

STATE OF CALIFORNIA
BOARD OF EQUALIZATION
BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition)	
for Redetermination Under the)	DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)	
)	
REDACTED TEXT)	No. REDACTED TEXT
)	
)	
<u>Petitioner</u>)	

The Appeals conference in the above-referenced matter was held by John Abbott on January 10, 1995 in San Diego, California.

Appearing for Petitioner: REDACTED TEXT
Attorney

REDACTED TEXT
CPA

Appearing for the
Sales and Use Tax Department: Philip Klepin
District Principal Auditor

Oscar Villasenor
Senior Tax Auditor

Protested Item

The protested tax liability for the period July 1, 1986 through June 30, 1991 is measured by:

<u>Item</u>	<u>State, Local and County</u>
C. Unreported taxable tips, actual basis.	\$791,952

Petitioner's Contention

Tips added as service charges to banquets were not mandatory and were therefore not includible in gross receipts.

Summary

Petitioner is a family-owned corporation that owns two resort hotels and two riverboats in the REDACTED TEXT area. The riverboats were available for cruises and banquets to members of the public and to groups staying at the hotels. For example, petitioner rented the riverboats for private parties such as weddings and for business conventions.

To help customers plan cruises and banquets, petitioner employed convention coordinators and caterer coordinators. These employees met with customers, gave them written policy information, and entered into agreements for the parties or meetings plus the banquets. During the audit period, both the standard policy information and the standard agreement stated that for food and beverage “the suggested gratuity is 15%.” Before the banquet, the parties signed a prospectus that specified, among other things, the details of food and beverage service and the agreed upon gratuity. The prospectus, the policy information, and the standard agreement collectively constituted the contract for the banquet.

Petitioner states that the coordinators did not insist on any particular tip or gratuity. That was left up to the customers. By contrast, when a wedding party brought its own cake, petitioner required a 15% service charge to cut the cake. Whenever petitioner quoted food or beverage prices to customers, petitioner states the prices quoted were “plus gratuity,” simply to make it clear the quotes did not include the tip.

Both petitioner and the Department agree that, of all the transactions included in the audit period, about 1% to 2% included gratuities of amounts other than 15%. The Department in its audit used a block sample of two months, and discovered one transaction with a bar gratuity of 15% but a food gratuity of 11.93%. Mr. REDACTED TEXT, a shareholder and the president of petitioner, approved the prospectus for this transaction with the REDACTED TEXT. Only the coordinators signed all the other prospectuses. From this the Department infers that someone other than just the coordinators had to approve gratuities less than 15%. Petitioner disagrees, but was not able to provide me with any prospectuses during the audit period where the agreed upon gratuity was less than 15% and did not require the approval of an officer or supervisor.

Analysis and Conclusions

For sales and use tax purposes, services per se are not taxable. However, when a retailer sells tangible property subject to tax, Revenue and Taxation Code Section 6012 (b) (1) provides that “gross receipts” subject to sales tax includes, among other things, “[A]ny services that are a part of the sale.”

Several Business Taxes Law Guide annotations that address this issue are quoted below:

"550.0740 Service Charges. Where service charges are mandatorily imposed upon the purchase of drinks, the same being intended to cover tips, such charges must be included in taxable gross receipts. 9/22/53."

"550.0770 Tips--Amount Specified by Customer. Banquet tips were not considered part of the taxable selling price of meals when the caterer added to the price of the meals an amount specified by the customer and distributed this amount to its employees. The amount was not a charge made by the caterer but was voluntarily offered by the customer. 5/19/77."

"550.0760 Service Charges. A standard amount collected by a club from its members as a service charge is not a gratuity even though the charge is paid over to employees and is not used to offset their wages. The service charge, paid as an automatic obligation of the club members, is collected as an exaction and must be included in taxable gross receipts. 9/24/65."

When customers leave tips for waiters after meals, the tips are nontaxable voluntary payments for services rendered, not part of the price of the meals. On the other hand, when caterers and event planners require that customers agree in advance to include a mandatory specified gratuity as part of the selling price of the banquet, the gratuity is taxable as a service part of the sales price of the food and beverages.

Petitioner distinguishes its transactions from the latter case by stating in its written contracts that the gratuity is a "suggested" percentage, not a mandatory percentage. However, while there were isolated instances in which the gratuity agreed to by the customer was less than the suggested amount, petitioner cannot point to any instance in which this did not require the final approval of one of petitioner's officers or supervisors.

I conclude petitioner's receipts from gratuities are part of its taxable gross receipts. While petitioner correctly points out the suggested gratuity of 15% was not mandatory, the fact remains that some gratuity negotiated in advance between petitioner and its customers was mandatory. Customers did not have an option to enter into contracts for the sale of food and beverages but not specify any amount at all for the gratuity. This would be the case even if the catering and event coordinators had the authority to approve gratuities less than 15%. For sales and use tax purposes, when a retailer asks one price for the sale of tangible property, but accepts a lower price following negotiations with the buyer, the amount received remains subject to tax. The result is not different merely because the negotiated amount is for services that are a part of the sale.

Recommendation

Deny the petition.

John Abbott, Supervising Staff Counsel

Date: March 21, 1995