

ARIZONA DEPARTMENT OF REVENUE

ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 93-16

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

ISSUE:

Taxation under the restaurant classification of restaurant services provided in addition to meals and the taxation of service charges and gratuities.

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 42-1310.14 states:

- A. The restaurant classification is comprised of the business of operating restaurants, dining cars, dining rooms, lunchrooms, lunch stands, soda fountains, catering services or similar establishments where articles of food or drink are sold for consumption on or off the premises.
- B. The tax base for the restaurant classification is the gross proceeds of sales or gross income derived from the business.

Arizona Administrative Code (A.A.C.) R15-5-1708 states:

- A. Amounts charged separately by the seller on a check or bill for gratuities are not subject to the tax under the following conditions:
 - 1. The exact amount charged on a check for gratuities must be segregated on the seller's records for the account of the employees actually providing the services;
 - 2. The amounts so segregated must be distributed directly to the employees providing the services for which the charges were made.

B. In cases where the amounts charged cannot be specifically segregated or when any portion of the amounts charged for gratuities is not distributed to the employees involved, the total amount is taxable as part of the gross receipts.

DISCUSSION:

SERVICES:

A meal served in a restaurant or catered at a wedding involves both the transfer of food and drink and the rendition of services. The tax base for the restaurant classification is the gross proceeds of sales or gross income derived from the business. No deduction from the tax base is provided in statute for services rendered in conjunction with the sale of the food.

GRATUITIES:

A mandatory service charge or gratuity may be included in a restaurant or catering bill. If the service charge or gratuity is separately stated on the bill, is segregated in the seller's records, and is distributed directly to the employee(s) who provided the services, it is not includable in the tax base under the restaurant classification.

A.A.C. R15-5-1708.B provides that in the event a service charge or gratuity is not segregated in the seller's records, or when any portion of the gratuity is not directly distributed to the employees who provided the services, the total amount is includable in the tax base under the restaurant classification.

RULING:

The gross proceeds of sales or gross income derived from businesses operating under the restaurant classification is subject to tax. Included in the gross proceeds of sales or gross income is income received for services such as the preparation, serving, or delivery of food, whether or not such services are separately stated on the bill or invoice.

A service charge or gratuity which is shown separately on a bill is not includable in the gross proceeds of sales or gross income derived from the business under the restaurant classification if the total amount charged is segregated in the seller's records and the total amount so segregated is distributed directly to the employees providing the services for which the service charge or gratuity was made.

However, where a service charge or gratuity is not segregated in the seller's records or when any portion of the amount charged for a gratuity is not directly distributed to the employees involved, the total amount is includable in the gross proceeds of sales or gross income derived from the business and subject to transaction privilege tax under the restaurant classification.

Examples:

1. A 15 percent gratuity is charged on all food and beverage served by a caterer. The charge is listed separately on all checks and is itemized as follows:

Total Food and Beverage \$ 1,000

Service Charge (15%) 150

Total \$ 1,150

The total amount of the service charge is distributed to the service staff. The service charge is not included in the tax base and is not subject to transaction privilege tax under the restaurant classification.

2. A 15 percent gratuity is charged on all food and beverage served by a caterer. The charge is listed separately on all checks and is itemized as follows:

Total Food and Beverage \$ 1,000

Service Charge (15%) 150

Total \$ 1,150

Five percent of the total amount is retained by the owner of the business who did not participate in the service of the food. The remainder of the service charge is distributed to the service staff. Because the total amount of the service charge is not distributed to the service staff the total amount of the service charge is included in the tax base and is subject to transaction privilege tax under the restaurant classification.

Harold Scott, Acting Director
Signed April 6, 1993

Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law which are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement which provides interpretation, details or supplementary information concerning the application of the law. **Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling.** See GTP 92-1 for more detailed information regarding documents issued by the Department of Revenue.

