Nevada Supreme Court Confirms Meals Provided For Free Are Not Subject To Sales Or Use Tax

By John S. Bartlett, Esq.

On March 27, 2008 the Nevada Supreme Court on a 6-1 vote reversed a state district court and held that neither sales nor use tax was due on food purchased by a casino/restaurant and subsequently used to prepare and serve free complimentary meals to patrons and free meals to employees. See Sparks Nugget, Inc. v. State of Nevada ex rel. Department of Taxation, 124 Nev. ___, 179 P.3d 570 (2008). As a result of this decision the appellant, Sparks Nugget, is entitled to recover a refund of $501,369.77 in use taxes, plus interest.

The case began when Sparks Nugget filed a claim with the Nevada Department of Taxation on May 28, 2002 seeking a refund of these taxes. Both the Department of Taxation and the Nevada Tax Commission denied the claim. Thereafter, Sparks Nugget brought a complaint in the Second Judicial District Court for Washoe County to recover a refund of these taxes.

The matter was submitted to the District Court Judge on stipulated facts and cross motions for summary judgment. The parties stipulated that Sparks Nugget purchased the food at issue from its vendors in an unprepared state without paying sales or use tax at the time of purchase, and without providing the vendors with a resale certificate. To the extent Sparks Nugget used the food to prepare and sell meals in its restaurants the parties agreed Sparks Nugget collected and remitted sales tax on these sales. To the extent Sparks Nugget used the food to prepare and serve free meals to patrons (complimentary meals) or to employees, the parties agreed Sparks Nugget had accrued and remitted use tax to the Department of Taxation measured by the cost of the food used to prepare the meal. The amount of the use tax so accrued and remitted was the amount Sparks Nugget sought to obtain as a refund.

In its motion for summary judgment, Sparks Nugget argued that because it used the food at issue to prepare and serve free meals, no taxable moment occurred after its initial purchase of the food in the state of unprepared "food for human consumption." NRS 372.284(1) exempts the sale of "food for human consumption" from sales or use tax. Furthermore, article 10, §3A(1) of the Nevada Constitution specifically requires the Legislature to provide for the exemption of "food for human consumption" from sales or use tax. Sales or

use tax only apply to the retail sale of "prepared food intended for immediate consumption," a category of food excluded from the definition of "food for human consumption. See NRS 372.284(2)(d); Nev. Const. art. 10, §3A(2)(d). Therefore, Sparks Nugget argued, when it purchased the food as unprepared "food for human consumption" from its vendors and instead of reselling it in its restaurants subsequently gave it away for free, its purchase of the food from its

vendors was a retail purchase and exempt from sales or use tax under both the statutory exemption and the Nevada Constitution.

The Department responded by arguing two points. First, the Department pointed out that the statutory exemptions from sales and use tax only applied to retail sales transactions. Citing to the Nevada Supreme Court's decision in Nevada Tax Commission v. Nevada Cement Co., 117 Nev. 960, 36 P.3d 418 (2001), Sparks Nugget purchased all of its food with the primary purpose or intent to resell it, that is, in a wholesale transaction. Therefore, the food exemption could not apply to Sparks Nugget's food purchases. Second, when Sparks Nugget used the food as "prepared food intended for immediate consumption" a taxable moment took place that subjected Sparks Nugget to a use tax based on the cost of the food. The Department further argued the food exemption was never intended to apply to businesses, but was intended only for food purchased for home consumption.

The District Court granted summary judgment in favor of the Department, relying primarily on the Nevada Cement case and the Department's argument that Sparks Nugget was not entitled to rely on the food exemption when it furnished free meals to its patrons and employees. Sparks Nugget appealed this decision to the Nevada Supreme Court.

The Nevada Supreme Court opened its opinion with the statement. "In this appeal, we confront an issue of constitutional importance to Nevada: whether businesses in this state are required to pay sales or use tax on meals that they provide free of charge to patrons and employees. Article 10, §3A of the Nevada Constitution establishes a sales and use tax exemption for most "food for human consumption." Appellant contends that complimentary meals and employee meals are exempted under this provision because the uncooked food used to prepare those meals qualified as "food for human consumption" at the time of its initial purchase, and no taxable event occurred thereafter. We agree." Sparks Nugget, 179 P.3d at 572.

In reversing the District Court, the Nevada Supreme Court found the language of Article 10, §3A of the Nevada Constitution to be plain and unambiguous. Id. The Court found the language of both the constitutional provision and the statutory exemption exempted all sales of "food for human consumption" from sales or use tax, except for those cases where the food is sold as "prepared food intended for immediate consumption." Id., at 575.

The Court rejected the Department's argument that by using the unprepared "food for human consumption" it purchased to prepare free meals for its patrons and employees a taxable moment occurred to subject the cost of the food to use tax.

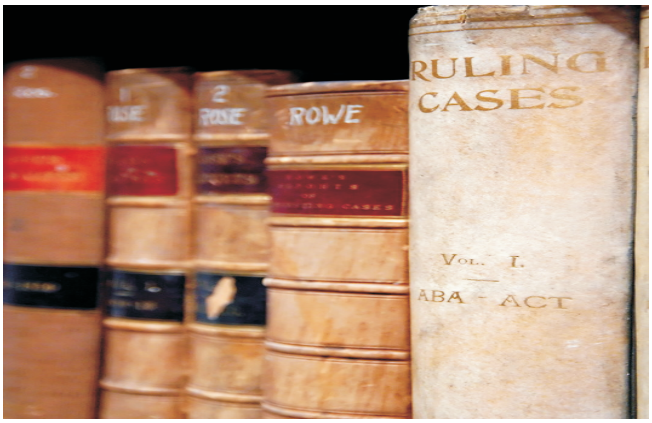
Because the food at issue in this case was not "prepared food intended for immediate consumption" at the time it was purchased by the Nugget, the Nugget's initial purchase was exempt from sales taxation. Furthermore, the Nugget's later "use" of that food to prepare complimentary meals was not subject to use taxation since the Nugget's "use" did not follow an otherwise taxable purchase that had "escaped" sales tax liability.
Id.

The Court also rejected the Department's arguments about the legislative intent of the food exemption. The Court noted the constitutional exemption of food for human consumption could have been written more narrowly. "Instead, however, the constitution's plain language clearly and broadly exempts all food for human consumption (unless that food if "prepared food intended for immediate consumption" at the time it is sold). Whether this exemption is the best approach is not for us to decide; we are bound to follow the constitution's plain language even though a different result might be desirable in some circumstances." Id., at 577.

Since this decision was issued, the State has filed a petition for rehearing which, as of this writing, remains pending. The State's petition is being supported by an amicus brief submitted by the Legislative Counsel Bureau. The petition and amicus brief basically re-argue the points raised in the initial

briefs to the Court, with LCB focusing primarily on the supposed legislative intent. The author believes the petition is without merit.

Reports in the press as to the potential economic impact of this decision range as high as $150 million. Given the current fiscal distress state government finds itself in, at the recent special session of the legislature a bill was drafted to reverse the Sparks Nugget decision retroactively. See AB 2, 2008 Special Session. While the bill went down to defeat in the Senate, one is left to ponder the ability of the legislature in the next special session to craft legislation to subject free complimentary meals and employee meals to sales or use taxation. The Nevada Supreme Court quite clearly based its ruling on



the plain and unambiguous language of article 10, §3A of the constitution; that the language mandated the exemption apply to all food sold with the exception of "prepared food intended for immediate consumption" at the time of sale. The legislature cannot simply legislate this constitutional provision away without changing the language in the constitution itself, a process that requires two legislative sessions and a vote of the people. Nev. Const. art. 16, §1. Therefore, the provision of free complimentary and employee meals should remain exempt from sales or use tax at least until 2011.

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The author is a sole practitioner based in Carson City, Nevada practicing in the area of state and local tax disputes. He formerly was a Sr. Deputy Attorney General assigned to represent the Nevada Department of Taxation and Nevada Tax Commission from 1987 to 1999. He has been involved in most of the Nevada Supreme Court cases involving sales and use taxation issued since 1988. Mr. Bartlett also regularly lectures on sales and use tax in Nevada, and would draft more articles if he had the time.