



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

Date Introduced: **01/27/09**

Bill No: **SB 107**

Tax: **Sales and Use**

Author: **Walters**

Related Bills:

BILL SUMMARY

This bill would provide an exemption from the sales and use tax for charges for mandatory gratuities, tips, or service charges made to specified nonprofit organizations by hotels, caterers, restaurants, and similar establishments for meals, food, and beverages.

ANALYSIS

CURRENT LAW

Under existing law, the sales tax applies to the gross receipts from the sale of tangible personal property in this state, unless specifically exempted. Revenue and Taxation Code Section 6012 of the Sales and Use Tax Law defines “gross receipts” for purposes of identifying amounts charged by retailers that are includable or excludable from the computation of sales tax. This section specifies that, in general, the total amount of the retail sales of retailers are subject to tax including any services that are a part of the sale and all receipts, cash, credits and property of any kind.

The Board’s Regulation 1603, *Taxable Sales of Food Products*, makes a distinction between two basic categories of tips in relation to food and beverage sales: voluntary tips, which are generally not taxable, and mandatory tips, which are. Voluntary tips include amounts paid by customers to an employee, when the customer has made no advance arrangement with the business regarding the amount of the tip and the employee retains the tip. For example, voluntary tips given for meals, carrying luggage, parking a car, cleaning a hotel room, or driving a cab are not subject to tax. However, when customers are *required* to give tips for a service that contributes to a taxable sale, such as the sale and service of meals or drinks in a restaurant, those tips may be taxable.

In a typical arrangement in most restaurants, the customer decides how much to tip the server and leaves that amount at the end of the meal. This is regarded as a voluntary tip, and is not includable in the amount subject to tax. However, mandatory tips *are* subject to tax. These tips include those amounts added by the restaurant to the meal or beverage prices, or amounts for tips the restaurant lists on a meal or beverage receipts before giving the receipt to the customer. Another example of a mandatory tip includes any tip or gratuity amount or percentage agreed to by the customer before a meal, banquet, or catered event, whether the customer agrees orally or by signing a written contract (i.e., most of us have seen this or something similar on a restaurant menu: “A mandatory tip of 18% will be added for parties of 6 or more”).

With respect to the application of sales tax to purchases by nonprofit organizations, the Sales and Use Tax Law provides no general statutory exemption merely because the purchaser is engaged in charitable activities, or enjoys certain privileges under property tax statutes or income tax statutes. Although current law is sprinkled with several separate sales and use tax exemptions designed to support various kinds of nonprofit

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groups engaged in charitable activities, there is no general statutory exemption for sales of food, meals, or beverages to nonprofit organizations. Therefore, sales of food, meals and beverages by hotels, caterers, restaurants, and similar establishments and any other related service charges made to nonprofit organizations are subject to tax to the same extent as sales to any other purchaser.

PROPOSED LAW

This bill would add Section 6363.4 to the Sales and Use Tax Law to provide an exemption from the sales and use tax for a mandatory gratuity, tip, or service charge that is charged by a hotel, caterer, restaurant, or similar establishment, for a meal, food, or beverages purchased by a nonprofit organization.

The bill would define "nonprofit organization" as an organization exempt from taxation under Section 501(c)(3) or Section 501(c)(4) of the Internal Revenue Code.

The bill would take effect immediately as a tax levy, but would become operative on the first day of the first calendar quarter commencing more than 90 days after the bill's effective date.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the California State National Association for the Advancement of Colored People (NAACP), a nonprofit organization that qualifies for tax exempt status under Section 501(c)(3) of the Internal Revenue Code. According to the author's office, this bill aims to pursue policy changes in the hotel and entertainment industry tax policy that are friendlier, and support the provision of relief to nonprofit organizations.
2. **The bill would only apply to two of the 26 types of tax-exempt nonprofit organizations.** The bill would only exempt mandatory tips and service charges made to nonprofit organizations qualifying for tax exempt status under Sections 501(c)(3) and (c)(4). Section 501(c)(3) organizations include religious, educational, charitable, scientific, literary, testing for public safety, to foster national or international amateur sports competition, and prevention of cruelty to children or animals organizations. Section 501(c)(4) organizations include civic leagues, social welfare organizations, and local associations of employees. Besides these two types of nonprofit organizations, there are an additional 24 other nonprofit organizations with tax-exempt status under Section 501(c).
3. **Retailers would have to document exempt charges.** Under the law, a retailer's total receipts are presumed to be subject to tax until the contrary has been established. In order for hotels, restaurants, caterers, and similar establishments to rebut this presumption and to exclude the charges for mandatory tips and services from the computation of sales tax, they would be required to obtain and retain an exemption certificate signed by the qualifying organizations. There are approximately 115,000 organizations that have 501(c)(3) tax exempt status, and 9,000 organizations qualifying for 501(c)(4) status. This would add an additional recordkeeping burden on these establishments, who would receive virtually no economic benefit from the effects of the bill.

COST ESTIMATE

Costs would be incurred if this bill were to become law. The Board would be required to notify all affected establishments in the dining and beverage industry, revise the Board's regulation and publications, and respond to inquiries. An estimate of these costs is pending.

REVENUE ESTIMATE**BACKGROUND, METHODOLOGY, AND ASSUMPTIONS**

We do not have specific information regarding the dollar amount of mandatory gratuities, tips, or service charges on meals, food and drinks purchased by the specified nonprofit organizations. However, for purposes of this revenue estimate, we have assumed that if every 501(c)3 and 501(c)4 nonprofit organization participated in one event each year, at a price of \$1,000 and a mandatory tip of 18%, then the mandatory tips and service charges that would be exempted by this measure would amount to \$22.32 million annually (124,000 organizations x \$1,000 x 18% = \$22.32 million).

REVENUE SUMMARY

The annual revenue loss from exempting mandatory gratuities, tips or service charges charged on meals, food and beverages purchased by the specified nonprofit organizations would amount to an estimated \$2 million annually, as follows:

		Millions
State General Fund	(6.0%)	\$1.34
Fiscal Recovery Fund	(0.25%)	.05
Local	(2.0%)	.44
District	(0.75%)	<u>.17</u>
Total		<u>\$2.00</u>

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