

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION FINAL ACTION SUMMARY

3 In the Matter of the Petitions for Redetermination)
 4 Under the Sales and Use Tax Law of:)
 5 BLOWFISH, LLC, dba Blowfish,) Account Number: SR BH 97-015787
 dba Sushi to Die For) Case ID 484932
 6 BLOWFISH SR, LLC, dba Blowfish Sushi) Account Number: SR GH 100-195888
 Case ID 479540
 7 Petitioners) City and County of San Francisco

8 Type of Business: Restaurant

9 Audit period: 07/01/04 – 06/30/07 (484932)

10 10/01/03 – 12/31/06 (479540)

11	<u>Item</u>	<u>Disputed Amount</u>	
		<u>484932</u>	<u>479540</u>
12	Unreported mandatory gratuities	\$143,059	\$110,703
13	Recorded but not reported sales	\$ 28,119	\$ 14,519
		<u>484932</u>	<u>479540</u>
14	Tax as determined:	\$19,359.66	\$26,970.65
15	Post-D&R adjustment	00.00	-10,698.93
16	Post-Board hearing adjustment	- 3,675.22	- 4,531.53
17	Proposed redetermination	\$15,684.44	\$11,740.19
18	Less concurred	- 1,134.26	- 1,409.27
19	Balance, protested	<u>\$14,550.18</u>	<u>\$10,330.92</u>
20	Proposed tax redetermination	\$15,684.44	\$11,740.19
21	Interest through 08/31/13	<u>9,389.03</u>	<u>7,773.36</u>
22	Total tax and interest	\$25,073.47	\$19,513.55
23	Payments	- 1,500.84	- 1,500.00
24	Balance Due	<u>\$23,572.63</u>	<u>\$18,013.55</u>
25	Monthly interest beginning 09/01/13	<u>\$ 70.92</u>	<u>\$ 51.20</u>

26 The Board held a hearing regarding this matter on November 16, 2011, and directed the Sales
 27 and Use Tax Department (Department) to conduct reaudits. Based on petitioner's submissions and the
 28 Department's response, we recommend reductions in the amounts of unreported mandatory gratuities
 of \$43,238 for case ID 484932 and \$54,928 for case ID 479540, as explained under Post Hearing
 Developments.

UNRESOLVED ISSUES

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2 **Issue 1:** Whether the disputed gratuities were mandatory. We conclude that they were
3 mandatory and therefore taxable. However, we do recommend adjustments in the audited amounts of
4 mandatory gratuities, as explained under Post Hearing Developments.

5 Petitioners operated restaurants specializing in sushi. Petitioners' server reports listed two
6 types of gratuities, "Auto Gratuities" and "Addl. Gratuities," and the audit workpapers contain a copy
7 of a menu that states "18% gratuity added to parties of six or more." During the audit, petitioner's
8 controller confirmed that this statement was on petitioner's menus during the entire audit period.
9 The Department determined that amounts listed as Auto Gratuities were mandatory tips that were
10 subject to tax. To establish the audited amounts of Auto Gratuities, the Department used a random
11 selection of server reports to compute the ratio of Auto Gratuities to taxable sales for each business,
12 and it applied those ratios to audited taxable sales to establish the audited amounts of taxable
13 mandatory gratuities.

14 Petitioners contend that none of the tips at issue were mandatory. They assert that, since the
15 controller did not start working for them until near the end of the audit period, she was not
16 knowledgeable about the menus during the entire audit period, and incorrectly stated that they included
17 the statement regarding tips. Petitioners also note that Blowfish was previously audited for a period
18 ending September 30, 2003, and state that a test of guest checks performed during that audit disclosed
19 no errors.

20 It is undisputed that, at the time of the audit, the Department examined menus including a
21 statement that an 18-percent gratuity would be added to bills for parties of six or more. On its website,
22 the to-go menu did not refer to the automatic gratuity or list alcoholic beverages, while the dine-in
23 menu did. The menu petitioners proffered at the conference did not include the automatic gratuity
24 statement, but appears similar to the to-go menu on its website and did not list alcoholic beverages.
25 We conclude the proffered menu is a to-go menu (which petitioner did not disclose when providing the
26 menu to us).

27 We can think of no logical reason why petitioners would have segregated the tips into separate
28 categories, including one labeled "Auto Gratuities" except to separately show the gratuities

1 automatically added to the bill by petitioners and those added by customers. Based on the available
2 evidence, we conclude that the menus during the audit period contained the automatic gratuity
3 statement. As for the prior audit, there were no specific comments relating to menus and mandatory
4 gratuities in the prior audit, and thus the prior audit has no probative value on the issue of the content
5 of the menus during the present audit period. Further, even if petitioners had established that the
6 menus during the prior audit period did not have the automatic gratuity statement, in the absence of
7 specific evidence of just when that statement was added, we would have no basis to alter our finding
8 that the menus contained the automatic gratuity statement during this entire audit period. We conclude
9 that the gratuities at issue were mandatory and therefore taxable.

10 **Issue 2:** Whether further adjustments are warranted to unreported sales. We recommend no
11 further adjustments.

12 For most quarters of the audit period, there was a difference between petitioners' recorded sales
13 tax accrued and their reported sales tax, and for most of these differences, sales tax accrued exceeded
14 sales tax reported. Except for one quarter for which the sales tax reported exceeded sales tax accrued
15 by an amount essentially offset by a reverse difference for the prior quarter, the Department accepted
16 reported sales tax where it exceeded accrued sales tax. For periods where accrued sales tax exceeded
17 reported sales tax, the Department regarded the difference as unreported taxable sales.

18 Petitioners contended that they reported the correct amount of tax and the tax accrual accounts
19 do not accurately reflect petitioners' taxable sales. Alternatively, petitioners argue that they should
20 receive credits for the periods in which sales tax reported exceeds sales tax accrued. Blowfish SR
21 additionally contends that its entire deficiency should be eliminated because schedules it provided
22 based on its report of sale system reflect sales that were only \$13,839 more than its reported sales.

23 For Blowfish, we find its sales tax accrual account represents tax reimbursement collected, and
24 thus evidences taxable sales. We find it improbable that petitioner would have remitted more sales tax
25 to the Board than it had collected in reimbursement for six of the 12 quarters of the audit period (the
26 six quarters do not include the one noted above that was offset against an understatement). Petitioner
27 has the burden to prove that it overpaid tax for those quarters, and it has not done so. Accordingly, we
28 find no adjustment is warranted to the difference between recorded and reported taxable sales for

1 Blowfish. For Blowfish SR, we accepted in the D&R that the deficiency should be based on its point
2 of sale system, which actually disclosed a deficiency of \$14,519. We reject petitioner's argument that
3 this is close enough to warrant deleting the deficiency altogether. Accordingly, we recommend no
4 further adjustment.

5 POST HEARING DEVELOPMENTS

6 At the Board hearing, the Board directed the Department to conduct reaudits to further review
7 the issue of mandatory gratuities. As mentioned above, the Department noted that petitioner's menu
8 stated, "18% gratuity added to parties of six or more," and that the 18 percent gratuity had been added
9 to bills issued to parties of six or more (large parties). Further, the Department noted that petitioner
10 separately recorded "Auto Gratuities" and "Addl. Gratuities," and the Department reasoned that the
11 "Auto Gratuities" represented 18 percent gratuities automatically added to bills issued to large parties.
12 Petitioner contends that none of its gratuities are mandatory, asserting that: 1) the 18 percent gratuity is
13 optional because the server negotiated with customers before adding the 18 percent gratuity to the bill,
14 and 2) there are gratuities on bills for large parties that are not at the 18 percent rate.

15 Regarding the first assertion, petitioner has provided no documentation to establish that the
16 server negotiated with customers before adding the 18 percent gratuity to a bill for a large party. Also,
17 while petitioner provided a menu that did not include a statement regarding an 18 percent gratuity on
18 bills for large parties, that menu was not dated. In addition, the Department located an archive menu
19 from 2005 for the San Francisco location on the Internet which referred to the 18 percent gratuity
20 added to bills for parties of six or more. Accordingly, we find that the available evidence supports a
21 finding that the menus during the audit period did include a statement regarding an 18 percent gratuity
22 that would be automatically added to bills for large parties. Accordingly, we reject petitioner's
23 assertion that none of its gratuities are mandatory.

24 With respect to petitioner's assertion that some gratuities on bills for large parties were not at
25 the 18 percent rate, the Department has reviewed the source documentation for all gratuities recorded
26 as "auto gratuities" for the original 30-day test period. For any day for which records could not be
27 located, the Department randomly selected another day as a replacement. The Department found that
28 the majority of auto gratuities consisted of 18 percent gratuities added to bills for large parties.

1 However, it did find that, on some bills for large parties, the gratuity was either less than or greater
2 than 18 percent, and it regarded all of those gratuities that were not 18 percent as optional, non-taxable
3 gratuities. The Department also reviewed source documents for “to-go” sales for the same test period,
4 and found mandatory gratuities that were added on “to go” sales. However, the Department noted that
5 petitioner had collected sales tax reimbursement on all “to-go” sales, which represented excess tax
6 reimbursement on sales of cold food “to go.” The Department applied the excess tax reimbursement
7 collected against the tax due, but not reported on the mandatory gratuities, and, for the majority of
8 transactions, the excess tax reimbursement offset the additional tax due. The reaudits resulted in
9 reductions of the amounts of unreported mandatory gratuities subject to tax of \$43,238, from \$186,297
10 to \$143,059 for case ID 484932, and \$54,928, from \$165,631 to \$110,703, for case ID 479540. We
11 concur, and we recommend those adjustments.

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