STATE OF CALIFORNIA

550.0827.725

BOARD OF EQUALIZATION

APPEALS UNIT

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	HEARING DECISION AND RECOMMENDATION
[M]	)	No. S- -- XX-XXXXXX-010
Petitioner	)	

The above-referenced matter came on regularly for hearing before Hearing Officer Tony Nevarez on June 7, 1990, in Van Nuys, California.

Appearing for Petitioner: Mr. [C]
Attorney at Law

Appearing for the
Sales and Use Tax Department: Mr. Ira. C. Anderson
Supervising Tax Auditor

Mr. Gerald P. Dunlay
Senior Tax Auditor

Protested Item

The protested tax liability for the period January 1, 1984 through December 31, 1986, is measured by:

	Item	State, Local and County
A.	Exclusions from gross receipts disallowed	$261,348
B.	Accounting errors in compiling returns	$ 2,147

Petitioner's Contentions

(1) It is not a retailer of meals or hot prepared food products, but rather sells meals for resale.

(2) Alternatively, the holding in Szabo Food Service of California, Inc. v. State Board of Equalization applies here and the fees and subsidies at issue are excluded from gross receipts.

Summary

Petitioner is a California corporation currently doing business as [M] Inc., which previously did business as [C]. Petitioner started in the catering business in April of 1981 and by the close of 1986, was reporting gross receipts from retail sales in excess of $5 million per year. During the audit period, January 1, 1984 through December 31, 1986, petitioner prepared and served meals in cafeterias and executive dining rooms pursuant to written agreements with various clients in the Los Angeles area. As part of its business, petitioner also caters special functions for its ongoing clients, operates a restaurant, and operates various vending machines.

Petitioner's operations at over twenty different clients' business locations were studied during this audit by the Department of Business Taxes (DBT) which found petitioner's operations to be substantially similar at all locations. Three of these locations however, raised issues which must be decided in this petition. The [G], ---, & --- (G), [L], --- & --- (L), and [C] (C) locations were found to be substantially different in their method of operations as to cause DBT to disallow certain of petitioner's claimed exclusions from gross receipts. This is petitioner's first audit.

Petitioner's contacts with various employers specify that petitioner will provide food services and operate executive dining facilities and cafeterias at the employers' business locations. A close reading of the three contracts relevant to this audit disclosed that the employers: own, furnish and maintain the cafeteria or dining room premises, granting to petitioner the exclusive use of those premises; furnish the utilities necessary to the operation of the cafeterias; furnish and maintain the equipment in the cafeterias; bear the cost of replacement of all china, glassware, flatware, trays, utensils, and other small ware; and determine the hours at which the cafeterias and dining rooms are to be operated.

Pursuant to the agreements, petitioner assumes the following duties and responsibilities:

1. Operate the food, dining, catering, beverage and vending services;

2. Prepare and serve wholesome food for the employees and supply the necessary merchandise, supplies and kitchenware;

3. Prepare and serve meals for special occasion luncheons, dinners, cocktail parties, buffets, etc., to such groups as the employer may from time to time arrange for, authorize, or invite to the premises;

4. Develop an in-house catering menu covering breakfast, lunch and dinner services as well as special event menus;

5. Employ, train, and maintain a staff of employees. Hiring, firing, supervision, training, and assignment of duties are responsibilities of petitioner as it is agreed that all personnel are employees of petitioner;

6. Provide complete administrative and local supervision of all operations contemplated by the agreement; and

7. Provide liability insurance and workers compensation insurance, and indemnify, defend, and hold harmless the employers.

Operations at the 21 to 23 locations surveyed provide for either a "management" or a "service" fee calculated at a specified percentage of gross sales or a fixed sum of money, whichever is greater, and provide for a subsidy, if necessary, to guarantee petitioner an adequate return on the operation. The subsidy is calculated as the amount by which the "cost of business" (as defined below) exceeds the "gross sales" of petitioner. Alternatively, should the gross sales exceed the cost of business, the excess must be rebated by petitioner to the employer. "Cost of Business" is defined to include:

a. Wages, salaries, and fringe benefits of direct labor and management employed by petitioner at the employers' locations;

b. Cost of food, food products, confections and other merchandise served;

c. Cost of all direct materials and supplies used ,in the premises;

d. Cost of insurance and other direct operating expenses attributable to the contract;

e. Cost and expense of taxes and licenses attributable to the contract; and

f. Cost of routine indirect overhead expenses, not to exceed a stated percentage as specified in the contract or a fixed amount as specified.

"Gross Sales" in the [G] and [L] contracts is defined as: total cash and charge receipts from sales made by petitioner on or off the premises. "Gross Sales" in the [C] contract is defined solely as cash receipts from sales on the premises and total billings for special occasion meals. All three contracts exclude from the definition of gross sales, applicable sales taxes, employees' tips and gratuities. No location at issue had excess sales necessitating a rebate to the employer.

All locations were found to have calculated sales tax reimbursement on meals prepared either as tax added to the sales price or as tax included in the sales price, and the tax on those meals has been properly remitted to the Board.

With the exception of the three locations, all other locations provide that employees, and others eating at that location, purchase and pay for the meal at the time of consumption. At all locations with the exception of these three, DBT included within petitioner's measure of tax only the actual receipts from the sale of meals, allowing petitioner to exclude from gross receipts the management or service fee (hereinafter "fees") and the subsidies. This exclusion for subsidies and fees was allowed pursuant to the holding in Szabo Food Service, Inc. v. State Board of Equalization ((1975) 46 Cal.App.3d 268) in which the court held that when the caterer charged and collected consideration for each meal directly from the person purchasing the meal, such fees and subsidies from the employer to the caterer did not represent consideration paid for the meals sold and that only those amounts paid directly for the meal were includible in gross receipts.

In contrast to the other locations however, the three locations at issue allow employees, and others, to eat without direct payment at the time of consumption of the meal. These three locations were found to operate by a procedure whereby petitioner would receive payment directly from the employer (not the employees) at a later date. Such payment included the fees, the subsidy, if applicable for that period, and a per meal charge for the number of meals eaten or a flat fee per employee.

Rates of payment for meals at the three locations were agreed upon by the employers and petitioner. It was established during the audit that the [C] location paid petitioner a flat $30 per month per employee and that the [G] location pays a flat $4 per meal per employee and that both of these locations collect no consideration from the employee. No information was submitted for the [L] location and the contract is silent in this regard.

Based upon this set of facts, DBT concluded that the Szabo exception for subsidies and fees did not apply since the consideration received by petitioner from the employers appears to be a single payment for all meals provided. The subsidies and fees were thus included as part of petitioner's gross receipts to arrive at the taxable measure.

By Notice of Determination dated October 26, 1987, petitioner was assessed sales tax on a measure of $263,495 which includes $261,348 in subsidies and fees received, and $2,147 attributed to accounting errors in tax returns filed for the first and second quarters of 1984.

A petition for redetermination was timely filed by petitioner. In its petition and supplemental brief received at the hearing, petitioner, through its representative, first contends that the meals prepared and served were meals sold to the employers in question for resale and that it is not the ultimate retailer of these meals and owes no tax on these sales. Taking this argument one step further, petitioner asserts that the individual employers are the retailers of the meals and that tax is owed, or not, by those employers, depending on whether an exemption in subsection (i) or (k) of Sales and Use Tax Regulation 1603 applies. Alternatively, petitioner contends that even if it is found that it is a retailer of meals, the subsidies and fees at issue are to be excluded from gross receipts pursuant to Szabo.

During the hearing, petitioner conceded that tax is due on the $2,147 attributed to accounting errors and contests only the inclusion of the subsidies and fees in the measure of tax.

Analysis and Conclusion

Petitioner first alleges that as to the three contracts and locations at issue, it is not a retailer of the meals. Rather, petitioner argues, the meals were sold for resale to the employers involved and that the employers were the retailers of the meals and that they are liable for the tax due, if any.

Section 6051 of the Revenue and Taxation (Rev. and Tax.) Code imposes a sales tax on the privilege of selling tangible personal property at retail. The measure of tax is the retailer's "gross receipts" which includes: "All receipts, cash, credits, and property of any kind…" (Rev. and Tax. Code, section 6012(b)(2)). Unless specifically exempted, receipts from the sale of meals or hot prepared food products are includible in gross receipts. (Sales and Use Tax Regulation (Regulation) 1603.) Additionally, section 6091 of the Revenue and Taxation Code states the presumption that all gross receipts are subject to tax until the contrary is established and imposes upon the taxpayer the burden of proving that a sale of tangible personal property is not a sale at retail. "Retailer" is defined to include "every seller who makes any retail sale or sales of tangible personal property." (Rev. and Tax. Code, Section 6015.)

The Revenue and Taxation Code imposes the tax upon every retailer engaged in business in the state. Liability for the tax is not extinguished until the tax is paid or satisfactory proof of exemption is shown. (See generally Rev. and Tax. sections 6051 et. seq.; Western L. Co. v. State Bd. of Equalization (1938) 11 C. 2d 156, 164.)

A sale for resale is not subject to the sales tax. Rather, liability for the tax would attach and become the obligation of the party making the ultimate retail sale, in this case the employers. In this context, a resale certificate, properly completed, accepted in a timely manner, and taken in good faith would relieve the seller from liability for the sales tax. Absent a resale certificate, subdivision (c) of Regulation 1668 allows a seller the alternative of producing other satisfactory evidence that the specific property at issue was resold. As stated above however, petitioner bears the burden of proving by a preponderance of credible evidence that the sales were in fact sales for resale. Without such proof, liability for the tax remains on the petitioner.

Since petitioner has not produced any resale certificates, we may look for alternate evidence pursuant to Regulation 1668 (c) to buttress the contention that the meals were sold for resale. Unfortunately, petitioner has not produced any solid, alternate evidence. During the intervening years since this audit was completed, petitioner could have secured statements from its customers to the effect that the meals were purchased and resold by the employers. It did not. Petitioner could have produced employer's personnel to support its contentions. It did not. We have only petitioner's self serving declarations that the meals were sold at resale. Furthermore, this assertion comes at least four years after the fact. Petitioner's declaration alone is not a substitute for credible and convincing evidence and absent any other proof, such evidence may

be disregarded. (Leonard v. Watsonville Community Hosp. (1956) 47 C. 2d 509, 518; People v. Schwartz (1947) 31 C. 2d 59, 66)

It is readily apparent that these were not sales for resale since the employers' personnel never participated in the preparation or serving of the meal, only petitioner's personnel did so. The employers never took title or possession of the meals involved. They did not engage in a buyer-seller relation with their employees and did not collect payment from their employees. Much to the contrary, the contracts state that petitioner will operate the dining rooms, purchase the food, prepare the meal, and serve the meal. The meal is served to individual employees by petitioner's personnel. The contracts further provide for preparation and serving of meals by petitioner at various times throughout the day, to various individuals and at various special functions. It was not contemplated that the employers would serve meals. Petitioner has not surmounted its burden of proving sales for resale.

As an adjunct to its assertion that it is not a retailer of meals, petitioner advances the argument that the employers purchased the meals for resale and that the subsequent transfer of the meal from the employer to the employee is exempt from tax pursuant to subdivision (i) or (k) of Regulation 1603.

Although Regulation 1603 (k) (3) seems at first blush to have possible application to this case since it speaks to sales of food products not being subject to tax, the subdivision does not apply here. First, [G] and [L] are law firms and [C] is a savings and loan institution. None of the three could be considered to be a restaurant, hotel, club, or association in the business of selling meals as intended by the subdivision. Secondly, this exemption applies to sales to an employer of raw food products which are generally sold tax free and does not apply to sales of fully prepared, ready to eat meals, which are generally taxable when sold. The subdivision expressly applies to employers in the business of selling meals, i.e., restaurants, hotels, etc, who sell meals during the course of the day to their employees. If, perhaps, the employers choose not to charge their employees for meals eaten, the food utilized in those meals may be purchased tax free, just as food products may be purchased tax free at any grocery store. Further support for finding this subdivision to be inapplicable comes from the fact that the section contains references to both "meals" and "food products". Food products are nontaxable when purchased; hot prepared "meals" are taxable when purchased. The terms are not synonymous and are not used interchangeably.

Similarly, Regulation 1603 provides a limited exemption from tax to a social club or fraternal organization such as a service club, a lodge, community club, country club, or athletic club, not to a law firm or savings and loan institution. Furthermore, subdivision (i) must be read in conjunction with subdivision (h) which contemplates sales of meals by caterers to such clubs, organizations, or other persons, "if such social clubs, fraternal organizations or other persons are the retailers of the meals subject to tax under (i)...and (emphasis added) [they] give valid resale certificates therefor." Thus, even if this exemption were to apply to petitioner's case, which it clearly does not, petitioner would have had to have obtained a resale certificate from the employers at point of sale. It did not. Moreover, an inquiry by this hearing officer reveals that

none of the employers possess a California sellers permit, thus it is doubtful that the employers at issue can give a valid resale certificate for resale purchases as required by the exemption.

It seems that petitioner misapprehends the application of subdivisions (i) and (k) to this particular case. It matters not that the [G], [L] and [C] employers might fall within the exemptions provided by Regulation 1603 (i) or (k). At issue here is the sale from petitioner to either the employers or their respective employees. The sale, at the point it is made by petitioner, is a taxable sale, absent proof to the contrary. Petitioner must demonstrate that the sales it made were made for resale purposes. In the alternative, petitioner must provide evidence showing that in fact the employers resold the meals. Bare allegations of sales for resale and citations to specific exemptions without more does nothing to rebut the presumption that sales made by petitioner are taxable retail sales. Petitioner is not entitled to an exemption from tax merely because it says it is, it must offer some credible evidence of entitlement. (Paine v. State Bd. of Equalization (1982) 137 Cal. App. 3d 438, 443) We are thus left with the only logical conclusion that petitioner is the retailer of the meals and thus liable for the tax.

In the alternative, petitioner contends that if it is found to be a retailer of meals, that the holding of Szabo dictates that the fees and subsidies at issue here be excluded from gross receipts and that this case is factually indistinguishable from Szabo.

Petitioner's reliance upon Szabo as being identical is misplaced. Szabo operated cafeterias on various employers' premises. Much like petitioner does here, Szabo hired and trained cafeteria personnel, purchased, prepared, and served the food, purchased maintenance supplies and services and provided bookkeeping and administrative services. The employers provided the physical plant and equipment. Prices for meals were established by Szabo and the employers.

In contrast however, Szabo's cafeterias operated on a direct payment system wherein those eating would pay for the meal directly to cafeteria personnel. Because the patrons paid for the meal directly, the court held that receipts from the sale of meals were includible in gross receipts, but fees and subsidies were not. The court reasoned that "The employees who purchased the cafeteria meals provided the only consideration for the sale of the meals." (Szabo, supra, at 272) The court agreed with Szabo that the subsidies and fees received were not consideration for the sale of the meals since amounts received as subsidies and fees did not relate directly to the sale of any particular item or any particular price component of the items.

A close reading of Szabo discloses that patrons paid directly for every purchase pursuant to a schedule of prices. The consideration paid was thus clearly traceable to sales of meals making for ease in calculating the consideration received. In a Szabo context, fees and subsidies are excluded from gross receipts, precisely because the amounts received as payment for meals is easily verified and represents the only consideration for the sale. Thus DBT could not consider the other amounts received, i.e. fees and subsidies, as consideration includible in gross receipts. Not so here.

At the locations in issue, petitioner does not collect cash payment from patrons. Patrons eat without paying (signing a guest check in some instances) and petitioner is paid at a later date pursuant to an agreed upon rate or formula. Petitioner's brief concedes, at page 8, that "sometimes no charges are made by employers [to the employees] for some meals, and [M] in some cases did not collect cash directly from the employees".

Nonetheless, in an effort to bring itself within the rule enunciated in Szabo, petitioner alleges that it did receive a per meal payment from the patrons, albeit indirectly. The employers at issue, petitioner continues, either withheld an amount from the employees' paychecks or the employees somehow paid their employers for the meal. But, petitioner offers no proof in support of its contentions. Given that petitioner bears the burden of proof, this lack of evidence is fatal. Bare allegations, without more, do not convince me that petitioner charges and collects consideration from patrons for meals sold.

Rather, it appears from the record that petitioner receives a single payment which includes consideration for the food and services as well as the fee and the subsidy. Here is the difference between this case and Szabo. In Szabo, the consideration received from the employees as payment for meals is readily calculable and easily verified as representing the only consideration which is to be included in the gross receipts. In this case the employers, not the employees, pay the consideration which includes the payment for the meals, the fees, and the subsidies.

Since petitioner has not definitively shown that amounts received as consideration for meals is received from the employees, DBT cannot clearly discern those amounts directly traceable to food sales and those amounts which are Szabo type subsidy. Thus, all amounts received by petitioner from the employers appear to be and must be deemed to be consideration received for meals provided and thus includable in gross receipts. To hold otherwise would be to allow petitioner, and others similarly situated, to bring itself within the holding of Szabo and to exclude from gross receipts any amount it wishes merely by alleging that consideration is paid for the meals. Absent direct proof that the employees paid for the meals, DBT's determination was upheld.

Recommendation

Redetermine without adjustment.

7-17-90

TONY NEVAREZ, Hearing Officer Date