

**CALIFORNIA STATE BOARD OF EQUALIZATION**  
**APPEALS DIVISION SUMMARY FOR BOARD HEARING**

In the Matter of the Petitions for Redetermination )  
Under the Sales and Use Tax Law of: )  
GMRI, Inc., dba Olive Garden ) Account Number: SR Y OHA 30-670200  
GMRI, Inc., dba Red Lobster ) Case ID 433701  
Petitioners ) Account Number: SR Y OHA 24-687755  
Orlando, Florida ) Case ID 434928

Type of Business: Restaurants

Audit period: 01/01/02 – 12/31/04

<u>Item</u>	<u>Disputed Amount</u>	
	<u>433701</u>	<u>434928</u>
Mandatory tips	\$5,069,028	\$2,413,450
Amnesty interest penalty	\$ 12,504	\$ 8,236
	<u>433701</u>	<u>434928</u>
Tax as determined and proposed to be redetermined:	\$425,409.91	\$269,335.91
Less concurred	<u>- 26,231.89</u>	<u>- 80,208.19</u>
Balance, protested	<u>\$399,178.02</u>	<u>\$189,127.72</u>
Proposed tax redetermination	\$425,409.91	\$269,335.91
Interest through 11/30/11	236,542.58	130,355.23
Amnesty interest penalty	<u>12,504.20</u>	<u>8,236.10</u>
Total tax, interest, and penalty	\$674,456.69	\$407,927.24
Payments	<u>- 186,348.00</u>	<u>- 186,762.00</u>
Balance Due	<u>\$488,108.69</u>	<u>\$221,165.24</u>
Monthly interest beginning 12/1/11	<u>\$ 1,195.31</u>	<u>\$ 412.87</u>

This matter was scheduled for Board hearing on December 15, 2010, and again on March 22, 2011, but was postponed each time at petitioner's request because of scheduling conflicts. It was then scheduled for hearing on May 25, 2011, but was deferred at the request of the Sales and Use Tax Department (Department) to allow time for additional investigation related to an issue raised in petitioner's opening brief. As explained under "Other Developments," no adjustments are recommended as a result of that investigation.

**UNRESOLVED ISSUES**

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2 **Issue 1:** Whether the tips at issue were mandatory tips and therefore includable in taxable gross  
3 receipts. We conclude that they were.

4 Petitioner operates chains of Olive Garden and Red Lobster restaurants. The menu for Olive  
5 Garden includes the notation “for your convenience, an optional 18% gratuity will be added to parties  
6 of 8 or more,” and the menu for Red Lobster includes the identical statement except the percentage is  
7 15 percent. Petitioner did not include the tips collected per the menu statements in its reported taxable  
8 sales, while the Department regards them as taxable as mandatory tips.

9 Petitioner contends that the tips at issue were not mandatory because the menu statements  
10 include the word “optional,” and asserts that only the manager has authority to add tips and that  
11 customers could alter the amounts of the tips, or refuse to pay them entirely. Petitioner has provided  
12 records indicating that tips were not added to approximately 12.5 percent of the bills it issued for  
13 parties of eight or more.

14 Petitioner’s menus informed its customers that the tips at issue would be added to bills for  
15 parties of eight or more persons. When petitioner’s customers accepted and paid the bills on which  
16 petitioner had automatically included the tips at issue, the agreed-upon selling price (and thus the  
17 taxable gross receipts) for those sales of meals and beverages included the amounts of the tips. None  
18 of the arguments raised by petitioner alters that conclusion. Accordingly, we find that the tips at issue  
19 were mandatory tips subject to tax.

20 **Issue 2:** Whether the amnesty interest penalty should be relieved. We find relief is not  
21 warranted.

22 Since petitioner did not participate in the amnesty program, amnesty interest penalties of  
23 \$12,504.20 and \$8,236.10 will be added to the determinations for the Olive Garden (433701) and Red  
24 Lobster (434928) restaurants, respectively. Petitioner has submitted requests for relief of the penalties,  
25 in which it refers to the version of California Code of Regulations, title 18, section (Regulation) 1603  
26 that was in effect during the audit period (before the August 15, 2007 amendment of the regulation).  
27 Although petitioner does not specifically address its failure to participate in the amnesty program, it  
28 apparently intends to argue that its failure to participate in the amnesty program was related to its

1 reliance on the language of Regulation 1603 before it was amended.

2 In order to recommend relief of the amnesty interest penalty, we must find that petitioner's  
3 failure to participate in the amnesty program was due to facts and circumstances that were beyond its  
4 control. With respect to the issue of mandatory tips, we find that there are no substantial differences  
5 between the versions of Regulation 1603 before and after the August 2007 amendment, except that the  
6 current version is more detailed. Therefore, we find that petitioner's failure to report the tax on  
7 mandatory tips for the amnesty-eligible period is not the result of its reliance on the prior version of  
8 Regulation 1603. Further, even if petitioner were to prevail on that argument, there are several other  
9 deficiencies in the audits that are unrelated to gratuities, and petitioner has offered no explanation of its  
10 failure to file amnesty returns reporting those amounts and complete the other requirements of the  
11 amnesty program.

#### 12 **OTHER DEVELOPMENTS**

13 In its opening brief, petitioner provided a report intended to show that the percentages of tips  
14 paid by parties of eight or more varied, and were sometimes lower or higher than the 15 or 18 percent  
15 stated on the restaurants' menus. The Department investigated and found that the tips did sometimes  
16 differ from the 15 percent or 18 percent stated on the menus. However, in the audit, the only tips  
17 regarded as mandatory were the amounts automatically generated by petitioner's Point of Sale system.  
18 If a patron had scratched off the automatically-generated tip amount and added a tip that was either  
19 higher or lower, the tip was not regarded as mandatory. If a patron left the automatically-generated  
20 amount of tip on the bill and added an additional tip, only the automatically-generated tip was regarded  
21 as mandatory. Accordingly, we find that the audited amount of mandatory tips does not include any  
22 amounts added by the customers that differed from the automatically-generated amounts, and thus no  
23 adjustment is warranted for this argument.

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25 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III  
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