

12-1871  
TAX TYPE: SALES AND USE TAX  
TAX YEARS: 2009, 2010, 2011, AND 2012  
DATE SIGNED: 1-10-2014  
COMMISSIONERS: B. JOHNSON, M. CRAGUN, R. PERO  
EXCUSED: D. DIXON

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BEFORE THE UTAH STATE TAX COMMISSION

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<p>PETITIONER,</p> <p>Petitioner,</p> <p>v.</p> <p>AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,</p> <p>Respondent.</p>	<p><b>INITIAL HEARING ORDER</b></p> <p>Appeal No. 12-1871</p> <p>Account No. #####</p> <p>Tax Type: Sales and Use Tax / Restaurant Tax</p> <p>Audit Period: 07/01/09 – 01/31/12</p> <p>Judge: Chapman</p>
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**Presiding:**

Kerry R. Chapman, Administrative Law Judge

**Appearances:**

For Petitioner: OWNER 1 OF PETITIONER, Owner  
OWNER 2 OF PETITIONER, Owner

For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General  
RESPONDENT 1, from Auditing Division  
RESPONDENT 2, from Auditing Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for an Initial Hearing pursuant to the provisions of Utah Code Ann. §59-1-502.5, on September 4, 2013.

PETITIONER (“Petitioner” or “taxpayer”) has appealed a sales and use tax assessment that Auditing Division (the “Division”) imposed for the period July 1, 2009 through January 31, 2012 (“audit period”). On

May 16, 2012, the Division issued a Statutory Notice - Sales and Use Tax (“Statutory Notice”), in which it imposed sales and use tax and interest (calculated through May 7, 2012)<sup>1</sup> for the audit period, as follows:

<u>Tax</u>	<u>Penalties</u>	<u>Interest</u>	<u>Total</u>
\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

The taxpayer operates a restaurant in CITY, Utah. For certain customers (such as banquet customers and large parties), the restaurant will add a mandatory tip to the customers’ bills. The restaurant has always passed on the entirety of a mandatory tip to the server or servers who waited on these customers. The restaurant did not collect sales and use tax or restaurant tax on mandatory tips added to customers’ bills.

When the Division audited the taxpayer’s restaurant, it discovered that with one exception, the taxpayer was properly collecting and reporting its sales and use taxes and its restaurant taxes.<sup>2</sup> The Division determined that the taxpayer was required to collect sales and use taxes and restaurant taxes on mandatory tips added to customers’ bills and that the taxpayer had not done so.<sup>3</sup> As a result, the Division assessed sales and use tax and restaurant tax on the amounts of these mandatory tips. Both parties agree that almost all of the assessment relates to this issue. This is the only portion of the Division’s audit that the taxpayer is contesting.

The taxpayer does not dispute the Division’s determination that under Utah law, a restaurant is required to collect and remit sales and use taxes and restaurant taxes on mandatory tips that are added to customers’ bills. In fact, when the taxpayer learned of this requirement during the audit process, it immediately changed its practices and has since collected and remitted sales and use taxes and restaurant taxes on such tips. The taxpayer, however, asks the Commission to consider that it did not know about the change in Utah law that led to the taxation of all mandatory tips added to customers’ bills and that it would be severely

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1 Interest continues to accrue until amounts due are paid.

2 The taxpayer indicates that the Division auditors who conducted the audit specifically commented on the accuracy of its records.

3 Both parties agree that most tips left by customers in restaurants are not subject to taxation because they are not mandatory and do not appear on the bill.

“penalized” if it had to pay the assessment because it did not collect any of these taxes from its customers. For these reasons, the taxpayer asks the Commission to consider allowing it pay a “one-time penalty” of approximately %%% of the assessment instead of the full assessment (tax plus interest) of \$\$\$\$\$. The “one-time penalty” the taxpayer proposes to pay is \$\$\$\$\$.

The taxpayer would also like the Commission to consider that it began its “due diligence” to purchase the restaurant in May 2009 and that it completed the purchase on July 16, 2009. The taxpayer stated that in August 2009, it went to the Tax Commission’s office in CITY to have the Tax Commission look over its July 2009 reports and tax returns to determine if it was properly collecting and reporting its sales and use taxes and restaurant taxes. The taxpayer stated that the Tax Commission employee with whom it met indicated that everything looked correct. However, the taxpayer admitted that the subject of collecting and remitting taxes on mandatory tips was never discussed. The taxpayer also admitted that the reports it took in for the Tax Commission employee to review would have shown a column for banquet sales, but that the reports did not separately show that mandatory tips had been collected from banquet customers and large parties.

Lastly, the taxpayer asks the Commission to consider that the Commission changed its method of notifying businesses of changes in Utah law around the time it purchased the restaurant and that the taxpayer did not receive notice of the change concerning mandatory tips either by email or by U.S. post mail. The taxpayer indicated that changes in the law used to be mailed to taxpayers on gold-colored paper so that it was easy for taxpayers to recognize the importance of these notices and to implement the changes reflected in them.

The Division stated that any mandatory tips added to a customer’s bill became taxable around 2004 when the Legislature amended the definition of “purchase price” and “sales price” to include “a charge by the seller for any service necessary to complete the sale[.]” Utah Code Ann. §59-12-102(94) (2012). The Division admitted, however, that until August 8, 2008, an administrative rule provided that mandatory tips passed on to a server or servers were not subject to taxation. Utah Admin. Rule R861-1A-94(1) (“Rule 94”). Nevertheless,

during the entirety of the audit period (July 1, 2009 through January 31, 2012), Rule 94 provided that all mandatory tips added to customers' bills were subject to taxation.

The Division also provides a copy of USTC Publication 55 (Revised 6/09) ("Publication 55), which provides guidance to restaurants. This version of Publication 55 provides that mandatory tips shown on customers' invoices are subject to taxation. The Division further stated that the version of Publication 55 in effect prior to this June 2009 version also provided that mandatory tips shown on customers' invoices were subject to taxation. However, neither party had copies of prior versions of Publication 55 to show when this change was reflected in the publication. Nevertheless, the version of Publication 55 that was available throughout the audit period is this June 2009 version, which provides that all mandatory tips shown on customers' bills are taxable.

The Division admitted that the Commission changed its policy of mailing bulletins and other notices alerting taxpayers of tax changes around 2006 and that these notices have since been available through the Internet.<sup>4</sup> The Division, however, contends that these circumstances do not warrant a reduction of the taxes that it has assessed. It also contends that the Commission's role in the appeals process is to determine whether the assessed taxes have been legally imposed, but not to consider settlement offers from the taxpayer. For these reasons, the Division asks the Commission to sustain its assessment in its entirety.

#### APPLICABLE LAW

1. Utah Code Ann. §59-12-103(1)(e) (2012)<sup>5</sup> provides that "sales of prepared food" are subject to Utah sales and use tax.

2. Throughout the audit period, UCA §59-12-102(94)<sup>6</sup> defines "purchase price" and "sale price,"

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4 The taxpayer contends that the change of practice in notifying taxpayers of changes in the law occurred in 2009, not 2006. It is not clear from the evidence proffered at the hearing when the change of practice concerning these notices occurred.

5 All references are to the 2012 version of Utah law, unless otherwise indicated.

6 The pertinent parts of Section 59-12-102(94) were enacted in 2004 and remained the same throughout

as follows in pertinent part:

- (a) "Purchase price" and "sales price" mean the total amount of consideration:
  - (i) valued in money; and
  - (ii) for which tangible personal property, a product transferred electronically, or services are:
    - (A) sold;
    - (B) leased; or
    - (C) rented.
- (b) "Purchase price" and "sales price" include:
  - ....
  - (iii) a charge by the seller for any service necessary to complete the sale; or
  - ....

3. Utah Admin. Rule R865-19S-94 ("Rule 94") provides sales and use tax guidance concerning tips and gratuities associated with sales of prepared food. Rule 94 was amended on August 8, 2008,<sup>7</sup> and this version of the rule was in effect throughout the audit period, as follows in pertinent part:

- (1) Restaurants, cafes, clubs, private clubs, and similar businesses must collect sales tax on tips or gratuities included on a patron's bill that are required to be paid.
  - (a) Tax on the required gratuity is due from a private club, even though the club is not open to the public.
  - (b) Voluntary tips left on the table or added to a credit card charge slip are not subject to sales tax.
- ....

4. USTC Publication 55 (Revised June 2009) ("Publication 55")<sup>8</sup> provides sales and use tax information for restaurants. Throughout the audit period, Publication 55 provided, as follows in pertinent part:  
....

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the audit period. However, the specific subsection of Section 59-12-102 in which the definition of "purchase price" and "sales price" is found changes from year to year.

7 Prior to August 8, 2008, Rule 94(A) provided that "mandatory" tips disclosed on a customer's invoice were not subject to taxation under certain circumstances, as follows:

- A. Restaurants, cafes, clubs, private clubs, and similar businesses must collect sales tax on tips or gratuities included on a patron's bill and which are required to be paid, unless the total amount of the gratuity or tip is passed on to the waiter or waitress who served the customer. Tax on the required gratuity is due from private clubs, even though the club is not open to the public. Voluntary tips left on the table or added to a credit card charge slip are not subject to sales tax.

8 Publication 55 and other publications are available on the Tax Commission's website at <http://www.tax.utah.gov/forms-pubs/>.

Tips and Gratuities

Tips are subject to sales tax if they are mandatory and are shown on the invoice. Service charges, gratuities or other charges shown on the invoice are also subject to tax.

Any charges subject to sales tax are also subject to restaurant tax.

....

5. UCA §59-12-603(1)(a)(ii) provides that “a county legislative body of any county may impose a tax of not to exceed 1% of all sales of the following that are sold by a restaurant: (A) alcoholic beverages; (B) food and food ingredients; or (C) prepared food[.]” Section 59-12-603(7)(a)(i) provides that the restaurant tax “shall be administered, collected, and enforced in accordance with: (A) the same procedures used to administer, collect, and enforce the tax under: (I) Part 1, Tax Collection; or (II) Part 2, Local Sales and Use Tax Act; and (B) Chapter 1, General Taxation Policies.”

6. UCA §59-1-401(13) (2013) provides that “[u]pon making a record of its actions, and upon reasonable cause shown, the commission may waive, reduce, or compromise any of the penalties or interest imposed under this part.”

7. Utah Admin. Rule R865-1A-42 (“Rule 42”) (2013) provides guidance concerning the waiver of penalties and interest, as follows in pertinent part:

....

(2) Reasonable Cause for Waiver of Interest. Grounds for waiving interest are more stringent than for penalty. To be granted a waiver of interest, the taxpayer must prove that the commission gave the taxpayer erroneous information or took inappropriate action that contributed to the error.

....

8. UCA §59-1-1417 (2013) provides that the burden of proof is upon the petitioner in proceedings before the Commission, with limited exceptions as follows:

(1) In a proceeding before the commission, the burden of proof is on the petitioner except for determining the following, in which the burden of proof is on the commission:

(a) whether the petitioner committed fraud with intent to evade a tax, fee, or charge;

(b) whether the petitioner is obligated as the transferee of property of the person that originally owes a liability or a preceding transferee, but not to show that the person that originally owes a liability is obligated for the liability; and

(c) whether the petitioner is liable for an increase in a deficiency if the increase is asserted initially after a notice of deficiency is mailed in accordance with Section 59-1-1405 and a petition under Part 5, Petitions for Redetermination of Deficiencies, is filed, unless the increase in the deficiency is the result of a change or correction of federal taxable income:

(i) required to be reported; and

(ii) of which the commission has no notice at the time the commission mails the notice of deficiency. . . .

#### DISCUSSION

At issue is whether the Commission should reduce the amount of taxes and interest that the Division has imposed on the mandatory tips the taxpayer added to customers' bills without collecting and remitting the taxes. The taxpayer does not contest the Division's determination that mandatory tips shown on customers' bills are subject to taxation under Utah during the audit period. The taxpayer, however, has asked the Commission to reduce the amount of the Division's assessment because it did not receive notice of the change in Utah law concerning mandatory tips through the U.S. mail and because of the steps it had taken to see if it was properly collecting and remitting taxes. The Commission will address the assessments of tax and interest separately.

Taxes. It is clear that mandatory tips charged by restaurants and shown on customers' bills have been subject to both sales and use tax and restaurant tax since, at the latest, August 8, 2008 (when Rule 94 was amended). Accordingly, the tips at issue in this appeal, which occurred after August 8, 2008, were all subject to taxation.

The taxpayer considers the Division's assessment to be a "penalty" because it did not collect the taxes at issue. The Commission is authorized under Section 59-1-401(13) to waive, reduce, or compromise penalties and interest if reasonable cause exists and if the penalties and interest were imposed under Title 59, Chapter 1, Part 4 of the Utah Code. The Commission, however, is not authorized to waive taxes that are legally due. Although the taxpayer refers to the Division's assessment as a penalty, it is not one of the

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penalties that the Legislature was established in Title 59, Chapter 1, Part 4 of the Utah Code. Furthermore, even though the Legislature has established a number of different penalties in the Utah tax statutes, it has not provided for the assessment of legally due taxes to be considered a penalty that the Commission is authorized to waive, reduce, or compromise under Section 59-1-401(13).

On rare occasions, the Commission has determined that a tax that is due under Utah law should not be collected on the theory of equitable estoppel. However, equitable estoppel is the exception rather the rule, and it does not appear that the elements necessary to apply equitable estoppel exist in this case. In *Eldredge v. Utah State Retirement Bd.*, 795 P.2d 671, 675 (Utah Ct. App. 1990), the Utah Court of Appeals set forth the three elements that must exist before equitable estoppel applies to include: 1) a statement, admission, act, or failure to act by one party inconsistent with a claim later asserted; 2) reasonable action or inaction by the other party taken on the basis of the first party's statement, admission, act, or failure to act; and 3) injury to the second party that would result from allowing the first party to contradict or repudiate such statement admission, act, or failure to act. In this case, there is no evidence that the first element exists because no evidence exists to suggest that the Tax Commission employee with whom the taxpayer met in August 2009 told the taxpayer not to collect taxes on the mandatory tips it added to customers' bills. In fact, the taxpayer admitted that the reports it shared with this employee would not have shown that it was charging these mandatory tips without collecting taxes on them. For these reasons, the Division's assessments of sales and use tax and restaurant tax should be sustained.

Interest. Under Section 59-12-401(13), the Commission is authorized to waive the interest that the Division has imposed if "reasonable cause" exists. Interest is imposed because a taxpayer has had use of money during a period when Utah should have had that money. Rule 42(2) provides that the criteria for waiving interest are more stringent than those for waiving penalties. Rule 42(2) specifically provides that "[t]o

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be granted a waiver of interest, the taxpayer must prove that the commission gave the taxpayer erroneous information or took inappropriate action that contributed to the error.”

As discussed earlier, the taxpayer went to the Tax Commission’s office in CITY in August 2009 to see if it was properly collecting and reporting its taxes. However, it does not appear that the issue concerning the taxation of mandatory tips was ever discussed with the Tax Commission employee. It also appears that Tax Commission employee would not have known that the taxpayer was charging mandatory tips on customers’ bills or that the taxpayer was not collecting taxes on such tips from the reports that the taxpayer shared with the Tax Commission employee. For these reasons, it does not appear that the Division gave erroneous advice or took inappropriate action that contributed to the taxpayer’s error. Accordingly, reasonable cause does not exist to waive the interest that the Division has imposed.

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Kerry R. Chapman  
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission denies the taxpayer's appeal and sustains the Division's assessment in its entirety. It is so ordered.

This decision does not limit a party's right to a Formal Hearing. However, this Decision and Order will become the Final Decision and Order of the Commission unless any party to this case files a written request within thirty (30) days of the date of this decision to proceed to a Formal Hearing. Such a request shall be mailed to the address listed below and must include the Petitioner's name, address, and appeal number:

Utah State Tax Commission  
Appeals Division  
210 North 1950 West  
Salt Lake City, Utah 84134

Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2014.

R. Bruce Johnson  
Commission Chair

D'Arcy Dixon Pignanelli  
Commissioner

Michael J. Cragun  
Commissioner

Robert P. Pero  
Commissioner

**Notice:** If a Formal Hearing is not requested as discussed above, failure to pay the balance resulting from this order within thirty (30) days from the date of this order may result in a late payment penalty.