Cite as Det. No. 14-0108, 33 WTD 444 (2014)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessment of . . .	)	D E T E R M I N A T I O N No. 14-0108 Registration No. . . .

[1] RULE 124; RCW 82.04.070: RETAIL SALES TAX – B&O TAX – GRATUITIES. In the absence of evidence that the 18 percent gratuity that a taxpayer added on all parties over six was "suggested" or "recommended," the gratuity is not "clearly voluntary." Because the gratuities are not "clearly voluntary," they are "mandatory" and are subject to the retail sales tax and retailing B&O tax as components of sales.

[2] RULE 170; RCW 82.04.051: RETAIL SALES TAX – CONSTRUCTION MANAGEMENT SERVICES – SERVICES RENDERED IN RESPECT TO CONSTRUCTING. A contractor who is on-site, full-time, and directs and supervises a remodeling project is engaged in "services rendered in respect to constructing" and its activities are subject to the retail sales tax.

[3] RULE 217; RCW 82.14.050: COUNTY FOOD AND BEVERAGE TAX – OVER-COLLECTED. Over-collected County Food and Beverage 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.

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.

Weaver, A.L.J. – Taxpayer, a club that offers live music and dining, petitions for the correction of assessment of an assessment of retail sales tax, retailing business and occupation ("B&O") tax, and deferred sales tax. We hold that Taxpayer is required to charge retail sales tax on its mandatory gratuities, is liable for deferred sales tax on construction services related to a remodel of its club, and is responsible to remit over-collected retail sales tax it collected in error. Taxpayer's petition is denied.[1]

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

ISSUES

1. Whether, under WAC 458-20-124, a restaurant that informed customers that an 18 percent gratuity may be added to parties over six is required to charge retail sales tax on those gratuities.

2. Whether, under RCW 82.04.051, a taxpayer who enters into a contract with a contractor who monitors a remodeling project is liable for deferred sales tax on the amounts paid to the contractor for his services.

3. Whether, under RCW 82.08.050 and WAC 458-20-217, a taxpayer who over-collected sales tax is required to remit the over-collected amounts to the Department of Revenue.

FINDINGS OF FACT

[Taxpayer] operates a . . . club that offers live music and dining. Taxpayer books a calendar of [musicians] who perform onstage while Taxpayer's patrons dine as they view the featured artist's performance. Taxpayer's books and records were audited by the Audit Division of the Department of Revenue ("Department") for the period of January 1, 2008 through March 31, 2012.

The Audit Division generated a 30-day random sample to verify that Taxpayer was correctly reporting tax on mandatory gratuities. During the review of the 30 day sample, the Audit Division determined that parties of six or more were being charged a mandatory service charge of 18 percent. This "service charge" was added to the customer's bill as a separate line item. The Audit Division noted that Taxpayer's menu included wording that the restaurant may charge 18 percent gratuity for parties of six or more. Taxpayer's position is that its customers are never forced into a pre-set gratuity, but that it is always their choice how much to tip. Taxpayer provided some . . . receipts where gratuity was added by the customer, but none of the . . . receipts had a mandatory gratuity included. The Audit Division determined the percentage of sales where mandatory gratuities were added without sales tax charged on those gratuities and then applied that error percentage to the whole population of Taxpayer's food sales.

The Audit Division also determined that Taxpayer made repairs and improvements to its premises during the audit period. Taxpayer hired an individual to assist Taxpayer during the remodel. The Audit Division was provided a copy of a contract between Taxpayer and that individual ("Contractor") which read, in pertinent part, as follows:

> [Taxpayer] and [Contractor] . . . on this date entered into an agreement for design services to be provided by [Contractor] during the construction and remodeling of [Taxpayer's] premises.
>
> [Contractor] will consult, on an hourly fee basis, on design issues and advise [Taxpayer] regarding its particular needs. [Contractor] will advise on segments of the project that are continuing in the club, including but not limited to: Paint Colors and textures, Bar design and seating, New Walk-In design, New Carpeting.

> Services will include but not limited to: meeting with vendors, selecting and coordinating materials and colors, and monitoring and reporting on the progress of construction by outside contractors work in the [Taxpayer's] premises, including Kitchen and Bar.
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> [Contractor] will charge [Taxpayer] at a rate of Fifty Dollars per hour payments to be made on a weekly basis. [Taxpayer] will issue a 1099 annually.

Taxpayer provided copies of the Contractor's invoices that show the Contractor was on-site, every week, between 30 and 40 hours a week, between September 30, 2011 and March 16, 2012. The name of the project upon which Contractor billed Taxpayer every week was labeled "[Taxpayer's] Facilities" on Contractor's invoices.

The invoices show that the Contractor was being paid for his labor, in addition to being reimbursed for dump fees. Taxpayer issued the Contractor and two other laborers Form 1099s showing the amount they were paid for work performed during the remodel phase. Taxpayer accounted for these charges under an account labeled "8620-Remodel" and expensed them for federal income tax purposes. The Audit Division assessed sales tax on the amount paid to the Contractor.

Taxpayer claims that the Contractor was actually Taxpayer's employee and that it is improper to tax payment to its employees. Taxpayer further claims that Taxpayer was not involved in actual construction, but was engaged in construction management or consulting services. Taxpayer takes the position that Contractor was on site during the remodel to make sure everything was installed correctly. Taxpayer protests the assessment of retail sales tax on the amounts in the "8620-Remodel" account paid to the Contractor.

During the review of the 30-day sample of Taxpayer's retail sales, the Audit Division determined that Taxpayer was over-collecting sales tax by half a percent (.005) from October 1, 2011 through March 30, 2012. The 30-day sample included one day in November, 2011, two days in January, 2012, two days in February 2012, and one day in March, 2012. During those six days, Taxpayer's charged its customers a tax of 10 percent, an amount which included the . . . County Food and Beverage ([CF&B]) tax. Taxpayer was over-collecting its sales tax, because it was unaware of the expiration of the [CF&B] tax on September 30, 2011. In any event, the over-collected sales tax was not remitted to the Department of Revenue.

Taxpayer states that in February, 2012, its accountant adjusted the amount it was charging in tax to account for the expiration of the [CF&B] tax. Taxpayer has posted on its website that it will refund any over-collected tax to patrons who were overcharged between October 1, 2011 and that date. Taxpayer protests the Department assessing it for over-collected and unremitted sales tax.

On November 30, 2012, the Audit Division issued an assessment to Taxpayer totaling $. . . , which included $. . . in retail sales tax, $. . . in retailing business and occupation ("B&O") tax, $. . . in use tax/deferred sales tax, and $. . . in interest. On February 13, 2013, the Audit Division issued a post-assessment adjustment ("PAA") totaling $. . . , which included $. . . in

retail sales tax, $. . . in retailing B&O tax, $. . . in use tax/deferred sales tax, $. . . in interest, and $. . . in additional interest from 01/01/2013 to 3/15/2013.

ANALYSIS

I. Retail Sales Tax and Retailing B&O tax on Mandatory Gratuities

Washington imposes a B&O tax "for the act or privilege of engaging in business" in the State of Washington. RCW 82.04.220. Washington levies a retail sales tax on each retail sale in this state. RCW 82.08.020, .050.

The measure of the retailing B&O tax is the gross proceeds of the sales. RCW 82.04.250(1); RCW 82.04.070. The measure of the retail sales tax is the selling price. RCW 82.08.020(2). The selling price includes the total consideration paid or delivered by a buyer to a seller. RCW 82.08.010(1).

WAC 458-20-124 (Rule 124), the Department's administrative rule on restaurants and bars, provides that mandatory additions to the price by the seller must be included in the selling price and are subject to tax under both the Retailing B&O and Retail Sales tax. Specifically Rule 124(10) states:[2]

> (10) **Gratuities.** Tips or gratuities representing donations or gifts by customers under circumstances which are clearly voluntary are not part of the selling price subject to tax. However, mandatory additions to the price by the seller, whether labeled service charges, tips, gratuities or otherwise must be included in the selling price and are subject to both the retailing B&O and retail sales taxes.

In a previous case where there was an issue as to the mandatory nature of a gratuity, we said that even when an invoice states that a gratuity is "suggested" or "recommended", a taxpayer must come forth with additional evidence that a specific percentage was not agreed on before the event. Det. No. 06-0030, 26 WTD 50, 55-56 (2007). In this case, there is an absence of such additional evidence, and the documents provided by Taxpayer do not say that the gratuity is "suggested" or "recommended."

Taxpayer's menu stated that an 18 percent gratuity may be added on parties over six may be added. But there was no evidence presented that customers who were charged the 18 percent gratuity could consider the gratuity voluntary. The only documentary evidence provided by Taxpayer at the appeals hearing were guest receipts where the mandatory gratuity was not added, so they were of limited utility. On these facts, we conclude that the tips in question are not voluntary. The mandatory gratuities in this case are, in fact, mandatory, and they are subject to the retailing B&O and retail sales tax as components of sales under Rule 124(10).

Taxpayer's petition is denied with respect to the assessment of retail sales tax and retailing B&O tax on mandatory gratuities.

[2] WAC 458-20-119 has the same rule for caterers.

II. Deferred Sales Tax on Construction Labor

RCW 82.08.020 imposes a retail sales tax on "each retail sale in this state." The seller must collect retail sales tax from its customer, the buyer. RCW 82.08.050(1). Where the buyer has failed to pay the seller the sales tax, the Department may proceed directly against the buyer for collection of the tax. RCW 82.08.050(6).

The Audit Division assessed deferred sales tax on Taxpayer's "8620-Remodel" expense account for payments made to Contractor. Construction services are classified for B&O tax purposes as a retail activity. RCW 82.04.050 defines a "sale at retail" to include:

> [T]he sale of or charge made for tangible personal property consumed and/or for labor or services rendered in respect to the following: . . . (b) the constructing, repairing, decorating, or improving of new or existing buildings or other structures under, upon, or above real property of or for consumers, including the installing or attaching of any article of tangible personal property therein or thereto, whether or not such personal property becomes a part of the realty by virtue of installation, . . .

RCW 82.04.050(2). Accordingly, "services rendered in respect to . . . constructing" are retailing activities. *See also* RCW 82.04.051.

Therefore, a company constructing, repairing, or improving new or existing buildings for a consumer is required to collect retail sales tax from the consumer and to pay retailing B&O tax. RCW 82.04.050; WAC 458-20-170 ("Rule 170"). However, RCW 82.04.051 provides:

> (1) As used in RCW 82.04.050, the term "services rendered in respect to" means those services that are directly related to the constructing, building, repairing, improving, and decorating of buildings or other structures and that are performed by a person who is responsible for the performance of the constructing, building, repairing, improving, or decorating activity. The term does not include services such as engineering, architectural, surveying, flagging, accounting, legal, consulting, or administrative services provided to the consumer of, or person responsible for performing, the constructing, building, repairing, improving, or decorating services.
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> (2) A contract or agreement under which a person is responsible for both services that would otherwise be subject to tax as a service under RCW 82.04.290(2) and also constructing, building, repairing, improving, or decorating activities that would otherwise be subject to tax under another section of this chapter is subject to the tax that applies to the predominant activity under the contract or agreement.

RCW 82.04.051 (emphasis added). Rule 170 defines the term "constructing, repairing, or improving new or existing buildings" as including:

> . . . the sale of or charge made for all service activities rendered in respect to such constructing, repairing, etc., regardless of whether or not such services are otherwise defined as "sale" by RCW 82.04.040 or "sales at retail" by RCW 82.04.050. Hence, for

> example, such service charges as engineering fees, architectural fees or supervisory fees are within the term when the services are included within a contract for the construction of a building or structure. The fact that the charge for such services may be shown separately in bid, contract or specifications does not establish the charge as a separate item in computing tax liability.

Rule 170. In this case, Taxpayer is claiming that Contractor was not actually engaged in services rendered in respect to constructing.

"Services rendered in respect to" construction means those services directly related to construction that are performed by a person who is responsible for the performance of the construction. RCW 82.04.051(1). The statute provides further:

> As used in this section, "responsible for the performance" means that the person is obligated to perform the activities, either personally or through a third party. A person who reviews work for a consumer, retailer, or wholesaler but does not supervise or direct the work is not responsible for the performance of the work. A person who is financially obligated for the work, such as a bank, but who does not have control over the work itself is not responsible for the performance of the work.

RCW 82.04.051(4). In Det. No. 12-0284, 32 WTD 260 (2013), the Department held "[u]nder this statute, the issue is whether taxpayer was responsible to supervise or direct the work of the general contractor and the sub-contractors." 32 WTD at 264. Det. No. 01-140, 22 WTD 26 (2003) held:

> The . . . statutory language provides for consideration of both the nature of the services provided and the entity providing them in characterizing the services for tax purposes. To be rendered in respect to construction activities the services themselves must 'directly relate to the constructing' and the provider of the services must be responsible for 'the performance of the constructing.'

22 WTD at 31. In this case, the contract between Taxpayer and Contractor and the invoices issued to Taxpayer by Contractor make it clear that the Contractor was on-site on a day-to-day basis and monitored the construction of the remodeling project. At the appeals hearing, Taxpayer stated that Contractor was on-site to make sure that everything was installed correctly. Contractor's invoices to Taxpayer show that Contractor was on-site, between 30 and 40 hours a week, for 22 straight weeks between September 30, 2011 and March 16, 2012. While we lack any facts on the specific tasks performed by Contractor, on the evidence submitted, we find that Contractor was hired to be on-site, full-time, directing and supervising the remodel of Taxpayer's venue. [Based on the evidence provided, we hold that the Contractor was responsible for the performance of the construction work.] Therefore, [we further] hold that Contractor was engaged in services rendered with respect to constructing activity and that Taxpayer was correctly assessed retail sales tax on those services.

Taxpayer makes an additional argument that it should not be charged sales tax on Contractor's services because Contractor was an "employee" of Taxpayer's. Taxpayer cites WAC 458-20-105 ("Rule 105") to support its contention that [Contractor's] services are not taxable because

[Contractor] was "acting solely in the capacity of an employee." Without opining on whether [Contracot's] status as an "employee" would render his services non-taxable, we first address the threshold question of whether Contractor was an employee of Taxpayer's in the first place. Taxpayer and Contractor had a written contract where Contractor was being paid hourly to perform certain services related to a remodel. Contractor had to invoice Taxpayer to receive payment for the hours he worked and received a Form 1099 for the amounts he was paid under the contract. On these facts, Contractor was acting in the capacity of an independent contractor while performing his duties with respect to the remodel and was not an employee of Taxpayer. *See* Rule 105(3), (4).

Finally, Taxpayer also takes the position that payments made to "day laborers" were paid out of the "8620-Remodel" expense account and that those payments should not be subject to retail sales tax as those day laborers were "casual laborers." *See* Rule 105(7). In circumstances where a taxpayer obtains temporary workers to perform construction services and those workers failed to charge sales tax, but should have, the Department has held that the taxpayer is liable for the deferred sales tax. *See* Det. No. 04-0287, 24 WTD 275, 281 (2005).

Taxpayer's petition is denied with respect to the assessment of deferred sales tax.

III. Collected and Unremitted Sales Tax.

Taxpayer's final issue on appeal is a protest of the Department assessing it for retail sales tax amounts it collected and failed to remit. Taxpayer states that it over-collected sales tax, because it was unaware that the . . . County Food & Beverage Tax expired on September 30, 2011. Because Taxpayer was unaware of this change, Taxpayer was over-collecting sales tax by half a percent (.005) from October 1, 2011 through March 30, 2012. Taxpayer protests the assessment of the tax it over-collected but failed to remit.

Under RCW 82.08.050 and WAC 458-20-217, retail sales tax shall be deemed held in trust by the seller until paid to the Department. RCW 82.14.050 extends this requirement to the overcharged [CF&B] taxes at issue, as that statute reads, as follows:

> All administrative provisions in chapters 82.03, 82.08, 82.12, and 82.32 RCW, as they now exist or may hereafter be amended, insofar as they are applicable to state sales and use taxes, are applicable to taxes imposed pursuant to this chapter.

RCW 82.14.050(2). In Det. No. 00-092, 24 WTD 47 (2001), the Department held:

> 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.

24 WTD at 51. The Washington Supreme Court, in *Kitsap-Mason Dairymen's Ass'n v. Tax Comm'n*, 77 Wn.2d 812, 467 P.2d 312 (1970), addressed a similar issue. In *Kitsap-Mason*

Dairymen's Ass'n, the taxpayer over-collected retail sales tax. It failed to remit the tax to the state. The Court held that the seller could not retain the over-collected sales tax for its own use. *Id* at 816. [As] here, the taxpayer in *Kitsap-Mason Dairymen's Ass'n*, charged excess sales tax, which is deemed to be held in trust, and it was required to remit the sales taxes it collected to the state.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 26th day of March 2014.