UPDATE ON ONGOING DISPUTE OVER THE

Application of Sales and Use Tax to Complimentary Meals and Free Meals to Employees

By John S. Bartlett

It is by now well-known there has been a long standing dispute between the gaming industry and the Nevada Department of Taxation over the proper application of the sales and use tax to food provided to casino patrons in the form of complimentary meals and to free meals provided to employees of the casino. From the perspective of the Department of Taxation's policy, three distinct stages can be identified: (1) the pre-*Sparks Nugget* period; (2) the period between March 27, 2008, and February 14, 2012; and (3) the post-*Boyd Gaming* decision period.

The pre-*Sparks Nugget* period. For many years the Department took the position that food purchased by a casino for resale in its restaurant as "prepared food intended for immediate consumption" was not subject to sales or use tax because the food was intended for resale as a restaurant meal.[1] However, if instead of reselling the food as prepared meals the casino used some of that food to prepare and serve complimentary meals to casino patrons, or free meals to employees in the employee dining room, the Department considered this a use of the food for a purpose other than resale, and thus the casino was considered as the consumer of the food. The Department required casinos to accrue and remit a use tax calculated on the cost of the food used to provide the complimentary meals and employee meals.[2]

While they agreed they should be considered as the consumers of the food used for complimentary meals and employee meals, beginning in 2002 casinos began challenging the applicability of the use tax to purchases of food later used to prepare and provide complimentary meals and employee meals through a series of refund claims. A refund claim submitted by Sparks Nugget, Inc., was chosen as a sort of test case with which to litigate this issue, with the remaining refund claims being held in abeyance pending a final result of the litigation. In the meantime, the Department continued to enforce the use tax on the cost of food used to prepare and provide complimentary meals and employee meals.

March 27, 2008 to February 14, 2012: On March 27, 2008, the Nevada Supreme Court ruled 6-1 that Sparks Nugget's purchases of unprepared food it later prepared and provided as complimentary meals and employee meals were exempt from sales and use tax by virtue of NRS 372.284(1) and Article X, §3(A) of the Nevada Constitution.[3] The Court agreed with Sparks Nugget that when food was taken out of its resale inventory and given away as a free complimentary meal or employee meal, no taxable event had taken place on which use tax was owed. Sparks Nugget was granted a full refund of the use taxes it previously remitted.

By the time the *Sparks Nugget* decision was rendered, there were (and remain) hundreds of similar refund claims pending with the Department of Taxation. However, after the State's petition for rehearing was denied in July 2008, no refunds were forthcoming to any other claimants, including Sparks Nugget's subsequent refund claims. After several months, the Attorney General's Office announced that the Department was now taking the position that, drawing inspiration from footnote 15 of the *Sparks Nugget* decision, all complimentary meals and free employee meals were subject to sales tax. Furthermore, the claimants' representatives were informed that the Department would be making assessments of sales tax for every open refund claim period, some of which went back to 2000. However, on its website the Department announced it was not at that time attempting to enforce sales tax on complimentary meals or employee meals for periods after the *Sparks Nugget* decision until at some point in the future it had vindicated its new sales tax theory through litigation of the pending refund claims and sales tax assessments. Thereafter, on subsequent audits of casinos, the Department scrupulously avoided addressing the issue of complimentary meals or employee meals.

The Department's Administrative Law Judge began holding hearings on refund claims and corresponding sales tax assessments one claimant at a time, with the first hearings not being held until April 2010. The first few cases involved significant discovery. Eventually, Boyd Gaming Corporation became the first taxpayer to have its case finally decided by the ALJ and then, on appeal, by the Nevada Tax Commission.[4]

In her decision, the ALJ ruled that complimentary meals provided to members of Boyd Gaming's player's club were transferred for consideration and so were subject to sales tax on the full retail value of the meal. The ALJ based this ruling on her interpretation of a player's club:

> **The process was much like a currency conversion system and the player's clubs established the rules and the valuation system for trading patrons' information and gaming activity for comps from the Taxpayers. Members of the player's clubs were rewarded by Taxpayers for providing personal information, information about their gaming activity and engaging in certain amounts and types of gaming activity. Over time, these programs evolved and became more specific regarding the valuation of gaming activity.**

In short, the ALJ found consideration for the complimentary meals in the patron's agreement to allow Boyd Gaming to track his gaming play and in the patron's agreement to gamble. The ALJ found the same consideration existed regardless of whether the patron redeemed reward points for the comp or received a discretionary comp upon request. The ALJ never fully explains her rationale for concluding Boyd Gaming's gross receipts from the "sale" of the complimentary meal equates to the regular retail value of the meal.

In her decision the ALJ also ruled that meals provided to employees in employee dining rooms were subject to sales tax. The ALJ based this ruling on her assertion that, despite no charge being made for the meal, consideration passed in exchange for the meal:

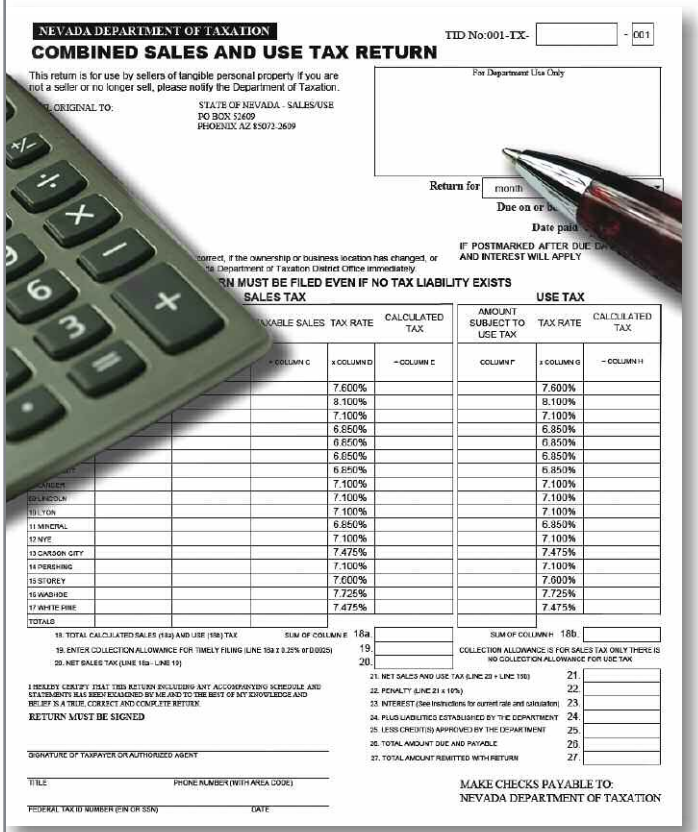
> **The employees' meals were an insignificant part of the employees' compensation packages. Nevertheless, the meals were the result of a bargained-for employment contract, whether under a union contract or otherwise. The exchange involved a meal on the part of the Taxpayers and labor on the part of the employees.**

However, unlike complimentary meals, the ALJ agreed with the Department that the taxable measure or gross receipts from the sale of the employee meal was the cost of the food purchased by the employer.[5] The ALJ never explains how she reached her conclusion on the appropriate measure of the sales tax on free employee meals.

After ruling that Boyd Gaming made taxable retail sales of both the complimentary meals to player's club members and free meals to employees, the ALJ turned to the defenses raised by Boyd Gaming to the sales tax assessments. Given the Department's long standing written instructions to taxpayers to accrue and remit use tax on the cost of food used to provide all complimentary meals and free meals to employees, the ALJ determined the doctrines of equitable estoppel and waiver applied to bar the Department from recovering any amount of sales tax over and above the amount of use tax already remitted. The ALJ also considered the appropriate statute of limitations on the Department's assessment of sales tax. She determined the applicable statute of limitations barred the Department's assessment of sales tax for periods covered by any refund claims filed prior to October 1, 2005.[6] The ALJ never explained what the effect of the statute of limitations barring some of the Department's sales tax assessments was, but no use tax was ordered to be refunded for refund claims filed prior to October 1, 2005. In short, the ALJ offset the use tax refund due to Boyd Gaming against the sales tax purportedly due on the complimentary and employee meals at issue.

In its decision rendered orally at the hearing on January 23, 2012, and later in its written decision dated February 14, 2012, the Tax Commission affirmed the ALJ's ruling in its entirety. Boyd Gaming has appealed this ruling to District Court on judicial review, where it is currently pending.

Post *Boyd Gaming* decision. On the same day the written Tax Commission decision was issued in *Boyd Gaming*, the Department began mailing letters to casinos informing them that the Department would now begin enforcing sales tax on complimentary and employee meals. After initially taking the position that it would require reporting of sales tax on complimentary meals and employee meals with the March 2012 tax return, the Department relented somewhat and agreed to allow taxpayers until the July 31, 2012 tax return to remit the sales tax due on all complimentary meals and employee meals provided after February 14, 2012. The Department has threatened to impose interest at 9% and penalties as high as 25% on taxpayers who fail to remit all sales tax due on these meals by then.[7]



NEVADA DEPARTMENT OF TAXATION

TID No:001-TX- - 001

COMBINED SALES AND USE TAX RETURN

This return is for use by sellers of tangible personal property. If you are not a seller or no longer sell, please notify the Department of Taxation.

FILE ORIGINAL TO: STATE OF NEVADA - SALES/USE PO BOX 52609 PHOENIX AZ 85072-2609

For Department Use Only

Return for month

Due on or b

Date paid

IF POSTMARKED AFTER DUE D AND INTEREST WILL APPLY

correct, if the ownership or business location has changed, or the Department of Taxation District Office immediately.

RN MUST BE FILED EVEN IF NO TAX LIABILITY EXISTS

	SALES TAX				USE TAX		
	TAXABLE SALES	TAX RATE	CALCULATED TAX	AMOUNT SUBJECT TO USE TAX	TAX RATE	CALCULATED TAX
	+ COLUMN C	x COLUMN D	= COLUMN E	COLUMN F	x COLUMN G	= COLUMN H
		7.600%			7.600%	
		8.100%			8.100%	
		7.100%			7.100%	
		6.850%			6.850%	
		6.850%			6.850%	
		6.850%			6.850%	
		6.850%			6.850%	
		7.100%			7.100%	
9 LINCOLN		7.100%			7.100%	
10 LYON		7.100%			7.100%	
11 MINERAL		6.850%			6.850%	
12 NYE		7.100%			7.100%	
13 CARSON CITY		7.475%			7.475%	
14 PERSHING		7.100%			7.100%	
15 STOREY		7.600%			7.600%	
16 WASHOE		7.725%			7.725%	
17 WHITE PINE		7.475%			7.475%	
TOTALS						

18. TOTAL CALCULATED SALES (15b) AND USE (16b) TAX — SUM OF COLUMN E 18a. — SUM OF COLUMN H 18b.

19. ENTER COLLECTION ALLOWANCE FOR TIMELY FILING (LINE 18a X 0.25% OR 0.0025) 19.

20. NET SALES TAX (LINE 18a - LINE 19) 20.

COLLECTION ALLOWANCE IS FOR SALES TAX ONLY THERE IS NO COLLECTION ALLOWANCE FOR USE TAX

I HEREBY CERTIFY THAT THIS RETURN INCLUDING ANY ACCOMPANYING SCHEDULE AND STATEMENTS HAS BEEN EXAMINED BY ME AND TO THE BEST OF MY KNOWLEDGE AND BELIEF IS A TRUE, CORRECT AND COMPLETE RETURN

RETURN MUST BE SIGNED

SIGNATURE OF TAXPAYER OR AUTHORIZED AGENT

TITLE PHONE NUMBER (WITH AREA CODE)

FEDERAL TAX ID NUMBER (EIN OR SSN) DATE

21. NET SALES AND USE TAX (LINE 20 + LINE 19b) 21.

22. PENALTY (LINE 21 x 10%) 22.

23. INTEREST (See instructions for current rate and calculation) 23.

24. PLUS LIABILITIES ESTABLISHED BY THE DEPARTMENT 24.

25. LESS CREDIT(S) APPROVED BY THE DEPARTMENT 25.

26. TOTAL AMOUNT DUE AND PAYABLE 26.

27. TOTAL AMOUNT REMITTED WITH RETURN 27.

MAKE CHECKS PAYABLE TO: NEVADA DEPARTMENT OF TAXATION

The Department describes those complimentary meals subject to sales tax as follows:

> **"If you are providing meals to patrons through a program whereby the patrons gamble and the decision to provide a complimentary meal to those patrons is based on that gaming activity, those transactions are taxable retail sales and sales tax should be collected from the patrons on the retail price of the meal."**

Thus, it appears the Department will treat all complimentary meals provided to members of a player's club as subject to sales tax on the full retail value of the meal, regardless of whether the patron redeems reward points, comp dollars, direct mail coupons, or merely asks for a discretionary comp.

The impact of the *Boyd Gaming* decision: While litigation continues, certain aspects of the Department's current policy are clear. First, with respect to pending refund claims, the Tax Commission affirmed that the Department cannot recover more sales tax than the amount of use tax accrued and remitted on the cost of food used to prepare and provide complimentary meals and employee meals during periods covered by any open refund claims. While the Department will continue to assess sales taxes on the full retail value of the complimentary meals provided to player's club members, the Department is not seeking to recover more than an offset against the use tax already remitted.[8]

Second, the Department will not attempt to recover any sales or use tax on complimentary meals or employee meals over the period from March 27, 2008, through February 14, 2012, unless a taxpayer has filed a refund claim for use taxes accrued and remitted on such meals during this period.

Third, a theme is developing in a number of cases being litigated at the administrative level whereby the ALJ (and to some extent the Department) is distinguishing between complimentary meals that are subject to sales tax and complimentary meals that aren't. In these cases, some casinos have been able to quantify complimentary meals that were provided for a number of different reasons unrelated to gaming activity. In those cases where categories of complimentary meals provided for non-gaming related reasons can be shown, the Department and ALJ appear to be in agreement that these complimentary meals are not subject to sales tax. This position appears to be consistent with the Department's policy as currently shown on its website.

Fourth, a recent development has been the Department's push to adopt new regulations consistent with the Tax Commission's decision in *Boyd Gaming* and its policy as shown on the website. Perhaps in response to petitions filed by the Nevada Resort Association and Boyd Gaming after the February 14, 2012 letters appeared, the Department commenced a regulation workshop to address how it intends to administer the sales tax upon complimentary and employee meals. The proposed regulations are expected to be presented to the Tax Commission for action at the Commission's June 2012 meeting.[9]

Based on comments made at the workshops, the Department appears determined to present regulations applying the sales tax to all complimentary meals exchanged as a result of the consumer's participation in a "marketing program." This regulation is not limited to the gaming industry, or player's clubs, but applies to all marketing programs in which the "participant's eligibility to receive a complimentary meal from a seller is contingent upon the participant's having (1) provided personal information which may be used by the seller to track or record the participant's transactions with the seller or any other commercial activity conducted by the participant on the premises of the seller; or (2) transacted a specified amount of business with the seller." Under the broad language of this proposal, any frequent dining card offered by a restaurant could conceivably be included in this regulation.

Likewise, the proposed regulation on employee meals will be broadly applicable to any business that provides free meals to its employees. The likely impact of this regulation, if it is upheld, will be to end the policy of providing free meals. Comments at the workshop suggest restaurants not connected with casinos will be more adversely affected because these entities have always provided free meals to employees, and probably never accrued a use tax. It may prove a difficult administrative burden for restaurants not associated with casinos to account for the sales tax.

If such a complimentary meal distinction holds up, then going forward the casinos may want to re-think how to reward or incentive casino patrons to continue to gamble in the casino. Interestingly, the Department has not yet taken the position that other kinds of tangible personal property awarded or transferred to player's club patrons are subject to sales tax. The old use tax regime still applies to such items as clothing, gift shop items, alcoholic beverages, contest prizes, etc. Even if the Department does not expand its sales tax theory to point redemptions for other kinds of tangible personal property, complimentary meals obviously form a major component of the rewards program. Subjecting these meals to sales tax in Nevada, places casinos in Nevada at a competitive disadvantage to casinos in other states that do not.[10] Given the current difficult economic times, and the highly competitive climate Nevada casinos now face from the proliferation of gaming in most other states, the Department's decision to pursue a policy of imposing sales tax on these meals is problematic on a number of fronts. For example, it will be difficult for a casino to explain to a patron why he must pay sales tax on a complimentary meal he believes he is receiving for a substantially discounted price, or for free. Obviously, the Department's policy is a pursuit of tax revenues for a cash-strapped government that it was receiving prior to the *Sparks Nugget* decision. By making domestic casinos less competitive, it may be a short-sighted decision that reduces tax revenues in the long run.

John Bartlett is a sole practitioner based in Carson City, Nevada, practicing in the area of state and local tax disputes. He formerly was a Senior 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 since 1988. John also regularly lectures on sales and use taxes in Nevada.

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1 See, generally, NRS 372.050(1); NRS 372.060(3)(c)

2 Nev. Admin. Code 372.350(3). Using the same theory, the Legislature enacted NRS 372.727 and 374.727 in 1995 for employee meals.

3 *Sparks Nugget, Inc. v. State of Nevada, ex rel. Dep't of Taxation*, 179 P.3d 570 (2008).

4 The written decision of the Tax Commission, which incorporates the decision of the ALJ, can be found on the Department's website at www.tax.state.nv.us and clicking on the Comp Meals Update link.

5 This, of course, is the same measure the Department was using to calculate use tax on employee meals.

6 See NRS 360.355. In 1995 the Legislature enacted a rather poorly worded statute, NRS 360.357, that tolls the statute of limitations on tax assessments for periods covered by any pending refund claim until the date the Department determines whether the taxpayer owes any taxes, or the date on which a deficiency determination is issued, whichever is later.

7 The Department's current position can be found on their website.

8 Since the measure of sales tax on employee meals is the same as the measure of use tax on employee meals previously required, this is a wash also.

9 As of this date, the proposed regulation is found at LCB File No. R057-12.

10 As far as the author knows, no other state subjects either complimentary meals or free employee meals to sales tax.