensure compliance with CJRS.

VAT in the restaurant sector can be complex - are you optimising your VAT position?

VAT

Retail VAT Accounting

PwC's national retail VAT team, led by Jim Wilkinson, has extensive experience advising the largest UK and international retail businesses, including many hospitality businesses. One of the key offerings we provide is undertaking retail VAT best practice reviews, which regularly result in our clients obtaining refunds of overpaid VAT. This includes specific catering and 'food to go' opportunities resulting in significant VAT refunds.

The retail VAT opportunities review consists of two distinct areas 1) Retail best practice review and 2) Targeted product file review.

1

Retail VAT best practice review
This review is an in-depth analysis of the Retail VAT accounting systems and processes that are currently in place and is aimed at identifying VAT saving opportunities, ensuring that our clients are in the optimum VAT position both historically and moving forwards.

2

Targeted product file review
The team has extensive experience of product liability issues and has carried out targeted product file reviews for many hospitality businesses, which have resulted in significant VAT refunds

Land and Property

A knock-on effect of the COVID-19 epidemic has been the need for commercial landlords and tenants to agree lease variations/amendments in order to provide tenants in the Restaurant sector with flexibility to continue trading in a post-lockdown economy. Significant VAT complexities can arise in these circumstances which can in turn lead to VAT costs being unnecessarily incurred.

Deal costs

Holding Company VAT recovery has been a contentious area for a number of years and is subject to a high level of scrutiny from HMRC, especially when large value costs are incurred on acquisitions, disposal or restructuring. Early advice in respect of engaging suppliers and evidencing eligibility for VAT recovery can help mitigate HMRC challenges and/or diligence issues later on.

We have extensive experience in supporting clients to navigate the above complexities, often resulting in VAT savings.

The **big** cost to businesses in the restaurant sector - real estate and commercial leases

Property strategy

Throughout 2020 and 2021, PwC advised many businesses on re-negotiating their property cost base, including via consensual negotiations, administrations, and Company Voluntary Agreements (CVAs). All were routes to amend commercial property leases, creating a new sustainable rent base for many businesses. What this has highlighted is that:

- **Most landlords are willing to be flexible -** A good working relationship is important and many landlords have been open to changing their approach to leases and the terms within, helping create a more collaborative relationship.
- **Real estate strategy is a "board level" concern -** The pandemic accelerated many trends, changing business strategies; as a result, ensuring that a business' property strategy is similarly updated is increasingly becoming an area immediate board level focus.

Short term

Value / cost levers	Key considerations
Sale and leaseback to provide cashflow from freeholds	• Quickly release cashflow from freehold real estate to support operations.
PwC act as a consensual broker for lease variations when struggling to meet rent payments	• Engaging in proactive and positive negotiations between landlords and tenants to achieve consensual rent reductions – resulting in a reasonable and fair outcome for both parties.

Medium term / Long term

Value / cost levers	Key considerations
Capital release	Generate cash and release locked in profit from real estate to re-invest in the business and/or pay back to shareholders • **Sale and leaseback to exit**: Strategic programme of sale and short term leaseback to facilitate an exit from non-core assets • **Regear leases**: Regear existing lease portfolio to achieve annual rent reductions and release one-off provisions
Asset strategy	• Review real estate strategy to ensure alignment with the strategic objectives and the future size and shape of the business, particularly given increased remote working • Assess current supply and future demand of real estate (both business and market) – optimising the configuration, reducing operating costs, and generating capital receipts/income • Develop a comprehensive business case outlining the case for change, informed by robust analytical evidence

Tax - the forgotten cost on leases

Real estate tax costs for occupiers are commonly the "forgotten costs", especially when businesses consider changes to their property footprint or leases. These include (a) sale and leasebacks, (b) lease assignments, (c) early lease terminations, (d) new leases including 'inducements' and similar.

In most cases, this is due to UK real estate tax being complicated and spread over multiple specialists. By illustration, some tax considerations are shown below:

Stamp Duty (2p - 5p in £)

Significant costs on lease, all payable upfront within 14 days. Also typically a capital cost (non-deductible).

Corporate Tax (19p - 25p in £)

With CT rate increasing to 25% in 2023, capital costs on leases are becoming more important. This is applicable especially on 'premiums' and 'inducements'

Capital Allowances (19p - 25p in £)

With the introduction of Structures and Building Allowances and the up to 130% Super-Deduction, maximising capital allowances is important.

VAT (20p in £)

As highlighted in the VAT section, transactions in land and property are complicated and require specialist advice.

CIS (20p - 30p in £)

Construction Industry Scheme (CIS) whilst targetted at contractors, can catch tenants out with landlords inducements and sub letting. CIS is a witholding tax, typically recoverable.

Business Rates (c.50p in £)

As a rough metric, business rates costs are approximately 50% of your rent cost. The Autumn 2021 Budget had a stark message for larger retailers and wider reliefs shouldn't be overlooked.

PwC solution - focused on occupiers

PwC has a dedicated Real Estate Team, focused solely on occupiers (rather than landlords). This team covers Advisory, Tax and Legal as "one team" rather then having multiple contacts. This means when it comes to real estate matters, businesses we advise have access to the right specialist across a number of disciplines, fully coordinated and able to provide tailored advice based upon our clients specific needs.

Maximising available tax reliefs is key to unlocking value

R&D tax relief

Qualifying R&D activities within the restaurant sector tend to centre around software development technology solutions, including areas such as;

- **E-commerce platforms** - including online ordering services; ordering through third party platforms (e.g. deliveroo/just eat) and integrating with their platforms; integrating with third party payment providers (e.g. mobile pay); development of web and android/iOS applications, location-aware systems (e.g. google maps) and new loyalty scheme system integrations.
- **System transformation** - where the business is implementing a new ERP system. Any elements of bespoke development such as the addition of new functionality and integrating with existing legacy programmes could contain qualifying activity.
- **New internal software tools** - integrating new software programmes or systems within the business and restaurants such as point of sale systems. Developing analytical solutions (e.g. social media analytics) for strategic insights and dynamic booking and pricing.
- **COVID-19 implications** - implementing new solutions in store such as ordering through your phone. Developing solutions wirelessly connecting restaurant areas (e.g. hand-helds, kitchen-displays, self-ordering kiosks, integrated vending machines, smart-hospitality solutions)

If any of the above activities have been undertaken by the business, either by an internal IT team or through use of agency/temp staff, then a 10% credit could be available to claim. The business has up to two years to make a claim, therefore a 31 December 19 year end would have until 31 December 21 to make a claim.

We can help with a range of areas from feasibility workshops to assess potential benefit, to review of existing claims to identify additional areas of opportunity to full claim preparation.

Capital Allowances

Significant levels of tax relief can be available on capital expenditure incurred on acquiring and fitting out properties within the restaurant sector either via the capital allowances regime or by way of revenue deductions.

The changing tax landscape and recent modifications to legislation has increased the level of scrutiny from HMRC on the approach adopted on the preparation of such claims and the robustness of existing processes in place.

Businesses within the restaurant sector are therefore considering ways to optimise and streamline their approach to capital allowances to save year-on-year cost and time, reduce process risk and achieve greater certainty on the overall tax outcome.

Research & Development - RDEC*

13%

above the line credit (post April 2020)

10%

cash value after tax

£1m

on R&D =

£100k

Cash from HMRC

Cash available regardless of tax position

*Assuming entity exceeds the thresholds under the SME regime.

How we can help with your capital allowances

There are a number of different ways in which we work with restaurant groups to unlock value and manage risk from a capital allowances perspective depending on a businesses specific fact pattern and requirements. This can include:

Retrospective reviews – An analysis of historical property expenditure (treated as ineligible for tax relief) to identify additional tax relief which can be claimed in a current period.

Short Life Assets ("SLAs") - introducing methodologies to identify accelerated tax relief for expenditure on assets that are disposed of within 8 years of acquisition.

Efficiency & simplifying processes - Implementing automated processes using analytics tools, refinement to existing templates or updating pre-existing/ entering into new agreements with HMRC.

Pre-Exit Due Diligence - Red flag reviews of the portfolios capital allowances position to help mitigate any risk of queries arising on sale and to ensure value of capital allowances attached to the property portfolio can be factored into commercial negotiations or retained within the business as required.

Enhanced reliefs - Identifying accelerated reliefs, including:

- Super deduction at 130% and 50%
- Research and Development Allowances - 100%
- Land Remediation Relief - 150% or 16% credit for loss making companies

Portfolio Re-organisation - Pre contract capital allowances reviews on transactions (e.g. on acquisition or sale of property, entering or existing leases, transferring property internally) to ensure tax relief is not lost and that the value of tax relievable assets are included in commercial negotiations.

Your key contacts

Emma Canavan

Tax Partner, sector tax lead
07776 317727
emma.canavan@pwc.com

James McRae

Corporate Tax
07843 334725
james.mcrae@pwc.com

Jim Wilkinson

VAT
07730 146758
jim.wilkinson@pwc.com

David O'Malley

Employment Taxes
T: 07740 240888
E: david.j.omalley@pwc.com

Sophie Crossley

R&D tax relief
07701 296290
sophie.j.crossley@pwc.com

Portia Pierrel

Capital Allowances
07483 316828
portia.pierrel@pwc.com

Ainsley Moore

Real Estate Advisory
07595 611487
ainsley.moore@pwc.com

Alex Kramarenko

Real Estate Tax
07710 033441
alex.kramarenko@pwc.com