Cite as Det. No. 00-092, 20 WTD 47 (2001)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment and Refund of	)	D E T E R M I N A T I O N
	)	No. 00-092
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

[1] RULE 119; RCW 82.08.050: RETAIL SALES TAX – EMPLOYEE MEALS. Meals furnished as fringe benefits are part of compensation to employees for services rendered and are taxable as retail sales and subject to sales tax.

[2] RULE 119; RCW 82.08.050: RETAIL SALES TAX – EMPLOYEEE MEALS – FOOD COST. Where no specific charge is made, the measure of the tax will be the average cost per meal served to each employee, based upon the actual cost of the food, and does not include labor.

[3] RULE 107; RCW 82.08.020; ETA 101: RETAIL SALES TAX -- OVER-COLLECTED. Over-collected retail sales tax may not be retained by the seller for its own use, but is held in trust and must be remitted to the state if not returned to the purchasers. *Kitsap-Mason Dairymen's Association v. Tax Commission*, 77 Wn.2d 812, 467 P.2d 312 (1970).

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

An operator of several fast-food franchises protests deferred sales tax assessed on meals provided to managers, as well as an assessment for over-collected retail sales tax.[1]

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

FACTS:

M. Pree, A.L.J. -- . . . and . . . (taxpayers) operate franchised fast food restaurants in Washington. The taxpayers provided meals at no charge to their managers, but did not collect or remit sales tax on the meals. In addition, the taxpayers over-charged its customers retail sales tax, which it did not refund or remit to the state.

The Department of Revenue (Department) reviewed the taxpayers' books and records for the period from January 1, 1995 through December 31, 1999. The Department's Audit Division issued the assessments referenced above. The taxpayers paid the assessments, but request a refund of tax assessed on employee meals and on over-collected sales tax.

The taxpayers contend they were being penalized for rules of which they were not aware and had never been enforced. The taxpayers did not charge managers for meals. Because the meals were fringe benefits, the taxpayers assert they were not taxable as retail sales.

Even if the provision of meals was taxable as a retail sale, the taxpayers contest the tax measure used by the Audit Division as excessive. According to the taxpayers, many of their managers' meals were worth less than $1.50 (retail) and their food costs were only 32% of the retail charge or less.

The assessment estimated the retail value of managers' meals at $2.00 of which the taxpayers' costs were 54%. The Audit Division indicates it obtained the 54% figure from the taxpayer's books, which included labor, but not overhead.

The taxpayers contend that not every manager ate meals. However, the Audit Division notes, some managers may eat more than one meal and other managers only have drinks. The $2.00 estimate may be low. The Audit Division offered to average the taxpayers' actual meal charges. The taxpayers acknowledge that most managers are provided meals, which the taxpayers consider a nontaxable fringe benefit.

Finally, the taxpayers state they were unaware of any rule regarding over-collection of sales tax. The taxpayers state they are not being enforced throughout the state. The taxpayers state it is impossible to further break down their sales. The taxpayers conclude, "We are most likely over paying our tax rather than underpaying." During the hearing the taxpayers indicated the discrepancy may be due to rounding, and agreed to cooperate with the Audit Division in resolving any computational issues.

The Auditor's Detail of Differences and Instruction to Taxpayers explains in schedule 2 the taxable differences were the result of overcharging sales tax or a miscalculation of over short sales. The Audit Division needs additional records from the taxpayer to identify the exact cause of the discrepancy.

ISSUES:

1. Are meals provided to management employees at no charge, retail sales subject to retail sales tax?

2. If the meals are taxable, how are they valued and what do they cost?

3. Did the taxpayer over-charge sales tax, and what is the remedy?

DISCUSSION:

The Department explains how meals furnished to employees are taxed in WAC 458-20-119 (Rule 119), which provides in subsection (6):[2]

> (6) **Meals furnished to employees.** Sales of meals to employees are sales at retail and subject to the retailing B&O and retail sales taxes. This is true whether individual meals are sold, whether a flat charge is made, or whether meals are furnished as a part of the compensation for services rendered.
>
> (a) Where a specific and reasonable charge is made to the employee, the measure of the tax is the selling price.
>
> (b) Where no specific charge is made, the measure of the tax will be the average cost per meal served to each employee, based upon the actual cost of the food.
>
> (c) It is often impracticable to collect the retail sales tax from employees on such sales. The employer may, in lieu of collecting such tax from employees, pay the tax directly to the department of revenue.
>
> (d) Where meals furnished to employees are not recorded as sales, the tax due shall be presumed to apply according to the following formula for determining meal count:
>
> (i) Those employees working shifts up to five hours, one meal; and
>
> (ii) Employees working shifts of more than five hours, two meals.

Because the taxpayers furnished meals to its management employees, but did not collect retail sales tax from them, it must pay the tax to the Department. As evidenced by the following published determinations, the Department did enforce tax on employee meals prior to the audit period:

- Det. No. 87-75A, 5 WTD 41 (1988) holding retail sales tax is due upon the selling price of employee meals supplied by an employer.
- Det. No. 87-75, 2 WTD 385 (1987) holding retail sales tax is due, based on the cost of food supplied by an employer to its employees, where no specific charge is made for the food.

[2] During the Audit period this subsection was numbered (7). Rule 119 was amended effective June 19, 1999. Other than renumbering this subsection, the amendments are not relevant to the issue of the taxability of employee meals. We also note, industry representatives appeared at the hearing leading to the last substantive amendment of this subsection in 1993.

- Det. No. 87-101, 2 WTD 429 (1987) holding an employer who provides meals at no charge to its employees, and who fails to collect retail sales tax, is liable for the tax, based on the cost of the food.
- Det. No. 87-158, 3 WTD 137 (1987) holding meals provided by restaurant operated as a partnership to owner/manager are subject to use tax where cost of providing meals was considered a business expense by the taxpayer. Measure of the tax was the cost of the food.

Also, the Department recognized such meals might constitute a fringe benefit or compensation to the employee. *See* Det. No. 87-75A, 5 WTD 041 (1988).[3]

Subsection (6) of Rule 119 clearly provides meals furnished as part of compensation for services rendered are retail sales. The meals the taxpayer provided to its managers are retail sales, subject to tax.

[2] Rule 119 and the determinations cited above measure the tax for the managers' meals by the cost of the food. The Audit Division included labor costs to prepare the food as a cost of the food. We believe the difference between the taxpayers' 32% figure, and the Audit Division's 54% figure may be whether labor costs should included in the measure.

Subsection (6)(b) specifically provides, "Where no specific charge is made, the measure of the tax will be the average cost per meal served to each employee, based upon the actual cost of the food." The distinction between average cost per *meal*, which could include labor, and actual cost of the *food*, suggests that by using the more restrictive term, food, the drafters intended to limit the cost components a meal, which could include labor and overhead, to expenditures for food only. To interpret "food" the same as "meal" would make the use of the term "food" merely surplusage. Only actual food costs should be included in the tax measure. Therefore, the taxpayers' labor costs to prepare the meal should not be included in the measure of tax, only the taxpayers' purchases of food.

[3] Retail sales tax is paid and collected on retail sales measured by the "selling price." *See* RCW 82.08.020 and WAC 458-20-107 (Rule 107). RCW 82.08.050 provides in part:

> The [retail sales] tax required by this chapter, to be collected by the seller, shall be deemed to be held in trust by the seller until paid to the department. . . .

The law requires sellers to collect retail sales tax, which is held in trust, before the seller remits the tax to the Department. The sellers are merely conduits. Retailers who collect sales tax are trustees and may not use these monies for their own purposes.

Based on the taxpayers' monthly reports and cash register readings, the Audit Division found the taxpayer did not remit the total sales tax collected. Cash register readings raise a presumption that sales were made in the amount recorded. ETA 101.04.107. The best evidence of the sales is

[3] This determination also noted the participation of the Washington Restaurant Association in the rule process. *See* Id. at 48.

the cash register reading. Det. No. 95-138, 16 WTD 33 (1995). Lacking other records, the Audit Division presumed the cash register sales measured the tax collected. The taxpayers failed to remit all of the sales tax collected to the state.

If sales tax was erroneously collected from the taxpayers' customers, then the over-reported sales tax comes from customers' funds. These are trust funds collected from customers for the benefit of the state. The money does not belong to the taxpayers and cannot be returned to the taxpayers until the taxpayers have refunded the over-collected sales tax to their customers.

The Washington Supreme Court addressed a situation similar to the taxpayers' in *Kitsap-Mason Dairymen's Association v. Tax Commission*, 77 Wn.2d 812, 467 P.2d 312 (1970). In *Kitsap* the taxpayer over-collected retail sales tax. It failed to remit the tax to the state. This failure was not discovered or addressed in prior audits. The Court found the seller could not retain for its own use sales tax funds collected. The taxpayer charged excess sales tax in the name of the state, on a constant and regular basis, which it was required to remit to the state under applicable law. *Id.*

Further, in *Kitsap*, the state Supreme Court also addressed the Audit Division's failure to assess tax in prior audits. The Court held that the failure to previously assess tax missed by oversight did not bar assessing it in a subsequent audit. *Kitsap*, at 818. While the Audit Division may not have assessed tax on the manager meals and overages in prior audits, but in the last audit discovered the oversight, this does not relieve the taxpayers of their liability for the correct tax during the audit period now under consideration. The taxpayers may not rely on the failure of the Audit Division to assess tax on these oversights in the past.

The taxpayers also challenge the Audit Division's computation of tax on this issue. The Audit Division has agreed to review additional records relevant to this issue if available. Accordingly, we remand this retail sale tax issue to the Audit Division for factual verification and recomputation.

DECISION AND DISPOSITION:

The taxpayers' petitions are denied in part. We will however, allow the taxpayers sixty days from the date of this determination to contact the Audit Division to provide additional documentation regarding their calculation of food cost for the managers' meals, as well as the amount of retail sales tax collected and not remitted for the entire audit period (or sample period with the agreement of the Audit Division). If the after review of these additional records, the auditor and the taxpayers do not agree on the amount of tax, the taxpayers may re-petition as provided in WAC 458-20-100.

Dated this 25th of May, 2000.