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## Gratuities and Service Charges

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This bulletin explains how state and local sales tax applies to gratuities and service charges.

For sales tax purposes, the term *gratuity* means money a customer gives a wait person, server, housekeeper, or other person as an expression of appreciation for service rendered, such as a tip at a restaurant or bar.

*Voluntary gratuities* that a customer leaves are not taxable.

*Mandatory gratuities* are different because they are automatically added onto the bill given to the customer. However, a mandatory gratuity is not taxable if **all** of these conditions are met:

- the charge is shown separately on the bill;
- the charge is identified as a *gratuity*; and
- the business gives the entire separately stated gratuity amount to its employees.

If any of these conditions is not met, the mandatory gratuity is taxable, along with the rest of the bill.

Service charges or other charges not specifically listed as gratuities on a bill or invoice are subject to sales tax.

The existence of a union contract or other agreement regarding gratuities does not determine the taxability of mandatory gratuities. However, in situations involving union contracts, businesses must be careful to establish that the conditions stated above have 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 in order for the gratuities to be exempt from sales tax. This condition would also 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, as long as any remaining gratuities are turned over to employees.

*Example: A hotel charges an 18% gratuity on all banquets held at the hotel. The charge is identified as a gratuity and is separately stated on the bills given to customers. The hotel turns the entire amount over to its wait staff. There is no sales tax on the 18% gratuity charge.*

*Example: 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.*

*Example: 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.*

*Example: 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.*

*Example: An establishment uses all mandatory gratuities collected from customers to pay the servers' portion of social security tax, withholding tax, and medical insurance premiums. Since the servers' portions of the employment taxes and medical insurance premiums are the obligations of the employees, this is the equivalent of turning the gratuities over to the servers. 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 or medical insurance premiums, the entire gratuity is subject to sales tax since the employer's portion is the employer's obligation, not the employees'.*

*Example: 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.*

For more details, see [TSB-M-09\(13\)S](#), *Sales Tax on Gratuities and Service Charges*.

Note: A Tax Bulletin is an informational document designed to provide general guidance in simplified language on a topic of interest to taxpayers. It is accurate as of the date issued. However, taxpayers should be aware that subsequent changes in the Tax Law or its interpretation may affect the accuracy of a Tax Bulletin. The information provided in this document does not cover every situation and is not intended to replace the law or change its meaning.

#### **References and other useful information**

**Tax Law:** Sections 1105(d), (e) and (f)

**Regulations:** Sections 527.8, 527.12

**Memoranda:** [TSB-M-09\(13\)S](#), *Sales Tax on Gratuities and Service Charges*

**Bulletins:**

[Caterers and Catering Services \(TB-ST-110\)](#)

[Sales by Restaurants, Taverns, and Similar Establishments \(TB-ST-806\)](#)