

13-1970

TAX TYPE: SALES AND USE TAX/RESTAURANT TAX

TAX YEARS: 6-1-10 – 2-28-13

DATE SIGNED: 8-2-2015

COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. PERO, R. ROCKWELL

BEFORE THE UTAH STATE TAX COMMISSION

<p>TAXPAYER,</p> <p style="padding-left: 40px;">Petitioner,</p> <p>v.</p> <p>AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,</p> <p style="padding-left: 40px;">Respondent.</p>	<p>INITIAL HEARING ORDER</p> <p>Appeal No. 13-1970</p> <p>Account No. #####</p> <p>Tax Type: Sales and Use Tax / Restaurant Tax</p> <p>Audit Period: 06/01/10 – 02/28/13</p> <p>Judge: Jensen</p>
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Presiding:

Clinton Jensen, Administrative Law Judge

Appearances:

For Petitioner: REPRESENTATIVE-1 FOR TAXPAYER, for the Taxpayer
REPRESENTATIVE-2 FOR TAXPAYER, for the Taxpayer

For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General
RESPONDENT, for the Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for an Initial Hearing on July 9, 2014 in accordance with Utah Code Ann. §59-1-502.5.

Petitioner (the “Taxpayer”) has appealed a sales and use tax assessment that Auditing Division (the “Division”) imposed for the period June 1, 2010 through February 28, 2013 (the “audit period”). On August 14, 2013, the Division issued a Statutory Notice - Sales and Use Tax (“Statutory Notice”), in which it imposed sales and use tax and interest (calculated through September 13, 2014)¹ for the audit period, as follows:

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

The parties agree regarding the types and amounts of transactions at issue in this case. They agree on the sales tax treatment of those transactions with the exception the addition of 18% charges to invoices

1 Interest continues to accrue until amounts due are paid.

for what the Taxpayer describes as gratuities and the Division describes as service charges. The parties agree that under Utah law, a restaurant is required to collect and remit sales tax, use tax, and restaurant tax on mandatory tips that are added to customers' bills and that no tax is due on voluntary tips.

APPLICABLE LAW

Utah Code Ann. §59-12-103(1)(e) (2013)² provides that "sales of prepared food" are subject to Utah sales and use tax.

Utah Code Ann. §59-12-102(98) defines "purchase price" and "sale price," 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:
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 - (iii) a charge by the seller for any service necessary to complete the sale; or
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Utah Admin. Rule R865-19S-94 provides sales and use tax guidance concerning tips and gratuities associated with sales of prepared food 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.

Utah State Tax Commission Publication 55 (Revised June 2009) ("Publication 55")³ provides sales and use tax information for restaurants. Throughout the audit period, Publication 55 provided, as follows in pertinent part:

Tips and Gratuities

2 Some of the Utah code provisions applicable in this case changed in non-material ways, such as the renumbering of some provisions, over the course of the audit period. Unless indicated otherwise, the Commission cites the 2013 version of Utah law.

3 Publication 55 was revised after the audit period effective September 2014. The Commission cites the version of Publication 55 in effect throughout the audit period. Publication 55 and other publications are available on the Tax Commission's website at <http://www.tax.utah.gov/forms-pubs/>.

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.

Utah Code Ann. §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.”

Utah Code Ann. §59-1-1417 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

The Taxpayer operates a full service restaurant. Following a pattern that the Taxpayer indicates is typical in its industry, the Taxpayer presents bills for parties of five or fewer with a subtotal line and a blank space for the customer to add a tip before totaling the bill. But for parties of six or more, the Taxpayer adds an 18% gratuity to the bill. The subtotal appearing on the bill includes the subtotal for food and beverages as well as the 18% gratuity charge. As is the case for bills presented to smaller groups, there is an additional line below the subtotal line labeled “tip” and a line to total the bill. In two places on the Taxpayer’s menu, a notation appears in very small print as follows:

For parties of 6 or more, an 18% gratuity will be added to your check. Please feel free to increase or decrease this gratuity at your discretion.

As part of a routine sales tax audit, the Division noted that the Taxpayer had not charged sales

and use tax on the gratuity charges that it automatically added to its customers' bills. The Division's position is that although an automatic 18% charge is termed a gratuity, the Taxpayer's action in automatically adding it to a customer's bill makes it a mandatory charge that is subject to sales tax. The Taxpayer disagreed and filed this appeal.

The parties supplied sample customer bills. One sample showed a customer that made no entry on the "tip" line of the invoice under the subtotal that included an 18% gratuity. The customer carried the subtotal amount forward to the line for total. Another sample showed a \$\$\$\$ subtotal, including 18% automatic gratuity, plus a handwritten \$\$\$\$ entry on the tip line. The parties agree that on bills such as this, additional amounts on the tip line were not automatic and thus not subject to sales and use tax. The parties agree that the menu notation advising customers to "feel free to increase or decrease . . . gratuity at your discretion" did not appear on customers' bills.

The parties agree 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. The Taxpayer's disagreement is limited to the Division's characterization of automatic gratuities as taxable mandatory charges rather than as voluntary gratuities.

In support of its position, the Taxpayer advances three arguments. First, it argues that the language on its menu advising customers that they can feel free to adjust the amount of the 18% automatic gratuity makes the charge voluntary. Second, the Taxpayer argues that all gratuities, automatic or otherwise, go to its employees. Third, the Taxpayer argues that categorizing an automatic gratuity as a service charge is of no benefit to customers, of no benefit to employees, and no benefit to the restaurant. For this reason, the Taxpayer finds the Division's audit findings a burden on already-underpaid restaurant workers.

Under Utah Code Ann. §59-12-102(98)(b)(iii), a charge is taxable as part of the "purchase price" if it is "a charge by the seller for any service necessary to complete the sale." Utah Admin. Rule R865-19S-94(1) provides further detail by explaining that "[r]estaurants, 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" but that "[v]oluntary tips left on the table or added to a credit card charge slip are not subject to sales tax." In a similar manner, Publication 55 provides that "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."

Applying these rules, the Commission notes that none of the applicable law makes taxability of

automatic gratuity dependent on whether the automatic gratuity goes to the employee or to the restaurant as raised in the Taxpayer's second argument or whether the automatic gratuity benefits or burdens specific individuals as raised in the Taxpayer's second argument. Accordingly, there is not a valid basis for the Commission to grant relief to the Taxpayer under the Taxpayer's second and third arguments.

The Taxpayer's first argument regarding mandatory charges or voluntary tips follows applicable Utah law. Under applicable Utah law, the tests for taxability of automatic gratuities are whether they are "included on a patron's bill that are required to be paid" or whether they are "[v]oluntary tips left on the table or added to a credit card charge slip" as described in Utah Admin. Rule R865-19S-94(1) and whether they are "mandatory and are shown on the invoice" as described in Publication 55. Under this analysis, it is clear that the Taxpayer shows automatic gratuities on its invoices to its customers and that unless a customer takes affirmative action, that bill is required to be paid. This puts the Taxpayer's automatic gratuities into the category of mandatory charges unless the Taxpayer's notices printed in its menus are sufficient to transform the charges into voluntary tips.

The evidence, taken as a whole, does not give reason to find that the Taxpayer's automatic gratuities are voluntary tips. First, the Taxpayer's printed notices in its menus are in very small print. Second, there is no evidence before the Commission that customers understood and exercised their option to give a lesser tip than the 18% that the Taxpayer added to its bills. It would have been up to the Taxpayer to supply this kind of evidence if it existed. *See* Utah Code Ann. §59-1-1417 (providing that burden of proof is on petitioner in an action before the Tax Commission). Third, the Taxpayer did not avail itself of the opportunity to place a notice regarding voluntary gratuity on its bills where it would have been available to customers at the time when they would have been paying the gratuity. These factors, taken together, convince the Commission that the Taxpayer's addition of an 18% automatic gratuity on its bills is a mandatory charge that the Taxpayer expects to be paid and is thus subject to sales and use tax. On that basis, there is good cause to sustain the Division's audit.

Clinton Jensen
Administrative Law Judge

DECISION AND ORDER

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

Appeal No. 10-2086

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 _____, 2015.

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner

Rebecca L. Rockwell
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.