

**DEPARTMENT OF TAXATION
2005 Fiscal Impact Statement**

1. Patron Thomas D. Gear

2. Bill Number HB 2232

3. Committee Senate Finance

House of Origin:

☐ Introduced

☐ Substitute

☐ Engrossed

4. Title Retail Sales and Use Tax:
Excludes Gratuity or Service Charges
from the Definition of Sales Price and from
the Local Meals Tax

Second House:

☒ In Committee

☐ Substitute

☐ Enrolled

5. Summary/Purpose:

This bill would amend the retail sales and use tax definition of "sales price" to exclude any gratuity or service charge added to the price of a meal whether added at the discretion of the purchaser or not. This bill would also exempt from the local meals tax any gratuity or service charge added to the price of a meal whether added at the discretion of the purchaser or not. This bill would effectively prohibit the imposition of the retail sales and use tax or local meals tax on any gratuity or service charge added to the price of a meal.

The effective date of this bill is not specified.

6. Fiscal Impact Estimates are: Not available. (See Line 8.)

7. Budget amendment necessary: No.

8. Fiscal implications:

This bill would eliminate the retail sales and use tax and local meals tax imposed on mandatory or automatic gratuities and service charges that are added to the price of a meal. This bill would decrease state and local revenue by an unknown amount.

This bill would have no administrative impact on the Department.

9. Specific agency or political subdivisions affected:

Department of Taxation
All localities that impose a meals tax.

10. Technical amendment necessary: No.

11. Other comments:

Current Law

Gratuity or service charges may be applied to the price of a meal at the discretion of the purchaser, or may be a mandatory charge automatically imposed by the dealer.

Currently, a gratuity or service charge is considered part of the sales price and is taxable when it is automatically imposed by the dealer. For example, a restaurant may impose a 20% service charge on any sales ticket for a party of eight or more guests. As such, the restaurant will add an additional amount equal to 20% of the price of the meal to the ticket. The price of the meal along with the service charge comprises the sales price that is subject to the sales tax and local meals tax.

Alternatively, a purchaser may add a gratuity to a meal ticket, the amount of which is totally at the discretion of the purchaser. The gratuity is usually added by the purchaser after the dealer has totaled the costs of the meal and presented the ticket to the purchaser. In this instance, the gratuity is not considered a part of the sales price and is therefore not subject to either the sales tax or the local meals tax. This has been the consistent position of the Department since the imposition of the Virginia Retail Sales and Use Tax Act in 1966. This policy was reflected in the Department's first sales and use regulations issued in 1966. Currently, the position is set forth in Virginia Regulation 23 VAC 10-210-930.

Services

Charges for services are generally exempt from the sales and use tax, however, services in connection with the sale of tangible personal property are taxable. Transactions that involve the provision of tangible personal property and services are generally either fully taxable or fully exempt, depending on the "true object" of the transaction. In the case of mandatory gratuities or service charges, the true object of the customer is the tangible personal property, i.e. the meal, and the mandatory gratuity is a service in connection with the meal that is not at the discretion of the customer, therefore subject to the tax. Other examples of taxable services are fabrication services, whether the property being fabricated is furnished by the customer or not, and an artist's commission for portrait painting, where the true object is the final portrait despite the fact that a considerable amount of the charge represents the artist's labor.

This Proposal

This bill would overturn the Department's regulations and effectively eliminate the sales tax and local meals tax on gratuity or service charges that are mandatory or automatically added to the price of a meal by the dealer. This would result in disparate treatment between the gratuities or service charges added to meals and all other services provided in connection with the sale of tangible personal property.

cc : Secretary of Finance

Date: 2/8/2005 WBS
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