STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

DIVISION OF TAXATION

ADMINISTRATIVE HEARING

FINAL DECISION AND ORDER

#2015-04

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
DEPARTMENT OF REVENUE
DVISION OF TAXATION
ONE CAPITOL HILL
PROVIDENCE, RHODE ISLAND 02908

IN THE MATTER OF:	
	Case No. 14-T-0033
	sales and use
Taxpayers.	

DECISION

I. INTRODUCTION

The above-entitled matter came before the undersigned as a result of a Notice of Hearing and Appointment of Hearing Officer ("Notice") dated April 11, 2014 and issued to the above captioned taxpayers ("Taxpayers") by the Division of Taxation ("Division") in response to the Taxpayers' request for hearing filed with the Division. The hearing was held on October 27, 2014. The Division was represented by counsel and the Taxpayers by their Chief Financial Officer. The parties timely submitted briefs by December 24, 2014.

II. JURISDICTION

The Division has jurisdiction over this matter pursuant to R.I. Gen. Laws § 44-18-1 *et seq.*, R.I. Gen. Laws § 44-19-1 *et seq.*, R.I. Gen. Laws § 44-1-1 *et seq.*, the *Division of Taxation Administrative Hearing Procedures Regulation AHP 97-01*, and the *Division of Legal Services Regulation 1 Rules of Procedure for Administrative Hearings.*

III. ISSUE

The parties agreed that issue is whether complimentary drinks are subject to use tax as a retailer making use of an inventory acquired *extax*, or are they non-taxable as discounts to the sales price made by the retailer at the point of sale?

IV. MATERIAL FACTS AND TESTIMONY

The parties agreed to the following facts:[1]

1. The seven (7) named Taxpayers are all properly chartered in Rhode Island with their principal places of business being in Rhode Island. All hold permits to make sales at retail and held them during the relevant audit period. All seven (7) are full service restaurants with alcohol sales with one (1) also operating a resort and inn. Exhibits One (1) through Fourteen (14). There is also a domestic for profit corporation with its principal place of business in Rhode Island that is a parent or affiliate of the Taxpayers and its declared business activity is to operate as a hospitality management company. Exhibits 15 and 16.

2. The Division is a state agency charged with the administration and enforcement of all state taxes including, *inter alia*, the sales and use tax and the meals and beverage tax imposed pursuant to R.I. Gen. Laws § 44-18-1 *et seq.*, R.I. Gen. Laws § 44-18.1-1 *et seq.*, and R.I. Gen. Laws § 44-19-1 *et seq.*

3. In August and September of 2013, a routine sales and use tax field audit of the Taxpayers was commenced for the period encompassing October 1, 2010 through September 30, 2013 inclusive ("Audit Period").

4. The Taxpayers all had a history of routinely filing and remitting sales tax to the Division during the Audit Period. Statute of Limitations waivers were secured for purposes of assessment. Exhibits 24-36.

5. During the course of the audit, the Division's agent reviewed the following records for each of the Taxpayers: general ledgers, corporate returns, sales and use tax returns, meals and beverage tax returns, bank deposits, sales journals, asset additions, expenses, and payroll documents. The condition of the Taxpayers' business records were good; they were complete, well organized and adequate for audit purposes.

6. Due to the volume of records, portions of the audit were performed on the basis of test sampling and duly executed Test Period Agreements were obtained from all the Taxpayers. Exhibits 37-43.

[1] See parties' agreed to statement of facts and agreed to exhibits filed with the undersigned.

7. As a result of this examination, the Division's agent, *inter alia*, determined additional taxable measures for each of the seven (7) Taxpayers. The taxable measure for each taxpayer is contained in their audit workpapers. Exhibits 44-50.

8. These taxable measures were all denoted Schedule 3B-1 and captioned "Use Tax Due on (Liquor) Comps" in the audit documents. This particular area of the audit was performed on the basis of the estimated wholesale cost of the liquor dispensed by each of the Taxpayers during the Audit Period in the form of complimentary drinks. Exhibits 44-50 (2nd page).

9. On January 14, 2014, a closing conference was held. The Division's auditor explained the audit findings and provided the Taxpayers' representative with audit work papers. Exhibits 51-57 (audit work paper receipts).

10. Portions of the audit were billed as agreed deficiency notices and issued under separate cover. These matters were paid and are not in dispute here. However, the Taxpayers' representative indicated disagreement with the Schedules 3B-1 denoted "Use Tax Due on (Liquor) Comps."

11. As a result, on different dates between January 29 and February 26 of 2014, seven (7) disagreed deficiency notices were issued against the Taxpayers seeking additional use tax and statutory interest. Exhibits 58-64 (interest calculation worksheets). The amounts asserted by the Division to be owed including tax and interest for each of the seven (7) Taxpayers are contained in their respective Notices of Deficiency. Exhibits 65-71 (the separate notices of deficiencies).

12. The Taxpayers filed timely requests with the Division for administrative review with regard to the disagreed deficiency determinations. The Taxpayers were afforded an informal preliminary conference and as the parties were still in disagreement after the preliminary conference, the matter was forwarded for a formal administrative hearing. Exhibits 72 to 76.

13. The disputed assessments arose out of a common business practice in the restaurant industry whereby complimentary alcoholic beverages (a/k/a comp drinks) are given free of charge to dining patrons.

14. There are various reasons for a restaurant to serve a complimentary drink, but the three most common situations are that they are given (1) to regular customers as a token of appreciation; (2) to dining patrons who had an adverse dining experience; and (3) to encourage customers waiting to be seated to stay until a table becomes available.

15. The Taxpayers routinely gave out complimentary drinks during the Audit Period. Their general policy regarding complimentary drinks is that they are given only to dining patrons or prospective dining patrons (those awaiting table availability). They are not given to bar patrons who are not ordering meals. Generally, only one complimentary drink is given to each member of a dining party.

16. During the Audit Period, the Taxpayers kept detailed records of the complimentary drinks dispensed for inventory control purposes. They would do this by 'ringing up' and listing

the retail sales price of the complimentary drink as a line item on the sales receipt given to the customer and then listing, as an offsetting credit, a line item of an equal dollar amount on the same sales receipt. Exhibit 77. On occasion, the price of the complimentary drinks and their offsetting credits would be rung up and listed on separate sales receipts which were kept by the Taxpayers.

17. During the Audit Period, the Taxpayers purchased all alcoholic beverages from their distributors tax-free under resale certificates. These alcoholic beverages were purchased in bulk wholesale units (i.e; a case of wine bottles or keg of beer), but were dispensed and sold in smaller retail units (i.e; a glass or bottle of wine or a mug of draft beer); the retail selling price of which the Taxpayers used to compute their sales tax obligations.

18. The additional use tax was computed as follows:

- From a point of sale system, each Taxpayer determined the retail sales amount complimentary drinks during specific time periods within the Audit Period.
- A blended wholesale cost was estimated for all the alcoholic beverages purchased by the Taxpayers during specific time periods within the Audit Period. This blended wholesale cost ranged from 21.5% to 28.8% of the retail selling price of the drinks dispensed by the Taxpayers.
- The taxable measure was computed by multiplying the retail sales amount of complimentary drinks dispensed during a specific time period by the blended wholesale cost for that same time period.
- The Division's agent multiplied the resulting figures given to her by 7% to compute the use tax. Exhibits 44-50 (2nd page).

V. DISCUSSION

A. Legislative Intent

The Rhode Island Supreme Court has consistently held that it effectuates legislative intent by examining a statute in its entirety and giving words their plain and ordinary meaning. *In re Falstaff Brewing Corp.,* 637 A.2d 1047 (R.I. 1994). If a statute is clear and unambiguous, "the Court must interpret the statute literally and must give the words of the statute their plain and ordinary meanings." *Oliveira v. Lombardi*, 794 A.2d 453, 457 (R.I. 2002) (citation omitted). The Supreme Court has also established that it will not interpret legislative enactments in a manner that renders them nugatory or that would produce an unreasonable result. See *Defenders of Animals v. Dept. of Environmental Management,* 553 A.2d 541 (R.I. 1989) (internal citation

omitted). In cases where a statute may contain ambiguous language, the Supreme Court has consistently held that the legislative intent must be considered. *Providence Journal Co. v. Rodgers*, 711 A.2d 1131 (R.I. 1998). The statutory provisions must be examined in their entirety and the meaning most consistent with the policies and purposes of the legislature must be effectuated. *Id.*

B. Relevant Statutes

Pursuant to R.I. Gen. Laws § 44-18-18, Rhode Island imposes a sales tax of 7% on gross receipts of a retailer. Pursuant to R.I. Gen. Laws § 44-18-19, the retailer is responsible for the collection of sales tax. Pursuant to R.I. Gen. Laws § 44-18-20, a use tax is imposed on the storage, use or consumption of tangible personal property. "The use tax . . . is a complement to Rhode Island's sales tax . . . The sales tax applies to 'sales at retail in this state.' (citation omitted). The use tax, in contradistinction, is imposed on 'the storage, use, or other consumption in this state of tangible personal property.'" *Dart Industries, Inc. v. Clark*, 696 A.2d 306, 309 (R.I.1997). In this matter, the Division argued that the complimentary drinks are subject to the use tax.

R.I. Gen. Laws § 44-18-12 defines "sales price" in part as follows:

> "Sale price" defined. – (a) "Sales price" applies to the measure subject to sales tax and means the total amount of consideration, including cash, credit, property, and services, for which personal property or services are sold, leased, or rented, valued in money, whether received in money or otherwise, without any deduction for the following:
> ***
> (b) "Sales price" shall not include:
> (i) Discounts, including cash, term, or coupons that are not reimbursed by a third party that are allowed by a seller and taken by a purchaser on a sale.

R.I. Gen. Laws § 44-18-8 provides in part as follows:

> Retail sale or sale at retail defined. – A "retail sale" or "sale at retail" means any sale, lease or rentals of tangible personal property, prewritten computer software delivered electronically or by load and leave, or services as defined in § 44-18-7.3 for any purpose other than resale, sublease or subrent in the regular course of business.

The sale of tangible personal property to be used for purposes of rental in the regular course of business is considered to be a sale for resale. ***

R.I. Gen. Laws § 44-18-13 provides as follows:

> Gross receipts defined. – "Gross receipts" means the total amount of the sale price, as defined in § 44-18-12 or the measure subject to tax as defined in § 44-18-12.1, of the retail sales of retailers.

R.I. Gen. Laws § 44-18-7 provides in part as follows

> Sales defined. – "Sales" means and includes:
> (1) Any transfer of title or possession, exchange, barter, lease, or rental, conditional or otherwise, in any manner or by any means of tangible personal property for a consideration. "Transfer of possession", "lease", or "rental" includes transactions found by the tax administrator to be in lieu of a transfer of title, exchange, or barter.
> ***
> (4) The furnishing, preparing, or serving for consideration of food, meals, or drinks, including any cover, minimum, entertainment, or other charge in connection therewith.

C. Arguments

The Division argued that complimentary drinks are not discounts at the point of sale pursuant to R.I. Gen. Laws § 44-18-12 since the free drinks are not available to all patrons and the Taxpayers exercise absolute discretion over whom shall get the complimentary drinks. The Division relied on the guidance of Division Sales and Use Tax Regulation SU 07-140 *Coupons – Discounted Selling Price – Buydowns* ("SU 07-140") arguing that the regulation requires that if merchandise is "unconditionally free of charge" and the retailer received no third-party reimbursement then the retailer is liable for tax upon the amount it paid for that item. The Division argued that R.I. Gen. Laws § 44-18-12 connotes that a discount is given for certain criteria (e.g. designated menu, designated day) but in this matter, the Taxpayers have absolute discretion in the giving of free drinks.

The Division also argued that some of the complimentary gifts represent business gifts which have been previously ruled to be a retailer's use of inventory. The Division relied on its

Administrative Decision 85-87 (5/20/85) ("85-87 Decision") in which a resort hotel acquired tangible personal property tax free and distributed them free of charge to prospective customers after they toured the facilities and heard a presentation for a "time share." That decision found these items to be gifts and subject to use tax. That decision relied on the Gifts and Premium regulation now known as Division Sales and Use Tax Regulation SU 87-53 *Gifts and Premiums* ("SU 87-53"). The Division also argued that dispensing complimentary drinks does not constitute a sale that can be the object of a discount because there is no mutual consideration. The Division argued that there is no consideration to buy another drink or return for another meal on the part of the patrons.

On the basis of its arguments, the Division argued that pursuant to R.I. Gen. Laws § 44-18-25, the complimentary drinks are subject to use tax and that it was the Taxpayers' burden on R.I. Gen. Laws § 44-18-25 to show otherwise and they cannot.

The Taxpayers argued that complimentary drinks are discounts provided for consideration because the drinks are only given to patrons dining in the restaurant and are part of the meal. The Taxpayers argued that the complimentary drinks are excluded from the "sales price" as they are discounts. The Taxpayers argued that whether complimentary drinks are available to all patrons or are based on objective criteria is not relevant. The Taxpayers argued that SU 07-140 is not relevant as it pertains to coupons. The Taxpayers argued that the drinks are only given to those patrons that are dining as part of a meal and are not given unconditionally free of charge. The Taxpayers argued that there is no basis for the Division to claim that there needs to be "objective" criteria for the point of sale discount since the statute does not provide that a discount be available to all patrons.

The Taxpayers argued that the complimentary drinks are part of a sale of a meal so that there is consideration between the Taxpayers and their patrons as meals are provided for consideration. Thus, the Taxpayers argued that their patrons are actually purchasing something (a meal) unlike the prospective purchasers of time shares who received free gifts in return for touring facilities. Additionally, the Taxpayers argued that the time shares purposely purchased items *extax* to give away in return for tours as opposed to the Taxpayers who purchase alcohol *extax* with the intent to resell it except in the instance of complimentary drinks given as a discount as part of a sale. The Taxpayers argued that they receive payment from patrons for dining unlike when free gifts for advertising, etc. as discussed in SU 87-53.

The Taxpayers argued that the use tax does not apply to complimentary drinks as the use tax applies to the storage or use of property for other purposes and for the purpose of the use tax, storage is defined as being retained in state except for sale in the regular course of business. The Taxpayers argued that their regular course of business includes the sale of complimentary drinks so that said drinks do not fall under the definitions of either storage or use.[2]

D. Whether the Taxpayer Owes the Assessments

In interpreting a statute, words are given their clear and unambiguous meanings. In *Roadway Express, Inc. v. Rhode Island Commission for Human Rights*, 416 A.2d 673, 674 (R.I. 1980), the Court relied on a dictionary definition in applying the "ordinary meaning" of "must."

[2] The Division argued that complimentary drinks do not fall under the demonstration or display of inventory as exemption provided for in R.I. Gen. Laws § 44-18-26. The Taxpayers did not assert that this statute applied to their complimentary drinks. It is clear that their use of complimentary drinks would not be considered a demonstration or display of inventory.

The Division also referenced the Taxpayers' argument that they already paid more on sales tax on liquor to cover any use tax on the wholesale cost of complimentary drinks. However, the Taxpayers did not rely on that argument and it does not need to be addressed as the issue is one of statutory interpretation and not the equities of taxing. It should be noted that equitable principles are not applicable to an administrative procedure. See *Nickerson v. Reitsma*, 853 A.2d 1202 (R.I. 2004) (Supreme Court vacated a Superior Court order that had vacated an agency sanction on so-called inherent equitable powers).

As the Court has found, "[i]n a situation in which a statute does not define a word, courts often apply the common meaning given, as given by a recognized dictionary." *Defenders of Animals, Inc.*, at 543. This statute provides that sales prices does not include discounts, including cash, term, or coupons that are not reimbursed by a third party that are allowed by a seller and taken by a purchaser on sale.

SU 07-140 explains and defines when coupons fall under the statutory definition of discount and when they do not. No regulation has been promulgated on discounts in general. *Black's Law Dictionary* (9th ed. 2009) defines "discount" as a "reduction from the full amount or value of something, esp. a price." It defines "cash discount" as a "seller's price reduction in exchange for an immediate cash payment" or a "reduction from the stated price if the bill is paid on or before a specified date." *Mirriam-Webster's* defines "discount" as "an amount taken off a regular price: a price reduction."[3] It defines "cash discount" as "a discount granted in consideration of immediate payment or payment within a prescribed time."[4] There are a variety of different types of different types of discounts that can be given on the terms of sales. For example, "2% Net 10" means that a customer will be given a 2% discount if the customer pays within 10 days.[5]

The complimentary drinks that were given were not a cash discount or a discount on the terms of payment. Nor were they given as a result of patrons using coupons. Rather the discount received by the patrons is a reduction from the full amount of the price or value something, especially the price. In this matter, the Taxpayers reduced the price of a meal by reducing the price of an alcoholic drink to "zero."

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[3] See http://www.merriam-webster.com/dictionary/discount.

[4] See http://www.merriam-webster.com/dictionary/cash%20discount.

[5] For example see, http://www.accountingtools.com/credit-terms-cost-of-credit.

Pursuant to R.I. Gen. Laws § 44-19-33,[6] the Division may promulgate regulations which are considered *prima facie* evidence of a statute's proper interpretation. The Division has not promulgated regulations related to complimentary drinks. Some states have regulations or statutes addressing the issue of complimentary drinks.[7] However, none of the other states which have a similar definition of sales (excluding discounts) have addressed the issue of complimentary drinks in the context of that definition. Since Rhode Island has not promulgated regulations on complimentary drinks, the issue revolves around the statutory definition of discount.

a. Business Gifts

In the Division's *Administrative Decision* 85-87, a hotel that sold time-share units bought items to give free of charge to potential customers for touring its facilities. The decision found that there was no sale or resale of items to the customers but rather the items were promotional items given to entice individuals to tour the facilities. The Division argued that complimentary drinks given to long-terms patrons are the same the same kind of promotional giveaway. However, unlike the time-share tours, the complimentary drinks are being given to long-term patrons who already have chosen to dine at a restaurant that night and are not being offered to

[6] R.I. Gen. Laws § 44-19-33 provides as follows:

> Rules and regulations – Forms. – The tax administrator may prescribe rules and regulations, not inconsistent with law, to carry into effect the provisions of chapters 18 and 19 of this title, which rules and regulations, when reasonably designed to carry out the intent and purpose of those chapters, are prima facie evidence of their proper interpretation. Those rules and regulations may from time to time be amended, suspended, or revoked, in whole or in part, by the tax administrator. The tax administrator may prescribe, and may furnish, any forms necessary or proper for the administration of those chapters.

[7] For example, Texas has a regulation that excludes free drinks from the gross receipts tax base but taxes the ingredients. See 34 TAC § 3.1001. Similarly, in *In the Matter of the Petitions of 172 Franklin Street, Inc. d/b/a The Buffalo House and David C. Forness*, 2000 WL 815502 (N.Y.Div.Tax.App), the audit guidelines provided for a 15% factor for spillage, overpouring, pilferage, employee drinks, and complimentary drinks but the guidelines noted that portions of the 15% allowance that represent employee and complimentary drinks are subject to use tax. South Carolina apparently imposes an excise tax on liquor sales for on-premises consumption and includes in the definition of gross receipts, the retail value of complimentary drinks. S.C. Code Ann. § 12-33-245.

entice patrons to dine that night at the restaurant. The drinks are not part of any offer to bring in long-term patrons to dine. They are not given away as advertising or sample use or as a prize as delineated in SU 87-53.[8] [9]

b. Coupons

SU 07-140[10] was promulgated in relation to the statutory inclusion of coupons as a discount, "coupons that are not reimbursed by a third party that are allowed by a seller and taken

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[8] SU 87-53 provides as follows:

> Gifts and Premiums
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> Tax applies to sales of tangible personal property to persons who make gifts of the property to others, as for example, property:
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> (a) given away for advertising purposes
>
> (b) given away for sample use
>
> (c) awarded as prizes, the winning of which depends upon chance or skill.
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> Tax does not apply to sales of tangible personal property to be given as a premium, together with tangible personal property sold by the purchaser of the premium. The transaction is regarded as a sale of both articles and the sale of the premium for such purpose is therefore a sale for resale, provided the obtaining of the premium is certain and does not depend upon chance or skill. Tax applies to the entire gross receipts received by the retailer from the purchaser of the goods and the premium, except where a premium, is delivered along with another exempt item, to a purchaser thereof. In such case, tax applies to the gross receipts from the sale of the premium, which will be regarded as the cost of the premium to the retailer, in the absence of any evidence that the retailer is receiving a larger sum. If there is no such evidence, and if the retailer has paid sales tax reimbursement to his or her vendors of the premiums, or use tax to his or her vendors or to the state, measured by the sale price of the premiums to him or her, no further tax is due from him or her.

[9] As an aside, if a restaurant which holds a Class BV liquor license offered free drink promotions those would most likely be in violation of R.I. Gen. Laws § 3-7-26.

[10] SU-140 provides in part as follows:

> Coupons - Discounted Selling Price - Buydowns
>
> Generally
>
> Cash discounts allowed and taken at the time of sale are excluded from the sales price of tangible personal property upon which the sales tax is based. Cash discounts which are given to customers after the time of sale are not excluded from the sales price.
>
> ***
>
> Price Reduction Coupons
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> In general, sales tax treatment of purchases made or items obtained using coupons which result in a reduced price to the consumer is based on whether or not the retailer can be reimbursed for the coupon by a manufacturer or other third party.
>
> A. "Retailer's or Store Coupons" are coupons issued by the retailer. When a retailer issues a store coupon and receives no reimbursement for the value of the coupon from any third party the tax is computed on the discounted sales price. This type of coupon is a seller's discount which is deducted from the sale price before computing the sales tax.
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> B. "Manufacturer's Coupons" are coupons issued by a manufacturer, distributor, promoter, or any other third party. When a retailer accepts a manufacturer's coupon for which it receives

by a purchaser on a sale." SU 07-140 states that in general, sales tax treatment of purchases made with coupons depends on whether the retailer is reimbursed for the coupon by a manufacturer or other third party. Thus, if a retailer issues a store coupon and receives no reimbursement for the value of the coupon, the tax is computed on the discounted sale price. However, if a retailer receives a manufacturer's coupon for which the retailer receives reimbursement the sales tax is computed on the full price of the merchandise.

If a retailer offers merchandise free with the purchase of merchandise and the retailer is reimbursed by the manufacturer, distributor, or other source, sales tax is levied on the usual sales price of the items. If a retailer gives a customer an item "unconditionally free of charge upon presentation of a coupon, and the retailer receives no reimbursement from any source for the

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reimbursement from the product manufacturer or any third party, the sales tax is computed on the full selling price of the item, i.e., the consideration paid to the retailer plus the face value of the coupon. The reimbursement may be in any form, including cash or credit towards the purchase of additional merchandise.

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Special Offers

If a retailer offers customers, upon presentation of a coupon, merchandise unconditionally free of charge, merchandise free of charge with the purchase of other merchandise or two items for the usual price of one, and the retailer receives reimbursement from a manufacturer, distributor, promoter or other source for the coupon, the sales tax is levied on the usual sales price of the item or items. The reimbursement may be in any form, including cash or credit towards the purchase of additional merchandise.

If a retailer sells an item to a customer at a discounted price and is reimbursed for the amount of the discount by a third party, the tax is computed on the discounted price of the item plus the reimbursement received whether or not a coupon is presented to the retailer.

If a retailer gives a customer an item unconditionally free of charge upon presentation of a coupon, and the retailer receives no reimbursement from any source for the coupon, the retailer is considered the consumer of that item and is responsible for the payment of a sales or use tax based upon the amount it paid for the item.

"Free" Meal Coupons

In general, the sales tax treatment of a "free" meal furnished to a customer who purchases another meal and presents a coupon or card for the free meal depends, like other coupon items, upon whether the restaurant receives any reimbursement for the coupon or card. If the restaurant issues its own coupon free of charge and does not receive any reimbursement for the coupon or card, the restaurant is regarded as selling two meals for the price of one and only one meal is subject to tax.

If the restaurant accepts a coupon or card which the customer previously purchased from a third party having a contract with the restaurant to redeem the coupons or cards and the restaurant is not reimbursed for the coupon or card, the restaurant is regarded as selling two meals for the price of one and only one meal is subject to tax.

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coupon," the retailer is considered the consumer of the item and is responsible for sales or use tax on the item. For free meals, treatment depends on reimbursement. If the restaurant accepts a coupon allowing a free meal with purchase of one meal and is not reimbursed, tax is only owed on one meal.[11] If a retailer offers a loyalty discount card at no cost to a customer and the discounts are identified on the register tape, the discounts are not included in the tax if there are no reimbursements received for the discounts.

The Division pointed to the SU 07-140 provision relating to merchandise given unconditionally free of charge. Complimentary drinks do not fall under that coupon scenario. In that example, a retailer gives a coupon that allows a customer to receive an item "unconditionally free of charge upon presentation of a coupon." The Taxpayers have not given their customers a coupon to receive a free drink unconditionally. Rather the Taxpayers have provided free drinks to dining customers in certain situations. The free-of-charge coupon requirement in the coupon regulation aligns with the gift and premium regulation in that the retailer who gives the free gift to potential customers (e.g. for a time share) is the ultimate consumer of the item like the retailer who gives the free-of-charge item coupon is the ultimate consumer. In this matter, the Taxpayers have not provided a free gift or an unconditional free gift coupon. However, the Taxpayers have given a discount for which they are not being reimbursed.

c. <u>Consideration</u>

The Division argued that complimentary drinks cannot be part of a sale that is the object of a cash discount because there is no mutual consideration. The Division argued that there is no

[11] The Taxpayers argued that by analogy SU 07-140 treatment of free meals is more applicable to the complimentary drinks in that if the restaurant offers a coupon for two-meals-for-price-of-one and is not being reimbursed for the free meal, only the cost of the one (1) meal is subject to tax. The Division argued that complimentary meals are distinguishable from complimentary drinks since food starts off with a presumption of non-taxability but alcohol does not since alcohol is excluded from the definition of exempt food pursuant to R.I. Gen. Laws § 44-18-7.1. However, meal served in a restaurant is taxed. Nonetheless, the issue in this matter turns on the statutory definition of discount.

obligation on the part of regular patrons who receive a free drink to buy another drink. The Division argued that those who receive free drinks while waiting for a table may choose to drink that one drink but order no other drinks. Thus, the Division argued there is no consideration for the free drinks as a sale is defined as a transfer of property for consideration. However, under the fact pattern in this matter, all patrons are buying a meal. The transfer of property is the payment for the meal. See R.I. Gen. Laws § 44-18-7. The complimentary drinks are then taken off the sales price of the meal which for some patrons included alcoholic drinks. The agreed to facts indicate that no one sitting at the bar only having a drink is given a free drink. The free drinks are a discount on the meal price only in the context of a patron purchasing a meal.[12]

d. Requirements to Receive a Discount

Using SU 07-140, the Division argued that it provides guidance so that the point of sale discount under R.I. Gen. Laws § 44-18-12 connotes that a customer is entitled to a price reduction if the customer meets certain criteria such as a discount for ordering off a certain menu or dining on a certain day and/or time. The Division argued that there must be objective criteria to receive a discount. The Taxpayers argued that there is no statutory requirement that there be objective criteria; however, the drinks were given based on established criteria (complaints, long-term patrons, patrons waiting to be seated).

The clear and unambiguous meaning of discount is a reduction in price. There is no requirement in the statute that a discount must be given if a customer meets "objective criteria." No regulation has been promulgated further refining the statutory meaning of discount to include

[12] It is unclear whether the long-terms patrons and complaining patrons who receive complimentary drinks only realize they will receive a "free drink" on the receipt of the bill or are informed after they have eaten their meal and complained or have sat down and ordered a meal and have been recognized as a long term patron. For those patrons who have a wait, it is unclear if the restaurant indicates that they can have a free drink while they wait or if the drink is only discounted upon presentation of the bill. Nonetheless, the only free drinks at issue in this matter are those given in conjunction with a meal.

objective criteria for the purpose of the imposing tax. Regulations have been promulgated on free gifts and coupons but complimentary drinks do not fall under either regulation.

e. Use Tax

Pursuant to R.I. Gen. Laws § 44-18-25,[13] there is a presumption that the use of all tangible personal property is subject to the use tax. The Division argued that the complimentary drinks are subject to the use tax as the Taxpayers are exercising the use[14] over their *ex tax* property. The Taxpayers argued that they are neither using nor storing the drinks pursuant to the use tax statute since the "use" and "storage"[15] definitions do not include the sale of the product in the regular course of business and as they are restaurants, they regularly sell food and drinks and the complimentary drinks are part of that sale. In the context of this fact pattern, the drinks are part of a meal that has been purchased by the patrons and for which there has been consideration. The drinks are then discounted as part of the sale.

f. Conclusion

Understandably, the Division is concerned about taxpayers circumventing the statutory sales or use tax by providing "discounts" that are really giveaways. However, merchandise

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[13] R.I. Gen. Laws § 44-18-25 provides as follows:

> Presumption that sale is for storage, use, or consumption – Resale certificate. – It is presumed that all gross receipts are subject to the sales tax, and that the use of all tangible personal property is subject to the use tax, and that all tangible personal property sold or in processing or intended for delivery or delivered in this state is sold or delivered for storage, use, or other consumption in this state, until the contrary is established to the satisfaction of the tax administrator. The burden of proving the contrary is upon the person who makes the sale and the purchaser, unless the person who makes the sale takes from the purchaser a certificate to the effect that the purchase was for resale. The certificate shall contain any information and be in the form that the tax administrator may require.

[14] R.I. Gen. Laws § 44-18-10 defines use as follows:

> "Use" defined. – "Use" includes the exercise of any right or power over tangible personal property incident to the ownership of that property, except that it does not include the sale of that property in the regular course of business.

[15] R.I. Gen. Laws § 44-18-9 defines storage as follows:

> "Storage" defined. – "Storage" includes any keeping or retention in this state, except for sale in the regular course of business or for subsequent use solely outside of this state, of tangible personal property purchased from a retailer.

giveaways fall under either the *Gift or Premium* regulation (SU 87-53) or the coupon for a free gift (SU 07-140). This matter relates to discounts given in very limited circumstances to certain patrons that are dining so that there is mutual consideration for meals.[16]

Based on the forgoing, the complimentary drinks are considered discounts so do not fall under the definition of "sales price" and therefore, the Taxpayers are not subject to additional tax or interest or penalty.[17]

VI. FINDINGS OF FACT

1. On or about April 11, 2014, the Division issued a Notice in response to the Taxpayers' request for hearing filed with the Division.

2. A hearing in this matter was held on October 27, 2014. The parties timely submitted briefs by December 24, 2014.

3. A sales and use tax field audit was conducted by the Division on the Taxpayer for the period of October 1, 2010 through September 30, 2013.

4. The facts contained in Sections IV and V are reincorporated by reference herein.

VII. CONCLUSIONS OF LAW

Based on the testimony and facts presented:

1. The Division has jurisdiction over this matter pursuant to R.I. Gen. Laws § 44-1-1 *et seq.*, R.I. Gen. Laws § 44-18-1 *et seq.*, and R.I. Gen. Laws § 44-19-1 *et seq.*

[16] The Taxpayers choose to discount a meal by giving a complimentary drink. The parties did not address the hypothetical of what would be the tax consequences of if the Taxpayers reduced the patrons' bills by a percentage of the bill.

[17] In this matter, the Tax Administrator had agreed to abate the penalty that would have been imposed pursuant to R.I. Gen. Laws § 44-19-12 if the Taxpayers were found to be liable for the assessed tax. See agreed statement of facts.

VIII. RECOMMENDATION

Based on the above analysis, the Hearing Officer recommends as follows:

The Taxpayers do not owe the assessed tax.

Date: 2/13/15

Catherine R. Warren
Hearing Officer

ORDER

I have read the Hearing Officer's Decision and Recommendation in this matter, and I hereby take the following action with regard to the Decision and Recommendation:

____ ADOPT
____ REJECT
____ MODIFY

Dated: 2/24/15

David Sullivan
Tax Administrator

NOTICE OF APPELLATE RIGHTS

THIS DECISION CONSTITUTES A FINAL ORDER OF THE DIVISION. THIS ORDER MAY BE APPEALED TO THE SIXTH DIVISION DISTRICT COURT PURSUANT TO THE FOLLOWING WHICH STATES AS FOLLOWS:

R.I. Gen. Laws § 44-19-18 Appeals

Appeals from administrative orders or decisions made pursuant to any provisions of this chapter are to the sixth (6th) division district court pursuant to chapter 8 of title 8. The taxpayer's right to appeal under this chapter is expressly made conditional upon prepayment of all taxes, interest, and penalties, unless the taxpayer moves for and is granted an exemption from the prepayment requirement pursuant to § 8-8-26.

CERTIFICATION

I hereby certify that on the 24th day of February, 2015 a copy of the above Decision and Notice of Appellate Rights were sent by first class mail, postage prepaid to the Taxpayer's representative at the address on file with the Division of Taxation and by hand delivery to Bernard Lemos, Esquire, Department of Administration, One Capitol Hill, Providence, RI 02908.