

Ruling 99-05

Vermont Department of Taxes

Date: December 6, 1999

Written By: George H. Phillips, Policy Analyst

Approved By: Sean P. Campbell, Commissioner of Taxes

You have asked for a ruling as to whether sales of meals at [corporation's] facilities are exempt from Vermont meals and rooms tax under the provisions of either 32 V.S.A. § 9202(10)(D)(ii)(I) or (IV). This ruling relies on information provided in your letter of October 6, 1999 and on the January 1995 contract between [contractor] and [corporation] which was enclosed with your October 25, 1999 letter.

FACTUAL BACKGROUND: [Corporation] is a tax-exempt, nonprofit corporation described in Section 501(c)(3) of the Internal Revenue Code of 1986 (the "Code"), which provides healthcare services to northwestern Vermont and adjacent communities. Since its formation in 1995, [corporation] has owned and operated cafeterias and coffee shops at its [facility 1 and facility 2] and [facility 3 and 4] and (collectively, the "Facilities"). [Location 1] and [location 2] licensed under the provisions of Chapter 43 of Title 18, Vermont Statutes Annotated. The Facilities serve snacks, prepared meals and beverages to [corporation] employees, patients, their visitors and family members, and are open to the general public. [Corporation] operates the Facilities primarily to offer convenience to staff, employees and patient visitors, who may be limited in their ability to leave hospital premises long enough for a comparable meal at a restaurant or at home. Any net revenues from operation of the Facilities are returned to [Corporation] operating budget.

[location 1]: The [location 1] campus has a coffee shop and a full cafeteria. Historically, 85% of sales at the coffee shop and cafeteria have been to [corporation] employees. The prices for meals sold at the cafeteria are generally below those charged at area restaurants and similar for-profit establishments.

[Facility 3]: The [facility 3] at the [location 2] is a cafeteria open to [corporation] employees and the public. The food pricing is the same as the [location 1] cafeteria, but in general, expenses have exceeded revenues.

[Facility 4]: Since January 1995, [corporation] has operated the [facility 4] Cafeteria through a third-party contract with [contractor] The contract requires [contractor] to operate and manage the [facility 4] Cafeteria and gives [contractor] exclusive right to sell food and non-alcoholic beverages to employees, guests and other persons at the [facility 4] Cafeteria. [Contractor] is an independent contractor which operates the [facility 4] Cafeteria with its own employees. Under their agreement, [corporation] has

paid [contractor] a fixed management fee of \$500 per week, plus the expenses of operating the [facility 4] Cafeteria. The expenses include direct costs (employees, food, etc.) as well as 5% of sales as allowance intended as a reimbursement of overhead expenses (described as "centralized and field functions performed by the operating, purchasing, personnel, labor relations, engineering, auditing, and accounting departments of contractor, including such administrative and special functions as may be necessary from time to time hereunder'). Prices for meals are set by mutual consent of [contractor] and [corporation]. [Corporation] retains any surplus revenues in excess of the operating expenses and management fees.

[Corporation] has given notice of termination of the contract with [contractor], and will begin operating the [facility 4] Cafeteria directly effective January 1, 2000. As is the case with the [facility 2] Cafeteria, the prices for meals sold at the [facility 4] Cafeteria are generally below those charged at area restaurants and similar for-profit establishments.

RULING:

Section § 9202(10)(D)(ii) provides two relevant exemptions for food or beverage:

(I) served or furnished on the premises of a nonprofit corporation or association organized and operated exclusively for religious or charitable purposes, in furtherance of any of the purposes for which it was organized; with the net proceeds of said food or beverage to be used exclusively for the purposes of the corporation or association; and

(IV) prepared by the employees thereof and served in any hospital licensed under chapter 43 of Title 18, or a sanitarium, convalescent home, nursing home or home for the aged;

Subsection (IV) is directly on point with regard to the [facility 1 and facility 2] coffee shop and cafeteria. Meals prepared by [corporation] employees and served at these facilities are exempt. Subsection (IV) does not reach the [facility 4] Cafeteria, however, as [location 3] is not one of the listed institutions and because the meals are prepared by employees of [contractor]. Therefore, the [facility 4] Cafeteria sales must be analyzed in light of subsection (I).

The meals in question are served on the premises of [corporation], Inc., an organization organized and operated exclusively for charitable purposes. The availability of meals for staff and visitors at the health center is in furtherance of its purpose - although the facilities are open to the public, there is no indication of an attempt to reach a clientele beyond persons who are at the facility for purposes consistent with the charitable purpose. The final prong of the § 9202(10)(D)(ii)(I) test is that the net proceeds must be used exclusively for the purposes of the charitable organization. This provision would bar a commercial operator from claiming the exemption. The facts presented here raise the question of whether the [facility 4] Cafeteria fails this prong because it is operated and managed by a commercial contractor.

The use of a commercial manager does not automatically disqualify a facility from exemption under § 9202(10)(D)(ii)(I). Such arrangements must be scrutinized carefully, however, and the exemption is unavailable if the effect of an arrangement is to allow the

commercial entity to participate in the profits of the enterprise. [Contractor] receives 5% of the gross receipts, reimbursement of direct expenses, and a flat monthly fee. Although the percentage payment is referenced in the contract as reimbursement of overhead expenses, it is not determined by the cost or value of any of the overhead services and [contractor] is in a position to increase its profits by increasing the receipts of the cafeteria or by minimizing the overhead costs of managing it. Other aspects of the contract support are consistent with the interpretation that [contractor] has an interest in the operations beyond being simply being hired to perform management functions. For example [contractor] was granted exclusive rights to sell food at [location 3].

Taken together, the provisions of the contract with [contractor] suggest an arrangement where the majority of the proceeds of the cafeteria belong to [contractor] and [corporation] retains only the right to any residual to the extent that the operation generates income in excess of the management fee and 5% commission accruing to the contractor. This is not sufficient for a finding that the net proceeds of the sales are used for the organization's charitable purposes.

CONCLUSION:

Because the meals served at [facility 4] Cafeteria do not qualify under the provisions of either § 9202(10)(D)(ii)(I) or (IV), they are subject to meals and rooms tax. The meals provided at the [facility 1 and 2] and the [facility 3] Cafeteria are exempt under subsection (IV).

This ruling is issued solely to you and is limited to the facts presented as affected by current statutes and regulations. Other taxpayers may refer to this ruling to determine the Department's general approach, but the Department will not be bound by this ruling in the case of any other taxpayer or in the case of any change in the relevant statute or regulations.