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Sales and Use Tax
Regulation 1603, *Taxable Sales of Food Products*

OAL Approval

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RECEIVED

NOV 07 2014

by EXECUTIVE DIRECTOR'S OFFICE
STATE BOARD OF EQUALIZATION

**State of California
Office of Administrative Law**

In re:
Board of Equalization

**NOTICE OF APPROVAL OF REGULATORY
ACTION**

Regulatory Action:

Government Code Section 11349.3

Title 18, California Code of Regulations

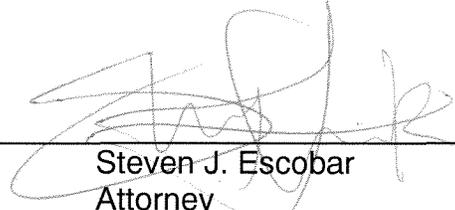
OAL File No. 2014-0924-01 S

Adopt sections:
Amend sections: 1603
Repeal sections:

This regular rulemaking by the Board of Equalization ("BOE") amends 18 CCR § 1603 to resolve confusion on the part of some retailers regarding what constitutes "mandatory" versus "optional" tips, gratuities, and service charges. An optional payment designated as a tip, gratuity, or service charge is not subject to tax. A mandatory payment designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if the amount is subsequently paid by the retailer to employees. This rulemaking amends Section 1603 by establishing a bright-line approach to how to treat amounts added by retailers to customers' bills consistent with how the retailers treat these amounts for Internal Revenue Service ("IRS") purposes. The amendments also include other technical and non-substantive amendments to Section 1603, including updating cross-references and moving the Authority and Reference citations so that they precede instead of follow Appendix A.

OAL approves this regulatory action pursuant to section 11349.3 of the Government Code. This regulatory action becomes effective on 1/1/2015.

Date: 11/5/2014



Steven J. Escobar
Attorney

For: **DEBRA M. CORNEZ**
Director

Original: Cynthia Bridges
Copy: Richard Bennion

OFFICE OF ADMINISTRATIVE LAW

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DEBRA M. CORNEZ
Director

MEMORANDUM

TO: Richard Bennion
FROM: OAL Front Desk
DATE: 11/6/2014
RE: Return of Approved Rulemaking Materials
OAL File No. 2014-0924-01S

OAL hereby returns this file your agency submitted for our review (OAL File No. 2014-0924-01S regarding Taxable Sales of Food Products).

If this is an approved file, it contains a copy of the regulation(s) stamped “ENDORSED APPROVED” by the Office of Administrative Law and “ENDORSED FILED” by the Secretary of State. The effective date of an approved regulation is specified on the Form 400 (see item B.5). **Beginning January 1, 2013**, unless an exemption applies, Government Code section 11343.4 states the effective date of an approved regulation is determined by the date the regulation is filed with the Secretary of State (see the date the Form 400 was stamped “ENDORSED FILED” by the Secretary of State) as follows:

- (1) **January 1** if the regulation or order of repeal is filed on September 1 to November 30, inclusive.
- (2) **April 1** if the regulation or order of repeal is filed on December 1 to February 29, inclusive.
- (3) **July 1** if the regulation or order of repeal is filed on March 1 to May 31, inclusive.
- (4) **October 1** if the regulation or order of repeal is filed on June 1 to August 31, inclusive.

If an exemption applies concerning the effective date of the regulation approved in this file, then it will be specified on the Form 400. The Notice of Approval that OAL sends to the state agency will contain the effective date of the regulation. The history note that will appear at the end of the regulation section in the California Code of Regulations will also include the regulation’s effective date. Additionally, the effective date of the regulation will be noted on OAL’s Web site once OAL posts the Internet Web site link to the full text of the regulation that is received from the state agency. (Gov. Code, secs. 11343 and 11344.)

Please note this new requirement: Unless an exemption applies, Government Code section 11343 now requires:

1. Section 11343(c)(1): Within 15 days of OAL filing a state agency’s regulation with the Secretary of State, the state agency is required to post the regulation on its Internet Web site in an easily marked and identifiable location. The state agency shall keep the regulation posted on its Internet Web site for at least six months from the date the regulation is filed with the Secretary of State.
2. Section 11343(c)(2): Within five (5) days of posting its regulation on its Internet Web site, the state agency shall send to OAL the Internet Web site link of each regulation that the agency posts on its Internet Web site pursuant to section 11343(c)(1).

OAL has established an email address for state agencies to send the Internet Web site link to for each regulation the agency posts. Please send the Internet Web site link for each regulation posted to OAL at postedregslink@oal.ca.gov.

NOTE ABOUT EXEMPTIONS. Posting and linking requirements do not apply to emergency regulations; regulations adopted by FPPC or Conflict of Interest regulations approved by FPPC; and regulations not subject to OAL/APA review. However, an exempt agency may choose to comply with these requirements, and OAL will post the information accordingly.

DO NOT DISCARD OR DESTROY THIS FILE

Due to its legal significance, you are required by law to preserve this rulemaking record. Government Code section 11347.3(d) requires that this record be available to the public and to the courts for possible later review. Government Code section 11347.3(e) further provides that "...no item contained in the file shall be removed, altered, or destroyed or otherwise disposed of." See also the State Records Management Act (Government Code section 14740 et seq.) and the State Administrative Manual (SAM) section 1600 et seq.) regarding retention of your records.

If you decide not to keep the rulemaking records at your agency/office or at the State Records Center, you may transmit it to the State Archives with instructions that the Secretary of State shall not remove, alter, or destroy or otherwise dispose of any item contained in the file. See Government Code section 11347.3(f).

Enclosures

NOTICE PUBLICATION/REGULATIONS SUBMISSION

REGULAR

(See instructions on reverse)

For use by Secretary of State only

STD. 400 (REV. 01-2013)

OAL FILE NUMBERS	NOTICE FILE NUMBER Z-2014-0610-02	REGULATORY ACTION NUMBER 2014-0924-015	EMERGENCY NUMBER
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For use by Office of Administrative Law (OAL) only

<p style="text-align: center;">NOTICE</p>	<p style="text-align: center;">REGULATIONS</p>
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2014 SEP 24 AM 11:17
OFFICE OF ADMINISTRATIVE LAW

ENDORSED FILED
IN THE OFFICE OF
2014 NOV -5 PM 3:20
SECRETARY OF STATE

AGENCY WITH RULEMAKING AUTHORITY State Board of Equalization	AGENCY FILE NUMBER (if any)
-----------------------------------------------------------------	-----------------------------

A. PUBLICATION OF NOTICE (Complete for publication in Notice Register)

1. SUBJECT OF NOTICE	TITLE(S)	FIRST SECTION AFFECTED	2. REQUESTED PUBLICATION DATE
3. NOTICE TYPE <input type="checkbox"/> Notice re Proposed Regulatory Action <input type="checkbox"/> Other	4. AGENCY CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)
OAL USE ONLY <input type="checkbox"/> Approved as Submitted <input type="checkbox"/> Approved as Modified <input type="checkbox"/> Disapproved/Withdrawn	NOTICE REGISTER NUMBER 2014, 252	PUBLICATION DATE 6/20/2014	

B. SUBMISSION OF REGULATIONS (Complete when submitting regulations)

1a. SUBJECT OF REGULATION(S) Taxable Sales of Food Products	1b. ALL PREVIOUS RELATED OAL REGULATORY ACTION NUMBER(S)
----------------------------------------------------------------	----------------------------------------------------------

2. SPECIFY CALIFORNIA CODE OF REGULATIONS TITLE(S) AND SECTION(S) (Including title 26, if toxics related)	ADOPT
SECTION(S) AFFECTED (List all section number(s) individually. Attach additional sheet if needed.)	AMEND 1603
TITLE(S) 18	REPEAL

3. TYPE OF FILING			
<input checked="" type="checkbox"/> Regular Rulemaking (Gov. Code §11346)	<input type="checkbox"/> Certificate of Compliance: The agency officer named below certifies that this agency complied with the provisions of Gov. Code §§11346.2-11347.3 either before the emergency regulation was adopted or within the time period required by statute.	<input type="checkbox"/> Emergency Readopt (Gov. Code, §11346.1(h))	<input type="checkbox"/> Changes Without Regulatory Effect (Cal. Code Regs., title 1, §100)
<input type="checkbox"/> Resubmittal of disapproved or withdrawn nonemergency filing (Gov. Code §§11349.3, 11349.4)	<input type="checkbox"/> Resubmittal of disapproved or withdrawn emergency filing (Gov. Code, §11346.1)	<input type="checkbox"/> File & Print	<input type="checkbox"/> Print Only
<input type="checkbox"/> Emergency (Gov. Code, §11346.1(b))	<input type="checkbox"/> Other (Specify) _____		

4. ALL BEGINNING AND ENDING DATES OF AVAILABILITY OF MODIFIED REGULATIONS AND/OR MATERIAL ADDED TO THE RULEMAKING FILE (Cal. Code Regs. title 1, §44 and Gov. Code §11347.1)

5. EFFECTIVE DATE OF CHANGES (Gov. Code, §§ 11343.4, 11346.1(d); Cal. Code Regs., title 1, §100)			
<input checked="" type="checkbox"/> Effective January 1, April 1, July 1, or October 1 (Gov. Code §11343.4(a))	<input type="checkbox"/> Effective on filing with Secretary of State	<input type="checkbox"/> \$100 Changes Without Regulatory Effect	<input type="checkbox"/> Effective other (Specify) _____

6. CHECK IF THESE REGULATIONS REQUIRE NOTICE TO, OR REVIEW, CONSULTATION, APPROVAL OR CONCURRENCE BY, ANOTHER AGENCY OR ENTITY		
<input type="checkbox"/> Department of Finance (Form STD. 399) (SAM §6660)	<input type="checkbox"/> Fair Political Practices Commission	<input type="checkbox"/> State Fire Marshal
<input type="checkbox"/> Other (Specify) _____		

7. CONTACT PERSON Richard E. Bennion	TELEPHONE NUMBER (916) 445-2130	FAX NUMBER (Optional) (916) 324-3984	E-MAIL ADDRESS (Optional) rbennion@boe.ca.gov
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8. I certify that the attached copy of the regulation(s) is a true and correct copy of the regulation(s) identified on this form, that the information specified on this form is true and correct, and that I am the head of the agency taking this action, or a designee of the head of the agency, and am authorized to make this certification.

SIGNATURE OF AGENCY HEAD OR DESIGNEE <i>Joann Richmond</i>	DATE September 24, 2014
TYPED NAME AND TITLE OF SIGNATORY Joann Richmond, Chief, Board Proceedings Division	

For use by Office of Administrative Law (OAL) only

ENDORSED APPROVED

NOV 05 2014

Office of Administrative Law

**Final Text of Proposed Amendments to
California Code of Regulations, Title 18, Section 1603**

1603. Taxable Sales of Food Products.

(a) Restaurants, Hotels, Boarding Houses, Soda Fountains, and Similar Establishments.

(1) Definitions.

(A) Boarding House. The term “boarding house” as used in this regulation means any establishment regularly serving meals, on the average to five or more paying guests. The term includes a “guest home,” “residential care home,” “halfway house,” and any other establishment providing room and board or board only, which is not an institution as defined in Regulation 1503 and section 6363.6 of the Revenue and Taxation Code. The fact that guests may be recipients of welfare funds does not affect the application of tax. A person or establishment furnishing meals on the average to fewer than five paying guests during the calendar quarter is not considered to be engaged in the business of selling meals at retail.

(B) American Plan Hotel. The term “American Plan Hotel” as used in this regulation means a hotel which charges guests a fixed sum by the day, week, or other period for room and meals combined.

(C) Complimentary Food and Beverages. As used in this subdivision (a), the term “complimentary food and beverages” means food and beverages (including alcoholic and non-alcoholic beverages) which are provided to transient guests on a complimentary basis and:

1. There is no segregation between the charges for rooms and the charges for the food and beverages on the guests’ bills, and
2. The guests are not given an option to refuse the food and beverages in return for a discounted room rental.

(D) Average Retail Value of Complimentary Food and Beverages. The term “average retail value of complimentary food and beverages” (ARV) as used in this regulation means the total amount of the costs of the complimentary food and beverages for the preceding calendar year marked-up one hundred percent (100%) and divided by the number of rooms rented for that year. Costs of complimentary food and beverages include charges for delivery to the lodging establishment but exclude discounts taken and sales tax reimbursement paid to vendors. The 100% markup factor includes the cost of food preparation labor by hotel employees, the fair rental value of hotel facilities used to prepare or serve the food and beverages, and profit.

(E) Average Daily Rate. The term “average daily rate” (ADR) as used in this regulation means the gross room revenue for the preceding calendar year divided by the number of rooms rented for that year. “Gross room revenue” means and includes the full charge to the hotel customers but excludes separately stated occupancy taxes, revenue from

contract and group rentals which do not qualify for complimentary food and beverages, and revenue from special packages (e.g., New Year's Eve packages which include food and beverages as well as guest room accommodations), unless it can be documented that the retail value of the food and beverages provided as a part of the special package is 10% or less of the total package charge as provided in subdivision (a)(2)(B). "Number of rooms rented for that year" means the total number of times all rooms have been rented on a nightly basis provided the revenue for those rooms is included in the "gross room revenue." For example, if a room is rented out for three consecutive nights by one guest, that room will be counted as rented three times when computing the ADR.

(2) Application Of Tax.

(A) In General. Tax applies to sales of meals or hot prepared food products (see (e) below) furnished by restaurants, concessionaires, hotels, boarding houses, soda fountains, and similar establishments whether served on or off the premises. In the case of American Plan Hhotels, special packages offered by hotels, e.g., a New Year's Eve package as described in subdivision (a)(1)(E), and boarding houses, a reasonable segregation must be made between the charges for rooms and the charges for the meals, hot prepared food products, and beverages. Charges by hotels or boarding houses for delivering meals or hot prepared food products to, or serving them in, the rooms of guests are includable in the measure of tax on the sales of the meals or hot prepared food products whether or not the charges are separately stated. (Caterers, see (h) below.) Sales of meals or hot prepared food products by restaurants, concessionaires, hotels, boarding houses, soda fountains, and similar establishments to persons such as event planners, party coordinators, or fundraisers, which buy and sell on their own account, are sales for resale for which a resale certificate may be accepted. (See subdivision (h)(3)(C).)

Souffle cups, straws, paper napkins, toothpicks and like items that are not of a reusable character which are furnished with meals or hot prepared food products are sold with the meals or hot prepared food products. Sales of such items for such purpose to persons engaged in the business of selling meals or hot prepared food products are, accordingly, sales for resale.

(B) Complimentary Food and Beverages. Lodging establishments which furnish, prepare, or serve complimentary food and beverages to guests in connection with the rental of rooms are consumers and not retailers of such food and beverages when the retail value of the complimentary food and beverages is "incidental" to the room rental service regardless of where within the hotel premises the complimentary food and beverages are served. For complimentary food and beverages to qualify as "incidental" for the current calendar year, the average retail value of the complimentary food and beverages (ARV) furnished for the preceding calendar year must be equal to or less than 10% of the average daily rate (ADR) for that year.

If a hotel provides guests with coupons or similar documents which may be exchanged for complimentary food and beverages in an area of the hotel where food and beverages are sold on a regular basis to the general public (e.g., a restaurant), the hotel will be

considered the consumer and not the retailer of such food and beverages if the coupons or similar documents are non-transferable and the guest is specifically identified by name. If the coupons or similar documents are transferable or the guest is not specifically identified, food and beverages provided will be considered sold to the guest at the fair retail value of similar food and beverages sold to the general public. In the case of coupons redeemed by guests at restaurants not operated by the lodging establishment, the hotel will be considered the consumer of food and beverages provided to the hotel's guests and tax will apply to the charge by the restaurant to the hotel.

Lodging establishments are retailers of food and beverages which do not qualify as "incidental" and tax applies as provided in subdivision (a)(2)(A) above. Amounts paid by guests for food and beverages in excess of a complimentary allowance are gross receipts subject to the tax. Lodging establishments are retailers of otherwise complimentary food and beverages sold to non-guests.

In the case of hotels with concierge floor, club level or similar programs, the formula set forth above shall be applied separately with respect to the complimentary food and beverages furnished to guests who participate in the concierge, club or similar program. That is, the concierge, club or similar program will be deemed to be an independent hotel separate and apart from the hotel in which it is operated. The ADR and the retail value of complimentary food and beverages per occupied room will be computed separately with respect to the guest room accommodations entitled to the privileges and amenities involved in the concierge, club or similar program.

The following example illustrates the steps in determining whether the food and beverages are complimentary:

FORMULA: $ARV \div ADR \leq 10\%$

Average Daily Rate (ADR):

Room Revenue	\$9,108,000
Rooms Rented	74,607
ADR (\$9,108,000 ÷ 74,607)	\$122.08

Average Retail Value of Complimentary Food and Beverages (ARV):

Complimentary Food Cost	\$169,057
Complimentary Beverage Cost	52,513
Total	\$221,570
Add 100% Markup	221,570
Average Retail Value	\$443,140
ARV per occupied room (\$443,140 ÷ 74,607)	\$5.94

Application of Formula:

$$\$5.94 \div \$122.08 = 4.87\%$$

In the above example, the average retail value of the complimentary food and beverages per occupied room for the preceding calendar year is equal to or less than 10% of the average daily rate. Therefore, under the provisions of this subdivision (a)(2)(B), the complimentary food and beverages provided to guests for the current calendar year qualify as “incidental.” The lodging establishment is the consumer and not the retailer of such food and beverages. This computation must be made annually.

When a lodging establishment consists of more than one location, the operations of each location will be considered separately in determining if that location’s complimentary food and beverages qualify as incidental.

(C) “Free” Meals. When a restaurant agrees to furnish a “free” meal to a customer who purchases another meal and presents a coupon or card, which the customer previously had purchased directly from the restaurant or through a sales promotional agency having a contract with the restaurant to redeem the coupons or cards, the restaurant is regarded as selling two meals for the price of one, plus any additional compensation from the agency or from its own sales of coupons. Any such additional compensation is a part of its taxable gross receipts for the period in which the meals are served.

Tax applies only to the price of the paid meal plus any such additional compensation.

(b) “Drive-Ins.” Tax applies to sales of food products ordinarily sold for immediate consumption on or near a location at which parking facilities are provided primarily for the use of patrons in consuming the products purchased at the “drive-in” establishment, even though such products are sold on a “take out” or “to go” order and are actually packaged or wrapped and taken from the premises of the retailer. Food products when sold in bulk, i.e., in quantities or in a form not suitable for consumption on the retailer’s premises, are not regarded as ordinarily sold for immediate consumption on or near the location at which parking facilities are provided by the retailer. Accordingly, with the exception of sales of hot prepared food products (see (e) below) and sales of cold food under the 80-80 rule (see (c) below), sales of ice cream, doughnuts, and other individual food items in quantities obviously not intended for consumption on the retailer’s premises, without eating utensils, trays, or dishes and not consumed on the retailer’s premises, are exempt from tax. Any retailer claiming a deduction on account of food sales of this type must support the deduction by complete and detailed records.¹

(c) Cold Food Sold on a “Take-Out” Order.

(1) General.

(A) Seller Meeting Criteria of 80-80 Rule. When a seller meets both criteria of the 80-80 rule as explained in subdivision (c)(3) below, tax applies to sales of cold food products (including sales for a separate price of hot bakery goods and hot beverages such as coffee) in a form suitable for consumption on the seller’s premises even though such food

products are sold on a "take-out" or "to go" order. Sales of cold food products which are suitable for consumption on the seller's premises are subject to the tax no matter how great the quantity purchased, e.g., 40 one-half pint containers of milk. Except as provided elsewhere in this regulation, tax does not apply to sales of food products which are furnished in a form not suitable for consumption on the seller's premises.

Operative April 1, 1996, although a seller may meet both criteria of the 80-80 rule, he or she may elect to separately account for the sale of "take-out" or "to go" orders of cold food products which are in a form suitable for consumption on the seller's premises. The gross receipts from the sale of those food products shall be exempt from the tax provided the seller keeps a separate accounting of these transactions in his or her records. Tax will remain applicable to the sale of food products as provided in subdivisions (a), (b), (e), or (f) of this regulation. Failure to maintain the required separate accounting and documentation claimed as exempt under this subdivision will revoke the seller's election under this subdivision.

(B) Seller Not Meeting Criteria of 80-80 Rule. When a seller does not meet both criteria of the 80-80 rule as explained in subdivision (c)(3) below, tax does not apply to sales of cold food products (including sales for a separate price of hot bakery goods and hot beverages such as coffee) when sold on a "take-out" or "to go" order.

(2) Definitions.

(A) For purposes of this subdivision (c), the term "suitable for consumption on the seller's premises" means food products furnished:

1. In a form which requires no further processing by the purchaser, including but not limited to cooking, heating, thawing, or slicing, and
2. In a size which ordinarily may be immediately consumed by one person such as a large milk shake, a pint of ice cream, a pint of milk, or a slice of pie. Cold food products (excluding milk shakes and similar milk products) furnished in containers larger in size than a pint are considered to be in a form not suitable for immediate consumption.

Pieces of candy sold in bulk quantities of one pound or greater are deemed to be sold in a form not suitable for consumption on the seller's premises.

The term does not include cold food products which obviously would not be consumed on the premises of the seller, e.g., a cold party tray or a whole cold chicken.

(B) For purposes of this subdivision (c), the term "seller's premises" means the individual location at which a sale takes place rather than the aggregate of all locations of the seller. For example, if a seller operates several drive-in and fast food restaurants, the operations of each location stand alone and are considered separately in determining if the sales of food products at each location meet the criteria of the 80-80 rule.

When two or more food-selling activities are conducted by the same person at the same location, the operations of all food related activities will be considered in determining if the sales of food products meet the criteria of the 80-80 rule. For example, if a seller operates a grocery store and a restaurant with no physical separation other than separate cash registers, the grocery store operations will be included in determining if the sales of food products meet the criteria of the 80-80 rule. When there is a physical separation where customers of one operation may not pass freely into the other operation, e.g., separate rooms with separate entrances but a common kitchen, each operation will be considered separately for purposes of this subdivision (c).

(3) 80-80 Rule. Tax applies under this subdivision (c) only if the seller meets both of the following criteria:

(A) More than 80 percent of the seller's gross receipts are from the sale of food products, and

(B) More than 80 percent of the seller's retail sales of food products are taxable as provided in subdivisions (a), (b), (e), and (f) of this regulation.

Sales of alcoholic beverages, carbonated beverages, or cold food to go not suitable for immediate consumption should not be included in this computation. Any seller meeting both of these criteria and claiming a deduction for the sale of cold food products in a form not suitable for consumption on the seller's premises must support the deduction by complete and detailed records of such sales made.

(d) Places Where Admission Is Charged.

(1) General. Tax applies to sales of food products when sold within, and for consumption within, a place the entrance to which is subject to an admission charge, during the period when the sales are made, except for national and state parks and monuments, and marinas, campgrounds, and recreational vehicle parks.

(2) Definitions.

(A) "Place" means an area the exterior boundaries of which are defined by walls, fences or otherwise in such a manner that the area readily can be recognized and distinguished from adjoining or surrounding property. Examples include buildings, fenced enclosures and areas delimited by posted signs.

(B) "Within a place" means inside the door, gate, turnstile, or other point at which the customer must pay an admission charge or present evidence, such as a ticket, that an admission charge has been paid. Adjacent to, or in close proximity to, a place is not within a place.

(C) "Admission charge" means any consideration required to be paid in money or otherwise, for admittance to a place.

"Admission charge" does not include:

1. Membership dues in a club or other organization entitling the member to, among other things, entrance to a place maintained by the club or organization, such as a fenced area containing a club house, tennis courts, and a swimming pool. Where a guest is admitted to such a place only when accompanied by or vouched for by a member of the club or organization, any charge made to the guest for use of facilities in the place is not an admission charge.
2. A charge for a student body card entitling the student to, among other things, entrance to a place, such as entrance to a school auditorium at which a dance is held.
3. A charge for the use of facilities within a place to which no entrance charge is made to spectators. For example, green fees paid for the privilege of playing a golf course, a charge made to swimmers for the use of a pool within a place, or a charge made for the use of lanes in a public bowling place.

(D) "National and state parks and monuments" means those which are part of the National Park System or the State Park System. The phrase does not include parks and monuments not within either of those systems, such as city, county, regional, district or private parks.

(3) Presumption That Food Is Sold for Consumption Within a Place.

When food products are sold within a place the entrance to which is subject to an admission charge, it will be presumed, in the absence of evidence to the contrary, that the food products are sold for consumption within the place. Obtaining and retaining evidence in support of the claimed tax exemption is the responsibility of the retailer. Such evidence may consist, for example, of proof that the sales were of canned jams, cake mixes, spices, cooking chocolate, or other items in a form in which it is unlikely that such items would be consumed within the place where sold.

(4) Food Sold to Students. The exemption otherwise granted by Section 6363 does not apply to sales of food products to students when sold within, and for consumption within, a place the entrance to which is subject to an admission charge, and such sales are subject to tax except as provided in (p) of this regulation. For example, when food products are sold by a student organization to students or to both students and nonstudents within a place the entrance to which is subject to an admission charge, such as a place where school athletic events are held, the sales to both students and nonstudents are taxable.

(e) Hot Prepared Food Products.

(1) General. Tax applies to all sales of hot prepared food products unless otherwise exempt. "Hot prepared food products" means those products, items, or components which have been prepared for sale in a heated condition and which are sold at any temperature which is higher than the air temperature of the room or place where they are sold. The mere heating of a food product constitutes preparation of a hot prepared food product, e.g., grilling a sandwich, dipping a sandwich bun in hot gravy, using infra-red lights, steam tables, etc. If the sale is intended to be of a hot food product, such sale is of a hot food product regardless of cooling which incidentally occurs. For example, the sale of a toasted sandwich intended to be in a heated condition when sold, such as a fried ham sandwich on toast, is a sale of a hot prepared food product even though it may have cooled due to delay. On the other hand, the sale of a toasted sandwich which is not intended to be in a heated condition when sold, such as a cold tuna sandwich on toast, is not a sale of a hot prepared food product.

When a single price has been established for a combination of hot and cold food items, such as a meal or dinner which includes cold components or side items, tax applies to the entire established price regardless of itemization on the sales check. The inclusion of any hot food product in an otherwise cold combination of food products sold for a single established price, results in the tax applying to the entire established price, e.g., hot coffee served with a meal consisting of cold food products, when the coffee is included in the established price of the meal. If a single price for the combination of hot and cold food items is listed on a menu, wall sign or is otherwise advertised, a single price has been established. Except as otherwise provided in (b), (c), (d) or (f) of this regulation, or in Regulation 1574, tax does not apply to the sale for a separate price of bakery goods, beverages classed as food products, or cold or frozen food products. Hot bakery goods and hot beverages such as coffee are hot prepared food products but their sale for a separate price is exempt unless taxable as provided in (b), (c), (d) or (f) of this regulation, or in Regulation 1574. Tax does apply if a hot beverage and a bakery product or cold food product are sold as a combination for a single price. Hot soup, bouillon, or consommé is a hot prepared food product, which is not a beverage.

(2) Air Carriers Engaged in Interstate or Foreign Commerce. Tax does not apply to the sale, storage, use, or other consumption of hot prepared food products sold by caterers or other vendors to air carriers engaged in interstate or foreign commerce for consumption by passengers on such air carriers, nor to the sale, storage, use, or other consumption of hot prepared food products sold or served to passengers by air carriers engaged in interstate or foreign commerce for consumption by passengers on such air carriers. "Air carriers" are persons or firms in the business of transporting persons or property for hire or compensation, and include both common and contract carriers. "Passengers" do not include crew members. Any caterer or other vendor claiming the exemption must support it with an exemption certificate from the air carrier substantially in the form prescribed in Appendix A of this regulation.

(f) Food for Consumption at Facilities Provided by the Retailer. Tax applies to sales of sandwiches, ice cream, and other foods sold in a form for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others.

A passenger's seat aboard a train, or a spectator's seat at a game, show, or similar event is not a "chair" within the meaning of this regulation. Accordingly, except as otherwise provided in (c), (d), and (e) above, tax does not apply to the sale of cold sandwiches, ice cream, or other food products sold by vendors passing among the passengers or spectators where the food products are not "for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware provided by the retailer."

(g) Tips, Gratuities, and Service Charges. (Prior to January 1, 2015)

The provisions of subdivision (g) apply to transactions occurring prior to January 1, 2015. This subdivision applies to restaurants, hotels, caterers, boarding houses, soda fountains, drive-ins and similar establishments.

An optional payment designated as a tip, gratuity, or service charge is not subject to tax. A mandatory payment designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if the amount is subsequently paid by the retailer to employees.

(1) Optional Payment.

(A) A payment of a tip, gratuity, or service charge is optional if the customer adds the amount to the bill presented by the retailer, or otherwise leaves a separate amount in payment over and above the actual amount due the retailer for the sale of meals, food, and drinks that include services. The following examples illustrate transactions where a payment of a tip, gratuity or service charge is optional and not included in taxable gross receipts. This is true regardless of printed statements on menus, brochures, advertisements or other materials notifying customers that tips, gratuities, or service charges will or may be added by the retailer to the prices of meals, food, or drinks:

Example 1. The restaurant check is presented to the customer with the "tip" area blank so the customer may voluntarily write in an amount, or

Example 2. The restaurant check is presented to the customer with options computed by the retailer and presented to the customer as tip suggestions. The "tip" area is blank so the customer may voluntarily write in an amount:

Guest Check~~Guest Check~~

Food Item A	\$9.95
Beverage Item B	3.75
Subtotal	\$13.70
8% sales tax	1.10
Subtotal	\$14.80
Tip*	
Total	

*Suggested tips:

15%=\$2.06; 18%=\$2.47; 20%=\$2.74; other.

If an employer misappropriates these payments for these charges, as discussed in subdivision (g)(1)(B) below, such payments are included in the retailer's taxable gross receipts.

(B) No employer shall collect, take, or receive any gratuity or a part thereof, paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of such gratuity, or require an employee to credit the amount, or any part thereof, of such gratuity against and as a part of the wages due the employee from the employer. (Labor Code section 351.) If this prohibition is violated, any amount of such gratuities received by the employer will be considered a part of the gross receipts of the employer and subject to the tax.

(2) Mandatory Payment.

(A) An amount negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is mandatory.

(B) When the menu, brochures, advertisements or other printed materials contain statements that notify customers that tips, gratuities, or service charges will or may be added, an amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is a mandatory charge and subject to tax. These amounts are considered negotiated in advance as specified in subdivision (g)(2)(A). Examples of printed statements include:

“An 18% gratuity [or service charge] will be added to parties of 8 or more.”

“Suggested gratuity 15%,” itemized on the invoice or bill by the restaurant, hotel, caterer, boarding house, soda fountain, drive-in or similar establishment.

“A 15% voluntary gratuity will be added for parties of 8 or more.”

An amount will be considered “automatically added” when the retailer adds the tip to the bill without first conferring with the customer after service of the meal and receiving approval to add the tip or without providing the customer with the option to write in the tip. Nonetheless, any amount added by the retailer is presumed to be mandatory. This presumption may be overcome as discussed in subdivision (g)(2)(C) below.

(C) It is presumed that an amount added as a tip by the retailer to the bill or invoice presented to the customer is mandatory. A statement on the bill or invoice that the amount added by the retailer is a “suggested tip,” “optional gratuity,” or that “the amount may be increased, decreased, or removed” by the customer does not change the mandatory nature of the charge.

This presumption may be controverted by documentary evidence showing that the customer specifically requested and authorized the gratuity be added to the amount billed.

Examples of documentary evidence that may be used to overcome the presumption include:

1. A guest check that is presented to the customer showing sales tax reimbursement and the amount upon which it was computed, without tip or with the "tip" area blank and a separate document, such as a credit card receipt, to which the retailer adds or prints the requested tip.
2. Guests receipts and payments showing that the percentage of tips paid by large groups varies from the percentage stated on the menu, brochure, advertisement or other printed materials.
3. A retailer's written policy stating that its employees shall receive confirmation from a customer before adding a tip together with additional verifiable evidence that the policy has been enforced. The policy is not in itself sufficient documentation to establish that the customer requested and authorized that a gratuity be added to the amount billed without such additional verifiable evidence.

The retailer must retain the guest checks and any additional separate documents to show that the payment is optional. The retailer is also required to maintain other records in accordance with the requirements of Regulation 1698, Records.

(h) Tips, Gratuities, and Service Charges. (On and after January 1, 2015)

The provisions of subdivision (h) apply to transactions occurring on and after January 1, 2015. This subdivision applies to restaurants, hotels, caterers, boarding houses, soda fountains, drive-ins and similar establishments.

An optional payment designated as a tip, gratuity, or service charge is not subject to tax. A mandatory payment designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if it is subsequently paid by the retailer to employees. For purposes of this subdivision, "amount" means a payment designated as a tip, gratuity, service charge, or any other separately stated payment for services associated with the purchase of meals, food, or drinks.

(1) Optional Payment.

When a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service (IRS) purposes, such amounts are presumed to be optional and not subject to tax. When a retailer does not maintain such records, this presumption does not apply and the amounts may be mandatory and included in taxable gross receipts as discussed in subdivisions (h)(2) and (h)(3).

The following examples illustrate transactions where an amount is optional and not included in taxable gross receipts:

Example 1. The restaurant check is presented to the customer with the "tip" area blank so the customer may voluntarily write in the amount, or

Example 2. The restaurant check is presented to the customer with options computed by the retailer and presented to the customer as tip suggestions. The “tip” area is blank so the customer may voluntarily write in the amount:

<u>Guest Check</u>	
<u>Food Item A</u>	<u>\$9.95</u>
<u>Beverage Item B</u>	<u>3.75</u>
<u>Subtotal</u>	<u>\$13.70</u>
<u>8% sales tax</u>	<u>1.10</u>
<u>Subtotal</u>	<u>\$14.80</u>
<u>Tip*</u>	
<u>Total</u>	
<u>*Suggested tips:</u>	
<u>15%=\$2.06; 18%=\$2.47; 20%=\$2.74; other.</u>	

Under these circumstances, the customer is free to enter the amount on the tip line or leave it blank; thus, the customer may enter an amount free from compulsion. The customer and restaurant did not negotiate the amount nor did the restaurant dictate the amount.

If an employer misappropriates these amounts, as discussed in subdivision (h)(4) below, such payments are included in the retailer’s taxable gross receipts.

(2) Mandatory Payment.

When a retailer’s records reflect that amounts are required to be reported to the IRS as non-tip wages, the amount is deemed to be mandatory.

(3) When a retailer does not maintain records for purposes of reporting the amounts to the IRS:

(A) An amount negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is mandatory.

(B) When the menu, brochures, advertisements or other printed materials contain statements that notify customers that tips, gratuities, or service charges will or may be added, an amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is a mandatory charge and subject to tax. These amounts are considered negotiated in advance as specified in subdivision (h)(3)(A). Examples of printed statements include:

“An 18% gratuity [or service charge] will be added to parties of 8 or more.”

“Suggested gratuity 15%,” itemized on the invoice or bill by the restaurant, hotel, caterer, boarding house, soda fountain, drive-in or similar establishment.

“A 15% voluntary gratuity will be added for parties of 8 or more.”

An amount will be considered “automatically added” when the retailer adds the amount to the bill without first conferring with the customer after service of the meal. Nonetheless, any amount added by the retailer is presumed to be automatically added and mandatory. This presumption may be overcome as discussed in subdivision (h)(3)(C) below.

(C) It is presumed that an amount added as a tip by the retailer to the bill or invoice presented to the customer is automatically added and mandatory. A statement on the bill or invoice that the amount added by the retailer is a “suggested tip,” “optional gratuity,” or that the amount “may be increased, decreased, or removed” by the customer does not change the mandatory nature of the charge.

This presumption may be controverted by documentary evidence showing that the customer specifically requested and authorized the amount be added to the bill.

Examples of documentary evidence that may be used to overcome the presumption include:

1. A guest check that is presented to the customer showing sales tax reimbursement and the figure upon which it was computed, without “tip” or with the “tip” area blank and a separate document, such as a credit card receipt, to which the retailer adds or prints the requested amount.
2. Guest receipts and payments showing that the percentage of amounts paid by large parties varies from the percentage stated on the menu, brochure, advertisement or other printed materials.
3. A retailer’s written policy stating that its employees shall receive confirmation from a customer before adding an amount together with additional verifiable evidence that the policy has been enforced. The policy is not in itself sufficient documentation to establish that the customer requested and authorized that the amount be added to the bill without such additional verifiable evidence.

The retailer must retain the guest checks and any additional separate documents to show that the payment is optional. The retailer is also required to maintain other records in accordance with the requirements of Regulation 1698, *Records*.

(4) No employer shall collect, take, or receive any gratuity or a part thereof, paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of such gratuity, or require an employee to credit the amount, or any part thereof, of such gratuity against and as a part of the wages due the employee from the employer. (Labor Code section 351.) If this prohibition is violated, any amount received by the employer will be considered a part of the gross receipts of the employer and subject to the tax.

(hi) Caterers.

(1) Definition. The term “caterer” as used in this regulation means a person engaged in the business of serving meals, food, or drinks on the premises of the customer, or on premises supplied by the customer, including premises leased by the customer from a person other than the caterer, but does not include employees hired by the customer by the hour or day.

(2) Sales to Caterers. A caterer generally is considered to be the consumer of tangible personal property normally used in the furnishing and serving of meals, food or drinks, except for separately stated charges by the caterer for the lease of tangible personal property or tangible personal property regarded as being sold with meals, food or drinks such as disposable plates, napkins, utensils, glasses, cups, stemware, place mats, trays, covers and toothpicks.

(3) Sales by Caterers.

(A) Caterer as Retailer. Tax applies to the entire charge made by caterers for serving meals, food, and drinks, inclusive of charges for food, the use of dishes, silverware, glasses, chairs, tables, etc., used in connection with serving meals, and for the labor of serving the meals, whether performed by the caterer, the caterer’s employees or subcontractors. Tax applies to charges made by caterers for preparing and serving meals and drinks even though the food is not provided by the caterers. Tax applies to charges made by caterers for hot prepared food products as in (e) above whether or not served by the caterers. A caterer who separately states or itemizes charges for the lease of tangible personal property regardless of the use of the property will be deemed to be the lessor of such property. Tax applies in accordance with Regulation 1660, Leases of Tangible Personal Property - In General. Tax does not apply to charges made by caterers for the rental of dishes, silverware, glasses, etc., purchased by the caterer with tax paid on the purchase price if no food is provided or served by the caterers in connection with such rental.

(B) Caterers as Lessors of Property Unrelated to the Serving or Furnishing of Meals, Food, or Drinks by a Caterer.

1. When a caterer who is furnishing or serving meals, food, or drinks also rents or leases from a third party tangible personal property which the caterer does not use himself or herself and the property is not customarily provided or used within the catering industry in connection with the furnishing and serving of food or drinks, such as decorative props related solely to optional entertainment, special lighting for guest speakers, sound or video systems, dance floors, stages, etc., he or she is a lessor of such property. In such instance, tax applies to the lease in accordance with Regulation 1660.

2. When a person who in other instances is a caterer does not furnish or serve any meals, food, or drinks to a customer, but rents or leases from a third party tangible personal property such as dishes, linen, silverware and glasses, etc., for purposes of

providing it to his or her customer, he or she is not acting as a caterer within the meaning of this regulation, but solely as a lessor of tangible personal property. In such instances, tax applies to the lease in accordance with Regulation 1660.

(C) Caterers Planning, Designing and Coordinating Events.

1. Tax applies to charges by a caterer for event planning, design, coordination, and/or supervision if they are made in connection with the furnishing of meals, food, or drinks for the event. Tax does not apply to separately stated charges for services unrelated to the furnishing and serving of meals, food, or drinks, such as optional entertainment or any staff who do not directly participate in the preparation, furnishing, or serving of meals, food, or drinks, e.g., coat-check clerks, parking attendants, security guards, etc.

2. When a caterer sells meals, food, or drinks, and the serving of them, to other persons such as event planners, party coordinators, or fundraisers, who buy and sell the same on their own account or for their own sake, it is a sale for resale for which the caterer may accept a resale certificate. However, a caterer may only claim the sale as a resale if the caterer obtains a resale certificate in compliance with Regulation 1668. A person is buying or selling for his or her own account, or own sake, when such person has his or her own contract with a customer to sell the meals, food, or drinks to the customer, and is not merely acting on behalf of the caterer.

3. When a caterer sells meals, food or drinks and the serving of them to other persons who charge a fee for their service unrelated to the taxable sale, the separately stated fee is not subject to tax.

(D) Sales of Meals by Caterers to Social Clubs, Fraternal Organizations. Sales of meals to social clubs and fraternal organizations, as those terms are defined in subdivision (ij) below, by caterers are sales for resale if such social clubs and fraternal organizations are the retailers of the meals subject to tax under subdivision (ij) and give valid resale certificates therefor.

(E) Tips, Gratuities, or Service Charges. Tips, gratuities, and service charges are discussed in subdivisions (g) and (h).

(4) Premises. General. Separately stated charges for the lease of premises on which meals, food, or drinks are served, are nontaxable leases of real property. Where a charge for leased premises is a guarantee against a minimum purchase of meals, food or drinks, the charge for the guarantee is gross receipts subject to tax. Where a person contracts to provide both premises and meals, food or drinks, the charge for the meals, food or drinks must be reasonable in order for the charge for the premises to be nontaxable~~non-taxable~~.

(5) Private Chefs. A private chef is generally not an employee of the customer, but an independent contractor who pays his or her own social security, and federal and state income

taxes. Such a private chef, who prepares and serves meals, food and drinks in the home of his or her customer is a caterer under this regulation.

(ij) Social Clubs and Fraternal Organizations. "Social Clubs and Fraternal Organizations" as used herein include any corporation, partnership, association or group or combination acting as a unit, such as service clubs, lodges, and community, country, and athletic clubs.

The tax applies to receipts from the furnishing of meals, food, and drink by social clubs and fraternal organizations unless furnished: (1) exclusively to members; and also, (2) less frequently than once a week. Both of these requirements must be met. If the club or organization furnishes meals, food or drink to nonmembers, all receipts from the furnishing of meals, food or drink are subject to tax whether furnished to members or nonmembers, including receipts on occasions when furnished exclusively to members. Meals, food or drink paid for by members are considered furnished to them even though consumed by guests who are not members.

(jk) Student Meals.

(1) Definitions.

(A) "Food Products,": As used herein, the term "food products" as defined in Regulation 1602 (18 CCR 1602) includes food furnished, prepared, or served for consumption at tables, chairs, or counters, or from trays, glasses, dishes, or other tableware provided by the retailer or by a person with whom the retailer contracts to furnish, prepare or serve food to others.

(B) "Meals,": As used herein, the term "meals" includes both food and nonfood products which are sold to students for an established single price at a time set aside for meals. If a single price for the combination of a nonfood product and a food product is listed on a menu or on a sign, a single price has been established. The term "meals" does not include nonfood products which are sold to students for a separate price and tax applies to the sales of such products. Examples of nonfood products are: carbonated beverages and beer. For the purpose of this regulation, products sold at a time designated as a "nutrition break", "recess", or similar break, will not be considered "meals,":

(2) Application of Tax.

(A) Sales by Schools, School Districts and Student Organizations. Sales of meals or food products for human consumption to students of a school by public or private schools, school districts, and student organizations are exempt from tax, except as otherwise provided in (d)(4) above.

(B) Sales by Parent-Teacher Associations. Tax does not apply to the sale of, nor the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served to the students of a school by parent-teacher associations. Parent-teacher associations qualifying under Regulation 1597 as consumers are not retailers of tangible personal property, which they sell. Accordingly, tax does

apply to the sale to such associations of nonfood items such as carbonated beverages, containers, straws and napkins.

(C) Sales by Blind Vendors. Tax does not apply to the sale of meals or food products for human consumption to students of a school by any blind person (as defined in section 19153 of the Welfare and Institutions Code) operating a restaurant or vending stand in an educational institution under article 5 of chapter 6 of part 2 of division 10 of the Welfare and Institutions Code, except as otherwise provided in (d)(4) above.

(D) Sales by Caterers. The application of tax to sales by caterers in general is explained in subdivision (h) above. However, tax does not apply to the sale by caterers of meals or food products for human consumption to students of a school, if all the following criteria are met:

1. The premises used by the caterer to serve the lunches to the students are used by the school for other purposes, such as sporting events and other school activities, during the remainder of the day;
2. The fixtures and equipment used by the caterer are owned and maintained by the school; and
3. The students purchasing the meals cannot distinguish the caterer from the employees of the school.

(k) Employees' Meals.

(1) In General. Any employer or employee organization that is in the business of selling meals, e.g., a restaurant, hotel, club, or association, must include its receipts from the sales of meals to employees, along with its receipts from sales to other purchasers of meals, in the amount upon which it computes its sales tax liability. An employer or an employee organization selling meals only to employees becomes a retailer of meals and liable for sales tax upon its receipts from sales of meals if it sells meals to an average number of five or more employees during the calendar quarter.

(2) Specific Charge. The tax applies only if a specific charge is made to employees for the meals. Tax does not apply to cash paid an employee in lieu of meals. A specific charge is made for meals if:

- (A) Employee pays cash for meals consumed.
- (B) Value of meals is deducted from employee's wages.
- (C) Employee receives meals in lieu of cash to bring compensation up to legal minimum wage.
- (D) Employee has the option to receive cash for meals not consumed.

(3) No Specific Charge. If an employer makes no specific charge for meals consumed by employees, the employer is the consumer of the food products and the ~~nonfood~~ ~~non-food~~ products, which are furnished to the employees as a part of the meals.

In the absence of any of the conditions under ~~(1)(2)(k)-(2)~~ a specific charge is not made if:

(A) A value is assigned to meals as a means of reporting the fair market value of employees' meals pursuant to state and federal laws or regulations or union contracts.

(B) Employees who do not consume available meals have no recourse on their employer for additional cash wages.

(C) Meals are generally available to employees, but the duties of certain employees exclude them from receiving the meals and are paid cash in lieu thereof.

(4) Meals Credited Toward Minimum Wage. If an employee receives meals in lieu of cash to bring his or her compensation up to the legal minimum wage, the amount by which the minimum wage exceeds the amount otherwise paid to the employee is includable in the employer's taxable gross receipts up to the value of the meals credited toward the minimum wage.

For example, if the minimum rate for an eight-hour day is \$46.00, and the employee received \$43.90 in cash, and a lunch is received which is credited toward the minimum wage in the maximum allowable amount of \$2.10, the employer has received gross receipts in the amount of \$2.10 for the lunch.

(5) Tax Reimbursement. If a separately stated amount for tax reimbursement is not added to the price of meals sold to employees for which a specific charge is made, the specific charge will be regarded as being a tax-included charge for the meals.

~~(4m)~~ Religious Organizations. Tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served by any religious organization at a social or other gathering conducted by it or under its auspices, if the purpose in furnishing or serving the meals and food products is to obtain revenue for the functions and activities of the organization and the revenue obtained from furnishing or serving the meals and food products is actually used in carrying on such functions and activities. For the purposes of this regulation, "religious organization" means any organization the property of which is exempt from taxation pursuant to subdivision (f) of section 3 of article XIII of the State Constitution.

~~(4n)~~ Institutions. Tax does not apply to the sale of, nor the storage, use, or other consumption in this state of, meals and food products for human consumption furnished or served to and consumed by patients or residents of an "institution" as defined in Regulation 1503. Tax, however, does apply to the sale of meals and food products by an institution to persons other than patients or residents of the institution.

(~~ho~~) Meal Programs for Low-Income Elderly Persons. Tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served to low-income elderly persons at or below cost by a nonprofit organization or governmental agency under a program funded by this state or the United States for such purposes.

(~~hp~~) Food Products, Nonalcoholic Beverages and Other Tangible Personal Property Transferred by Nonprofit Youth Organizations. See Regulation 1597 for the application of tax on food products, nonalcoholic beverages and other tangible personal property transferred by nonprofit youth organizations.

(~~hq~~) Nonprofit Parent-Teacher Associations. Nonprofit parent-teacher associations and equivalent organizations qualifying under Regulation 1597 are consumers and not retailers of tangible personal property, which they sell.

(~~hr~~) Meals and Food Products Served to Condominium Residents. Tax does not apply to the sale of, and the storage, use, or other consumption in this state of meals and food products for human consumption furnished to and consumed by persons 62 years of age or older residing in a condominium and who own equal shares in a common kitchen facility; provided, that the meals and food products are served to such persons on a regular basis.

This exemption is applicable only to sales of meals and food products for human consumption prepared and served at the common kitchen facility of the condominium. Tax applies to sales to persons less than 62 years of age.

(~~hs~~) Veteran's Organization. Beginning April 1, 2004, tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served by any nonprofit veteran's organization at a social or other gathering conducted by it or under its auspices, if the purpose in furnishing or serving the meals and food products is to obtain revenue for the functions and activities of the organization and the revenue obtained from furnishing or serving the meals and food products is actually used in carrying on those functions and activities.

(~~ht~~) Food Stamp Coupons. Tax does not apply to tangible personal property which is eligible to be purchased with federal food stamp coupons acquired pursuant to the Food Stamp Act of 1977 and so purchased. When payment is made in the form of both food stamps and cash, the amount of the food stamp coupons must be applied first to tangible personal property normally subject to the tax, e.g., nonalcoholic carbonated beverages. Retailers are prohibited from adding any amount designated as sales tax, use tax, or sales tax reimbursement to sales of tangible personal property purchased with food stamp coupons. (See paragraph (c) of Regulation 1602.5 for special reporting provisions by grocers.)

(~~hu~~) Honor System Snack Sales. An "honor system snack sale" means a system where customers take snacks from a box or tray and pay by depositing money in a container provided by the seller. Snacks sold through such a system may be subject to tax depending upon where the sale

takes place. Sales of such snacks are taxable when sold at or near a lunchroom, break room, or other facility that provides tables and chairs, and it is contemplated that the food sold will normally be consumed at such facilities. Honor system snack sales do not include hotel room mini-bars or snack baskets.

(uv) Mobile Food Vendors. Mobile food vendors include retailers who sell food and beverages for immediate consumption from motorized vehicles or un-motorized carts. Examples of mobile food vendors include food trucks, coffee carts, and hot dog carts. For sales made on or after July 1, 2014, unless a separate amount for tax reimbursement is added to the price, mobile food vendors' sales of taxable items are presumed to be made on a tax-included basis.

This presumption does not apply when a mobile food vendor is making sales as a "caterer" as defined in (hi)(1).

1 The records acceptable in support of such a deduction are:

- (a) A sales ticket prepared for each transaction claimed as being tax exempt showing:
 - (1) Date of the sale,
 - (2) The kind of merchandise sold,
 - (3) The quantity of each kind of merchandise sold,
 - (4) The price of each kind of merchandise sold,
 - (5) The total price of merchandise sold,
 - (6) A statement to the effect that the merchandise purchased is not to be consumed on or near the location at which parking facilities are provided by the retailer, and
- (b) A daily sales record kept in sufficient detail to permit verification by audit that all gross receipts from sales have been accounted for and that all sales claimed as being tax exempt are included therein.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374 and 6376.5, Revenue and Taxation Code. Food Products Generally, see Regulation 1602. Sales tax reimbursement, see Regulation 1700. Meals served to residents or patients of an institution, see Regulation 1503. Food products sold through vending machines, see Regulation 1574. Meals at organized camps, see Regulation 1506. Nonprofit organizations as consumers, see Regulation 1597.

Appendix A

California Sales Tax Exemption Certificate
Supporting Exemption Under Section 6359.1

The undersigned certifies that it is an air carrier engaged in interstate or foreign commerce and that the hot prepared food products purchased from _____ will be consumed by passengers on its flights.

The undersigned further certifies that it understands and agrees that if the property purchased under this certificate is used by the purchaser for any purpose other than that specified above, the purchaser shall be liable for sales tax as if it were a retailer making a retail sale of the property at the time of such use, and the sales price of the property to it shall be deemed the gross receipts from such sale.

Date Certificate Given _____

Purchasing Air Carrier _____
(company name)

Address _____

Signed By _____
(signature of authorized person)

(print or type name)

Title _____
(owner, partner, purchasing agent, etc.)

Seller's Permit No. (if any) _____

~~Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374 and 6376.5, Revenue and Taxation Code.~~

~~Food Products Generally, see Regulation 1602.~~

~~Alcoholic Beverages, tax reimbursements when served with, see Regulation 1700.~~

~~"Free" meals with purchased meals, see Regulation 1670.~~

~~Meals served to patients and inmates of an institution, see Regulation 1503.~~

~~Vending Machines, when considered selling meals, see Regulation 1574.~~

~~Meals at summer camps, see Regulation 1506(e).~~

~~Parent-Teacher associations as consumers, see Regulation 1597.~~

Mr. Charlie Ridenour
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WHERE DO I GET INFORMATION?

Copies of these documents, key technical reports, and other site-related information are available:

In Person (By Appointment only):
DTSC Regional Records Office
File Room
8800 Cal Centre Drive
Sacramento, CA 95826

By Internet:
DTSC Envirostor Website
https://www.envirostor.dtsc.ca.gov/public/profile_report.asp?global_id=34370014

Please click on the Community Involvement tab.

By Mail (Per your request):
Mr. Charlie Ridenour
DTSC
8800 Cal Centre Drive
Sacramento, CA 95826
(916) 255-6442
Charlie.Ridenour@dtsc.ca.gov

SUMMARY OF REGULATORY ACTIONS

REGULATIONS FILED WITH SECRETARY OF STATE

This Summary of Regulatory Actions lists regulations filed with the Secretary of State on the dates indicated. Copies of the regulations may be obtained by contacting the agency or from the Secretary of State, Archives, 1020 O Street, Sacramento, CA 95814, (916) 653-7715. Please have the agency name and the date filed (see below) when making a request.

File# 2014-0924-01
BOARD OF EQUALIZATION
Taxable Sales of Food Products

This regular rulemaking by the Board of Equalization (“BOE”) amends 18 CCR § 1603 to resolve confusion on the part of some retailers regarding what constitutes “mandatory” versus “optional” tips, gratuities, and service charges. An optional payment designated as a tip, gratuity, or service charge is not subject to tax. A mandatory payment designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if the amount is subsequently paid by the retailer to employees. This rulemaking amends Section 1603 by establishing a bright-line approach to how to treat amounts added by retailers to customers’ bills consistent with how the retailers treat these amounts for Internal Revenue Service (“IRS”) purposes. The amendments also include other technical and non-substantive amendments to Section 1603, including updating cross-references and moving the Authority and Reference citations so that they precede instead of follow Appendix A.

Title 18
California Code of Regulations
AMEND: 1603
Filed 11/05/2014
Effective 01/01/2015
Agency Contact:
Richard E. Bennion (916)445-2130

File# 2014-1014-01
BOARD OF STATE AND COMMUNITY CORRECTIONS
Conflict-of-Interest Code

This is a Conflict-of-Interest code filing that has been approved by the Fair Political Practices Commission on October 3, 2014, and is being submitted for filing with the Secretary of State and printing only.

Title 15
California Code of Regulations
ADOPT: 1
Filed 11/05/2014
Effective 12/05/2014
Agency Contact: Ginger Wolfe (916)341-7325

File# 2014-0923-01
CALIFORNIA HIGHWAY PATROL
CVSA North American Standard Out-of-Service Criteria

This rulemaking action by the California Highway Patrol amends section 1239, Title 13, of the California Code of Regulations to reflect changes in the North American Standard Out-of-Service Criteria, which is incorporated by reference.

Rulemaking File Index
Title 18. Public Revenue
Sales and Use Tax

Regulation 1603, *Taxable Sales of Food Products*

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 - CA Regulatory Notice Register 2014, Volume No. 25-Z
8. [Notice to Interested Parties, June 20, 2014](#)

The following items are exhibited:

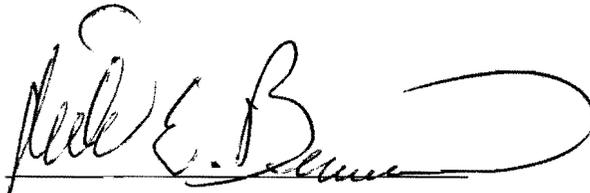
 - Notice of Hearing
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VERIFICATION

I, Richard E. Bennion, Regulations Coordinator of the State Board of Equalization, state that the rulemaking file of which the contents as listed in the index is complete, and that the record was closed on September 23, 2014 and that the attached copy is complete.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

September 23, 2014

A handwritten signature in black ink, appearing to read "Richard E. Bennion", with a large, sweeping flourish at the end.

Richard E. Bennion
Regulations Coordinator
State Board of Equalization

**Final Statement of Reasons for the Adoption of the
Proposed Amendments to California Code of Regulations,
Title 18, Section 1603, *Taxable Sales of Food Products***

Update of Information in the Initial Statement of Reasons

The State Board of Equalization (Board) held a public hearing regarding the proposed amendments to California Code of Regulations, title 18, section (Regulation) 1603, *Taxable Sales of Food Products*, on August 5, 2014. During the public hearing, the Board unanimously voted to adopt the proposed amendments to Regulation 1603 without making any changes. The Board did not receive any written comments regarding the proposed regulatory action and no interested parties appeared at the public hearing on August 5, 2014, to comment on the proposed regulatory action.

The factual basis, specific purpose, and necessity for, the problem to be addressed by, and the anticipated benefits from the adoption of the proposed amendments to Regulation 1603 are the same as provided in the initial statement of reasons. The Board anticipates that the proposed amendments to Regulation 1603 will promote fairness and benefit taxpayers, Board staff, and the Board by providing regulatory provisions that may be applied using a bright-line approach that is consistent with federal tax reporting, and thereby reduce confusion for retailers and staff.

The adoption of the proposed amendments to Regulation 1603 is not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Regulation 1603 or the proposed amendments to Regulation 1603.

The Board did not rely on any data or any technical, theoretical, or empirical study, report, or similar document in proposing or adopting the proposed amendments to Regulation 1603 that was not identified in the initial statement of reasons, or which was otherwise not identified or made available for public review prior to the close of the public comment period.

In addition, the factual basis has not changed for the Board's initial determination that the proposed regulatory action will not have a significant adverse economic impact on business, the Board's determination that the proposed regulatory action is not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, and the Board's economic impact assessment, which determined that the Board's proposed regulatory action:

- Will neither create nor eliminate jobs in the State of California;
- Nor result in the elimination of existing businesses;
- Nor create or expand business in the State of California; and
- Will not affect the benefits of Regulation 1603 to the health and welfare of California residents, worker safety, or the state's environment.

The proposed amendments to Regulation 1603 may affect small business.

The notice of proposed regulatory action and the initial statement of reasons each include an inadvertent typographical error explaining that Formal Issue Paper 14-003 recommended that the amendments adding new subdivision (h) to Regulation 1603 apply to sales made on or after July 1, 2015, instead of January 1, 2015.

No Mandate on Local Agencies or School Districts

The Board has determined that the adoption of the proposed amendments to Regulation 1603 does not impose a mandate on local agencies or school districts.

No Public Comments

The Board did not receive any written comments regarding the proposed regulatory action and no interested parties appeared at the public hearing on August 5, 2014, to comment on the proposed regulatory action.

Determinations Regarding Alternatives

By its motion on August 5, 2014, the Board determined that no alternative to the proposed amendments to Regulation 1603 would be more effective in carrying out the purpose for which the amendments are proposed, would be as effective and less burdensome to affected private persons than the adopted amendments, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provisions of law.

The Board did not reject any reasonable alternatives to the proposed amendments to Regulation 1603 that would lessen any adverse impact the proposed amendments may have on small business.

No reasonable alternatives have been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

**Updated Informative Digest for the State Board of Equalization’s
Adoption of Proposed Amendments to California Code of Regulations,
Title 18, Section 1603, *Taxable Sales of Food Products***

The State Board of Equalization (Board) held a public hearing regarding the proposed amendments to California Code of Regulations, title 18, section (Regulation) 1603, *Taxable Sales of Food Products*, on August 5, 2014. During the public hearing, the Board unanimously voted to adopt the proposed amendments to Regulation 1603 without making any changes.

The Board did not receive any written comments regarding the proposed regulatory action and no interested parties appeared at the public hearing on August 5, 2014, to comment on the proposed regulatory action. There have not been any changes to the applicable laws or the effect of, the objective of, and anticipated benefits from the adoption of the proposed amendments to Regulation 1603 described in the informative digest included in the notice of proposed regulatory action. The informative digest included in the notice of proposed regulatory action provides:

Summary of Existing Laws and Regulations

California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (RTC, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer’s gross receipts from the retail sale of tangible personal property in California. (RTC, §§ 6012, 6051.) The term “gross receipts” means the total amount of the sale price without any deduction for the cost of materials used, labor or service costs, interest paid, losses, or any other expense. (RTC, § 6012, subd. (a)(2).) Gross receipts include any services that are part of the sale and all receipts, cash, credits, and property of any kind. (RTC, § 6012.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700, subd. (a)(1).)

Sales of food products for human consumption are generally exempt from tax. However, this exemption does not apply to sales of food products furnished, prepared, or served for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware whether provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others, or to sales of food products served as meals on or off the premises of the retailer. (RTC, § 6359.) Therefore, issues arise as to whether payments designated as tips, gratuities, and service charges that are related to the taxable sale of food products are includible in retailers’ gross receipts.

Under Regulation 1603, subdivision (g), optional payments designated as tips, gratuities, and service charges are not subject to tax (and not included in a retailer's gross receipts); however, mandatory payments designated as tips, gratuities, and service charges are included in gross receipts subject to tax, even if the amount is subsequently paid by the retailer to the server.

On June 25, 2012, the Internal Revenue Service published Internal Revenue Bulletin No. 2012-26, which includes Revenue Ruling 2012-18. This revenue ruling clarified and updated guidelines on taxes imposed on tips under the Federal Insurance Contributions Act, including information on the difference between tips (tip wages) and service charges (non-tip wages). The ruling reaffirmed prior guidance which provided that the absence of any of the following four factors creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge: 1. The payment must be made free from compulsion; 2. The customer must have the unrestricted right to determine the amount; 3. The payment should not be the subject of negotiation or dictated by employer policy; 4. Generally, the customer has the right to determine who receives the payment.

Effect, Objective, and Benefits of the Proposed Amendments to Regulation 1603

Although Regulation 1603, subdivision (g), was amended in 2007 to clarify the application of tax to tips, gratuities and service charges, it has become evident to Board staff that some retailers are having compliance issues because there is still some remaining confusion regarding what constitutes "mandatory" versus "optional" tips, gratuities, and service charges. The proposed amendments to Regulation 1603 are intended to have the effect and accomplish the objective of addressing these retailers' compliance issues by establishing a bright-line approach to how to treat amounts added by retailers to customers' bills that is consistent with how the retailers treated the amounts for Internal Revenue Service purposes. This new approach will ease compliance for retailers by making it clear that the application of sales tax to the transactions at issue is consistent with federal tax reporting requirements.

Interested Parties Process

Originally, the Board's Business Taxes Committee (BTC) staff prepared draft amendments to subdivision (g) of Regulation 1603 to address the retailers' compliance issues. The draft amendments suggested adding provisions to the regulation explaining that when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. The draft amendments also provided that a payment of a

tip, gratuity, or service charge is deemed to be mandatory if the amounts are required to be reported, for the purposes of income tax to the Internal Revenue Service, as non-tip wages, and the amendments listed the four factors from Revenue Ruling 2012-18 that the Internal Revenue Service examines to determine if a payment is a tip or service charge (non-tip wage). The draft amendments also clarified subdivision (g)'s existing language and deleted provisions of subdivision (g) that had caused confusion to retailers and staff. The draft amendments also made non-substantive changes to the regulation by updating cross-references and making strictly grammatical changes throughout the regulation. The draft amendments also updated the cross-reference to other regulations following the regulations authority and reference note. Additionally, the draft amendments moved the note section to a point preceding the appendix to the regulation.

BTC staff subsequently provided its draft amendments to Regulation 1603 to the interested parties and conducted an interested parties meeting in December 2013, to discuss the draft amendments. During the December 2013 meeting, interested parties appeared open to staff's proposal and there was a general consensus that creating a bright-line approach with respect to tips, gratuities, and service charges would be helpful to the restaurant industry and staff. Also, participants discussed the effect of the presumption and asked BTC staff what would happen if a retailer did not maintain records for purposes of its federal income tax reporting.

Subsequent to the December 2013 interested parties meeting, staff received letters from Kara Bush on behalf of the California Restaurant Association and from James Dumler of McClellan Davis, LLC. Both letters were dated January 10, 2014. In the first letter, Ms. Bush expressed the California Restaurant Association's appreciation of the Board's efforts to clarify this issue and that the association looks forward to continuing to work with staff and other interested parties to develop a bright-line approach that will foster reporting compliance and audit efficiency. Ms. Bush also expressed appreciation for staff's suggestions and stated that the association will continue to explore other alternatives. In the second letter, Mr. Dumler reiterated concerns expressed during the interested parties meeting that a taxpayer that lacks support for the IRS tip designations would not benefit from the proposed presumption and optional gratuities could incorrectly be presumed to be mandatory. Mr. Dumler also recommended that the examples in the current regulation with respect to mandatory payments be retained.

In response to the concerns expressed at the December 2013 interested parties meeting, staff added language to its draft amendments clarifying the application of the new presumption regarding federal tax reporting and also added provisions to determine whether a payment is "optional" or

“mandatory” when a retailer does not maintain records for purposes of reporting tips to the IRS. When a retailer does not maintain these records, the determination of whether or not the payments are mandatory is consistent with the provisions currently in Regulation 1603, subdivision (g). Additionally, staff added clarifying language to its draft amendments to define the term “amount” as a payment designated as a tip, gratuity, or service charge, or any other separately stated payment for services associated with the purchase of meals, food, or drinks. This amendment was made to reduce historical confusion associated with the use of the word “amount” to refer to payments throughout subdivision (g). Also, due to perceived confusion with staff applying the four factors from Revenue Ruling 2012-18 (referred to above), these factors were deleted from staff’s draft amendments.

In February 2014, staff again met with interested parties to discuss the draft amendments. Staff and interested parties discussed how to make it clear that the draft amendments are only to apply prospectively.

Following the February 2014, interested parties meeting, staff received a letter from Mr. Matt Sutton, sent on behalf of the California Restaurant Association. In his March 6, 2014, letter, Mr. Sutton explained that while the California Restaurant Association has historically disagreed with the taxation of mandatory gratuities, it was appreciative of staff’s ideas and acknowledged that the suggestions for a “bright line” approach, discussed in the discussion papers and both interested parties meetings, have merit. Mr. Sutton further stated that it remains to be seen how the industry will respond to the Internal Revenue Service guidance and how that will interplay with the Board’s practice of taxing mandatory tips.

May 22, 2014, BTC Meeting

Staff made changes to its draft amendments to Regulation 1603 in response to the discussion of the prospective application of the draft amendments at the February 2014 interested parties meeting. Staff changed the draft amendments so that subdivision (g) of Regulation 1603 continues to apply to transactions prior to January 1, 2015, and new subdivision (h), containing what had previously been staff’s draft amendments to subdivision (g), will apply to transactions on and after January 1, 2015. Staff also changed the draft amendments in order to renumber the subdivisions of the regulation following new subdivision (h), and update the regulation’s cross-reference to the renumbered subdivisions.

Subsequently, BTC staff prepared Formal Issue Paper 14-003 and distributed it to the Board Members for consideration at the Board’s May 22, 2014, BTC meeting. Formal Issue Paper 14-003 recommended

that the Board propose to add new subdivision (h) to Regulation 1603 to define the term “amount,” and provide that, for sales made on and after [January¹] 1, 2015, when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. Additionally, new subdivision (h) provides that when a retailer’s records reflect that amounts are required to be reported to the Internal Revenue Service as non-tip wages, the amount is deemed to be mandatory. Finally, new subdivision (h) provides that when a retailer does not maintain records for purposes of reporting amounts to the Internal Revenue Service, the application of tax to the amounts will be consistent with the provisions currently in Regulation 1603, subdivision (g). The formal issue paper also recommended making non-substantive amendments to the regulation.

The Board discussed Formal Issue Paper 14-003 during its May 22, 2014, BTC meeting. Mr. Matt Sutton appeared on behalf of the California Restaurant Association and made statements similar to those in his March 6, 2014, letter. At the conclusion of the discussion, the Board Members voted 4-0 to propose the amendments to Regulation 1603 recommended in the formal issue paper, subject to conforming to the official text of the regulation at the time of publication. The Board determined that the proposed amendments to Regulation 1603 are necessary to have the effect and accomplish the objective of addressing retailers’ compliance issues by establishing a bright-line approach to how to treat amounts added by retailers to customers’ bills that is consistent with how the retailers treated the amounts for Internal Revenue Service purposes.

The Board also anticipates that the proposed amendments to Regulation 1603 will promote fairness and benefit retailers, Board staff, and the Board by providing regulatory provisions that may be applied using a bright-line approach that is consistent with federal tax reporting requirements on these transactions, and thereby reduce confusion for retailers and staff.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1603 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations. This is because there are no other sales and use tax regulations that specifically apply to restaurants’ and similar establishments’ collection of amounts as tips, gratuities, and service charges. In addition, the Board has determined that there are no comparable federal regulations or statutes to Regulation 1603 or the proposed amendments to Regulation 1603.

¹ The informative digest in the notice of proposed regulatory action contained a typographical error indicating the month of July instead of January.



BOARD OF EQUALIZATION

BUSINESS TAXES COMMITTEE MEETING MINUTES

HONORABLE MICHELLE STEEL, COMMITTEE CHAIR

450 N STREET, SACRAMENTO

MEETING DATE: MAY 22, 2014, TIME: 10:00 A.M.

ACTION ITEMS & STATUS REPORT ITEMS

Agenda Item No: 1

Title: Proposed Amendments to Regulation 1603, *Taxable Sales of Food Products (Tips, Gratuities, and Service Charges)*.

Issue:

Whether the Board should amend Sales and Use Tax Regulation 1603 to clarify the application of tax to tips, gratuities, and service charges.

Committee Discussion:

Staff introduced the issue. Mr. Matt Sutton, from the California Restaurant Association, thanked the Board and staff and stated that the proposed amendments provide clarification. Ms. Steel thanked staff for including regulatory language that will assist small businesses.

Committee Action:

Upon motion by Mr. Runner and seconded by Ms. Yee, without objection, the Committee approved and authorized for publication the proposed amendments to Regulation 1603, *Taxable Sales of Food Products*. A copy of the proposed amendments to Regulation 1603 is attached.

Honorable Michelle Steel, Committee Chair

Cynthia Bridges, Executive Director

BOARD APPROVED

at the 5/22/14 Board Meeting

Joann Richmond, Chief

Board Proceedings Division

Sales and Use Tax Regulation 1603. *Taxable Sales of Food Products.*

(a) Restaurants, Hotels, Boarding Houses, Soda Fountains, and Similar Establishments.

(1) Definitions.

(A) Boarding House. The term "boarding house" as used in this regulation means any establishment regularly serving meals, on the average to five or more paying guests. The term includes a "guest home," "residential care home," "halfway house," and any other establishment providing room and board or board only, which is not an institution as defined in Regulation 1503 and section 6363.6 of the Revenue and Taxation Code. The fact that guests may be recipients of welfare funds does not affect the application of tax. A person or establishment furnishing meals on the average to fewer than five paying guests during the calendar quarter is not considered to be engaged in the business of selling meals at retail.

(B) American Plan Hotel. The term "American Plan Hotel" as used in this regulation means a hotel which charges guests a fixed sum by the day, week, or other period for room and meals combined.

(C) Complimentary Food and Beverages. As used in this subdivision (a), the term "complimentary food and beverages" means food and beverages (including alcoholic and non-alcoholic beverages) which are provided to transient guests on a complimentary basis and:

1. There is no segregation between the charges for rooms and the charges for the food and beverages on the guests' bills, and
2. The guests are not given an option to refuse the food and beverages in return for a discounted room rental.

(D) Average Retail Value of Complimentary Food and Beverages. The term "average retail value of complimentary food and beverages" (ARV) as used in this regulation means the total amount of the costs of the complimentary food and beverages for the preceding calendar year marked-up one hundred percent (100%) and divided by the number of rooms rented for that year. Costs of complimentary food and beverages include charges for delivery to the lodging establishment but exclude discounts taken and sales tax reimbursement paid to vendors. The 100% markup factor includes the cost of food preparation labor by hotel employees, the fair rental value of hotel facilities used to prepare or serve the food and beverages, and profit.

(E) Average Daily Rate. The term "average daily rate" (ADR) as used in this regulation means the gross room revenue for the preceding calendar year divided by the number of rooms rented for that year. "Gross room revenue" means and includes the full charge to the hotel customers but excludes separately stated occupancy taxes, revenue from contract and group rentals which do not qualify for complimentary food and beverages, and revenue from special packages (e.g., New Year's Eve packages which include food and beverages as well as guest room accommodations), unless it can be documented that the retail value of the food and beverages provided as a part of the special package is 10% or less of the total package charge as provided in subdivision (a)(2)(B). "Number of rooms rented for that year" means the total number of times all rooms have been rented

The proposed regulation contained in this document may not be adopted. Any version that is adopted may differ from this text.

on a nightly basis provided the revenue for those rooms is included in the "gross room revenue." For example, if a room is rented out for three consecutive nights by one guest, that room will be counted as rented three times when computing the ADR.

(2) Application Of Tax.

(A) In General. Tax applies to sales of meals or hot prepared food products (see (e) below) furnished by restaurants, concessionaires, hotels, boarding houses, soda fountains, and similar establishments whether served on or off the premises. In the case of American Plan ~~H~~hotels, special packages offered by hotels, e.g., a New Year's Eve package as described in subdivision (a)(1)(E), and boarding houses, a reasonable segregation must be made between the charges for rooms and the charges for the meals, hot prepared food products, and beverages. Charges by hotels or boarding houses for delivering meals or hot prepared food products to, or serving them in, the rooms of guests are includable in the measure of tax on the sales of the meals or hot prepared food products whether or not the charges are separately stated. (Caterers, see (~~ih~~) below.) Sales of meals or hot prepared food products by restaurants, concessionaires, hotels, boarding houses, soda fountains, and similar establishments to persons such as event planners, party coordinators, or fundraisers, which buy and sell on their own account, are sales for resale for which a resale certificate may be accepted. (sSee subdivision (~~ih~~)(3)(C)2.)

Souffle cups, straws, paper napkins, toothpicks and like items that are not of a reusable character which are furnished with meals or hot prepared food products are sold with the meals or hot prepared food products. Sales of such items for such purpose to persons engaged in the business of selling meals or hot prepared food products are, accordingly, sales for resale.

(B) Complimentary Food and Beverages. Lodging establishments which furnish, prepare, or serve complimentary food and beverages to guests in connection with the rental of rooms are consumers and not retailers of such food and beverages when the retail value of the complimentary food and beverages is "incidental" to the room rental service regardless of where within the hotel premises the complimentary food and beverages are served. For complimentary food and beverages to qualify as "incidental" for the current calendar year, the average retail value of the complimentary food and beverages (ARV) furnished for the preceding calendar year must be equal to or less than 10% of the average daily rate (ADR) for that year.

If a hotel provides guests with coupons or similar documents which may be exchanged for complimentary food and beverages in an area of the hotel where food and beverages are sold on a regular basis to the general public (e.g., a restaurant), the hotel will be considered the consumer and not the retailer of such food and beverages if the coupons or similar documents are non-transferable and the guest is specifically identified by name. If the coupons or similar documents are transferable or the guest is not specifically identified, food and beverages provided will be considered sold to the guest at the fair retail value of similar food and beverages sold to the general public. In the case of coupons redeemed by guests at restaurants not operated by the lodging establishment, the hotel will be considered the consumer of food and beverages provided to the hotel's guests and tax will apply to the charge by the restaurant to the hotel.

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Lodging establishments are retailers of food and beverages which do not qualify as "incidental" and tax applies as provided in subdivision (a)(2)(A) above. Amounts paid by guests for food and beverages in excess of a complimentary allowance are gross receipts subject to the tax. Lodging establishments are retailers of otherwise complimentary food and beverages sold to non-guests.

In the case of hotels with concierge floor, club level or similar programs, the formula set forth above shall be applied separately with respect to the complimentary food and beverages furnished to guests who participate in the concierge, club or similar program. That is, the concierge, club or similar program will be deemed to be an independent hotel separate and apart from the hotel in which it is operated. The ADR and the retail value of complimentary food and beverages per occupied room will be computed separately with respect to the guest room accommodations entitled to the privileges and amenities involved in the concierge, club or similar program.

The following example illustrates the steps in determining whether the food and beverages are complimentary:

FORMULA:	$ARV/ADR \leq 10\%$
Average Daily Rate (ADR):	
Room Revenue	\$9,108,000
Rooms Rented	74,607
ADR (\$9,108,000/74,607)	\$122.08
Average Retail Value of Complimentary	
Food and Beverages (ARV):	
Complimentary Food Cost	\$169,057
Complimentary Beverage Cost	52,513
Total	\$221,570
Add 100% Markup	221,570
Average Retail Value	\$443,140
ARV per occupied room (\$443,140/74,607)	\$5.94
Application of Formula:	$\$5.94/\$122.08 = 4.87\%$

In the above example, the average retail value of the complimentary food and beverages per occupied room for the preceding calendar year is equal to or less than 10% of the average daily rate. Therefore, under the provisions of this subdivision (a)(2)(B), the complimentary food and beverages provided to guests for the current calendar year qualify as "incidental." The lodging establishment is the consumer and not the retailer of such food and beverages. This computation must be made annually.

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When a lodging establishment consists of more than one location, the operations of each location will be considered separately in determining if that location's complimentary food and beverages qualify as incidental.

(C) "Free" Meals. When a restaurant agrees to furnish a "free" meal to a customer who purchases another meal and presents a coupon or card, which the customer previously had purchased directly from the restaurant or through a sales promotional agency having a contract with the restaurant to redeem the coupons or cards, the restaurant is regarded as selling two meals for the price of one, plus any additional compensation from the agency or from its own sales of coupons. Any such additional compensation is a part of its taxable gross receipts for the period in which the meals are served.

Tax applies only to the price of the paid meal plus any such additional compensation.

(b) "Drive-Ins." Tax applies to sales of food products ordinarily sold for immediate consumption on or near a location at which parking facilities are provided primarily for the use of patrons in consuming the products purchased at the "drive-in" establishment, even though such products are sold on a "take out" or "to go" order and are actually packaged or wrapped and taken from the premises of the retailer. Food products when sold in bulk, i.e., in quantities or in a form not suitable for consumption on the retailer's premises, are not regarded as ordinarily sold for immediate consumption on or near the location at which parking facilities are provided by the retailer. Accordingly, with the exception of sales of hot prepared food products (see (e) below) and sales of cold food under the 80-80 rule (see (c) below), sales of ice cream, doughnuts, and other individual food items in quantities obviously not intended for consumption on the retailer's premises, without eating utensils, trays, or dishes and not consumed on the retailer's premises, are exempt from tax. Any retailer claiming a deduction on account of food sales of this type must support the deduction by complete and detailed records.¹

(c) Cold Food Sold on a "Take-Out" Order.

(1) General.

(A) Seller Meeting Criteria of 80-80 Rule. When a seller meets both criteria of the 80-80 rule as explained in subdivision (c)(3) below, tax applies to sales of cold food products (including sales for a separate price of hot bakery goods and hot beverages such as coffee) in a form suitable for consumption on the seller's premises even though such food products are sold on a "take-out" or "to go" order. Sales of cold food products which are suitable for consumption on the seller's premises are subject to the tax no matter how great the quantity purchased, e.g., 40 one-half pint containers of milk. Except as provided elsewhere in this regulation, tax does not apply to sales of food products which are furnished in a form not suitable for consumption on the seller's premises.

Operative April 1, 1996, although a seller may meet both criteria of the 80-80 rule, he or she may elect to separately account for the sale of "take-out" or "to go" orders of cold food products which are in a form suitable for consumption on the seller's premises. The gross receipts from the sale of those food products shall be exempt from the tax provided the seller keeps a separate accounting of these transactions in his or her records. Tax will remain applicable to the sale of food products as provided in subdivisions (a), (b), (e), or (f) of this regulation. Failure to maintain the required separate accounting and

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documentation claimed as exempt under this subdivision will revoke the seller's election under this subdivision.

(B) Seller Not Meeting Criteria of 80-80 Rule. When a seller does not meet both criteria of the 80-80 rule as explained in subdivision (c)(3) below, tax does not apply to sales of cold food products (including sales for a separate price of hot bakery goods and hot beverages such as coffee) when sold on a "take-out" or "to go" order.

(2) Definitions.

(A) For purposes of this subdivision (c), the term "suitable for consumption on the seller's premises" means food products furnished:

1. In a form which requires no further processing by the purchaser, including but not limited to cooking, heating, thawing, or slicing, and
2. In a size which ordinarily may be immediately consumed by one person such as a large milk shake, a pint of ice cream, a pint of milk, or a slice of pie. Cold food products (excluding milk shakes and similar milk products) furnished in containers larger in size than a pint are considered to be in a form not suitable for immediate consumption.

Pieces of candy sold in bulk quantities of one pound or greater are deemed to be sold in a form not suitable for consumption on the seller's premises.

The term does not include cold food products which obviously would not be consumed on the premises of the seller, e.g., a cold party tray or a whole cold chicken.

(B) For purposes of this subdivision (c), the term "seller's premises" means the individual location at which a sale takes place rather than the aggregate of all locations of the seller. For example, if a seller operates several drive-in and fast food restaurants, the operations of each location stand alone and are considered separately in determining if the sales of food products at each location meet the criteria of the 80-80 rule.

When two or more food-selling activities are conducted by the same person at the same location, the operations of all food related activities will be considered in determining if the sales of food products meet the criteria of the 80-80 rule. For example, if a seller operates a grocery store and a restaurant with no physical separation other than separate cash registers, the grocery store operations will be included in determining if the sales of food products meet the criteria of the 80-80 rule. When there is a physical separation where customers of one operation may not pass freely into the other operation, e.g., separate rooms with separate entrances but a common kitchen, each operation will be considered separately for purposes of this subdivision (c).

(3) 80-80 Rule. Tax applies under this subdivision (c) only if the seller meets both of the following criteria:

- (A) More than 80 percent of the seller's gross receipts are from the sale of food products, and
- (B) More than 80 percent of the seller's retail sales of food products are taxable as provided in subdivisions (a), (b), (e), and (f) of this regulation.

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Sales of alcoholic beverages, carbonated beverages, or cold food to go not suitable for immediate consumption should not be included in this computation. Any seller meeting both of these criteria and claiming a deduction for the sale of cold food products in a form not suitable for consumption on the seller's premises must support the deduction by complete and detailed records of such sales made.

(d) Places Where Admission Is Charged.

(1) General. Tax applies to sales of food products when sold within, and for consumption within, a place the entrance to which is subject to an admission charge, during the period when the sales are made, except for national and state parks and monuments, and marinas, campgrounds, and recreational vehicle parks.

(2) Definitions.

(A) "Place" means an area the exterior boundaries of which are defined by walls, fences or otherwise in such a manner that the area readily can be recognized and distinguished from adjoining or surrounding property. Examples include buildings, fenced enclosures and areas delimited by posted signs.

(B) "Within a place" means inside the door, gate, turnstile, or other point at which the customer must pay an admission charge or present evidence, such as a ticket, that an admission charge has been paid. Adjacent to, or in close proximity to, a place is not within a place.

(C) "Admission charge" means any consideration required to be paid in money or otherwise, for admittance to a place.

"Admission charge" does not include:

1. Membership dues in a club or other organization entitling the member to, among other things, entrance to a place maintained by the club or organization, such as a fenced area containing a club house, tennis courts, and a swimming pool. Where a guest is admitted to such a place only when accompanied by or vouched for by a member of the club or organization, any charge made to the guest for use of facilities in the place is not an admission charge.
2. A charge for a student body card entitling the student to, among other things, entrance to a place, such as entrance to a school auditorium at which a dance is held.
3. A charge for the use of facilities within a place to which no entrance charge is made to spectators. For example, green fees paid for the privilege of playing a golf course, a charge made to swimmers for the use of a pool within a place, or a charge made for the use of lanes in a public bowling place.

(D) "National and state parks and monuments" means those which are part of the National Park System or the State Park System. The phrase does not include parks and monuments not within either of those systems, such as city, county, regional, district or private parks.

(3) Presumption That Food Is Sold for Consumption Within a Place-

When food products are sold within a place the entrance to which is subject to an admission charge, it will be presumed, in the absence of evidence to the contrary, that the food products

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are sold for consumption within the place. Obtaining and retaining evidence in support of the claimed tax exemption is the responsibility of the retailer. Such evidence may consist, for example, of proof that the sales were of canned jams, cake mixes, spices, cooking chocolate, or other items in a form in which it is unlikely that such items would be consumed within the place where sold.

(4) Food Sold to Students. The exemption otherwise granted by Section 6363 does not apply to sales of food products to students when sold within, and for consumption within, a place the entrance to which is subject to an admission charge, and such sales are subject to tax except as provided in (qp) of this regulation. For example, when food products are sold by a student organization to students or to both students and nonstudents within a place the entrance to which is subject to an admission charge, such as a place where school athletic events are held, the sales to both students and nonstudents are taxable.

(e) Hot Prepared Food Products.

(1) General. Tax applies to all sales of hot prepared food products unless otherwise exempt. "Hot prepared food products" means those products, items, or components which have been prepared for sale in a heated condition and which are sold at any temperature which is higher than the air temperature of the room or place where they are sold. The mere heating of a food product constitutes preparation of a hot prepared food product, e.g., grilling a sandwich, dipping a sandwich bun in hot gravy, using infra-red lights, steam tables, etc.. If the sale is intended to be of a hot food product, such sale is of a hot food product regardless of cooling which incidentally occurs. For example, the sale of a toasted sandwich intended to be in a heated condition when sold, such as a fried ham sandwich on toast, is a sale of a hot prepared food product even though it may have cooled due to delay. On the other hand, the sale of a toasted sandwich which is not intended to be in a heated condition when sold, such as a cold tuna sandwich on toast, is not a sale of a hot prepared food product.

When a single price has been established for a combination of hot and cold food items, such as a meal or dinner which includes cold components or side items, tax applies to the entire established price regardless of itemization on the sales check. The inclusion of any hot food product in an otherwise cold combination of food products sold for a single established price, results in the tax applying to the entire established price, e.g., hot coffee served with a meal consisting of cold food products, when the coffee is included in the established price of the meal. If a single price for the combination of hot and cold food items is listed on a menu, wall sign or is otherwise advertised, a single price has been established. Except as otherwise provided in (b), (c), (d) or (f) of this regulation, or in Regulation 1574, tax does not apply to the sale for a separate price of bakery goods, beverages classed as food products, or cold or frozen food products. Hot bakery goods and hot beverages such as coffee are hot prepared food products but their sale for a separate price is exempt unless taxable as provided in (b), (c), (d) or (f) of this regulation, or in Regulation 1574. Tax does apply if a hot beverage and a bakery product or cold food product are sold as a combination for a single price. Hot soup, bouillon, or consomme is a hot prepared food product, which is not a beverage.

(2) Air Carriers Engaged in Interstate or Foreign Commerce. Tax does not apply to the sale, storage, use, or other consumption of hot prepared food products sold by caterers or other vendors to air carriers engaged in interstate or foreign commerce for consumption by passengers on such air carriers, nor to the sale, storage, use, or other consumption of hot

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Beverage Item B	3.75
Subtotal	\$13.70
8% sales tax	1.10
Subtotal	\$14.80
Tip*	
Total	

*Suggested tips:

15%=\$2.06; 18%=\$2.47; 20%=\$2.74; other.

If an employer misappropriates these payments for these charges, as discussed in subdivision (g)(1)(B) below, such payments are included in the retailer's taxable gross receipts.

(B) No employer shall collect, take, or receive any gratuity or a part thereof, paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of such gratuity, or require an employee to credit the amount, or any part thereof, of such gratuity against and as a part of the wages due the employee from the employer. (Labor Code section 351.) If this prohibition is violated, any amount of such gratuities received by the employer will be considered a part of the gross receipts of the employer and subject to the tax.

(2) Mandatory Payment.

(A) An amount negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is mandatory.

(B) When the menu, brochures, advertisements or other printed materials contain statements that notify customers that tips, gratuities, or service charges will or may be added, an amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is a mandatory charge and subject to tax. These amounts are considered negotiated in advance as specified in subdivision (g)(2)(A). Examples of printed statements include:

"An 18% gratuity [or service charge] will be added to parties of 8 or more."

"Suggested gratuity 15%," itemized on the invoice or bill by the restaurant, hotel, caterer, boarding house, soda fountain, drive-in or similar establishment.

"A 15% voluntary gratuity will be added for parties of 8 or more."

An amount will be considered "automatically added" when the retailer adds the tip to the bill without first conferring with the customer after service of the meal and receiving approval to add the tip or without providing the customer with the option to write in the tip. Nonetheless, any amount added by the retailer is presumed to be mandatory. This presumption may be overcome as discussed in subdivision (g)(2)(C) below.

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(C) It is presumed that an amount added as a tip by the retailer to the bill or invoice presented to the customer is mandatory. A statement on the bill or invoice that the amount added by the retailer is a "suggested tip," "optional gratuity," or that "the amount may be increased, decreased, or removed" by the customer does not change the mandatory nature of the charge.

This presumption may be controverted by documentary evidence showing that the customer specifically requested and authorized the gratuity be added to the amount billed.

Examples of documentary evidence that may be used to overcome the presumption include:

1. A guest check that is presented to the customer showing sales tax reimbursement and the amount upon which it was computed, without tip or with the "tip" area blank and a separate document, such as a credit card receipt, to which the retailer adds or prints the requested tip.
2. Guests receipts and payments showing that the percentage of tips paid by large groups varies from the percentage stated on the menu, brochure, advertisement or other printed materials.
3. A retailer's written policy stating that its employees shall receive confirmation from a customer before adding a tip together with additional verifiable evidence that the policy has been enforced. The policy is not in itself sufficient documentation to establish that the customer requested and authorized that a gratuity be added to the amount billed without such additional verifiable evidence.

The retailer must retain the guest checks and any additional separate documents to show that the payment is optional. The retailer is also required to maintain other records in accordance with the requirements of Regulation 1698, Records.

(h) Tips, Gratuities, and Service Charges. (On and after January 1, 2015)

The provisions of subdivision (h) apply to transactions occurring on and after January 1, 2015. This subdivision applies to restaurants, hotels, caterers, boarding houses, soda fountains, drive-ins and similar establishments.

An optional payment designated as a tip, gratuity, or service charge is not subject to tax. A mandatory payment designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if it is subsequently paid by the retailer to employees. For purposes of this subdivision, "amount" means a payment designated as a tip, gratuity, service charge, or any other separately stated payment for services associated with the purchase of meals, food, or drinks.

(1) Optional Payment.

When a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service (IRS) purposes, such amounts are presumed to be optional and not subject to tax. When a retailer does not maintain such records, this presumption does not apply and the amounts may be mandatory and included in taxable gross receipts as discussed in subdivisions (h)(2) and (h)(3).

The following examples illustrate transactions where an amount is optional and not included in taxable gross receipts:

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Example 1. The restaurant check is presented to the customer with the "tip" area blank so the customer may voluntarily write in the amount, or

Example 2. The restaurant check is presented to the customer with options computed by the retailer and presented to the customer as tip suggestions. The "tip" area is blank so the customer may voluntarily write in the amount:

Guest Check

<u>Food Item A</u>	<u>\$9.95</u>
<u>Beverage Item B</u>	<u>3.75</u>
<u>Subtotal</u>	<u>\$13.70</u>
<u>8% sales tax</u>	<u>1.10</u>
<u>Subtotal</u>	<u>\$14.80</u>
<u>Tip*</u>	
<u>Total</u>	

*Suggested tips:

15%=\$2.06; 18%=\$2.47; 20%=\$2.74; other.

Under these circumstances, the customer is free to enter the amount on the tip line or leave it blank; thus, the customer may enter an amount free from compulsion. The customer and restaurant did not negotiate the amount nor did the restaurant dictate the amount.

If an employer misappropriates these amounts, as discussed in subdivision (h)(4) below, such payments are included in the retailer's taxable gross receipts.

(2) Mandatory Payment.

When a retailer's records reflect that amounts are required to be reported to the IRS as non-tip wages, the amount is deemed to be mandatory.

(3) When a retailer does not maintain records for purposes of reporting the amounts to the IRS:

(A) An amount negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is mandatory.

(B) When the menu, brochures, advertisements or other printed materials contain statements that notify customers that tips, gratuities, or service charges will or may be added, an amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is a mandatory charge and subject to tax. These amounts are considered negotiated in advance as specified in subdivision (h)(3)(A). Examples of printed statements include:

"An 18% gratuity [or service charge] will be added to parties of 8 or more."

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"Suggested gratuity 15%," itemized on the invoice or bill by the restaurant, hotel, caterer, boarding house, soda fountain, drive-in or similar establishment.

"A 15% voluntary gratuity will be added for parties of 8 or more."

An amount will be considered "automatically added" when the retailer adds the amount to the bill without first conferring with the customer after service of the meal. Nonetheless, any amount added by the retailer is presumed to be automatically added and mandatory. This presumption may be overcome as discussed in subdivision (h)(3)(C) below.

(C) It is presumed that an amount added as a tip by the retailer to the bill or invoice presented to the customer is automatically added and mandatory. A statement on the bill or invoice that the amount added by the retailer is a "suggested tip," "optional gratuity," or that the amount "may be increased, decreased, or removed" by the customer does not change the mandatory nature of the charge.

This presumption may be controverted by documentary evidence showing that the customer specifically requested and authorized the amount be added to the bill.

Examples of documentary evidence that may be used to overcome the presumption include:

1. A guest check that is presented to the customer showing sales tax reimbursement and the figure upon which it was computed, without "tip" or with the "tip" area blank and a separate document, such as a credit card receipt, to which the retailer adds or prints the requested amount.
2. Guest receipts and payments showing that the percentage of amounts paid by large parties varies from the percentage stated on the menu, brochure, advertisement or other printed materials.
3. A retailer's written policy stating that its employees shall receive confirmation from a customer before adding an amount together with additional verifiable evidence that the policy has been enforced. The policy is not in itself sufficient documentation to establish that the customer requested and authorized that the amount be added to the bill without such additional verifiable evidence.

The retailer must retain the guest checks and any additional separate documents to show that the payment is optional. The retailer is also required to maintain other records in accordance with the requirements of Regulation 1698, *Records*.

(4) No employer shall collect, take, or receive any gratuity or a part thereof, paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of such gratuity, or require an employee to credit the amount, or any part thereof, of such gratuity against and as a part of the wages due the employee from the employer. (Labor Code section 351.) If this prohibition is violated, any amount received by the employer will be considered a part of the gross receipts of the employer and subject to the tax.

(ih) Caterers.

(1) Definition. The term "caterer" as used in this regulation means a person engaged in the business of serving meals, food, or drinks on the premises of the customer, or on premises

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supplied by the customer, including premises leased by the customer from a person other than the caterer, but does not include employees hired by the customer by the hour or day.

(2) Sales to Caterers. A caterer generally is considered to be the consumer of tangible personal property normally used in the furnishing and serving of meals, food or drinks, except for separately stated charges by the caterer for the lease of tangible personal property or tangible personal property regarded as being sold with meals, food or drinks such as disposable plates, napkins, utensils, glasses, cups, stemware, place mats, trays, covers and toothpicks.

(3) Sales by Caterers.

(A) Caterer as Retailer. Tax applies to the entire charge made by caterers for serving meals, food, and drinks, inclusive of charges for food, the use of dishes, silverware, glasses, chairs, tables, etc., used in connection with serving meals, and for the labor of serving the meals, whether performed by the caterer, the caterer's employees or subcontractors. Tax applies to charges made by caterers for preparing and serving meals and drinks even though the food is not provided by the caterers. Tax applies to charges made by caterers for hot prepared food products as in (e) above whether or not served by the caterers. A caterer who separately states or itemizes charges for the lease of tangible personal property regardless of the use of the property will be deemed to be the lessor of such property. Tax applies in accordance with Regulation 1660, Leases of Tangible Personal Property - In General. Tax does not apply to charges made by caterers for the rental of dishes, silverware, glasses, etc., purchased by the caterer with tax paid on the purchase price if no food is provided or served by the caterers in connection with such rental.

(B) Caterers as Lessors of Property Unrelated to the Serving or Furnishing of Meals, Food, or Drinks by a Caterer.

1. When a caterer who is furnishing or serving meals, food, or drinks also rents or leases from a third party tangible personal property which the caterer does not use himself or herself and the property is not customarily provided or used within the catering industry in connection with the furnishing and serving of food or drinks, such as decorative props related solely to optional entertainment, special lighting for guest speakers, sound or video systems, dance floors, stages, etc., he or she is a lessor of such property. In such instance, tax applies to the lease in accordance with Regulation 1660.

2. When a person who in other instances is a caterer does not furnish or serve any meals, food, or drinks to a customer, but rents or leases from a third party tangible personal property such as dishes, linen, silverware and glasses, etc., for purposes of providing it to his or her customer, he or she is not acting as a caterer within the meaning of this regulation, but solely as a lessor of tangible personal property. In such instances, tax applies to the lease in accordance with Regulation 1660.

(C) Caterers Planning, Designing and Coordinating Events.

1. Tax applies to charges by a caterer for event planning, design, coordination, and/or supervision if they are made in connection with the furnishing of meals, food, or drinks for the event. Tax does not apply to separately stated charges for services

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unrelated to the furnishing and serving of meals, food, or drinks, such as optional entertainment or any staff who do not directly participate in the preparation, furnishing, or serving of meals, food, or drinks, e.g., coat-check clerks, parking attendants, security guards, etc.

2. When a caterer sells meals, food, or drinks, and the serving of them, to other persons such as event planners, party coordinators, or fundraisers, who buy and sell the same on their own account or for their own sake, it is a sale for resale for which the caterer may accept a resale certificate. However, a caterer may only claim the sale as a resale if the caterer obtains a resale certificate in compliance with Regulation 1668. A person is buying or selling for his or her own account, or own sake, when such person has his or her own contract with a customer to sell the meals, food, or drinks to the customer, and is not merely acting on behalf of the caterer.

3. When a caterer sells meals, food or drinks and the serving of them to other persons who charge a fee for their service unrelated to the taxable sale, the separately stated fee is not subject to tax.

(D) Sales of Meals by Caterers to Social Clubs, Fraternal Organizations. Sales of meals to social clubs and fraternal organizations, as those terms are defined in subdivision (j) below, by caterers are sales for resale if such social clubs and fraternal organizations are the retailers of the meals subject to tax under subdivision (j) and give valid resale certificates therefor.

(E) Tips, Gratuities, or Service Charges. Tips, gratuities, and service charges are discussed in subdivisions (g) and (h).

(4) Premises. General. Separately stated charges for the lease of premises on which meals, food, or drinks are served, are nontaxable leases of real property. Where a charge for leased premises is a guarantee against a minimum purchase of meals, food or drinks, the charge for the guarantee is gross receipts subject to tax. Where a person contracts to provide both premises and meals, food or drinks, the charge for the meals, food or drinks must be reasonable in order for the charge for the premises to be nontaxable~~non-taxable~~.

(5) Private Chefs. A private chef is generally not an employee of the customer, but an independent contractor who pays his or her own social security, and federal and state income taxes. Such a private chef, who prepares and serves meals, food and drinks in the home of his or her customer is a caterer under this regulation.

(j) Social Clubs and Fraternal Organizations. "Social Clubs and Fraternal Organizations" as used herein include any corporation, partnership, association or group or combination acting as a unit, such as service clubs, lodges, and community, country, and athletic clubs.

The tax applies to receipts from the furnishing of meals, food, and drink by social clubs and fraternal organizations unless furnished: (1) exclusively to members; and also, (2) less frequently than once a week. Both of these requirements must be met. If the club or organization furnishes meals, food or drink to nonmembers, all receipts from the furnishing of meals, food or drink are subject to tax whether furnished to members or nonmembers, including receipts on occasions when furnished exclusively to members. Meals, food or drink paid for by members are considered furnished to them even though consumed by guests who are not members.

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(kj) Student Meals.

(1) Definitions.

(A) "Food Products": As used herein, the term "food products" as defined in Regulation 1602 (18 CCR 1602) includes food furnished, prepared, or served for consumption at tables, chairs, or counters, or from trays, glasses, dishes, or other tableware provided by the retailer or by a person with whom the retailer contracts to furnish, prepare or serve food to others.

(B) "Meals": As used herein, the term "meals" includes both food and nonfood products which are sold to students for an established single price at a time set aside for meals. If a single price for the combination of a nonfood product and a food product is listed on a menu or on a sign, a single price has been established. The term "meals" does not include nonfood products which are sold to students for a separate price and tax applies to the sales of such products. Examples of nonfood products are: carbonated beverages and beer. For the purpose of this regulation, products sold at a time designated as a "nutrition break," "recess," or similar break, will not be considered "meals."

(2) Application of Tax.

(A) Sales by Schools, School Districts and Student Organizations. Sales of meals or food products for human consumption to students of a school by public or private schools, school districts, and student organizations are exempt from tax, except as otherwise provided in (d)(4) above.

(B) Sales by Parent-Teacher Associations. Tax does not apply to the sale of, nor the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served to the students of a school by parent-teacher associations. Parent-teacher associations qualifying under Regulation 1597 as consumers are not retailers of tangible personal property, which they sell. Accordingly, tax does apply to the sale to such associations of nonfood items such as carbonated beverages, containers, straws and napkins.

(C) Sales by Blind Vendors. Tax does not apply to the sale of meals or food products for human consumption to students of a school by any blind person (as defined in section 19153 of the Welfare and Institutions Code) operating a restaurant or vending stand in an educational institution under article 5 of chapter 6 of part 2 of division 10 of the Welfare and Institutions Code, except as otherwise provided in (d)(4) above.

(D) Sales by Caterers. The application of tax to sales by caterers in general is explained in subdivision (ih) above. However, tax does not apply to the sale by caterers of meals or food products for human consumption to students of a school, if all the following criteria are met:

1. The premises used by the caterer to serve the lunches to the students are used by the school for other purposes, such as sporting events and other school activities, during the remainder of the day;
2. The fixtures and equipment used by the caterer are owned and maintained by the school; and

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3. The students purchasing the meals cannot distinguish the caterer from the employees of the school.

(~~1k~~) Employees' Meals.

(1) In General. Any employer or employee organization that is in the business of selling meals, e.g., a restaurant, hotel, club, or association, must include its receipts from the sales of meals to employees, along with its receipts from sales to other purchasers of meals, in the amount upon which it computes its sales tax liability. An employer or an employee organization selling meals only to employees becomes a retailer of meals and liable for sales tax upon its receipts from sales of meals if it sells meals to an average number of five or more employees during the calendar quarter.

(2) Specific Charge. The tax applies only if a specific charge is made to employees for the meals. Tax does not apply to cash paid an employee in lieu of meals. A specific charge is made for meals if:

(A) Employee pays cash for meals consumed.

(B) Value of meals is deducted from employee's wages.

(C) Employee receives meals in lieu of cash to bring compensation up to legal minimum wage.

(D) Employee has the option to receive cash for meals not consumed.

(3) No Specific Charge. If an employer makes no specific charge for meals consumed by employees, the employer is the consumer of the food products and the ~~nonfood~~~~non-~~~~food~~ products, which are furnished to the employees as a part of the meals.

In the absence of any of the conditions under (~~1k~~)-(2) a specific charge is not made if:

(A) A value is assigned to meals as a means of reporting the fair market value of employees' meals pursuant to state and federal laws or regulations or union contracts.

(B) Employees who do not consume available meals have no recourse on their employer for additional cash wages.

(C) Meals are generally available to employees, but the duties of certain employees exclude them from receiving the meals and are paid cash in lieu thereof.

(4) Meals Credited Toward Minimum Wage. If an employee receives meals in lieu of cash to bring his or her compensation up to the legal minimum wage, the amount by which the minimum wage exceeds the amount otherwise paid to the employee is includable in the employer's taxable gross receipts up to the value of the meals credited toward the minimum wage.

For example, if the minimum rate for an eight-hour day is \$46.00, and the employee received \$43.90 in cash, and a lunch is received which is credited toward the minimum wage in the maximum allowable amount of \$2.10, the employer has received gross receipts in the amount of \$2.10 for the lunch.

(5) Tax Reimbursement. If a separately stated amount for tax reimbursement is not added to the price of meals sold to employees for which a specific charge is made, the specific charge will be regarded as being a tax-included charge for the meals.

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~~(ml)~~ Religious Organizations. Tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served by any religious organization at a social or other gathering conducted by it or under its auspices, if the purpose in furnishing or serving the meals and food products is to obtain revenue for the functions and activities of the organization and the revenue obtained from furnishing or serving the meals and food products is actually used in carrying on such functions and activities. For the purposes of this regulation, "religious organization" means any organization the property of which is exempt from taxation pursuant to subdivision (f) of section 3 of article XIII of the State Constitution.

~~(nm)~~ Institutions. Tax does not apply to the sale of, nor the storage, use, or other consumption in this state of, meals and food products for human consumption furnished or served to and consumed by patients or residents of an "institution" as defined in Regulation 1503. Tax, however, does apply to the sale of meals and food products by an institution to persons other than patients or residents of the institution.

~~(on)~~ Meal Programs for Low-Income Elderly Persons. Tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served to low-income elderly persons at or below cost by a nonprofit organization or governmental agency under a program funded by this state or the United States for such purposes.

~~(pe)~~ Food Products, Nonalcoholic Beverages and Other Tangible Personal Property Transferred by Nonprofit Youth Organizations. See Regulation 1597 for the application of tax on food products, nonalcoholic beverages and other tangible personal property transferred by nonprofit youth organizations.

~~(qf)~~ Nonprofit Parent-Teacher Associations. Nonprofit parent-teacher associations and equivalent organizations qualifying under Regulation 1597 are consumers and not retailers of tangible personal property, which they sell.

~~(rj)~~ Meals and Food Products Served to Condominium Residents. Tax does not apply to the sale of, and the storage, use, or other consumption in this state of meals and food products for human consumption furnished to and consumed by persons 62 years of age or older residing in a condominium and who own equal shares in a common kitchen facility; provided, that the meals and food products are served to such persons on a regular basis.

This exemption is applicable only to sales of meals and food products for human consumption prepared and served at the common kitchen facility of the condominium. Tax applies to sales to persons less than 62 years of age.

~~(sf)~~ Veteran's Organization. Beginning April 1, 2004, tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served by any nonprofit veteran's organization at a social or other gathering conducted by it or under its auspices, if the purpose in furnishing or serving the meals and food products is to obtain revenue for the functions and activities of the organization and the revenue obtained from furnishing or serving the meals and food products is actually used in carrying on those functions and activities.

~~(ts)~~ Food Stamp Coupons. Tax does not apply to tangible personal property which is eligible to be purchased with federal food stamp coupons acquired pursuant to the Food Stamp Act of 1977

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and so purchased. When payment is made in the form of both food stamps and cash, the amount of the food stamp coupons must be applied first to tangible personal property normally subject to the tax, e.g., nonalcoholic carbonated beverages. Retailers are prohibited from adding any amount designated as sales tax, use tax, or sales tax reimbursement to sales of tangible personal property purchased with food stamp coupons. (See paragraph (c) of Regulation 1602.5 for special reporting provisions by grocers.)

(u†) Honor System Snack Sales. An "honor system snack sale" means a system where customers take snacks from a box or tray and pay by depositing money in a container provided by the seller. Snacks sold through such a system may be subject to tax depending upon where the sale takes place. Sales of such snacks are taxable when sold at or near a lunchroom, break room, or other facility that provides tables and chairs, and it is contemplated that the food sold will normally be consumed at such facilities. Honor system snack sales do not include hotel room mini-bars or snack baskets.

¹ The records acceptable in support of such a deduction are:

- (a) A sales ticket prepared for each transaction claimed as being tax exempt showing:
 - (1) Date of the sale,
 - (2) The kind of merchandise sold,
 - (3) The quantity of each kind of merchandise sold,
 - (4) The price of each kind of merchandise sold,
 - (5) The total price of merchandise sold,
 - (6) A statement to the effect that the merchandise purchased is not to be consumed on or near the location at which parking facilities are provided by the retailer, and
- (b) A daily sales record kept in sufficient detail to permit verification by audit that all gross receipts from sales have been accounted for and that all sales claimed as being tax exempt are included therein.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374 and 6376.5, Revenue and Taxation Code. Food Products Generally, see Regulation 1602. Sales tax reimbursement, see Regulation 1700. Meals served to residents or patients of an institution, see Regulation 1503. Food products sold through vending machines, see Regulation 1574. Meals at organized camps, see Regulation 1506. Nonprofit organizations as consumers, see Regulation 1597.

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Appendix A

California Sales Tax Exemption Certificate
Supporting Exemption Under Section 6359.1

The undersigned certifies that it is an air carrier engaged in interstate or foreign commerce and that the hot prepared food products purchased from _____ will be consumed by passengers on its flights.

The undersigned further certifies that it understands and agrees that if the property purchased under this certificate is used by the purchaser for any purpose other than that specified above, the purchaser shall be liable for sales tax as if it were a retailer making a retail sale of the property at the time of such use, and the sales price of the property to it shall be deemed the gross receipts from such sale.

Date Certificate Given _____

Purchasing Air Carrier _____
(company name)

Address _____

Signed By _____
(signature of authorized person)

(print or type name)

Title _____
(owner, partner, purchasing agent, etc.)

Seller's Permit No. (if any) _____

~~Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374 and 6376.5, Revenue and Taxation Code. Food Products Generally, see Regulation 1602. Alcoholic Beverages, tax reimbursements when served with, see Regulation 1700. "Free" meals with purchased meals, see Regulation 1670. Meals served to patients and inmates of an institution, see Regulation 1503. Vending Machines, when considered selling meals, see Regulation 1574. Meals at summer camps, see Regulation 1506(e). Parent Teacher associations as consumers, see Regulation 1597.~~

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STATE BOARD OF EQUALIZATION

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State Controller

CYNTHIA BRIDGES
Executive Director

May 9, 2014

Dear Interested Party:

Enclosed are the Agenda, Issue Paper, and Revenue Estimate for the May 22, 2014 Business Taxes Committee meeting. This meeting will address the proposed amendments to Regulation 1603, *Taxable Sales of Food Products*, to clarify the application of tax to tips, gratuities, and service charges.

Please feel free to publish this information on your website or otherwise distribute it to your associates, members, or other persons that may be interested in this issue.

Thank you for your input on these issues and I look forward to seeing you at the Business Taxes Committee meeting at **10:00 a.m. on May 22, 2014** in Room 121 at the address shown above.

Sincerely,

Susanne Buehler, Chief
Tax Policy Division
Sales and Use Tax Department

SB:rsw

Enclosures

cc: (all with enclosures)

Honorable Jerome E. Horton, Chairman, Fourth District
Honorable Michelle Steel, Vice Chair, Third District
Honorable Betty T. Yee, Member, First District (MIC 71)
Senator George Runner (Ret.), Member, Second District (via email)
Honorable John Chiang, State Controller, c/o Ms. Marcy Jo Mandel

(via email)

Mr. David Hunter, Board Member's Office, Fourth District
Mr. Jaclyn Appleby, Board Member's Office, Fourth District
Mr. Neil Shah, Board Member's Office, Third District
Mr. Tim Treichelt, Board Member's Office, Third District
Mr. Alan LoFaso, Board Member's Office, First District
Ms. Mengjun He, Board Member's Office, First District
Ms. Yvette Stowers, Board Member's Office, First District
Mr. Ramon Salazar, Board Member's Office, First District
Mr. Sean Wallentine, Board Member's Office, Second District
Ms. Mai Harvill, Board Member's Office, Second District
Mr. James Kuhl, Board Member's Office, Second District
Mr. Lee Williams, Board Member's Office, Second District
Mr. Alan Giorgi, Board Member's Office, Second District
Ms. Lynne Kinst, Board Member's Office, Second District
Ms. Tanya Vandrick, Board Member's Office, Second District
Ms. Natasha Ralston Ratcliff, State Controller's Office
Ms. Cynthia Bridges (MIC 73)
Mr. Randy Ferris (MIC 83)
Mr. Jeffrey L. McGuire (MIC 43)
Mr. Robert Tucker (MIC 82)
Mr. Bradley Heller (MIC 82)
Mr. Lawrence Mendel (MIC 82)
Mr. Cary Huxsoll (MIC 82)
Mr. Bradley Miller (MIC 92)
Ms. Trista Gonzalez (MIC 44)
Mr. Jason Parker (MIC 44)
Ms. Kirsten Stark (MIC 50)
Mr. Clifford Oakes (MIC 50)
Mr. Michael Patno (MIC 50)
Mr. Robert Wilke (MIC 50)

AGENDA — May 22, 2014 Business Taxes Committee Meeting
Proposed Amendments to Regulation 1603, *Taxable Sales of Food Products*

<p>Action 1 – Staff Recommendation</p>	<p>(a) Restaurants, Hotels, Boarding Houses, Soda Fountains, and Similar Establishments.</p> <p>(1) Definitions.</p> <p>(A) Boarding House. The term "boarding house" as used in this regulation means any establishment regularly serving meals, on the average to five or more paying guests. The term includes a "guest home," "residential care home," "halfway house," and any other establishment providing room and board or board only, which is not an institution as defined in Regulation 1503 and section 6363.6 of the Revenue and Taxation Code. The fact that guests may be recipients of welfare funds does not affect the application of tax. A person or establishment furnishing meals on the average to fewer than five paying guests during the calendar quarter is not considered to be engaged in the business of selling meals at retail.</p> <p>(B) American Plan Hotel. The term "American Plan Hotel" as used in this regulation means a hotel which charges guests a fixed sum by the day, week, or other period for room and meals combined.</p> <p>(C) Complimentary Food and Beverages. As used in this subdivision (a), the term "complimentary food and beverages" means food and beverages (including alcoholic and non-alcoholic beverages) which are provided to transient guests on a complimentary basis and:</p> <ol style="list-style-type: none">1. There is no segregation between the charges for rooms and the charges for the food and beverages on the guests' bills, and2. The guests are not given an option to refuse the food and beverages in return for a discounted room rental. <p>(D) Average Retail Value of Complimentary Food and Beverages. The term "average retail value of complimentary food and beverages" (ARV) as used in this regulation means the total amount of the costs of the complimentary food and beverages for the preceding calendar year marked-up one hundred percent (100%) and divided by the number of rooms rented for that year. Costs of complimentary food and beverages include charges for delivery to the lodging establishment but exclude discounts taken and sales tax reimbursement paid to vendors. The 100% markup factor includes the cost of food preparation labor by hotel employees, the fair rental value of hotel facilities used to prepare or serve the food and beverages, and profit.</p>
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Action 1 – Staff Recommendation

(E) Average Daily Rate. The term "average daily rate" (ADR) as used in this regulation means the gross room revenue for the preceding calendar year divided by the number of rooms rented for that year. "Gross room revenue" means and includes the full charge to the hotel customers but excludes separately stated occupancy taxes, revenue from contract and group rentals which do not qualify for complimentary food and beverages, and revenue from special packages (e.g., New Year's Eve packages which include food and beverages as well as guest room accommodations), unless it can be documented that the retail value of the food and beverages provided as a part of the special package is 10% or less of the total package charge as provided in subdivision (a)(2)(B). "Number of rooms rented for that year" means the total number of times all rooms have been rented on a nightly basis provided the revenue for those rooms is included in the "gross room revenue." For example, if a room is rented out for three consecutive nights by one guest, that room will be counted as rented three times when computing the ADR.

(2) Application Of Tax.

(A) In General. Tax applies to sales of meals or hot prepared food products (see (e) below) furnished by restaurants, concessionaires, hotels, boarding houses, soda fountains, and similar establishments whether served on or off the premises. In the case of American Plan ~~H~~hotels, special packages offered by hotels, e.g., a New Year's Eve package as described in subdivision (a)(1)(E), and boarding houses, a reasonable segregation must be made between the charges for rooms and the charges for the meals, hot prepared food products, and beverages. Charges by hotels or boarding houses for delivering meals or hot prepared food products to, or serving them in, the rooms of guests are includable in the measure of tax on the sales of the meals or hot prepared food products whether or not the charges are separately stated. (Caterers, see (~~ih~~) below.) Sales of meals or hot prepared food products by restaurants, concessionaires, hotels, boarding houses, soda fountains, and similar establishments to persons such as event planners, party coordinators, or fundraisers, which buy and sell on their own account, are sales for resale for which a resale certificate may be accepted. (~~s~~See subdivision (~~ih~~)(3)(C)2.)

Souffle cups, straws, paper napkins, toothpicks and like items that are not of a reusable character which are furnished with meals or hot prepared food products are sold with the meals or hot prepared food products. Sales of such items for such purpose to persons engaged in the business of selling meals or hot prepared food products are, accordingly, sales for resale.

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(B) Complimentary Food and Beverages. Lodging establishments which furnish, prepare, or serve complimentary food and beverages to guests in connection with the rental of rooms are consumers and not retailers of such food and beverages when the retail value of the complimentary food and beverages is "incidental" to the room rental service regardless of where within the hotel premises the complimentary food and beverages are served. For complimentary food and beverages to qualify as "incidental" for the current calendar year, the average retail value of the complimentary food and beverages (ARV) furnished for the preceding calendar year must be equal to or less than 10% of the average daily rate (ADR) for that year.

If a hotel provides guests with coupons or similar documents which may be exchanged for complimentary food and beverages in an area of the hotel where food and beverages are sold on a regular basis to the general public (e.g., a restaurant), the hotel will be considered the consumer and not the retailer of such food and beverages if the coupons or similar documents are non-transferable and the guest is specifically identified by name. If the coupons or similar documents are transferable or the guest is not specifically identified, food and beverages provided will be considered sold to the guest at the fair retail value of similar food and beverages sold to the general public. In the case of coupons redeemed by guests at restaurants not operated by the lodging establishment, the hotel will be considered the consumer of food and beverages provided to the hotel's guests and tax will apply to the charge by the restaurant to the hotel.

Lodging establishments are retailers of food and beverages which do not qualify as "incidental" and tax applies as provided in subdivision (a)(2)(A) above. Amounts paid by guests for food and beverages in excess of a complimentary allowance are gross receipts subject to the tax. Lodging establishments are retailers of otherwise complimentary food and beverages sold to non-guests.

In the case of hotels with concierge floor, club level or similar programs, the formula set forth above shall be applied separately with respect to the complimentary food and beverages furnished to guests who participate in the concierge, club or similar program. That is, the concierge, club or similar program will be deemed to be an independent hotel separate and apart from the hotel in which it is operated. The ADR and the retail value of complimentary food and beverages per occupied room will be computed separately with respect to the guest room accommodations entitled to the privileges and amenities involved in the concierge, club or similar program.

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Action 1 – Staff Recommendation	The following example illustrates the steps in determining whether the food and beverages are complimentary:
	FORMULA: ARV/ADR \leq or = 10%
	Average Daily Rate (ADR):
	Room Revenue \$9,108,000
	Rooms Rented 74,607
	ADR (\$9,108,000/74,607) \$122.08
	Average Retail Value of Complimentary
	Food and Beverages (ARV):
	Complimentary Food Cost \$169,057
	Complimentary Beverage Cost 52,513
	Total \$221,570
	Add 100% Markup 221,570
	Average Retail Value \$443,140
	ARV per occupied room (\$443,140/74,607) \$5.94
	Application of Formula: \$5.94/\$122.08 = 4.87%
In the above example, the average retail value of the complimentary food and beverages per occupied room for the preceding calendar year is equal to or less than 10% of the average daily rate. Therefore, under the provisions of this subdivision (a)(2)(B), the complimentary food and beverages provided to guests for the current calendar year qualify as "incidental." The lodging establishment is the consumer and not the retailer of such food and beverages. This computation must be made annually.	

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<p>Action 1 – Staff Recommendation</p>	<p>When a lodging establishment consists of more than one location, the operations of each location will be considered separately in determining if that location's complimentary food and beverages qualify as incidental.</p> <p>(C) "Free" Meals. When a restaurant agrees to furnish a "free" meal to a customer who purchases another meal and presents a coupon or card, which the customer previously had purchased directly from the restaurant or through a sales promotional agency having a contract with the restaurant to redeem the coupons or cards, the restaurant is regarded as selling two meals for the price of one, plus any additional compensation from the agency or from its own sales of coupons. Any such additional compensation is a part of its taxable gross receipts for the period in which the meals are served.</p> <p>Tax applies only to the price of the paid meal plus any such additional compensation.</p> <p>(b) "Drive-Ins." Tax applies to sales of food products ordinarily sold for immediate consumption on or near a location at which parking facilities are provided primarily for the use of patrons in consuming the products purchased at the "drive-in" establishment, even though such products are sold on a "take out" or "to go" order and are actually packaged or wrapped and taken from the premises of the retailer. Food products when sold in bulk, i.e., in quantities or in a form not suitable for consumption on the retailer's premises, are not regarded as ordinarily sold for immediate consumption on or near the location at which parking facilities are provided by the retailer. Accordingly, with the exception of sales of hot prepared food products (see (e) below) and sales of cold food under the 80-80 rule (see (c) below), sales of ice cream, doughnuts, and other individual food items in quantities obviously not intended for consumption on the retailer's premises, without eating utensils, trays, or dishes and not consumed on the retailer's premises, are exempt from tax. Any retailer claiming a deduction on account of food sales of this type must support the deduction by complete and detailed records.¹</p> <p>(c) Cold Food Sold on a "Take-Out" Order.</p> <p>(1) General.</p> <p>(A) Seller Meeting Criteria of 80-80 Rule. When a seller meets both criteria of the 80-80 rule as explained in subdivision (c)(3) below, tax applies to sales of cold food products (including sales for a separate price of hot bakery goods and hot beverages such as coffee) in a form suitable for consumption on the seller's premises even though such food products are sold on a "take-out" or "to go" order. Sales of cold food products which are suitable for consumption on the seller's premises are subject to the tax</p>
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Proposed Amendments to Regulation 1603, Taxable Sales of Food Products

Action 1 – Staff Recommendation

no matter how great the quantity purchased, e.g., 40 one-half pint containers of milk. Except as provided elsewhere in this regulation, tax does not apply to sales of food products which are furnished in a form not suitable for consumption on the seller's premises.

Operative April 1, 1996, although a seller may meet both criteria of the 80-80 rule, he or she may elect to separately account for the sale of "take-out" or "to go" orders of cold food products which are in a form suitable for consumption on the seller's premises. The gross receipts from the sale of those food products shall be exempt from the tax provided the seller keeps a separate accounting of these transactions in his or her records. Tax will remain applicable to the sale of food products as provided in subdivisions (a), (b), (e), or (f) of this regulation. Failure to maintain the required separate accounting and documentation claimed as exempt under this subdivision will revoke the seller's election under this subdivision.

(B) Seller Not Meeting Criteria of 80-80 Rule. When a seller does not meet both criteria of the 80-80 rule as explained in subdivision (c)(3) below, tax does not apply to sales of cold food products (including sales for a separate price of hot bakery goods and hot beverages such as coffee) when sold on a "take-out" or "to go" order.

(2) Definitions.

(A) For purposes of this subdivision (c), the term "suitable for consumption on the seller's premises" means food products furnished:

1. In a form which requires no further processing by the purchaser, including but not limited to cooking, heating, thawing, or slicing, and
2. In a size which ordinarily may be immediately consumed by one person such as a large milk shake, a pint of ice cream, a pint of milk, or a slice of pie. Cold food products (excluding milk shakes and similar milk products) furnished in containers larger in size than a pint are considered to be in a form not suitable for immediate consumption.

Pieces of candy sold in bulk quantities of one pound or greater are deemed to be sold in a form not suitable for consumption on the seller's premises.

The term does not include cold food products which obviously would not be consumed on the premises

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of the seller, e.g., a cold party tray or a whole cold chicken.

(B) For purposes of this subdivision (c), the term "seller's premises" means the individual location at which a sale takes place rather than the aggregate of all locations of the seller. For example, if a seller operates several drive-in and fast food restaurants, the operations of each location stand alone and are considered separately in determining if the sales of food products at each location meet the criteria of the 80-80 rule.

When two or more food-selling activities are conducted by the same person at the same location, the operations of all food related activities will be considered in determining if the sales of food products meet the criteria of the 80-80 rule. For example, if a seller operates a grocery store and a restaurant with no physical separation other than separate cash registers, the grocery store operations will be included in determining if the sales of food products meet the criteria of the 80-80 rule. When there is a physical separation where customers of one operation may not pass freely into the other operation, e.g., separate rooms with separate entrances but a common kitchen, each operation will be considered separately for purposes of this subdivision (c).

(3) 80-80 Rule. Tax applies under this subdivision (c) only if the seller meets both of the following criteria:

(A) More than 80 percent of the seller's gross receipts are from the sale of food products, and

(B) More than 80 percent of the seller's retail sales of food products are taxable as provided in subdivisions (a), (b), (e), and (f) of this regulation.

Sales of alcoholic beverages, carbonated beverages, or cold food to go not suitable for immediate consumption should not be included in this computation. Any seller meeting both of these criteria and claiming a deduction for the sale of cold food products in a form not suitable for consumption on the seller's premises must support the deduction by complete and detailed records of such sales made.

(d) Places Where Admission Is Charged.

(1) General. Tax applies to sales of food products when sold within, and for consumption within, a place the entrance to which is subject to an admission charge, during the period when the sales are made, except for national and state parks and monuments, and marinas, campgrounds, and recreational vehicle parks.

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<p>Action 1 – Staff Recommendation</p>	<p>(2) Definitions.</p> <p>(A) "Place" means an area the exterior boundaries of which are defined by walls, fences or otherwise in such a manner that the area readily can be recognized and distinguished from adjoining or surrounding property. Examples include buildings, fenced enclosures and areas delimited by posted signs.</p> <p>(B) "Within a place" means inside the door, gate, turnstile, or other point at which the customer must pay an admission charge or present evidence, such as a ticket, that an admission charge has been paid. Adjacent to, or in close proximity to, a place is not within a place.</p> <p>(C) "Admission charge" means any consideration required to be paid in money or otherwise, for admittance to a place.</p> <p>"Admission charge" does not include:</p> <ol style="list-style-type: none">1. Membership dues in a club or other organization entitling the member to, among other things, entrance to a place maintained by the club or organization, such as a fenced area containing a club house, tennis courts, and a swimming pool. Where a guest is admitted to such a place only when accompanied by or vouched for by a member of the club or organization, any charge made to the guest for use of facilities in the place is not an admission charge.2. A charge for a student body card entitling the student to, among other things, entrance to a place, such as entrance to a school auditorium at which a dance is held.3. A charge for the use of facilities within a place to which no entrance charge is made to spectators. For example, green fees paid for the privilege of playing a golf course, a charge made to swimmers for the use of a pool within a place, or a charge made for the use of lanes in a public bowling place. <p>(D) "National and state parks and monuments" means those which are part of the National Park System or the State Park System. The phrase does not include parks and monuments not within either of those systems, such as city, county, regional, district or private parks.</p> <p>(3) Presumption That Food Is Sold for Consumption Within a Place-</p> <p>When food products are sold within a place the entrance to which is subject to an admission charge, it will</p>
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Proposed Amendments to Regulation 1603, Taxable Sales of Food Products

<p>Action 1 – Staff Recommendation</p>	<p>be presumed, in the absence of evidence to the contrary, that the food products are sold for consumption within the place. Obtaining and retaining evidence in support of the claimed tax exemption is the responsibility of the retailer. Such evidence may consist, for example, of proof that the sales were of canned jams, cake mixes, spices, cooking chocolate, or other items in a form in which it is unlikely that such items would be consumed within the place where sold.</p> <p>(4) Food Sold to Students. The exemption otherwise granted by Section 6363 does not apply to sales of food products to students when sold within, and for consumption within, a place the entrance to which is subject to an admission charge, and such sales are subject to tax except as provided in (g) of this regulation. For example, when food products are sold by a student organization to students or to both students and nonstudents within a place the entrance to which is subject to an admission charge, such as a place where school athletic events are held, the sales to both students and nonstudents are taxable.</p> <p>(e) Hot Prepared Food Products.</p> <p>(1) General. Tax applies to all sales of hot prepared food products unless otherwise exempt. "Hot prepared food products" means those products, items, or components which have been prepared for sale in a heated condition and which are sold at any temperature which is higher than the air temperature of the room or place where they are sold. The mere heating of a food product constitutes preparation of a hot prepared food product, e.g., grilling a sandwich, dipping a sandwich bun in hot gravy, using infra-red lights, steam tables, etc. If the sale is intended to be of a hot food product, such sale is of a hot food product regardless of cooling which incidentally occurs. For example, the sale of a toasted sandwich intended to be in a heated condition when sold, such as a fried ham sandwich on toast, is a sale of a hot prepared food product even though it may have cooled due to delay. On the other hand, the sale of a toasted sandwich which is not intended to be in a heated condition when sold, such as a cold tuna sandwich on toast, is not a sale of a hot prepared food product.</p> <p>When a single price has been established for a combination of hot and cold food items, such as a meal or dinner which includes cold components or side items, tax applies to the entire established price regardless of itemization on the sales check. The inclusion of any hot food product in an otherwise cold combination of food products sold for a single established price, results in the tax applying to the entire established price, e.g., hot coffee served with a meal consisting of cold food products, when the coffee is included in the established price of the meal. If a single price for the combination of hot and cold food items is listed on a menu, wall sign or is otherwise advertised, a single price has been established. Except as otherwise</p>
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Recommendation**

provided in (b), (c), (d) or (f) of this regulation, or in Regulation 1574, tax does not apply to the sale for a separate price of bakery goods, beverages classed as food products, or cold or frozen food products. Hot bakery goods and hot beverages such as coffee are hot prepared food products but their sale for a separate price is exempt unless taxable as provided in (b), (c), (d) or (f) of this regulation, or in Regulation 1574. Tax does apply if a hot beverage and a bakery product or cold food product are sold as a combination for a single price. Hot soup, bouillon, or consomme is a hot prepared food product, which is not a beverage.

(2) Air Carriers Engaged in Interstate or Foreign Commerce. Tax does not apply to the sale, storage, use, or other consumption of hot prepared food products sold by caterers or other vendors to air carriers engaged in interstate or foreign commerce for consumption by passengers on such air carriers, nor to the sale, storage, use, or other consumption of hot prepared food products sold or served to passengers by air carriers engaged in interstate or foreign commerce for consumption by passengers on such air carriers. "Air carriers" are persons or firms in the business of transporting persons or property for hire or compensation, and include both common and contract carriers. "Passengers" do not include crew members. Any caterer or other vendor claiming the exemption must support it with an exemption certificate from the air carrier substantially in the form prescribed in Appendix A of this regulation.

(f) Food for Consumption at Facilities Provided by the Retailer. Tax applies to sales of sandwiches, ice cream, and other foods sold in a form for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others.

A passenger's seat aboard a train, or a spectator's seat at a game, show, or similar event is not a "chair" within the meaning of this regulation. Accordingly, except as otherwise provided in (c), (d), and (e) above, tax does not apply to the sale of cold sandwiches, ice cream, or other food products sold by vendors passing among the passengers or spectators where the food products are not "for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware provided by the retailer."

(g) Tips, Gratuities, and Service Charges. (Prior to January 1, 2015)

The provisions of subdivision (g) apply to transactions occurring prior to January 1, 2015. This subdivision applies to restaurants, hotels, caterers, boarding houses, soda fountains, drive-ins and similar establishments.

An optional payment designated as a tip, gratuity, or service charge is not subject to tax. A mandatory payment

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Proposed Amendments to Regulation 1603, Taxable Sales of Food Products

<p>Action 1 – Staff Recommendation</p>	<p>designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if the amount is subsequently paid by the retailer to employees.</p> <p>(1) Optional Payment.</p> <p>(A) A payment of a tip, gratuity, or service charge is optional if the customer adds the amount to the bill presented by the retailer, or otherwise leaves a separate amount in payment over and above the actual amount due the retailer for the sale of meals, food, and drinks that include services. The following examples illustrate transactions where a payment of a tip, gratuity or service charge is optional and not included in taxable gross receipts. This is true regardless of printed statements on menus, brochures, advertisements or other materials notifying customers that tips, gratuities, or service charges will or may be added by the retailer to the prices of meals, food, or drinks:</p> <p>Example 1. The restaurant check is presented to the customer with the "tip" area blank so the customer may voluntarily write in an amount, or</p> <p>Example 2. The restaurant check is presented to the customer with options computed by the retailer and presented to the customer as tip suggestions. The "tip" area is blank so the customer may voluntarily write in an amount:</p> <table border="0" style="margin-left: auto; margin-right: auto;"> <tr> <td colspan="2"><i>Guest Check</i></td> </tr> <tr> <td style="padding-right: 20px;">Food Item A</td> <td style="text-align: right;">\$9.95</td> </tr> <tr> <td>Beverage Item B</td> <td style="text-align: right;">3.75</td> </tr> <tr> <td>Subtotal</td> <td style="text-align: right;">\$13.70</td> </tr> <tr> <td>8% sales tax</td> <td style="text-align: right;">1.10</td> </tr> <tr> <td>Subtotal</td> <td style="text-align: right;">\$14.80</td> </tr> <tr> <td>Tip*</td> <td></td> </tr> <tr> <td>Total</td> <td></td> </tr> </table>	<i>Guest Check</i>		Food Item A	\$9.95	Beverage Item B	3.75	Subtotal	\$13.70	8% sales tax	1.10	Subtotal	\$14.80	Tip*		Total	
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the retailer is presumed to be mandatory. This presumption may be overcome as discussed in subdivision (g)(2)(C) below.

(C) It is presumed that an amount added as a tip by the retailer to the bill or invoice presented to the customer is mandatory. A statement on the bill or invoice that the amount added by the retailer is a "suggested tip," "optional gratuity," or that "the amount may be increased, decreased, or removed" by the customer does not change the mandatory nature of the charge.

This presumption may be controverted by documentary evidence showing that the customer specifically requested and authorized the gratuity be added to the amount billed.

Examples of documentary evidence that may be used to overcome the presumption include:

1. A guest check that is presented to the customer showing sales tax reimbursement and the amount upon which it was computed, without tip or with the "tip" area blank and a separate document, such as a credit card receipt, to which the retailer adds or prints the requested tip.
2. Guests receipts and payments showing that the percentage of tips paid by large groups varies from the percentage stated on the menu, brochure, advertisement or other printed materials.
3. A retailer's written policy stating that its employees shall receive confirmation from a customer before adding a tip together with additional verifiable evidence that the policy has been enforced. The policy is not in itself sufficient documentation to establish that the customer requested and authorized that a gratuity be added to the amount billed without such additional verifiable evidence.

The retailer must retain the guest checks and any additional separate documents to show that the payment is optional. The retailer is also required to maintain other records in accordance with the requirements of Regulation 1698, Records.

(h) Tips, Gratuities, and Service Charges. (On and after January 1, 2015)

The provisions of subdivision (h) apply to transactions occurring on and after January 1, 2015. This subdivision applies to restaurants, hotels, caterers, boarding houses, soda fountains, drive-ins and similar establishments.

An optional payment designated as a tip, gratuity, or service charge is not subject to tax. A mandatory payment designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if it is subsequently

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paid by the retailer to employees. For purposes of this subdivision, "amount" means a payment designated as a tip, gratuity, service charge, or any other separately stated payment for services associated with the purchase of meals, food, or drinks.

(1) Optional Payment.

When a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service (IRS) purposes, such amounts are presumed to be optional and not subject to tax. When a retailer does not maintain such records, this presumption does not apply and the amounts may be mandatory and included in taxable gross receipts as discussed in subdivisions (h)(2) and (h)(3).

The following examples illustrate transactions where an amount is optional and not included in taxable gross receipts:

Example 1. The restaurant check is presented to the customer with the "tip" area blank so the customer may voluntarily write in the amount, or

Example 2. The restaurant check is presented to the customer with options computed by the retailer and presented to the customer as tip suggestions. The "tip" area is blank so the customer may voluntarily write in the amount:

Guest Check

<u>Food Item A</u>	<u>\$9.95</u>
<u>Beverage Item B</u>	<u>3.75</u>
<u>Subtotal</u>	<u>\$13.70</u>
<u>8% sales tax</u>	<u>1.10</u>
<u>Subtotal</u>	<u>\$14.80</u>
<u>Tip*</u>	
<u>Total</u>	

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*Suggested tips:

15%=\$2.06; 18%=\$2.47; 20%=\$2.74; other.

Under these circumstances, the customer is free to enter the amount on the tip line or leave it blank; thus, the customer may enter an amount free from compulsion. The customer and restaurant did not negotiate the amount nor did the restaurant dictate the amount.

If an employer misappropriates these amounts, as discussed in subdivision (h)(4) below, such payments are included in the retailer's taxable gross receipts.

(2) Mandatory Payment.

When a retailer's records reflect that amounts are required to be reported to the IRS as non-tip wages, the amount is deemed to be mandatory.

(3) When a retailer does not maintain records for purposes of reporting the amounts to the IRS:

(A) An amount negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is mandatory.

(B) When the menu, brochures, advertisements or other printed materials contain statements that notify customers that tips, gratuities, or service charges will or may be added, an amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is a mandatory charge and subject to tax. These amounts are considered negotiated in advance as specified in subdivision (h)(3)(A). Examples of printed statements include:

"An 18% gratuity [or service charge] will be added to parties of 8 or more."

"Suggested gratuity 15%," itemized on the invoice or bill by the restaurant, hotel, caterer, boarding house, soda fountain, drive-in or similar establishment.

"A 15% voluntary gratuity will be added for parties of 8 or more."

An amount will be considered "automatically added" when the retailer adds the amount to the bill without first conferring with the customer after service of the meal. Nonetheless, any amount added by

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the retailer is presumed to be automatically added and mandatory. This presumption may be overcome as discussed in subdivision (h)(3)(C) below.

(C) It is presumed that an amount added as a tip by the retailer to the bill or invoice presented to the customer is automatically added and mandatory. A statement on the bill or invoice that the amount added by the retailer is a "suggested tip," "optional gratuity," or that the amount "may be increased, decreased, or removed" by the customer does not change the mandatory nature of the charge.

This presumption may be controverted by documentary evidence showing that the customer specifically requested and authorized the amount be added to the bill.

Examples of documentary evidence that may be used to overcome the presumption include:

1. A guest check that is presented to the customer showing sales tax reimbursement and the figure upon which it was computed, without "tip" or with the "tip" area blank and a separate document, such as a credit card receipt, to which the retailer adds or prints the requested amount.

2. Guest receipts and payments showing that the percentage of amounts paid by large parties varies from the percentage stated on the menu, brochure, advertisement or other printed materials.

3. A retailer's written policy stating that its employees shall receive confirmation from a customer before adding an amount together with additional verifiable evidence that the policy has been enforced. The policy is not in itself sufficient documentation to establish that the customer requested and authorized that the amount be added to the bill without such additional verifiable evidence.

The retailer must retain the guest checks and any additional separate documents to show that the payment is optional. The retailer is also required to maintain other records in accordance with the requirements of Regulation 1698, *Records*.

(4) No employer shall collect, take, or receive any gratuity or a part thereof, paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of such gratuity, or require an employee to credit the amount, or any part thereof, of such gratuity against and as a part of the wages due the employee from the employer. (Labor Code section 351.) If this prohibition is violated, any amount received by the employer will be considered a part of the gross receipts of the employer and subject to the tax.

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<p>Action 1 – Staff Recommendation</p>	<p>(i) Caterers.</p> <p>(1) Definition. The term "caterer" as used in this regulation means a person engaged in the business of serving meals, food, or drinks on the premises of the customer, or on premises supplied by the customer, including premises leased by the customer from a person other than the caterer, but does not include employees hired by the customer by the hour or day.</p> <p>(2) Sales to Caterers. A caterer generally is considered to be the consumer of tangible personal property normally used in the furnishing and serving of meals, food or drinks, except for separately stated charges by the caterer for the lease of tangible personal property or tangible personal property regarded as being sold with meals, food or drinks such as disposable plates, napkins, utensils, glasses, cups, stemware, place mats, trays, covers and toothpicks.</p> <p>(3) Sales by Caterers.</p> <p>(A) Caterer as Retailer. Tax applies to the entire charge made by caterers for serving meals, food, and drinks, inclusive of charges for food, the use of dishes, silverware, glasses, chairs, tables, etc., used in connection with serving meals, and for the labor of serving the meals, whether performed by the caterer, the caterer's employees or subcontractors. Tax applies to charges made by caterers for preparing and serving meals and drinks even though the food is not provided by the caterers. Tax applies to charges made by caterers for hot prepared food products as in (e) above whether or not served by the caterers. A caterer who separately states or itemizes charges for the lease of tangible personal property regardless of the use of the property will be deemed to be the lessor of such property. Tax applies in accordance with Regulation 1660, Leases of Tangible Personal Property - In General. Tax does not apply to charges made by caterers for the rental of dishes, silverware, glasses, etc., purchased by the caterer with tax paid on the purchase price if no food is provided or served by the caterers in connection with such rental.</p> <p>(B) Caterers as Lessors of Property Unrelated to the Serving or Furnishing of Meals, Food, or Drinks by a Caterer.</p> <p>1. When a caterer who is furnishing or serving meals, food, or drinks also rents or leases from a third party tangible personal property which the caterer does not use himself or herself and the property is not customarily provided or used within the catering industry in connection with the furnishing and serving of food or drinks, such as decorative props related solely to optional</p>
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entertainment, special lighting for guest speakers, sound or video systems, dance floors, stages, etc., he or she is a lessor of such property. In such instance, tax applies to the lease in accordance with Regulation 1660.

2. When a person who in other instances is a caterer does not furnish or serve any meals, food, or drinks to a customer, but rents or leases from a third party tangible personal property such as dishes, linen, silverware and glasses, etc., for purposes of providing it to his or her customer, he or she is not acting as a caterer within the meaning of this regulation, but solely as a lessor of tangible personal property. In such instances, tax applies to the lease in accordance with Regulation 1660.

(C) Caterers Planning, Designing and Coordinating Events.

1. Tax applies to charges by a caterer for event planning, design, coordination, and/or supervision if they are made in connection with the furnishing of meals, food, or drinks for the event. Tax does not apply to separately stated charges for services unrelated to the furnishing and serving of meals, food, or drinks, such as optional entertainment or any staff who do not directly participate in the preparation, furnishing, or serving of meals, food, or drinks, e.g., coat-check clerks, parking attendants, security guards, etc.

2. When a caterer sells meals, food, or drinks, and the serving of them, to other persons such as event planners, party coordinators, or fundraisers, who buy and sell the same on their own account or for their own sake, it is a sale for resale for which the caterer may accept a resale certificate. However, a caterer may only claim the sale as a resale if the caterer obtains a resale certificate in compliance with Regulation 1668. A person is buying or selling for his or her own account, or own sake, when such person has his or her own contract with a customer to sell the meals, food, or drinks to the customer, and is not merely acting on behalf of the caterer.

3. When a caterer sells meals, food or drinks and the serving of them to other persons who charge a fee for their service unrelated to the taxable sale, the separately stated fee is not subject to tax.

(D) Sales of Meals by Caterers to Social Clubs, Fraternal Organizations. Sales of meals to social clubs and fraternal organizations, as those terms are defined in subdivision (j) below, by caterers are sales for resale if such social clubs and fraternal organizations are the retailers of the meals subject to tax under subdivision (j) and give valid resale certificates therefor.

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<p>Action 1 – Staff Recommendation</p>	<p>(E) Tips, Gratuities, or Service Charges. Tips, gratuities, and service charges are discussed in subdivisions <u>(g)</u> and <u>(h)</u>.</p> <p>(4) Premises. General. Separately stated charges for the lease of premises on which meals, food, or drinks are served, are nontaxable leases of real property. Where a charge for leased premises is a guarantee against a minimum purchase of meals, food or drinks, the charge for the guarantee is gross receipts subject to tax. Where a person contracts to provide both premises and meals, food or drinks, the charge for the meals, food or drinks must be reasonable in order for the charge for the premises to be <u>nontaxable</u>non-taxable.</p> <p>(5) Private Chefs. A private chef is generally not an employee of the customer, but an independent contractor who pays his or her own social security, and federal and state income taxes. Such a private chef, who prepares and serves meals, food and drinks in the home of his or her customer is a caterer under this regulation.</p> <p>(j) Social Clubs and Fraternal Organizations. "Social Clubs and Fraternal Organizations" as used herein include any corporation, partnership, association or group or combination acting as a unit, such as service clubs, lodges, and community, country, and athletic clubs.</p> <p>The tax applies to receipts from the furnishing of meals, food, and drink by social clubs and fraternal organizations unless furnished: (1) exclusively to members; and also, (2) less frequently than once a week. Both <u>of</u> these requirements must be met. If the club or organization furnishes meals, food or drink to nonmembers, all receipts from the furnishing of meals, food or drink are subject to tax whether furnished to members or nonmembers, including receipts on occasions when furnished exclusively to members. Meals, food or drink paid for by members are considered furnished to them even though consumed by guests who are not members.</p> <p>(k) Student Meals.</p> <p>(1) Definitions.</p> <p>(A) "Food Products." As used herein, the term "food products" as defined in Regulation 1602 (18 CCR 1602) includes food furnished, prepared, or served for consumption at tables, chairs, or counters, or from trays, glasses, dishes, or other tableware provided by the retailer or by a person with whom the retailer contracts to furnish, prepare or serve food to others.</p>
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(B) "Meals": As used herein, the term "meals" includes both food and nonfood products which are sold to students for an established single price at a time set aside for meals. If a single price for the combination of a nonfood product and a food product is listed on a menu or on a sign, a single price has been established. The term "meals" does not include nonfood products which are sold to students for a separate price and tax applies to the sales of such products. Examples of nonfood products are: carbonated beverages and beer. For the purpose of this regulation, products sold at a time designated as a "nutrition break"; "recess"; or similar break, will not be considered "meals".

(2) Application of Tax.

(A) Sales by Schools, School Districts and Student Organizations. Sales of meals or food products for human consumption to students of a school by public or private schools, school districts, and student organizations are exempt from tax, except as otherwise provided in (d)(4) above.

(B) Sales by Parent-Teacher Associations. Tax does not apply to the sale of, nor the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served to the students of a school by parent-teacher associations. Parent-teacher associations qualifying under Regulation 1597 as consumers are not retailers of tangible personal property, which they sell. Accordingly, tax does apply to the sale to such associations of nonfood items such as carbonated beverages, containers, straws and napkins.

(C) Sales by Blind Vendors. Tax does not apply to the sale of meals or food products for human consumption to students of a school by any blind person (as defined in section 19153 of the Welfare and Institutions Code) operating a restaurant or vending stand in an educational institution under article 5 of chapter 6 of part 2 of division 10 of the Welfare and Institutions Code, except as otherwise provided in (d)(4) above.

(D) Sales by Caterers. The application of tax to sales by caterers in general is explained in subdivision (i) above. However, tax does not apply to the sale by caterers of meals or food products for human consumption to students of a school, if all the following criteria are met:

1. The premises used by the caterer to serve the lunches to the students are used by the school for other purposes, such as sporting events and other school activities, during the remainder of the day;
2. The fixtures and equipment used by the caterer are owned and maintained by the school; and

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receiving the meals and are paid cash in lieu thereof.

(4) Meals Credited Toward Minimum Wage. If an employee receives meals in lieu of cash to bring his or her compensation up to the legal minimum wage, the amount by which the minimum wage exceeds the amount otherwise paid to the employee is includable in the employer's taxable gross receipts up to the value of the meals credited toward the minimum wage.

For example, if the minimum rate for an eight-hour day is \$46.00, and the employee received \$43.90 in cash, and a lunch is received which is credited toward the minimum wage in the maximum allowable amount of \$2.10, the employer has received gross receipts in the amount of \$2.10 for the lunch.

(5) Tax Reimbursement. If a separately stated amount for tax reimbursement is not added to the price of meals sold to employees for which a specific charge is made, the specific charge will be regarded as being a tax-included charge for the meals.

~~(m)~~ Religious Organizations. Tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served by any religious organization at a social or other gathering conducted by it or under its auspices, if the purpose in furnishing or serving the meals and food products is to obtain revenue for the functions and activities of the organization and the revenue obtained from furnishing or serving the meals and food products is actually used in carrying on such functions and activities. For the purposes of this regulation, "religious organization" means any organization the property of which is exempt from taxation pursuant to subdivision (f) of section 3 of article XIII of the State Constitution.

~~(n)~~ Institutions. Tax does not apply to the sale of, nor the storage, use, or other consumption in this state of, meals and food products for human consumption furnished or served to and consumed by patients or residents of an "institution" as defined in Regulation 1503. Tax, however, does apply to the sale of meals and food products by an institution to persons other than patients or residents of the institution.

~~(o)~~ Meal Programs for Low-Income Elderly Persons. Tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served to low-income elderly persons at or below cost by a nonprofit organization or governmental agency under a program funded by this state or the United States for such purposes.

~~(p)~~ Food Products, Nonalcoholic Beverages and Other Tangible Personal Property Transferred by Nonprofit

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<p>Action 1 – Staff Recommendation</p>	<p>Youth Organizations. See Regulation 1597 for the application of tax on food products, nonalcoholic beverages and other tangible personal property transferred by nonprofit youth organizations.</p> <p>(qp) Nonprofit Parent-Teacher Associations. Nonprofit parent-teacher associations and equivalent organizations qualifying under Regulation 1597 are consumers and not retailers of tangible personal property, which they sell.</p> <p>(rq) Meals and Food Products Served to Condominium Residents. Tax does not apply to the sale of, and the storage, use, or other consumption in this state of meals and food products for human consumption furnished to and consumed by persons 62 years of age or older residing in a condominium and who own equal shares in a common kitchen facility; provided, that the meals and food products are served to such persons on a regular basis.</p> <p>This exemption is applicable only to sales of meals and food products for human consumption prepared and served at the common kitchen facility of the condominium. Tax applies to sales to persons less than 62 years of age.</p> <p>(sf) Veteran's Organization. Beginning April 1, 2004, tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served by any nonprofit veteran's organization at a social or other gathering conducted by it or under its auspices, if the purpose in furnishing or serving the meals and food products is to obtain revenue for the functions and activities of the organization and the revenue obtained from furnishing or serving the meals and food products is actually used in carrying on those functions and activities.</p> <p>(ts) Food Stamp Coupons. Tax does not apply to tangible personal property which is eligible to be purchased with federal food stamp coupons acquired pursuant to the Food Stamp Act of 1977 and so purchased. When payment is made in the form of both food stamps and cash, the amount of the food stamp coupons must be applied first to tangible personal property normally subject to the tax, e.g., nonalcoholic carbonated beverages. Retailers are prohibited from adding any amount designated as sales tax, use tax, or sales tax reimbursement to sales of tangible personal property purchased with food stamp coupons. (See paragraph (c) of Regulation 1602.5 for special reporting provisions by grocers.)</p> <p>(ut) Honor System Snack Sales. An "honor system snack sale" means a system where customers take snacks from a box or tray and pay by depositing money in a container provided by the seller. Snacks sold through such a system may be subject to tax depending upon where the sale takes place. Sales of such snacks are taxable</p>
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Action 1 – Staff Recommendation	<p>when sold at or near a lunchroom, break room, or other facility that provides tables and chairs, and it is contemplated that the food sold will normally be consumed at such facilities. Honor system snack sales do not include hotel room mini-bars or snack baskets.</p> <hr/> <p>¹ The records acceptable in support of such a deduction are:</p> <ul style="list-style-type: none">(a) A sales ticket prepared for each transaction claimed as being tax exempt showing:<ul style="list-style-type: none">(1) Date of the sale,(2) The kind of merchandise sold,(3) The quantity of each kind of merchandise sold,(4) The price of each kind of merchandise sold,(5) The total price of merchandise sold,(6) A statement to the effect that the merchandise purchased is not to be consumed on or near the location at which parking facilities are provided by the retailer, and(b) A daily sales record kept in sufficient detail to permit verification by audit that all gross receipts from sales have been accounted for and that all sales claimed as being tax exempt are included therein. <p><u>Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374 and 6376.5, Revenue and Taxation Code. Food Products Generally, see Regulation 1602. Sales tax reimbursement, see Regulation 1700. Meals served to residents or patients of an institution, see Regulation 1503. Food products sold through vending machines, see Regulation 1574. Meals at organized camps, see Regulation 1506. Nonprofit organizations as consumers, see Regulation 1597.</u></p>
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**AGENDA — May 22, 2014 Business Taxes Committee Meeting
Proposed Amendments to Regulation 1603, *Taxable Sales of Food Products***

<p>Action 1 – Staff Recommendation</p>	<p align="center">Appendix A</p> <p align="center">California Sales Tax Exemption Certificate Supporting Exemption Under Section 6359.1</p> <p>The undersigned certifies that it is an air carrier engaged in interstate or foreign commerce and that the hot prepared food products purchased from _____ will be consumed by passengers on its flights.</p> <p>The undersigned further certifies that it understands and agrees that if the property purchased under this certificate is used by the purchaser for any purpose other than that specified above, the purchaser shall be liable for sales tax as if it were a retailer making a retail sale of the property at the time of such use, and the sales price of the property to it shall be deemed the gross receipts from such sale.</p> <p>Date Certificate Given _____</p> <p>Purchasing Air Carrier _____ (company name)</p> <p>Address _____</p> <p>Signed By _____ (signature of authorized person)</p> <p>_____ (print or type name)</p> <p>Title _____ (owner, partner, purchasing agent, etc.)</p> <p>Seller's Permit No. (if any) _____</p> <p>Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374 and 6376.5, Revenue and Taxation Code. Food Products Generally, see Regulation 1602. Alcoholic Beverages, tax reimbursements when served with, see Regulation 1700. "Free" meals with purchased meals, see Regulation 1670. Meals served to patients and inmates of an institution, see Regulation 1503. Vending Machines, when considered selling meals, see Regulation 1574. Meals at summer camps, see Regulation 1506(e). Parent Teacher associations as consumers, see Regulation 1597.</p>
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Issue Paper Number 14-003



- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

Proposed Amendments to Regulation 1603, *Taxable Sales of Food Products* (Tips, Gratuities, and Service Charges)

I. Issue

Whether the Board should amend Sales and Use Tax Regulation 1603 to clarify the application of tax to tips, gratuities, and service charges.

II. Alternative 1 – Staff Recommendation

Staff recommends the Board approve and authorize publication of the amendments to Regulation 1603, as set forth in Exhibit 2. Staff’s proposed amendments, which have a prospective application, specify that tips, gratuities, and service charges are presumed optional and not subject to tax when a retailer keeps records consistent with reporting such amounts as tip wages for Internal Revenue Service (IRS) purposes. With respect to mandatory charges, staff’s proposed amendments specify that when a retailer’s records reflect that amounts are required to be reported to the IRS as non-tip wages, the amounts are deemed mandatory and subject to tax. Furthermore, staff recommends other technical and non-substantive amendments to update references and maintain consistency with other regulations.

For a more detailed explanation of Alternative 1 - Staff Recommendation, refer to section VI of this paper.

III. Other Alternative Considered

Do not approve proposed amendments to Regulation 1603.

IV. Background

General Legal Background / Current Administrative Practice

Sales tax is imposed on a retail sale of tangible personal property in this state, measured by the retailer's gross receipts, unless specifically exempt from taxation by statute. (Rev. & Tax. Code, § 6051.) While the sales tax is imposed upon the retailer for the privilege of selling tangible personal property at retail in California, the retailer may collect tax reimbursement from the customer if the contract of sale so provides. (Civ. Code, §1656.1; Cal. Code Regs., tit. 18, §1700, subd. (a)(1).) All of a retailer's gross receipts are presumed subject to tax, unless the retailer can prove otherwise. (Rev. & Tax. Code, § 6091.)

The term "gross receipts" means the total amount of the sale without any deduction for the cost of materials used, labor or service costs, interest paid, losses, or any other expense. (Rev. & Tax. Code, §6012, subd. (a)(2).) Gross receipts also include any services that are part of the sale and all receipts, cash, credits and property of any kind. (Rev. & Tax. Code, § 6012, subd. (b)(1) & (2).)

Regulation 1603, Taxable Sales of Food Products

While sales of food products for human consumption are generally exempt from tax (Rev. & Tax. Code, § 6359, subd. (a)), this exemption does not apply to sales of meals or hot prepared food products furnished by restaurants and similar establishments whether served on or off the premises.

Regulation 1603 provides guidance to establishments that make taxable sales of food products. With respect to tips, gratuities, and service charges, subdivision (g) specifies that an optional payment designated as a tip, gratuity, or service charge is not subject to tax, but a mandatory payment designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if the amount is subsequently paid by the retailer to the server.

Optional Payment

A tip, gratuity, or service charge is clearly optional if the customer adds the amount to the bill presented by the retailer, or otherwise leaves a separate amount in payment over and above the actual amount due the retailer for the sale of meals, food, and drinks and services related to those sales. The following examples illustrate transactions where a payment of a tip, gratuity or service charge is clearly optional: (1) the restaurant check is presented to the customer with the "tip" area blank so the customer may voluntarily write in an amount, or (2) the restaurant check is presented to the customer with options computed by the retailer and presented to the customer as tip suggestions, with the "tip" area blank so the customer may voluntarily write in an amount.

Labor Code

Pursuant to Labor Code section 351, no employer or agent shall collect, take, or receive any gratuity or a part thereof that is paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of a gratuity, or require an employee to credit the amount, or any part thereof, of a gratuity against and as a part of the wages due the employee from the employer. However, in the event this does occur, any amount of the gratuities received by the employer will be considered part of the employer's taxable gross receipts.

Mandatory Payment

An amount expressly negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is clearly mandatory. For example, when the

retailer enters into contracts to cater banquets that specify that an amount for gratuities or service charges will be added, the amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is clearly a mandatory charge.

Presumption that an Amount is a Mandatory Payment

Any amount added as a tip by the retailer to the bill or invoice presented to the customer is presumed to be a mandatory payment. The presumption may be overcome by documentary evidence showing that the customer specifically requested and authorized the gratuity be added to the amount billed. (Cal. Code Regs., tit. 18, § 1603, subd. (g)(2)(C).)

Examples of documentary evidence that may be used to overcome the presumption include: (1) a guest check that is presented to the customer showing sales tax reimbursement and the amount upon which it was computed, without tip or with the “tip” area blank and a separate document, such as a credit card receipt, to which the retailer adds or prints the requested tip; (2) guest receipts and payments showing that the percentage of tips paid by large groups varies from the percentage stated on the menu, brochure, advertisement or other printed materials; and (3) a retailer’s written policy stating that its employees shall receive confirmation from a customer before adding a tip together with additional verifiable evidence that the policy has been enforced. (Cal. Code Regs., tit. 18, § 1603, subd. (g)(2)(C).)

V. Discussion

General

Voluntary tips are not intended for the owner of a restaurant, but are gratuities for the restaurant’s employees. These gratuities are intended by the customers to augment the compensation paid to the employees by the employer, but there is no legal obligation for the customers to give these gratuities. An amount added to the bill by the customer for a gratuity is considered to be “optional.” Under current law, a mandatory service charge made by the retailer in connection with its sale of tangible personal property is subject to tax if the sale of the property is subject to tax. The Board’s policy has presumed a gratuity added to the bill by the retailer to be mandatory, even when a statement on the menu or bill indicates that the gratuity is optional.

Although Regulation 1603 subdivision (g) was amended in 2007 to clarify the application of tax to tips, gratuities and service charges, it has become evident to staff that there remains confusion regarding what constitutes “mandatory” versus “optional” tips and gratuities.

Alternative Approach to Current Administrative Practice / Internal Revenue Service (IRS) Guidance

During the interested parties’ process, staff emphasized that it was open to input on ways to clarify Regulation 1603 to provide better guidance for distinguishing between optional and mandatory tips and gratuities. Staff also suggested that an approach consistent with current IRS guidelines may help reduce confusion, provide a more uniform approach for retailers, and provide a bright-line rule.

On June 25, 2012, the IRS published the *2012-26 Internal Revenue Bulletin*, which includes Revenue Ruling 2012-18. The purpose of the revenue ruling was to clarify and update guidelines regarding taxes imposed on tips under the Federal Insurance Contributions Act, including information on the difference between tips and service charges (which are regarded as non-tip wages). The revenue ruling states that an employer’s characterization of payment as a “tip” is not determinative. The revenue ruling also reaffirms prior IRS guidance, which provides that the absence of any of the

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following factors creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge:

- (1) The payment must be made free from compulsion;
- (2) The customer must have the unrestricted right to determine the amount;
- (3) The payment should not be the subject of negotiation or dictated by employer policy; and
- (4) Generally, the customer has the right to determine who receives the payment.

For purposes of discussion, staff drafted proposed regulatory amendments to Regulation 1603 that make a retailer's reporting of these amounts under the Sales and Use Tax Law consistent with reporting such amounts to the IRS. Staff offered the draft language as an example of a bright-line approach that eases compliance for retailers. As explained below, staff made further amendments to its proposal to address concerns raised by interested parties.

Interested Parties Comments

Staff conducted an interested parties meeting to discuss the proposed amendments to Regulation 1603 on December 10, 2013. During the meeting, interested parties appeared open to staff's proposal and there was a general consensus that creating a bright-line approach with respect to tips, gratuities, and service charges would be helpful to the restaurant industry and staff.

Interested parties inquired as to what types of records would be considered consistent with reporting the tips as tip wages for IRS purposes. They also expressed concern that a retailer who failed to keep proper records would not benefit from the presumption that its tips were optional payments and not subject to tax. Staff explained that it would be helpful to receive input from the restaurant industry regarding common recordkeeping and reporting practices with respect to tips, gratuities, and service charges.

Staff received written comments from Ms. Kara Bush sent on behalf of the California Restaurant Association (CRA), in a January 10, 2014 letter (Exhibit 3). In the letter, Ms. Bush expressed appreciation of the Board's efforts to clarify this issue and that the association looks forward to continuing to work with staff and other interested parties to develop a bright-line approach that will foster reporting compliance and audit efficiency. Ms. Bush also expressed appreciation for staff's suggestions and stated that the association will continue to explore other alternatives.

Staff also received comments from Mr. James R. Dumler, of McClellan Davis, LLC, in a January 10, 2014 letter (Exhibit 4). Mr. Dumler reiterated concerns expressed during the interested parties meeting that a taxpayer that lacks support for the IRS tip designations would not benefit from the proposed presumption and optional gratuities could incorrectly be presumed to be mandatory. Mr. Dumler also recommended that the examples in the current regulation with respect to mandatory payments be retained.

With respect to concerns regarding taxpayers that fail to maintain adequate records for IRS purposes, staff added language clarifying the application of the presumption and also added a subdivision to provide the application of tax when a retailer does not maintain records for purposes of reporting the tips to the IRS. When a retailer does not maintain these records, the analysis of whether or not the payments are mandatory is consistent with the analysis currently in Regulation 1603, subdivision (g)(2).

Following the interested parties' meeting held on February 20, 2014, staff received additional

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comments from Mr. Matt Sutton, sent on behalf of the CRA. In his March 6, 2014 letter (Exhibit 5), Mr. Sutton explains that while the CRA has historically disagreed with the taxation of mandatory gratuities, it is appreciative of staff's ideas and acknowledges that the suggestions for a "bright line" approach, discussed in the discussion papers and both interested parties meetings, have merit. Mr. Sutton further states that it remains to be seen how the industry will respond to the IRS guidance and how that will interplay with the Board's practice of taxing mandatory tips.

Technical / Non-Substantive Amendments

In addition to the proposed amendments regarding tips, gratuities, and service charges, staff proposes other technical and non-substantive amendments. These proposed amendments include revisions to the "Reference" section of Regulation 1603 to accurately reflect the references to other sales and use tax regulations. Staff also proposes to move the "Note" section currently under Appendix A of the regulation to appear immediately after the regulation for consistency with other regulations. Staff made other technical and non-substantive amendments throughout the regulation.

Prospective Basis for Amendments

Under Revenue and Taxation Code section 7051, "[t]he board may prescribe the extent to which any ruling or regulation shall be applied without retroactive effect." In other words, when the Board wishes to limit the retroactive effect of a regulation, or amendments thereto, it is authorized to do so, and would accomplish it by taking affirmative action in the regulatory process by means of specifying an operative date for the amendments.

Because of the general confusion staff perceives with respect to the records that must be kept to rebut the presumption of a mandatory charge (when applicable), staff recommends that any amendments to Regulation 1603 have a prospective application so that taxpayers and staff are notified well in advance of any record-keeping changes that may be expected. Based on the estimated approval process for regulatory amendments, staff identified an operative date of January 1, 2015.

Other Amendments Pending Approval from the Office of Administrative Law (OAL)

On March 25, 2014, the Board adopted amendments to add subdivision (u) to Regulation 1603 regarding the presumption that a mobile food vendors' sales of taxable items are made on a tax-included basis. Since those amendments are pending OAL approval, staff did not include them in the proposed text of Regulation 1603 in this paper. To the extent that the amendments adding subdivision (u) are approved, staff will include those amendments going forward and ensure that cross-references within subdivision (u) are updated to correspond to any renumbering of subdivisions as the result of any amendments for this issue.

VI. Alternative 1 - Staff Recommendation**A. Description of Alternative 1**

Staff recommends the Board approve and authorize publication of the amendments to Regulation 1603 to clarify the application of tax to tips, gratuities, and service charges. After discussing the proposed amendments with the interested parties and reviewing the interested parties' comments, staff recommends Regulation 1603 be amended to:

- Specify that the existing subdivision (g), *Tips, Gratuities, and Service Charges*, is applicable to transactions occurring prior to January 1, 2015.
- Create a new subdivision (h), *Tips, Gratuities, and Service Charges*, which is applicable to transactions occurring on and after January 1, 2015.

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- Define “amount”(for purposes of new subdivision (h)) to mean a payment designated as tip, gratuity, service charge, or any other separately stated payment for services associated with the purchase of meals, food, or drinks.
- Presume amounts are optional when a retailer keeps records consistent with reporting the amounts to the IRS as tip wages. (Subdivision (h)(1).)
- Specify that the presumption that such amounts are optional does not apply when a retailer does not maintain records for reporting the amount to the IRS and amounts may be mandatory as discussed in (h)(2) and (h)(3).
- Provide two examples of when amounts are optional and not included in taxable gross receipts.
- Specify that when a retailer’s records reflect that amounts are required to be reported to the IRS as non-tip wages, the amounts are deemed to be mandatory. (Subdivision (h)(2).)
- Provide guidance for instances in which a retailer does not maintain records for purposes of reporting the amounts to the IRS. (Subdivision (h)(3).)
- Revise the “Reference” section of Regulation 1603 to accurately reflect the references to other sales and use tax regulations.
- Move the “Note” section currently under Appendix A of the regulation to appear immediately after the regulation for consistency with other regulations.
- Make other technical and non-substantive revisions throughout the regulation.

B. Pros of Alternative 1

- Maintains consistency with the legal principles that optional amounts are not subject to tax and mandatory amounts are included in taxable gross receipts.
- Ensures consistency with IRS reporting requirements for tip wages, which may result in greater clarity regarding the application of tax to tips, gratuities, and service charges.
- Allows easier compliance with both IRS and BOE reporting requirements.
- Ensures that taxpayers and staff are notified well in advance of any record-keeping changes that may be expected.
- Updates references and provides consistency with other regulations.

C. Cons of Alternative 1

None.

D. Statutory or Regulatory Change for Alternative 1

No statutory change is required. However, staff’s recommendation does require adoption of amendments to Regulation 1603.

E. Operational Impact of Alternative 1

Staff will publish the proposed amendments to Regulation 1603 and thereby begin the formal rulemaking process.

F. Administrative Impact of Alternative 1

1. Cost Impact

The workload associated with publishing the regulation, updating industry specific guidance, and engaging in other outreach efforts is considered routine. Any corresponding cost associated with these activities would be absorbed within the BOE's existing budget.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact of Alternative 1

Staff believes making a retailer's reporting of tips, gratuities, and service charges under the Sales and Use Tax Law consistent with reporting such amounts to the IRS creates a bright-line approach that will ease compliance for retailers.

H. Critical Time Frames of Alternative 1

Staff expects the Office of Administrative Law will complete their review and approval of the proposed amendments prior to November 30, 2014, which will allow an effective date of January 1, 2015.

VII. Other Alternative

A. Description of Alternative 2

Do not amend Regulation 1603.

B. Pros of Alternative 2

The BOE would not incur the workload associated with processing the amended regulation.

C. Cons of Alternative 2

There may continue to be confusion as to when a tip, gratuity, or service charge is deemed mandatory and subject to tax and the types of records necessary to establish that a tip, gratuity or service charge is not mandatory. In addition, the format of Regulation 1603 would not be entirely consistent with other BOE regulations, some references would be inaccurate, and other technical, non-substantive errors would remain.

D. Statutory or Regulatory Changes for Alternative 2

None.

E. Operational Impact of Alternative 2

None.

F. Administrative Impact of Alternative 2

1. Cost Impact

None.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

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G. Taxpayer/Customer Impact of Alternative 2

Without regulatory amendments, there may continue to be confusion as to the application of tax to tips, gratuities, and service charges. In addition, Taxpayers may find it difficult to maintain compliance with both IRS and BOE reporting requirements.

H. Critical Time Frames for Alternative 2

None.

Preparer/Reviewer Information

Prepared by: Tax Policy Division, Sales and Use Tax Department.

Current as of: May 1, 2014

REVENUE ESTIMATE

STATE OF CALIFORNIA
BOARD OF EQUALIZATION



Proposed Amendments to Regulation 1603, Taxable Sales of Food Products (Tips, Gratuities, and Service Charges)

I. Issue

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II. Alternative 1 - Staff Recommendation

Staff recommends the Board approve and authorize publication of the amendments to Regulation 1603. Staff's proposed amendments, which have a prospective application, specify that tips, gratuities, and service charges are presumed optional and not subject to tax when a retailer keeps records consistent with reporting such amounts as tip wages for Internal Revenue Service (IRS) purposes. With respect to mandatory charges, staff's proposed amendments specify that when a retailer's records reflect that amounts are required to be reported to the IRS as non-tip wages, the amounts are deemed mandatory and subject to tax. Furthermore, staff recommends other technical and non-substantive amendments to update references and maintain consistency with other regulations.

III. Other Alternative(s) Considered

Do not approve proposed amendments to Regulation 1603.

Background, Methodology, and Assumptions

Alternative 1 – Staff Recommendation

There is nothing in the staff recommendation that would impact revenue. Staff's proposed amendments to Regulation 1603 would clarify the application of tax to tips, gratuities, and service charges. In addition, staff's proposed amendments to Regulation 1603 will do all of the following:

- Maintain consistency with the legal principles that optional amounts are not subject to tax and mandatory amounts are included in taxable gross receipts.

- Ensure consistency with IRS reporting requirements for tip wages, which may result in greater clarity regarding the application of tax to tips, gratuities, and service charges.
- Allow easier compliance with both IRS and BOE reporting requirements.
- Ensure that taxpayers and staff are notified well in advance of any record-keeping changes that may be expected.
- Update references and provide consistency with other regulations.

Other Alternatives Considered

There is nothing in Alternative 2 that would impact revenue. However, there may continue to be confusion as to when a tip, gratuity, or service charge is deemed mandatory and subject to tax and the types of records necessary to establish that a tip, gratuity or service charge is not mandatory. In addition, the format of Regulation 1603 would not be entirely consistent with other BOE regulations, some references would be inaccurate, and other technical, non-substantive errors would remain.

Revenue Summary

Alternative 1 – staff recommendation does not have a revenue impact.

The other alternative considered does not have a revenue impact.

Preparation

Mr. Bill Benson, Jr., Research and Statistics Section, Legislative and Research Division, prepared this revenue estimate. This estimate has been reviewed by Mr. Joe Fitz, Chief, Research and Statistics Section, Legislative and Research Division, and Ms. Susanne Buehler, Chief, Tax Policy Division, Sales and Use Tax Department. For additional information, please contact Mr. Benson at (916) 445-0840.

Current as of May 1, 2014.

Sales and Use Tax Regulation 1603. *Taxable Sales of Food Products.*

(a) Restaurants, Hotels, Boarding Houses, Soda Fountains, and Similar Establishments.

(1) Definitions.

(A) Boarding House. The term "boarding house" as used in this regulation means any establishment regularly serving meals, on the average to five or more paying guests. The term includes a "guest home," "residential care home," "halfway house," and any other establishment providing room and board or board only, which is not an institution as defined in Regulation 1503 and section 6363.6 of the Revenue and Taxation Code. The fact that guests may be recipients of welfare funds does not affect the application of tax. A person or establishment furnishing meals on the average to fewer than five paying guests during the calendar quarter is not considered to be engaged in the business of selling meals at retail.

(B) American Plan Hotel. The term "American Plan Hotel" as used in this regulation means a hotel which charges guests a fixed sum by the day, week, or other period for room and meals combined.

(C) Complimentary Food and Beverages. As used in this subdivision (a), the term "complimentary food and beverages" means food and beverages (including alcoholic and non-alcoholic beverages) which are provided to transient guests on a complimentary basis and:

1. There is no segregation between the charges for rooms and the charges for the food and beverages on the guests' bills, and
2. The guests are not given an option to refuse the food and beverages in return for a discounted room rental.

(D) Average Retail Value of Complimentary Food and Beverages. The term "average retail value of complimentary food and beverages" (ARV) as used in this regulation means the total amount of the costs of the complimentary food and beverages for the preceding calendar year marked-up one hundred percent (100%) and divided by the number of rooms rented for that year. Costs of complimentary food and beverages include charges for delivery to the lodging establishment but exclude discounts taken and sales tax reimbursement paid to vendors. The 100% markup factor includes the cost of food preparation labor by hotel employees, the fair rental value of hotel facilities used to prepare or serve the food and beverages, and profit.

(E) Average Daily Rate. The term "average daily rate" (ADR) as used in this regulation means the gross room revenue for the preceding calendar year divided by the number of rooms rented for that year. "Gross room revenue" means and includes the full charge to the hotel customers but excludes separately stated occupancy taxes, revenue from contract and group rentals which do not qualify for complimentary food and beverages, and revenue from special packages (e.g., New Year's Eve packages which include food and beverages as well as guest room accommodations), unless it can be documented that the retail value of the food and beverages provided as a part of the special package is 10% or less of the total package charge as provided in subdivision (a)(2)(B). "Number of rooms rented for that year" means the total number of times all rooms have been rented

on a nightly basis provided the revenue for those rooms is included in the "gross room revenue." For example, if a room is rented out for three consecutive nights by one guest, that room will be counted as rented three times when computing the ADR.

(2) Application Of Tax.

(A) In General. Tax applies to sales of meals or hot prepared food products (see (e) below) furnished by restaurants, concessionaires, hotels, boarding houses, soda fountains, and similar establishments whether served on or off the premises. In the case of American Plan ~~H~~hotels, special packages offered by hotels, e.g., a New Year's Eve package as described in subdivision (a)(1)(E), and boarding houses, a reasonable segregation must be made between the charges for rooms and the charges for the meals, hot prepared food products, and beverages. Charges by hotels or boarding houses for delivering meals or hot prepared food products to, or serving them in, the rooms of guests are includable in the measure of tax on the sales of the meals or hot prepared food products whether or not the charges are separately stated. (Caterers, see (i~~h~~) below.) Sales of meals or hot prepared food products by restaurants, concessionaires, hotels, boarding houses, soda fountains, and similar establishments to persons such as event planners, party coordinators, or fundraisers, which buy and sell on their own account, are sales for resale for which a resale certificate may be accepted. (s~~See~~ subdivision (i~~h~~)(3)(C)2.)

Souffle cups, straws, paper napkins, toothpicks and like items that are not of a reusable character which are furnished with meals or hot prepared food products are sold with the meals or hot prepared food products. Sales of such items for such purpose to persons engaged in the business of selling meals or hot prepared food products are, accordingly, sales for resale.

(B) Complimentary Food and Beverages. Lodging establishments which furnish, prepare, or serve complimentary food and beverages to guests in connection with the rental of rooms are consumers and not retailers of such food and beverages when the retail value of the complimentary food and beverages is "incidental" to the room rental service regardless of where within the hotel premises the complimentary food and beverages are served. For complimentary food and beverages to qualify as "incidental" for the current calendar year, the average retail value of the complimentary food and beverages (ARV) furnished for the preceding calendar year must be equal to or less than 10% of the average daily rate (ADR) for that year.

If a hotel provides guests with coupons or similar documents which may be exchanged for complimentary food and beverages in an area of the hotel where food and beverages are sold on a regular basis to the general public (e.g., a restaurant), the hotel will be considered the consumer and not the retailer of such food and beverages if the coupons or similar documents are non-transferable and the guest is specifically identified by name. If the coupons or similar documents are transferable or the guest is not specifically identified, food and beverages provided will be considered sold to the guest at the fair retail value of similar food and beverages sold to the general public. In the case of coupons redeemed by guests at restaurants not operated by the lodging establishment, the hotel will be considered the consumer of food and beverages provided to the hotel's guests and tax will apply to the charge by the restaurant to the hotel.

Lodging establishments are retailers of food and beverages which do not qualify as "incidental" and tax applies as provided in subdivision (a)(2)(A) above. Amounts paid by guests for food and beverages in excess of a complimentary allowance are gross receipts subject to the tax. Lodging establishments are retailers of otherwise complimentary food and beverages sold to non-guests.

In the case of hotels with concierge floor, club level or similar programs, the formula set forth above shall be applied separately with respect to the complimentary food and beverages furnished to guests who participate in the concierge, club or similar program. That is, the concierge, club or similar program will be deemed to be an independent hotel separate and apart from the hotel in which it is operated. The ADR and the retail value of complimentary food and beverages per occupied room will be computed separately with respect to the guest room accommodations entitled to the privileges and amenities involved in the concierge, club or similar program.

The following example illustrates the steps in determining whether the food and beverages are complimentary:

FORMULA:	$ARV/ADR \leq 10\%$
Average Daily Rate (ADR):	
Room Revenue	\$9,108,000
Rooms Rented	74,607
ADR (\$9,108,000/74,607)	\$122.08
Average Retail Value of Complimentary	
Food and Beverages (ARV):	
Complimentary Food Cost	\$169,057
Complimentary Beverage Cost	52,513
Total	\$221,570
Add 100% Markup	221,570
Average Retail Value	\$443,140
ARV per occupied room (\$443,140/74,607)	\$5.94
Application of Formula:	$\$5.94/\$122.08 = 4.87\%$

In the above example, the average retail value of the complimentary food and beverages per occupied room for the preceding calendar year is equal to or less than 10% of the average daily rate. Therefore, under the provisions of this subdivision (a)(2)(B), the complimentary food and beverages provided to guests for the current calendar year qualify as "incidental." The lodging establishment is the consumer and not the retailer of such food and beverages. This computation must be made annually.

When a lodging establishment consists of more than one location, the operations of each location will be considered separately in determining if that location's complimentary food and beverages qualify as incidental.

(C) "Free" Meals. When a restaurant agrees to furnish a "free" meal to a customer who purchases another meal and presents a coupon or card, which the customer previously had purchased directly from the restaurant or through a sales promotional agency having a contract with the restaurant to redeem the coupons or cards, the restaurant is regarded as selling two meals for the price of one, plus any additional compensation from the agency or from its own sales of coupons. Any such additional compensation is a part of its taxable gross receipts for the period in which the meals are served.

Tax applies only to the price of the paid meal plus any such additional compensation.

(b) "Drive-Ins." Tax applies to sales of food products ordinarily sold for immediate consumption on or near a location at which parking facilities are provided primarily for the use of patrons in consuming the products purchased at the "drive-in" establishment, even though such products are sold on a "take out" or "to go" order and are actually packaged or wrapped and taken from the premises of the retailer. Food products when sold in bulk, i.e., in quantities or in a form not suitable for consumption on the retailer's premises, are not regarded as ordinarily sold for immediate consumption on or near the location at which parking facilities are provided by the retailer. Accordingly, with the exception of sales of hot prepared food products (see (e) below) and sales of cold food under the 80-80 rule (see (c) below), sales of ice cream, doughnuts, and other individual food items in quantities obviously not intended for consumption on the retailer's premises, without eating utensils, trays, or dishes and not consumed on the retailer's premises, are exempt from tax. Any retailer claiming a deduction on account of food sales of this type must support the deduction by complete and detailed records.¹

(c) Cold Food Sold on a "Take-Out" Order.

(1) General.

(A) Seller Meeting Criteria of 80-80 Rule. When a seller meets both criteria of the 80-80 rule as explained in subdivision (c)(3) below, tax applies to sales of cold food products (including sales for a separate price of hot bakery goods and hot beverages such as coffee) in a form suitable for consumption on the seller's premises even though such food products are sold on a "take-out" or "to go" order. Sales of cold food products which are suitable for consumption on the seller's premises are subject to the tax no matter how great the quantity purchased, e.g., 40 one-half pint containers of milk. Except as provided elsewhere in this regulation, tax does not apply to sales of food products which are furnished in a form not suitable for consumption on the seller's premises.

Operative April 1, 1996, although a seller may meet both criteria of the 80-80 rule, he or she may elect to separately account for the sale of "take-out" or "to go" orders of cold food products which are in a form suitable for consumption on the seller's premises. The gross receipts from the sale of those food products shall be exempt from the tax provided the seller keeps a separate accounting of these transactions in his or her records. Tax will remain applicable to the sale of food products as provided in subdivisions (a), (b), (e), or (f) of this regulation. Failure to maintain the required separate accounting and

documentation claimed as exempt under this subdivision will revoke the seller's election under this subdivision.

(B) Seller Not Meeting Criteria of 80-80 Rule. When a seller does not meet both criteria of the 80-80 rule as explained in subdivision (c)(3) below, tax does not apply to sales of cold food products (including sales for a separate price of hot bakery goods and hot beverages such as coffee) when sold on a "take-out" or "to go" order.

(2) Definitions.

(A) For purposes of this subdivision (c), the term "suitable for consumption on the seller's premises" means food products furnished:

1. In a form which requires no further processing by the purchaser, including but not limited to cooking, heating, thawing, or slicing, and
2. In a size which ordinarily may be immediately consumed by one person such as a large milk shake, a pint of ice cream, a pint of milk, or a slice of pie. Cold food products (excluding milk shakes and similar milk products) furnished in containers larger in size than a pint are considered to be in a form not suitable for immediate consumption.

Pieces of candy sold in bulk quantities of one pound or greater are deemed to be sold in a form not suitable for consumption on the seller's premises.

The term does not include cold food products which obviously would not be consumed on the premises of the seller, e.g., a cold party tray or a whole cold chicken.

(B) For purposes of this subdivision (c), the term "seller's premises" means the individual location at which a sale takes place rather than the aggregate of all locations of the seller. For example, if a seller operates several drive-in and fast food restaurants, the operations of each location stand alone and are considered separately in determining if the sales of food products at each location meet the criteria of the 80-80 rule.

When two or more food-selling activities are conducted by the same person at the same location, the operations of all food related activities will be considered in determining if the sales of food products meet the criteria of the 80-80 rule. For example, if a seller operates a grocery store and a restaurant with no physical separation other than separate cash registers, the grocery store operations will be included in determining if the sales of food products meet the criteria of the 80-80 rule. When there is a physical separation where customers of one operation may not pass freely into the other operation, e.g., separate rooms with separate entrances but a common kitchen, each operation will be considered separately for purposes of this subdivision (c).

(3) 80-80 Rule. Tax applies under this subdivision (c) only if the seller meets both of the following criteria:

- (A) More than 80 percent of the seller's gross receipts are from the sale of food products, and
- (B) More than 80 percent of the seller's retail sales of food products are taxable as provided in subdivisions (a), (b), (e), and (f) of this regulation.

Sales of alcoholic beverages, carbonated beverages, or cold food to go not suitable for immediate consumption should not be included in this computation. Any seller meeting both of these criteria and claiming a deduction for the sale of cold food products in a form not suitable for consumption on the seller's premises must support the deduction by complete and detailed records of such sales made.

(d) Places Where Admission Is Charged.

(1) **General.** Tax applies to sales of food products when sold within, and for consumption within, a place the entrance to which is subject to an admission charge, during the period when the sales are made, except for national and state parks and monuments, and marinas, campgrounds, and recreational vehicle parks.

(2) **Definitions.**

(A) "Place" means an area the exterior boundaries of which are defined by walls, fences or otherwise in such a manner that the area readily can be recognized and distinguished from adjoining or surrounding property. Examples include buildings, fenced enclosures and areas delimited by posted signs.

(B) "Within a place" means inside the door, gate, turnstile, or other point at which the customer must pay an admission charge or present evidence, such as a ticket, that an admission charge has been paid. Adjacent to, or in close proximity to, a place is not within a place.

(C) "Admission charge" means any consideration required to be paid in money or otherwise, for admittance to a place.

"Admission charge" does not include:

1. Membership dues in a club or other organization entitling the member to, among other things, entrance to a place maintained by the club or organization, such as a fenced area containing a club house, tennis courts, and a swimming pool. Where a guest is admitted to such a place only when accompanied by or vouched for by a member of the club or organization, any charge made to the guest for use of facilities in the place is not an admission charge.

2. A charge for a student body card entitling the student to, among other things, entrance to a place, such as entrance to a school auditorium at which a dance is held.

3. A charge for the use of facilities within a place to which no entrance charge is made to spectators. For example, green fees paid for the privilege of playing a golf course, a charge made to swimmers for the use of a pool within a place, or a charge made for the use of lanes in a public bowling place.

(D) "National and state parks and monuments" means those which are part of the National Park System or the State Park System. The phrase does not include parks and monuments not within either of those systems, such as city, county, regional, district or private parks.

(3) Presumption That Food Is Sold for Consumption Within a Place-

When food products are sold within a place the entrance to which is subject to an admission charge, it will be presumed, in the absence of evidence to the contrary, that the food products

are sold for consumption within the place. Obtaining and retaining evidence in support of the claimed tax exemption is the responsibility of the retailer. Such evidence may consist, for example, of proof that the sales were of canned jams, cake mixes, spices, cooking chocolate, or other items in a form in which it is unlikely that such items would be consumed within the place where sold.

(4) Food Sold to Students. The exemption otherwise granted by Section 6363 does not apply to sales of food products to students when sold within, and for consumption within, a place the entrance to which is subject to an admission charge, and such sales are subject to tax except as provided in (q) of this regulation. For example, when food products are sold by a student organization to students or to both students and nonstudents within a place the entrance to which is subject to an admission charge, such as a place where school athletic events are held, the sales to both students and nonstudents are taxable.

(e) Hot Prepared Food Products.

(1) General. Tax applies to all sales of hot prepared food products unless otherwise exempt. "Hot prepared food products" means those products, items, or components which have been prepared for sale in a heated condition and which are sold at any temperature which is higher than the air temperature of the room or place where they are sold. The mere heating of a food product constitutes preparation of a hot prepared food product, e.g., grilling a sandwich, dipping a sandwich bun in hot gravy, using infra-red lights, steam tables, etc.. If the sale is intended to be of a hot food product, such sale is of a hot food product regardless of cooling which incidentally occurs. For example, the sale of a toasted sandwich intended to be in a heated condition when sold, such as a fried ham sandwich on toast, is a sale of a hot prepared food product even though it may have cooled due to delay. On the other hand, the sale of a toasted sandwich which is not intended to be in a heated condition when sold, such as a cold tuna sandwich on toast, is not a sale of a hot prepared food product.

When a single price has been established for a combination of hot and cold food items, such as a meal or dinner which includes cold components or side items, tax applies to the entire established price regardless of itemization on the sales check. The inclusion of any hot food product in an otherwise cold combination of food products sold for a single established price, results in the tax applying to the entire established price, e.g., hot coffee served with a meal consisting of cold food products, when the coffee is included in the established price of the meal. If a single price for the combination of hot and cold food items is listed on a menu, wall sign or is otherwise advertised, a single price has been established. Except as otherwise provided in (b), (c), (d) or (f) of this regulation, or in Regulation 1574, tax does not apply to the sale for a separate price of bakery goods, beverages classed as food products, or cold or frozen food products. Hot bakery goods and hot beverages such as coffee are hot prepared food products but their sale for a separate price is exempt unless taxable as provided in (b), (c), (d) or (f) of this regulation, or in Regulation 1574. Tax does apply if a hot beverage and a bakery product or cold food product are sold as a combination for a single price. Hot soup, bouillon, or consomme is a hot prepared food product, which is not a beverage.

(2) Air Carriers Engaged in Interstate or Foreign Commerce. Tax does not apply to the sale, storage, use, or other consumption of hot prepared food products sold by caterers or other vendors to air carriers engaged in interstate or foreign commerce for consumption by passengers on such air carriers, nor to the sale, storage, use, or other consumption of hot

prepared food products sold or served to passengers by air carriers engaged in interstate or foreign commerce for consumption by passengers on such air carriers. "Air carriers" are persons or firms in the business of transporting persons or property for hire or compensation, and include both common and contract carriers. "Passengers" do not include crew members. Any caterer or other vendor claiming the exemption must support it with an exemption certificate from the air carrier substantially in the form prescribed in Appendix A of this regulation.

(f) Food for Consumption at Facilities Provided by the Retailer. Tax applies to sales of sandwiches, ice cream, and other foods sold in a form for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others.

A passenger's seat aboard a train, or a spectator's seat at a game, show, or similar event is not a "chair" within the meaning of this regulation. Accordingly, except as otherwise provided in (c), (d), and (e) above, tax does not apply to the sale of cold sandwiches, ice cream, or other food products sold by vendors passing among the passengers or spectators where the food products are not "for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware provided by the retailer."

(g) Tips, Gratuities, and Service Charges. (Prior to January 1, 2015)

The provisions of subdivision (g) apply to transactions occurring prior to January 1, 2015. This subdivision applies to restaurants, hotels, caterers, boarding houses, soda fountains, drive-ins and similar establishments.

An optional payment designated as a tip, gratuity, or service charge is not subject to tax. A mandatory payment designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if the amount is subsequently paid by the retailer to employees.

(1) Optional Payment.

(A) A payment of a tip, gratuity, or service charge is optional if the customer adds the amount to the bill presented by the retailer, or otherwise leaves a separate amount in payment over and above the actual amount due the retailer for the sale of meals, food, and drinks that include services. The following examples illustrate transactions where a payment of a tip, gratuity or service charge is optional and not included in taxable gross receipts. This is true regardless of printed statements on menus, brochures, advertisements or other materials notifying customers that tips, gratuities, or service charges will or may be added by the retailer to the prices of meals, food, or drinks:

Example 1. The restaurant check is presented to the customer with the "tip" area blank so the customer may voluntarily write in an amount, or

Example 2. The restaurant check is presented to the customer with options computed by the retailer and presented to the customer as tip suggestions. The "tip" area is blank so the customer may voluntarily write in an amount:

Guest Check

Food Item A

\$9.95

Beverage Item B	3.75
Subtotal	\$13.70
8% sales tax	1.10
Subtotal	\$14.80
Tip*	
Total	

*Suggested tips:

15%=\$2.06; 18%=\$2.47; 20%=\$2.74; other.

If an employer misappropriates these payments for these charges, as discussed in subdivision (g)(1)(B) below, such payments are included in the retailer's taxable gross receipts.

(B) No employer shall collect, take, or receive any gratuity or a part thereof, paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of such gratuity, or require an employee to credit the amount, or any part thereof, of such gratuity against and as a part of the wages due the employee from the employer. (Labor Code section 351.) If this prohibition is violated, any amount of such gratuities received by the employer will be considered a part of the gross receipts of the employer and subject to the tax.

(2) Mandatory Payment.

(A) An amount negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is mandatory.

(B) When the menu, brochures, advertisements or other printed materials contain statements that notify customers that tips, gratuities, or service charges will or may be added, an amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is a mandatory charge and subject to tax. These amounts are considered negotiated in advance as specified in subdivision (g)(2)(A). Examples of printed statements include:

"An 18% gratuity [or service charge] will be added to parties of 8 or more."

"Suggested gratuity 15%," itemized on the invoice or bill by the restaurant, hotel, caterer, boarding house, soda fountain, drive-in or similar establishment.

"A 15% voluntary gratuity will be added for parties of 8 or more."

An amount will be considered "automatically added" when the retailer adds the tip to the bill without first conferring with the customer after service of the meal and receiving approval to add the tip or without providing the customer with the option to write in the tip. Nonetheless, any amount added by the retailer is presumed to be mandatory. This presumption may be overcome as discussed in subdivision (g)(2)(C) below.

(C) It is presumed that an amount added as a tip by the retailer to the bill or invoice presented to the customer is mandatory. A statement on the bill or invoice that the amount added by the retailer is a "suggested tip," "optional gratuity," or that "the amount may be increased, decreased, or removed" by the customer does not change the mandatory nature of the charge.

This presumption may be controverted by documentary evidence showing that the customer specifically requested and authorized the gratuity be added to the amount billed.

Examples of documentary evidence that may be used to overcome the presumption include:

1. A guest check that is presented to the customer showing sales tax reimbursement and the amount upon which it was computed, without tip or with the "tip" area blank and a separate document, such as a credit card receipt, to which the retailer adds or prints the requested tip.
2. Guests receipts and payments showing that the percentage of tips paid by large groups varies from the percentage stated on the menu, brochure, advertisement or other printed materials.
3. A retailer's written policy stating that its employees shall receive confirmation from a customer before adding a tip together with additional verifiable evidence that the policy has been enforced. The policy is not in itself sufficient documentation to establish that the customer requested and authorized that a gratuity be added to the amount billed without such additional verifiable evidence.

The retailer must retain the guest checks and any additional separate documents to show that the payment is optional. The retailer is also required to maintain other records in accordance with the requirements of Regulation 1698, Records.

(h) Tips, Gratuities, and Service Charges. (On and after January 1, 2015)

The provisions of subdivision (h) apply to transactions occurring on and after January 1, 2015. This subdivision applies to restaurants, hotels, caterers, boarding houses, soda fountains, drive-ins and similar establishments.

An optional payment designated as a tip, gratuity, or service charge is not subject to tax. A mandatory payment designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if it is subsequently paid by the retailer to employees. For purposes of this subdivision, "amount" means a payment designated as a tip, gratuity, service charge, or any other separately stated payment for services associated with the purchase of meals, food, or drinks.

(1) Optional Payment.

When a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service (IRS) purposes, such amounts are presumed to be optional and not subject to tax. When a retailer does not maintain such records, this presumption does not apply and the amounts may be mandatory and included in taxable gross receipts as discussed in subdivisions (h)(2) and (h)(3).

The following examples illustrate transactions where an amount is optional and not included in taxable gross receipts:

Example 1. The restaurant check is presented to the customer with the "tip" area blank so the customer may voluntarily write in the amount, or

Example 2. The restaurant check is presented to the customer with options computed by the retailer and presented to the customer as tip suggestions. The "tip" area is blank so the customer may voluntarily write in the amount:

Guest Check

<u>Food Item A</u>	<u>\$9.95</u>
<u>Beverage Item B</u>	<u>3.75</u>
<u>Subtotal</u>	<u>\$13.70</u>
<u>8% sales tax</u>	<u>1.10</u>
<u>Subtotal</u>	<u>\$14.80</u>
<u>Tip*</u>	
<u>Total</u>	

*Suggested tips:

15%=\$2.06; 18%=\$2.47; 20%=\$2.74; other.

Under these circumstances, the customer is free to enter the amount on the tip line or leave it blank; thus, the customer may enter an amount free from compulsion. The customer and restaurant did not negotiate the amount nor did the restaurant dictate the amount.

If an employer misappropriates these amounts, as discussed in subdivision (h)(4) below, such payments are included in the retailer's taxable gross receipts.

(2) Mandatory Payment.

When a retailer's records reflect that amounts are required to be reported to the IRS as non-tip wages, the amount is deemed to be mandatory.

(3) When a retailer does not maintain records for purposes of reporting the amounts to the IRS:

(A) An amount negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is mandatory.

(B) When the menu, brochures, advertisements or other printed materials contain statements that notify customers that tips, gratuities, or service charges will or may be added, an amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is a mandatory charge and subject to tax. These amounts are considered negotiated in advance as specified in subdivision (h)(3)(A). Examples of printed statements include:

"An 18% gratuity [or service charge] will be added to parties of 8 or more."

"Suggested gratuity 15%," itemized on the invoice or bill by the restaurant, hotel, caterer, boarding house, soda fountain, drive-in or similar establishment.

"A 15% voluntary gratuity will be added for parties of 8 or more."

An amount will be considered "automatically added" when the retailer adds the amount to the bill without first conferring with the customer after service of the meal. Nonetheless, any amount added by the retailer is presumed to be automatically added and mandatory. This presumption may be overcome as discussed in subdivision (h)(3)(C) below.

(C) It is presumed that an amount added as a tip by the retailer to the bill or invoice presented to the customer is automatically added and mandatory. A statement on the bill or invoice that the amount added by the retailer is a "suggested tip," "optional gratuity," or that the amount "may be increased, decreased, or removed" by the customer does not change the mandatory nature of the charge.

This presumption may be controverted by documentary evidence showing that the customer specifically requested and authorized the amount be added to the bill.

Examples of documentary evidence that may be used to overcome the presumption include:

1. A guest check that is presented to the customer showing sales tax reimbursement and the figure upon which it was computed, without "tip" or with the "tip" area blank and a separate document, such as a credit card receipt, to which the retailer adds or prints the requested amount.
2. Guest receipts and payments showing that the percentage of amounts paid by large parties varies from the percentage stated on the menu, brochure, advertisement or other printed materials.
3. A retailer's written policy stating that its employees shall receive confirmation from a customer before adding an amount together with additional verifiable evidence that the policy has been enforced. The policy is not in itself sufficient documentation to establish that the customer requested and authorized that the amount be added to the bill without such additional verifiable evidence.

The retailer must retain the guest checks and any additional separate documents to show that the payment is optional. The retailer is also required to maintain other records in accordance with the requirements of Regulation 1698, *Records*.

(4) No employer shall collect, take, or receive any gratuity or a part thereof, paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of such gratuity, or require an employee to credit the amount, or any part thereof, of such gratuity against and as a part of the wages due the employee from the employer. (Labor Code section 351.) If this prohibition is violated, any amount received by the employer will be considered a part of the gross receipts of the employer and subject to the tax.

(ih) Caterers.

(1) Definition. The term "caterer" as used in this regulation means a person engaged in the business of serving meals, food, or drinks on the premises of the customer, or on premises

supplied by the customer, including premises leased by the customer from a person other than the caterer, but does not include employees hired by the customer by the hour or day.

(2) Sales to Caterers. A caterer generally is considered to be the consumer of tangible personal property normally used in the furnishing and serving of meals, food or drinks, except for separately stated charges by the caterer for the lease of tangible personal property or tangible personal property regarded as being sold with meals, food or drinks such as disposable plates, napkins, utensils, glasses, cups, stemware, place mats, trays, covers and toothpicks.

(3) Sales by Caterers.

(A) Caterer as Retailer. Tax applies to the entire charge made by caterers for serving meals, food, and drinks, inclusive of charges for food, the use of dishes, silverware, glasses, chairs, tables, etc., used in connection with serving meals, and for the labor of serving the meals, whether performed by the caterer, the caterer's employees or subcontractors. Tax applies to charges made by caterers for preparing and serving meals and drinks even though the food is not provided by the caterers. Tax applies to charges made by caterers for hot prepared food products as in (e) above whether or not served by the caterers. A caterer who separately states or itemizes charges for the lease of tangible personal property regardless of the use of the property will be deemed to be the lessor of such property. Tax applies in accordance with Regulation 1660, Leases of Tangible Personal Property - In General. Tax does not apply to charges made by caterers for the rental of dishes, silverware, glasses, etc., purchased by the caterer with tax paid on the purchase price if no food is provided or served by the caterers in connection with such rental.

(B) Caterers as Lessors of Property Unrelated to the Serving or Furnishing of Meals, Food, or Drinks by a Caterer.

1. When a caterer who is furnishing or serving meals, food, or drinks also rents or leases from a third party tangible personal property which the caterer does not use himself or herself and the property is not customarily provided or used within the catering industry in connection with the furnishing and serving of food or drinks, such as decorative props related solely to optional entertainment, special lighting for guest speakers, sound or video systems, dance floors, stages, etc., he or she is a lessor of such property. In such instance, tax applies to the lease in accordance with Regulation 1660.

2. When a person who in other instances is a caterer does not furnish or serve any meals, food, or drinks to a customer, but rents or leases from a third party tangible personal property such as dishes, linen, silverware and glasses, etc., for purposes of providing it to his or her customer, he or she is not acting as a caterer within the meaning of this regulation, but solely as a lessor of tangible personal property. In such instances, tax applies to the lease in accordance with Regulation 1660.

(C) Caterers Planning, Designing and Coordinating Events.

1. Tax applies to charges by a caterer for event planning, design, coordination, and/or supervision if they are made in connection with the furnishing of meals, food, or drinks for the event. Tax does not apply to separately stated charges for services

unrelated to the furnishing and serving of meals, food, or drinks, such as optional entertainment or any staff who do not directly participate in the preparation, furnishing, or serving of meals, food, or drinks, e.g., coat-check clerks, parking attendants, security guards, etc.

2. When a caterer sells meals, food, or drinks, and the serving of them, to other persons such as event planners, party coordinators, or fundraisers, who buy and sell the same on their own account or for their own sake, it is a sale for resale for which the caterer may accept a resale certificate. However, a caterer may only claim the sale as a resale if the caterer obtains a resale certificate in compliance with Regulation 1668. A person is buying or selling for his or her own account, or own sake, when such person has his or her own contract with a customer to sell the meals, food, or drinks to the customer, and is not merely acting on behalf of the caterer.

3. When a caterer sells meals, food or drinks and the serving of them to other persons who charge a fee for their service unrelated to the taxable sale, the separately stated fee is not subject to tax.

(D) Sales of Meals by Caterers to Social Clubs, Fraternal Organizations. Sales of meals to social clubs and fraternal organizations, as those terms are defined in subdivision (j) below, by caterers are sales for resale if such social clubs and fraternal organizations are the retailers of the meals subject to tax under subdivision (j) and give valid resale certificates therefor.

(E) Tips, Gratuities, or Service Charges. Tips, gratuities, and service charges are discussed in subdivisions (g) and (h).

(4) Premises. General. Separately stated charges for the lease of premises on which meals, food, or drinks are served, are nontaxable leases of real property. Where a charge for leased premises is a guarantee against a minimum purchase of meals, food or drinks, the charge for the guarantee is gross receipts subject to tax. Where a person contracts to provide both premises and meals, food or drinks, the charge for the meals, food or drinks must be reasonable in order for the charge for the premises to be nontaxable~~non-taxable~~.

(5) Private Chefs. A private chef is generally not an employee of the customer, but an independent contractor who pays his or her own social security, and federal and state income taxes. Such a private chef, who prepares and serves meals, food and drinks in the home of his or her customer is a caterer under this regulation.

(j) Social Clubs and Fraternal Organizations. "Social Clubs and Fraternal Organizations" as used herein include any corporation, partnership, association or group or combination acting as a unit, such as service clubs, lodges, and community, country, and athletic clubs.

The tax applies to receipts from the furnishing of meals, food, and drink by social clubs and fraternal organizations unless furnished: (1) exclusively to members; and also, (2) less frequently than once a week. Both of these requirements must be met. If the club or organization furnishes meals, food or drink to nonmembers, all receipts from the furnishing of meals, food or drink are subject to tax whether furnished to members or nonmembers, including receipts on occasions when furnished exclusively to members. Meals, food or drink paid for by members are considered furnished to them even though consumed by guests who are not members.

(k) Student Meals.

(1) Definitions.

(A) "Food Products": As used herein, the term "food products" as defined in Regulation 1602 (18 CCR 1602) includes food furnished, prepared, or served for consumption at tables, chairs, or counters, or from trays, glasses, dishes, or other tableware provided by the retailer or by a person with whom the retailer contracts to furnish, prepare or serve food to others.

(B) "Meals": As used herein, the term "meals" includes both food and nonfood products which are sold to students for an established single price at a time set aside for meals. If a single price for the combination of a nonfood product and a food product is listed on a menu or on a sign, a single price has been established. The term "meals" does not include nonfood products which are sold to students for a separate price and tax applies to the sales of such products. Examples of nonfood products are: carbonated beverages and beer. For the purpose of this regulation, products sold at a time designated as a "nutrition break," "recess," or similar break, will not be considered "meals":

(2) Application of Tax.

(A) Sales by Schools, School Districts and Student Organizations. Sales of meals or food products for human consumption to students of a school by public or private schools, school districts, and student organizations are exempt from tax, except as otherwise provided in (d)(4) above.

(B) Sales by Parent-Teacher Associations. Tax does not apply to the sale of, nor the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served to the students of a school by parent-teacher associations. Parent-teacher associations qualifying under Regulation 1597 as consumers are not retailers of tangible personal property, which they sell. Accordingly, tax does apply to the sale to such associations of nonfood items such as carbonated beverages, containers, straws and napkins.

(C) Sales by Blind Vendors. Tax does not apply to the sale of meals or food products for human consumption to students of a school by any blind person (as defined in section 19153 of the Welfare and Institutions Code) operating a restaurant or vending stand in an educational institution under article 5 of chapter 6 of part 2 of division 10 of the Welfare and Institutions Code, except as otherwise provided in (d)(4) above.

(D) Sales by Caterers. The application of tax to sales by caterers in general is explained in subdivision (i) above. However, tax does not apply to the sale by caterers of meals or food products for human consumption to students of a school, if all the following criteria are met:

1. The premises used by the caterer to serve the lunches to the students are used by the school for other purposes, such as sporting events and other school activities, during the remainder of the day;
2. The fixtures and equipment used by the caterer are owned and maintained by the school; and

3. The students purchasing the meals cannot distinguish the caterer from the employees of the school.

(~~lk~~) Employees' Meals.

(1) In General. Any employer or employee organization that is in the business of selling meals, e.g., a restaurant, hotel, club, or association, must include its receipts from the sales of meals to employees, along with its receipts from sales to other purchasers of meals, in the amount upon which it computes its sales tax liability. An employer or an employee organization selling meals only to employees becomes a retailer of meals and liable for sales tax upon its receipts from sales of meals if it sells meals to an average number of five or more employees during the calendar quarter.

(2) Specific Charge. The tax applies only if a specific charge is made to employees for the meals. Tax does not apply to cash paid an employee in lieu of meals. A specific charge is made for meals if:

(A) Employee pays cash for meals consumed.

(B) Value of meals is deducted from employee's wages.

(C) Employee receives meals in lieu of cash to bring compensation up to legal minimum wage.

(D) Employee has the option to receive cash for meals not consumed.

(3) No Specific Charge. If an employer makes no specific charge for meals consumed by employees, the employer is the consumer of the food products and the nonfood~~non-food~~ products, which are furnished to the employees as a part of the meals.

In the absence of any of the conditions under (~~lk~~)-(2) a specific charge is not made if:

(A) A value is assigned to meals as a means of reporting the fair market value of employees' meals pursuant to state and federal laws or regulations or union contracts.

(B) Employees who do not consume available meals have no recourse on their employer for additional cash wages.

(C) Meals are generally available to employees, but the duties of certain employees exclude them from receiving the meals and are paid cash in lieu thereof.

(4) Meals Credited Toward Minimum Wage. If an employee receives meals in lieu of cash to bring his or her compensation up to the legal minimum wage, the amount by which the minimum wage exceeds the amount otherwise paid to the employee is includable in the employer's taxable gross receipts up to the value of the meals credited toward the minimum wage.

For example, if the minimum rate for an eight-hour day is \$46.00, and the employee received \$43.90 in cash, and a lunch is received which is credited toward the minimum wage in the maximum allowable amount of \$2.10, the employer has received gross receipts in the amount of \$2.10 for the lunch.

(5) Tax Reimbursement. If a separately stated amount for tax reimbursement is not added to the price of meals sold to employees for which a specific charge is made, the specific charge will be regarded as being a tax-included charge for the meals.

(~~ml~~) Religious Organizations. Tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served by any religious organization at a social or other gathering conducted by it or under its auspices, if the purpose in furnishing or serving the meals and food products is to obtain revenue for the functions and activities of the organization and the revenue obtained from furnishing or serving the meals and food products is actually used in carrying on such functions and activities. For the purposes of this regulation, "religious organization" means any organization the property of which is exempt from taxation pursuant to subdivision (f) of section 3 of article XIII of the State Constitution.

(~~nm~~) Institutions. Tax does not apply to the sale of, nor the storage, use, or other consumption in this state of, meals and food products for human consumption furnished or served to and consumed by patients or residents of an "institution" as defined in Regulation 1503. Tax, however, does apply to the sale of meals and food products by an institution to persons other than patients or residents of the institution.

(~~on~~) Meal Programs for Low-Income Elderly Persons. Tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served to low-income elderly persons at or below cost by a nonprofit organization or governmental agency under a program funded by this state or the United States for such purposes.

(~~po~~) Food Products, Nonalcoholic Beverages and Other Tangible Personal Property Transferred by Nonprofit Youth Organizations. See Regulation 1597 for the application of tax on food products, nonalcoholic beverages and other tangible personal property transferred by nonprofit youth organizations.

(~~qp~~) Nonprofit Parent-Teacher Associations. Nonprofit parent-teacher associations and equivalent organizations qualifying under Regulation 1597 are consumers and not retailers of tangible personal property, which they sell.

(~~rq~~) Meals and Food Products Served to Condominium Residents. Tax does not apply to the sale of, and the storage, use, or other consumption in this state of meals and food products for human consumption furnished to and consumed by persons 62 years of age or older residing in a condominium and who own equal shares in a common kitchen facility; provided, that the meals and food products are served to such persons on a regular basis.

This exemption is applicable only to sales of meals and food products for human consumption prepared and served at the common kitchen facility of the condominium. Tax applies to sales to persons less than 62 years of age.

(~~sf~~) Veteran's Organization. Beginning April 1, 2004, tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served by any nonprofit veteran's organization at a social or other gathering conducted by it or under its auspices, if the purpose in furnishing or serving the meals and food products is to obtain revenue for the functions and activities of the organization and the revenue obtained from furnishing or serving the meals and food products is actually used in carrying on those functions and activities.

(~~ts~~) Food Stamp Coupons. Tax does not apply to tangible personal property which is eligible to be purchased with federal food stamp coupons acquired pursuant to the Food Stamp Act of 1977

and so purchased. When payment is made in the form of both food stamps and cash, the amount of the food stamp coupons must be applied first to tangible personal property normally subject to the tax, e.g., nonalcoholic carbonated beverages. Retailers are prohibited from adding any amount designated as sales tax, use tax, or sales tax reimbursement to sales of tangible personal property purchased with food stamp coupons. (See paragraph (c) of Regulation 1602.5 for special reporting provisions by grocers.)

(ut) Honor System Snack Sales. An "honor system snack sale" means a system where customers take snacks from a box or tray and pay by depositing money in a container provided by the seller. Snacks sold through such a system may be subject to tax depending upon where the sale takes place. Sales of such snacks are taxable when sold at or near a lunchroom, break room, or other facility that provides tables and chairs, and it is contemplated that the food sold will normally be consumed at such facilities. Honor system snack sales do not include hotel room mini-bars or snack baskets.

¹The records acceptable in support of such a deduction are:

- (a) A sales ticket prepared for each transaction claimed as being tax exempt showing:
 - (1) Date of the sale,
 - (2) The kind of merchandise sold,
 - (3) The quantity of each kind of merchandise sold,
 - (4) The price of each kind of merchandise sold,
 - (5) The total price of merchandise sold,
 - (6) A statement to the effect that the merchandise purchased is not to be consumed on or near the location at which parking facilities are provided by the retailer, and
- (b) A daily sales record kept in sufficient detail to permit verification by audit that all gross receipts from sales have been accounted for and that all sales claimed as being tax exempt are included therein.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374 and 6376.5, Revenue and Taxation Code. Food Products Generally, see Regulation 1602. Sales tax reimbursement, see Regulation 1700. Meals served to residents or patients of an institution, see Regulation 1503. Food products sold through vending machines, see Regulation 1574. Meals at organized camps, see Regulation 1506. Nonprofit organizations as consumers, see Regulation 1597.

Appendix A

California Sales Tax Exemption Certificate
Supporting Exemption Under Section 6359.1

The undersigned certifies that it is an air carrier engaged in interstate or foreign commerce and that the hot prepared food products purchased from _____ will be consumed by passengers on its flights.

The undersigned further certifies that it understands and agrees that if the property purchased under this certificate is used by the purchaser for any purpose other than that specified above, the purchaser shall be liable for sales tax as if it were a retailer making a retail sale of the property at the time of such use, and the sales price of the property to it shall be deemed the gross receipts from such sale.

Date Certificate Given _____

Purchasing Air Carrier _____
(company name)

Address _____

Signed By _____
(signature of authorized person)

(print or type name)

Title _____
(owner, partner, purchasing agent, etc.)

Seller's Permit No. (if any) _____

~~Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374 and 6376.5, Revenue and Taxation Code. Food Products Generally, see Regulation 1602. Alcoholic Beverages, tax reimbursements when served with, see Regulation 1700. "Free" meals with purchased meals, see Regulation 1670. Meals served to patients and inmates of an institution, see Regulation 1503. Vending Machines, when considered selling meals, see Regulation 1574. Meals at summer camps, see Regulation 1506(e). Parent Teacher associations as consumers, see Regulation 1597.~~



January 10, 2014

Susanne Buehler
Chief, Tax Policy Division – Sales and Use Tax Department
California State Board of Equalization
450 N Street
Sacramento, CA 95814
Email: Susanne.Buehler@boe.ca.gov

Jerome Horton
Chairman, California State Board of Equalization
450 N Street
Sacramento, CA 95814

**RE: Regulation 1603 – Taxable Sales of Food Products Clarification of Tax to
Mandatory Tips, Gratuities and Service Charges -- Issue to be discussed at 5/22/14
Business Taxes Committee Meeting**

Dear Ms. Buehler,

On behalf of the California Restaurant Association (CRA), we would like to thank the California State Board of Equalization (BOE) for the opportunity to comment on the proposed regulation, which intends to clarify the application of sales tax on tips, gratuities and services charges under Regulation 1603 *Taxable Sales of Food Products*.

The California Restaurant Association is the definitive voice of the food service industry in California and is the oldest restaurant trade association in the nation. California is home to more than 90,000 eating and drinking places that ring up more than \$58 billion in sales and employ more than 1.4 million workers, making restaurants an indisputable driving force in the state's economy.

Although Regulation 1603 subdivision (g) was amended in 2007 to clarify the application of tax to tips, gratuities and service charges, confusion still remains as to what constitutes "mandatory" versus "optional".

While we differ on what constitutes a "mandatory gratuity" and have discussed that with Board members for years, we greatly appreciate the BOE revisiting the issue in order to

provide better guidance for the appropriate application, if any, of taxes. Updating this rule may be helpful in providing a more uniform approach for retailers and a bright-line rule on the difference between tips and service charges in the application of sales tax.

We look forward to working with staff and interested parties to develop a bright-line approach that will foster reporting compliance and audit efficiency with respects to tip, gratuities and services charges. We appreciate some of the suggestions staff has made and will continue to explore other alternatives that would also clarify the application of tax to these transactions, remove any ambiguity and provide more certainty so that taxpayers can more easily understand their obligation under the Sales and Use Tax Law.

We thank you for your consideration of our comments and look forward to working together on the clarification of this ruling as it relates to restaurant compliance. If you have any questions or would like any additional information, please don't hesitate to contact me directly at 916.431.2773.

Sincerely,



Kara Bush
Senior Legislative Director, Government Affairs + Public Policy
California Restaurant Association





MCCLELLAN DAVIS, LLC
SALES AND USE TAX CONSULTANTS

8928 VOLUNTEER LANE, SUITE 200
SACRAMENTO, CA 95826
(855) 995-6789 | (916) 737-5637
FAX (916) 737-5242 | WWW.USA-SALESTAX.COM
JAMES@USA-SALESTAX.COM

January 10, 2014

Ms. Susanne Buehler, Chief
Board of Equalization
Tax Policy Division
Sales and Use Tax Department
450 N Street
Sacramento, CA 94279-0092

VIA: Email: Susanne.Beuhler@boe.ca.gov

Re: Comments related to proposed revision of Regulation 1603, Taxable Sales of Food Products.

Dear Ms. Buehler,

This submission is in response to the Initial Discussion Paper issued on November 22, 2013, in addition to the interested parties meeting held on December 10, 2013 regarding the proposed revisions to Regulation 1603, *Taxable Sales of Food Products*.

Because our firm has been involved with numerous California sales and use tax audits of restaurant establishments over the years, and nearly all of our consultants were previously Board of Equalization auditors, we can provide a useful perspective on the subject regulation.

Along with our firm's knowledge and expertise, I personally have over 15 years of experience in the restaurant industry both as a manager and owner. I can speak first-hand about the confusion that surrounds the application of tax to gratuities and I applaud the Board's efforts at providing further clarification on the matter.

Ms. Susanne Buehler, Chief
Proposed Regulation 1603
January 10, 2014
Page 2 of 4

Tips, Gratuities, and Service Charges

Sections (g)(1) and (g)(2) of the proposed language attempt to clarify the taxability of gratuities by creating a presumption based on whether the amounts paid are required to be reported to the Internal Revenue Service (IRS) as ‘tip wages’ or ‘non-tip wages’.

Optional Payment- “When a retailer keeps records consistent with reporting the tips as tip wages for IRS purposes, such amounts are presumed to be optional and not subject to tax.”

Mandatory Payment- “A payment of a tip...is deemed mandatory if the amounts are required to be reported, for the purposes of income tax to the Internal Revenue Service, as non-tip wages.”

As was discussed at the interested parties meeting, a taxpayer that lacks support for the IRS tip designations would not benefit from the proposed presumption.

Discussion

Based on our experience in the industry we are certain there will be taxpayers that do not explicitly follow the IRS’ reporting guidelines, and as a result, will lack a thorough understanding of the difference between the two designations. In addition, if a taxpayer fails to “keep records consistent with reporting these tips as tip wages for IRS purposes” (to quote the proposed language of the regulation), optional gratuities could incorrectly be presumed to be mandatory. In the context of an audit, it could then become overly difficult and time consuming for taxpayers to overcome the presumption.

In an effort to avoid confusion by taxpayers, and the audit staff, we recommend that the following examples (which are currently slated for removal) be retained in the Regulation.

The examples provided in the current Regulation which we recommend retaining include the following:

(A) An amount negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is mandatory.

(B) When the menu, brochures, advertisements or other printed materials contain statements that notify customers that tips, gratuities, or service charges will or may be

Ms. Susanne Buehler, Chief
Proposed Regulation 1603
January 10, 2014
Page 3 of 4

added, an amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is a mandatory charge and subject to tax. These amounts are considered negotiated in advance as specified in subdivision (g)(2)(A). Examples of printed statements include:

"An 18% gratuity [or service charge] will be added to parties of 8 or more."

"Suggested gratuity 15%," itemized on the invoice or bill by the restaurant, hotel, caterer, boarding house, soda fountain, drive-in or similar establishment.

"A 15%voluntary gratuity will be added for parties of 8 or more."

An amount will be considered "automatically added" when the retailer adds the tip to the bill without first conferring with the customer after service of the meal and receiving approval to add the tip or without providing the customer with the option to write in the tip. Nonetheless, any amount added by the retailer is presumed to be mandatory. This presumption may be overcome as discussed in subdivision (g)(2)(C) below.

(C) It is presumed that an amount added as a tip by the retailer to the bill or invoice presented to the customer is mandatory. A statement on the bill or invoice that the amount added by the retailer is a "suggested tip," "optional gratuity," or that "the amount may be increased, decreased, or removed" by the customer does not change the mandatory nature of the charge.

This presumption may be controverted by documentary evidence showing that the customer specifically requested and authorized the gratuity be added to the amount billed.

Examples of documentary evidence that may be used to overcome the presumption include:

- 1. A guest check that is presented to the customer showing sales tax reimbursement and the amount upon which it was computed, without tip or with the "tip" area blank and a separate document, such as a credit card receipt, to which the retailer adds or prints the requested tip.*
- 2. Guest receipts and payments showing that the percentage of tips paid by large groups varies from the percentage stated on the menu, brochure, advertisement or other printed materials.*

Ms. Susanne Buehler, Chief
Proposed Regulation 1603
January 10, 2014
Page 4 of 4

3. A retailer's written policy stating that its employees shall receive confirmation from a customer before adding a tip together with additional verifiable evidence that the policy has been enforced. The policy is not in itself sufficient documentation to establish that the customer requested and authorized that a gratuity be added to the amount billed without such additional verifiable evidence.

The retailer must retain the guest checks and any additional separate documents to show that the payment is optional. The retailer is also required to maintain other records in accordance with the requirements of Regulation 1698, Records.

These examples provide taxpayers and auditors with useful and necessary guidance for audit and tax compliance purposes.

Conclusion

Therefore, we request that the Board maintain the aforementioned portions of the current regulation.

Thank you for the opportunity to submit these suggestions. Please feel free to contact me with any questions or comments.

Sincerely,

James R. Dumler
Senior Consultant



March 6, 2014

Susanne Buehler
Chief, Tax Policy Division – Sales and Use Tax Department
California State Board of Equalization
450 N Street
Sacramento, CA 95814
Email: Susanne.Buehler@boe.ca.gov

Jerome Horton
Chairman, California State Board of Equalization
450 N Street
Sacramento, CA 95814

RE: Regulation 1603 – Taxable Sales of Food Products Clarification of Tax to Mandatory Tips, Gratuities and Service Charges -- Issue to be discussed at 5/22/14 Business Taxes Committee Meeting

Dear Ms. Buehler,

On behalf of the California Restaurant Association (CRA), we would like to thank the California State Board of Equalization (BOE) for the opportunity to comment on the proposed regulation, which intends to clarify the application of sales tax on tips, gratuities and services charges under Regulation 1603 *Taxable Sales of Food Products*.

The California Restaurant Association is the definitive voice of the food service industry in California and is the oldest restaurant trade association in the nation. California is home to more than 90,000 eating and drinking places that ring up more than \$58 billion in sales and employ more than 1.4 million workers, making restaurants an indisputable driving force in the state's economy.

The CRA has a lengthy history on this issue and has discussed with individual Board members over the years our objection to the current practice of taxing "mandatory tips." For sales tax purposes, the BOE separates tips associated with taxable sales and service into two basic categories: optional payments, which are generally not taxable, and mandatory payments, which are.

Thus, if a tip is classified as a mandatory payment, the restaurateur is responsible for paying sales taxes on such tip amounts to the BOE. This is true even though the

restaurateur never received any part of the tips and the tips are the sole property of their employees.

The CRA has sought to change this regulation, arguing that the policy/concept the BOE created in taxing "mandatory tips" is contrary to current law, as the law indicates tips are the sole property of employees.

Although Regulation 1603 subdivision (g) was amended in 2007 to clarify the application of tax to tips, gratuities and service charges, confusion still remains as to what constitutes "mandatory" versus "optional".

While we differ on what constitutes a "mandatory gratuity" and have discussed that with Board members for years, we appreciate the BOE revisiting the issue in order to provide better guidance for the appropriate application, *if any*, of taxes. Updating this rule may be helpful in providing a more uniform approach for retailers and a bright-line rule on the difference between tips and service charges in the application of sales tax.

Suggestions for such a "bright line" in the issue papers and those discussed at both interested parties meetings certainly have merit and we appreciate those ideas.

It remains to be seen how restaurants respond to the relatively recent implementation of the federal IRS ruling that "mandatory tips" will now be classified as wages and how that interplays with the BOE's current practice of taxing "mandatory tips."

We thank you for your consideration of our comments and look forward to working together on the clarification of this ruling as it relates to restaurant compliance.

Sincerely,



Matt Sutton
Vice President, Government Affairs & Public Policy



BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N STREET

SACRAMENTO, CALIFORNIA

REPORTER'S TRANSCRIPT

MAY 22, 2014

BUSINESS TAXES COMMITTEE

REPORTED BY: Kathleen Skidgel

CSR NO. 9039

P R E S E N T

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For the Committee:

Michelle Steel
Chair

Betty T. Yee
Member

George Runner
Member

Marcy Jo Mandel
Appearing for John
Chiang, State Controller
(per Government Code
Section 7.9)

Joann Richmond
Chief
Board Proceedings
Division

For Board of
Equalization Staff:

Susanne Buehler
Chief
Tax Policy Division

Cary Huxsoll
Tax Counsel III
Legal Department

Speaker:

Matt Sutton
Vice President Government
Affairs
California Restaurant
Association

---oOo---

1 450 N STREET
2 SACRAMENTO, CALIFORNIA
3 MAY 22, 2014

4 ---oOo---

5 MS. STEEL: Ms. Richmond.

6 MS. RICHMOND: Our next item is the
7 Business Taxes Committee. Ms. Steel is the Chair of
8 that committee.

9 Ms. Steel.

10 MS. STEEL: I'm really busy today.

11 MS. RICHMOND: And we do have a speaker.

12 MS. STEEL: Okay. I call the Business Tax
13 Committee meeting to order.

14 And we have only one item here, I believe.
15 And staff is going to explain that what -- present
16 the items here.

17 MS. BUEHLER: Certainly.

18 Good morning. I am Susanne Buehler with
19 the Sales and Use Tax Department. With me is Mr.
20 Cary Huxsoll from our Legal Department.

21 We have one agenda item for your
22 consideration this morning. For this agenda item we
23 request your approval and authorization to publish
24 proposed amendments to regul- -- Sales and Use Tax
25 Regulation 1603, taxable sales of food products, to
26 clarify the application of tax to tips, gratuities
27 and service charges.

28 We request that the Board approve

1 publication of the proposed amendments subject to
2 conforming to the official Office of Administrative
3 Law text at the time of publication.

4 Staff's recommended amendments, which have
5 a prospective application, specify that tips,
6 gratuities and service charges are presumed optional
7 and not subject to tax when a retailer keeps records
8 consistent with reporting such amounts as tip wages
9 for Internal Revenue Service purposes.

10 The recommended amendments also include
11 other technical and nonsubstantive amendments
12 throughout the regulation.

13 If we have speakers on this item, we would
14 happy -- be happy to answer any questions you may
15 have after their presentation.

16 MS. STEEL: Yeah, we have one speaker,
17 Mr. Matt Sutton from California Restaurant
18 Associations.

19 Good morning.

20 ---oOo---

21 MATT SUTTON

22 ---oOo---

23 MR. SUTTON: Good morning. Thank you.

24 I will be brief, but I wanted to thank the
25 Board for the leadership on this issue and the staff
26 for the interested parties process, and just for
27 taking a look at this issue.

28 I'm Matt Sutton with the California

1 Restaurant Association. We represent about 22,000
2 different eating establishments throughout the
3 state.

4 This issue has been an issue that's -- it's
5 been a big one for us for many years, and I know
6 we've talked with the Board Members individually
7 about sort of our underlying objection to applying
8 sales tax to gratuities that are deemed mandatory.

9 This approach does provide some
10 clarification and we appreciate that. And, again, I
11 just, you know, wanted to highlight just a few
12 things that when a tip is classified as a mandatory
13 payment, the restaurateur is paying the sales tax on
14 that tip, even though the restaurateur did not
15 receive that tip and the tip is the sole property of
16 the employee; that's state law.

17 So, the reason many restaurateurs put the
18 language on the menu and have that system on the
19 billing is so that there's proper tipping for the
20 servers. And what we find when people are
21 disincentivized to do that quote/unquote auto
22 gratuity, servers get far, far, far less in tips.
23 And so the "18 percent" language helps people, you
24 know, pay on larger parties, you know, more
25 appropriate tip amounts.

26 And so that's, you know, sort of where our
27 underlying objection has been for years, and we've
28 talked to you about it and appreciate this movement.

1 It's movement in the right direction, and we want to
2 thank you.

3 MS. STEEL: Thank you, Mr. Sutton.

4 Any comments?

5 I just want to say thank you to staff that,
6 you know, this is actually more of the big
7 restaurant chains. But, you know, staff really
8 worked with our office closely with try to help for
9 small restaurants, too. So we decide to keep that
10 language, that, you know, the mandatory and optional
11 stuffs on the regulations. So I really appreciate
12 this.

13 And, Members, any motion here?

14 MR. RUNNER: Move -- move the staff
15 recommendation.

16 MS. STEEL: Thank you.

17 MS. YEE: Second.

18 MS. STEEL: Okay. Moved and second.

19 Thank you very much, staff.

20 MS. BUEHLER: Thank you.

21 MS. STEEL: Okay. That concludes Business
22 Tax Association -- Committee meeting.

23 ---oOo---

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REPORTER'S CERTIFICATE

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State of California)
) ss
County of Sacramento)

I, KATHLEEN SKIDGEL, Hearing Reporter for the California State Board of Equalization certify that on May 22, 2014 I recorded verbatim, in shorthand, to the best of my ability, the proceedings in the above-entitled hearing; that I transcribed the shorthand writing into typewriting; and that the preceding pages 1 through 6 constitute a complete and accurate transcription of the shorthand writing.

Dated: May 28, 2014

Kathleen Skidgel

KATHLEEN SKIDGEL, CSR #9039

Hearing Reporter



**ESTIMATE OF COST OR SAVINGS RESULTING
FROM PROPOSED REGULATORY ACTION**

Proposed Amendment of Sales and Use Tax Regulation 1603, Taxable Sales of Food Products

STATEMENT OF COST OR SAVINGS FOR NOTICE OF PUBLIC HEARING

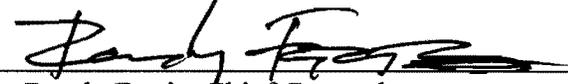
The State Board of Equalization has determined that the proposed action does not impose a mandate on local agencies or school districts. Further, the Board has determined that the action will result in no direct or indirect cost or savings to any State agency, any local agency or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the Government Code or other non-discretionary cost or savings imposed on local agencies, or cost or savings in Federal funding to the State of California.

The cost impact on private persons or businesses will be insignificant. This proposal will not have a significant adverse economic impact on businesses.

This proposal will not be detrimental to California businesses in competing with businesses in other states.

This proposal will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses or create or expand business in the State of California.

Statement
Prepared by  Date 7-24-14
Richard Bennion, Regulations Coordinator

Approved by  Date 7/25/14
Randy Ferris, Chief Counsel

If Costs or Savings are Identified, Signatures of Chief, Fiscal Management Division, and Chief, Board Proceedings Division, are Required

Approved by _____ Date _____
Chief, Financial Management Division

Approved by _____ Date _____
Chief, Board Proceedings Division

NOTE: SAM Section 6615 requires that estimates resulting in cost or savings be submitted for Department of Finance concurrence before the notice of proposed regulatory action is released.

**ECONOMIC AND FISCAL IMPACT STATEMENT
(REGULATIONS AND ORDERS)**

STD. 399 (REV. 12/2013)

ECONOMIC IMPACT STATEMENT

DEPARTMENT NAME The Board of Equalization	CONTACT PERSON Richard E. Bennion	EMAIL ADDRESS rbennion@boe.ca.gov	TELEPHONE NUMBER 916-445-2130
DESCRIPTIVE TITLE FROM NOTICE REGISTER OR FORM 400 Title 18, Section 1603, Taxable Sale of Food Products			NOTICE FILE NUMBER Z

A. ESTIMATED PRIVATE SECTOR COST IMPACTS *Include calculations and assumptions in the rulemaking record.*

1. Check the appropriate box(es) below to indicate whether this regulation:

- | | |
|----------------------------------------------------------------|---------------------------------------------------------------------------|
| <input type="checkbox"/> a. Impacts business and/or employees | <input type="checkbox"/> e. Imposes reporting requirements |
| <input type="checkbox"/> b. Impacts small businesses | <input type="checkbox"/> f. Imposes prescriptive instead of performance |
| <input type="checkbox"/> c. Impacts jobs or occupations | <input type="checkbox"/> g. Impacts individuals |
| <input type="checkbox"/> d. Impacts California competitiveness | <input checked="" type="checkbox"/> h. None of the above (Explain below): |

Please see the attached .

***If any box in Items 1 a through g is checked, complete this Economic Impact Statement.
If box in Item 1.h. is checked, complete the Fiscal Impact Statement as appropriate.***

2. The _____ estimates that the economic impact of this regulation (which includes the fiscal impact) is:
(Agency/Department)

- Below \$10 million
 Between \$10 and \$25 million
 Between \$25 and \$50 million
 Over \$50 million *[If the economic impact is over \$50 million, agencies are required to submit a Standardized Regulatory Impact Assessment as specified in Government Code Section 11346.3(c)]*

3. Enter the total number of businesses impacted: _____

Describe the types of businesses (Include nonprofits): _____

Enter the number or percentage of total businesses impacted that are small businesses: _____

4. Enter the number of businesses that will be created: _____ eliminated: _____

Explain: _____

5. Indicate the geographic extent of impacts: Statewide
 Local or regional (List areas): _____

6. Enter the number of jobs created: _____ and eliminated: _____

Describe the types of jobs or occupations impacted: _____

7. Will the regulation affect the ability of California businesses to compete with other states by making it more costly to produce goods or services here? YES NO

If YES, explain briefly: _____

**ECONOMIC AND FISCAL IMPACT STATEMENT
(REGULATIONS AND ORDERS)**

STD. 399 (REV. 12/2013)

ECONOMIC IMPACT STATEMENT (CONTINUED)

B. ESTIMATED COSTS *Include calculations and assumptions in the rulemaking record.*

1. What are the total statewide dollar costs that businesses and individuals may incur to comply with this regulation over its lifetime? \$ _____
 - a. Initial costs for a small business: \$ _____ Annual ongoing costs: \$ _____ Years: _____
 - b. Initial costs for a typical business: \$ _____ Annual ongoing costs: \$ _____ Years: _____
 - c. Initial costs for an individual: \$ _____ Annual ongoing costs: \$ _____ Years: _____
 - d. Describe other economic costs that may occur: _____

2. If multiple industries are impacted, enter the share of total costs for each industry: _____

3. If the regulation imposes reporting requirements, enter the annual costs a typical business may incur to comply with these requirements. *Include the dollar costs to do programming, record keeping, reporting, and other paperwork, whether or not the paperwork must be submitted.* \$ _____

4. Will this regulation directly impact housing costs? YES NO
 If YES, enter the annual dollar cost per housing unit: \$ _____
 Number of units: _____

5. Are there comparable Federal regulations? YES NO

Explain the need for State regulation given the existence or absence of Federal regulations: _____

Enter any additional costs to businesses and/or individuals that may be due to State - Federal differences: \$ _____

C. ESTIMATED BENEFITS *Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.*

1. Briefly summarize the benefits of the regulation, which may include among others, the health and welfare of California residents, worker safety and the State's environment: _____

2. Are the benefits the result of: specific statutory requirements, or goals developed by the agency based on broad statutory authority?

Explain: _____

3. What are the total statewide benefits from this regulation over its lifetime? \$ _____

4. Briefly describe any expansion of businesses currently doing business within the State of California that would result from this regulation: _____

D. ALTERNATIVES TO THE REGULATION *Include calculations and assumptions in the rulemaking record. Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.*

1. List alternatives considered and describe them below. If no alternatives were considered, explain why not: _____

**ECONOMIC AND FISCAL IMPACT STATEMENT
(REGULATIONS AND ORDERS)**

STD. 399 (REV. 12/2013)

ECONOMIC IMPACT STATEMENT (CONTINUED)

2. Summarize the total statewide costs and benefits from this regulation and each alternative considered:

Regulation: Benefit: \$ _____ Cost: \$ _____

Alternative 1: Benefit: \$ _____ Cost: \$ _____

Alternative 2: Benefit: \$ _____ Cost: \$ _____

3. Briefly discuss any quantification issues that are relevant to a comparison of estimated costs and benefits for this regulation or alternatives: _____

4. Rulemaking law requires agencies to consider performance standards as an alternative, if a regulation mandates the use of specific technologies or equipment, or prescribes specific actions or procedures. Were performance standards considered to lower compliance costs? YES NO

Explain: _____

E. MAJOR REGULATIONS Include calculations and assumptions in the rulemaking record.

California Environmental Protection Agency (Cal/EPA) boards, offices and departments are required to submit the following (per Health and Safety Code section 57005). Otherwise, skip to E4.

1. Will the estimated costs of this regulation to California business enterprises exceed \$10 million? YES NO

If YES, complete E2. and E3

If NO, skip to E4

Briefly describe each alternative, or combination of alternatives, for which a cost-effectiveness analysis was performed:

Alternative 1: _____

Alternative 2: _____

(Attach additional pages for other alternatives)

3. For the regulation, and each alternative just described, enter the estimated total cost and overall cost-effectiveness ratio:

Regulation: Total Cost \$ _____ Cost-effectiveness ratio: \$ _____

Alternative 1: Total Cost \$ _____ Cost-effectiveness ratio: \$ _____

Alternative 2: Total Cost \$ _____ Cost-effectiveness ratio: \$ _____

4. Will the regulation subject to OAL review have an estimated economic impact to business enterprises and individuals located in or doing business in California exceeding \$50 million in any 12-month period between the date the major regulation is estimated to be filed with the Secretary of State through 12 months after the major regulation is estimated to be fully implemented?

YES NO

If YES, agencies are required to submit a Standardized Regulatory Impact Assessment (SRIA) as specified in Government Code Section 11346.3(c) and to include the SRIA in the Initial Statement of Reasons.

5. Briefly describe the following:

The increase or decrease of investment in the State: _____

The incentive for innovation in products, materials or processes: _____

The benefits of the regulations, including, but not limited to, benefits to the health, safety, and welfare of California residents, worker safety, and the state's environment and quality of life, among any other benefits identified by the agency: _____

**ECONOMIC AND FISCAL IMPACT STATEMENT
(REGULATIONS AND ORDERS)**

STD. 399 (REV. 12/2013)

FISCAL IMPACT STATEMENT

A. FISCAL EFFECT ON LOCAL GOVERNMENT *Indicate appropriate boxes 1 through 6 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.*

1. Additional expenditures in the current State Fiscal Year which are reimbursable by the State. (Approximate)
(Pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code).

\$ _____

a. Funding provided in _____

Budget Act of _____ or Chapter _____, Statutes of _____

b. Funding will be requested in the Governor's Budget Act of _____

Fiscal Year: _____

2. Additional expenditures in the current State Fiscal Year which are NOT reimbursable by the State. (Approximate)
(Pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code).

\$ _____

Check reason(s) this regulation is not reimbursable and provide the appropriate information:

a. Implements the Federal mandate contained in _____

b. Implements the court mandate set forth by the _____ Court.

Case of: _____ vs. _____

c. Implements a mandate of the people of this State expressed in their approval of Proposition No. _____

Date of Election: _____

d. Issued only in response to a specific request from affected local entity(s).

Local entity(s) affected: _____

e. Will be fully financed from the fees, revenue, etc. from: _____

Authorized by Section: _____ of the _____ Code;

f. Provides for savings to each affected unit of local government which will, at a minimum, offset any additional costs to each;

g. Creates, eliminates, or changes the penalty for a new crime or infraction contained in _____

3. Annual Savings. (approximate)

\$ _____

4. No additional costs or savings. This regulation makes only technical, non-substantive or clarifying changes to current law regulations.

5. No fiscal impact exists. This regulation does not affect any local entity or program.

6. Other. Explain

**ECONOMIC AND FISCAL IMPACT STATEMENT
(REGULATIONS AND ORDERS)**

STD. 399 (REV. 12/2013)

FISCAL IMPACT STATEMENT (CONTINUED)

B. FISCAL EFFECT ON STATE GOVERNMENT *Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.*

1. Additional expenditures in the current State Fiscal Year. (Approximate)

\$ _____

It is anticipated that State agencies will:

a. Absorb these additional costs within their existing budgets and resources.

b. Increase the currently authorized budget level for the _____ Fiscal Year

2. Savings in the current State Fiscal Year. (Approximate)

\$ _____

3. No fiscal impact exists. This regulation does not affect any State agency or program.

4. Other. Explain _____

C. FISCAL EFFECT ON FEDERAL FUNDING OF STATE PROGRAMS *Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.*

1. Additional expenditures in the current State Fiscal Year. (Approximate)

\$ _____

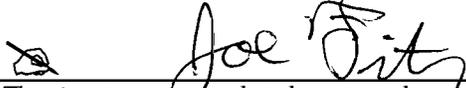
2. Savings in the current State Fiscal Year. (Approximate)

\$ _____

3. No fiscal impact exists. This regulation does not affect any federally funded State agency or program.

4. Other. Explain _____

FISCAL OFFICER SIGNATURE



DATE

June 10, 2014

The signature attests that the agency has completed the STD. 399 according to the instructions in SAM sections 6601-6616, and understands the impacts of the proposed rulemaking. State boards, offices, or departments not under an Agency Secretary must have the form signed by the highest ranking official in the organization.

AGENCY SECRETARY



DATE

June 10, 2014

Finance approval and signature is required when SAM sections 6601-6616 require completion of Fiscal Impact Statement in the STD. 399.

DEPARTMENT OF FINANCE PROGRAM BUDGET MANAGER

Exempt under SAM section 6615

DATE

Attachment to Economic and Fiscal Impact
Statement (STD. 399 (Rev. 12/2013)) for the Proposed Amendments to
California Code of Regulations, Title 18, Section 1603,
Taxable Sale of Food Products

As explained in more detail in the initial statement of reasons, California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (Rev. & Tax. Code, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California. (Rev. & Tax. Code, §§ 6012, 6051.) The term "gross receipts" means the total amount of the sale price without any deduction for the cost of materials used, labor or service costs, interest paid, losses, or any other expense. (Rev. & Tax. Code, § 6012, subd. (a)(2).) Gross receipts include any services that are part of the sale and all receipts, cash, credits, and property of any kind. (Rev. & Tax. Code, § 6012.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700, subd. (a)(1).)

Sales of food products from human consumption are generally exempt from tax. However, this exemption does not apply to sales of food products furnished, prepared, or served for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware whether provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others, or to sales of food products served as meals on or off the premises of the retailer. (Rev. & Tax. Code, § 6359.)

California Code of Regulations, title 18, section (Regulation) 1603, *Taxable Sales of Food Products*, provides guidance to restaurants, hotels, boarding houses, soda fountains, and similar establishments that make taxable sales of food products. Under Regulation 1603, subdivision (g), optional payments designated as tips, gratuities, and service charges are not subject to tax; however, mandatory payments designated as tips, gratuities, and service charges are included in gross receipts subject to tax, even if the amount is subsequently paid by the retailer to the server.

On June 25, 2012, the Internal Revenue Service published Internal Revenue Bulletin No. 2012-26, which includes Revenue Ruling 2012-18. This revenue ruling clarified and updated guidelines on taxes imposed on tips under the Federal Insurance Contributions Act, including information on the difference between tips (tip wages) and service charges (non-tip wages). The ruling reaffirmed prior guidance which provided that the absence of any of the four following factors creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge: 1. The payment must be made free from compulsion; 2. The customer must have the unrestricted right to determine the amount; 3. The payment should not be the subject of negotiation or dictated by employer policy; 4. Generally, the customer has the right to determine who receives the payment.

The proposed amendments add subdivision (h) to Regulation 1603 to define "amount" as a payment designated as a tip, gratuity, service charge, or any other separately stated payment for services associated with the purchase of meals, food, or drinks. The proposed amendments provide a new presumption that for transactions occurring on and after January 1, 2015, when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue

Service purposes, such amounts are presumed to be optional and not subject to tax. When a retailer does not maintain such records, this newly added presumption does not apply. Otherwise, the proposed amendments provide examples of transactions where amounts are optional and not subject to tax that are consistent with the examples currently in Regulation 1603, subdivision (g).

The proposed amendments adding subdivision (h) to Regulation 1603 also provide that when a retailer's records reflect that amounts are required to be reported to the Internal Revenue Service as non-tip wages, the amount is deemed to be mandatory. The proposed amendments prescribe the application of tax when the examples of amounts that are optional do not apply and a retailer does not maintain records for purposes of reporting the amounts to the Internal Revenue Service, in a manner that is consistent with the way the application of tax is prescribed by the current provisions of Regulation 1603, subdivision (g). The proposed amendments provide that when an amount is negotiated between the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks, the amount is mandatory. When the menu or other printed materials notify customers that amounts will or may be added by the retailer to the bill, and such amounts are automatically added by the retailer to the bill, the amount is a mandatory charge and subject to tax. It is presumed that an amount added by the retailer to the bill is automatically added and mandatory; however, this presumption may be overcome by documentary evidence showing that the customer specifically requested and authorized the amount to be added to the bill.

Also, as explained in the initial statement of reasons, the proposed amendments are intended to address retailers' compliance issues due to the confusion regarding what constitutes "mandatory" versus "optional" tips, gratuities, and service charges by establishing a bright-line approach to how to treat amounts added by retailers to customers' bills that is consistent with how the retailers treated the amounts for Internal Revenue Service purposes.

Therefore, there is nothing in the proposed amendments to Regulation 1603 that would significantly change how restaurants and similar establishments would generally behave in the absence of the proposed amendments. And, there is nothing in the proposed amendments to Regulation 1603 that would impact sales and use tax revenue.

In addition, the amendments to Regulation 1603 do not impose any costs on any persons, including restaurant businesses, because the proposed amendments do not impose new record keeping requirements and take into account, rather than impact, current practices in the restaurant industry regarding tips, gratuities, and service charges.

Furthermore, the Board anticipates that the proposed amendments to Regulation 1603 will promote fairness and benefit retailers, Board staff, and the Board by providing regulatory provisions that may be applied using a bright-line approach that is consistent with federal tax reporting, and thereby reduce confusion for retailers and staff.

Therefore, based upon the foregoing information and all of the information in the rulemaking file, the Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed regulatory action, and the Board has determined that the proposed amendments to Regulation 1603:

- Will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states;
- Will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California;
- Will not have a significant effect on housing costs;
- Will result in no direct or indirect cost or savings to any state agency, no cost to any local agency or school district that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, no other non-discretionary cost or savings imposed on local agencies, and no cost or savings in federal funding to the State of California; and
- Will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

The Board has also determined that the proposed amendments to Regulation 1603 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed amendments will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars (\$50,000,000) during any 12-month period.

Finally, Regulation 1603 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Regulation 1603 will not affect the benefits of Regulation 1603 to the health and welfare of California residents, worker safety, or the state's environment.

NOTICE PUBLICATION/REGULATIONS SUBMISSION

(See instructions on reverse)

For use by Secretary of State only

STD. 400 (REV. 01-2013)

OAL FILE NUMBERS	NOTICE FILE NUMBER Z-2014-0610-02	REGULATORY ACTION NUMBER	EMERGENCY NUMBER
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For use by Office of Administrative Law (OAL) only

<p>RECEIVED FOR FILING PUBLICATION DATE</p> <p>JUN 10 '14 JUN 20 '14</p> <p>Office of Administrative Law</p>	<p>NOTICE</p>	<p>REGULATIONS</p>
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AGENCY WITH RULEMAKING AUTHORITY State Board of Equalization	AGENCY FILE NUMBER (If any)
------------------------------------------------------------------------	------------------------------------

A. PUBLICATION OF NOTICE (Complete for publication in Notice Register)

1. SUBJECT OF NOTICE Taxable Sales of Food Products		TITLE(S) 18	FIRST SECTION AFFECTED 1603	2. REQUESTED PUBLICATION DATE June 20, 2014
3. NOTICE TYPE <input checked="" type="checkbox"/> Notice re Proposed Regulatory Action <input type="checkbox"/> Other		4. AGENCY CONTACT PERSON Rick Bennion		TELEPHONE NUMBER (916) 445-2130
OAL USE ONLY		ACTION ON PROPOSED NOTICE		FAX NUMBER (Optional) (916) 324-3984
<input type="checkbox"/> Approved as Submitted		<input type="checkbox"/> Approved as Modified		<input type="checkbox"/> Disapproved/Withdrawn
NOTICE REGISTER NUMBER			PUBLICATION DATE	

B. SUBMISSION OF REGULATIONS (Complete when submitting regulations)

1a. SUBJECT OF REGULATION(S)	1b. ALL PREVIOUS RELATED OAL REGULATORY ACTION NUMBER(S)
-------------------------------------	-----------------------------------------------------------------

SPECIFY CALIFORNIA CODE OF REGULATIONS TITLE(S) AND SECTION(S) (Including title 26, if toxics related)

SECTION(S) AFFECTED (List all section number(s) individually. Attach additional sheet if needed.)	ADOPT
	AMEND
	REPEAL
TITLE(S)	

3. TYPE OF FILING

<input type="checkbox"/> Regular Rulemaking (Gov. Code §11346)	<input type="checkbox"/> Certificate of Compliance: The agency officer named below certifies that this agency complied with the provisions of Gov. Code §§11346.2-11347.3 either before the emergency regulation was adopted or within the time period required by statute.	<input type="checkbox"/> Emergency Readopt (Gov. Code, §11346.1(h))	<input type="checkbox"/> Changes Without Regulatory Effect (Cal. Code Regs., title 1, §100)
<input type="checkbox"/> Resubmittal of disapproved or withdrawn nonemergency filing (Gov. Code §§11349.3, 11349.4)	<input type="checkbox"/> Resubmittal of disapproved or withdrawn emergency filing (Gov. Code, §11346.1)	<input type="checkbox"/> File & Print	<input type="checkbox"/> Print Only
<input type="checkbox"/> Emergency (Gov. Code, §11346.1(b))		<input type="checkbox"/> Other (Specify) _____	

4. ALL BEGINNING AND ENDING DATES OF AVAILABILITY OF MODIFIED REGULATIONS AND/OR MATERIAL ADDED TO THE RULEMAKING FILE (Cal. Code Regs. title 1, §44 and Gov. Code §11347.1)

5. EFFECTIVE DATE OF CHANGES (Gov. Code, §§ 11343.4, 11346.1(d); Cal. Code Regs., title 1, §100)

<input type="checkbox"/> Effective January 1, April 1, July 1, or October 1 (Gov. Code §11343.4(a))	<input type="checkbox"/> Effective on filing with Secretary of State	<input type="checkbox"/> §100 Changes Without Regulatory Effect	<input type="checkbox"/> Effective other (Specify) _____
-----------------------------------------------------------------------------------------------------	----------------------------------------------------------------------	-----------------------------------------------------------------	----------------------------------------------------------

6. CHECK IF THESE REGULATIONS REQUIRE NOTICE TO, OR REVIEW, CONSULTATION, APPROVAL OR CONCURRENCE BY, ANOTHER AGENCY OR ENTITY

<input type="checkbox"/> Department of Finance (Form STD. 399) (SAM §6660)	<input type="checkbox"/> Fair Political Practices Commission	<input type="checkbox"/> State Fire Marshal
<input type="checkbox"/> Other (Specify) _____		

7. CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)	E-MAIL ADDRESS (Optional)
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8. I certify that the attached copy of the regulation(s) is a true and correct copy of the regulation(s) identified on this form, that the information specified on this form is true and correct, and that I am the head of the agency taking this action, or a designee of the head of the agency, and am authorized to make this certification.

SIGNATURE OF AGENCY HEAD OR DESIGNEE	DATE
---------------------------------------------	-------------

TYPED NAME AND TITLE OF SIGNATORY

For use by Office of Administrative Law (OAL) only

TITLE 18. BOARD OF EQUALIZATION

The State Board of Equalization Proposes to Adopt Amendments to California Code of Regulations, Title 18, Section 1603, *Taxable Sales of Food Products*

NOTICE IS HEREBY GIVEN that the State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1603, *Taxable Sales of Food Products*. The proposed amendments do not change the rule that an optional payment designated as a tip, gratuity, or service charge is not subject to tax, and a mandatory payment designated as a tip, gratuity, or service charge is includable in taxable gross receipts. Instead, the proposed amendments make Regulation 1603's treatment of payments designated as tips, gratuities, and services charges consistent with the records retailers keep for reporting such payments as tip wages or non-tip wages for Internal Revenue Service purposes by adding a new presumption as to whether or not a tip, gratuity, or service charge is subject to tax based on such records. The proposed amendments also clarify subdivision (g)'s existing language regarding the application of tax to payments designated as tips, gratuities, and service charges by adding new subdivision (h) to Regulation 1603, effective for transactions occurring on and after January 1, 2015. In addition, the proposed amendments make non-substantive amendments to the regulation, including moving the regulation's authority and reference note so that it precedes the regulation's appendix, and updating the cross-references to other regulations following the authority and reference note.

PUBLIC HEARING

The Board will conduct a meeting in Room 207 at its offices at 5901 Green Valley Circle, Culver City, California on August 5-7, 2014. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at www.boe.ca.gov at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 9:30 a.m. or as soon thereafter as the matter may be heard on August 5, 6, or 7, 2014. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1603.

AUTHORITY

RTC section 7051

REFERENCE

RTC sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374, and 6376.5.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Summary of Existing Laws and Regulations

California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (RTC, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California. (RTC, §§ 6012, 6051.) The term "gross receipts" means the total amount of the sale price without any deduction for the cost of materials used, labor or service costs, interest paid, losses, or any other expense. (RTC, § 6012, subd. (a)(2).) Gross receipts include any services that are part of the sale and all receipts, cash, credits, and property of any kind. (RTC, § 6012.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700, subd. (a)(1).)

Sales of food products for human consumption are generally exempt from tax. However, this exemption does not apply to sales of food products furnished, prepared, or served for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware whether provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others, or to sales of food products served as meals on or off the premises of the retailer. (RTC, § 6359.) Therefore, issues arise as to whether payments designated as tips, gratuities, and service charges that are related to the taxable sale of food products are includible in retailers' gross receipts.

Under Regulation 1603, subdivision (g), optional payments designated as tips, gratuities, and service charges are not subject to tax (and not included in a retailer's gross receipts); however, mandatory payments designated as tips, gratuities, and service charges are included in gross receipts subject to tax, even if the amount is subsequently paid by the retailer to the server.

On June 25, 2012, the Internal Revenue Service published Internal Revenue Bulletin No. 2012-26, which includes Revenue Ruling 2012-18. This revenue ruling clarified and updated guidelines on taxes imposed on tips under the Federal Insurance Contributions Act, including information on the difference between tips (tip wages) and service charges (non-tip wages). The ruling reaffirmed prior guidance which provided that the absence of any of the following four factors creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge: 1. The payment must be made free from compulsion; 2. The customer must have the unrestricted right to determine the amount; 3. The payment should not be the subject of negotiation or dictated by employer policy; 4. Generally, the customer has the right to determine who receives the payment.

Effect, Objective, and Benefits of the Proposed Amendments to Regulation 1603

Although Regulation 1603, subdivision (g), was amended in 2007 to clarify the application of tax to tips, gratuities and service charges, it has become evident to Board staff that some retailers are having compliance issues because there is still some remaining confusion regarding what constitutes “mandatory” versus “optional” tips, gratuities, and service charges. The proposed amendments to Regulation 1603 are intended to have the effect and accomplish the objective of addressing these retailers’ compliance issues by establishing a bright-line approach to how to treat amounts added by retailers to customers’ bills that is consistent with how the retailers treated the amounts for Internal Revenue Service purposes. This new approach will ease compliance for retailers by making it clear that the application of sales tax to the transactions at issue is consistent with federal tax reporting requirements.

Interested Parties Process

Originally, the Board’s Business Taxes Committee (BTC) staff prepared draft amendments to subdivision (g) of Regulation 1603 to address the retailers’ compliance issues. The draft amendments suggested adding provisions to the regulation explaining that when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. The draft amendments also provided that a payment of a tip, gratuity, or service charge is deemed to be mandatory if the amounts are required to be reported, for the purposes of income tax to the Internal Revenue Service, as non-tip wages, and the amendments listed the four factors from Revenue Ruling 2012-18 that the Internal Revenue Service examines to determine if a payment is a tip or service charge (non-tip wage). The draft amendments also clarified subdivision (g)’s existing language and deleted provisions of subdivision (g) that had caused confusion to retailers and staff. The draft amendments also made non-substantive changes to the regulation by updating cross-references and making strictly grammatical changes throughout the regulation. The draft amendments also updated the cross-reference to other regulations following the regulations authority and reference note. Additionally, the draft amendments moved the note section to a point preceding the appendix to the regulation.

BTC staff subsequently provided its draft amendments to Regulation 1603 to the interested parties and conducted an interested parties meeting in December 2013, to discuss the draft amendments. During the December 2013 meeting, interested parties appeared open to staff’s proposal and there was a general consensus that creating a bright-line approach with respect to tips, gratuities, and service charges would be helpful to the restaurant industry and staff. Also, participants discussed the effect of the presumption and asked BTC staff what would happen if a retailer did not maintain records for purposes of its federal income tax reporting.

Subsequent to the December 2013 interested parties meeting, staff received letters from Kara Bush on behalf of the California Restaurant Association and from James Dumler of McClellan Davis, LLC. Both letters were dated January 10, 2014. In the first letter,

Ms. Bush expressed the California Restaurant Association's appreciation of the Board's efforts to clarify this issue and that the association looks forward to continuing to work with staff and other interested parties to develop a bright-line approach that will foster reporting compliance and audit efficiency. Ms. Bush also expressed appreciation for staff's suggestions and stated that the association will continue to explore other alternatives. In the second letter, Mr. Dumler reiterated concerns expressed during the interested parties meeting that a taxpayer that lacks support for the IRS tip designations would not benefit from the proposed presumption and optional gratuities could incorrectly be presumed to be mandatory. Mr. Dumler also recommended that the examples in the current regulation with respect to mandatory payments be retained.

In response to the concerns expressed at the December 2013 interested parties meeting, staff added language to its draft amendments clarifying the application of the new presumption regarding federal tax reporting and also added provisions to determine whether a payment is "optional" or "mandatory" when a retailer does not maintain records for purposes of reporting tips to the IRS. When a retailer does not maintain these records, the determination of whether or not the payments are mandatory is consistent with the provisions currently in Regulation 1603, subdivision (g). Additionally, staff added clarifying language to its draft amendments to define the term "amount" as a payment designated as a tip, gratuity, or service charge, or any other separately stated payment for services associated with the purchase of meals, food, or drinks. This amendment was made to reduce historical confusion associated with the use of the word "amount" to refer to payments throughout subdivision (g). Also, due to perceived confusion with staff applying the four factors from Revenue Ruling 2012-18 (referred to above), these factors were deleted from staff's draft amendments.

In February 2014, staff again met with interested parties to discuss the draft amendments. Staff and interested parties discussed how to make it clear that the draft amendments are only to apply prospectively.

Following the February 2014, interested parties meeting, staff received a letter from Mr. Matt Sutton, sent on behalf of the California Restaurant Association. In his March 6, 2014, letter, Mr. Sutton explained that while the California Restaurant Association has historically disagreed with the taxation of mandatory gratuities, it was appreciative of staff's ideas and acknowledged that the suggestions for a "bright line" approach, discussed in the discussion papers and both interested parties meetings, have merit. Mr. Sutton further stated that it remains to be seen how the industry will respond to the Internal Revenue Service guidance and how that will interplay with the Board's practice of taxing mandatory tips.

May 22, 2014, BTC Meeting

Staff made changes to its draft amendments to Regulation 1603 in response to the discussion of the prospective application of the draft amendments at the February 2014 interested parties meeting. Staff changed the draft amendments so that subdivision (g) of Regulation 1603 continues to apply to transactions prior to January 1, 2015, and new

subdivision (h), containing what had previously been staff's draft amendments to subdivision (g), will apply to transactions on and after January 1, 2015. Staff also changed the draft amendments in order to renumber the subdivisions of the regulation following new subdivision (h), and update the regulation's cross-reference to the renumbered subdivisions.

Subsequently, BTC staff prepared Formal Issue Paper 14-003 and distributed it to the Board Members for consideration at the Board's May 22, 2014, BTC meeting. Formal Issue Paper 14-003 recommended that the Board propose to add new subdivision (h) to Regulation 1603 to define the term "amount," and provide that, for sales made on and after July 1, 2015, when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. Additionally, new subdivision (h) provides that when a retailer's records reflect that amounts are required to be reported to the Internal Revenue Service as non-tip wages, the amount is deemed to be mandatory. Finally, new subdivision (h) provides that when a retailer does not maintain records for purposes of reporting amounts to the Internal Revenue Service, the application of tax to the amounts will be consistent with the provisions currently in Regulation 1603, subdivision (g). The formal issue paper also recommended making non-substantive amendments to the regulation.

The Board discussed Formal Issue Paper 14-003 during its May 22, 2014, BTC meeting. Mr. Matt Sutton appeared on behalf of the California Restaurant Association and made statements similar to those in his March 6, 2014, letter. At the conclusion of the discussion, the Board Members voted 4-0 to propose the amendments to Regulation 1603 recommended in the formal issue paper, subject to conforming to the official text of the regulation at the time of publication. The Board determined that the proposed amendments to Regulation 1603 are necessary to have the effect and accomplish the objective of addressing retailers' compliance issues by establishing a bright-line approach to how to treat amounts added by retailers to customers' bills that is consistent with how the retailers treated the amounts for Internal Revenue Service purposes.

The Board also anticipates that the proposed amendments to Regulation 1603 will promote fairness and benefit retailers, Board staff, and the Board by providing regulatory provisions that may be applied using a bright-line approach that is consistent with federal tax reporting requirements on these transactions, and thereby reduce confusion for retailers and staff.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1603 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations. This is because there are no other sales and use tax regulations that specifically apply to restaurants' and similar establishments' collection of amounts as tips, gratuities, and service charges. In addition, the Board has determined that there are no comparable federal regulations or statutes to Regulation 1603 or the proposed amendments to Regulation 1603.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1603 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

NO COST OR SAVINGS TO ANY STATE AGENCY, LOCAL AGENCY, OR SCHOOL DISTRICT

The Board has determined that the adoption of the proposed amendments to Regulation 1603 will result in no direct or indirect cost or savings to any state agency, no cost to any local agency or school district that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, no other non-discretionary cost or savings imposed on local agencies, and no cost or savings in federal funding to the State of California.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The Board has made an initial determination that the adoption of the proposed amendments to Regulation 1603 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Regulation 1603 may affect small business.

NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has determined that the proposed amendments to Regulation 1603 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000. Therefore, the Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1603 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1603 will not affect the benefits of Regulation 1603 to the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

The adoption of the proposed amendments to Regulation 1603 will not have a significant effect on housing costs.

DETERMINATION REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Cary Huxsoll, Tax Counsel III, by telephone at (916) 323-3092, by e-mail at Cary.Huxsoll@boe.ca.gov, or by mail at State Board of Equalization, Attn: Cary Huxsoll, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 9:30 a.m. on August 5, 2014, or as soon thereafter as the Board begins the public hearing regarding the adoption of the proposed amendments to Regulation 1603 during the August 5-7, 2014, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1603. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underscored and strikeout version of the text of Regulation 1603 illustrating the express terms of the proposed amendments. The Board has also prepared an initial statement of reasons for the adoption of the proposed amendments to Regulation 1603, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed amendments and the initial statement of reasons are also available on the Board's Website at www.boe.ca.gov.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt the proposed amendments to Regulation 1603 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed regulation, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the original proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts the proposed amendments to Regulation 1603, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at www.boe.ca.gov.

Bennion, Richard

From: BOE-Board Meeting Material
Sent: Friday, June 20, 2014 4:40 PM
To: Alonzo, Mary Ann (Legal); Angeja, Jeff (Legal); Angeles, Joel; Appleby, Jaclyn; Armenta, Christopher; Baetge, Michelle; Bartolo, Lynn; Bennion, Richard; Benson, Bill; Bisauta, Christine (Legal); Blake, Sue; BOE-Board Meeting Material; Boyle, Kevin; Bridges, Cynthia; Brown, Michele C; Chung, Sophia (Legal); Cruz, Giovan; Davis, Toya P.; Delgado, Maria; Dixon, Camille; Duran, David; Eaton, Janet; Elliott, Claudia; Epolite, Anthony (Legal); Ferris, Randy (Legal); Ford, Ladeena L; Garcia, Laura; Gau, David; Gilman, Todd; Goehring, Teresa; Hale, Mike; Hamilton, Tabitha; Hanohano, Rebecca; Harvill, Mai; He, Mengjun; Heller, Bradley (Legal); Hellmuth, Leila; Herrera, Cristina; Holmes, Dana; Hughes, Shellie L; Jacobson, Andrew; Kinkle, Sherrie L; Kinst, Lynne; Kruckenberg, Kendra; Kuhl, James; Lambert, Gary; Lambert, Robert (Legal); Lee, Chris; Levine, David H. (Legal); LoFaso, Alan; Madrigal, Claudia; Mandel, Marcy Jo; Matsumoto, Sid; McGuire, Jeff; Miller, Brad; Mandel, Marcy Jo @ SCO; Moon, Richard (Legal); Morquecho, Raymond; Nienow, Trecia (Legal); Oakes, Clifford; Pielsticker, Michele; Ralston, Natasha; Richmond, Joann; Riley, Denise (Legal); Salazar, Ramon; Salgado-Ponce, Sylvia; Schultz, Glenna; Shah, Neil; Silva, Monica (Legal); Singh, Sam; Smith, Kevin (Legal); Smith, Rose; Stowers, Yvette; Torres, Rodrigo; Torres, Rodrigo; Tran, Mai (Legal); Treichelt, Tim; Tucker, Robert (Legal); Vandrick, Tanya; Vasquez, Rosalyn; Vigil, Michael; Wallentine, Sean; Whitaker, Lynn; White, Sharon; Williams, Lee; Zivkovich, Robert
Subject: State Board of Equalization - Announcement of Regulatory Change 1603

The State Board of Equalization proposes to adopt amendments to Regulation 1603, Taxable Sales of Food Products. A public hearing regarding the proposed amendments will be held in Room 121, 450 N Street, Sacramento, at 9:30 a.m., or as soon thereafter as the matter may be heard, on August 5-7, 2014.

The proposed amendments to Regulation 1603, Taxable Sales of Food Products, clarify the application of tax to tips, gratuities, and service charges.

To view the notice of hearing, initial statement of reasons, proposed text, and history click on the following link: http://www.boe.ca.gov/regs/reg_1603a_2014.htm.

Questions regarding the substance of the proposed amendments should be directed to Mr. Cary Huxsoll, Tax Counsel III, at 450 N Street, MIC:82, Sacramento, CA 94279-0082, email Cary.Huxsoll@boe.ca.gov<<mailto:Cary.Huxsoll@boe.ca.gov>>, telephone (916) 323-3092, or FAX (916) 323-3387.

Written comments for the Board's consideration, notices of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed regulatory action should be directed to Mr. Rick Bennion, Regulations Coordinator, telephone (916) 445-2130, fax (916) 324-3984, e-mail Richard.Bennion@boe.ca.gov<<mailto:Richard.Bennion@boe.ca.gov>> or by mail to: State Board of Equalization, Attn: Rick Bennion, MIC: 80, P.O. Box 942879-0080, Sacramento, CA 94279-0080.

Please do not reply to this message.

Board Proceedings Division, MIC:80
Rick Bennion

Regulations Coordinator
Phone (916) 445-2130
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Bennion, Richard

From: State Board of Equalization - Announcement of Regulatory Change
Sent: Friday, June 20, 2014 4:41 PM
To: 'BOE_REGULATIONS@listserv.state.ca.gov' (BOE_REGULATIONS@listserv.state.ca.gov)
Subject: State Board of Equalization - Announcement of Regulatory Change 1603

The State Board of Equalization proposes to adopt amendments to Regulation 1603, Taxable Sales of Food Products. A public hearing regarding the proposed amendments will be held in Room 121, 450 N Street, Sacramento, at 9:30 a.m., or as soon thereafter as the matter may be heard, on August 5-7, 2014.

The proposed amendments to Regulation 1603, Taxable Sales of Food Products, clarify the application of tax to tips, gratuities, and service charges.

To view the notice of hearing, initial statement of reasons, proposed text, and history click on the following link:
http://www.boe.ca.gov/regs/reg_1603a_2014.htm.

Questions regarding the substance of the proposed amendments should be directed to Mr. Cary Huxsoll, Tax Counsel III, at 450 N Street, MIC:82, Sacramento, CA 94279-0082, email Cary.Huxsoll@boe.ca.gov<<mailto:Cary.Huxsoll@boe.ca.gov>>, telephone (916) 323-3092, or FAX (916) 323-3387.

Written comments for the Board's consideration, notices of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed regulatory action should be directed to Mr. Rick Bennion, Regulations Coordinator, telephone (916) 445-2130, fax (916) 324-3984, e-mail Richard.Bennion@boe.ca.gov<<mailto:Richard.Bennion@boe.ca.gov>> or by mail to: State Board of Equalization, Attn: Rick Bennion, MIC: 80, P.O. Box 942879-0080, Sacramento, CA 94279-0080.

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The Commission does not anticipate any impacts on the creation or elimination of jobs, the creation of new business, the elimination of existing businesses or the expansion of businesses in California, because the amendments merely make existing regulations in these sections consistent with the prohibited use of these animals which are listed as a restricted species in subsection 671(c)(3)(C)1.

The Commission does not anticipate benefits to the health and welfare of California residents or to worker safety because the proposed amendments do not affect health, welfare, or safety.

The Commission anticipates benefits to the state's environment because the amendments make existing regulations in these sections consistent with the prohibited use of these animals which are listed as a restricted species (subsection 671(c)(3)(C)1.) due to their detrimental effects on native wildlife.

(c) **Cost Impacts on a Representative Private Person or Business:**

The Commission is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

(d) **Costs or Savings to State Agencies or Costs/Savings in Federal Funding to the State:** None.

(e) **Nondiscretionary Costs/Savings to Local Agencies:** None.

(f) **Programs Mandated on Local Agencies or School Districts:** None.

(g) **Costs Imposed on Any Local Agency or School District that is Required to be Reimbursed Under Part 7 (commencing with Section 17500) of Division 4, Government Code:** None.

(h) **Effect on Housing Costs:** None.

Effect on Small Business

It has been determined that the adoption of these regulations may affect small business. The Commission has drafted the regulations in Plain English pursuant to Government Code sections 11342.580 and 11346.2(a)(1).

Consideration of Alternatives

The Commission must determine that no reasonable alternative considered by the Commission, or that has otherwise been identified and brought to the attention of the Commission, would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more

cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law.

TITLE 18. BOARD OF EQUALIZATION

The State Board of Equalization Proposes to Adopt Amendments to California Code of Regulations, Title 18, Section 1603, Taxable Sales of Food Products

NOTICE IS HEREBY GIVEN that the State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1603, *Taxable Sales of Food Products*. The proposed amendments do not change the rule that an optional payment designated as a tip, gratuity, or service charge is not subject to tax, and a mandatory payment designated as a tip, gratuity, or service charge is includable in taxable gross receipts. Instead, the proposed amendments make Regulation 1603's treatment of payments designated as tips, gratuities, and services charges consistent with the records retailers keep for reporting such payments as tip wages or non-tip wages for Internal Revenue Service purposes by adding a new presumption as to whether or not a tip, gratuity, or service charge is subject to tax based on such records. The proposed amendments also clarify subdivision (g)'s existing language regarding the application of tax to payments designated as tips, gratuities, and service charges by adding new subdivision (h) to Regulation 1603, effective for transactions occurring on and after January 1, 2015. In addition, the proposed amendments make non-substantive amendments to the regulation, including moving the regulation's authority and reference note so that it precedes the regulation's appendix, and updating the cross-references to other regulations following the authority and reference note.

PUBLIC HEARING

The Board will conduct a meeting in Room 207 at its offices at 5901 Green Valley Circle, Culver City, California on August 5-7, 2014. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at www.boe.ca.gov at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 9:30 a.m. or as soon thereafter as the matter may be heard on August 5, 6, or 7, 2014. At

the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1603.

AUTHORITY

RTC section 7051

REFERENCE

RTC sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374, and 6376.5.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Summary of Existing Laws and Regulations

California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (RTC, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer’s gross receipts from the retail sale of tangible personal property in California. (RTC, §§ 6012, 6051.) The term “gross receipts” means the total amount of the sale price without any deduction for the cost of materials used, labor or service costs, interest paid, losses, or any other expense. (RTC, § 6012, subd. (a)(2).) Gross receipts include any services that are part of the sale and all receipts, cash, credits, and property of any kind. (RTC, § 6012.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700, subd. (a)(1).)

Sales of food products for human consumption are generally exempt from tax. However, this exemption does not apply to sales of food products furnished, prepared, or served for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware whether provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others, or to sales of food products served as meals on or off the premises of the retailer. (RTC, § 6359.) Therefore, issues arise as to whether payments designated as tips, gratuities, and service charges that are related to the taxable sale of food products are includible in retailers’ gross receipts.

Under Regulation 1603, subdivision (g), optional payments designated as tips, gratuities, and service charges are not subject to tax (and not included in a retailer’s gross receipts); however, mandatory payments designated as tips, gratuities, and service charges are in-

cluded in gross receipts subject to tax, even if the amount is subsequently paid by the retailer to the server.

On June 25, 2012, the Internal Revenue Service published Internal Revenue Bulletin No. 2012–26, which includes Revenue Ruling 2012–18. This revenue ruling clarified and updated guidelines on taxes imposed on tips under the Federal Insurance Contributions Act, including information on the difference between tips (tip wages) and service charges (non–tip wages). The ruling reaffirmed prior guidance which provided that the absence of any of the following four factors creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge: 1. The payment must be made free from compulsion; 2. The customer must have the unrestricted right to determine the amount; 3. The payment should not be the subject of negotiation or dictated by employer policy; 4. Generally, the customer has the right to determine who receives the payment.

Effect, Objective, and Benefits of the Proposed Amendments to Regulation 1603

Although Regulation 1603, subdivision (g), was amended in 2007 to clarify the application of tax to tips, gratuities and service charges, it has become evident to Board staff that some retailers are having compliance issues because there is still some remaining confusion regarding what constitutes “mandatory” versus “optional” tips, gratuities, and service charges. The proposed amendments to Regulation 1603 are intended to have the effect and accomplish the objective of addressing these retailers’ compliance issues by establishing a bright–line approach to how to treat amounts added by retailers to customers’ bills that is consistent with how the retailers treated the amounts for Internal Revenue Service purposes. This new approach will ease compliance for retailers by making it clear that the application of sales tax to the transactions at issue is consistent with federal tax reporting requirements.

Interested Parties Process

Originally, the Board’s Business Taxes Committee (BTC) staff prepared draft amendments to subdivision (g) of Regulation 1603 to address the retailers’ compliance issues. The draft amendments suggested adding provisions to the regulation explaining that when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. The draft amendments also provided that a payment of a tip, gratuity, or service charge is deemed to be mandatory if the amounts are required to be reported, for the purposes of income tax to the Internal Revenue Service, as non–tip wages, and the amendments listed the four factors from Revenue Ruling 2012–18 that the Internal Revenue Service examines to determine if a

payment is a tip or service charge (non-tip wage). The draft amendments also clarified subdivision (g)'s existing language and deleted provisions of subdivision (g) that had caused confusion to retailers and staff. The draft amendments also made non-substantive changes to the regulation by updating cross-references and making strictly grammatical changes throughout the regulation. The draft amendments also updated the cross-reference to other regulations following the regulation's authority and reference note. Additionally, the draft amendments moved the note section to a point preceding the appendix to the regulation.

BTC staff subsequently provided its draft amendments to Regulation 1603 to the interested parties and conducted an interested parties meeting in December 2013, to discuss the draft amendments. During the December 2013 meeting, interested parties appeared open to staff's proposal and there was a general consensus that creating a bright-line approach with respect to tips, gratuities, and service charges would be helpful to the restaurant industry and staff. Also, participants discussed the effect of the presumption and asked BTC staff what would happen if a retailer did not maintain records for purposes of its federal income tax reporting.

Subsequent to the December 2013 interested parties meeting, staff received letters from Kara Bush on behalf of the California Restaurant Association and from James Dumler of McClellan Davis, LLC. Both letters were dated January 10, 2014. In the first letter, Ms. Bush expressed the California Restaurant Association's appreciation of the Board's efforts to clarify this issue and that the association looks forward to continuing to work with staff and other interested parties to develop a bright-line approach that will foster reporting compliance and audit efficiency. Ms. Bush also expressed appreciation for staff's suggestions and stated that the association will continue to explore other alternatives. In the second letter, Mr. Dumler reiterated concerns expressed during the interested parties meeting that a taxpayer that lacks support for the IRS tip designations would not benefit from the proposed presumption and optional gratuities could incorrectly be presumed to be mandatory. Mr. Dumler also recommended that the examples in the current regulation with respect to mandatory payments be retained.

In response to the concerns expressed at the December 2013 interested parties meeting, staff added language to its draft amendments clarifying the application of the new presumption regarding federal tax reporting and also added provisions to determine whether a payment is "optional" or "mandatory" when a retailer does not maintain records for purposes of reporting tips to the IRS. When a retailer does not maintain these records, the determination of whether or not the payments are mandatory is consistent with the provisions current-

ly in Regulation 1603, subdivision (g). Additionally, staff added clarifying language to its draft amendments to define the term "amount" as a payment designated as a tip, gratuity, or service charge, or any other separately stated payment for services associated with the purchase of meals, food, or drinks. This amendment was made to reduce historical confusion associated with the use of the word "amount" to refer to payments throughout subdivision (g). Also, due to perceived confusion with staff applying the four factors from Revenue Ruling 2012-18 (referred to above), these factors were deleted from staff's draft amendments.

In February 2014, staff again met with interested parties to discuss the draft amendments. Staff and interested parties discussed how to make it clear that the draft amendments are only to apply prospectively.

Following the February 2014, interested parties meeting, staff received a letter from Mr. Matt Sutton, sent on behalf of the California Restaurant Association. In his March 6, 2014, letter, Mr. Sutton explained that while the California Restaurant Association has historically disagreed with the taxation of mandatory gratuities, it was appreciative of staff's ideas and acknowledged that the suggestions for a "bright line" approach, discussed in the discussion papers and both interested parties meetings, have merit. Mr. Sutton further stated that it remains to be seen how the industry will respond to the Internal Revenue Service guidance and how that will interplay with the Board's practice of taxing mandatory tips.

May 22, 2014, BTC Meeting

Staff made changes to its draft amendments to Regulation 1603 in response to the discussion of the prospective application of the draft amendments at the February 2014 interested parties meeting. Staff changed the draft amendments so that subdivision (g) of Regulation 1603 continues to apply to transactions prior to January 1, 2015, and new subdivision (h), containing what had previously been staff's draft amendments to subdivision (g), will apply to transactions on and after January 1, 2015. Staff also changed the draft amendments in order to renumber the subdivisions of the regulation following new subdivision (h), and update the regulation's cross-reference to the renumbered subdivisions.

Subsequently, BTC staff prepared Formal Issue Paper 14-003 and distributed it to the Board Members for consideration at the Board's May 22, 2014, BTC meeting. Formal Issue Paper 14-003 recommended that the Board propose to add new subdivision (h) to Regulation 1603 to define the term "amount," and provide that, for sales made on and after July 1, 2015, when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to

tax. Additionally, new subdivision (h) provides that when a retailer's records reflect that amounts are required to be reported to the Internal Revenue Service as non-tip wages, the amount is deemed to be mandatory. Finally, new subdivision (h) provides that when a retailer does not maintain records for purposes of reporting amounts to the Internal Revenue Service, the application of tax to the amounts will be consistent with the provisions currently in Regulation 1603, subdivision (g). The formal issue paper also recommended making non-substantive amendments to the regulation.

The Board discussed Formal Issue Paper 14-003 during its May 22, 2014, BTC meeting. Mr. Matt Sutton appeared on behalf of the California Restaurant Association and made statements similar to those in his March 6, 2014, letter. At the conclusion of the discussion, the Board Members voted 4-0 to propose the amendments to Regulation 1603 recommended in the formal issue paper, subject to conforming to the official text of the regulation at the time of publication. The Board determined that the proposed amendments to Regulation 1603 are necessary to have the effect and accomplish the objective of addressing retailers' compliance issues by establishing a bright-line approach to how to treat amounts added by retailers to customers' bills that is consistent with how the retailers treated the amounts for Internal Revenue Service purposes.

The Board also anticipates that the proposed amendments to Regulation 1603 will promote fairness and benefit retailers, Board staff, and the Board by providing regulatory provisions that may be applied using a bright-line approach that is consistent with federal tax reporting requirements on these transactions, and thereby reduce confusion for retailers and staff.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1603 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations. This is because there are no other sales and use tax regulations that specifically apply to restaurants' and similar establishments' collection of amounts as tips, gratuities, and service charges. In addition, the Board has determined that there are no comparable federal regulations or statutes to Regulation 1603 or the proposed amendments to Regulation 1603.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1603 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed un-

der part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

NO COST OR SAVINGS TO ANY STATE AGENCY, LOCAL AGENCY, OR SCHOOL DISTRICT

The Board has determined that the adoption of the proposed amendments to Regulation 1603 will result in no direct or indirect cost or savings to any state agency, no cost to any local agency or school district that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, no other non-discretionary cost or savings imposed on local agencies, and no cost or savings in federal funding to the State of California.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The Board has made an initial determination that the adoption of the proposed amendments to Regulation 1603 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Regulation 1603 may affect small business.

NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has determined that the proposed amendments to Regulation 1603 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000. Therefore, the Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1603 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of

California. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1603 will not affect the benefits of Regulation 1603 to the health and welfare of California residents, worker safety, or the state's environment.

**NO SIGNIFICANT EFFECT ON
HOUSING COSTS**

The adoption of the proposed amendments to Regulation 1603 will not have a significant effect on housing costs.

**DETERMINATION REGARDING
ALTERNATIVES**

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Cary Huxsoll, Tax Counsel III, by telephone at (916) 323-3092, by e-mail at Cary.Huxsoll@boe.ca.gov, or by mail at State Board of Equalization, Attn: Cary Huxsoll, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

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WRITTEN COMMENT PERIOD

The written comment period ends at 9:30 a.m. on August 5, 2014, or as soon thereafter as the Board begins the public hearing regarding the adoption of the pro-

posed amendments to Regulation 1603 during the August 5-7, 2014, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1603. The Board will only consider written comments received by that time.

**AVAILABILITY OF INITIAL STATEMENT OF
REASONS AND TEXT OF
PROPOSED REGULATION**

The Board has prepared an underscored and strikethrough version of the text of Regulation 1603 illustrating the express terms of the proposed amendments. The Board has also prepared an initial statement of reasons for the adoption of the proposed amendments to Regulation 1603, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed amendments and the initial statement of reasons are also available on the Board's Website at www.boe.ca.gov.

**SUBSTANTIALLY RELATED CHANGES
PURSUANT TO GOVERNMENT CODE
SECTION 11346.8**

The Board may adopt the proposed amendments to Regulation 1603 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed regulation, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the original proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

AVAILABILITY OF FINAL STATEMENT
OF REASONS

If the Board adopts the proposed amendments to Regulation 1603, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at www.boe.ca.gov.

**TITLE 20. PUBLIC UTILITIES
COMMISSION**

The California Public Utilities Commission (the Commission) proposes to amend the regulation described below after considering all comments, objections, or recommendations regarding the proposal.

At a duly noticed, regularly scheduled meeting, not earlier than August 04, 2014, at 9:00 a.m., in the Commission Auditory, 5050 Van Ness Avenue, San Francisco, the Commission will consider a proposal to amend the Rules of Practice and Procedure set forth in Division 1, Chapter 1, Article 3 of Title 20 of the California Code of Regulations. The proposed amended regulation will respond to recent legislative revisions to the statutory requirements for issuance and transfer of passenger stage corporation (PSC) certificates and will simplify the Commission's regulatory procedure.

AUTHORITY TO ADOPT RULES

Article XII, Section 23 of the California Constitution and Section 1701 of the Public Utilities Code authorize the Commission to adopt Rules of Practice and Procedure.

INFORMATIVE DIGEST

The Commission proposes amendments to its Rules of Practice and Procedure in order to respond to recent legislative revisions to the statutory requirements for issuance and transfer of PSC certificates and to simplify the Commission's regulatory procedures. These amendments include:

- Modifying the Commission's procedures for granting and denying an application for a passenger stage corporation (PSC) certificate;
- Granting authority to transfer a PSC certificate that has already been issued;
- Granting authority to acquire or control a PSC;
- Establishing a zone of rate freedom (ZORF) that permits a PSC to adjust its rates within specified limits without seeking further approval from the Commission.

AVAILABILITY OF STATEMENT OF REASONS
AND PROPOSED TEXT

The proposed rule amendments are set forth in the Assigned Commissioner's Ruling and will be available on the Commission's website, www.cpuc.ca.gov. The Assigned Commissioner's Ruling includes a more detailed initial statement of the reasons for the rule amendments. For convenience, the proposed rule amendments are included here, in a strike-through and underlined format:

3.3. (Rule 3.3) Certificate to Operate.

(a) Applications for a certificate to operate as a vessel common carrier or passenger stage corporation shall contain the following information:

(1) The type of service applicant seeks to perform or that is being performed by applicant, a general description of it, and a reference to the authority under which existing service is performed.

(2) The specific authority requested and the particular statutory provision under which the certificate is requested.

~~(3) If a carrier or property, a description of specified commodities proposed to be transported, and, if general commodities with exceptions are proposed to be transported, a statement specifying such exceptions.~~

~~(4) The geographical scope of the proposed operation, including the termini and other points proposed to be served, and a concise narrative description of the proposed route.~~

(3) The areas and points where the applicant will be holding out service, by county, fixed termini, and regular route, if appropriate. If the applicant intends to serve one or more commercial airports, this information must include each airport proposed to be served.

~~(5)~~ (4) A map or sketch of the route and points to be served, drawn to suitable indicated scale, and showing present and proposed operation by distinctive coloring or marking.

~~(6)~~ (5) A statement of the rates or fares proposed to be charged and rules governing service. A list of the base fares to be charged, and identification of existing competitors who offer the same or substantially similar services. In addition, all proposed discounted fares must be disclosed as part of this list. Applications for certificates need not contain tariffs, but shall indicate the level and nature of proposed rates and rules, as required herein, and may refer to tariffs on file with or issued by the Commission.

(7) ~~(6)~~ A statement indicating the frequency of the proposed service. If "on call" service is proposed, the application shall set forth conditions under which such service would be performed.

~~(8)~~ (7) The kind and approximate number of units of equipment to be employed in the proposed service.



STATE OF CALIFORNIA

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Executive Director

June 20, 2014

To Interested Parties:

Notice of Proposed Regulatory Action

The State Board of Equalization Proposes to Adopt Amendments to California Code of Regulations, Title 18, Section 1603, *Taxable Sales of Food Products*

NOTICE IS HEREBY GIVEN that the State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1603, *Taxable Sales of Food Products*. The proposed amendments do not change the rule that an optional payment designated as a tip, gratuity, or service charge is not subject to tax, and a mandatory payment designated as a tip, gratuity, or service charge is includable in taxable gross receipts. Instead, the proposed amendments make Regulation 1603's treatment of payments designated as tips, gratuities, and services charges consistent with the records retailers keep for reporting such payments as tip wages or non-tip wages for Internal Revenue Service purposes by adding a new presumption as to whether or not a tip, gratuity, or service charge is subject to tax based on such records. The proposed amendments also clarify subdivision (g)'s existing language regarding the application of tax to payments designated as tips, gratuities, and service charges by adding new subdivision (h) to Regulation 1603, effective for transactions occurring on and after January 1, 2015. In addition, the proposed amendments make non-substantive amendments to the regulation, including moving the regulation's authority and reference note so that it precedes the regulation's appendix, and updating the cross-references to other regulations following the authority and reference note.

PUBLIC HEARING

The Board will conduct a meeting in Room 207 at its offices at 5901 Green Valley Circle, Culver City, California on August 5-7, 2014. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at www.boe.ca.gov at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 9:30 a.m. or as soon thereafter as the matter may be heard on August 5, 6, or 7, 2014. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1603.

AUTHORITY

RTC section 7051

REFERENCE

RTC sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374, and 6376.5.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Summary of Existing Laws and Regulations

California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (RTC, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California. (RTC, §§ 6012, 6051.) The term "gross receipts" means the total amount of the sale price without any deduction for the cost of materials used, labor or service costs, interest paid, losses, or any other expense. (RTC, § 6012, subd. (a)(2).) Gross receipts include any services that are part of the sale and all receipts, cash, credits, and property of any kind. (RTC, § 6012.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700, subd. (a)(1).)

Sales of food products for human consumption are generally exempt from tax. However, this exemption does not apply to sales of food products furnished, prepared, or served for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware whether provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others, or to sales of food products served as meals on or off the premises of the retailer. (RTC, § 6359.) Therefore, issues arise as to whether payments designated as tips, gratuities, and service charges that are related to the taxable sale of food products are includible in retailers' gross receipts.

Under Regulation 1603, subdivision (g), optional payments designated as tips, gratuities, and service charges are not subject to tax (and not included in a retailer's gross receipts); however, mandatory payments designated as tips, gratuities, and service charges are included in gross receipts subject to tax, even if the amount is subsequently paid by the retailer to the server.

On June 25, 2012, the Internal Revenue Service published Internal Revenue Bulletin No. 2012-26, which includes Revenue Ruling 2012-18. This revenue ruling clarified and updated guidelines on taxes imposed on tips under the Federal Insurance Contributions Act, including information on the difference between tips (tip wages) and service charges (non-tip wages). The ruling reaffirmed prior guidance which provided that the absence of any of the following four factors creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge: 1. The payment must be made free from compulsion; 2. The customer must have the unrestricted right to determine the amount; 3. The payment should not be the subject of negotiation or dictated by employer policy; 4. Generally, the customer has the right to determine who receives the payment.

Effect, Objective, and Benefits of the Proposed Amendments to Regulation 1603

Although Regulation 1603, subdivision (g), was amended in 2007 to clarify the application of tax to tips, gratuities and service charges, it has become evident to Board staff that some retailers are having compliance issues because there is still some remaining confusion regarding what constitutes "mandatory" versus "optional" tips, gratuities, and service charges. The proposed amendments to Regulation 1603 are intended to have the effect and accomplish the objective of addressing these retailers' compliance issues by establishing a bright-line approach to how to treat amounts added by retailers to customers' bills that is consistent with how the retailers treated the amounts for Internal Revenue Service purposes. This new approach will ease compliance for retailers by making it clear that the application of sales tax to the transactions at issue is consistent with federal tax reporting requirements.

Interested Parties Process

Originally, the Board's Business Taxes Committee (BTC) staff prepared draft amendments to subdivision (g) of Regulation 1603 to address the retailers' compliance issues. The draft amendments suggested adding provisions to the regulation explaining that when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. The draft amendments also provided that a payment of a tip, gratuity, or service charge is deemed to be mandatory if the amounts are required to be reported, for the purposes of income tax to the Internal Revenue Service, as non-tip wages, and the amendments listed the four factors from Revenue Ruling 2012-18 that the Internal Revenue Service examines to determine if a payment is a tip or service charge (non-tip wage). The draft amendments also clarified subdivision (g)'s existing language and deleted provisions of subdivision (g) that had caused confusion to retailers and staff. The draft amendments also made non-substantive changes to the regulation by updating cross-

references and making strictly grammatical changes throughout the regulation. The draft amendments also updated the cross-reference to other regulations following the regulations authority and reference note. Additionally, the draft amendments moved the note section to a point preceding the appendix to the regulation.

BTC staff subsequently provided its draft amendments to Regulation 1603 to the interested parties and conducted an interested parties meeting in December 2013, to discuss the draft amendments. During the December 2013 meeting, interested parties appeared open to staff's proposal and there was a general consensus that creating a bright-line approach with respect to tips, gratuities, and service charges would be helpful to the restaurant industry and staff. Also, participants discussed the effect of the presumption and asked BTC staff what would happen if a retailer did not maintain records for purposes of its federal income tax reporting.

Subsequent to the December 2013 interested parties meeting, staff received letters from Kara Bush on behalf of the California Restaurant Association and from James Dumler of McClellan Davis, LLC. Both letters were dated January 10, 2014. In the first letter, Ms. Bush expressed the California Restaurant Association's appreciation of the Board's efforts to clarify this issue and that the association looks forward to continuing to work with staff and other interested parties to develop a bright-line approach that will foster reporting compliance and audit efficiency. Ms. Bush also expressed appreciation for staff's suggestions and stated that the association will continue to explore other alternatives. In the second letter, Mr. Dumler reiterated concerns expressed during the interested parties meeting that a taxpayer that lacks support for the IRS tip designations would not benefit from the proposed presumption and optional gratuities could incorrectly be presumed to be mandatory. Mr. Dumler also recommended that the examples in the current regulation with respect to mandatory payments be retained.

In response to the concerns expressed at the December 2013 interested parties meeting, staff added language to its draft amendments clarifying the application of the new presumption regarding federal tax reporting and also added provisions to determine whether a payment is "optional" or "mandatory" when a retailer does not maintain records for purposes of reporting tips to the IRS. When a retailer does not maintain these records, the determination of whether or not the payments are mandatory is consistent with the provisions currently in Regulation 1603, subdivision (g). Additionally, staff added clarifying language to its draft amendments to define the term "amount" as a payment designated as a tip, gratuity, or service charge, or any other separately stated payment for services associated with the purchase of meals, food, or drinks. This amendment was made to reduce historical confusion associated with the use of the word "amount" to refer to payments throughout subdivision (g). Also, due to perceived confusion with staff applying the four factors from Revenue Ruling 2012-18 (referred to above), these factors were deleted from staff's draft amendments.

In February 2014, staff again met with interested parties to discuss the draft amendments. Staff and interested parties discussed how to make it clear that the draft amendments are only to apply prospectively.

Following the February 2014, interested parties meeting, staff received a letter from Mr. Matt Sutton, sent on behalf of the California Restaurant Association. In his March 6, 2014, letter, Mr. Sutton explained that while the California Restaurant Association has historically disagreed with the taxation of mandatory gratuities, it was appreciative of staff's ideas and acknowledged that the suggestions for a "bright line" approach, discussed in the discussion papers and both interested parties meetings, have merit. Mr. Sutton further stated that it remains to be seen how the industry will respond to the Internal Revenue Service guidance and how that will interplay with the Board's practice of taxing mandatory tips.

May 22, 2014, BTC Meeting

Staff made changes to its draft amendments to Regulation 1603 in response to the discussion of the prospective application of the draft amendments at the February 2014 interested parties meeting. Staff changed the draft amendments so that subdivision (g) of Regulation 1603 continues to apply to transactions prior to January 1, 2015, and new subdivision (h), containing what had previously been staff's draft amendments to subdivision (g), will apply to transactions on and after January 1, 2015. Staff also changed the draft amendments in order to renumber the subdivisions of the regulation following new subdivision (h), and update the regulation's cross-reference to the renumbered subdivisions.

Subsequently, BTC staff prepared Formal Issue Paper 14-003 and distributed it to the Board Members for consideration at the Board's May 22, 2014, BTC meeting. Formal Issue Paper 14-003 recommended that the Board propose to add new subdivision (h) to Regulation 1603 to define the term "amount," and provide that, for sales made on and after July 1, 2015, when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. Additionally, new subdivision (h) provides that when a retailer's records reflect that amounts are required to be reported to the Internal Revenue Service as non-tip wages, the amount is deemed to be mandatory. Finally, new subdivision (h) provides that when a retailer does not maintain records for purposes of reporting amounts to the Internal Revenue Service, the application of tax to the amounts will be consistent with the provisions currently in Regulation 1603, subdivision (g). The formal issue paper also recommended making non-substantive amendments to the regulation.

The Board discussed Formal Issue Paper 14-003 during its May 22, 2014, BTC meeting. Mr. Matt Sutton appeared on behalf of the California Restaurant Association and made statements similar to those in his March 6, 2014, letter. At the conclusion of the discussion, the Board Members voted 4-0 to propose the amendments to Regulation 1603 recommended in the formal issue paper, subject to conforming to the official text of the regulation at the time of publication. The Board determined that the proposed amendments to Regulation 1603 are necessary to have the effect and accomplish the objective of addressing retailers' compliance issues by establishing a bright-line approach to how to treat amounts added by retailers to

customers' bills that is consistent with how the retailers treated the amounts for Internal Revenue Service purposes.

The Board also anticipates that the proposed amendments to Regulation 1603 will promote fairness and benefit retailers, Board staff, and the Board by providing regulatory provisions that may be applied using a bright-line approach that is consistent with federal tax reporting requirements on these transactions, and thereby reduce confusion for retailers and staff.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1603 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations. This is because there are no other sales and use tax regulations that specifically apply to restaurants' and similar establishments' collection of amounts as tips, gratuities, and service charges. In addition, the Board has determined that there are no comparable federal regulations or statutes to Regulation 1603 or the proposed amendments to Regulation 1603.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1603 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

NO COST OR SAVINGS TO ANY STATE AGENCY, LOCAL AGENCY, OR SCHOOL DISTRICT

The Board has determined that the adoption of the proposed amendments to Regulation 1603 will result in no direct or indirect cost or savings to any state agency, no cost to any local agency or school district that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, no other non-discretionary cost or savings imposed on local agencies, and no cost or savings in federal funding to the State of California.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The Board has made an initial determination that the adoption of the proposed amendments to Regulation 1603 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Regulation 1603 may affect small business.

NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

**RESULTS OF THE ECONOMIC IMPACT ASSESSMENT REQUIRED BY
GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)**

The Board has determined that the proposed amendments to Regulation 1603 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000. Therefore, the Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1603 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1603 will not affect the benefits of Regulation 1603 to the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

The adoption of the proposed amendments to Regulation 1603 will not have a significant effect on housing costs.

DETERMINATION REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Cary Huxsoll, Tax Counsel III, by telephone at (916) 323-3092, by e-mail at Cary.Huxsoll@boe.ca.gov, or by mail at State Board of Equalization, Attn: Cary Huxsoll, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 9:30 a.m. on August 5, 2014, or as soon thereafter as the Board begins the public hearing regarding the adoption of the proposed amendments to Regulation 1603 during the August 5-7, 2014, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1603. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underscored and strikeout version of the text of Regulation 1603 illustrating the express terms of the proposed amendments. The Board has also prepared an initial statement of reasons for the adoption of the proposed amendments to Regulation 1603, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed amendments and the initial statement of reasons are also available on the Board's Website at www.boe.ca.gov.

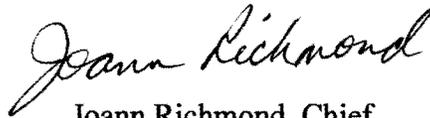
SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt the proposed amendments to Regulation 1603 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed regulation, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the original proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts the proposed amendments to Regulation 1603, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at www.boe.ca.gov.

Sincerely,



Joann Richmond, Chief
Board Proceedings Division

JR:reb

STATE BOARD OF EQUALIZATION



BOARD APPROVED

At the August 5, 2014 Board Meeting

Joann Richmond
Joann Richmond, Chief
Board Proceedings Division

**Initial Statement of Reasons for
Proposed Amendments to California Code of Regulations,
Title 18, Section 1603, *Taxable Sales of Food Products***

SPECIFIC PURPOSE, PROBLEM INTENDED TO BE ADDRESSED, NECESSITY, AND ANTICIPATED BENEFIT

Current Law

California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (Rev. & Tax. Code, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California. (Rev. & Tax. Code, §§ 6012, 6051.) The term "gross receipts" means the total amount of the sale price without any deduction for the cost of materials used, labor or service costs, interest paid, losses, or any other expense. (Rev. & Tax. Code, § 6012, subd. (a)(2).) Gross receipts include any services that are part of the sale and all receipts, cash, credits, and property of any kind. (Rev. & Tax. Code, § 6012.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700, subd. (a)(1).)

Sales of food products for human consumption are generally exempt from tax. However, as relevant here, this exemption does not apply to sales of food products furnished, prepared, or served for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware whether provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others, or to sales of food products served as meals on or off the premises of the retailer. (Rev. & Tax. Code, § 6359.) Therefore, issues arise as to whether payments designated as tips, gratuities, and service charges that are related to taxable sales of food products are includible in retailers' gross receipts.

In addition, Labor Code section 351 provides that no employer or agent shall collect, take, or receive any gratuity or a part thereof that is paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of a gratuity, or require an employee to credit the amount, or any part thereof, of a gratuity against and as a part of the wages due the employee from the employer. And, this prohibition applies to employers who operate restaurants and similar establishments whose employees receive gratuities from their customers.

California Code of Regulations, title 18, section (Regulation) 1603, *Taxable Sales of Food Products*, provides guidance to restaurants, hotels, boarding houses, soda fountains, and similar establishments that make taxable sales of food products. Under Regulation 1603, subdivision (g), optional payments designated as tips, gratuities, and service charges are not subject to tax (and not included in a retailer's gross receipts); however, mandatory payments designated as tips, gratuities, and service charges are included in gross receipts subject to tax, even if the amount is subsequently paid by the retailer to the server.

Specifically, Regulation 1603, subdivision (g)(1)(A), provides that “[a] payment of a tip, gratuity, or service charge is optional if the customer adds the amount to the bill presented by the retailer, or otherwise leaves a separate amount in payment over and above the actual amount due the retailer for the sale of meals, food, and drinks that include services,” and provides examples illustrating when the payment of an amount designated as a tip, gratuity, or service charge is optional. Also, Regulation 1603, subdivision (g)(1)(B) incorporates the prohibition in Labor Code section 351, and provides that when the “prohibition is violated, any amount of such gratuities received by the employer will be considered a part of the gross receipts of the employer and subject to the tax.”

Regulation 1603, subdivision (g)(2)(A), provides that “[a]n amount negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is mandatory.” Regulation 1603, subdivision (g)(2)(B), provides that “[w]hen the menu, brochures, advertisements or other printed materials contain statements that notify customers that tips, gratuities, or service charges will or may be added, an amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is a mandatory charge and subject to tax,” and provides examples of such printed statements. Regulation 1603, subdivision (g)(2)(B) provides that “[a]n amount will be considered ‘automatically added’ when the retailer adds the tip to the bill without first conferring with the customer after service of the meal and receiving approval to add the tip or without providing the customer with the option to write in the tip.” Also, Regulation 1603, subdivision (g)(2)(B), provides that “any amount added [to the bill] by the retailer is presumed to be mandatory,” and Regulation 1603, subdivision (g)(2)(C), prescribes the type of evidence that must be provided to controvert (or rebut) the presumption and provides examples of such evidence.

On June 25, 2012, the Internal Revenue Service published Internal Revenue Bulletin No. 2012-26, which includes Revenue Ruling 2012-18. This revenue ruling clarified and updated guidelines on taxes imposed on tips under the Federal Insurance Contributions Act, including information on the difference between tips (tip wages) and service charges (non-tip wages). The ruling reaffirmed prior guidance which provided that the absence of any of the four following factors creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge: 1. The payment must be made free from compulsion; 2. The customer must have the unrestricted right to determine the amount; 3. The payment should not be the subject of negotiation or dictated by employer policy; 4. Generally, the customer has the right to determine who receives the payment.

Proposed Amendments

Interested Parties Process

Although Regulation 1603, subdivision (g), was amended in 2007 to clarify the application of tax to tips, gratuities and service charges, it has become evident to State Board of Equalization (Board) staff that some retailers are having compliance issues because there is still some remaining confusion regarding what constitutes “mandatory” versus “optional” tips, gratuities, and service charges. As a result, the Board’s Business Taxes Committee (BTC) staff prepared

draft amendments to subdivision (g) of Regulation 1603 to address the retailers' compliance issues (or problems within the meaning of Gov. Code, § 11346.2, subdivision (b)) by establishing a new bright-line approach for determining whether payments (or amounts) designated as tips, gratuities, and service charges are "optional" or "mandatory" based upon how the retailer treated the amounts for Internal Revenue Service purposes. The draft amendments suggested adding provisions to the regulation explaining that when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. The draft amendments also provided that a payment of a tip, gratuity, or service charge is deemed to be mandatory if the amounts are required to be reported, for the purposes of income tax to the Internal Revenue Service, as non-tip wages, and the amendments listed the four factors from Revenue Ruling 2012-18 that the Internal Revenue Service examines to determine if a payment is a tip or service charge (non-tip wage). The draft amendments also clarified subdivision (g)'s existing language and deleted provisions of subdivision (g) that had caused confusion for retailers and staff.

BTC staff subsequently provided its draft amendments to Regulation 1603 to the interested parties and conducted an interested parties meeting in December 2013 to discuss the draft amendments. During the December 2013 meeting, interested parties appeared open to staff's proposal and there was a general consensus that creating a bright-line approach with respect to tips, gratuities, and service charges would be helpful to the restaurant industry and staff. Also, participants discussed the effect of the new presumption and asked BTC staff what would happen if a retailer did not maintain records for purposes of its federal income tax reporting.

Subsequent to the December 2013 interested parties meeting, staff received letters from Kara Bush on behalf of the California Restaurant Association and from James Dumler of McClellan Davis, LLC. Both letters were dated January 10, 2014. (See Exhibits 3 and 4 to Formal Issue Paper 2014-003 referred to below.) In the first letter, Ms. Bush expressed the California Restaurant Association's appreciation of the Board's efforts to clarify this issue and stated that the association looks forward to continuing to work with staff and other interested parties to develop a bright-line approach that will foster reporting compliance and audit efficiency. Ms. Bush also expressed appreciation for staff's suggestions and stated that the association will continue to explore other alternatives. In the second letter, Mr. Dumler reiterated concerns expressed during the interested parties meeting that a taxpayer that lacks support for the IRS tip designations would not benefit from the proposed presumption and optional gratuities could incorrectly be presumed to be mandatory. Mr. Dumler also recommended that the examples in the current regulation with respect to mandatory payments be retained.

In response to the concerns expressed at the December 2013 interested parties meeting, staff added language to its draft amendments clarifying the application of the new presumption regarding federal tax reporting and also added provisions to determine whether a payment is "optional" or "mandatory" when a retailer does not maintain records for purposes of reporting tips to the IRS. When a retailer does not maintain these records, the determination of whether or not the payments are mandatory is consistent with the provisions currently in Regulation 1603, subdivision (g) (discussed above). Additionally, staff added clarifying language to its draft amendments to define the term "amount" as a payment designated as a tip, gratuity, or service charge, or any other separately stated payment for services associated with the purchase of

meals, food, or drinks. This amendment was made to reduce historical confusion associated with the use of the word “amount” to refer to payments throughout Regulation 1603, subdivision (g). Additionally, due to perceived confusion with staff applying the four factors from Revenue Ruling 2012-18 (referred to above), these factors were deleted from staff’s draft amendments.

In February 2014, staff again met with interested parties to discuss the draft amendments. Staff and interested parties discussed how to make it clear that the draft amendments are only to apply prospectively.

Following the February 2014, interested parties meeting, staff received a letter from Mr. Matt Sutton, sent on behalf of the California Restaurant Association. (See Exhibit 5 to Formal Issue Paper 2014-003 referred to below.) In his March 6, 2014, letter, Mr. Sutton explained that while the California Restaurant Association has historically disagreed with the taxation of mandatory gratuities, it was appreciative of staff’s ideas and acknowledged that the suggestions for a “bright line” approach, discussed in the discussion papers and both interested parties meetings, have merit. Mr. Sutton further stated that it remains to be seen how the industry will respond to the Internal Revenue Service guidance and how that will interplay with the Board’s practice of taxing mandatory tips.

May 22, 2014, BTC Meeting

Staff made changes to its draft amendments to Regulation 1603 in response to the discussion of the prospective application of the draft amendments at the February 2014 interested parties meeting. Staff changed the draft amendments so that subdivision (g) of Regulation 1603 continues to apply to transactions prior to January 1, 2015, without any changes, and new subdivision (h), containing what had previously been staff’s draft amendments to subdivision (g), will apply to transactions on and after January 1, 2015. Staff also changed the draft amendments in order to renumber the subdivisions of the regulation following new subdivision (h), and update the regulation’s current cross-references to the renumbered subdivisions.

Subsequently, BTC staff prepared Formal Issue Paper 14-003 and distributed it to the Board Members for consideration at the Board’s May 22, 2014, BTC meeting. Formal Issue Paper 14-003 recommended that the Board propose to add new subdivision (h) to Regulation 1603 to define the term “amount,” and provide that, for sales made on and after July 1, 2015, when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. Additionally, new subdivision (h) provides that when a retailer’s records reflect that amounts are required to be reported to the Internal Revenue Service as non-tip wages, the amount is deemed to be mandatory. Finally, new subdivision (h) provides that when a retailer does not maintain records for purposes of reporting amounts to the Internal Revenue Service, the application of tax to the amounts will be consistent with the provisions currently in Regulation 1603, subdivision (g), including subdivision (g)’s record keeping requirements and provisions regarding violations of the prohibition in Labor Code section 351. The formal issue paper also recommended making non-substantive amendments to the regulation, including moving the regulation’s authority and reference note so that it precedes the regulation’s appendix, and updating the cross-references to

other regulations following the authority and reference note. (See Exhibit 2 to Formal Issue Paper 14-003.)

The Board discussed Formal Issue Paper 14-003 during its May 22, 2014, BTC meeting. Mr. Matt Sutton appeared on behalf of the California Restaurant Association and made statements similar to those in his March 6, 2014, letter. At the conclusion of the discussion, the Board Members voted 4-0 to propose the amendments to Regulation 1603 recommended in the formal issue paper, subject to conforming to the official text of the regulation at the time of publication. The Board determined that the proposed amendments to Regulation 1603 are reasonably necessary to have the effect and accomplish the specific purpose of addressing the retailers' compliance issues (discussed above) due to the confusion regarding what constitutes "mandatory" versus "optional" tips, gratuities, and service charges.

The Board anticipates that the proposed amendments to Regulation 1603 will promote fairness and benefit retailers, Board staff, and the Board by providing regulatory provisions that may be applied using a bright-line approach that is consistent with federal tax reporting, and thereby reduce confusion for retailers and staff.

In addition, the Board has determined that the proposed amendments are not mandated by federal law or regulations, and there are no federal regulations or statutes that are identical to Regulation 1603 or the proposed amendments to Regulation 1603.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 14-003, the exhibits to the issue paper, and the comments made during the Board's discussion of the issue paper during its May 22, 2014, BTC meeting in deciding to propose the amendments to Regulation 1603 described above.

ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1603 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1603 at this time because the Board determined that the proposed amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Regulation 1603 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2,
SUBDIVISION (b)(5) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY
GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

As previously explained, the proposed amendments do not change the rule that an optional payment designated as a tip, gratuity, or service charge is not subject to tax, and a mandatory payment designated as a tip, gratuity, or service charge is includable in taxable gross receipts. The proposed amendments make Regulation 1603's treatment of payments designated as tips, gratuities, and services charges consistent with the records retailers keep for reporting such payments as tip wages or non-tip wages for Internal Revenue Service purposes by adding a new presumption as to whether or not a tip, gratuity, or service charge is subject to tax based on such records. The amendments also clarify subdivision (g)'s existing language regarding the application of tax to payments designated as tips, gratuities, and service charges by adding new subdivision (h) to Regulation 1603, effective for transactions on or after January 1, 2015.

Specifically, new subdivision (h) defines "amount" as a payment designated as a tip, gratuity, service charge, or any other separately stated payment for services associated with the purchase of meals, food, or drinks. New subdivision (h)(1) provides that when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. When a retailer does not maintain such records, this presumption does not apply. And, new subdivision (h)(1) provides examples of transactions where amounts are optional and not subject to tax, which are consistent with the current examples in Regulation 1603, subdivision (g)(1)(A).

Also as previously explained, new subdivision (h)(2) provides that when a retailer's records reflect that amounts are required to be reported to the Internal Revenue Service as non-tip wages, the amount is deemed to be mandatory. New subdivision (h)(3) prescribes the application of tax when the examples of amounts that are optional in subdivision (h)(1) do not apply and a retailer does not maintain records for purposes of reporting the amounts to the Internal Revenue Service, and new subdivision (h)(3) is consistent with the current provisions of Regulation 1603, subdivision (g)(2). New subdivision (h)(3) provides that when an amount is negotiated between the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks, the amount is mandatory. When the menu or other printed materials notify customers that amounts will or may be added by the retailer to the bill, and such amounts are automatically added by the retailer to the bill, the amount is a mandatory charge and subject to tax. It is presumed that an amount added by the retailer to the bill is automatically added and mandatory; however, this presumption may be overcome by documentary evidence showing that the customer specifically requested and authorized the amount to be added to the bill.

Also, as previously explained, the proposed amendments are intended to address retailers' compliance issues due to the confusion regarding what constitutes "mandatory" versus "optional" tips, gratuities, and service charges by establishing a bright-line approach to how to treat amounts added by retailers to customers' bills that is consistent with how the retailers treated the amounts for Internal Revenue Service purposes. There is nothing in the proposed amendments to Regulation 1603 that would significantly change how restaurants and similar establishments would generally behave in the absence of the proposed amendments. And, the

Board anticipates that the proposed amendments to Regulation 1603 will promote fairness and benefit retailers, Board staff, and the Board by addressing and reducing such confusion.

In addition, the amendments to Regulation 1603 do not impose any costs on any persons, including restaurant businesses, because the proposed amendments do not impose new record keeping requirements and take into account, rather than impact, current practices in the restaurant industry regarding tips, gratuities, and service charges. And, the proposed amendments do not impact revenue. (See Exhibit 1 to Formal Issue Paper 14-003.) Therefore, the Board estimates that the proposed amendments will not have a measurable economic impact on individuals and business. And, the Board has determined that the proposed amendments to Regulation 1603 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed amendments will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars (\$50,000,000) during any 12-month period.

Further, based on these facts and all of the information in the rulemaking file, the Board has also determined that the adoption of the proposed amendments to Regulation 1603 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

Furthermore, Regulation 1603 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Regulation 1603 will not affect the benefits of Regulation 1603 to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Regulation 1603 will not have a significant adverse economic impact on business.

The proposed amendments to Regulation 1603 may affect small businesses.

**Text of Proposed Amendments to
California Code of Regulations, Title 18, Section 1603**

1603. Taxable Sales of Food Products.

(a) Restaurants, Hotels, Boarding Houses, Soda Fountains, and Similar Establishments.

(1) Definitions.

(A) Boarding House. The term “boarding house” as used in this regulation means any establishment regularly serving meals, on the average to five or more paying guests. The term includes a “guest home,” “residential care home,” “halfway house,” and any other establishment providing room and board or board only, which is not an institution as defined in Regulation 1503 and section 6363.6 of the Revenue and Taxation Code. The fact that guests may be recipients of welfare funds does not affect the application of tax. A person or establishment furnishing meals on the average to fewer than five paying guests during the calendar quarter is not considered to be engaged in the business of selling meals at retail.

(B) American Plan Hotel. The term “American Plan Hotel” as used in this regulation means a hotel which charges guests a fixed sum by the day, week, or other period for room and meals combined.

(C) Complimentary Food and Beverages. As used in this subdivision (a), the term “complimentary food and beverages” means food and beverages (including alcoholic and non-alcoholic beverages) which are provided to transient guests on a complimentary basis and:

1. There is no segregation between the charges for rooms and the charges for the food and beverages on the guests’ bills, and
2. The guests are not given an option to refuse the food and beverages in return for a discounted room rental.

(D) Average Retail Value of Complimentary Food and Beverages. The term “average retail value of complimentary food and beverages” (ARV) as used in this regulation means the total amount of the costs of the complimentary food and beverages for the preceding calendar year marked-up one hundred percent (100%) and divided by the number of rooms rented for that year. Costs of complimentary food and beverages include charges for delivery to the lodging establishment but exclude discounts taken and sales tax reimbursement paid to vendors. The 100% markup factor includes the cost of food preparation labor by hotel employees, the fair rental value of hotel facilities used to prepare or serve the food and beverages, and profit.

(E) Average Daily Rate. The term “average daily rate” (ADR) as used in this regulation means the gross room revenue for the preceding calendar year divided by the number of rooms rented for that year. “Gross room revenue” means and includes the full charge to the hotel customers but excludes separately stated occupancy taxes, revenue from

contract and group rentals which do not qualify for complimentary food and beverages, and revenue from special packages (e.g., New Year's Eve packages which include food and beverages as well as guest room accommodations), unless it can be documented that the retail value of the food and beverages provided as a part of the special package is 10% or less of the total package charge as provided in subdivision (a)(2)(B). "Number of rooms rented for that year" means the total number of times all rooms have been rented on a nightly basis provided the revenue for those rooms is included in the "gross room revenue." For example, if a room is rented out for three consecutive nights by one guest, that room will be counted as rented three times when computing the ADR.

(2) Application Of Tax.

(A) In General. Tax applies to sales of meals or hot prepared food products (see (e) below) furnished by restaurants, concessionaires, hotels, boarding houses, soda fountains, and similar establishments whether served on or off the premises. In the case of American Plan hotels, special packages offered by hotels, e.g., a New Year's Eve package as described in subdivision (a)(1)(E), and boarding houses, a reasonable segregation must be made between the charges for rooms and the charges for the meals, hot prepared food products, and beverages. Charges by hotels or boarding houses for delivering meals or hot prepared food products to, or serving them in, the rooms of guests are includable in the measure of tax on the sales of the meals or hot prepared food products whether or not the charges are separately stated. (Caterers, see (h) below.) Sales of meals or hot prepared food products by restaurants, concessionaires, hotels, boarding houses, soda fountains, and similar establishments to persons such as event planners, party coordinators, or fundraisers, which buy and sell on their own account, are sales for resale for which a resale certificate may be accepted. (See subdivision (h)(3)(C).)

Souffle cups, straws, paper napkins, toothpicks and like items that are not of a reusable character which are furnished with meals or hot prepared food products are sold with the meals or hot prepared food products. Sales of such items for such purpose to persons engaged in the business of selling meals or hot prepared food products are, accordingly, sales for resale.

(B) Complimentary Food and Beverages. Lodging establishments which furnish, prepare, or serve complimentary food and beverages to guests in connection with the rental of rooms are consumers and not retailers of such food and beverages when the retail value of the complimentary food and beverages is "incidental" to the room rental service regardless of where within the hotel premises the complimentary food and beverages are served. For complimentary food and beverages to qualify as "incidental" for the current calendar year, the average retail value of the complimentary food and beverages (ARV) furnished for the preceding calendar year must be equal to or less than 10% of the average daily rate (ADR) for that year.

If a hotel provides guests with coupons or similar documents which may be exchanged for complimentary food and beverages in an area of the hotel where food and beverages are sold on a regular basis to the general public (e.g., a restaurant), the hotel will be

considered the consumer and not the retailer of such food and beverages if the coupons or similar documents are non-transferable and the guest is specifically identified by name. If the coupons or similar documents are transferable or the guest is not specifically identified, food and beverages provided will be considered sold to the guest at the fair retail value of similar food and beverages sold to the general public. In the case of coupons redeemed by guests at restaurants not operated by the lodging establishment, the hotel will be considered the consumer of food and beverages provided to the hotel's guests and tax will apply to the charge by the restaurant to the hotel.

Lodging establishments are retailers of food and beverages which do not qualify as "incidental" and tax applies as provided in subdivision (a)(2)(A) above. Amounts paid by guests for food and beverages in excess of a complimentary allowance are gross receipts subject to the tax. Lodging establishments are retailers of otherwise complimentary food and beverages sold to non-guests.

In the case of hotels with concierge floor, club level or similar programs, the formula set forth above shall be applied separately with respect to the complimentary food and beverages furnished to guests who participate in the concierge, club or similar program. That is, the concierge, club or similar program will be deemed to be an independent hotel separate and apart from the hotel in which it is operated. The ADR and the retail value of complimentary food and beverages per occupied room will be computed separately with respect to the guest room accommodations entitled to the privileges and amenities involved in the concierge, club or similar program.

The following example illustrates the steps in determining whether the food and beverages are complimentary:

FORMULA: $ARV \div ADR \leq 10\%$

Average Daily Rate (ADR):

Room Revenue	\$9,108,000
Rooms Rented	74,607
ADR (\$9,108,000 ÷ 74,607)	\$122.08

Average Retail Value of Complimentary Food and Beverages (ARV):

Complimentary Food Cost	\$169,057
Complimentary Beverage Cost	52,513
Total	\$221,570
Add 100% Markup	221,570
Average Retail Value	\$443,140
ARV per occupied room (\$443,140 ÷ 74,607)	\$5.94

Application of Formula:

$$\$5.94 \div \$122.08 = 4.87\%$$

In the above example, the average retail value of the complimentary food and beverages per occupied room for the preceding calendar year is equal to or less than 10% of the average daily rate. Therefore, under the provisions of this subdivision (a)(2)(B), the complimentary food and beverages provided to guests for the current calendar year qualify as “incidental.” The lodging establishment is the consumer and not the retailer of such food and beverages. This computation must be made annually.

When a lodging establishment consists of more than one location, the operations of each location will be considered separately in determining if that location’s complimentary food and beverages qualify as incidental.

(C) “Free” Meals. When a restaurant agrees to furnish a “free” meal to a customer who purchases another meal and presents a coupon or card, which the customer previously had purchased directly from the restaurant or through a sales promotional agency having a contract with the restaurant to redeem the coupons or cards, the restaurant is regarded as selling two meals for the price of one, plus any additional compensation from the agency or from its own sales of coupons. Any such additional compensation is a part of its taxable gross receipts for the period in which the meals are served.

Tax applies only to the price of the paid meal plus any such additional compensation.

(b) “Drive-Ins.” Tax applies to sales of food products ordinarily sold for immediate consumption on or near a location at which parking facilities are provided primarily for the use of patrons in consuming the products purchased at the “drive-in” establishment, even though such products are sold on a “take out” or “to go” order and are actually packaged or wrapped and taken from the premises of the retailer. Food products when sold in bulk, i.e., in quantities or in a form not suitable for consumption on the retailer’s premises, are not regarded as ordinarily sold for immediate consumption on or near the location at which parking facilities are provided by the retailer. Accordingly, with the exception of sales of hot prepared food products (see (e) below) and sales of cold food under the 80-80 rule (see (c) below), sales of ice cream, doughnuts, and other individual food items in quantities obviously not intended for consumption on the retailer’s premises, without eating utensils, trays, or dishes and not consumed on the retailer’s premises, are exempt from tax. Any retailer claiming a deduction on account of food sales of this type must support the deduction by complete and detailed records.¹

(c) Cold Food Sold on a “Take-Out” Order.

(1) General.

(A) Seller Meeting Criteria of 80-80 Rule. When a seller meets both criteria of the 80-80 rule as explained in subdivision (c)(3) below, tax applies to sales of cold food products (including sales for a separate price of hot bakery goods and hot beverages such as coffee) in a form suitable for consumption on the seller’s premises even though such food

products are sold on a “take-out” or “to go” order. Sales of cold food products which are suitable for consumption on the seller’s premises are subject to the tax no matter how great the quantity purchased, e.g., 40 one-half pint containers of milk. Except as provided elsewhere in this regulation, tax does not apply to sales of food products which are furnished in a form not suitable for consumption on the seller’s premises.

Operative April 1, 1996, although a seller may meet both criteria of the 80-80 rule, he or she may elect to separately account for the sale of “take-out” or “to go” orders of cold food products which are in a form suitable for consumption on the seller’s premises. The gross receipts from the sale of those food products shall be exempt from the tax provided the seller keeps a separate accounting of these transactions in his or her records. Tax will remain applicable to the sale of food products as provided in subdivisions (a), (b), (e), or (f) of this regulation. Failure to maintain the required separate accounting and documentation claimed as exempt under this subdivision will revoke the seller’s election under this subdivision.

(B) Seller Not Meeting Criteria of 80-80 Rule. When a seller does not meet both criteria of the 80-80 rule as explained in subdivision (c)(3) below, tax does not apply to sales of cold food products (including sales for a separate price of hot bakery goods and hot beverages such as coffee) when sold on a “take-out” or “to go” order.

(2) Definitions.

(A) For purposes of this subdivision (c), the term “suitable for consumption on the seller’s premises” means food products furnished:

1. In a form which requires no further processing by the purchaser, including but not limited to cooking, heating, thawing, or slicing, and
2. In a size which ordinarily may be immediately consumed by one person such as a large milk shake, a pint of ice cream, a pint of milk, or a slice of pie. Cold food products (excluding milk shakes and similar milk products) furnished in containers larger in size than a pint are considered to be in a form not suitable for immediate consumption.

Pieces of candy sold in bulk quantities of one pound or greater are deemed to be sold in a form not suitable for consumption on the seller’s premises.

The term does not include cold food products which obviously would not be consumed on the premises of the seller, e.g., a cold party tray or a whole cold chicken.

(B) For purposes of this subdivision (c), the term “seller’s premises” means the individual location at which a sale takes place rather than the aggregate of all locations of the seller. For example, if a seller operates several drive-in and fast food restaurants, the operations of each location stand alone and are considered separately in determining if the sales of food products at each location meet the criteria of the 80-80 rule.

When two or more food-selling activities are conducted by the same person at the same location, the operations of all food related activities will be considered in determining if the sales of food products meet the criteria of the 80-80 rule. For example, if a seller operates a grocery store and a restaurant with no physical separation other than separate cash registers, the grocery store operations will be included in determining if the sales of food products meet the criteria of the 80-80 rule. When there is a physical separation where customers of one operation may not pass freely into the other operation, e.g., separate rooms with separate entrances but a common kitchen, each operation will be considered separately for purposes of this subdivision (c).

(3) 80-80 Rule. Tax applies under this subdivision (c) only if the seller meets both of the following criteria:

(A) More than 80 percent of the seller's gross receipts are from the sale of food products, and

(B) More than 80 percent of the seller's retail sales of food products are taxable as provided in subdivisions (a), (b), (e), and (f) of this regulation.

Sales of alcoholic beverages, carbonated beverages, or cold food to go not suitable for immediate consumption should not be included in this computation. Any seller meeting both of these criteria and claiming a deduction for the sale of cold food products in a form not suitable for consumption on the seller's premises must support the deduction by complete and detailed records of such sales made.

(d) Places Where Admission Is Charged.

(1) General. Tax applies to sales of food products when sold within, and for consumption within, a place the entrance to which is subject to an admission charge, during the period when the sales are made, except for national and state parks and monuments, and marinas, campgrounds, and recreational vehicle parks.

(2) Definitions.

(A) "Place" means an area the exterior boundaries of which are defined by walls, fences or otherwise in such a manner that the area readily can be recognized and distinguished from adjoining or surrounding property. Examples include buildings, fenced enclosures and areas delimited by posted signs.

(B) "Within a place" means inside the door, gate, turnstile, or other point at which the customer must pay an admission charge or present evidence, such as a ticket, that an admission charge has been paid. Adjacent to, or in close proximity to, a place is not within a place.

(C) "Admission charge" means any consideration required to be paid in money or otherwise, for admittance to a place.

"Admission charge" does not include:

1. Membership dues in a club or other organization entitling the member to, among other things, entrance to a place maintained by the club or organization, such as a fenced area containing a club house, tennis courts, and a swimming pool. Where a guest is admitted to such a place only when accompanied by or vouched for by a member of the club or organization, any charge made to the guest for use of facilities in the place is not an admission charge.
2. A charge for a student body card entitling the student to, among other things, entrance to a place, such as entrance to a school auditorium at which a dance is held.
3. A charge for the use of facilities within a place to which no entrance charge is made to spectators. For example, green fees paid for the privilege of playing a golf course, a charge made to swimmers for the use of a pool within a place, or a charge made for the use of lanes in a public bowling place.

(D) "National and state parks and monuments" means those which are part of the National Park System or the State Park System. The phrase does not include parks and monuments not within either of those systems, such as city, county, regional, district or private parks.

(3) Presumption That Food Is Sold for Consumption Within a Place.

When food products are sold within a place the entrance to which is subject to an admission charge, it will be presumed, in the absence of evidence to the contrary, that the food products are sold for consumption within the place. Obtaining and retaining evidence in support of the claimed tax exemption is the responsibility of the retailer. Such evidence may consist, for example, of proof that the sales were of canned jams, cake mixes, spices, cooking chocolate, or other items in a form in which it is unlikely that such items would be consumed within the place where sold.

(4) Food Sold to Students. The exemption otherwise granted by Section 6363 does not apply to sales of food products to students when sold within, and for consumption within, a place the entrance to which is subject to an admission charge, and such sales are subject to tax except as provided in (p) of this regulation. For example, when food products are sold by a student organization to students or to both students and nonstudents within a place the entrance to which is subject to an admission charge, such as a place where school athletic events are held, the sales to both students and nonstudents are taxable.

(e) Hot Prepared Food Products.

(1) General. Tax applies to all sales of hot prepared food products unless otherwise exempt. "Hot prepared food products" means those products, items, or components which have been prepared for sale in a heated condition and which are sold at any temperature which is higher than the air temperature of the room or place where they are sold. The mere heating of a food product constitutes preparation of a hot prepared food product, e.g., grilling a sandwich, dipping a sandwich bun in hot gravy, using infra-red lights, steam tables, etc.- If the sale is intended to be of a hot food product, such sale is of a hot food product regardless of cooling which incidentally occurs. For example, the sale of a toasted sandwich intended to be in a heated condition when sold, such as a fried ham sandwich on toast, is a sale of a hot prepared food product even though it may have cooled due to delay. On the other hand, the sale of a toasted sandwich which is not intended to be in a heated condition when sold, such as a cold tuna sandwich on toast, is not a sale of a hot prepared food product.

When a single price has been established for a combination of hot and cold food items, such as a meal or dinner which includes cold components or side items, tax applies to the entire established price regardless of itemization on the sales check. The inclusion of any hot food product in an otherwise cold combination of food products sold for a single established price, results in the tax applying to the entire established price, e.g., hot coffee served with a meal consisting of cold food products, when the coffee is included in the established price of the meal. If a single price for the combination of hot and cold food items is listed on a menu, wall sign or is otherwise advertised, a single price has been established. Except as otherwise provided in (b), (c), (d) or (f) of this regulation, or in Regulation 1574, tax does not apply to the sale for a separate price of bakery goods, beverages classed as food products, or cold or frozen food products. Hot bakery goods and hot beverages such as coffee are hot prepared food products but their sale for a separate price is exempt unless taxable as provided in (b), (c), (d) or (f) of this regulation, or in Regulation 1574. Tax does apply if a hot beverage and a bakery product or cold food product are sold as a combination for a single price. Hot soup, bouillon, or consomme is a hot prepared food product, which is not a beverage.

(2) Air Carriers Engaged in Interstate or Foreign Commerce. Tax does not apply to the sale, storage, use, or other consumption of hot prepared food products sold by caterers or other vendors to air carriers engaged in interstate or foreign commerce for consumption by passengers on such air carriers, nor to the sale, storage, use, or other consumption of hot prepared food products sold or served to passengers by air carriers engaged in interstate or foreign commerce for consumption by passengers on such air carriers. "Air carriers" are persons or firms in the business of transporting persons or property for hire or compensation, and include both common and contract carriers. "Passengers" do not include crew members. Any caterer or other vendor claiming the exemption must support it with an exemption certificate from the air carrier substantially in the form prescribed in Appendix A of this regulation.

(f) Food for Consumption at Facilities Provided by the Retailer. Tax applies to sales of sandwiches, ice cream, and other foods sold in a form for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others.

A passenger's seat aboard a train, or a spectator's seat at a game, show, or similar event is not a "chair" within the meaning of this regulation. Accordingly, except as otherwise provided in (c), (d), and (e) above, tax does not apply to the sale of cold sandwiches, ice cream, or other food products sold by vendors passing among the passengers or spectators where the food products are not "for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware provided by the retailer."

(g) Tips, Gratuities, and Service Charges. (Prior to January 1, 2015)

The provisions of subdivision (g) apply to transactions occurring prior to January 1, 2015. This subdivision applies to restaurants, hotels, caterers, boarding houses, soda fountains, drive-ins and similar establishments.

An optional payment designated as a tip, gratuity, or service charge is not subject to tax. A mandatory payment designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if the amount is subsequently paid by the retailer to employees.

(1) Optional Payment.

(A) A payment of a tip, gratuity, or service charge is optional if the customer adds the amount to the bill presented by the retailer, or otherwise leaves a separate amount in payment over and above the actual amount due the retailer for the sale of meals, food, and drinks that include services. The following examples illustrate transactions where a payment of a tip, gratuity or service charge is optional and not included in taxable gross receipts. This is true regardless of printed statements on menus, brochures, advertisements or other materials notifying customers that tips, gratuities, or service charges will or may be added by the retailer to the prices of meals, food, or drinks:

Example 1. The restaurant check is presented to the customer with the "tip" area blank so the customer may voluntarily write in an amount, or

Example 2. The restaurant check is presented to the customer with options computed by the retailer and presented to the customer as tip suggestions. The "tip" area is blank so the customer may voluntarily write in an amount:

Guest Check	Guest Check
Food Item A	\$9.95
Beverage Item B	3.75
Subtotal	\$13.70
8% sales tax	1.10
Subtotal	\$14.80

Tip*

Total

*Suggested tips:

15%=\$2.06; 18%=\$2.47; 20%=\$2.74; other.

If an employer misappropriates these payments for these charges, as discussed in subdivision (g)(1)(B) below, such payments are included in the retailer's taxable gross receipts.

(B) No employer shall collect, take, or receive any gratuity or a part thereof, paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of such gratuity, or require an employee to credit the amount, or any part thereof, of such gratuity against and as a part of the wages due the employee from the employer. (Labor Code section 351.) If this prohibition is violated, any amount of such gratuities received by the employer will be considered a part of the gross receipts of the employer and subject to the tax.

(2) Mandatory Payment.

(A) An amount negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is mandatory.

(B) When the menu, brochures, advertisements or other printed materials contain statements that notify customers that tips, gratuities, or service charges will or may be added, an amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is a mandatory charge and subject to tax. These amounts are considered negotiated in advance as specified in subdivision (g)(2)(A). Examples of printed statements include:

“An 18% gratuity [or service charge] will be added to parties of 8 or more.”

“Suggested gratuity 15%,” itemized on the invoice or bill by the restaurant, hotel, caterer, boarding house, soda fountain, drive-in or similar establishment.

“A 15% voluntary gratuity will be added for parties of 8 or more.”

An amount will be considered “automatically added” when the retailer adds the tip to the bill without first conferring with the customer after service of the meal and receiving approval to add the tip or without providing the customer with the option to write in the tip. Nonetheless, any amount added by the retailer is presumed to be mandatory. This presumption may be overcome as discussed in subdivision (g)(2)(C) below.

(C) It is presumed that an amount added as a tip by the retailer to the bill or invoice presented to the customer is mandatory. A statement on the bill or invoice that the amount added by the retailer is a “suggested tip,” “optional gratuity,” or that “the amount may be increased, decreased, or removed” by the customer does not change the mandatory nature of the charge.

This presumption may be controverted by documentary evidence showing that the customer specifically requested and authorized the gratuity be added to the amount billed.

Examples of documentary evidence that may be used to overcome the presumption include:

1. A guest check that is presented to the customer showing sales tax reimbursement and the amount upon which it was computed, without tip or with the “tip” area blank and a separate document, such as a credit card receipt, to which the retailer adds or prints the requested tip.
2. Guests receipts and payments showing that the percentage of tips paid by large groups varies from the percentage stated on the menu, brochure, advertisement or other printed materials.
3. A retailer’s written policy stating that its employees shall receive confirmation from a customer before adding a tip together with additional verifiable evidence that the policy has been enforced. The policy is not in itself sufficient documentation to establish that the customer requested and authorized that a gratuity be added to the amount billed without such additional verifiable evidence.

The retailer must retain the guest checks and any additional separate documents to show that the payment is optional. The retailer is also required to maintain other records in accordance with the requirements of Regulation 1698, Records.

(h) Tips, Gratuities, and Service Charges. (On and after January 1, 2015)

The provisions of subdivision (h) apply to transactions occurring on and after January 1, 2015. This subdivision applies to restaurants, hotels, caterers, boarding houses, soda fountains, drive-ins and similar establishments.

An optional payment designated as a tip, gratuity, or service charge is not subject to tax. A mandatory payment designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if it is subsequently paid by the retailer to employees. For purposes of this subdivision, “amount” means a payment designated as a tip, gratuity, service charge, or any other separately stated payment for services associated with the purchase of meals, food, or drinks.

(1) Optional Payment.

When a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service (IRS) purposes, such amounts are presumed to be optional and not subject to tax. When a retailer does not maintain such records, this presumption does not apply and the amounts may be mandatory and included in taxable gross receipts as discussed in subdivisions (h)(2) and (h)(3).

The following examples illustrate transactions where an amount is optional and not included in taxable gross receipts:

Example 1. The restaurant check is presented to the customer with the “tip” area blank so the customer may voluntarily write in the amount, or

Example 2. The restaurant check is presented to the customer with options computed by the retailer and presented to the customer as tip suggestions. The “tip” area is blank so the customer may voluntarily write in the amount:

<u>Guest Check</u>	
<u>Food Item A</u>	<u>\$9.95</u>
<u>Beverage Item B</u>	<u>3.75</u>
<u>Subtotal</u>	<u>\$13.70</u>
<u>8% sales tax</u>	<u>1.10</u>
<u>Subtotal</u>	<u>\$14.80</u>
<u>Tip*</u>	
<u>Total</u>	
<u>*Suggested tips:</u>	
<u>15%=\$2.06; 18%=\$2.47; 20%=\$2.74; other.</u>	

Under these circumstances, the customer is free to enter the amount on the tip line or leave it blank; thus, the customer may enter an amount free from compulsion. The customer and restaurant did not negotiate the amount nor did the restaurant dictate the amount.

If an employer misappropriates these amounts, as discussed in subdivision (h)(4) below, such payments are included in the retailer’s taxable gross receipts.

(2) Mandatory Payment.

When a retailer’s records reflect that amounts are required to be reported to the IRS as non-tip wages, the amount is deemed to be mandatory.

(3) When a retailer does not maintain records for purposes of reporting the amounts to the IRS:

(A) An amount negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is mandatory.

(B) When the menu, brochures, advertisements or other printed materials contain statements that notify customers that tips, gratuities, or service charges will or may be added, an amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is a mandatory charge and subject to tax. These amounts are considered negotiated in advance as specified in subdivision (h)(3)(A). Examples of printed statements include:

“An 18% gratuity [or service charge] will be added to parties of 8 or more.”

“Suggested gratuity 15%,” itemized on the invoice or bill by the restaurant, hotel, caterer, boarding house, soda fountain, drive-in or similar establishment.

“A 15% voluntary gratuity will be added for parties of 8 or more.”

An amount will be considered “automatically added” when the retailer adds the amount to the bill without first conferring with the customer after service of the meal.

Nonetheless, any amount added by the retailer is presumed to be automatically added and mandatory. This presumption may be overcome as discussed in subdivision (h)(3)(C) below.

(C) It is presumed that an amount added as a tip by the retailer to the bill or invoice presented to the customer is automatically added and mandatory. A statement on the bill or invoice that the amount added by the retailer is a “suggested tip,” “optional gratuity,” or that the amount “may be increased, decreased, or removed” by the customer does not change the mandatory nature of the charge.

This presumption may be controverted by documentary evidence showing that the customer specifically requested and authorized the amount be added to the bill.

Examples of documentary evidence that may be used to overcome the presumption include:

1. A guest check that is presented to the customer showing sales tax reimbursement and the figure upon which it was computed, without “tip” or with the “tip” area blank and a separate document, such as a credit card receipt, to which the retailer adds or prints the requested amount.
2. Guest receipts and payments showing that the percentage of amounts paid by large parties varies from the percentage stated on the menu, brochure, advertisement or other printed materials.
3. A retailer’s written policy stating that its employees shall receive confirmation from a customer before adding an amount together with additional verifiable evidence that the policy has been enforced. The policy is not in itself sufficient documentation to establish that the customer requested and authorized that the amount be added to the bill without such additional verifiable evidence.

The retailer must retain the guest checks and any additional separate documents to show that the payment is optional. The retailer is also required to maintain other records in accordance with the requirements of Regulation 1698, *Records*.

(4) No employer shall collect, take, or receive any gratuity or a part thereof, paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of such gratuity, or require an employee to credit the amount, or any part thereof, of such gratuity against and as a part of the wages due the employee from the employer. (Labor Code section 351.) If this prohibition is violated, any amount received by the employer will be considered a part of the gross receipts of the employer and subject to the tax.

(hi) Caterers.

(1) Definition. The term “caterer” as used in this regulation means a person engaged in the business of serving meals, food, or drinks on the premises of the customer, or on premises supplied by the customer, including premises leased by the customer from a person other than the caterer, but does not include employees hired by the customer by the hour or day.

(2) Sales to Caterers. A caterer generally is considered to be the consumer of tangible personal property normally used in the furnishing and serving of meals, food or drinks, except for separately stated charges by the caterer for the lease of tangible personal property or tangible personal property regarded as being sold with meals, food or drinks such as disposable plates, napkins, utensils, glasses, cups, stemware, place mats, trays, covers and toothpicks.

(3) Sales by Caterers.

(A) Caterer as Retailer. Tax applies to the entire charge made by caterers for serving meals, food, and drinks, inclusive of charges for food, the use of dishes, silverware, glasses, chairs, tables, etc., used in connection with serving meals, and for the labor of serving the meals, whether performed by the caterer, the caterer’s employees or subcontractors. Tax applies to charges made by caterers for preparing and serving meals and drinks even though the food is not provided by the caterers. Tax applies to charges made by caterers for hot prepared food products as in (e) above whether or not served by the caterers. A caterer who separately states or itemizes charges for the lease of tangible personal property regardless of the use of the property will be deemed to be the lessor of such property. Tax applies in accordance with Regulation 1660, Leases of Tangible Personal Property - In General. Tax does not apply to charges made by caterers for the rental of dishes, silverware, glasses, etc., purchased by the caterer with tax paid on the purchase price if no food is provided or served by the caterers in connection with such rental.

(B) Caterers as Lessors of Property Unrelated to the Serving or Furnishing of Meals, Food, or Drinks by a Caterer.

1. When a caterer who is furnishing or serving meals, food, or drinks also rents or leases from a third party tangible personal property which the caterer does not use himself or herself and the property is not customarily provided or used within the catering industry in connection with the furnishing and serving of food or drinks, such as decorative props related solely to optional entertainment, special lighting for guest speakers, sound or video systems, dance floors, stages, etc., he or she is a lessor of such property. In such instance, tax applies to the lease in accordance with Regulation 1660.

2. When a person who in other instances is a caterer does not furnish or serve any meals, food, or drinks to a customer, but rents or leases from a third party tangible personal property such as dishes, linen, silverware and glasses, etc., for purposes of

providing it to his or her customer, he or she is not acting as a caterer within the meaning of this regulation, but solely as a lessor of tangible personal property. In such instances, tax applies to the lease in accordance with Regulation 1660.

(C) Caterers Planning, Designing and Coordinating Events.

1. Tax applies to charges by a caterer for event planning, design, coordination, and/or supervision if they are made in connection with the furnishing of meals, food, or drinks for the event. Tax does not apply to separately stated charges for services unrelated to the furnishing and serving of meals, food, or drinks, such as optional entertainment or any staff who do not directly participate in the preparation, furnishing, or serving of meals, food, or drinks, e.g., coat-check clerks, parking attendants, security guards, etc.

2. When a caterer sells meals, food, or drinks, and the serving of them, to other persons such as event planners, party coordinators, or fundraisers, who buy and sell the same on their own account or for their own sake, it is a sale for resale for which the caterer may accept a resale certificate. However, a caterer may only claim the sale as a resale if the caterer obtains a resale certificate in compliance with Regulation 1668. A person is buying or selling for his or her own account, or own sake, when such person has his or her own contract with a customer to sell the meals, food, or drinks to the customer, and is not merely acting on behalf of the caterer.

3. When a caterer sells meals, food or drinks and the serving of them to other persons who charge a fee for their service unrelated to the taxable sale, the separately stated fee is not subject to tax.

(D) Sales of Meals by Caterers to Social Clubs, Fraternal Organizations. Sales of meals to social clubs and fraternal organizations, as those terms are defined in subdivision (ij) below, by caterers are sales for resale if such social clubs and fraternal organizations are the retailers of the meals subject to tax under subdivision (ij) and give valid resale certificates therefor.

(E) Tips, Gratuities, or Service Charges. Tips, gratuities, and service charges are discussed in subdivisions (g) and (h).

(4) Premises. General. Separately stated charges for the lease of premises on which meals, food, or drinks are served, are nontaxable leases of real property. Where a charge for leased premises is a guarantee against a minimum purchase of meals, food or drinks, the charge for the guarantee is gross receipts subject to tax. Where a person contracts to provide both premises and meals, food or drinks, the charge for the meals, food or drinks must be reasonable in order for the charge for the premises to be nontaxable ~~non-taxable~~.

(5) Private Chefs. A private chef is generally not an employee of the customer, but an independent contractor who pays his or her own social security, and federal and state income

taxes. Such a private chef, who prepares and serves meals, food and drinks in the home of his or her customer is a caterer under this regulation.

(ij) Social Clubs and Fraternal Organizations. “Social Clubs and Fraternal Organizations” as used herein include any corporation, partnership, association or group or combination acting as a unit, such as service clubs, lodges, and community, country, and athletic clubs.

The tax applies to receipts from the furnishing of meals, food, and drink by social clubs and fraternal organizations unless furnished: (1) exclusively to members; and also, (2) less frequently than once a week. Both of these requirements must be met. If the club or organization furnishes meals, food or drink to nonmembers, all receipts from the furnishing of meals, food or drink are subject to tax whether furnished to members or nonmembers, including receipts on occasions when furnished exclusively to members. Meals, food or drink paid for by members are considered furnished to them even though consumed by guests who are not members.

(jk) Student Meals.

(1) Definitions.

(A) “Food Products.”: As used herein, the term “food products” as defined in Regulation 1602 (18 CCR 1602) includes food furnished, prepared, or served for consumption at tables, chairs, or counters, or from trays, glasses, dishes, or other tableware provided by the retailer or by a person with whom the retailer contracts to furnish, prepare or serve food to others.

(B) “Meals.”: As used herein, the term “meals” includes both food and nonfood products which are sold to students for an established single price at a time set aside for meals. If a single price for the combination of a nonfood product and a food product is listed on a menu or on a sign, a single price has been established. The term “meals” does not include nonfood products which are sold to students for a separate price and tax applies to the sales of such products. Examples of nonfood products are: carbonated beverages and beer. For the purpose of this regulation, products sold at a time designated as a “nutrition break”, “recess”, or similar break, will not be considered “meals.”:

(2) Application of Tax.

(A) Sales by Schools, School Districts and Student Organizations. Sales of meals or food products for human consumption to students of a school by public or private schools, school districts, and student organizations are exempt from tax, except as otherwise provided in (d)(4) above.

(B) Sales by Parent-Teacher Associations. Tax does not apply to the sale of, nor the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served to the students of a school by parent-teacher associations. Parent-teacher associations qualifying under Regulation 1597 as consumers are not retailers of tangible personal property, which they sell. Accordingly, tax does

apply to the sale to such associations of nonfood items such as carbonated beverages, containers, straws and napkins.

(C) Sales by Blind Vendors. Tax does not apply to the sale of meals or food products for human consumption to students of a school by any blind person (as defined in section 19153 of the Welfare and Institutions Code) operating a restaurant or vending stand in an educational institution under article 5 of chapter 6 of part 2 of division 10 of the Welfare and Institutions Code, except as otherwise provided in (d)(4) above.

(D) Sales by Caterers. The application of tax to sales by caterers in general is explained in subdivision (h) above. However, tax does not apply to the sale by caterers of meals or food products for human consumption to students of a school, if all the following criteria are met:

1. The premises used by the caterer to serve the lunches to the students are used by the school for other purposes, such as sporting events and other school activities, during the remainder of the day;
2. The fixtures and equipment used by the caterer are owned and maintained by the school; and
3. The students purchasing the meals cannot distinguish the caterer from the employees of the school.

~~(k)~~ Employees' Meals.

(1) In General. Any employer or employee organization that is in the business of selling meals, e.g., a restaurant, hotel, club, or association, must include its receipts from the sales of meals to employees, along with its receipts from sales to other purchasers of meals, in the amount upon which it computes its sales tax liability. An employer or an employee organization selling meals only to employees becomes a retailer of meals and liable for sales tax upon its receipts from sales of meals if it sells meals to an average number of five or more employees during the calendar quarter.

(2) Specific Charge. The tax applies only if a specific charge is made to employees for the meals. Tax does not apply to cash paid an employee in lieu of meals. A specific charge is made for meals if:

- (A) Employee pays cash for meals consumed.
- (B) Value of meals is deducted from employee's wages.
- (C) Employee receives meals in lieu of cash to bring compensation up to legal minimum wage.
- (D) Employee has the option to receive cash for meals not consumed.

(3) No Specific Charge. If an employer makes no specific charge for meals consumed by employees, the employer is the consumer of the food products and the ~~nonfood~~~~non-food~~ products, which are furnished to the employees as a part of the meals.

In the absence of any of the conditions under ~~(1)(2)(k)~~ (2) a specific charge is not made if:

(A) A value is assigned to meals as a means of reporting the fair market value of employees' meals pursuant to state and federal laws or regulations or union contracts.

(B) Employees who do not consume available meals have no recourse on their employer for additional cash wages.

(C) Meals are generally available to employees, but the duties of certain employees exclude them from receiving the meals and are paid cash in lieu thereof.

(4) Meals Credited Toward Minimum Wage. If an employee receives meals in lieu of cash to bring his or her compensation up to the legal minimum wage, the amount by which the minimum wage exceeds the amount otherwise paid to the employee is includable in the employer's taxable gross receipts up to the value of the meals credited toward the minimum wage.

For example, if the minimum rate for an eight-hour day is \$46.00, and the employee received \$43.90 in cash, and a lunch is received which is credited toward the minimum wage in the maximum allowable amount of \$2.10, the employer has received gross receipts in the amount of \$2.10 for the lunch.

(5) Tax Reimbursement. If a separately stated amount for tax reimbursement is not added to the price of meals sold to employees for which a specific charge is made, the specific charge will be regarded as being a tax-included charge for the meals.

~~(lm)~~ Religious Organizations. Tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served by any religious organization at a social or other gathering conducted by it or under its auspices, if the purpose in furnishing or serving the meals and food products is to obtain revenue for the functions and activities of the organization and the revenue obtained from furnishing or serving the meals and food products is actually used in carrying on such functions and activities. For the purposes of this regulation, "religious organization" means any organization the property of which is exempt from taxation pursuant to subdivision (f) of section 3 of article XIII of the State Constitution.

~~(mn)~~ Institutions. Tax does not apply to the sale of, nor the storage, use, or other consumption in this state of, meals and food products for human consumption furnished or served to and consumed by patients or residents of an "institution" as defined in Regulation 1503. Tax, however, does apply to the sale of meals and food products by an institution to persons other than patients or residents of the institution.

(~~no~~) Meal Programs for Low-Income Elderly Persons. Tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served to low-income elderly persons at or below cost by a nonprofit organization or governmental agency under a program funded by this state or the United States for such purposes.

(~~op~~) Food Products, Nonalcoholic Beverages and Other Tangible Personal Property Transferred by Nonprofit Youth Organizations. See Regulation 1597 for the application of tax on food products, nonalcoholic beverages and other tangible personal property transferred by nonprofit youth organizations.

(~~oq~~) Nonprofit Parent-Teacher Associations. Nonprofit parent-teacher associations and equivalent organizations qualifying under Regulation 1597 are consumers and not retailers of tangible personal property, which they sell.

(~~er~~) Meals and Food Products Served to Condominium Residents. Tax does not apply to the sale of, and the storage, use, or other consumption in this state of meals and food products for human consumption furnished to and consumed by persons 62 years of age or older residing in a condominium and who own equal shares in a common kitchen facility; provided, that the meals and food products are served to such persons on a regular basis.

This exemption is applicable only to sales of meals and food products for human consumption prepared and served at the common kitchen facility of the condominium. Tax applies to sales to persons less than 62 years of age.

(~~rs~~) Veteran's Organization. Beginning April 1, 2004, tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served by any nonprofit veteran's organization at a social or other gathering conducted by it or under its auspices, if the purpose in furnishing or serving the meals and food products is to obtain revenue for the functions and activities of the organization and the revenue obtained from furnishing or serving the meals and food products is actually used in carrying on those functions and activities.

(~~st~~) Food Stamp Coupons. Tax does not apply to tangible personal property which is eligible to be purchased with federal food stamp coupons acquired pursuant to the Food Stamp Act of 1977 and so purchased. When payment is made in the form of both food stamps and cash, the amount of the food stamp coupons must be applied first to tangible personal property normally subject to the tax, e.g., nonalcoholic carbonated beverages. Retailers are prohibited from adding any amount designated as sales tax, use tax, or sales tax reimbursement to sales of tangible personal property purchased with food stamp coupons. (See paragraph (c) of Regulation 1602.5 for special reporting provisions by grocers.)

(~~tu~~) Honor System Snack Sales. An "honor system snack sale" means a system where customers take snacks from a box or tray and pay by depositing money in a container provided by the seller. Snacks sold through such a system may be subject to tax depending upon where the sale

takes place. Sales of such snacks are taxable when sold at or near a lunchroom, break room, or other facility that provides tables and chairs, and it is contemplated that the food sold will normally be consumed at such facilities. Honor system snack sales do not include hotel room mini-bars or snack baskets.

(uv) Mobile Food Vendors. Mobile food vendors include retailers who sell food and beverages for immediate consumption from motorized vehicles or un-motorized carts. Examples of mobile food vendors include food trucks, coffee carts, and hot dog carts. For sales made on or after July 1, 2014, unless a separate amount for tax reimbursement is added to the price, mobile food vendors' sales of taxable items are presumed to be made on a tax-included basis.

This presumption does not apply when a mobile food vendor is making sales as a "caterer" as defined in (hi)(1).

1 The records acceptable in support of such a deduction are:

- (a) A sales ticket prepared for each transaction claimed as being tax exempt showing:
 - (1) Date of the sale,
 - (2) The kind of merchandise sold,
 - (3) The quantity of each kind of merchandise sold,
 - (4) The price of each kind of merchandise sold,
 - (5) The total price of merchandise sold,
 - (6) A statement to the effect that the merchandise purchased is not to be consumed on or near the location at which parking facilities are provided by the retailer, and
- (b) A daily sales record kept in sufficient detail to permit verification by audit that all gross receipts from sales have been accounted for and that all sales claimed as being tax exempt are included therein.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374 and 6376.5, Revenue and Taxation Code. Food Products Generally, see Regulation 1602. Sales tax reimbursement, see Regulation 1700. Meals served to residents or patients of an institution, see Regulation 1503. Food products sold through vending machines, see Regulation 1574. Meals at organized camps, see Regulation 1506. Nonprofit organizations as consumers, see Regulation 1597.

Appendix A

**California Sales Tax Exemption Certificate
Supporting Exemption Under Section 6359.1**

The undersigned certifies that it is an air carrier engaged in interstate or foreign commerce and that the hot prepared food products purchased from _____ will be consumed by passengers on its flights.

The undersigned further certifies that it understands and agrees that if the property purchased under this certificate is used by the purchaser for any purpose other than that specified above, the purchaser shall be liable for sales tax as if it were a retailer making a retail sale of the property at the time of such use, and the sales price of the property to it shall be deemed the gross receipts from such sale.

Date Certificate Given _____

Purchasing Air Carrier _____
(company name)

Address _____

Signed By _____
(signature of authorized person)

(print or type name)

Title _____
(owner, partner, purchasing agent, etc.)

Seller's Permit No. (if any) _____

~~Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374 and 6376.5, Revenue and Taxation Code.~~

~~Food Products Generally, see Regulation 1602.~~

~~Alcoholic Beverages, tax reimbursements when served with, see Regulation 1700.~~

~~"Free" meals with purchased meals, see Regulation 1670.~~

~~Meals served to patients and inmates of an institution, see Regulation 1503.~~

~~Vending Machines, when considered selling meals, see Regulation 1574.~~

~~Meals at summer camps, see Regulation 1506(e).~~

~~Parent Teacher associations as consumers, see Regulation 1597.~~

Regulation History

Type of Regulation: Sales and Use Tax

Regulation: 1603

Title: 1603, *Taxable Sales of Food Products*

Preparation: Cary Huxsoll

Legal Contact: Cary Huxsoll

The proposed amendments to Regulation 1603, *Taxable Sales of Food Products*, clarify the application of tax to tips, gratuities, and service charges.

History of Proposed Regulation:

August 5-7, 2014	Public Hearing
June 20, 2014	OAL publication date; 45-day public comment period begins; Interested Parties mailing
June 10, 2014	Notice to OAL
May 22, 2014	Business Tax Committee, Board Authorized Publication (Vote 4-0)

Sponsor: NA

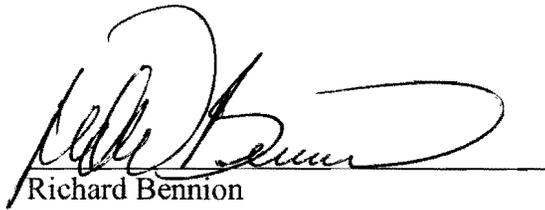
Support: NA

Oppose: NA

Statement of Compliance

The State Board of Equalization, in process of adopting Sales and Use Taxes Regulation 1603, *Taxable Sales of Food Products*, did comply with the provision of Government Code section 11346.4(a)(1) through (4). A notice to interested parties was mailed on June 20, 2014, 46 days prior to the public hearing.

July 30, 2014

A handwritten signature in black ink, appearing to read "Richard Bennion", written over a horizontal line.

Richard Bennion
Regulations Coordinator
State Board of Equalization

BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION
5901 GREEN VALLEY CIRCLE
CULVER CITY, CALIFORNIA

REPORTER'S TRANSCRIPT

AUGUST 5, 2014

ITEM F

PUBLIC HEARING

ITEM F1

PROPOSED ADOPTION OF AMENDMENTS TO SALES AND USE TAX
REGULATION 1603, TAXABLE SALES OF FOOD PRODUCTS

REPORTED BY: Kathleen Skidgel

CSR NO. 9039

P R E S E N T

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For the Board
of Equalization:

Jerome E. Horton
Chairman

Michelle Steel
Vice-Chairwoman

Betty T. Yee
Member

George Runner
Member

Marcy Jo Mandel
Appearing for John
Chiang, State Controller
(per Government Code
Section 7.9)

Joann Richmond
Chief
Board Proceedings
Division

For Board of
Equalization Staff:

Cary Huxsoll
Tax Counsel III
Legal Department

Bradley Heller
Tax Counsel IV
Legal Department

---oOo---

1 5901 GREEN VALLEY CIRCLE
2 CULVER CITY, CALIFORNIA
3 AUGUST 5, 2014

4 ---oOo---

5 MR. HORTON: Ms. Richmond, our next matter.

6 MS. RICHMOND: Our next matter is Item F,
7 Public Hearing; Item F1, Proposed Adoption of
8 Amendments to Sales and Use Tax Regulation 1603,
9 Taxable Sales of Food Products.

10 MR. HORTON: Welcome, gentlemen. Please
11 introduce yourself for the record, then commence
12 your presentation.

13 MR. HUXSOLL: Good afternoon, Mr. Chairman,
14 Members of the Board. I'm Cary Huxsoll from the
15 Legal Department along with Bradley Heller from the
16 Legal Department.

17 We'd request that the Board vote to adopt
18 the proposed amendments to Regulation 1603, taxable
19 sales of food products. The proposed amendments
20 provide that for transactions occurring on or after
21 January 1st, 2015 when a retailer keeps records
22 consistent with reporting amounts designated as
23 tips, gratuities or service charges as tip wages for
24 Internal Revenue Service purposes, such amounts are
25 presumed to be optional and not subject to tax.

26 Staff has not received any public comments
27 on the proposed amendments.

28 MR. HORTON: Discussion, Members?

1 Let me thank staff for their work on this;
2 we truly appreciate that.

3 I understand the Restaurant Association
4 is -- did send in comments; would you like to share
5 that with the Board?

6 MR. HUXSOLL: The Restaurant Association
7 did send in letters during the -- prior to
8 publication of the proposed amendments. Following
9 publication, nothing has been received. They were
10 involved in the interested parties process, but
11 we've not received any public comment since
12 publication.

13 MS. MANDEL: But their -- their comment
14 before was favorable, I believe.

15 MR. HUXSOLL: Yeah, they were, uh --

16 MS. MANDEL: I think that's what
17 Mr. Horton's really asking.

18 MR. HUXSOLL: They were in support of the
19 amendments as written.

20 MR. HORTON: There you go. Thanks, Member
21 Mandel.

22 Members, I must say I -- I have a little
23 bit of concern about the federal versus the state's
24 view of this. And even though we are, I think,
25 doing a yeoman's job to bring some clarity, we may
26 want to entertain some consistency language to
27 somehow be in conformity with the Internal Revenue's
28 view of this. And I guess I would ask the Leg.

1 Committee to take a look at that to see if there's
2 leg- -- potential legislation that would have the
3 state conform or clarify as it relates to how the
4 federal government treats gratu- -- tips.

5 Discussion, Members?

6 Hearing none, thank you very much. We will
7 receive and file your report.

8 MS. MANDEL: Move adoption.

9 MR. HORTON: Move --

10 MS. YEE: Second.

11 MR. HORTON: Yeah. I'm in a rush here, it
12 seems.

13 Member Mandel moves adoption.

14 MS. STEEL: Second.

15 MR. HORTON: Second by Member Steel.

16 Without objection, Members, such will be the order.

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REPORTER'S CERTIFICATE

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State of California)
) ss
County of Sacramento)

I, KATHLEEN SKIDGEL, Hearing Reporter for the California State Board of Equalization certify that on August 5, 2014 I recorded verbatim, in shorthand, to the best of my ability, the proceedings in the above-entitled hearing; that I transcribed the shorthand writing into typewriting; and that the preceding pages 1 through 5 constitute a complete and accurate transcription of the shorthand writing.

Dated: August 11, 2014

Kathleen Skidgel

KATHLEEN SKIDGEL
Hearing Reporter



2014 MINUTES OF THE STATE BOARD OF EQUALIZATION**Tuesday, August 5, 2014****F1 Proposed Adoption of Amendments to Sales and Use Tax Regulation 1603,
Taxable Sales of Food Products**

Cary Huxsoll, Tax Counsel, Tax and Fee Programs Division, Legal Department, made introductory remarks regarding amendments to Sales and Use Tax Regulation 1603, clarifying the application of tax to tips, gratuities, and service charges (Exhibit 8.4).

Speakers were invited to address the Board, but there were none.

Action: Upon motion of Ms. Mandel, seconded by Ms. Steel and unanimously carried, Mr. Horton, Ms. Steel, Ms. Yee, Mr. Runner and Ms. Mandel voting yes, the Board adopted the amendments to Regulation 1603 as published.

[G1] LEGAL APPEALS MATTERS, CONSENT

The Board deferred consideration of the following matter: *G1.12 Nirvair Corporation, 529714 (EA)*.

With respect to the Legal Appeals Matters Consent Agenda, upon a single motion of Ms. Yee, seconded by Ms. Steel and unanimously carried, Mr. Horton, Ms. Steel, Ms. Yee, Mr. Runner and Ms. Mandel voting yes, the Board made the following orders:

G1.1 Eric Paul Leiss, 567149 (DF)

10/01/04 to 12/31/08, \$0.00 Tax, \$299.70 Late Payment Penalties, \$1,998.20 Late Payment of Returns Penalties, \$2,479.50 Finality Penalties

Action: Redetermine as recommended by the Appeals Division.

G1.2 Manuel Rodriguez Luna, 595512 (EA)

01/01/05 to 01/24/07, \$579,123.72 Tax, \$144,780.99 Fraud Penalty, \$940.21 Failure-to-File Penalty

Action: Redetermine as recommended by the Appeals Division.

G1.3 Beatriz Martinez, 556435 (AC)

07/01/06 to 06/30/09, \$15,761.64 Tax, \$1,591.15 Negligence Penalty

Action: Redetermine as recommended by the Appeals Division

G1.4a Franklin Evan Tyler, 606109 (FH)**G1.4b Debbie Tyler, 606111 (FH)**

07/01/08 to 06/30/09, \$16,720.14 Tax, \$1,875.10 Late Payments of Returns Penalties, \$9.10 Finality Penalty

Action: Redetermine as recommended by the Appeals Division.

Note: These minutes are not final until Board approved.



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

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BETTY T. YEE
First District, San Francisco

SEN. GEORGE RUNNER (RET.)
Second District, Lancaster

MICHELLE STEEL
Third District, Rolling Hills Estates

JEROME E. HORTON
Fourth District, Los Angeles

JOHN CHIANG
State Controller

CYNTHIA BRIDGES
Executive Director

June 20, 2014

To Interested Parties:

Notice of Proposed Regulatory Action

**The State Board of Equalization Proposes to Adopt Amendments to
California Code of Regulations, Title 18,
Section 1603, *Taxable Sales of Food Products***

NOTICE IS HEREBY GIVEN that the State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1603, *Taxable Sales of Food Products*. The proposed amendments do not change the rule that an optional payment designated as a tip, gratuity, or service charge is not subject to tax, and a mandatory payment designated as a tip, gratuity, or service charge is includable in taxable gross receipts. Instead, the proposed amendments make Regulation 1603's treatment of payments designated as tips, gratuities, and services charges consistent with the records retailers keep for reporting such payments as tip wages or non-tip wages for Internal Revenue Service purposes by adding a new presumption as to whether or not a tip, gratuity, or service charge is subject to tax based on such records. The proposed amendments also clarify subdivision (g)'s existing language regarding the application of tax to payments designated as tips, gratuities, and service charges by adding new subdivision (h) to Regulation 1603, effective for transactions occurring on and after January 1, 2015. In addition, the proposed amendments make non-substantive amendments to the regulation, including moving the regulation's authority and reference note so that it precedes the regulation's appendix, and updating the cross-references to other regulations following the authority and reference note.

PUBLIC HEARING

The Board will conduct a meeting in Room 207 at its offices at 5901 Green Valley Circle, Culver City, California on August 5-7, 2014. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at www.boe.ca.gov at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 9:30 a.m. or as soon thereafter as the matter may be heard on August 5, 6, or 7, 2014. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1603.

AUTHORITY

RTC section 7051

REFERENCE

RTC sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374, and 6376.5.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Summary of Existing Laws and Regulations

California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (RTC, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California. (RTC, §§ 6012, 6051.) The term "gross receipts" means the total amount of the sale price without any deduction for the cost of materials used, labor or service costs, interest paid, losses, or any other expense. (RTC, § 6012, subd. (a)(2).) Gross receipts include any services that are part of the sale and all receipts, cash, credits, and property of any kind. (RTC, § 6012.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700, subd. (a)(1).)

Sales of food products for human consumption are generally exempt from tax. However, this exemption does not apply to sales of food products furnished, prepared, or served for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware whether provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others, or to sales of food products served as meals on or off the premises of the retailer. (RTC, § 6359.) Therefore, issues arise as to whether payments designated as tips, gratuities, and service charges that are related to the taxable sale of food products are includible in retailers' gross receipts.

Under Regulation 1603, subdivision (g), optional payments designated as tips, gratuities, and service charges are not subject to tax (and not included in a retailer's gross receipts); however, mandatory payments designated as tips, gratuities, and service charges are included in gross receipts subject to tax, even if the amount is subsequently paid by the retailer to the server.

On June 25, 2012, the Internal Revenue Service published Internal Revenue Bulletin No. 2012-26, which includes Revenue Ruling 2012-18. This revenue ruling clarified and updated guidelines on taxes imposed on tips under the Federal Insurance Contributions Act, including information on the difference between tips (tip wages) and service charges (non-tip wages). The ruling reaffirmed prior guidance which provided that the absence of any of the following four factors creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge: 1. The payment must be made free from compulsion; 2. The customer must have the unrestricted right to determine the amount; 3. The payment should not be the subject of negotiation or dictated by employer policy; 4. Generally, the customer has the right to determine who receives the payment.

Effect, Objective, and Benefits of the Proposed Amendments to Regulation 1603

Although Regulation 1603, subdivision (g), was amended in 2007 to clarify the application of tax to tips, gratuities and service charges, it has become evident to Board staff that some retailers are having compliance issues because there is still some remaining confusion regarding what constitutes "mandatory" versus "optional" tips, gratuities, and service charges. The proposed amendments to Regulation 1603 are intended to have the effect and accomplish the objective of addressing these retailers' compliance issues by establishing a bright-line approach to how to treat amounts added by retailers to customers' bills that is consistent with how the retailers treated the amounts for Internal Revenue Service purposes. This new approach will ease compliance for retailers by making it clear that the application of sales tax to the transactions at issue is consistent with federal tax reporting requirements.

Interested Parties Process

Originally, the Board's Business Taxes Committee (BTC) staff prepared draft amendments to subdivision (g) of Regulation 1603 to address the retailers' compliance issues. The draft amendments suggested adding provisions to the regulation explaining that when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. The draft amendments also provided that a payment of a tip, gratuity, or service charge is deemed to be mandatory if the amounts are required to be reported, for the purposes of income tax to the Internal Revenue Service, as non-tip wages, and the amendments listed the four factors from Revenue Ruling 2012-18 that the Internal Revenue Service examines to determine if a payment is a tip or service charge (non-tip wage). The draft amendments also clarified subdivision (g)'s existing language and deleted provisions of subdivision (g) that had caused confusion to retailers and staff. The draft amendments also made non-substantive changes to the regulation by updating cross-

references and making strictly grammatical changes throughout the regulation. The draft amendments also updated the cross-reference to other regulations following the regulations authority and reference note. Additionally, the draft amendments moved the note section to a point preceding the appendix to the regulation.

BTC staff subsequently provided its draft amendments to Regulation 1603 to the interested parties and conducted an interested parties meeting in December 2013, to discuss the draft amendments. During the December 2013 meeting, interested parties appeared open to staff's proposal and there was a general consensus that creating a bright-line approach with respect to tips, gratuities, and service charges would be helpful to the restaurant industry and staff. Also, participants discussed the effect of the presumption and asked BTC staff what would happen if a retailer did not maintain records for purposes of its federal income tax reporting.

Subsequent to the December 2013 interested parties meeting, staff received letters from Kara Bush on behalf of the California Restaurant Association and from James Dumler of McClellan Davis, LLC. Both letters were dated January 10, 2014. In the first letter, Ms. Bush expressed the California Restaurant Association's appreciation of the Board's efforts to clarify this issue and that the association looks forward to continuing to work with staff and other interested parties to develop a bright-line approach that will foster reporting compliance and audit efficiency. Ms. Bush also expressed appreciation for staff's suggestions and stated that the association will continue to explore other alternatives. In the second letter, Mr. Dumler reiterated concerns expressed during the interested parties meeting that a taxpayer that lacks support for the IRS tip designations would not benefit from the proposed presumption and optional gratuities could incorrectly be presumed to be mandatory. Mr. Dumler also recommended that the examples in the current regulation with respect to mandatory payments be retained.

In response to the concerns expressed at the December 2013 interested parties meeting, staff added language to its draft amendments clarifying the application of the new presumption regarding federal tax reporting and also added provisions to determine whether a payment is "optional" or "mandatory" when a retailer does not maintain records for purposes of reporting tips to the IRS. When a retailer does not maintain these records, the determination of whether or not the payments are mandatory is consistent with the provisions currently in Regulation 1603, subdivision (g). Additionally, staff added clarifying language to its draft amendments to define the term "amount" as a payment designated as a tip, gratuity, or service charge, or any other separately stated payment for services associated with the purchase of meals, food, or drinks. This amendment was made to reduce historical confusion associated with the use of the word "amount" to refer to payments throughout subdivision (g). Also, due to perceived confusion with staff applying the four factors from Revenue Ruling 2012-18 (referred to above), these factors were deleted from staff's draft amendments.

In February 2014, staff again met with interested parties to discuss the draft amendments. Staff and interested parties discussed how to make it clear that the draft amendments are only to apply prospectively.

Following the February 2014, interested parties meeting, staff received a letter from Mr. Matt Sutton, sent on behalf of the California Restaurant Association. In his March 6, 2014, letter, Mr. Sutton explained that while the California Restaurant Association has historically disagreed with the taxation of mandatory gratuities, it was appreciative of staff's ideas and acknowledged that the suggestions for a "bright line" approach, discussed in the discussion papers and both interested parties meetings, have merit. Mr. Sutton further stated that it remains to be seen how the industry will respond to the Internal Revenue Service guidance and how that will interplay with the Board's practice of taxing mandatory tips.

May 22, 2014, BTC Meeting

Staff made changes to its draft amendments to Regulation 1603 in response to the discussion of the prospective application of the draft amendments at the February 2014 interested parties meeting. Staff changed the draft amendments so that subdivision (g) of Regulation 1603 continues to apply to transactions prior to January 1, 2015, and new subdivision (h), containing what had previously been staff's draft amendments to subdivision (g), will apply to transactions on and after January 1, 2015. Staff also changed the draft amendments in order to renumber the subdivisions of the regulation following new subdivision (h), and update the regulation's cross-reference to the renumbered subdivisions.

Subsequently, BTC staff prepared Formal Issue Paper 14-003 and distributed it to the Board Members for consideration at the Board's May 22, 2014, BTC meeting. Formal Issue Paper 14-003 recommended that the Board propose to add new subdivision (h) to Regulation 1603 to define the term "amount," and provide that, for sales made on and after July 1, 2015, when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. Additionally, new subdivision (h) provides that when a retailer's records reflect that amounts are required to be reported to the Internal Revenue Service as non-tip wages, the amount is deemed to be mandatory. Finally, new subdivision (h) provides that when a retailer does not maintain records for purposes of reporting amounts to the Internal Revenue Service, the application of tax to the amounts will be consistent with the provisions currently in Regulation 1603, subdivision (g). The formal issue paper also recommended making non-substantive amendments to the regulation.

The Board discussed Formal Issue Paper 14-003 during its May 22, 2014, BTC meeting. Mr. Matt Sutton appeared on behalf of the California Restaurant Association and made statements similar to those in his March 6, 2014, letter. At the conclusion of the discussion, the Board Members voted 4-0 to propose the amendments to Regulation 1603 recommended in the formal issue paper, subject to conforming to the official text of the regulation at the time of publication. The Board determined that the proposed amendments to Regulation 1603 are necessary to have the effect and accomplish the objective of addressing retailers' compliance issues by establishing a bright-line approach to how to treat amounts added by retailers to

customers' bills that is consistent with how the retailers treated the amounts for Internal Revenue Service purposes.

The Board also anticipates that the proposed amendments to Regulation 1603 will promote fairness and benefit retailers, Board staff, and the Board by providing regulatory provisions that may be applied using a bright-line approach that is consistent with federal tax reporting requirements on these transactions, and thereby reduce confusion for retailers and staff.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1603 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations. This is because there are no other sales and use tax regulations that specifically apply to restaurants' and similar establishments' collection of amounts as tips, gratuities, and service charges. In addition, the Board has determined that there are no comparable federal regulations or statutes to Regulation 1603 or the proposed amendments to Regulation 1603.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1603 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

NO COST OR SAVINGS TO ANY STATE AGENCY, LOCAL AGENCY, OR SCHOOL DISTRICT

The Board has determined that the adoption of the proposed amendments to Regulation 1603 will result in no direct or indirect cost or savings to any state agency, no cost to any local agency or school district that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, no other non-discretionary cost or savings imposed on local agencies, and no cost or savings in federal funding to the State of California.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The Board has made an initial determination that the adoption of the proposed amendments to Regulation 1603 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Regulation 1603 may affect small business.

NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

**RESULTS OF THE ECONOMIC IMPACT ASSESSMENT REQUIRED BY
GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)**

The Board has determined that the proposed amendments to Regulation 1603 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000. Therefore, the Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1603 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1603 will not affect the benefits of Regulation 1603 to the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

The adoption of the proposed amendments to Regulation 1603 will not have a significant effect on housing costs.

DETERMINATION REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Cary Huxsoll, Tax Counsel III, by telephone at (916) 323-3092, by e-mail at Cary.Huxsoll@boe.ca.gov, or by mail at State Board of Equalization, Attn: Cary Huxsoll, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 9:30 a.m. on August 5, 2014, or as soon thereafter as the Board begins the public hearing regarding the adoption of the proposed amendments to Regulation 1603 during the August 5-7, 2014, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1603. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underscored and strikeout version of the text of Regulation 1603 illustrating the express terms of the proposed amendments. The Board has also prepared an initial statement of reasons for the adoption of the proposed amendments to Regulation 1603, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed amendments and the initial statement of reasons are also available on the Board's Website at www.boe.ca.gov.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

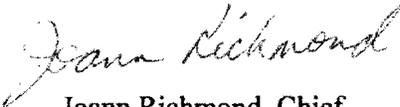
The Board may adopt the proposed amendments to Regulation 1603 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed regulation, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the original proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

June 20, 2014

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts the proposed amendments to Regulation 1603, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at www.boe.ca.gov.

Sincerely,



Joann Richmond, Chief
Board Proceedings Division

JR:reb

**Initial Statement of Reasons for
Proposed Amendments to California Code of Regulations,
Title 18, Section 1603, *Taxable Sales of Food Products***

SPECIFIC PURPOSE, PROBLEM INTENDED TO BE ADDRESSED, NECESSITY, AND ANTICIPATED BENEFIT

Current Law

California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (Rev. & Tax. Code, § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California. (Rev. & Tax. Code, §§ 6012, 6051.) The term "gross receipts" means the total amount of the sale price without any deduction for the cost of materials used, labor or service costs, interest paid, losses, or any other expense. (Rev. & Tax. Code, § 6012, subd. (a)(2).) Gross receipts include any services that are part of the sale and all receipts, cash, credits, and property of any kind. (Rev. & Tax. Code, § 6012.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700, subd. (a)(1).)

Sales of food products for human consumption are generally exempt from tax. However, as relevant here, this exemption does not apply to sales of food products furnished, prepared, or served for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware whether provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others, or to sales of food products served as meals on or off the premises of the retailer. (Rev. & Tax. Code, § 6359.) Therefore, issues arise as to whether payments designated as tips, gratuities, and service charges that are related to taxable sales of food products are includible in retailers' gross receipts.

In addition, Labor Code section 351 provides that no employer or agent shall collect, take, or receive any gratuity or a part thereof that is paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of a gratuity, or require an employee to credit the amount, or any part thereof, of a gratuity against and as a part of the wages due the employee from the employer. And, this prohibition applies to employers who operate restaurants and similar establishments whose employees receive gratuities from their customers.

California Code of Regulations, title 18, section (Regulation) 1603, *Taxable Sales of Food Products*, provides guidance to restaurants, hotels, boarding houses, soda fountains, and similar establishments that make taxable sales of food products. Under Regulation 1603, subdivision (g), optional payments designated as tips, gratuities, and service charges are not subject to tax (and not included in a retailer's gross receipts); however, mandatory payments designated as tips, gratuities, and service charges are included in gross receipts subject to tax, even if the amount is subsequently paid by the retailer to the server.

Specifically, Regulation 1603, subdivision (g)(1)(A), provides that “[a] payment of a tip, gratuity, or service charge is optional if the customer adds the amount to the bill presented by the retailer, or otherwise leaves a separate amount in payment over and above the actual amount due the retailer for the sale of meals, food, and drinks that include services,” and provides examples illustrating when the payment of an amount designated as a tip, gratuity, or service charge is optional. Also, Regulation 1603, subdivision (g)(1)(B) incorporates the prohibition in Labor Code section 351, and provides that when the “prohibition is violated, any amount of such gratuities received by the employer will be considered a part of the gross receipts of the employer and subject to the tax.”

Regulation 1603, subdivision (g)(2)(A), provides that “[a]n amount negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is mandatory.” Regulation 1603, subdivision (g)(2)(B), provides that “[w]hen the menu, brochures, advertisements or other printed materials contain statements that notify customers that tips, gratuities, or service charges will or may be added, an amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is a mandatory charge and subject to tax,” and provides examples of such printed statements. Regulation 1603, subdivision (g)(2)(B) provides that “[a]n amount will be considered ‘automatically added’ when the retailer adds the tip to the bill without first conferring with the customer after service of the meal and receiving approval to add the tip or without providing the customer with the option to write in the tip.” Also, Regulation 1603, subdivision (g)(2)(B), provides that “any amount added [to the bill] by the retailer is presumed to be mandatory,” and Regulation 1603, subdivision (g)(2)(C), prescribes the type of evidence that must be provided to controvert (or rebut) the presumption and provides examples of such evidence.

On June 25, 2012, the Internal Revenue Service published Internal Revenue Bulletin No. 2012-26, which includes Revenue Ruling 2012-18. This revenue ruling clarified and updated guidelines on taxes imposed on tips under the Federal Insurance Contributions Act, including information on the difference between tips (tip wages) and service charges (non-tip wages). The ruling reaffirmed prior guidance which provided that the absence of any of the four following factors creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge: 1. The payment must be made free from compulsion; 2. The customer must have the unrestricted right to determine the amount; 3. The payment should not be the subject of negotiation or dictated by employer policy; 4. Generally, the customer has the right to determine who receives the payment.

Proposed Amendments

Interested Parties Process

Although Regulation 1603, subdivision (g), was amended in 2007 to clarify the application of tax to tips, gratuities and service charges, it has become evident to State Board of Equalization (Board) staff that some retailers are having compliance issues because there is still some remaining confusion regarding what constitutes “mandatory” versus “optional” tips, gratuities, and service charges. As a result, the Board’s Business Taxes Committee (BTC) staff prepared

draft amendments to subdivision (g) of Regulation 1603 to address the retailers' compliance issues (or problems within the meaning of Gov. Code, § 11346.2, subdivision (b)) by establishing a new bright-line approach for determining whether payments (or amounts) designated as tips, gratuities, and service charges are "optional" or "mandatory" based upon how the retailer treated the amounts for Internal Revenue Service purposes. The draft amendments suggested adding provisions to the regulation explaining that when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. The draft amendments also provided that a payment of a tip, gratuity, or service charge is deemed to be mandatory if the amounts are required to be reported, for the purposes of income tax to the Internal Revenue Service, as non-tip wages, and the amendments listed the four factors from Revenue Ruling 2012-18 that the Internal Revenue Service examines to determine if a payment is a tip or service charge (non-tip wage). The draft amendments also clarified subdivision (g)'s existing language and deleted provisions of subdivision (g) that had caused confusion for retailers and staff.

BTC staff subsequently provided its draft amendments to Regulation 1603 to the interested parties and conducted an interested parties meeting in December 2013 to discuss the draft amendments. During the December 2013 meeting, interested parties appeared open to staff's proposal and there was a general consensus that creating a bright-line approach with respect to tips, gratuities, and service charges would be helpful to the restaurant industry and staff. Also, participants discussed the effect of the new presumption and asked BTC staff what would happen if a retailer did not maintain records for purposes of its federal income tax reporting.

Subsequent to the December 2013 interested parties meeting, staff received letters from Kara Bush on behalf of the California Restaurant Association and from James Dumler of McClellan Davis, LLC. Both letters were dated January 10, 2014. (See Exhibits 3 and 4 to Formal Issue Paper 2014-003 referred to below.) In the first letter, Ms. Bush expressed the California Restaurant Association's appreciation of the Board's efforts to clarify this issue and stated that the association looks forward to continuing to work with staff and other interested parties to develop a bright-line approach that will foster reporting compliance and audit efficiency. Ms. Bush also expressed appreciation for staff's suggestions and stated that the association will continue to explore other alternatives. In the second letter, Mr. Dumler reiterated concerns expressed during the interested parties meeting that a taxpayer that lacks support for the IRS tip designations would not benefit from the proposed presumption and optional gratuities could incorrectly be presumed to be mandatory. Mr. Dumler also recommended that the examples in the current regulation with respect to mandatory payments be retained.

In response to the concerns expressed at the December 2013 interested parties meeting, staff added language to its draft amendments clarifying the application of the new presumption regarding federal tax reporting and also added provisions to determine whether a payment is "optional" or "mandatory" when a retailer does not maintain records for purposes of reporting tips to the IRS. When a retailer does not maintain these records, the determination of whether or not the payments are mandatory is consistent with the provisions currently in Regulation 1603, subdivision (g) (discussed above). Additionally, staff added clarifying language to its draft amendments to define the term "amount" as a payment designated as a tip, gratuity, or service charge, or any other separately stated payment for services associated with the purchase of

meals, food, or drinks. This amendment was made to reduce historical confusion associated with the use of the word “amount” to refer to payments throughout Regulation 1603, subdivision (g). Additionally, due to perceived confusion with staff applying the four factors from Revenue Ruling 2012-18 (referred to above), these factors were deleted from staff’s draft amendments.

In February 2014, staff again met with interested parties to discuss the draft amendments. Staff and interested parties discussed how to make it clear that the draft amendments are only to apply prospectively.

Following the February 2014, interested parties meeting, staff received a letter from Mr. Matt Sutton, sent on behalf of the California Restaurant Association. (See Exhibit 5 to Formal Issue Paper 2014-003 referred to below.) In his March 6, 2014, letter, Mr. Sutton explained that while the California Restaurant Association has historically disagreed with the taxation of mandatory gratuities, it was appreciative of staff’s ideas and acknowledged that the suggestions for a “bright line” approach, discussed in the discussion papers and both interested parties meetings, have merit. Mr. Sutton further stated that it remains to be seen how the industry will respond to the Internal Revenue Service guidance and how that will interplay with the Board’s practice of taxing mandatory tips.

May 22, 2014, BTC Meeting

Staff made changes to its draft amendments to Regulation 1603 in response to the discussion of the prospective application of the draft amendments at the February 2014 interested parties meeting. Staff changed the draft amendments so that subdivision (g) of Regulation 1603 continues to apply to transactions prior to January 1, 2015, without any changes, and new subdivision (h), containing what had previously been staff’s draft amendments to subdivision (g), will apply to transactions on and after January 1, 2015. Staff also changed the draft amendments in order to renumber the subdivisions of the regulation following new subdivision (h), and update the regulation’s current cross-references to the renumbered subdivisions.

Subsequently, BTC staff prepared Formal Issue Paper 14-003 and distributed it to the Board Members for consideration at the Board’s May 22, 2014, BTC meeting. Formal Issue Paper 14-003 recommended that the Board propose to add new subdivision (h) to Regulation 1603 to define the term “amount,” and provide that, for sales made on and after July 1, 2015, when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. Additionally, new subdivision (h) provides that when a retailer’s records reflect that amounts are required to be reported to the Internal Revenue Service as non-tip wages, the amount is deemed to be mandatory. Finally, new subdivision (h) provides that when a retailer does not maintain records for purposes of reporting amounts to the Internal Revenue Service, the application of tax to the amounts will be consistent with the provisions currently in Regulation 1603, subdivision (g), including subdivision (g)’s record keeping requirements and provisions regarding violations of the prohibition in Labor Code section 351. The formal issue paper also recommended making non-substantive amendments to the regulation, including moving the regulation’s authority and reference note so that it precedes the regulation’s appendix, and updating the cross-references to

other regulations following the authority and reference note. (See Exhibit 2 to Formal Issue Paper 14-003.)

The Board discussed Formal Issue Paper 14-003 during its May 22, 2014, BTC meeting. Mr. Matt Sutton appeared on behalf of the California Restaurant Association and made statements similar to those in his March 6, 2014, letter. At the conclusion of the discussion, the Board Members voted 4-0 to propose the amendments to Regulation 1603 recommended in the formal issue paper, subject to conforming to the official text of the regulation at the time of publication. The Board determined that the proposed amendments to Regulation 1603 are reasonably necessary to have the effect and accomplish the specific purpose of addressing the retailers' compliance issues (discussed above) due to the confusion regarding what constitutes "mandatory" versus "optional" tips, gratuities, and service charges.

The Board anticipates that the proposed amendments to Regulation 1603 will promote fairness and benefit retailers, Board staff, and the Board by providing regulatory provisions that may be applied using a bright-line approach that is consistent with federal tax reporting, and thereby reduce confusion for retailers and staff.

In addition, the Board has determined that the proposed amendments are not mandated by federal law or regulations, and there are no federal regulations or statutes that are identical to Regulation 1603 or the proposed amendments to Regulation 1603.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 14-003, the exhibits to the issue paper, and the comments made during the Board's discussion of the issue paper during its May 22, 2014, BTC meeting in deciding to propose the amendments to Regulation 1603 described above.

ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1603 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1603 at this time because the Board determined that the proposed amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Regulation 1603 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2,
SUBDIVISION (b)(5) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY
GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

As previously explained, the proposed amendments do not change the rule that an optional payment designated as a tip, gratuity, or service charge is not subject to tax, and a mandatory payment designated as a tip, gratuity, or service charge is includable in taxable gross receipts. The proposed amendments make Regulation 1603's treatment of payments designated as tips, gratuities, and services charges consistent with the records retailers keep for reporting such payments as tip wages or non-tip wages for Internal Revenue Service purposes by adding a new presumption as to whether or not a tip, gratuity, or service charge is subject to tax based on such records. The amendments also clarify subdivision (g)'s existing language regarding the application of tax to payments designated as tips, gratuities, and service charges by adding new subdivision (h) to Regulation 1603, effective for transactions on or after January 1, 2015.

Specifically, new subdivision (h) defines "amount" as a payment designated as a tip, gratuity, service charge, or any other separately stated payment for services associated with the purchase of meals, food, or drinks. New subdivision (h)(1) provides that when a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service purposes, such amounts are presumed to be optional and not subject to tax. When a retailer does not maintain such records, this presumption does not apply. And, new subdivision (h)(1) provides examples of transactions where amounts are optional and not subject to tax, which are consistent with the current examples in Regulation 1603, subdivision (g)(1)(A).

Also as previously explained, new subdivision (h)(2) provides that when a retailer's records reflect that amounts are required to be reported to the Internal Revenue Service as non-tip wages, the amount is deemed to be mandatory. New subdivision (h)(3) prescribes the application of tax when the examples of amounts that are optional in subdivision (h)(1) do not apply and a retailer does not maintain records for purposes of reporting the amounts to the Internal Revenue Service, and new subdivision (h)(3) is consistent with the current provisions of Regulation 1603, subdivision (g)(2). New subdivision (h)(3) provides that when an amount is negotiated between the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks, the amount is mandatory. When the menu or other printed materials notify customers that amounts will or may be added by the retailer to the bill, and such amounts are automatically added by the retailer to the bill, the amount is a mandatory charge and subject to tax. It is presumed that an amount added by the retailer to the bill is automatically added and mandatory; however, this presumption may be overcome by documentary evidence showing that the customer specifically requested and authorized the amount to be added to the bill.

Also, as previously explained, the proposed amendments are intended to address retailers' compliance issues due to the confusion regarding what constitutes "mandatory" versus "optional" tips, gratuities, and service charges by establishing a bright-line approach to how to treat amounts added by retailers to customers' bills that is consistent with how the retailers treated the amounts for Internal Revenue Service purposes. There is nothing in the proposed amendments to Regulation 1603 that would significantly change how restaurants and similar establishments would generally behave in the absence of the proposed amendments. And, the

Board anticipates that the proposed amendments to Regulation 1603 will promote fairness and benefit retailers, Board staff, and the Board by addressing and reducing such confusion.

In addition, the amendments to Regulation 1603 do not impose any costs on any persons, including restaurant businesses, because the proposed amendments do not impose new record keeping requirements and take into account, rather than impact, current practices in the restaurant industry regarding tips, gratuities, and service charges. And, the proposed amendments do not impact revenue. (See Exhibit 1 to Formal Issue Paper 14-003.) Therefore, the Board estimates that the proposed amendments will not have a measurable economic impact on individuals and business. And, the Board has determined that the proposed amendments to Regulation 1603 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed amendments will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars (\$50,000,000) during any 12-month period.

Further, based on these facts and all of the information in the rulemaking file, the Board has also determined that the adoption of the proposed amendments to Regulation 1603 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

Furthermore, Regulation 1603 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Regulation 1603 will not affect the benefits of Regulation 1603 to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Regulation 1603 will not have a significant adverse economic impact on business.

The proposed amendments to Regulation 1603 may affect small businesses.

**Text of Proposed Amendments to
California Code of Regulations, Title 18, Section 1603**

1603. Taxable Sales of Food Products.

(a) Restaurants, Hotels, Boarding Houses, Soda Fountains, and Similar Establishments.

(1) Definitions.

(A) Boarding House. The term “boarding house” as used in this regulation means any establishment regularly serving meals, on the average to five or more paying guests. The term includes a “guest home,” “residential care home,” “halfway house,” and any other establishment providing room and board or board only, which is not an institution as defined in Regulation 1503 and section 6363.6 of the Revenue and Taxation Code. The fact that guests may be recipients of welfare funds does not affect the application of tax. A person or establishment furnishing meals on the average to fewer than five paying guests during the calendar quarter is not considered to be engaged in the business of selling meals at retail.

(B) American Plan Hotel. The term “American Plan Hotel” as used in this regulation means a hotel which charges guests a fixed sum by the day, week, or other period for room and meals combined.

(C) Complimentary Food and Beverages. As used in this subdivision (a), the term “complimentary food and beverages” means food and beverages (including alcoholic and non-alcoholic beverages) which are provided to transient guests on a complimentary basis and:

1. There is no segregation between the charges for rooms and the charges for the food and beverages on the guests’ bills, and
2. The guests are not given an option to refuse the food and beverages in return for a discounted room rental.

(D) Average Retail Value of Complimentary Food and Beverages. The term “average retail value of complimentary food and beverages” (ARV) as used in this regulation means the total amount of the costs of the complimentary food and beverages for the preceding calendar year marked-up one hundred percent (100%) and divided by the number of rooms rented for that year. Costs of complimentary food and beverages include charges for delivery to the lodging establishment but exclude discounts taken and sales tax reimbursement paid to vendors. The 100% markup factor includes the cost of food preparation labor by hotel employees, the fair rental value of hotel facilities used to prepare or serve the food and beverages, and profit.

(E) Average Daily Rate. The term “average daily rate” (ADR) as used in this regulation means the gross room revenue for the preceding calendar year divided by the number of rooms rented for that year. “Gross room revenue” means and includes the full charge to the hotel customers but excludes separately stated occupancy taxes, revenue from

contract and group rentals which do not qualify for complimentary food and beverages, and revenue from special packages (e.g., New Year's Eve packages which include food and beverages as well as guest room accommodations), unless it can be documented that the retail value of the food and beverages provided as a part of the special package is 10% or less of the total package charge as provided in subdivision (a)(2)(B). "Number of rooms rented for that year" means the total number of times all rooms have been rented on a nightly basis provided the revenue for those rooms is included in the "gross room revenue." For example, if a room is rented out for three consecutive nights by one guest, that room will be counted as rented three times when computing the ADR.

(2) Application Of Tax.

(A) In General. Tax applies to sales of meals or hot prepared food products (see (e) below) furnished by restaurants, concessionaires, hotels, boarding houses, soda fountains, and similar establishments whether served on or off the premises. In the case of American Plan ~~H~~hotels, special packages offered by hotels, e.g., a New Year's Eve package as described in subdivision (a)(1)(E), and boarding houses, a reasonable segregation must be made between the charges for rooms and the charges for the meals, hot prepared food products, and beverages. Charges by hotels or boarding houses for delivering meals or hot prepared food products to, or serving them in, the rooms of guests are includable in the measure of tax on the sales of the meals or hot prepared food products whether or not the charges are separately stated. (Caterers, see (h) below.) Sales of meals or hot prepared food products by restaurants, concessionaires, hotels, boarding houses, soda fountains, and similar establishments to persons such as event planners, party coordinators, or fundraisers, which buy and sell on their own account, are sales for resale for which a resale certificate may be accepted. (See subdivision (h)(3)(C)2.)

Souffle cups, straws, paper napkins, toothpicks and like items that are not of a reusable character which are furnished with meals or hot prepared food products are sold with the meals or hot prepared food products. Sales of such items for such purpose to persons engaged in the business of selling meals or hot prepared food products are, accordingly, sales for resale.

(B) Complimentary Food and Beverages. Lodging establishments which furnish, prepare, or serve complimentary food and beverages to guests in connection with the rental of rooms are consumers and not retailers of such food and beverages when the retail value of the complimentary food and beverages is "incidental" to the room rental service regardless of where within the hotel premises the complimentary food and beverages are served. For complimentary food and beverages to qualify as "incidental" for the current calendar year, the average retail value of the complimentary food and beverages (ARV) furnished for the preceding calendar year must be equal to or less than 10% of the average daily rate (ADR) for that year.

If a hotel provides guests with coupons or similar documents which may be exchanged for complimentary food and beverages in an area of the hotel where food and beverages are sold on a regular basis to the general public (e.g., a restaurant), the hotel will be

considered the consumer and not the retailer of such food and beverages if the coupons or similar documents are non-transferable and the guest is specifically identified by name. If the coupons or similar documents are transferable or the guest is not specifically identified, food and beverages provided will be considered sold to the guest at the fair retail value of similar food and beverages sold to the general public. In the case of coupons redeemed by guests at restaurants not operated by the lodging establishment, the hotel will be considered the consumer of food and beverages provided to the hotel's guests and tax will apply to the charge by the restaurant to the hotel.

Lodging establishments are retailers of food and beverages which do not qualify as "incidental" and tax applies as provided in subdivision (a)(2)(A) above. Amounts paid by guests for food and beverages in excess of a complimentary allowance are gross receipts subject to the tax. Lodging establishments are retailers of otherwise complimentary food and beverages sold to non-guests.

In the case of hotels with concierge floor, club level or similar programs, the formula set forth above shall be applied separately with respect to the complimentary food and beverages furnished to guests who participate in the concierge, club or similar program. That is, the concierge, club or similar program will be deemed to be an independent hotel separate and apart from the hotel in which it is operated. The ADR and the retail value of complimentary food and beverages per occupied room will be computed separately with respect to the guest room accommodations entitled to the privileges and amenities involved in the concierge, club or similar program.

The following example illustrates the steps in determining whether the food and beverages are complimentary:

FORMULA: $ARV \div ADR \leq 10\%$

Average Daily Rate (ADR):

Room Revenue	\$9,108,000
Rooms Rented	74,607
ADR (\$9,108,000 ÷ 74,607)	\$122.08

Average Retail Value of Complimentary Food and Beverages (ARV):

Complimentary Food Cost	\$169,057
Complimentary Beverage Cost	52,513
Total	\$221,570
Add 100% Markup	221,570
Average Retail Value	\$443,140
ARV per occupied room (\$443,140 ÷ 74,607)	\$5.94

Application of Formula:

$$\$5.94 \div \$122.08 = 4.87\%$$

In the above example, the average retail value of the complimentary food and beverages per occupied room for the preceding calendar year is equal to or less than 10% of the average daily rate. Therefore, under the provisions of this subdivision (a)(2)(B), the complimentary food and beverages provided to guests for the current calendar year qualify as “incidental.” The lodging establishment is the consumer and not the retailer of such food and beverages. This computation must be made annually.

When a lodging establishment consists of more than one location, the operations of each location will be considered separately in determining if that location’s complimentary food and beverages qualify as incidental.

(C) “Free” Meals. When a restaurant agrees to furnish a “free” meal to a customer who purchases another meal and presents a coupon or card, which the customer previously had purchased directly from the restaurant or through a sales promotional agency having a contract with the restaurant to redeem the coupons or cards, the restaurant is regarded as selling two meals for the price of one, plus any additional compensation from the agency or from its own sales of coupons. Any such additional compensation is a part of its taxable gross receipts for the period in which the meals are served.

Tax applies only to the price of the paid meal plus any such additional compensation.

(b) “Drive-Ins.” Tax applies to sales of food products ordinarily sold for immediate consumption on or near a location at which parking facilities are provided primarily for the use of patrons in consuming the products purchased at the “drive-in” establishment, even though such products are sold on a “take out” or “to go” order and are actually packaged or wrapped and taken from the premises of the retailer. Food products when sold in bulk, i.e., in quantities or in a form not suitable for consumption on the retailer’s premises, are not regarded as ordinarily sold for immediate consumption on or near the location at which parking facilities are provided by the retailer. Accordingly, with the exception of sales of hot prepared food products (see (e) below) and sales of cold food under the 80-80 rule (see (c) below), sales of ice cream, doughnuts, and other individual food items in quantities obviously not intended for consumption on the retailer’s premises, without eating utensils, trays, or dishes and not consumed on the retailer’s premises, are exempt from tax. Any retailer claiming a deduction on account of food sales of this type must support the deduction by complete and detailed records.¹

(c) Cold Food Sold on a “Take-Out” Order.

(1) General.

(A) Seller Meeting Criteria of 80-80 Rule. When a seller meets both criteria of the 80-80 rule as explained in subdivision (c)(3) below, tax applies to sales of cold food products (including sales for a separate price of hot bakery goods and hot beverages such as coffee) in a form suitable for consumption on the seller’s premises even though such food

products are sold on a "take-out" or "to go" order. Sales of cold food products which are suitable for consumption on the seller's premises are subject to the tax no matter how great the quantity purchased, e.g., 40 one-half pint containers of milk. Except as provided elsewhere in this regulation, tax does not apply to sales of food products which are furnished in a form not suitable for consumption on the seller's premises.

Operative April 1, 1996, although a seller may meet both criteria of the 80-80 rule, he or she may elect to separately account for the sale of "take-out" or "to go" orders of cold food products which are in a form suitable for consumption on the seller's premises. The gross receipts from the sale of those food products shall be exempt from the tax provided the seller keeps a separate accounting of these transactions in his or her records. Tax will remain applicable to the sale of food products as provided in subdivisions (a), (b), (e), or (f) of this regulation. Failure to maintain the required separate accounting and documentation claimed as exempt under this subdivision will revoke the seller's election under this subdivision.

(B) Seller Not Meeting Criteria of 80-80 Rule. When a seller does not meet both criteria of the 80-80 rule as explained in subdivision (c)(3) below, tax does not apply to sales of cold food products (including sales for a separate price of hot bakery goods and hot beverages such as coffee) when sold on a "take-out" or "to go" order.

(2) Definitions.

(A) For purposes of this subdivision (c), the term "suitable for consumption on the seller's premises" means food products furnished:

1. In a form which requires no further processing by the purchaser, including but not limited to cooking, heating, thawing, or slicing, and
2. In a size which ordinarily may be immediately consumed by one person such as a large milk shake, a pint of ice cream, a pint of milk, or a slice of pie. Cold food products (excluding milk shakes and similar milk products) furnished in containers larger in size than a pint are considered to be in a form not suitable for immediate consumption.

Pieces of candy sold in bulk quantities of one pound or greater are deemed to be sold in a form not suitable for consumption on the seller's premises.

The term does not include cold food products which obviously would not be consumed on the premises of the seller, e.g., a cold party tray or a whole cold chicken.

(B) For purposes of this subdivision (c), the term "seller's premises" means the individual location at which a sale takes place rather than the aggregate of all locations of the seller. For example, if a seller operates several drive-in and fast food restaurants, the operations of each location stand alone and are considered separately in determining if the sales of food products at each location meet the criteria of the 80-80 rule.

When two or more food-selling activities are conducted by the same person at the same location, the operations of all food related activities will be considered in determining if the sales of food products meet the criteria of the 80-80 rule. For example, if a seller operates a grocery store and a restaurant with no physical separation other than separate cash registers, the grocery store operations will be included in determining if the sales of food products meet the criteria of the 80-80 rule. When there is a physical separation where customers of one operation may not pass freely into the other operation, e.g., separate rooms with separate entrances but a common kitchen, each operation will be considered separately for purposes of this subdivision (c).

(3) 80-80 Rule. Tax applies under this subdivision (c) only if the seller meets both of the following criteria:

(A) More than 80 percent of the seller's gross receipts are from the sale of food products, and

(B) More than 80 percent of the seller's retail sales of food products are taxable as provided in subdivisions (a), (b), (e), and (f) of this regulation.

Sales of alcoholic beverages, carbonated beverages, or cold food to go not suitable for immediate consumption should not be included in this computation. Any seller meeting both of these criteria and claiming a deduction for the sale of cold food products in a form not suitable for consumption on the seller's premises must support the deduction by complete and detailed records of such sales made.

(d) Places Where Admission Is Charged.

(1) General. Tax applies to sales of food products when sold within, and for consumption within, a place the entrance to which is subject to an admission charge, during the period when the sales are made, except for national and state parks and monuments, and marinas, campgrounds, and recreational vehicle parks.

(2) Definitions.

(A) "Place" means an area the exterior boundaries of which are defined by walls, fences or otherwise in such a manner that the area readily can be recognized and distinguished from adjoining or surrounding property. Examples include buildings, fenced enclosures and areas delimited by posted signs.

(B) "Within a place" means inside the door, gate, turnstile, or other point at which the customer must pay an admission charge or present evidence, such as a ticket, that an admission charge has been paid. Adjacent to, or in close proximity to, a place is not within a place.

(C) "Admission charge" means any consideration required to be paid in money or otherwise, for admittance to a place.

"Admission charge" does not include:

1. Membership dues in a club or other organization entitling the member to, among other things, entrance to a place maintained by the club or organization, such as a fenced area containing a club house, tennis courts, and a swimming pool. Where a guest is admitted to such a place only when accompanied by or vouched for by a member of the club or organization, any charge made to the guest for use of facilities in the place is not an admission charge.
2. A charge for a student body card entitling the student to, among other things, entrance to a place, such as entrance to a school auditorium at which a dance is held.
3. A charge for the use of facilities within a place to which no entrance charge is made to spectators. For example, green fees paid for the privilege of playing a golf course, a charge made to swimmers for the use of a pool within a place, or a charge made for the use of lanes in a public bowling place.

(D) "National and state parks and monuments" means those which are part of the National Park System or the State Park System. The phrase does not include parks and monuments not within either of those systems, such as city, county, regional, district or private parks.

(3) Presumption That Food Is Sold for Consumption Within a Place.

When food products are sold within a place the entrance to which is subject to an admission charge, it will be presumed, in the absence of evidence to the contrary, that the food products are sold for consumption within the place. Obtaining and retaining evidence in support of the claimed tax exemption is the responsibility of the retailer. Such evidence may consist, for example, of proof that the sales were of canned jams, cake mixes, spices, cooking chocolate, or other items in a form in which it is unlikely that such items would be consumed within the place where sold.

(4) Food Sold to Students. The exemption otherwise granted by Section 6363 does not apply to sales of food products to students when sold within, and for consumption within, a place the entrance to which is subject to an admission charge, and such sales are subject to tax except as provided in (p) of this regulation. For example, when food products are sold by a student organization to students or to both students and nonstudents within a place the entrance to which is subject to an admission charge, such as a place where school athletic events are held, the sales to both students and nonstudents are taxable.

(e) Hot Prepared Food Products.

(1) General. Tax applies to all sales of hot prepared food products unless otherwise exempt. "Hot prepared food products" means those products, items, or components which have been prepared for sale in a heated condition and which are sold at any temperature which is higher than the air temperature of the room or place where they are sold. The mere heating of a food product constitutes preparation of a hot prepared food product, e.g., grilling a sandwich, dipping a sandwich bun in hot gravy, using infra-red lights, steam tables, etc. If the sale is intended to be of a hot food product, such sale is of a hot food product regardless of cooling which incidentally occurs. For example, the sale of a toasted sandwich intended to be in a heated condition when sold, such as a fried ham sandwich on toast, is a sale of a hot prepared food product even though it may have cooled due to delay. On the other hand, the sale of a toasted sandwich which is not intended to be in a heated condition when sold, such as a cold tuna sandwich on toast, is not a sale of a hot prepared food product.

When a single price has been established for a combination of hot and cold food items, such as a meal or dinner which includes cold components or side items, tax applies to the entire established price regardless of itemization on the sales check. The inclusion of any hot food product in an otherwise cold combination of food products sold for a single established price, results in the tax applying to the entire established price, e.g., hot coffee served with a meal consisting of cold food products, when the coffee is included in the established price of the meal. If a single price for the combination of hot and cold food items is listed on a menu, wall sign or is otherwise advertised, a single price has been established. Except as otherwise provided in (b), (c), (d) or (f) of this regulation, or in Regulation 1574, tax does not apply to the sale for a separate price of bakery goods, beverages classed as food products, or cold or frozen food products. Hot bakery goods and hot beverages such as coffee are hot prepared food products but their sale for a separate price is exempt unless taxable as provided in (b), (c), (d) or (f) of this regulation, or in Regulation 1574. Tax does apply if a hot beverage and a bakery product or cold food product are sold as a combination for a single price. Hot soup, bouillon, or consomme is a hot prepared food product, which is not a beverage.

(2) Air Carriers Engaged in Interstate or Foreign Commerce. Tax does not apply to the sale, storage, use, or other consumption of hot prepared food products sold by caterers or other vendors to air carriers engaged in interstate or foreign commerce for consumption by passengers on such air carriers, nor to the sale, storage, use, or other consumption of hot prepared food products sold or served to passengers by air carriers engaged in interstate or foreign commerce for consumption by passengers on such air carriers. "Air carriers" are persons or firms in the business of transporting persons or property for hire or compensation, and include both common and contract carriers. "Passengers" do not include crew members. Any caterer or other vendor claiming the exemption must support it with an exemption certificate from the air carrier substantially in the form prescribed in Appendix A of this regulation.

(f) Food for Consumption at Facilities Provided by the Retailer. Tax applies to sales of sandwiches, ice cream, and other foods sold in a form for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others.

A passenger’s seat aboard a train, or a spectator’s seat at a game, show, or similar event is not a “chair” within the meaning of this regulation. Accordingly, except as otherwise provided in (c), (d), and (e) above, tax does not apply to the sale of cold sandwiches, ice cream, or other food products sold by vendors passing among the passengers or spectators where the food products are not “for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware provided by the retailer.”

(g) Tips, Gratuities, and Service Charges. (Prior to January 1, 2015)

The provisions of subdivision (g) apply to transactions occurring prior to January 1, 2015. This subdivision applies to restaurants, hotels, caterers, boarding houses, soda fountains, drive-ins and similar establishments.

An optional payment designated as a tip, gratuity, or service charge is not subject to tax. A mandatory payment designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if the amount is subsequently paid by the retailer to employees.

(1) Optional Payment.

(A) A payment of a tip, gratuity, or service charge is optional if the customer adds the amount to the bill presented by the retailer, or otherwise leaves a separate amount in payment over and above the actual amount due the retailer for the sale of meals, food, and drinks that include services. The following examples illustrate transactions where a payment of a tip, gratuity or service charge is optional and not included in taxable gross receipts. This is true regardless of printed statements on menus, brochures, advertisements or other materials notifying customers that tips, gratuities, or service charges will or may be added by the retailer to the prices of meals, food, or drinks:

Example 1. The restaurant check is presented to the customer with the “tip” area blank so the customer may voluntarily write in an amount, or

Example 2. The restaurant check is presented to the customer with options computed by the retailer and presented to the customer as tip suggestions. The “tip” area is blank so the customer may voluntarily write in an amount:

Guest Check	
Food Item A	\$9.95
Beverage Item B	3.75
Subtotal	\$13.70
8% sales tax	1.10
Subtotal	\$14.80
Tip*	
Total	
*Suggested tips:	
15%=\$2.06; 18%=\$2.47; 20%=\$2.74; other.	

If an employer misappropriates these payments for these charges, as discussed in subdivision (g)(1)(B) below, such payments are included in the retailer's taxable gross receipts.

(B) No employer shall collect, take, or receive any gratuity or a part thereof, paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of such gratuity, or require an employee to credit the amount, or any part thereof, of such gratuity against and as a part of the wages due the employee from the employer. (Labor Code section 351.) If this prohibition is violated, any amount of such gratuities received by the employer will be considered a part of the gross receipts of the employer and subject to the tax.

(2) Mandatory Payment.

(A) An amount negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is mandatory.

(B) When the menu, brochures, advertisements or other printed materials contain statements that notify customers that tips, gratuities, or service charges will or may be added, an amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is a mandatory charge and subject to tax. These amounts are considered negotiated in advance as specified in subdivision (g)(2)(A). Examples of printed statements include:

"An 18% gratuity [or service charge] will be added to parties of 8 or more."

"Suggested gratuity 15%," itemized on the invoice or bill by the restaurant, hotel, caterer, boarding house, soda fountain, drive-in or similar establishment.

"A 15% voluntary gratuity will be added for parties of 8 or more."

An amount will be considered "automatically added" when the retailer adds the tip to the bill without first conferring with the customer after service of the meal and receiving approval to add the tip or without providing the customer with the option to write in the tip. Nonetheless, any amount added by the retailer is presumed to be mandatory. This presumption may be overcome as discussed in subdivision (g)(2)(C) below.

(C) It is presumed that an amount added as a tip by the retailer to the bill or invoice presented to the customer is mandatory. A statement on the bill or invoice that the amount added by the retailer is a "suggested tip," "optional gratuity," or that "the amount may be increased, decreased, or removed" by the customer does not change the mandatory nature of the charge.

This presumption may be controverted by documentary evidence showing that the customer specifically requested and authorized the gratuity be added to the amount billed.

Examples of documentary evidence that may be used to overcome the presumption include:

1. A guest check that is presented to the customer showing sales tax reimbursement and the amount upon which it was computed, without tip or with the “tip” area blank and a separate document, such as a credit card receipt, to which the retailer adds or prints the requested tip.
2. Guests receipts and payments showing that the percentage of tips paid by large groups varies from the percentage stated on the menu, brochure, advertisement or other printed materials.
3. A retailer’s written policy stating that its employees shall receive confirmation from a customer before adding a tip together with additional verifiable evidence that the policy has been enforced. The policy is not in itself sufficient documentation to establish that the customer requested and authorized that a gratuity be added to the amount billed without such additional verifiable evidence.

The retailer must retain the guest checks and any additional separate documents to show that the payment is optional. The retailer is also required to maintain other records in accordance with the requirements of Regulation 1698, Records.

(h) Tips, Gratuities, and Service Charges. (On and after January 1, 2015)

The provisions of subdivision (h) apply to transactions occurring on and after January 1, 2015. This subdivision applies to restaurants, hotels, caterers, boarding houses, soda fountains, drive-ins and similar establishments.

An optional payment designated as a tip, gratuity, or service charge is not subject to tax. A mandatory payment designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if it is subsequently paid by the retailer to employees. For purposes of this subdivision, “amount” means a payment designated as a tip, gratuity, service charge, or any other separately stated payment for services associated with the purchase of meals, food, or drinks.

(1) Optional Payment.

When a retailer keeps records consistent with reporting amounts as tip wages for Internal Revenue Service (IRS) purposes, such amounts are presumed to be optional and not subject to tax. When a retailer does not maintain such records, this presumption does not apply and the amounts may be mandatory and included in taxable gross receipts as discussed in subdivisions (h)(2) and (h)(3).

The following examples illustrate transactions where an amount is optional and not included in taxable gross receipts:

Example 1. The restaurant check is presented to the customer with the “tip” area blank so the customer may voluntarily write in the amount, or

Example 2. The restaurant check is presented to the customer with options computed by the retailer and presented to the customer as tip suggestions. The “tip” area is blank so the customer may voluntarily write in the amount:

<u>Guest Check</u>	
<u>Food Item A</u>	<u>\$9.95</u>
<u>Beverage Item B</u>	<u>3.75</u>
<u>Subtotal</u>	<u>\$13.70</u>
<u>8% sales tax</u>	<u>1.10</u>
<u>Subtotal</u>	<u>\$14.80</u>

Tip*

Total

*Suggested tips:

15%=\$2.06; 18%=\$2.47; 20%=\$2.74; other.

Under these circumstances, the customer is free to enter the amount on the tip line or leave it blank; thus, the customer may enter an amount free from compulsion. The customer and restaurant did not negotiate the amount nor did the restaurant dictate the amount.

If an employer misappropriates these amounts, as discussed in subdivision (h)(4) below, such payments are included in the retailer’s taxable gross receipts.

(2) Mandatory Payment.

When a retailer’s records reflect that amounts are required to be reported to the IRS as non-tip wages, the amount is deemed to be mandatory.

(3) When a retailer does not maintain records for purposes of reporting the amounts to the IRS:

(A) An amount negotiated between the retailer and the customer in advance of a meal, food, or drinks, or an event that includes a meal, food, or drinks is mandatory.

(B) When the menu, brochures, advertisements or other printed materials contain statements that notify customers that tips, gratuities, or service charges will or may be added, an amount automatically added by the retailer to the bill or invoice presented to and paid by the customer is a mandatory charge and subject to tax. These amounts are considered negotiated in advance as specified in subdivision (h)(3)(A). Examples of printed statements include:

“An 18% gratuity [or service charge] will be added to parties of 8 or more.”

“Suggested gratuity 15%,” itemized on the invoice or bill by the restaurant, hotel, caterer, boarding house, soda fountain, drive-in or similar establishment.

“A 15% voluntary gratuity will be added for parties of 8 or more.”

An amount will be considered “automatically added” when the retailer adds the amount to the bill without first conferring with the customer after service of the meal. Nonetheless, any amount added by the retailer is presumed to be automatically added and mandatory. This presumption may be overcome as discussed in subdivision (h)(3)(C) below.

(C) It is presumed that an amount added as a tip by the retailer to the bill or invoice presented to the customer is automatically added and mandatory. A statement on the bill or invoice that the amount added by the retailer is a “suggested tip,” “optional gratuity,” or that the amount “may be increased, decreased, or removed” by the customer does not change the mandatory nature of the charge.

This presumption may be controverted by documentary evidence showing that the customer specifically requested and authorized the amount be added to the bill.

Examples of documentary evidence that may be used to overcome the presumption include:

1. A guest check that is presented to the customer showing sales tax reimbursement and the figure upon which it was computed, without “tip” or with the “tip” area blank and a separate document, such as a credit card receipt, to which the retailer adds or prints the requested amount.
2. Guest receipts and payments showing that the percentage of amounts paid by large parties varies from the percentage stated on the menu, brochure, advertisement or other printed materials.
3. A retailer’s written policy stating that its employees shall receive confirmation from a customer before adding an amount together with additional verifiable evidence that the policy has been enforced. The policy is not in itself sufficient documentation to establish that the customer requested and authorized that the amount be added to the bill without such additional verifiable evidence.

The retailer must retain the guest checks and any additional separate documents to show that the payment is optional. The retailer is also required to maintain other records in accordance with the requirements of Regulation 1698, *Records*.

(4) No employer shall collect, take, or receive any gratuity or a part thereof, paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of such gratuity, or require an employee to credit the amount, or any part thereof, of such gratuity against and as a part of the wages due the employee from the employer. (Labor Code section 351.) If this prohibition is violated, any amount received by the employer will be considered a part of the gross receipts of the employer and subject to the tax.

(hi) Caterers.

(1) Definition. The term “caterer” as used in this regulation means a person engaged in the business of serving meals, food, or drinks on the premises of the customer, or on premises supplied by the customer, including premises leased by the customer from a person other than the caterer, but does not include employees hired by the customer by the hour or day.

(2) Sales to Caterers. A caterer generally is considered to be the consumer of tangible personal property normally used in the furnishing and serving of meals, food or drinks, except for separately stated charges by the caterer for the lease of tangible personal property or tangible personal property regarded as being sold with meals, food or drinks such as disposable plates, napkins, utensils, glasses, cups, stemware, place mats, trays, covers and toothpicks.

(3) Sales by Caterers.

(A) Caterer as Retailer. Tax applies to the entire charge made by caterers for serving meals, food, and drinks, inclusive of charges for food, the use of dishes, silverware, glasses, chairs, tables, etc., used in connection with serving meals, and for the labor of serving the meals, whether performed by the caterer, the caterer’s employees or subcontractors. Tax applies to charges made by caterers for preparing and serving meals and drinks even though the food is not provided by the caterers. Tax applies to charges made by caterers for hot prepared food products as in (e) above whether or not served by the caterers. A caterer who separately states or itemizes charges for the lease of tangible personal property regardless of the use of the property will be deemed to be the lessor of such property. Tax applies in accordance with Regulation 1660, Leases of Tangible Personal Property - In General. Tax does not apply to charges made by caterers for the rental of dishes, silverware, glasses, etc., purchased by the caterer with tax paid on the purchase price if no food is provided or served by the caterers in connection with such rental.

(B) Caterers as Lessors of Property Unrelated to the Serving or Furnishing of Meals, Food, or Drinks by a Caterer.

1. When a caterer who is furnishing or serving meals, food, or drinks also rents or leases from a third party tangible personal property which the caterer does not use himself or herself and the property is not customarily provided or used within the catering industry in connection with the furnishing and serving of food or drinks, such as decorative props related solely to optional entertainment, special lighting for guest speakers, sound or video systems, dance floors, stages, etc., he or she is a lessor of such property. In such instance, tax applies to the lease in accordance with Regulation 1660.

2. When a person who in other instances is a caterer does not furnish or serve any meals, food, or drinks to a customer, but rents or leases from a third party tangible personal property such as dishes, linen, silverware and glasses, etc., for purposes of

providing it to his or her customer, he or she is not acting as a caterer within the meaning of this regulation, but solely as a lessor of tangible personal property. In such instances, tax applies to the lease in accordance with Regulation 1660.

(C) Caterers Planning, Designing and Coordinating Events.

1. Tax applies to charges by a caterer for event planning, design, coordination, and/or supervision if they are made in connection with the furnishing of meals, food, or drinks for the event. Tax does not apply to separately stated charges for services unrelated to the furnishing and serving of meals, food, or drinks, such as optional entertainment or any staff who do not directly participate in the preparation, furnishing, or serving of meals, food, or drinks, e.g., coat-check clerks, parking attendants, security guards, etc.

2. When a caterer sells meals, food, or drinks, and the serving of them, to other persons such as event planners, party coordinators, or fundraisers, who buy and sell the same on their own account or for their own sake, it is a sale for resale for which the caterer may accept a resale certificate. However, a caterer may only claim the sale as a resale if the caterer obtains a resale certificate in compliance with Regulation 1668. A person is buying or selling for his or her own account, or own sake, when such person has his or her own contract with a customer to sell the meals, food, or drinks to the customer, and is not merely acting on behalf of the caterer.

3. When a caterer sells meals, food or drinks and the serving of them to other persons who charge a fee for their service unrelated to the taxable sale, the separately stated fee is not subject to tax.

(D) Sales of Meals by Caterers to Social Clubs, Fraternal Organizations. Sales of meals to social clubs and fraternal organizations, as those terms are defined in subdivision (ij) below, by caterers are sales for resale if such social clubs and fraternal organizations are the retailers of the meals subject to tax under subdivision (ij) and give valid resale certificates therefor.

(E) Tips, Gratuities, or Service Charges. Tips, gratuities, and service charges are discussed in subdivisions (g) and (h).

(4) Premises. General. Separately stated charges for the lease of premises on which meals, food, or drinks are served, are nontaxable leases of real property. Where a charge for leased premises is a guarantee against a minimum purchase of meals, food or drinks, the charge for the guarantee is gross receipts subject to tax. Where a person contracts to provide both premises and meals, food or drinks, the charge for the meals, food or drinks must be reasonable in order for the charge for the premises to be nontaxable~~non-taxable~~.

(5) Private Chefs. A private chef is generally not an employee of the customer, but an independent contractor who pays his or her own social security, and federal and state income

taxes. Such a private chef, who prepares and serves meals, food and drinks in the home of his or her customer is a caterer under this regulation.

(ij) Social Clubs and Fraternal Organizations. “Social Clubs and Fraternal Organizations” as used herein include any corporation, partnership, association or group or combination acting as a unit, such as service clubs, lodges, and community, country, and athletic clubs.

The tax applies to receipts from the furnishing of meals, food, and drink by social clubs and fraternal organizations unless furnished: (1) exclusively to members; and also, (2) less frequently than once a week. Both of these requirements must be met. If the club or organization furnishes meals, food or drink to nonmembers, all receipts from the furnishing of meals, food or drink are subject to tax whether furnished to members or nonmembers, including receipts on occasions when furnished exclusively to members. Meals, food or drink paid for by members are considered furnished to them even though consumed by guests who are not members.

(jk) Student Meals.

(1) Definitions.

(A) “Food Products.”: As used herein, the term “food products” as defined in Regulation 1602 (18 CCR 1602) includes food furnished, prepared, or served for consumption at tables, chairs, or counters, or from trays, glasses, dishes, or other tableware provided by the retailer or by a person with whom the retailer contracts to furnish, prepare or serve food to others.

(B) “Meals.”: As used herein, the term “meals” includes both food and nonfood products which are sold to students for an established single price at a time set aside for meals. If a single price for the combination of a nonfood product and a food product is listed on a menu or on a sign, a single price has been established. The term “meals” does not include nonfood products which are sold to students for a separate price and tax applies to the sales of such products. Examples of nonfood products are: carbonated beverages and beer. For the purpose of this regulation, products sold at a time designated as a “nutrition break”, “recess”, or similar break, will not be considered “meals.”:

(2) Application of Tax.

(A) Sales by Schools, School Districts and Student Organizations. Sales of meals or food products for human consumption to students of a school by public or private schools, school districts, and student organizations are exempt from tax, except as otherwise provided in (d)(4) above.

(B) Sales by Parent-Teacher Associations. Tax does not apply to the sale of, nor the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served to the students of a school by parent-teacher associations. Parent-teacher associations qualifying under Regulation 1597 as consumers are not retailers of tangible personal property, which they sell. Accordingly, tax does

apply to the sale to such associations of nonfood items such as carbonated beverages, containers, straws and napkins.

(C) Sales by Blind Vendors. Tax does not apply to the sale of meals or food products for human consumption to students of a school by any blind person (as defined in section 19153 of the Welfare and Institutions Code) operating a restaurant or vending stand in an educational institution under article 5 of chapter 6 of part 2 of division 10 of the Welfare and Institutions Code, except as otherwise provided in (d)(4) above.

(D) Sales by Caterers. The application of tax to sales by caterers in general is explained in subdivision (h) above. However, tax does not apply to the sale by caterers of meals or food products for human consumption to students of a school, if all the following criteria are met:

1. The premises used by the caterer to serve the lunches to the students are used by the school for other purposes, such as sporting events and other school activities, during the remainder of the day;
2. The fixtures and equipment used by the caterer are owned and maintained by the school; and
3. The students purchasing the meals cannot distinguish the caterer from the employees of the school.

(kl) Employees' Meals.

(1) In General. Any employer or employee organization that is in the business of selling meals, e.g., a restaurant, hotel, club, or association, must include its receipts from the sales of meals to employees, along with its receipts from sales to other purchasers of meals, in the amount upon which it computes its sales tax liability. An employer or an employee organization selling meals only to employees becomes a retailer of meals and liable for sales tax upon its receipts from sales of meals if it sells meals to an average number of five or more employees during the calendar quarter.

(2) Specific Charge. The tax applies only if a specific charge is made to employees for the meals. Tax does not apply to cash paid an employee in lieu of meals. A specific charge is made for meals if:

- (A) Employee pays cash for meals consumed.
- (B) Value of meals is deducted from employee's wages.
- (C) Employee receives meals in lieu of cash to bring compensation up to legal minimum wage.
- (D) Employee has the option to receive cash for meals not consumed.

(3) No Specific Charge. If an employer makes no specific charge for meals consumed by employees, the employer is the consumer of the food products and the ~~nonfood~~non-food products, which are furnished to the employees as a part of the meals.

In the absence of any of the conditions under ~~(1)(2)(k)(2)~~ a specific charge is not made if:

(A) A value is assigned to meals as a means of reporting the fair market value of employees' meals pursuant to state and federal laws or regulations or union contracts.

(B) Employees who do not consume available meals have no recourse on their employer for additional cash wages.

(C) Meals are generally available to employees, but the duties of certain employees exclude them from receiving the meals and are paid cash in lieu thereof.

(4) Meals Credited Toward Minimum Wage. If an employee receives meals in lieu of cash to bring his or her compensation up to the legal minimum wage, the amount by which the minimum wage exceeds the amount otherwise paid to the employee is includable in the employer's taxable gross receipts up to the value of the meals credited toward the minimum wage.

For example, if the minimum rate for an eight-hour day is \$46.00, and the employee received \$43.90 in cash, and a lunch is received which is credited toward the minimum wage in the maximum allowable amount of \$2.10, the employer has received gross receipts in the amount of \$2.10 for the lunch.

(5) Tax Reimbursement. If a separately stated amount for tax reimbursement is not added to the price of meals sold to employees for which a specific charge is made, the specific charge will be regarded as being a tax-included charge for the meals.

~~(lm)~~ Religious Organizations. Tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served by any religious organization at a social or other gathering conducted by it or under its auspices, if the purpose in furnishing or serving the meals and food products is to obtain revenue for the functions and activities of the organization and the revenue obtained from furnishing or serving the meals and food products is actually used in carrying on such functions and activities. For the purposes of this regulation, "religious organization" means any organization the property of which is exempt from taxation pursuant to subdivision (f) of section 3 of article XIII of the State Constitution.

~~(mn)~~ Institutions. Tax does not apply to the sale of, nor the storage, use, or other consumption in this state of, meals and food products for human consumption furnished or served to and consumed by patients or residents of an "institution" as defined in Regulation 1503. Tax, however, does apply to the sale of meals and food products by an institution to persons other than patients or residents of the institution.

(~~no~~) Meal Programs for Low-Income Elderly Persons. Tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served to low-income elderly persons at or below cost by a nonprofit organization or governmental agency under a program funded by this state or the United States for such purposes.

(~~op~~) Food Products, Nonalcoholic Beverages and Other Tangible Personal Property Transferred by Nonprofit Youth Organizations. See Regulation 1597 for the application of tax on food products, nonalcoholic beverages and other tangible personal property transferred by nonprofit youth organizations.

(~~oq~~) Nonprofit Parent-Teacher Associations. Nonprofit parent-teacher associations and equivalent organizations qualifying under Regulation 1597 are consumers and not retailers of tangible personal property, which they sell.

(~~or~~) Meals and Food Products Served to Condominium Residents. Tax does not apply to the sale of, and the storage, use, or other consumption in this state of meals and food products for human consumption furnished to and consumed by persons 62 years of age or older residing in a condominium and who own equal shares in a common kitchen facility; provided, that the meals and food products are served to such persons on a regular basis.

This exemption is applicable only to sales of meals and food products for human consumption prepared and served at the common kitchen facility of the condominium. Tax applies to sales to persons less than 62 years of age.

(~~os~~) Veteran's Organization. Beginning April 1, 2004, tax does not apply to the sale of, and the storage, use or other consumption in this state of, meals and food products for human consumption furnished or served by any nonprofit veteran's organization at a social or other gathering conducted by it or under its auspices, if the purpose in furnishing or serving the meals and food products is to obtain revenue for the functions and activities of the organization and the revenue obtained from furnishing or serving the meals and food products is actually used in carrying on those functions and activities.

(~~ot~~) Food Stamp Coupons. Tax does not apply to tangible personal property which is eligible to be purchased with federal food stamp coupons acquired pursuant to the Food Stamp Act of 1977 and so purchased. When payment is made in the form of both food stamps and cash, the amount of the food stamp coupons must be applied first to tangible personal property normally subject to the tax, e.g., nonalcoholic carbonated beverages. Retailers are prohibited from adding any amount designated as sales tax, use tax, or sales tax reimbursement to sales of tangible personal property purchased with food stamp coupons. (See paragraph (c) of Regulation 1602.5 for special reporting provisions by grocers.)

(~~ou~~) Honor System Snack Sales. An "honor system snack sale" means a system where customers take snacks from a box or tray and pay by depositing money in a container provided by the seller. Snacks sold through such a system may be subject to tax depending upon where the sale

takes place. Sales of such snacks are taxable when sold at or near a lunchroom, break room, or other facility that provides tables and chairs, and it is contemplated that the food sold will normally be consumed at such facilities. Honor system snack sales do not include hotel room mini-bars or snack baskets.

(uv) Mobile Food Vendors. Mobile food vendors include retailers who sell food and beverages for immediate consumption from motorized vehicles or un-motorized carts. Examples of mobile food vendors include food trucks, coffee carts, and hot dog carts. For sales made on or after July 1, 2014, unless a separate amount for tax reimbursement is added to the price, mobile food vendors' sales of taxable items are presumed to be made on a tax-included basis.

This presumption does not apply when a mobile food vendor is making sales as a "caterer" as defined in (h)(1).

1 The records acceptable in support of such a deduction are:

(a) A sales ticket prepared for each transaction claimed as being tax exempt showing:

- (1) Date of the sale,
- (2) The kind of merchandise sold,
- (3) The quantity of each kind of merchandise sold,
- (4) The price of each kind of merchandise sold,
- (5) The total price of merchandise sold,
- (6) A statement to the effect that the merchandise purchased is not to be consumed on or near the location at which parking facilities are provided by the retailer, and

(b) A daily sales record kept in sufficient detail to permit verification by audit that all gross receipts from sales have been accounted for and that all sales claimed as being tax exempt are included therein.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374 and 6376.5, Revenue and Taxation Code. Food Products Generally, see Regulation 1602. Sales tax reimbursement, see Regulation 1700. Meals served to residents or patients of an institution, see Regulation 1503. Food products sold through vending machines, see Regulation 1574. Meals at organized camps, see Regulation 1506. Nonprofit organizations as consumers, see Regulation 1597.

Appendix A

California Sales Tax Exemption Certificate
Supporting Exemption Under Section 6359.1

The undersigned certifies that it is an air carrier engaged in interstate or foreign commerce and that the hot prepared food products purchased from _____ will be consumed by passengers on its flights.

The undersigned further certifies that it understands and agrees that if the property purchased under this certificate is used by the purchaser for any purpose other than that specified above, the purchaser shall be liable for sales tax as if it were a retailer making a retail sale of the property at the time of such use, and the sales price of the property to it shall be deemed the gross receipts from such sale.

Date Certificate Given _____

Purchasing Air Carrier _____
(company name)

Address _____

Signed By _____
(signature of authorized person)

(print or type name)

Title _____
(owner, partner, purchasing agent, etc.)

Seller's Permit No. (if any) _____

~~Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6006, 6012, 6359, 6359.1, 6359.45, 6361, 6363, 6363.5, 6363.6, 6363.8, 6370, 6373, 6374 and 6376.5, Revenue and Taxation Code.~~

~~Food Products Generally, see Regulation 1602.~~

~~Alcoholic Beverages, tax reimbursements when served with, see Regulation 1700.~~

~~"Free" meals with purchased meals, see Regulation 1670.~~

~~Meals served to patients and inmates of an institution, see Regulation 1503.~~

~~Vending Machines, when considered selling meals, see Regulation 1574.~~

~~Meals at summer camps, see Regulation 1506(e).~~

~~Parent Teacher associations as consumers, see Regulation 1597.~~

Regulation History

Type of Regulation: Sales and Use Tax

Regulation: 1603

Title: 1603, *Taxable Sales of Food Products*

Preparation: Cary Huxsoll

Legal Contact: Cary Huxsoll

The proposed amendments to Regulation 1603, *Taxable Sales of Food Products*, clarify the application of tax to tips, gratuities, and service charges.

History of Proposed Regulation:

August 5-7, 2014	Public Hearing
June 20, 2014	OAL publication date; 45-day public comment period begins; Interested Parties mailing
June 10, 2014	Notice to OAL
May 22, 2014	Business Tax Committee, Board Authorized Publication (Vote 4-0)

Sponsor:	NA
Support:	NA
Oppose:	NA