

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

*In the Matter of the Petitions for Redetermination of*  
EMBASSY SUITES, INC., EMBASSY SUITES, INC., ARCADIA BONHEUR, INC.  
U.S.A., BUENA PARK HOMTEL ASSOC. LTD. PTN., BUENA PARK HOMTEL  
ASSOC. LTD. PTN., EMBASSY SUITES, INC., EMBASSY SUITES, INC., EPT  
COVINA LIMITED PARTNERSHIP, EPT COVINA LIMITED PARTNERSHIP,  
EMBASSY SUITES, INC., EMBASSY SUITES, INC., EMBASSY SUITES CLUB NO.  
TWO, INC., MORIHIRO SEKIYAMA, MD., EMBASSY SUITES, INC., EMBASSY  
SUITES, INC., EMBASSY LA JOLLA PARTNERS LMT. PTNR., EMBASSY  
SUITES, INC., PACIFIC MARKET INVESTMENT COMPANY, EMBASSY SUITES,  
INC., EPT SANTA CLARA LTD. PARTNERSHIP, *Petitioners*

*Appearances:*

*For petitioners:* Mr. Joseph A. Vinatieri  
Attorney at Law  
Mr. Michael Fannon  
Embassy Suites  
Mr. Randy Traylor  
The Promus Companies, Inc.

*For Business  
Taxes Appeals  
Section, Legal  
Division:*

Ms. Susan M. Wengel  
Assistant Chief Counsel

*For Sales and  
Use Tax  
Department:*

Mr. Robert W. Lambert  
Tax Counsel III

MEMORANDUM OPINION

Corrected by Board Action on October 10, 1996

This opinion considers the merits of a number of petitions under the Sales and Use Tax Law of various Embassy Suites and other legal entities, for various periods, in the total amount of \$527,949.68 tax plus interest. Petitioners are hotels serving meals and beverages. They offer hotel guests complimentary breakfasts every morning and bar service for one or two hours every evening. Embassy Suites use an atrium area of the hotel lobby or meeting rooms for the breakfast and bar service.

For breakfast, a self-serve, buffet-style table is maintained with cold and hot food and beverages. Reusable plates and silverware are furnished to the guests. Guests can also receive made-to-order items such as a fried egg breakfast.

For evening beverages, guests are served drinks ordered from a bartender. Mixed drinks are made to order and served in reusable glassware. A variety of bar snacks are

available. All personnel involved in serving the breakfasts and evening drinks are hired for a fee from the restaurant and bar located in the hotel.

There was no segregation of the sales of meals and beverages on the guests' checks or in the hotels' records; therefore, the Sales and Use Tax Department's audit established a retail sales price using a ten percent markup to all costs, including the cost of food, beverages, supplies and preparation costs. A tax-paid purchases resold credit was also allowed where appropriate.

### OPINION

The hotels provided complimentary food and beverages only to guests of the hotel, with very limited exceptions for "friends of guests." Food and beverages were never provided to the general public.

Renting a particular room entitled a guest to obtain complimentary food and beverages. That guest renting a particular room was never allowed the option of refusing complimentary food and beverages in return for a discounted room rental.

California local governments take the position that the entire charge is "for the room," while the Department views part of the charge as being for food and beverages. Accordingly, local governments impose a transient occupancy tax on the full charge to the hotel customer, including the value of complimentary food and beverages provided, while the Department considers the complimentary food and beverages to be subject to sales tax. Therefore, if we adopted the Department's position, hotels would be subject to tax based on two inconsistent theories asserted by two different levels of government.

According to Regulation 1501, "Service Enterprises Generally," persons engaged in the business of rendering services are consumers, not retailers, of the tangible personal property which they incidentally use in rendering the service. The basic distinction in determining whether a particular transaction involves a sale of tangible personal property or the transfer of tangible personal property incidental to the performance of a service is one of the true object of the contract; that is, is the real object sought by the buyer the service per se or the property produced by the service.

A guest of a hotel or motel seeks the service of a room rental from the operator of the facility. A factor in the decision making process of the guest when choosing one facility over another may be that one facility has better towels or provides specific amenities, such as shampoo or hand lotion. Similarly, a decision making factor may be that complimentary food and beverages are offered by one lodging facility. So long as such items are de minimis in value, the true object of the guest remains the lodging service.

Complimentary food and beverages are no different than the amenities which the Board has long recognized as incidental to the providing of the lodging service. In accordance with the regulation, the lodging provider is engaged in the business of providing service and is not a retailer of the soap, shampoo, or food and beverages which are incidentally used in rendering the service.

In order to simplify the administration of the law and to prevent abuses, we established a bright line test. Regulation 1546(b)(2) provides a de minimis exception where the value of parts and materials furnished in connection with repair work is ten percent or less of the total charge. A similar de minimis exception provides a fair and equitable bright line test in the case of complimentary food and beverages provided incidental to lodging services.

In general, tax applies to sales of meals or hot prepared food products furnished by restaurants, concessionaires, hotels, boarding houses, soda fountains and similar establishments whether served on or off the premises. (Regulation 1603(a).) The furnishing, preparing, or serving of complimentary food and drinks is de minimis and incidental when the retail value of the complimentary food and beverages furnished in connection with the rental of a hotel room is ten percent or less of the average daily rate for that hotel for the preceding year. The hotel is the consumer of the complimentary food and beverages and tax applies to the sale of the property to it.

The formula to determine whether complimentary food and beverages are incidental is as follows:

$$\frac{\text{Retail Value of Complimentary Food and Beverages per Occupied Room*}}{\text{Average Daily Rate**}}$$

\* “Retail Value of Complimentary Food and Beverages” is defined as the cost to the hotel of the food and beverages (both alcoholic and nonalcoholic) marked-up one hundred percent. The term “cost to the hotel of food and beverages” includes the amounts paid by the hotel to vendors, without increase for the food preparation labor of hotel employees, nor the fair rental value of hotel facilities used to prepare or serve meals. The value of such labor and facilities is taken into account in the above formula by use of the 100% mark-up.

\*\* “Average daily rate” is defined as the gross room revenue of the hotel for the preceding calendar year divided by the number of rooms rented for that year.

If applying the formula results in the complimentary food and beverages being ten percent or less, such food and beverages are deemed incidental to the lodging, and not subject to sales tax. For example, if the average daily rate for a hotel in 1995 was \$80, and the cost of the complimentary food and beverages per occupied room for the same year was \$3.00, the retail food and beverages value is less than ten percent ( $\$80 \times 10\% = \$8$   $\times$   $\$3.00 \times 2 = \$6$ ). The hotel is the consumer of the food and beverages and tax applies to its cost, where appropriate.

When a lodging facility provides complimentary food and beverages to its resident guests as part of its service and the requirements of the formula are met, a lodging facility is not a retailer of such food and beverages. We understand that a lodging facility may occasionally sell similar items to friends of guests to accommodate its resident guests (for example, a resident guest may invite a friend or business

acquaintance for a breakfast meeting). If a lodging facility regularly sells the otherwise complimentary meals and beverages to the general public, then that facility is a retailer of the food and beverages provided.

At the hearing of Embassy, held on October 25, 1995, the taxpayer introduced as Exhibit "A" a statistical recap of the average food and beverage costs for Embassy Suites in California per year. The exhibit also included information regarding the average daily rate/room revenue for those years. When the formula presented above is applied to the figures presented in Exhibit "A," the retail value of the complimentary food and beverages is less than ten percent of the average daily rate. Accordingly, we conclude that the complimentary food and beverages provided are incidental to the service of providing lodging, and sales tax does not apply. We order the petitions be granted in full.

Done at Sacramento, California, this 25th day of July, 1996.

Dean F. Andal, Member  
Brad Sherman, Member  
Rex Halverson, Member

Attested by E. L. Sorensen, Jr., Executive Director