

**Letter of Findings: 04-20110617**  
**Gross Retail Tax**  
**For the Tax Years 2008-2010**

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**ISSUE**

**I. Gross Retail Tax—Gratuities.**

**Authority:** IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-4-1; IC § 6-2.5-9-3; IC § 6-8.1-5-1; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Revenue Ruling # 2001-07ST (July 26, 2001); Letter of Findings 04-20100498 (January 12, 2011).

Taxpayer argues that money, which Taxpayer received as gratuities, is not subject to gross retail tax.

**STATEMENT OF FACTS**

Taxpayer owns and operates a riverboat casino in Indiana. The Indiana Department of Revenue ("Department") conducted a sales/use tax audit of Taxpayer for 2008, 2009, and 2010 tax years and issued proposed assessments for additional amounts of sales tax, use tax, and interest. The Department determined that Taxpayer failed to collect and remit sales tax on certain retail transactions, specifically, the amounts of separately stated, mandatory gratuity charges on its catering services. The Department also found that Taxpayer had made purchases without paying sales tax at the time of its purchases or remitting use tax due to the Department. Taxpayer protested the audit's assessment of sales tax for its failure to collect tax on the amounts listed on the bill as gratuities. A hearing was held, and this Letter of Findings results. Additional facts will be provided as necessary.

**I. Gross Retail Tax—Gratuities.**

**DISCUSSION**

The Department notes that all tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Taxpayer, as a registered retail merchant, is responsible for collecting and remitting sales tax on retail transactions. "The retail merchant is required to collect the tax [due on the retail transaction] as [an] agent for the state." IC § 6-2.5-2-1(b). The retail merchant "has a duty to remit Indiana [sales] or use taxes... to the department, [to] hold those taxes in trust for the state, and is personally liable for the payment of those taxes, plus any penalties and interest attributable to those taxes, to the state." IC § 6-2.5-9-3(2). Thus, when a retail merchant fails to collect and hold the taxes in trust for the state, the retail merchant is personally liable for the sales tax, interest, and penalties due to the state for those sales.

On initial review, the Department determined that Taxpayer failed to collect and remit the correct amount of sales tax in its catering transactions, and assessed Taxpayer additional sales tax on the transactions. Taxpayer's billings included a separately stated, mandatory charge for gratuities, and Taxpayer did not collect sales tax on the charges for gratuities. Taxpayer maintains that these amounts for gratuities are excluded from sales tax and, therefore, it was not responsible for collecting and remitting the sales tax. Taxpayer explains that the gratuities, at issue, are receipts that represent "charges for serving or delivery food," which are excluded from sales tax under IC § 6-2.5-4-1(g).

Pursuant to IC § 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. IC § 6-2.5-1-2 defines a retail transaction as "a transaction of a retail merchant that constitutes selling at retail as described in IC § 6-2.5-4-1... or that is described in any other section of IC § 6-2.5-4." A retail transaction is defined as occurring when a person "acquires tangible personal property... and transfers that property to another person for consideration." IC § 6-2.5-4-1(b)(1)-(2). Additionally, IC § 6-2.5-4-1(c)(2) provides that it "does not matter whether the property is transferred... alone or in conjunction with other property or services."

Pursuant to IC § 6-2.5-4-1(e), the amount of the retail transaction that is subject to sales and use tax includes "the price of the property transferred" and "except as provided in subsection (g), any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records." [45 IAC 2.2-4-1\(b\)\(3\)](#) states that the amount of the retail transaction that is subject to tax includes the amounts collected for "services performed or work done on behalf of the seller prior to transfer of such property at retail."

IC § 6-2.5-4-1(g) provides:

Gross retail income does not include income that represents charges for serving or delivering food and food

ingredients furnished, prepared, or served for consumption at a location, or on equipment, provided by the retail merchant. However, the exclusion under this subsection only applies if the charges for the serving or delivery are stated separately from the price of the food and food ingredients when the purchaser pays the charges.

Accordingly, as a general rule, gross retail income includes the amounts from all charges, whether or not they are separately stated, that represent the transfer of tangible personal property and services that occur prior to the transfer of that tangible personal property. However, a limited exclusion from gross retail income has been granted for charges "for serving or delivery of food and food ingredients" when certain conditions are met. The food must be "furnished, prepared, or served for consumption at a location, or on equipment, provided by the retail merchant." The charges must represent actual charges "for the serving or delivery of food," and these charges must be "separately stated."

In Revenue Ruling # 2001-07ST (July 26, 2001), 24 Ind. Reg. 4334, the Department explained:

[IC § 6-2.5-4-1(g)] is intended to exempt only those services which are directly related to serving and/or delivering food. The intent is not to provide a blanket exemption for overhead charges while serving or delivery food. Therefore, a service charge to serve and/or deliver food would be exempt from sales/use tax.

[However,] [s]ervice charges for insurance, depreciation, and other operational costs would not be exempt.

Even a service charge for preparing food in this case is subject to sales/use tax, as the preparation of food is not part of the serving and/or delivery of the food.

In Letter of Findings 04-20100498 (January 12, 2011), 20110323 Ind. Reg. 045110138NRA, the retail merchant was denied the exclusion because the retail merchant was not paying the amount collected as "gratuities" to the employees as a charge for serving and delivering the food. Instead, the amount at issue represented the "the difference between the food and beverage gratuity collected from [Taxpayer's] customers and the amount paid out to employees." Thus, this "gratuity" charge was an overhead charge in which the retail merchant retained the amount and paid a lesser amount to the employees.

When a gratuity is voluntarily provided to a server who retains the gratuity, there is no question that the charge is a separate stated charge given for the serving of food. However, when a gratuity is mandatory, further analysis needs to be made. The mandatory gratuity would need to meet the tests of representing actual charges "for the serving or delivery of food," and being "separately stated" for the costs of providing the food.

If any of the mandatory gratuities are retained by the employer, the charge would be a charge to cover an overhead cost of providing the food and would not represent a bona fide charge for serving the food. Likewise, if the employees were not receiving wages from the employees, the gratuity would represent a "wage replacement," which is the equivalent of a charge for the overhead cost of the employer providing the food. Therefore, for a mandatory gratuity, to meet these tests the gratuity must be entirely distributed to the employees serving the food and must not represent the employee's wages, salaries, or other compensation.

During the hearing, Taxpayer presented additional documentation, including customer contracts, employee compensation records, and gratuity distribution records. In the instant case, the mandatory gratuity is separately stated on the bill to the customer meeting the first test. Also, the gratuities are entirely distributed to the employees and are not, in any part, retained by Taxpayer. Lastly, Taxpayer's employees receive wages of \$8.50 an hour from Taxpayer for the time worked, and thus, the gratuities do not represent a wage, salary, or other compensation. Accordingly, Taxpayer has demonstrated that the mandatory gratuities qualify as "charges for the serving of food" that are excluded from sales tax.

#### **FINDING**

Taxpayer's protest is sustained.

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