

DEPARTMENT OF TAXATION

2006 Fiscal Impact Statement

1. **Patron** Thomas D. Gear

2. **Bill Number** HB 896

3. **Committee** Passed House and Senate

House of Origin:

 Introduced

 Substitute

 Engrossed

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

Second House:

 In Committee

 Substitute

 X **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 at the discretion of the purchaser, and any mandatory gratuity or service charge added by a restaurant to the sales price of a meal, to the extent that such gratuity does not exceed 20% of the sales price. This bill would also exempt from the local meals tax any mandatory gratuity or service charge added to the price of a meal by the establishment, provided that the charge does not exceed 20% of the cost of the 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, but significant amount.

This bill would have no administrative impact on TAX.

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

Gratuities 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 TAX since the imposition of the Virginia Retail Sales and Use Tax Act in 1966. This policy was reflected in TAX'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 TAX'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.

For purposes of both the retail sales and use tax and the local meals tax, the exemption will only apply if the mandatory gratuity does not exceed 20% of the sales price of the meal. Those service charges in excess of the 20% cap would remain subject to the retail sales and use tax and the local meals tax.

Similar legislation

Senate Bill 85 is identical to this bill.

cc : Secretary of Finance

Date: 03/13/2006 KP

DLAS File Name: HB896FER161.doc