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5 things restaurant operators must know about taxes and personal liability

Owners and operators could be personally liable for improper tax reporting and compliance

Lance E. Rothenberg | Jan 02, 2018



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Successfully operating a restaurant takes grit and passion. We don't have to tell you that it's hard work. But rather than focus on the myriad challenges, let's talk about taxes: Specifically, who must pay restaurant trust fund taxes?

Many operators don't understand until it's too late that sales-and-use taxes and payroll taxes are trust fund taxes, which carry personal liability. That means owners and operators can be personally liable for the company's improper sales-and-use and payroll tax reporting and compliance.

If the restaurant doesn't pay taxes, the Internal Revenue Service and state tax authority can come after individuals involved with the business. This is true regardless of the type of entity. A corporation or LLC does not offer protection against these types of tax liabilities.¹

Here are five key points that every restaurant owner, operator and investor should know:

1. Restaurants are frequent targets for tax audits.

The restaurant industry is a frequent target for audits. Restaurants, bars, taverns, delis, pizzerias and other establishments, from fine dining to dive bars, are all five stars on the tax man's audit rating scale. At the same time, cash flow issues, low profit margins, and other challenges often lead to periodic crunches for restaurants where choices must be made: pay the landlord; repair the walk-in freezer; upgrade the website and menus; pay the liquor vendor; or pay the sales tax this month. Sound familiar? But tax payments should always be prioritized.

2. Restaurant taxes are complex.

Tax laws applicable to the restaurant industry are complex. For example, sales of food and food products are subject to complicated sales tax rules. Generally, most foods sold by grocery stores are exempt from sales taxes, while prepared foods sold by restaurants are taxable. Employee meals may have special rules. Coupons, Groupons, discounts and gift cards can have special rules. Complimentary meals, by definition, may be offered free of charge, but they are still likely subject to use taxes payable by the restaurant.

What about tip income? Tips employees receive from customers are generally subject to

withholding. Employers must withhold income tax, employee Social Security tax and employee Medicare tax on tips reported by employees, as well as upon wages paid. Further, wages subject to withholding generally include all pay given to an employee, including salaries, vacation allowances, bonuses, commissions and certain fringe benefits.

With all of these dizzying tax rules, let alone the task of actually running the restaurant, it's not hard to see that mistakes can easily be made. And those mistakes can be costly.

3. Certain individuals may be personally liable for sales-and-use taxes and payroll taxes owed by the business.

State sales-and-use taxes and payroll taxes, both federal and state, are considered trust fund taxes. Sales taxes are collected (or should be collected) from customers by the restaurant as a fiduciary for the state. Likewise, payroll taxes are withheld (or should be withheld) from employee wages by the restaurant as a fiduciary for the Internal Revenue Service and states, respectively. Not only is the restaurant responsible, but certain individuals (owners, officers, directors, employees, partners or members) who are active in the restaurant's management may be deemed "responsible persons" and can be, and often are, held personally liable for taxes owed by the business.

As a general matter, owners, operators and key employees should ask themselves: Are you actively involved in managing the business on a daily basis? Are you involved in deciding which financial obligations are paid? Are you involved in hiring or firing employees? Do you have check signing authority? Are you involved in preparing tax returns? Do you have authority over financial decisions? Are you aware of mismanagement? Are you aware that the business is paying other business expenses instead of trust fund taxes? Each of these can be a factor in determining whether you qualify as a "responsible person" and could have personal liability for business tax debts.

As for payroll taxes, have you outsourced your payroll reporting to a third-party payroll company? Good, but you may still be responsible and liable for any improper withholding.

4. Accurate record-keeping is critical.

What can you do to minimize your exposure? As with all things, the best defense is a good offense. In the tax world, that means maintaining good books and records. Not only do inaccurate or incomplete records make it impossible to know how your business is doing, it's lethal in a tax audit. Accurate records are essential in tracking deductible expenses, verifying sales, recording purchases

and validating proper withholding.

Poor record-keeping can make it difficult to challenge an audit, and can lead to serious financial consequences to both the restaurant and its owners and operators. Furthermore, states and the Internal Revenue Service impose statutory record-keeping obligations upon businesses that require records to be made available to an auditor for inspection. Failure to maintain proper records can lead to audit methodologies that may produce wildly different findings than the actual books and records would have otherwise shown.

5. The consequences of improper tax compliance are severe.

A trust fund tax problem could lead to financial ruin. Penalties and interest can be imposed on the business, as well as any responsible persons, for failing to pay sales tax or properly withhold. A business may also have its sales tax license revoked or, in egregious cases, could face criminal prosecution.

Taxing authorities may use a combination of enforcement methods, such as liens, bank levies, income executions and business seizures, to collect what is owed. Some states have additional methods. For example, New York can suspend a taxpayer's in-state driver's license if he or she owes more than \$10,000 in taxes, penalties and interest. Similarly, the Internal Revenue Service can suspend a taxpayer's U.S. Passport if he or she owes more than \$50,000 in taxes, penalties and interest.

If you have a tax compliance problem, many tax authorities offer relief in the form of voluntary disclosure programs, where a taxpayer can voluntarily come forward before an audit and agree to pay back taxes in exchange for the state agreeing to waive penalties and criminal charges.

Restaurants have many tax and accounting obligations from local, state and federal governments. It is essential that owners and operators develop a basic understanding of these requirements, or hire competent and trustworthy advisors to act for them. Taxes are a cost of doing business. While there are lawful ways to minimize them, there is simply no way to avoid them.

¹This discussion is general in nature. Sales-and-use taxes are administered separately by each of the 45 states that impose a sales tax. Further, payroll withholding taxes are also separately administered by the states, as well as the Internal Revenue Service. For specifics for your state or issue, please contact a tax professional to discuss proper compliance and how to resolve a tax dispute.

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Video of the week: Anaheim White House reopens after devastating fire

Chef and owner Bruno Serato talks about the California concept's return with CBS Los Angeles

Anna.Kang | May 07, 2018



When a fire broke out last February, the Anaheim White House, a restaurant located in its namesake city in California, was left destroyed — and along with it, chef and owner Bruno Serato's livelihood.

Because of the extensive damage, the 30-year-old concept was temporarily closed. As of January this year, the hardship of this closing had costed the Anaheim White House roughly \$3 million in sales, [according to The Orange County Register](#).

Much to Serato's joy, the restaurant is now fully restored and open to the public, with a few changes.

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Poke chains battle for dominance

Like fro-yo and cupcakes, a shakeout of the trendy segment appears imminent

Nancy.Luna | May 07, 2018



In late 2015, four college buddies from the suburbs of Southern California made the risky decision to open a poke restaurant in New York City. Even more challenging, they unveiled the fast-casual, raw-fish eatery in the throes of winter and next to the Big Apple's first Chick-fil-A.

Curious crispy-chicken-sandwich fans swarmed the quick-service eatery, blocking the front entrance of little-known Pokeworks. But within several weeks, Pokeworks had earned social-media fame and a [positive mention in a New York Times review](#).

Related: [6 poke concepts that are leading the segment](#)

Among the biggest talkers was its mashup menu item, the poke burrito. The giant sushi roll is a tortilla-size roasted seaweed wrap stuffed with rice and raw fish pieces. Wait times at the restaurant clocked in at two hours.



Pokeworks

“Our line was longer than Chick-fil-A,” co-founder Kevin Hsu said.

Pokeworks has since opened two more New York City restaurants, along with a dozen other locations in Washington, California, Texas and Illinois. The Irvine, Calif.-based concept is among hundreds of fast-casual poke shops — both chains and independents — blanketing the country from coast to coast.

But, like foodie fads of the past — think fro-yo and cupcakes — a shakeout of the saturated industry appears to be imminent.

“It’s maxed out,” said Yoon Ju, co-founder of Los Angeles-based Poké Bar. “Eventually, the small mom-and-pop stores will die down.”

Poké Bar is a first-wave poke concept. A few years ago, savvy entrepreneurs like Ju realized that poke filled a void for affordable, fast-casual sushi restaurants.

Hawaiian-inspired poke, bowls filled with brown or white rice and topped with bite-sized pieces of marinated raw fish, solved that problem.

These modern Mainland poke concepts have since adopted the Chipotle-style of service, where

Customers can build their own bowls. Most also offer ready-made bowls for those who don't want to build their own.

owners customize each bowl along an assembly line. Most also offer nearly the same base protein and topping choices: kale noodles, two types of rice, spicy tuna, ahi tuna, salmon, tofu and scratch-made ponzu sauces.

Since opening in Southern California three years ago, Poké Bar has become one of the fastest-growing poke chains in the country. It has 53 locations stretching from San Francisco to New York.

Ju's strategy is simple: flood the zone.

Poké Bar plans to grow to 100 units by the end of the year. Most locations will be franchises.

“We have to be the market leader,” Ju said.

Poké Bar is going after untapped regions before rivals that look identical to the brand enter the same area.

“It’s hard to differentiate me versus them,” he said.

But some restaurants are setting themselves apart by offering seasonal fish and alternative bases such as quinoa, forbidden black rice, bamboo rice or wonton chips.



Sweetfin, which has received capital support from well-regarded hospitality veterans, is one of

those rogue leaders.

The company is taking the Tender Greens approach by offering chef-driven bowls created by Sweetfin partner Dakota Weiss, a veteran Los Angeles chef who competed on “Top Chef” Season 9.

Bowls made with sustainably sourced seafood and scratch sauces are prepared by line cooks who break down fish and produce daily in an exhibition kitchen.

Like Whole Foods Market and other eco-friendly food brands, in-store fliers describe where and how fish is caught — billed by the chain as “pole to bowl” transparency.

And while most chains are franchising, Sweetfin’s eight locations are corporate-owned and look less cookie-cutter, with stylish fixtures, tables and chairs.

“Our stores are run more like proper restaurants,” co-founder Seth Cohen said. “Everything is homemade and handmade.”

Cohen and his partners launched the first Sweetfin in Santa Monica, Calif., in April 2015. Since then, the velocity of shops serving poke has exploded as restaurant owners strive to meet demand.

Grubhub, an online and mobile ordering company, said poke was the most popular dish ordered on its platform in 2017. Delivery provider DoorDash said poke orders have doubled over the last two years.

Ju said poke meets a growing consumer desire for convenient, better-for-you foods.

“It’s healthy and there’s no cooking. You can taste the freshness,” he said.

Cohen, whose restaurants are clustered in Southern California, said consolidation in the segment is coming.

“There’s probably room for two to three concepts to dominate the space, along with mom-and-pops,” he said.

But who will emerge as the top leaders? So far, these concepts are blazing a trail:



Poké Bar

HQ: Los Angeles

Number of units: 53 (50 domestic, 3 international)

Growth plans: 100 units by the end of 2018

When and where founded: April 2015, in West Hollywood, Calif.

Owners: Yoon Ju and Jason Park

Price range: \$12-\$15

Service style: Assembly line

Why it's buzzworthy: Poké Bar touts itself as the poke category leader because it's been serving poke long before anyone else. Yoon Ju's parents have run a popular Chinese restaurant in Northridge, Calif., for about 30 years. About 20 years ago, the family added poke to the appetizer section of the menu. Seeing steady takeout business for the poke bowls, Ju created a shop dedicated to build-your-own poke bowls. They've been opening restaurants ever since.



Aloha Poke Co.

HQ: Chicago

Number of units: 13

Growth plans: 8 new locations by the end of 2018, including units in Southern California and Washington, D.C.

When and where founded: March 2016, in Chicago

Owners: Owned by investors that include Levy Family Partners and Lakeview Investment Group

Price range: \$7.50-\$14.50

Service style: Pay at the counter, no assembly line

Why it's buzzworthy: Founder Zach Friedlander noticed the poke craze occurring in Los Angeles and New York and decided to give it a shot in Chicago. Instagrammers and local food bloggers instantly took note of the brand's tiny food stand at the city's French Market in the West Loop. It led to opening another shop in Chicago a few months later and caught the eye of investment firms tied to Chicago restaurant tycoon Larry Levy. The capital infusion from Levy Family Partners escalated growth. In late April, the company tapped [Potbelly](#) veteran [Chris Birkinshaw](#) as its first

CEO, who said “poke is here to stay.” The chain’s focus on making customizable bowls without forcing customers to “walk along a line” is a differentiator. “We’re able to execute in a smaller space with greater speed,” he said.



Poke Bros.

HQ: Columbus, Ohio

Number of units: 13

Growth plans: About 20 locations planned by end of 2018, with new units coming to Ohio, South Carolina, Delaware, North Carolina and Virginia

When and where founded: November 2016, in Columbus, Ohio

Owners: Xuegong Chen, Scott McCarthy and Anthony Wellman

Price range: \$9-\$15

Service style: Assembly line

Why it's buzzworthy: Chen’s family, who emigrated from China a few decades ago, opened some

of the first Chinese restaurants in the Columbus region. Chen saw poke as an opportunity to bring a healthful, quick-service meal option to a region loaded with fast-food burger joints. While poke isn't an exciting proposition during a blistering winter in Columbus, it has proven to make sense as a year-round option. The company plans to blanket the Midwest and "climate friendly" towns in the Southeast, with an eye towards college communities, where Poke Bros. has seen success, spokesman Braden McGlone said. The brand's 13 locations include a sit-down restaurant called Poke Bros. Bistro in Columbia, S.C.



Sweetfin

HQ: West Hollywood, Calif.

Number of units: 8

Growth plans: Establish brand dominance in the Southern California market, where it is scouting new locations in San Diego, Orange County and the South Bay

When founded: April 2015

Owners: Seth Cohen, Alan Nathan, Brett Nestadt and Dakota Weiss; investors include former Shake Shack CEO David Swinghamer and Il Fornaio founder Larry Mindel

Price range: \$8 to \$14 (\$12 average)

Service style: Counter service, no walk-along ordering

Why it's buzzworthy: Sweetfin's ethos is based on transparency, with a menu of chef-driven recipes served in a stylish setting. Fish is cut daily in-house and served with scratch sauces. Customers watch bowls being made by trained line chefs cutting sustainable raw fish. Signature bowls, including seasonal specials, are created in collaboration with well-regarded chefs such as Claudette Zepeda-Wilkins, a two-time competitor on Bravo's "Top Chef," and Matthew Beaudin, executive chef at the Monterey Bay Aquarium. In the summer, "Top Chef" All-Stars champion Richard Blais will craft a seasonal bowl. Sweetfin was named a [2016 Breakout Brand by NRN](#).



Pokéworks

HQ: Irvine, Calif.

Number of units: 19

Growth plans: 20-25 locations by the end of 2018, with 120 units projected by 2020, mostly through franchising

When and where founded: Late 2015, in New York City

Owners: Kevin Hsu, Mike Wu, Peter Yang and Kasper Hsu

Price: \$11-\$15

Service style: Assembly line

Brand story: Four college buddies discovered poke while traveling in Hawaii. When they returned to Southern California, they couldn't find any restaurant to satisfy their poke craving. Two of the four owners had restaurant experience, so they decided to open a poke concept. They began testing flavor combinations and service setup in Yang's Irvine, Calif., garage. Instead of opening close to home, they decided to test the concept in New York City. "For those that were familiar with poke, they loved it. For those not, they became intrigued," Hsu said. The brand is known for its poke burrito — seaweed-wrapped poke that looks like a giant sushi roll.



QuickFish

HQ: Portland, Ore.

Number of units: 2, in Portland and Denver

Growth plans: A third unit is coming soon to Portland; the company is scouting locations in Seattle, San Francisco and Los Angeles

When founded: December 2016

Owner: Privately-held Sustainable Restaurant Group (SRG)

Price range: \$13-\$15

Service style: Assembly line

Why it's buzzworthy: QuickFish is an offshoot of the company's highly popular Bamboo Sushi restaurant in Portland, Ore. The full-service sushi eatery had outgrown its kitchen space. When a small storefront became vacant in the same center, Bamboo tried to snatch it for a larger prep space. But the landlord had another idea: he suggested poke. "It was a happy accident," said creative director Cory Schisler. It was an easy transition for the veteran sushi restaurant. QuickFish sources seafood from the same high-quality and sustainably caught suppliers as Bamboo. The menu features seven signature bowls, including a spicy Fire Bowl made with Kodiak sockeye from Alaska. All fish is cut in house. Some seafood is "frozen at sea" to maintain freshness, Schisler said.

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