



STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA  
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0092  
1-916-324-1825 • FAX 1-916-322-4530  
[www.boe.ca.gov](http://www.boe.ca.gov)

BETTY T. YEE  
First District, San Francisco

SEN. GEORGE RUNNER (Ret.)  
Second District, Lancaster

MICHELLE STEEL  
Third District, Orange County

JEROME E. HORTON  
Fourth District, Los Angeles

JOHN CHIANG  
State Controller

CYNTHIA BRIDGES  
Executive Director

February 7, 2014

Dear Interested Party:

Enclosed is the Second Discussion Paper on whether to amend Regulation 1603, *Taxable Sales of Food Products*, to clarify the application of tax to mandatory tips, gratuities, and service charges. Before the issue is presented at the Board's May 22, 2014 Business Taxes Committee meeting, staff would like to invite you to discuss the issue and present any additional suggestions or comments. Accordingly, a second interested parties meeting is scheduled as follows:

**February 20, 2014**  
**Room 122 at 10:00 a.m.**  
**450 N Street, Sacramento, CA**

If you would like to participate by teleconference, call 1-888-636-3807 and enter access code 499201. You are also welcome to submit your comments to me at the address or fax number in this letterhead or via email at [Susanne.Buehler@boe.ca.gov](mailto:Susanne.Buehler@boe.ca.gov) by March 7, 2014. Copies of the materials you submit may be provided to other interested parties, therefore, ensure your comments do not contain confidential information. Please feel free to publish this information on your website or distribute it to others that may be interested in attending the meeting or presenting their comments.

If you are interested in other Business Taxes Committee topics refer to our webpage at (<http://www.boe.ca.gov/meetings/btcommittee.htm>) for copies of discussion or issue papers, minutes, a procedures manual, and calendars arranged according to subject matter and by month.

Thank you for your consideration. We look forward to your comments and suggestions. Should you have any questions, please feel free to contact our Business Taxes Committee staff member Mr. Robert Wilke at 1-916-445-2137, who will be leading the meeting.

Sincerely,

A handwritten signature in cursive script that reads "Susanne Buehler".

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  
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. 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. Jeff Vest (MIC 85)  
Mr. Jeff Angeja (MIC 85)  
Mr. David Levine (MIC 85)  
Mr. Robert Tucker (MIC 82)  
Mr. Bradley Heller (MIC 82)  
Mr. Lawrence Mendel (MIC 82)  
Mr. Cary Huxsoll (MIC 82)  
Mr. Todd Gilman (MIC 70)  
Ms. Laureen Simpson (MIC 70)  
Mr. Bill Benson (MIC 67)  
Mr. Joe Fitz (MIC 67)  
Mr. Wayne Mashihara (MIC 46)  
Mr. Kevin Hanks (MIC 49)  
Mr. Bradley Miller (MIC 92)  
Ms. Kirsten Stark (MIC 50)  
Mr. Clifford Oakes (MIC 50)  
Mr. Michael Patno (MIC 50)  
Mr. Robert Wilke (MIC 50)

## SECOND DISCUSSION PAPER

### **Regulation 1603, *Taxable Sales of Food Products* Application of Tax to Tips, Gratuities, and Service Charges**

#### **Issue**

Whether Regulation 1603, *Taxable Sales of Food Products*, should be amended to clarify the application of tax to tips, gratuities, and service charges.

#### **General Legal Background / Current Administrative Practice**

Sales tax is imposed on a retail sale of tangible personal property in the 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.

## SECOND DISCUSSION PAPER

### **Regulation 1603, *Taxable Sales of Food Products* Application of Tax to Tips, Gratuities, and Service Charges**

#### *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).)

#### **Discussion**

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.

## SECOND DISCUSSION PAPER

### **Regulation 1603, Taxable Sales of Food Products Application of Tax to Tips, Gratuities, and Service Charges**

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 Approaches to Current Administrative Practice

Staff is open to input on ways to clarify Regulation 1603 to provide better guidance for distinguishing between optional and mandatory tips and gratuities. For example, an approach consistent with current Internal Revenue Service (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 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.

Aligning the mandatory tip provisions of Regulation 1603 so that they are consistent with IRS reporting requirements for tip wages may result in greater clarity regarding the application of tax to tips, gratuities, and service charges. This would allow easier compliance with both IRS and BOE reporting requirements. Staff would like to stress, however, that it is open to other suggestions for how to increase clarity and ease compliance with regard to this issue.

#### Sample Regulatory Amendments Applying the IRS Approach

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 this draft language as an example of a bright-line approach that eases compliance for retailers. As explained below, staff suggests 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 tips, gratuities, and service charges would be helpful to the restaurant industry and staff.

## SECOND DISCUSSION PAPER

### **Regulation 1603, *Taxable Sales of Food Products* Application of Tax to Tips, Gratuities, and Service Charges**

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 also received written comments from Ms. Kara Bush sent on behalf of the California Restaurant Association, in a letter dated January 10, 2014 (Exhibit 2). In the letter, she 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 letter dated January 10, 2014 (Exhibit 3). He 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.

#### Staff's Recommendation / Proposed Amendments

Staff believes that a thorough understanding of the restaurant industry's record keeping practices and procedures with respect to reporting tips, gratuities, and service charges to the IRS is essential. While staff has a general understanding of the reporting process, staff is hopeful that it can continue to work with interested parties to develop a thorough understanding of their recordkeeping and reporting processes which will be beneficial in developing practical guidance.

With respect to concerns regarding taxpayers that fail to maintain adequate records, staff proposes to add language to subdivisions (g)(1) and (g)(2) clarifying application of the presumption and also add subdivision (g)(3) 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).

#### *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.

**SECOND DISCUSSION PAPER**  
**Regulation 1603, *Taxable Sales of Food Products***  
**Application of Tax to Tips, Gratuities, and Service Charges**

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.

**Summary**

Staff appreciates the input provided by the interested parties and looks forward to continuing to work with them to develop a bright-line approach that will foster reporting compliance and audit efficiency with respect to tips, gratuities, and service charges. Staff remains open to any other suggestions or options that might be presented by industry that would serve to clarify the application of tax to these transactions, remove any ambiguity, and provide more certainty so that taxpayers can more easily understand their obligations under the Sales and Use Tax Law. Interested parties are welcome to submit comments or suggestions on the issues discussed in this paper, and are invited to participate in the interested parties meeting scheduled for February 20, 2014.

Prepared by the Tax Policy Division, Sales and Use Tax Department

Current as of February 6, 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 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:	$ARV/ADR3 < \text{or} = 10\%$
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.

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.<sup>1</sup>

(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

---

<sup>1</sup> 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.

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.

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~~ 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.

(A) 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 (g)(2) and (g)(3).

~~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:~~

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 thean 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.

Under these circumstances, the customer was free to enter the amount on the tip line or leave it blank; thus, the customer could 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~~payments for these charges~~, as discussed in subdivision (g)(4)~~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.

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 (g)(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 (g)(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 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 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 an amount 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*.

(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.

~~(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) 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 (i) 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 (i) and give valid resale certificates therefor.

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

(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 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.

- (i) 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 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.

- (j) Student Meals.

(1) Definitions.

(A) "Food Products<sub>2</sub>": 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<sub>2</sub>": 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<sub>2</sub>"; "recess<sub>2</sub>"; or similar break, will not be considered "meals<sub>2</sub>":

(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 non-food products, which are furnished to the employees as a part of the meals.

In the absence of any of the conditions under (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.

(l) 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.

(m) 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.

(n) 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.

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

(p) 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.

(q) 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.

(r) 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.

(s) 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.)

(t) 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.

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~~ Sales tax reimbursement, see Regulation 1700. ~~"Free" meals with purchased meals, see Regulation 1670.~~ Meals served to residents or patients and inmates of an institution, see Regulation 1503. ~~Vending Machines, when considered selling meals~~ Food products sold through vending machines, see Regulation 1574. Meals at ~~summer~~ organized camps, see Regulation 1506(e). ~~Parent Teacher associations~~ 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](mailto: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.Buehler@boe.ca.gov](mailto:Susanne.Buehler@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