

ST 16-04

Tax Type: Sales Tax

**Tax Issue: Unreported/Underreported Receipts (Non-Fraudulent)
Books And Records Insufficient**

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

ABC BUSINESS, INC.,

TAXPAYER.

**No. XXXX
Mandatory Service Charges &
Banquet Hall Rentals**

**Kelly Yi
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

APPEARANCES: Mr. Ronald Belmonte appeared for *ABC Business, Inc.*; Mr. George Foster, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

SYNOPSIS: This matter arose when *ABC Business, Inc.* (“Taxpayer”) protested the two Notices of Tax Liability the Illinois Department of Revenue (“Department”) issued following an audit to assess Retailers’ Occupation Tax (“ROT”). The issues to be determined are: 1) whether Taxpayer failed to collect and remit sales tax on the mandatory gratuities charged for banquet events; 2) whether Taxpayer failed to collect and remit sales tax on the banquet event extras, such as extra servers, upgraded chairs and linens, and bartenders; and 3) whether invoices simply marked “Hall Rental” claimed as cancellation fees are taxable. On January 14, 2015, a formal administrative hearing was held before Administrative Law Judge Ken Galvin¹ with Mr. *John Doe* (“*John Doe*”), Taxpayer’s outside accountant, Mr. *Jack Black* (“*Jack Black*”), Taxpayer’s

¹ This Recommendation is written by undersigned Administrative Law Judge Kelly K. Yi and is based on the review of the hearing transcript and the exhibits admitted at hearing. Credibility of the witnesses is at issue only to the extent that the testimony is unsupported by the documentary evidence in the record.

Treasurer and General Manager, and Ms. Wilma White (“*Wilma White*”), the Department’s auditor, testifying. Following a careful review of the testimony and evidence, it is recommended that the Department’s determination be affirmed.

FINDINGS OF FACT:

1. The Department’s *prima facie* case, inclusive of all jurisdictional elements, was established by the admission into evidence, under the certificate of the Director, of the Department’s two Notices of Tax Liability (“NTLs”) showing a liability due and owing including penalties and interest through April 18, 2013 under the ROT for the reporting period January 1, 2007 through June 30, 2009 in the amount of \$XXXX and \$XXXX for the reporting period July 1, 2009 through June 30, 2011. Dept. Ex. 1, pp. 2-3.
2. Taxpayer is a banquet facility located in Chicago, Illinois and has been in business since July 1993. Dept. Ex. 1, p. 4.
3. Taxpayer is registered for sales tax and files sales and use tax returns monthly. Dept. Ex. 1, p. 4.
4. Taxpayer rents banquet rooms and serves food and beverage on site for various events such as weddings and funerals. Tr. pp. 58, 88.
5. A customer is quoted a price per person, and the invoice would show that “sales taxes and gratuities are included” without a line item, but extra charge such as overtime is itemized Tr. pp. 59-61; Taxpayer Ex. 3, Part 1.
6. In case of cancellation, Taxpayer retains the deposit as the cancellation fee and does not collect or remit sales tax. *Jack Black* testified that “if the invoices simply show hall rental, those are all cancellation fees.”² Tr. pp. 63-64, 66.

² This testimony conflicts with #12 of the findings of fact.

7. The banquet customers normally sign a contract for “a wedding or something like that, but not for a funeral.” Tr. p. 88.
8. *Jack Black* testified that the contracts include the cancellation policy and are kept with the accounting records. Tr. pp. 88-89.
9. *Wilma White* allowed exceptions to sales tax for the “Hall Rental” invoices submitted along with contracts evidencing the cancellation policy. Tr. pp. 91-92; Taxpayer’s Ex. 2.
10. The Department’s Global Taxable Exceptions Detailed Report (“audit report”) lists 29 “Hall Rental” invoices; two “Overtime” invoices; two “Bartender” invoices; one “Chair & Table Covers” invoice; and 34 “Tip/Gratuities” invoices. Taxpayer’s Ex. 2.
11. Taxpayer offered 17 invoices marked “Hall Rental” into evidence. Tr. pp. 63-65; Taxpayer’s Ex. 3, Part 1.
12. *Jack Black* testified that only the first 17 “Hall Rental” invoices³ in the audit report were cancellations and that food and drinks were served on the remaining invoices. Tr. p. 65.
13. *Jack Black* admitted that overtime charges are taxable. Tr. p. 68-69.
14. *Jack Black* testified that bartender fees are charged separately because it is difficult to have bartenders come in for two hours of work for \$10 an hour. Tr. p. 88.
15. *Wilma White* testified that the payroll should reflect the hourly rate and gratuities, separately, not together, as Taxpayer has done. Tr. p. 95.
16. *Wilma White* testified that Taxpayer failed to collect and pay sales tax on the mandatory gratuities charged to the customers and used them to fund wages. Tr. p. 99.

³ The 17 invoices admitted into evidence do not sequentially match the first 17 invoices listed in the audit report but all of them are included in the audit report. Taxpayer’s Exs. 2 and 3, Part 1.

17. Taxpayer produced a total of 14 employee timesheets for a period of two weekends along with a sample payroll spreadsheet, which was prepared for the Department's Informal Conference Board. Tr. pp. 72-73; Taxpayer's Ex. 3, Part 3 and 5.
18. *Jack Black* testified that gratuities are allocated to employees according to the predetermined rates for job titles: the bartender makes 17.5%, divided by the number of bartenders; the captain makes 17.5%; the second captain makes 15.19%; the waitress makes 33.3% divided by the number of waitresses; and the dishwasher makes 7.75%. This adds to 90.89% and the staff determines the allocation of the remaining 9.11% among themselves. Tr. pp. 80-83; Taxpayer's Ex. 3, Part 5.
19. *Jack Black* testified that an employee paystub shows the hourly wage and the number of hours worked but the gratuities are not separately paid. Tr. pp. 86-87.
20. *John Doe* testified that his review of a 6-month period of the total gratuities collected, the total gross payroll, and the total hours worked showed that Taxpayer's employees were paid through payroll all the gratuities collected. Tr. pp. 51-55.
21. *Wilma White* testified that she would have allowed exceptions to sales tax for gratuities had the paystubs showed separate payments of hourly wage and gratuities. Tr. pp. 93-94.
22. Taxpayer failed to submit to the auditor any documentary evidence of the amount of gratuities collected and the payment of the same to the employees. Tr. p. 93.

CONCLUSIONS OF LAW:

Under the Retailers' Occupation Tax Act ("ROTA"), tax is imposed upon persons engaged in the business of selling at retail tangible personal property. 35 ILCS 120/2. Every person engaged in the business of selling tangible personal property at retail in this State shall

keep records and books of all sales of tangible personal property. 35 ILCS 120/7. Section 4 of the ROTA provides that the Department's determination of tax due constituted *prima facie* proof that tax is due in the amount determined by the Department. 35 ILCS 120/4. In this case, the Department established its *prima facie* case when it introduced Department Exhibit 1, consisting of a copy of the two Notices of Tax Liability at issue under the certificate of the Director. With the Department's *prima facie* case, the burden shifts to the Department to prove its case, only after Taxpayer presents evidence that is consistent, probable and identified with its books and records, to show that the Department's determinations were not correct. Copilevitz v. Department of Revenue, 41 Ill.2d 154, 157-158 (1968). Additionally, when a taxpayer claims that a transaction is exempt from a particular tax, the burden of proof is on the taxpayer. 35 ILCS 105/12; 35 ILCS 120/7; Balla v. Department of Revenue, 96 Ill.App.3d 293, 295 (1st Dist. 1981), citing Telco Leasing, Inc. v. Allphin, 63 Ill.2d 305 (1976); Bodine Electric Co. v. Allphin, 81 Ill.2d 502 (1980).

The Department regulation 86 Ill.Admin.Code 130.2145(d)-(f) governs mandatory gratuities and banquet room rentals:

d) Mandatory Service Charges

Mandatory gratuities are not included in the taxable receipts of persons operating restaurants, hotels and other places of business that come under the Act, if the mandatory gratuity is added to banquet or dinner checks in the form of a percentage of the total bill, or as a flat rate, to the extent that the proceeds of the service charge are in fact turned over as tips or as a substitute for tips to the employees who participate directly in preparing, serving, hosting or cleaning up the food or beverage function with respect to which the service charge is imposed. (Section 2-5(15) of the Act) If any part of the service charges are used to fund or pay wages, labor costs, employee benefits or employer costs of doing business, that part of the service charge is includable in gross receipts. (*Italics in the original*).

e) Rentals of Banquet, Meeting and Conference Rooms – True-object Test

The taxation of charges for the rental of a banquet, meeting, conference or similar room in conjunction with the providing of food or beverages will depend upon the nature of the

transaction. The Department uses a "true-object" test to characterize the nature of these transactions.

- 1) If the true object of the transaction is the rental of the room and if food or beverages are provided incidentally to the rental of the room, no tax is incurred on the charges for the rental of the room. If no separate charge is made under the contract for the incidental amount of food or beverages provided, the rentor is considered the user of the food or beverages and incurs Use Tax on its cost price of the food or beverages transferred incidentally to the rental of the room. If a separate charge is made for any food and beverages transferred incidentally to the rental of the room, the rentor incurs Retailers' Occupation Tax on the selling price of the food or beverages. See Section 130.310 of this Part regarding the appropriate tax rate for sales of food.
- 2) If the true object of the transaction is the sale of food or beverages, any room rental charges are part of the seller's costs of doing business and are includable in the seller's taxable gross receipts even if the charges for the room rental are separately stated on the agreement or bill between the seller and its customers. See Section 130.410 of this Part. The rental of the room is considered an inseparable link in the sale of the food and beverages to the customer and is not merely incidental to the seller's business of selling food or beverages.
- 3) If the rental contract requires that alcoholic beverages or food and other beverages be provided or sold by a specific third party or from a choice of providers specified by the rentor, the rentor shall be deemed to be the provider of the alcoholic beverages, food and other beverages for purposes of determining the taxation of the room rental charge.

f) True Object – Rental of Room

The Department deems an incidental provision of food or beverages to include the providing of non-alcoholic beverages, such as coffee, tea and soft drinks, and the providing of snacks, such as cookies, popcorn, candy, doughnuts, fruits and raw vegetables.

Taxpayer contends that because the cancellation fees are not taxable, it should not be taxed for cancellation fees, which are simply marked "Hall Rental" in the invoices. Section 7 of the ROTA governs a retailer's obligation to maintain the books and records to support any claims of exception to sales tax. It provides, in relevant part:

"To support deductions made on the tax return form, or authorized under this Act, on account of receipts from***any other kind of transaction that is not taxable under this Act, entries in any books, records or other pertinent papers or documents of the taxpayer

in relation thereto shall be in detail sufficient to show the name and address of the taxpayer's customer in each such transaction, the character of every such transaction, the date of every such transaction, the amount of receipts realized from every such transaction and such other information as may be necessary to establish the non-taxable character of such transaction under this Act.

It shall be presumed that all sales of tangible personal property are subject to tax under this Act until the contrary is established, and the burden of proving that a transaction is not taxable hereunder shall be upon the person who would be required to remit the tax to the Department if such transaction is taxable.” 35 ILCS 120/7.

During the audit, the Department’s auditor allowed exceptions to the sales tax on the “Hall Rental” invoices submitted along with a copy of the contract evidencing the cancellation policy. Of the 29 “Hall Rental” invoices at issue, only 17 of them were presented at hearing. Tr. p. 68; Taxpayer Ex. Part 1. Taxpayer claims that the invoices alone without the contracts entitle them to sale tax exceptions. I disagree. I do not believe Taxpayer has overcome the Department’s *prima facie* correctness of tax liability for the following reasons: 1) the “Hall Rental” invoices do not reference the underlying contract that describes the obligation of the parties in the transaction; 2) the descriptions lack as to which banquet rooms and for how long they were reserved; and 3) the invoices do not reveal the customers’ addresses which would have enabled a simple verification of the charges. Absence of these details raises more questions. As the audit report shows, the purported cancellation fees range \$30 to \$1,300, but without the contracts in evidence, I cannot evaluate whether the amount of purported cancellation fees fall in the same range as the invoices of auditor allowed exceptions. Moreover, because the hall rental prices were not presented at hearing, I cannot compare them with the purported cancellation fees, one of which, unlike the rest, oddly ends in cents, \$480.25. *See* Taxpayer’s Ex. 2.

Section 7 of the ROTA requires that the documents to support exceptions “shall be in detail sufficient to show the name and address of the taxpayer’s customer...the character of every such transaction...the date of every such transaction...and such other information as may

be necessary to establish the non-taxable character of such transaction under this Act.” 35 ILCS 120/7. Taxpayer’s invoices show the customer’s name without the address, and “Hall Rental” as the sole description. There is no other information to establish why “Hall Rental” invoices were not taxed. Whether they were indeed cancellations or whether food or drinks were served are unknown from these invoices.⁴ This is information necessary to determine taxability pursuant to the statutes and regulations cited above. Since the “non-taxable character” of the “Hall Rental” invoices cannot be determined by the documentary evidence presented, I conclude that Taxpayer has failed to overcome the Department’s presumption of correctness of the tax liability on the 29 “Hall Rental” invoices. Of note, all of the 17 “Hall Rental” invoices offered are dated in the month of May 2010, but the “PAID” stamp dates range 2001 to 2008. The record does not explain this extraordinary gap in dates but it is difficult to imagine that someone would reserve a banquet room as far back as 9 years prior to a scheduled event.

As to the issue of overtime charges, Taxpayer’s Treasurer and General Manager *Jack Black* testified that the claimed exceptions were made in error and admitted that overtime charges are taxable. Tr. pp. 67-68. Accordingly, the sales tax attributable to invoice #3769 and #3764 for overtime charges are taxable, and the Department’s assessment on the invoices is affirmed.

With the issue of taxability of separate charges for upgraded chair and table covers and bartenders’ fees, Taxpayer did not present the actual invoices for these items. Without pointing to a specific section of the ROTA, *John Doe* opined that the upgraded linens are not taxable even if offered with food and drinks. Tr. pp. 44-45. Pursuant to the Department regulations cited earlier, taxability of those depends on the True-object Test to characterize the nature of such

⁴ As mentioned in footnote 1, Taxpayer’s witness gave a conflicting testimony on the “Hall Rental” invoices. *Jack Black* testified that only the first 17 of 29 “Hall Rental” invoices in the audit report were cancellations but later testified that “if the invoices simply show hall rental, those are all cancellation fees.” See Findings of Fact 6, 12.

transaction. Taxpayer did not present the invoices and the audit report documents only the date, the customer's name and the descriptions "Chair & Table Covers" and "Bartender."⁵ The documentary evidence offered is insufficient to apply the True-object Test to determine whether the true object of the transactions were the rental of the room or sale of food or beverages. I find that Taxpayer has failed to overcome the Department's presumption of correctness of liability on the separately charged items.

Under the Department's *prima facie* case, the claimed exceptions are not allowed pursuant to section 1 of the ROTA, which states in relevant part:

"Selling price" or the "amount of sale" means the consideration for a sale valued in money whether received in money...and shall be determined without any deduction on account of the cost of the property sold, the cost of materials used, labor or service cost or any other expense whatsoever...." 35 ILCS 120/1

The corresponding section of the Department regulation states that:

"...no deductions shall be made by a taxpayer from gross receipts or selling prices on account of the cost of property sold, the cost of materials used, labor or service costs ... or any other expenses whatsoever. Costs of doing business are an element of the retailer's gross receipts subject to tax even if separately stated on the bill to the customer." 86 Ill.Admin.Code 130.140.

As shown in the definition, tax is imposed upon Taxpayer's entire gross receipts from sale, without any deduction on account of service costs or other overhead costs. Taxpayer's gross receipts include all receipts associated with the sale of food such as charges for linens, tables, chairs, dishes, glasses, flowers, labor, and set-up because each of these items is a part of the cost of doing business. It is immaterial whether a customer was separately billed for the price of these items, as Taxpayer claims. Only the separate charges *not associated* with the sale of food,

⁵ *Jack Black* testified that bartender fees are charged separately as an incentive for coming into work for two hours at \$10 an hour. However, the sample payroll spreadsheet, corresponding to the actual employee timesheets, shows the bartenders' wage was not higher but same as the rest of Taxpayer's tipped employees at \$4.95 an hour in 2011. Tr. p. 88; Taxpayer's Ex. 3, Part 5.

such as entertainment at a banquet, are not taxable. Accordingly, I find that upgraded chair and table covers, invoice #3768, and bartender's fees, invoice #4055 and #4066, are taxable.

The next issue is whether Taxpayer has distributed the gratuities to the employees who worked at the events that generated the gratuities. The audit report lists the collected but not taxed gratuities on the 34 invoices, which Taxpayer claims were paid to the employees as gratuities. *Wilma White* requested a copy of the paystubs to determine Taxpayer's assertions. Taxpayer did not provide the paystubs to the auditor or at hearing; instead, Taxpayer presented a sample payroll spreadsheet corresponding to actual employee timesheets to demonstrate the method of calculation of wages and gratuities. *Jack Black* testified that the gratuities, based on the rate of allocation assigned to job titles, are added to the employees' gross wages. A bartender working alone at an event, for example, would be given 17.5% of the tips; if more than one bartender worked that night, 17.5% would be divided by the number of bartenders. *Jack Black* testified that the paystubs show the hourly wage and the number of hours worked, but the tips are not separately paid. This is problematic because no documentary evidence was offered to the amount of gratuities collected during a pay period or at any time during the audit periods. The spreadsheet illustrates how the gross wage was calculated but Taxpayer did not produce the paystubs. With this crucial information missing, there is no way to determine the distribution of the collected gratuities to the employees. *John Doe* testified that he examined the payroll records of a 6-month period but he did not know which period. Tr. p. 54. Based on his review of a 6-month period, *John Doe* determined that the employees were paid the gratuities through payroll. However, Taxpayer did not present the actual books and records *John Doe* reviewed in reaching his conclusion. Without those books and records, there is no way to determine that the employees were paid the gratuities. *John Doe's* oral testimony alone, without the supporting

documentary evidence, is insufficient to overcome the Department's *prima facie* correctness of the assessed tax liability. Even assuming that the employees were fully paid the gratuities earned, the evidence shows that the gratuities were not paid separately but used to fund wages, and therefore, must be subject to taxation.

Recommendation:

For the foregoing reasons, it is recommended that the NTLs be finalized as issued.

Kelly K. Yi
Administrative Law Judge

January 21, 2016