



Special Notice

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When are Tips, Gratuities, and Service Charges Taxable?

As part of the Board of Equalization's (BOE) sales and use tax education outreach efforts, we are contacting businesses in the restaurant, bar, and catering industry in California to make them aware of how tax applies to tips and service charges. For sales tax purposes, tips associated with taxable sales and services are separated into two categories: (1) optional or voluntary tips, which generally are not taxable, and (2) mandatory tips, which are taxable. When a preset amount is added to the customer's bill, it is considered mandatory. On the other hand, if the customer decides how much to tip when the bill is received, it is considered optional.

Mandatory Tips

Often, restaurants and bars will add a preset tip when serving a large group. The percentage that will be added as a tip is usually posted in the menu or advertising brochures. When this preset service charge or "mandatory tip" is added by the retailer to the customer's bill, it is subject to tax. These charges are part of the restaurant or bar's income and should be reported as taxable sales. Tax is due on these amounts even if tax was not charged to the customer. Mandatory tip charges are taxable whether or not the tips are paid to an employee.

Tips, gratuities, or service charges added to catering contracts are also mandatory tips. These charges are subject to tax. If customers add an additional tip at their discretion (optional), that amount is not taxable.

Businesses that have not reported their mandatory tips and service charges as taxable should file amended returns to report these amounts.

Optional or Voluntary Tips

Tips, gratuities, and service charges are not taxable for sales tax purposes if they are left by customers on a voluntary basis and paid to the employees. The following examples show when the payment of a tip is optional and not included in taxable sales:

- The customer leaves a separate amount in payment over and above the total amount charged by the restaurant, or
- The employee presents the check to the customer with the tip area blank so that the customer can voluntarily write in an amount, or
- The employee presents the check to the customer with options computed as tip suggestions but the tip area remains blank so that the customer may voluntarily write in an amount.

For More Information

If you would like more detailed information regarding this topic or other topics related to the food industry, you may download the following Sales and Use Tax regulation and BOE publication from our website at www.boe.ca.gov or request a copy from our Taxpayer Information Section at 800-400-7115.

Regulation 1603, *Taxable Sales of Food Products*
Publication 22, *Tax Tips for the Dining and Beverage Industry*