

Cite as Det. No. 98-011, 17 WTD 243 (1998)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Correction of	)	<u>D E T E R M I N A T I O N</u>
Assessment of	)	
	)	No. 98-011
	)	
...	)	Registration No. ...
	)	FY. ... /Audit No. ...

[1] WAC 458-20-119; RCW 82.04.250; RCW 82.08.010(1); RCW 82.08.020: RETAIL SALES TAX -- RETAILING B&O TAX -- GROSS PROCEEDS OF SALE. Where the operator of an employee cafeteria is paid a subsidy by the employer to guarantee a profitable operation, and the subsidy is not traceable to any particular sale of tangible personal property, the subsidy is not part of the selling price of the meals and not subject to retail sales tax.

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:

Company that operates and manages employee cafeterias protests the assessment of retail sales tax and retailing business and occupation (B&O) tax on subsidies provided by the employer.<sup>1</sup>

FACTS:

Mahan, A.L.J. -- The taxpayer contracts to prepare and provide meals to employees at cafeterias owned by various employers in Washington. Under some contracts the taxpayer simply operates and manages a cafeteria on behalf of the employer, which sells the meals to employees. Under other contracts, the taxpayer itself sells meals to employees.

Under the latter type of contract, the taxpayer's client supplies the facilities and equipment and the taxpayer purchases and owns the inventory, employs the food service workers, prepares the meals, and collects receipts from the sale of the meals. The taxpayer also collects and remits retail sales tax on the amounts paid by the employees for the meals.

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<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

Under the terms of its contracts, to the extent that the receipts are less than the taxpayer's labor and food costs, an administrative allowance, and a "service fee", the taxpayer is paid a "subsidy" by the client. The taxpayer's clients also agree to "guarantee" reimbursement of the taxpayer's costs plus an agreed fee, to the extent those amounts are not covered by the gross receipts from the sale of meals. The taxpayer and its clients "mutually determine the prices at which the items shall be sold."

The Department of Revenue (Department) audited the taxpayer's books and records for the January 1, 1991 through September 30, 1995 period. Under Schedules 11 through 19 of the audit, the Department assessed unreported retail sales tax and retailing B&O tax on the amount of the client subsidy, except for the amount of the service fee, which the taxpayer was allowed to continue reporting under the service or selected business services classifications. The Department reasoned that the subsidy, except for the service fee, constituted part of the gross proceeds from the sale of the meals.

On appeal, the taxpayer contends that the retail sales tax is imposed on the sale of tangible personal property and the client subsidy is not part of the gross proceeds from the sale of the meals to the employees. In a similar fashion, it contends that it cannot collect sales tax from its clients because there is no "taxable sale of tangible property" to its clients. In support, it cites M&M/Mars, Inc. v. Commonwealth, 162 Pa. Cmwlth. 375, 639 A.2d 848 (1994). Alternatively, the taxpayer contends that the Department is estopped from assessing the tax on past periods as a result of a December 23, 1991 letter from the Department's Taxpayer Information and Education Section to the taxpayer. It stated "the meal sales will be subject to Retailing business and occupation tax and retail sales tax. Additional amounts paid to [taxpayer] by the client will be subject to Service business tax."

At the hearing, the taxpayer stated that, in its experience, subsidies vary and are rarely significant amounts in relation to total food sales. In general, the taxpayer tries to set costs of food items at or near the market rate for similar items. Because of the nature of employee cafeterias, which are provided as a convenience to employees, they generally do not operate at a profit for employers.

#### ISSUE:

When a food service contractor sells meals in an employee cafeteria and receives subsidies from the employer to cover any operational loss and to pay the vendor a profit, are the subsidies subject to retail sales tax?

#### DISCUSSION:

[1] Taxpayers who sell tangible personal property are required to collect retail sales tax on sales to consumers. RCW 82.08.020. WAC 458-20-119 (Rule 119) specifically provides that "food service contractors who sell meals or prepared foods to consumers are subject to the retailing B&O and retail sales taxes upon their gross proceeds of sales." Failure by sellers to collect the full amount of tax results in their liability for the tax. See, RCW 82.08.050. Under RCW 82.08.020(1), the tax is measured by the "selling price."

RCW 82.08.010(1) defines selling price as:

(1) "Selling price" means the consideration, whether money, credits, rights, or other property except trade-in property of like kind, expressed in the terms of money paid or delivered by a buyer to a seller without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes other than taxes imposed under this chapter if the seller advertises the price as including the tax or that the seller is paying the tax, or any other expenses whatsoever paid or accrued and without any deduction on account of losses; but shall not include the amount of cash discount actually taken by a buyer; and shall be subject to modification to the extent modification is provided for in RCW 82.08.080.

Under RCW 82.04.250, the retailing B&O tax is based on the "gross proceeds of sales." That term is defined to include the "value proceeding or accruing from the sale of tangible personal property and/or services rendered" without any deduction of expenses or losses. RCW 82.04.070. At issue in this case is whether the subsidy, all or in part, constituted part of the gross proceeds of sale of tangible personal property. Because the subsidy at issue did not proceed or accrue from the sale of any tangible personal property, but only guaranteed a profit on part of the vendor/taxpayer, we conclude it was not subject to retail sales tax. This conclusion is well supported by case law from other jurisdictions.

In addition to the case cited by the taxpayer, M&M/Mars, Inc. v. Commonwealth, 162 Pa. Cmwlth. 375, 639 A.2d 848 (1994), other courts have considered the issue of whether employer subsidies to food vendors for meals provided in employee cafeterias should be considered as part of the vendors' selling price for retail sales tax purposes. See, e.g., Chet's Vending Serv. Inc. v. Department of Rev., 71 Ill. 2d 38, 374 N.E.2d 468 (1978); Davis v. Chilivis, 142 Ga. App. 679, 237 S.E.2d 2 (1977); Szabo Food Service of Cal. v. State Bd. of Equalization, 46 Cal. App. 3d 273, 119 Cal. Rptr. 911 (1973).

In M&M, the court held that a subsidy paid to a food service contractor measured by an operating fee plus expenses, less sales, did not constitute a sale of tangible property at retail. M&M, supra, at 850. The court reasoned that the subsidy did not:

involve the transfer of ownership, custody, or possession of the food/tangible personal property as required by the Code. Rather, the amount paid by the cafeteria patrons represents the only purchase price or taxable amount paid by anyone for the transfer of ownership, custody or possession of the personal property, food, at issue here.

Similarly, the court in Szabo, 119 Cal. Rptr. at 913, concluded:

Intermittent subsidies paid by employers merely guaranteed Szabo's reasonable profit and gave it an incentive to continue to provide cafeteria service to employees at reasonable prices. The subsidies cannot be traced to particular sales of particular meals;. And clearly, they were not part of a scheme to avoid sales taxes.

A different result was reached in the Davis case, where employees were granted a 30 to 40 percent discount on the regular price of meals at a cafeteria. The vendor later received reimbursement for the discounts from the employer. The court held those payments to be part of the purchase price of the meals and, therefore, the vendor owed retail sales tax on those payments. Davis, 237 S.E.2d at 3.

In the present case the subsidies guarantee that the taxpayer will make a profit and the payments have not been traced to any particular sale of tangible property. This is not a case where the payments were part of the purchase price of any particular meal, were unreasonable, or part of a scheme to avoid taxes.<sup>2</sup> Under such circumstances, we conclude that the subsidies were not part of the “selling price” of the meals and, instead, were for the taxpayer’s services. Accordingly, such subsidies were not subject to retail sales tax and retailing B&O tax.

#### DECISION AND DISPOSITION:

The taxpayer’s petition is granted.

Dated this 26th day of February 1998.

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<sup>2</sup>In an analogous situation, when an employer has the ability to set prices, the Department has required the charges to be reasonable. See WAC 458-20-119(7)(c) (where employers make a “specific and reasonable” charge to employees for meals, the measure of tax is the selling price). Because the taxpayer under the terms of the contract has the right to help set the prices of the food items, there is the potential for it to agree to pay part of the purchase price in the form of a subsidy on particular food items or to set unreasonable rates. We have no evidence that is the case here.