

ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 02-1

(This ruling supersedes and rescinds Arizona Transaction Privilege Tax Ruling TPR 96-3)

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

ISSUE:

Complimentary food and drink provided by restaurants or lodging facilities.

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 42-5001(5) states that "gross proceeds of sales" means the value proceeding or accruing from the sale of tangible personal property without any deduction on account of the cost of property sold, expense of any kind or losses, but cash discounts allowed and taken on sales are not included as gross income.

A.R.S. § 42-5001(13) states that "sale" means any transfer of title or possession, or both, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatever, including consignment transactions and auctions, of tangible personal property or other activities taxable under this chapter, for a consideration.

A.R.S. § 42-5061 imposes the transaction privilege tax on the retail classification. The retail classification is comprised of the business of selling tangible personal property at retail. The tax base for the retail classification is the gross proceeds of sales or gross income derived from the business.

A.R.S. § 42-5061(A)(5) provides that the tax imposed on the retail classification does not apply to the gross proceeds of sales or gross income from sales to persons engaged in business classified under the restaurant classification of articles used by human beings for food, drink or condiment, whether simple, mixed or compounded.

A.R.S. § 42-5061(A)(47) provides that the tax imposed on the retail classification does not apply to the gross proceeds of sales or gross income from tangible personal property sold to a

person engaged in business and subject to tax under the transient lodging classification if the tangible personal property is a personal hygiene item or articles used by human beings for food, drink or condiment, except alcoholic beverages, which are furnished without additional charge to and intended to be consumed by the transient during the transient's occupancy.

A.R.S. § 42-5061(A)(52) provides that the tax imposed on the retail classification does not apply to the gross proceeds of sales or gross income from sales of any spirituous, vinous or malt liquor by a person that is licensed in this state as a wholesaler by the department of liquor licenses and control pursuant to title 4, chapter 2, article 1.

A.R.S. § 42-5074 imposes the transaction privilege tax under the restaurant classification, which is comprised of the business of operating restaurants, dining cars, dining rooms, lunchrooms, lunch stands, soda fountains, catering services or similar establishments where articles of food or drink are sold for consumption on or off the premises. The tax base for the restaurant classification is the gross proceeds of sales or gross income derived from the business.

A.R.S. § 42-5151(20) defines "use or consumption" as the exercise of any right or power over tangible personal property incidental to owning the property except holding for sale or selling the property in the regular course of business.

A.R.S. § 42-5155 imposes Arizona's use tax on tangible personal property purchased from a retailer which is used, stored or consumed in Arizona, and stipulates that the use tax applies to any tangible personal property that was purchased for resale which is subsequently used or consumed by the purchaser.

A.R.S. § 42-5159(A)(13)(k) provides that the use tax does not apply to tangible personal property purchased by a person engaged in business under the transient lodging classification if the tangible personal property is a personal hygiene product or articles used by human beings for food, drink or condiment, except alcoholic beverages, which are furnished without additional charge to and intended to be consumed by the transient during the transient's occupancy.

A.R.S. § 42-5159(A)(25) provides that the use tax does not apply to tangible personal property that is used or consumed in a business subject to § 42-5074 for human food, drink or condiment, whether simple, mixed or compounded.

DISCUSSION:

Establishments Taxed Under the Restaurant Classification

Restaurants and drinking establishments frequently supply food and drink to customers free or

at reduced prices. The food or drink is provided as an incentive to bring customers to the establishment or as goodwill to increase the customers' enjoyment of the establishment. Examples include complimentary food furnished to customers as a buffet, as individual items provided to a table of customers, or discounts on customers' purchase of menu items.

All sales of tangible personal property are subject to transaction privilege tax under the retail classification unless a specific statutory exclusion or deduction applies. A.R.S. § 42-5061(A)(5) provides that the transaction privilege tax does not apply to the gross proceeds of sales or gross income from sales of articles used by human beings as food, drink or condiment when purchased by establishments taxable under the restaurant classification. Therefore, retailers that sell food items to restaurants are not subject to transaction privilege tax on the gross proceeds of sales or gross income from such sales.

Use tax is imposed on the use or consumption in this state of tangible personal property that is purchased from a retailer. The use tax does not apply if the transaction privilege tax was paid when the item was purchased. A purchaser who purchases tangible personal property for resale but subsequently uses or consumes the property is subject to use tax. However, A.R.S. § 42-5159(A)(25) provides that the use tax does not apply to food that is used or consumed in a business subject to the restaurant classification. Food provided free of charge by a restaurant or bar for a business purpose, such as attracting new customers, is exempt from use tax. Food provided free of charge by a restaurant or bar for a non-business purpose, such as feeding the owner's family, is subject to use tax on the purchase price of the food.

However, pursuant to A.R.S. § 42-5074, a business classified under the restaurant classification must pay the transaction privilege tax on its gross proceeds of sales or gross income. Cash discounts allowed and taken on sales are not included in the gross proceeds of sales under the restaurant classification. Thus, the transaction privilege tax only applies to the gross income received from the items sold.

Establishments Taxed Under the Transient Lodging Classification

Laws 2001, Chapter 137 (Senate Bill 1130) amended the retail classification and use tax statutes to provide that tax does not apply to articles used by human beings for food, drink or condiment, except alcoholic beverages, sold to a person engaged in business and subject to tax under the transient lodging classification, which are furnished without additional charge to and intended to be consumed by the transient during the transient's occupancy. This enactment is effective from and after August 9, 2001, and applies retroactively to taxable periods beginning from and after June 7, 1994. (See TPP 01-2 for information regarding the procedure for requesting a refund of tax paid that is available under the retroactive provisions of this legislation.)

Lodging facilities such as hotels, motels, bed and breakfasts, inns or other lodging facilities in

the business of providing lodging to transients in exchange for consideration may provide complimentary food and beverages to their customers. Examples of complimentary items include continental breakfasts and free social hours where alcoholic and non-alcoholic beverages and food are provided to customers. A lodging facility provides a service. As a business engaged in providing a service, it consumes the food and beverages it purchases for its customers. It does not resell them.

A specific statutory exclusion is provided for sales of food and non-alcoholic beverages by a person conducting business under the retail classification, sold to a transient lodging business that will provide the items to guests at no additional charge. The gross proceeds of sales or gross income from such sales are not subject to tax. Additionally, the gross proceeds of sales or gross income from sales of alcoholic beverages by a licensed liquor wholesaler are not subject to tax.

Sales of prepared food items by a restaurant or caterer are subject to tax under the restaurant classification and not the retail classification. There are no deductions or exclusions under the restaurant classification for sales to a transient lodging business. Therefore, the gross proceeds of sales or gross income from sales by a restaurant or caterer to a transient lodging business are taxable, notwithstanding that the transient lodging business will furnish the food to guests at no additional cost.

A hotel may contain a restaurant that is a separate legal entity. If the restaurant business purchases and prepares the food that is given free of charge by the hotel to transient lodgers and the restaurant is paid by the transient lodging business, the restaurant is subject to transaction privilege tax on the amounts received from the transient lodging business. If the restaurant is not paid by the transient lodging business for the food given free of charge to transient lodgers, then the restaurant is subject to use tax on the food since it is not used or consumed in the furtherance of the restaurant business.

RULING:

A restaurant that provides complimentary food or beverages to its customers as a business strategy to increase sales is not subject to use tax on the food or beverage. If the food is given away for a purpose unrelated to the restaurant business then the restaurant is subject to use tax on the purchase price of the food and beverage. The restaurant is subject to transaction privilege tax on its gross receipts.

Examples:

1. ABC Restaurant offers a "happy hour" during which it

provides customers a complimentary buffet and two-for-one drinks between 4:00 p.m. and 6:00 p.m. The complimentary food is provided to customers to encourage them to stay and buy drinks after happy hour is over. The use of the food is exempt from use tax because it was used in the restaurant business. A cocktail normally sells for \$4.00. A customer purchases a cocktail, which entitles her to two cocktails. She also partakes of the complimentary buffet. The restaurant collects \$4.00 from the customer. The restaurant is subject to transaction privilege tax on \$4.00.

2. XYZ Restaurant provides free meals to the owner's children after they get out of school. The use of the food is not exempt from use tax because the food is used for a purpose unrelated to the restaurant business.

The transaction privilege tax does not apply to the gross proceeds of sales or gross income from sales of food and non-alcoholic beverages by a person conducting business under the retail classification, sold to a transient lodging business that will provide the items to guests at no additional charge. Additionally, the tax imposed on the retail classification does not apply to the gross proceeds of sales or gross income from sales of any spirituous, vinous or malt liquor by a person that is licensed in this state as a wholesaler by the department of liquor licenses and control.

Example:

3. NewSuites Hotel does not have a restaurant; it only provides a complimentary "happy hour" for its guests. Employees of the hotel prepare and serve a variety of food and beverages. The hotel purchases the food and non-alcoholic beverages from a wholesale grocery warehouse. The alcoholic beverages are purchased from a licensed liquor wholesaler. The gross proceeds of sales or gross income from sales by the wholesale grocery warehouse are exempt from tax, as well as the gross proceeds of sales or gross income from sales by the liquor wholesaler.

The gross proceeds of sales or gross income from sales of food and drink by a person conducting business under the restaurant classification, sold to a transient lodging business that will provide the items to guests at no additional charge, is taxable.

Examples:

4. AllSuites Hotel provides complimentary breakfasts to its customers. The breakfast is purchased from a caterer that brings the food items to the lobby of the hotel. The hotel also provides a complimentary social hour between 5:00 p.m. and 7:00 p.m. The same caterer provides the beverages and food items served during the social hour. The caterer must pay transaction privilege tax under the restaurant classification on the gross receipts from the transactions.

5. Phoenix Hotel contains a restaurant that is a separate legal entity. The hotel provides a free breakfast buffet for the transient lodgers. The buffet is prepared by the restaurant business. The restaurant business is paid \$5.00 for each transient lodger by the transient lodging business. The restaurant is subject to transaction privilege tax, under the restaurant classification on the \$5.00 paid by the transient lodging business.

Mark W. Killian, Director
Signed: February 19, 2002

Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law that are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement that provides interpretation, detail, or supplementary information concerning application of the law. Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.