

and other states. All such catering services involve airlines which operate scheduled commercial passenger flights in intrastate, interstate or foreign commerce. In addition, petitioner operated some restaurants located in airport terminals and provided management services to airline-owned private membership clubs at New York airport terminals. Petitioner operated the following facilities in New York State: flight kitchen, two restaurants and shops at John F. Kennedy Airport; flight kitchen and bakery at LaGuardia Airport; flight kitchen, restaurant and shop at Syracuse Airport. The private flight clubs managed by petitioner were the Admirals Club and the Ambassador Club at John F. Kennedy and LaGuardia Airports, respectively.

2. On September 20, 1984, as the result of an audit, the Audit Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due against petitioner covering the period March 1, 1980 through May 31, 1983 for taxes due of \$3,243,852.25, plus interest of \$1,042,838.48, for a total of \$4,286,690.73.

3. Petitioner executed consents extending the period of limitation for assessment of sales and use taxes for the period March 1, 1980 through May 31, 1983 to September 20, 1984.

4. Petitioner reported the following sales as nontaxable on the sales tax returns filed:

- (a) sales of meals to airlines for in-flight consumption;
- (b) charges for services to airlines;
- (c) sales of medicines;
- (d) sales of newspapers and periodicals;
- (e) management fees;
- (f) miscellaneous.

On audit, the Audit Division disallowed the sales in categories (b), (e) and (f) and determined additional taxable sales as follows:

<u>Category</u>	<u>Sales</u>	<u>Tax Due</u>
service charges	\$38,360,949.00	\$3,099,878.01
management fees	106,943.00	8,696.51
miscellaneous	350,838.00	26,024.73

The audit also disclosed that petitioner had not reported any tax on meals furnished to its

employees. The cost of such meals amounted to \$1,364,722.00 for the audit period, with tax due thereon of \$109,253.01. Use taxes of \$1,572.20 were assessed on fixed assets and \$13,602.51 on purchases of recurring expense items. Petitioner agreed to the use tax liability and made payment of \$15,174.71 in tax, plus interest of \$5,083.79.

5. Petitioner conceded its liability for the tax due of \$26,024.73 on the miscellaneous sales.

6. Various airlines operate flight clubs at New York airport terminals. These clubs are private membership clubs; however, membership is open to the public. The clubs provide members with an opportunity to await connecting flights in a quiet atmosphere conducive to the production of reports, reading and meetings. Meals are not available at these clubs, although, in some instances, snacks (pretzels and peanuts) are provided. Drinks are sold to members at a price designed to provide a profit to the airline. Petitioner is under contract with the airlines to manage the clubs indicated in Finding of Fact "1". The personnel utilized to staff the clubs are petitioner's employees; however, the airline does designate one of its employees as manager of the club. This manager establishes the days and hours of operation, sets all prices to be charged, and sets all service standards. Under the contract, the airline pays a management fee to petitioner for managing the respective club. This fee compensates petitioner for its expertise in management capabilities (accounting, cash management, licensing, payroll, etc.). The management fee is based on a fixed percentage of monthly gross receipts with a guaranteed minimum. All revenues and costs are borne by the airline except that petitioner pays the wages of its employees utilized to fulfill its contractual obligations. The net profits, if any, from the operations are paid monthly by petitioner to the airlines and all losses, if any, are paid monthly by the airlines to petitioner.

7. Petitioner supplies various airlines with catered meals for in-flight consumption. In conjunction therewith, petitioner provides certain other services which the Audit Division has characterized as pick-up, cleaning and return of airline-owned meal service equipment and utensils. Petitioner recharacterized these services as cleaning meal service equipment, delivery

services¹, strip services², liquor acquisition services³ and overhead charge.⁴ These services are billed to the airlines either by direct computer entries by petitioner or by an invoice reflecting an aggregate service charge.⁵ The aggregate service charge is shown separately from the charge for food on petitioner's daily billing recap and recorded as such in a separate income account in the general ledger. The separate service charge was for accounting purposes only. Petitioner did not clean meal service equipment without the sale of food and drinks.

8. Under a union contract with its employees, petitioner must furnish at least one meal, and sometimes two, during the work shift of the employees at no cost to the employee. Petitioner employed 718 people in New York of which 461 worked in the flight kitchens. Petitioner conceded that meals provided to employees who worked in the restaurant operation as opposed to those in the flight kitchen catering operation were taxable and the amount of tax due is \$39,107.17 (257 divided by 718 x \$109,253.01).

¹Petitioner delivers the prepared food and serving equipment directly to the aircraft.

²“Strip service” is the industry term used to describe the interior cleaning of aircraft upon termination of a flight. Petitioner was responsible for removing garbage bags and the food service equipment.

³Some airlines request petitioner to provide beverages. Non-alcoholic beverages are purchased by the airlines from petitioner; however, alcoholic beverages are purchased by the airlines through petitioner as its agent. Petitioner loads the liquor on the aircraft and charges the airline for this service.

⁴Overhead charge includes all indirect costs such as utilities, insurance and rent.

⁵Internal accounting records indicate that these five components of the service charge reflect the following percentages of the service charge:

Cleaning equipment	16%
Delivery charges	5%
Strip charges	10%
Liquor acquisition charges	5%
Overhead	64%

SUMMARY OF PARTIES' POSITIONS

Management Fees

9. The position taken by the Audit Division is that the management fee is a taxable receipt as it constitutes a sale of food and drink under section 1105(d)(i) of the Tax Law. The position of petitioner is that management fees are for services not within those specified under section 1105(c) of the Tax Law.

Service Charges

10. The Audit Division took the position that, in addition to providing food and beverage services, petitioner provided the service of cleaning meal service equipment owned by the airlines and held the entire service charge as a taxable receipt regardless of any nontaxable components. The Division relied on Regulations 20 NYCRR 526.5(e) and 20 NYCRR 527.1(b). Petitioner argued that the cleaning of the meal service equipment, as well as the other charges set forth in Finding of Fact "7", are necessary elements of serving food and drink which are passed through to the purchasing airline and are all part of the sales price of the food and drink which is exempt from tax under section 1105(d)(ii)(A) of the Tax Law.

Employee Meals

11. Petitioner argued that 20 NYCRR 527.8(j)(1) limits the scope of "employee meals" to "employees of restaurants, hotels, motels and similar establishments" and that flight kitchens should not be viewed as similar to restaurants, hotels and motels in that they do not serve the public nor are they operated for on-premise consumption.

CONCLUSIONS OF LAW

A. That section 1105(d)(i) of the Tax Law imposes a tax upon:

"The receipts from every sale of...food and drink of any nature or of food alone, when sold in or by restaurants, taverns or other establishments...or by caterers, including in the amount of such receipts any cover, minimum, entertainment or other charge made to patrons or customers."

B. That the amounts received by petitioner from the airlines under the management fee arrangement for the operation of the flight clubs described in Finding of Fact "6" are taxable receipts from the sale of drinks within the meaning and intent of section 1105(d)(i) of the Tax

Law (Matter of Chemical Bank v. Tully, 94 AD2d 1).

C. That 20 NYCRR 527.8(j) provides, in part, that:

"(1) Food and drink furnished by an employer for his convenience to employees are subject to tax.

* * *

(5) This subdivision shall apply only to meals furnished to employees of restaurants, hotels, motels and similar establishments."

It was reasonable for the Audit Division to consider petitioner's catering of food and drink to airlines as a "similar establishment" for purposes of 20 NYCRR 527.8(j)(5). Unless a regulation is shown to be irrational and inconsistent with the statute or erroneous, it should be upheld (Matter of Blue Spruce Farms v. State Tax Commission, 99 AD2d 867, affd 64 NY2d 682). Accordingly, the Audit Division properly determined tax due on employee meals in the amount of \$109,253.01.

D. That section 1105(d)(ii) of the Tax Law provides that the tax imposed under subdivision (i) shall not apply to: "(A) food or drink which is sold to an airline for consumption while in flight." The service charge as set forth in Finding of Fact "7" was for ancillary services provided by petitioner directly related and performed in conjunction with the sale of prepared food and drink by a caterer. Such charge, albeit separately stated from the food, constituted an "other charge" in accordance with section 1105(d)(i) of the Tax Law and thus became part of the receipt for the sale of food and drink. Since the food and drink were sold to airlines for consumption in flight, the receipts are excluded from the imposition of tax pursuant to section 1105(d)(ii) of the Tax Law. Accordingly, the tax assessed in the amount of \$3,099,878.01 is hereby cancelled.

E. That the petition of Sky Chefs Division of Flagship International is granted to the extent indicated in Conclusion of Law "D"; the Audit Division is hereby directed to modify the

Notice of Determination and Demand for Payment of Sales and Use Taxes Due issued
September 20, 1984; and except as so granted, the petition is in all other respects denied.

DATED: Albany, New York
November 6, 1987

ADMINISTRATIVE LAW JUDGE