

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

DIVISION OF TAXATION

ADMINISTRATIVE HEARING

FINAL DECISION AND ORDER

#2012-14

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
DEPARTMENT OF REVENUE
DIVISION OF TAXATION
ONE CAPITOL HILL
PROVIDENCE, RHODE ISLAND 02908**

IN THE MATTER OF:

**Case No. 12-T-0024
Sales and Use**

Taxpayer.

DECISION

I. INTRODUCTION

The above-entitled matter came before the undersigned as a result of a Notice of Hearing and Appointment of Hearing Officer dated August 22, 2012 issued to the above captioned taxpayer ("Taxpayer") by the Division of Taxation ("Division") in response to the Taxpayer's request for hearing filed with the Division on or about June 20, 2012. The hearing was held on November 16, 2012. The Division was represented by counsel. The Taxpayer's representative notified the undersigned prior to hearing that he would not appear at the hearing. As the Taxpayer had notice of the hearing, the hearing was held. The Division rested on the record.

II. JURISDICTION

The Division has jurisdiction over this matter pursuant to R.I. Gen. Laws § 44-18-1 *et seq.*, R.I. Gen. Laws § 44-19-1 *et seq.*, R.I. Gen. Laws § 44-1-1 *et seq.*, the *Division of Taxation Administrative Hearing Procedures Regulation AHP 97-01*, and the *Division of Legal Services Regulation 1 Rules of Procedure for Administrative Hearings*.

III. ISSUE

Whether pursuant to R.I. Gen. Laws § 44-18-1 *et seq.*, the Taxpayer owes the Division's tax assessments.^{1 2}

IV. MATERIAL FACTS AND TESTIMONY

Senior Revenue Agent, testified on behalf of the Division. He testified that he performed a re-audit on the Taxpayer which is a hotel with a restaurant and function services. He testified the audit period for the assets schedule was February, 2008 to March, 2011 and for the other sales and use assessments, the audit periods were February, 2009 to March, 2011. He testified that the Taxpayer was assessed four (4) different kinds of liabilities: 1) tax on forced gratuities; 2) tax on in-state *ex tax* purchases; 3) tax on out-of-state *ex tax* purchases; and 4) assets.

testified that there were additional taxable sales on service charges (forced gratuities). See Division's Exhibits Eight (8) and 14 (audit workpapers and schedule 1). He testified that he used a test period of July 2010 of guest receipts to ascertain the tax owed on the forced gratuities on large restaurant parties, banquets, *etc.* See Division's Exhibits 15 (schedule of receipts) and 16 (non-taxed service charges). He testified that based on his review, he came up with a measure and error factor that he applied for the audit period.

testified that there was use tax owed on supply and expense items purchased in-state *ex tax*. See Division's Exhibits Nine (9) (audit workpapers schedule

¹ The Division issued a Notice of Deficiency for meals and beverage tax but at hearing indicated that it was not going forward on said Notice so that assessment is not addressed in this decision.

² The Division indicated that this matter is being treated as a request for refund (as allowed by R.I. Gen. Laws § 44-19-25) since the Taxpayer pre-paid the assessment but then filed a request for hearing out-of-time on the assessment.

2B). He testified that he used 2010 as the test period and reviewed all invoices from Rhode Island vendors to determine the tax owed. He testified that there was also tax owed on assets such as equipment, repairs, bedding, and curtains and for those items, he reviewed them item by item and gave credit for sales tax paid to Rhode Island. See Division's Exhibit Ten (10) (audit workpapers schedule 3A). Finally, he testified that tax was owed on out-of-state *ex tax* supply and expense purchases and he used a test period for the out-of-state purchases and came up with a measure to apply and gave credit for out-of-state taxes paid. See Division's Exhibit 11 (audit workpapers schedule 3B). He testified that a Notice of Deficiency was issued to the Taxpayer for these four (4) areas of liability. See Division's Exhibit 22 (sales and use Notice of Deficiency issued October 31, 2011).

V. DISCUSSION

A. Legislative Intent

The Rhode Island Supreme Court has consistently held that it effectuates legislative intent by examining a statute in its entirety and giving words their plain and ordinary meaning. *In re Falstaff Brewing Corp.*, 637 A.2d 1047, 1049 (R.I. 1994). See *Parkway Towers Associates v. Godfrey*, 688 A.2d 1289 (R.I. 1997). If a statute is clear and unambiguous, "the Court must interpret the statute literally and must give the words of the statute their plain and ordinary meanings." *Oliveira v. Lombardi*, 794 A.2d 453, 457 (R.I. 2002) (citation omitted). The Supreme Court has also established that it will not interpret legislative enactments in a manner that renders them nugatory or that would produce an unreasonable result. See *Defenders of Animals v. Dept. of Environmental Management*, 553 A.2d 541 (R.I. 1989) (internal citation omitted). In cases where a

statute may contain ambiguous language, the Supreme Court has consistently held that the legislative intent must be considered. *Providence Journal Co. v. Rodgers*, 711 A.2d 1131 (R.I. 1998). The statutory provisions must be examined in their entirety and the meaning most consistent with the policies and purposes of the legislature must be effectuated. *Id.*

B. Relevant Statutes and Regulation

Pursuant to R.I. Gen. Laws § 44-18-18, the State of Rhode Island imposes a sales tax of 7% on gross receipts of a retailer. Pursuant to R.I. Gen. Laws § 44-18-19, the retailer is responsible for the collection of sales tax.

R.I. Gen. Laws § 44-18-12 defines “sales price” as follows:

(a) “Sales price” applies to the measure subject to sales tax and means the total amount of consideration, including cash, credit, property, and services, for which personal property or services are sold, leased, or rented, valued in money, whether received in money or otherwise, without any deduction for the following.

Rule 9 of *Food and Food Ingredients, Prepared Food/Meals, Candy, Soft Drinks, Dietary Supplements, and Alcoholic Beverages* Regulation SU 09-59 (“SU 09-59”) states in part as follows:

A. Gratuities and other charges: When a retailer bills a customer for the rental of a public room or for gratuities, service charges, cover charges, or entertainment charges (including charges for bands or orchestras) in connection with the serving of meals or soft/alcoholic drinks, the amount billed or received by the retailer will be considered as part of the gross receipts from the sale of the meal or soft/alcoholic drinks and must be included in the measure of tax. Amounts designated as service charges, added to the price of meals, are a part of the selling price of the meals and, accordingly must be included in the retailer’s gross sales subject to tax.

SU 09-59 was effective January 1, 2010 and replaced *Division Regulation* SU 04-59 (“SU 04-59”) that also had a very similar provision on forced gratuities. SU 04-59 provided as follows:

D. Gratuities and other charges: When a retailer bills a customer for the rental of a public room or for gratuities, service charges, cover charges, or entertainment charges (including charges for bands or orchestras) in connection with the serving of meals or drinks; or when an employer requires employees to turn over to the employer the amount of tips or a portion thereof, received in connection with the serving of meals or drinks, the amounts so billed or received by the retailers will be considered as part of gross receipts from the sales of the meals or drinks and must be included in the measure of tax. Amounts designated as service charges, added to the price of meals, are a part of the selling price of the meals and, accordingly, must be included in the retailer's gross sales subject to tax even though such service charges are made in lieu of tips and are paid over by the retailer to the employees.

C. Arguments

The Division argued that the statute and the regulations are clear and unambiguous that forced service charges are taxed and it has been that way without change by the legislature for 50 years. From the Taxpayer's representative's email prior to hearing stating that he would not be appearing, the Taxpayer's position apparently is that R.I. Gen. Laws § 44-18-7.1 requires tax to be imposed on the transfer of tangible personal property and that 09-59 is invalid to the extent it treats voluntary tips differently from mandated tips.

D. Whether the Taxpayer Owes the Assessments or is Eligible for a Refund

i. Forced Gratuities

The audit period for forced gratuities spans the effective dates of regulations SU 04-59 and 09-59 but there is no difference in their substantive requirements that forced gratuities are taxed. They both require that the amount of the designated service charge that is added to the price of the meal is to be considered part of the selling price of the meal and be subject to tax.

In *The Coachman, Inc. v. Norberg*, A.A. No. 83-121 (Rhode Island 6th Div'n Court 10/04/84, *cert. den.*, no. 84-508 MP (11/21/84)), the Court found, "[G]ratuities must be collected as a charge to be taxable." See *Coachman*, at 4. In other words, when the gratuity is collected as part of the charge – e.g. a forced charge – the gratuity is taxable. See also *Tax Decision* 2008-10 (6/12/10); *Final Decision* (2/11/83); *Final Decision* (12/8/81); *Final Decision* (9/22/77).

The Taxpayer's email made reference to R.I. Gen. Laws § 44-18-7.1 arguing that tax be imposed on the transfer of tangible personal property. That statute relates to the Streamlined Sales and Use Tax Agreement. The Taxpayer is being taxed on the cost of a meal which includes forced gratuities as defined under R.I. Gen. Laws § 44-18-12 and the pertinent regulations. R.I. Gen. Laws § 44-18-7.1 is irrelevant. The Taxpayer also argues that voluntary and mandated tips are being treated differently so that 04-59 is invalid. Voluntary tips are treated the same. Mandated tips are treated the same. There is no requirement that voluntary and mandated tips be treated the same as they are different. Mandated tips are taxed because they are part of the sales price since they are included in the price. Voluntary tips are not included in the sales price. The Taxpayer's arguments are without merit.

ii. Tax on Assets and In-State and Out-of-State Purchases

The Taxpayer made no arguments that it should not be taxed on its assets or in-state or out-of-state *ex tax* purchases. Pursuant to R.I. Gen. Laws § 44-19-11, the Division may compute and make a determination of amounts owed based on returns filed and/or on the basis of any information in its possession which is what the Division did in this matter.

E. Interest

The Division properly imposed interest on the assessment pursuant to R.I. Gen. Laws § 44-19-11.³ See Division's Exhibit 20 (sales and use interest calculation).

F. Conclusion

The Division properly assessed the Taxpayer on the four (4) areas of liability: 1) forced gratuities; 2) assets; 3) in-state *ex tax* purchases; and 4) out-of-state *ex tax* purchases as set forth in the Notice of Deficiency admitted as Division's Exhibit 22.

VI. FINDINGS OF FACT

1. On or about August 22, 2012, the Division issued a Notice in response to the Taxpayer's request for hearing filed with the Division on or about June 20, 2012.
2. A hearing in this matter was held on November 16, 2012.
3. Despite having notice of hearing, the Taxpayer chose not to appear at hearing. As the Taxpayer was adequately notified of hearing, the undersigned held the hearing.
4. The Division rested after hearing.
5. A field audit was conducted by the Division on the Taxpayer for the period of February, 2008 to March, 2011 for assets and for February, 2009 to March, 2011 for the other assessments.

³ R.I. Gen. Laws § 44-19-11 states as follows:

Deficiency determinations – Interest. – If the tax administrator is not satisfied with the return or returns or the amount of tax paid to the tax administrator by any person, the administrator may compute and determine the amount required to be paid upon the basis of the facts contained in the return or returns or upon the basis of any information in his or her possession or that may come into his or her possession. One or more deficiency determinations may be made of the amount due for one or for more than one month. The amount of the determination, exclusive of penalties, bears interest at the annual rate provided by § 44-1-7 from the fifteenth day (15th) after the close of the month for which the amount, or any portion of it, should have been paid until the date of payment.

6. The Taxpayer signed a statute of limitations' waiver and agreed to use a test period for the audit. See Division's Exhibits Five (5) and Six (6).

7. The facts contained in Sections IV and V are reincorporated by reference herein.

VII. CONCLUSIONS OF LAW

Based on the testimony and facts presented:

1. The Division has jurisdiction over this matter pursuant to R.I. Gen. Laws § 44-1-1 *et seq.*, R.I. Gen. Laws § 44-18-1 *et seq.*, and R.I. Gen. Laws § 44-19-1 *et seq.*

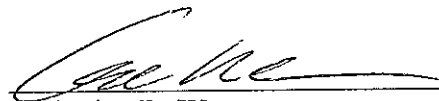
2. Pursuant to R.I. Gen. Laws § 44-18-12, SU 04-59, SU 09-59, the Taxpayer owes sales tax on the forced gratuities and other assessments as set forth in the Notice of Deficiency admitted as the Division's Exhibit 22. Pursuant to R.I. Gen. Laws § 44-19-11, the Taxpayer owes the assessed interest in the Notice of Deficiency.

VIII. RECOMMENDATION

Based on the above analysis, the Hearing Officer recommends as follows:

The Taxpayer did not make a showing that it did not owe taxes on the forced gratuities or the other assessments. The Division properly assessed the Taxpayer these four (4) liabilities. Pursuant to R.I. Gen. Laws § 44-18-1 *et seq.*, SU 04-59, SU 09-59, the Taxpayer owes the sales taxes on the gratuities and other assessments as set forth in said Notice of Deficiency and pursuant to R.I. Gen. Laws § 44-19-11, the Taxpayer owes the assessed interest.

Date: 12/20/12


Catherine R. Warren
Hearing Officer

ORDER

I have read the Hearing Officer's Decision and Recommendation in this matter, and I hereby take the following action with regard to the Decision and Recommendation:

 / ADOPT
 REJECT
 MODIFY

Dated: December 21, 2012

David Sullivan
David Sullivan
Tax Administrator

NOTICE OF APPELLATE RIGHTS

THIS DECISION CONSTITUTES A FINAL ORDER OF THE DIVISION. THIS ORDER MAY BE APPEALED TO THE SIXTH DIVISION DISTRICT COURT PURSUANT TO THE FOLLOWING WHICH STATES AS FOLLOWS:

R.I. Gen. Laws § 44-19-18 Appeals

Appeals from administrative orders or decisions made pursuant to any provisions of this chapter are to the sixth (6th) division district court pursuant to chapter 8 of title 8. The taxpayer's right to appeal under this chapter is expressly made conditional upon prepayment of all taxes, interest, and penalties, unless the taxpayer moves for and is granted an exemption from the prepayment requirement pursuant to § 8-8-26.

CERTIFICATION

I hereby certify that on the 21st day of December, 2012 a copy of the above Decision and Notice of Appellate Rights were sent by first class mail, postage prepaid to the Taxpayer's representative at the address on file with the Division of Taxation and by hand delivery to Bernard Lemos, Esquire, Department of Administration, One Capitol Hill, Providence, RI 02908.

Paul Belasco