

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
AAFF, INC., ANITA LONG	:	DETERMINATION
AND FRANK J. SCIAME, JR.	:	DTA NOS. 820969, 820970,
	:	AND 820971
for Revision of Determinations or for Refund of	:	
Sales and Use Taxes under Articles 28 and 29 of	:	
the Tax Law for the Period December 1, 1999	:	
through August 31, 2002.	:	

Petitioners, AAFF, Inc., Anita Long and Frank J. Sciame, Jr., filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1999 through August 31, 2002.

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on February 20, 2008 at 10:30 A.M., with all briefs to be submitted by June 12, 2008, which date began the six-month period for the issuance of this determination. Petitioners appeared by S. Buxbaum & Co. Sales Tax Consulting, LLC (Michael Buxbaum, CPA). The Division of Taxation appeared by Daniel Smirlock, Esq. (Margaret T. Neri, Esq., of counsel).

ISSUE

Whether a portion of the banquet service charge which is listed on petitioners' invoices as a gratuity is subject to the imposition of sales tax.

FINDINGS OF FACT

1. Petitioner AAFF, Inc., (AAFF) operated a catering hall in Glen Cove, New York. It conducted business as The Metropolitan.

2. On or about October 29, 2002, the Division of Taxation (Division) commenced a field audit of The Metropolitan by mailing a letter stating that its sales and use tax returns had been scheduled for a field audit for the period December 1, 1999 through August 31, 2002.¹ The letter provided that “[a]ll books and records pertaining to the sales and use tax liability, for the audit period, must be available on the appointment date.” A schedule of books and records to be produced was attached to the letter.

3. Thereafter, the Division conducted an audit of The Metropolitan. To the extent relevant to this matter, the Division reviewed contracts executed by patrons of the Metropolitan for catered events. The first page of each contract listed, along with other charges, a gratuity of either 18 or 20 percent. The auditor observed that while The Metropolitan included gratuities in gross sales on its sales tax returns, they were not included in taxable sales. Similarly, The Metropolitan did not charge its customers sales tax on the gratuities.

4. The auditor determined that The Metropolitan recorded the amount of tips and other gratuities in the general ledger in a gratuity column. However, the records did not show that the tips or gratuities were turned over to the employees. Rather, the Division observed that some employees received a weekly salary and that other employees were paid by the hour. During the audit, the taxpayers and their representative explained to the Division that the employees of The

¹ AAFF, Inc.’s representative executed a series of consents extending the period of limitations for assessment of sales and use taxes under Articles 28 and 29 of the Tax Law.

Metropolitan were paid a higher hourly rate and that this was the same as their receiving the gratuities.

5. The Division concluded that sales tax was due on the gratuities because the corporation could not provide records showing that the gratuities that were charged and collected on the contracts were turned over to the employees. On the basis of a detailed review of the records, the Division determined that tax was due on the gratuities received by The Metropolitan in the amount of \$70,246.40.

6. The Division issued a Notice of Determination, dated January 20, 2004, which assessed sales and use taxes for the period December 1, 1999 through August 31, 2002 in the amount of \$93,888.82 plus interest in the amount of \$18,928.09 for a balance due of \$112,816.91. The Division also issued notices of determination, dated February 12, 2004, to petitioners Frank J. Sciame, Jr., and Anita Long as officers or responsible persons of AAFF. The notices issued to the individuals assessed tax for the period December 1, 2001 through August 31, 2002 in the amount of \$56,752.19 plus interest in the amount of \$8,925.14 for a balance due of \$65,677.33.²

7. The gratuities and tips collected by The Metropolitan were recorded in a gratuities account in the general ledger. The gratuities were always separately shown in the general ledger so that management could separately track the gratuities collected versus the amount of the payroll. Keeping the accounts separate enabled the management to be able to determine if it made a profit on a party.

² Following the audit, the Division concluded that sales and use tax was due on sales or purchases in three areas: (1) additional taxable sales of \$935,083.22 resulting in tax due of \$86,974.83; (2) acquisition of assets of \$24,299.50 resulting in tax due of \$2,065.46; and, (3) expense purchases of \$57,299.50 resulting in tax due of \$4,848.53. The assessment of the additional taxable sales arose from a finding that sales tax was due on unreported catering and on unreported gratuities. The only item at issue here concerns the unreported gratuities. The difference in the amount of the assessments of tax between the corporation and the individuals is attributable to the difference in the number of taxable periods assessed.

8. In a catering hall such as The Metropolitan, the staff worked together and the gratuities were paid by the customer as a percentage of the invoice. The tips were pooled. The amount of the tip that an individual received from the pool of gratuities depended upon the job status of that individual and the number of hours worked. The Metropolitan had a well-established written policy regarding the distribution of gratuities on the basis of the task which the individual performed. No amount remained after the gratuities were distributed to the staff. In contrast, those individuals who did not directly work with those attending a party, such as kitchen help, management and the accounting department, were paid a weekly salary.

9. The hourly wage which The Metropolitan paid to its employees who worked at the parties, such as servers and bartenders, had two components. One component was the minimum wage and the other was the gratuity. The combination of the two components resulted in an hourly compensation which was well in excess of the minimum wage. In 2001, the gratuities collected were \$333,158.19, while the salaries paid to employees were \$435,769.03. Thus, during 2001, the wages exceeded gratuities by \$102,610.84.

10. The accountant for The Metropolitan updated the catering hall's books and records monthly. When he did so, the gratuities that were collected during the month were evident from the corporation's books. It was also clear from the payroll records what was paid by The Metropolitan from its earnings. The payroll taxes were then deducted from this amount. The employees believed that they were paying payroll taxes on tips.

11. For federal income tax purposes, The Metropolitan reported its income plus the gratuities as gross income. Gratuities were then subtracted from gross income as part of the payroll expense. The net effect on the income of the business was zero.

12. The Worker's Compensation Board conducts an annual audit of The Metropolitan. Following the audits, the board concluded that the gratuities were paid to the employees.

13. When The Metropolitan is audited by its insurance company, the gratuities are subtracted from the premium base. They are not considered income and are not recoverable by the business.

14. Some of the events at The Metropolitan were conducted by tax exempt entities. However, the record does not show the amount of sales to the tax exempt entities.

15. Statements from employees of The Metropolitan show that they believe that their hourly salary is based upon a minimum wage and a percentage of pooled tips.

SUMMARY OF THE PARTIES' POSITIONS

16. At the hearing, petitioners agreed to the tax assessed on unreported catering, fixed assets and expenses. Further, they did not challenge the contention that Frank J. Sciamme, Jr., and Anita Long were responsible officers of AAFF. Consequently, the only issue is petitioners' challenge to the assessment of sales tax on gratuities.

17. In their brief, petitioners make a series of references to the testimony in the record to support the proposition that the Audit Division incorrectly assessed sales tax on employee tips.

18. The Division posits that petitioners have not demonstrated that the gratuities were turned over to the service employees. The Division stresses that in order to be exempt from tax, the gratuities must be separately stated, charged, collected and turned over to the employees in total. According to the Division, the gratuities account is not proof that the gratuities were turned over, in total, to the employees. The Division submits that the record is devoid of any evidence that the gratuities were paid to the service staff. It is submitted that the amount paid to the service staff is based on time spent at the party.

19. In a reply brief, petitioners maintain that while the Division can argue over nomenclature, the transactions show that the gratuities were collected and paid to the employees. Petitioners also rely upon Labor Law § 196-d and *Samiento v. World Yacht Inc.*(10 NY3d 70 [2008]) in support of its position.

CONCLUSIONS OF LAW

A. Tax Law § 1105(d)(i) imposes sales tax upon “receipts . . . from every sale of food and drink of any nature . . . including in the amount of such receipts any cover, minimum . . . or other charge made to patrons or customers” Tax Law § 1101(b)(3) defines receipts as “[t]he amount of the sale price of any property and the charge for any service taxable under this article . . . without any deduction for expenses” The sales tax regulations state that the service charge or gratuity billed to customers is taxable, as a receipt from the sale of food or drink, unless: “(1) the charge is separately stated on the bill or invoice given to the customer; (2) the charge is specifically designated as a gratuity; and (3) all such monies received are paid over in total to employees.” (20 NYCRR 527.8[1].)

B. Petitioners established that the amounts designated as a gratuity in the contracts were, in fact, paid over to the employees. Petitioners have offered a number of facts which support this conclusion. Submitted into evidence were notarized statements of staff employed by petitioner attesting to their understanding that their hourly salary was based upon a minimum wage and a percentage of pooled tips. The notarized statements were consistent with a long-established written policy of The Metropolitan explaining how the gratuities would be distributed on the basis of the particular task which the individual performed. The conclusion that the gratuities were distributed to the employees is further supported by the fact that the total compensation paid to the individuals who worked at the parties on an annual basis substantially exceeded the

amount of gratuities over the same period of time. It is further supported by the conclusion of the Workers' Compensation Board that the gratuities were paid to the employees and by the conclusion of AAFF's insurance company that the gratuities were not insurable.

C. The sales and use tax regulations dealing with the taxability of gratuity or service charges are meant to insure that if there is an additional charge, such charge is to be considered a gratuity and, as such, will be paid over to the service employees. The regulations require that for a gratuity or service charge to be exempt from the imposition of sales tax, the charge must be separately stated on the customer invoice, specifically designated as a gratuity and all such monies received must be paid over to the employees (20 NYCRR 527.8[1]). AAFF's treatment of the gratuities clearly meets the requirements of the regulation. The invoices clearly label the separate charges in issue as a gratuity. Finally, as previously noted, all the monies earmarked for as a gratuity go to the service employees. Therefore, pursuant to 20 NYCRR 527.8(1), the amounts labeled as a gratuity are not subject to the imposition of sales tax.

D. In view of the forgoing, it is unnecessary to consider Labor Law § 196-d and *Samiento v. World Yacht Inc.*

E. The petitions of AAFF, Inc., Anita Long and Frank J. Sciame, Jr., are granted to the extent of Conclusion of Law C and the notices of determination dated January 30, 2004 and February 12, 2004 are to be modified accordingly. As modified, the notices of determination are otherwise sustained.

DATED: Troy, New York
December 11, 2008

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE