OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **D. GRIFFITH** **dba GRIFF'S BBQ & GRILL**	OTA Case No. 19125549 CDTFA Case ID 025-066

OPINION

Representing the Parties:

For Appellant: Gary Kimzey, Representative

For Respondent: Jarrett Noble, Tax Counsel III

For Office of Tax Appeals: Deborah Cumins, Business Taxes Specialist III

A. WONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, D. Griffith (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) in response to appellant's timely petition for redetermination of a Notice of Determination (NOD), which was for tax of $24,099.14 and applicable interest, for the period April 1, 2012, through December 31, 2014 (audit period).[1] In its decision (and a subsequent explanatory letter), CDTFA reduced the tax liability from $24,099.14 to $18,051, but denied the remainder of the petitioned amount.

Appellant waived his right to an oral hearing, so we are deciding this matter based on the written record.

ISSUE

Whether a reduction to the measure of unreported taxable mandatory gratuities is warranted.

[1] The State Board of Equalization (BOE) formerly administered sales taxes. In 2017, BOE functions relevant to this case transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to acts or events that occurred before July 1, 2017, "CDTFA" will mean BOE; and when this Opinion refers to acts or events that occurred on or after July 1, 2017, "CDTFA" will mean CDTFA.

FACTUAL FINDINGS

1. Appellant has operated a restaurant, with a full bar, in Copperopolis, California, since July 2011.
2. As relevant here, during its audit, CDTFA found that appellant's point-of-sale (POS) reports included amounts recorded under the category of "Auto Gratuity." Appellant's menu included a statement that a gratuity of 18 percent would be added for parties of eight or more.[2] CDTFA concluded that the recorded "Auto Gratuity" amounts, which totaled $40,669 for the audit period, represented mandatory gratuities that were subject to tax.
3. On October 11, 2017, CDTFA issued an NOD for the deficiency disclosed by audit, which appellant timely petitioned.
4. CDTFA subsequently issued a decision, concluding that gratuities totaling $40,669 were mandatory gratuities subject to tax.[3]
5. This timely appeal followed.

DISCUSSION

California imposes upon a retailer a sales tax measured by the retailer's gross receipts from the retail sales of tangible personal property in this state. (R&TC, § 6051.) All of a retailer's gross receipts are presumed subject to tax, unless the retailer can prove otherwise. (R&TC, § 6091.)

"Gross receipts" means the total amount of the sale price, including any services that are part of the sale. (R&TC, § 6012(b)(1).) A "sale" includes the furnishing, preparing, or serving for a consideration of food, meals, or drinks. (R&TC, § 6006(d).)

California Code of Regulations, title 18, (Regulation) section 1603(g) applies to restaurants and governs the application of tax to tips, gratuities, and service charges for transactions occurring prior to January 1, 2015. An optional payment designated as a tip, gratuity, or service charge is not subject to tax. (Cal. Code Regs., tit. 18, § 1603(g).) A

[2] Prior to March 17, 2013, this policy applied to parties of six or more.

[3] During CDTFA's internal appeals process, CDTFA reduced appellant's tax liability from $24,099.14 to $18,051 based on a reduction to a separate, unrelated audit item that appellant no longer disputes.

mandatory payment designated as a tip, gratuity, or service charge is included in taxable gross receipts, even if the amount is subsequently paid by the retailer to employees. (*Ibid*.)

A payment of a tip, gratuity, or service charge is optional if the customer either (1) adds the amount to the bill presented by the retailer, or (2) 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. (Cal. Code Regs., tit. 18, § 1603(g)(1)(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. (Cal. Code Regs., tit. 18, § 1603(g)(2)(A).) When a menu, brochure, advertisement, or other printed material contains a statement or notice 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. (Cal. Code Regs., tit. 18, § 1603(g)(2)(B).) An amount is considered "automatically added" when the retailer adds the tip to the bill without either (1) first conferring with the customer after service of the meal and receiving approval to add the tip or (2) providing the customer with the option to write in the tip. (*Ibid*.) These automatically added amounts are considered "negotiated in advance" and thus mandatory. (*Ibid*.) Nonetheless, any amount added by the retailer is presumed to be mandatory. (*Ibid*.)

It is presumed that any amount added as a tip by the retailer to the bill or invoice presented to the customer is mandatory. (Cal. Code Regs., tit. 18, § 1603(g)(2)(C).) 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. (*Ibid*.) This presumption may be controverted by documentary evidence showing that the customer specifically requested and authorized the gratuity be added to the amount billed. (*Ibid*.) As relevant here, examples of documentary evidence that may be used to overcome the presumption include 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. (*Ibid*.)

On appeal, appellant argues that the recorded "Auto Gratuity" amounts in his POS records were all nontaxable optional gratuities. Appellant claims that, while his restaurant has an informal policy of charging an 18 percent gratuity for parties of eight or more,[4] employees and

[4] See footnote 2, *ante*, page 2.

servers did not consistently follow this policy. Appellant contends that employees and servers can decide whether to charge a gratuity and, if so, in what amount. As evidence, appellant has provided detailed sales records documenting various transactions that employees and servers "reopened" in order to change the default gratuity amount or to delete the gratuity altogether. Appellant claims that reopening a transaction only occurred when a customer requested and authorized a change to the default gratuity amount. Appellant alleges that this is verified by the fact that, for all "reopened" transactions, only the amount of the gratuity changed (i.e., it varied from the 18 percent default). Appellant argues that this evidence rebuts the presumption that the gratuities at issue were mandatory and taxable.

In sum, appellant argues that when a customer requests and authorizes a change to the default gratuity amount automatically added by appellant, an employee or server reopens that transaction in appellant's POS system, transforming a taxable mandatory gratuity into a nontaxable optional gratuity. Moreover, appellant contends that *all* automatically added gratuities are optional gratuities because "they could all be negotiated by the customer after the customer was presented with the bill."

At our request, appellant provided daily sales reports for the audit period, as well as an analysis of the $40,669 in gratuities at issue. According to appellant, the $40,669 measure was comprised of 2,482 transactions involving large parties (i.e., parties of six or more prior to March 17, 2013, and parties of eight or more beginning on or after that date). Of these, 2,417 transactions (or 97.38 percent) had a gratuity of 18 percent added, and 65 transactions (or 2.62 percent) did not. Twenty-one of these 65 transactions were "reopened" by an employee or server because, per appellant, the customer questioned or complained about the amount of the gratuity after being presented the guest check. Appellant did not specify the nature of the remaining 44 (65-21) transactions.

Here, appellant's menu included a statement that a gratuity of 18 percent would be added for large parties, and appellant's POS system recorded total "Auto Gratuity" amounts of $40,669 for the audit period. The $40,669 measure was comprised of 2,482 transactions, of which 2,417 had a gratuity of 18 percent. Based on appellant's stated policy, described procedures, and materials supplied on appeal, we find that the 18 percent gratuities for these 2,417 transactions were added without first conferring with customers or providing customers with the option to write in the tip. Accordingly, we conclude that the 18 percent gratuities for these 2,417

transactions were automatically added, negotiated in advance, and are therefore mandatory gratuities subject to tax.

Appellant has also provided evidence of 21 "reopened" transactions for which a customer purportedly first received the bill, but disagreed with the added 18 percent gratuity; an employee or server then reopened the transaction to change the gratuity amount or to delete the gratuity altogether. Our review of these "reopened" transactions indicates that all had final gratuity percentages of 0 percent. Because the "Auto Gratuity" amount for these transactions is $0, these transactions would not have contributed to the measure of unreported taxable mandatory gratuities, and, therefore, could not warrant an adjustment.

Finally, appellant contends that employees and servers have the option to charge a different gratuity and, in fact, did so. Based on appellant's analysis, 44 transactions had a non-18 percent gratuity that an employee or server apparently added prior to presenting the guest check to a customer. These gratuities are presumed to be mandatory per Regulation section 1603(g)(2)(B) ("[A]ny amount added by the retailer is presumed to be mandatory.") (See also R&TC, § 6091 [all gross receipts presumed subject to tax until contrary is established].) With respect to these 44 transactions, appellant has not provided evidence of any of the following: (1) an employee or server first conferred with the customer after service of the meal and received approval to add the tip; (2) an employee or server provided the customer with the option to write in the tip; or (3) customers specifically requested and authorized adding the non-18 percent gratuity to the amount billed in these 44 transactions. Accordingly, absent evidence to the contrary, we find that the gratuities in these 44 transactions are mandatory and are therefore taxable.

Based on the foregoing, we conclude that appellant has not provided any evidence to show that any portion of the $40,669 "Auto Gratuity" amount at issue was optional and not subject to tax.

HOLDING

A reduction to the measure of unreported taxable mandatory gratuities is not warranted.

DISPOSITION

We sustain CDTFA's decision to reduce the tax liability from $24,099.14 to $18,051, but otherwise deny the petition.

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Andrew Wong
Administrative Law Judge

We concur:

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Josh Aldrich
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Josh Aldrich
Administrative Law Judge

DocuSigned by:
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Andrew J. Kwee
Administrative Law Judge

Date Issued: 4/7/2021