

Sales Tax on Gratuities and Service Charges

This memorandum explains the existing Tax Department policy on applying state and local sales taxes (sales tax) to gratuities and service charges.

General

Section 1105(d) of the Tax Law imposes sales tax on the receipts, including any cover, minimum, entertainment, or other charge, from every sale of beer, wine, or other alcoholic beverages and food or drink of any nature sold in or by restaurants, taverns, or other establishments or by caterers. Therefore, as a rule, the total charges by such establishments from the sale of food and drink, including gratuities and/or service charges, are subject to sales tax under section 1105(d). However, section 527.8(1) of the Sales Tax Regulations contains an exception to this rule:

Gratuities and service charges. Any charge, made to a customer, is taxable as a receipt from the sale of food or drink unless:

- (1) the charge is separately stated on the bill or invoice given to the customer;
- (2) the charge is specifically designated as a gratuity; and
- (3) all such monies received are paid over in total to employees.

Based on the law and regulations, the department has established the following policy on the taxation of voluntary and mandatory gratuities and service charges.

Voluntary gratuities

When a customer chooses to leave a gratuity for a waitperson, it is considered a voluntary gratuity. In some cases, the waitperson keeps all the voluntary gratuities that he or she receives. In other cases, the establishment gathers all of the voluntary gratuities and divides them among the wait staff, the kitchen staff, and the host or hostess (the employees). Occasionally, an establishment may keep part of the gratuities. Since the gratuities are voluntary, they do not constitute a charge by the establishment and are not subject to sales tax.

Mandatory gratuities

Establishments may charge a mandatory gratuity in certain situations. For example, some establishments add a gratuity of 20% to all checks for groups of six or more. Since the gratuity charge is made by the establishment, the gratuity is subject to sales tax unless all three of the conditions in regulation section 527.8(1) are met. Accordingly, if an establishment separately states the gratuity charge on the check (or other invoice) given to a customer, specifically

designates the charge as a gratuity, and gives 100% of the gratuity collected to the employees, the gratuity is not subject to sales tax.

In some cases, an establishment may use part of an employee's gratuities to pay part of the employee's tax liability (for example, withholding tax or the employee's portion of social security) and give the remainder of the gratuities to the employee. Since the end result of this situation is that 100% of the gratuities are, in effect, turned over to the employee, the gratuities charge is not subject to sales tax. However, if the establishment keeps any part of the gratuities or uses any part of the gratuities to pay its own liabilities, such as the employee's wages or the employer's portion of social security, the entire gratuities charge is subject to sales tax.

Union contract or other agreement

The mere existence of a union contract or other agreement regarding gratuities does not determine the taxability of mandatory gratuities. However, the existence of a union contract may make it difficult to establish if condition 3 of regulation section 527.8(1) has been met.

For example, an establishment may impose mandatory gratuities, separately state them on the checks as gratuities and, pursuant to a contract or other agreement, give 100% of the gratuities to the union. In this case, the establishment would also have to substantiate that the union turned over 100% of the gratuities to the employees (i.e., that condition 3 is met) in order for the gratuities to be exempt from sales tax. Condition 3 would be met if the contract or agreement allows the union to apply employees' gratuities to union dues and other union fees that the employees owe, provided any remaining gratuities are turned over to employees.

Service charges

Separately stated service charges or other charges not specifically designated as gratuities on a bill or invoice are always subject to sales tax.

Examples

The following examples illustrate the policy on gratuities and service charges set forth in this memorandum. Unless otherwise stated, the examples assume that any charge for gratuities is separately stated and designated as a gratuity on the bill or invoice (i.e., conditions 1 and 2 in the regulation have been met).

- 1. A hotel charges an 18% gratuity on all banquets held at the hotel. The hotel turns the entire amount over to its wait staff. There is no sales tax on the 18% gratuity charge.*
- 2. A hotel charges a \$2.00 per person gratuity and a \$1.00 per person service charge for rolling bar services at banquets held at the hotel. The hotel separately states the charges on the invoice as a gratuity and service charge, respectively. The hotel pays the entire gratuity amount to its wait staff. There is no sales tax on the gratuity charge. However, the service charge is subject to sales tax.*

3. *A caterer charges its customers an 8% service charge and a 15% gratuity that are separately stated and designated as a service charge and gratuity on the invoice. Both the service charge and gratuity are entirely turned over to the servers. The 15% gratuity is not subject to sales tax. However, the 8% service charge is subject to sales tax because it was not designated as a gratuity.*
4. *A hotel charges a 23% gratuity on all banquets held at the hotel. Of the 23% charge, the hotel pays its wait staff 18% and retains 5%. The entire 23% charge is subject to sales tax because the entire amount is not paid over to employees.*
5. *A hotel charges its customers an 8% service charge and a 15% gratuity that are separately stated and designated as a service charge and gratuity respectively on the invoice. Of the 23% charge, the hotel retains the 8% service charge and pays its wait staff the entire 15% gratuity. The 8% service charge is subject to sales tax because it was not designated as a gratuity and because it was not paid over to employees. However, the 15% gratuity is not subject to sales tax because it was designated as a gratuity and because it was paid over to employees.*
6. *A restaurant uses mandatory gratuities to pay the wages of the wait staff. Since the employer has used the gratuities to meet the employer's wage obligations, the gratuities are subject to sales tax.*
7. *An establishment uses all mandatory gratuities collected from customers to pay the servers' portion of social security and withholding tax. Since the servers' portions of social security and withholding taxes are the obligations of the employees, this is the equivalent of turning the gratuities over to the servers and; therefore, the gratuities are not subject to sales tax. However, if the establishment uses any portion of the gratuities to pay the employer's portion of employment taxes, the entire gratuity is subject to sales tax since the employer's portion of the employment taxes is the employer's obligation.*
8. *A hotel has a contract with a restaurant workers union that states that the hotel will charge a mandatory gratuity of 18% and will turn all of those gratuities over to the union. The contract also states that the union must turn all of the gratuities it receives over to the employees. If the hotel can establish that the union did in fact pay all the gratuities over to the employees, the gratuities are not subject to sales tax.*

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