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June 6, 1997

Mr. A--- D. F---
 --- --- LLP
 XXX --- --- Street
 --- ---, CA XXXXX-XXXX

**Re: M--- F--- O--- C--- C---, Inc.
 SY -- XX-XXXXXX**

Dear Mr. F---:

This is in response to your letter of April 15, 1997 in which you inquire about the application of sales tax to your client's sales of food products.

You explain that your client, M--- F--- O--- C--- C---, Inc. (M---), sells the following products: cookies, brownies, muffins, nibblers (small cookies), hot pretzels, milk, coffee, fruit juices, carbonated beverages, non-carbonated beverages and seasonal novelty items.

You explain that M--- operates two types of bakery outlets, one which specializes in sales of cookies and the other which also sell hot pretzels and beverages. You indicate that sales of cookies comprise approximately 90% of M---'s total sales. The products are packaged, depending on the quantity purchased, in either a small paper bag, large paper bag, or in a metal tin. The carbonated beverages are primarily sold in the can with a few stores using a fountain dispenser.

You state that your client leases spaces in either shopping malls or street front locations. The mall stores generally are not located in the food courts area, however, several of the stores are located in or adjacent to common areas which provide seating facilities for the consumption of food or beverages. In addition, several of the street front locations provide seating facilities on the premises. You have provided a list of the food products sold by M--- with your conclusions as to whether or not the gross receipts from these sales are subject to sales tax. Since you have provided a voluminous list of products and combinations thereof, we will respond to your inquiries by explaining the applicable sales and use tax laws.

As you know, retail sales of tangible personal property in California are subject to sales tax, measured by gross receipts, unless specifically exempt by statute. (Rev. & Tax. Code § 6051.) Revenue and Taxation Code section 6359, as interpreted and implemented by Sales and Use Tax Regulations 1602 and 1603, state the general rule that gross receipts from the sale of food products for human consumption are exempt from sales tax. Regulation 1602(a)(1) includes snacks, confectionery, coffee, bakery products, milk and milk products in the definition of food products. Business Taxes Law Guide (BTLG) Annotation 550.1880 (11/16/73) classifies pretzels as bakery products. Fruit juices and non-carbonated beverages are also considered to be food products, whereas, carbonated beverages and carbonated and effervescent waters are not considered food products. (Reg. 1602 (a)(2).)

There is no applicable exemption for M--- sales of carbonated beverages and seasonal novelty items. You are therefore correct that those sales are always subject to tax without regard to the discussion below. The sales of the other enumerated products which constitute “food products for human consumption” under these provisions are exempt from tax under the general exemption provided for food products sold for human consumption unless excepted from that general exemption. Section 6359(d) contains a list of seven exceptions to the general exemption. The relevant exceptions that might apply to M---’s business activities are as follows:

(1) Food products furnished, prepared, or served for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware whether provided by the seller or by a person with whom the seller contracts to furnish, prepare or serve food products to others. (Rev. & Tax. Code § 6359(d)(2) Reg. 1602(f).)

(2) Food products sold as hot prepared food products. (Rev. & Tax. Code § 6359(d)(7) Rev. & Tax. Code § 6359(e) Reg. 1602 (e).)

(3) Food products furnished in a form suitable for consumption on the seller’s premises when (a) over 80 percent of the seller's gross receipts are from the sale of food products with (b) over 80 percent of the retail sales of food products subject to tax pursuant to Revenue and Taxation Code section 6359 (d)(1), (d)(2), (d)(3), or (d)(7). (Rev. & Tax Code § 6359(d)(6), Reg. 1602 (c).)

Exception (3) is known as the “80/80” rule. Under that rule, sales which would otherwise be exempt under other provisions are subject to tax. In my discussion below, when I conclude that a sale is exempt from tax, this conclusion is premised on the 80/80 rule’s not applying. I will discuss this rule last.

With respect to exception (1), we have previously concluded that food courts located in shopping malls where the person who licenses the food retailer to sell on the premises also provides facilities for the patrons of the food retailers are facilities of the retailer. Thus, any

sales by M--- of food products for consumption on such premises are taxable. This includes sales of nibblers, brownies, pretzels, and any other items consumed on the premises, and this is true whether they are hot prepared foods or are cold foods. Furthermore, I note that the fact that the sale is "in bulk" is not sufficient to establish that the items are not eaten on the premises. We have previously concluded that sales "in bulk" of individual items are in a form suitable for consumption at facilities of the retailer. (BTLG Annot. 550.0345 (4/15/94). For example, the sale of a dozen cookies or donuts is a sale of items in a form suitable for consumption on the retailer's premises. That customer may very well be purchasing such items for a group that will eat on the premises. When such items are eaten on the premises, tax applies. Thus, your conclusion that **all** bulk sales of cookies, brownies, pretzels, and bulk sales of nibblers, in excess of half a dozen, qualify as exempt sales is incorrect.

While all sales of food for consumption on the premises of M--- are taxable, this does not mean that all other sales of food for human consumption are exempt. Even when such an item is sold "to go" and is actually eaten off the premises, further analysis is required to determine whether tax applies.

For example, you inquire about "combination" sales. We assume that this means the sale of a bakery item and a beverage for a single price. Subdivision (e) of section 6359 defines "hot prepared food product" as those products which have been "prepared for sale in a heated condition and which are sold at any temperature which is higher than the air temperature of the room or place where they are sold." Hot bakery goods, such as hot pretzels, and hot beverages, such as coffee, are "hot prepared foods" but their sale for a **separate price** is exempt unless sold for consumption at the facilities provided by the seller. However, when a separate price has been established for a combination which includes a "hot food," such as coffee and a bakery product (whether hot or cold), sales tax applies to the entire purchase price regardless of whether or not sold for consumption on the retailer's premises. (Reg. 1603(e)(1).) The same rule applies to any combination package including a hot food item, such as a combination sale of a hot pretzel and a glass of milk or juice, a combination sale of a hot pretzel and a soft drink, or a combination sale of a hot pretzel and a novelty item. All these combination sales for a single price are taxable even if the food item(s) is sold for consumption off the premises. Combination sales of food products which do not include any hot foods or non-foods are not subject to this rule. When such combination sales of food are "to go" and actually eaten off the premises, tax does not apply unless they constitute a meal under Regulation 1602(a).

As to combination sales of carbonated beverages (not considered to be a food product) and a food product which is not a "hot food," such as a cookie or a brownie, sold at a single price "to go" and actually eaten off the premises, Regulation 1602(b) explains the application of sales tax. In the case of a sale of a combination food and non-food product package, if more than 10% of the value of the package represents non-food products, then a segregation must be made and sales tax will be measured by the value of the non-food items. Thus, for combination sales of carbonated beverages and a cookie or a brownie, sales tax will apply to the portion of the value attributable to the carbonated beverage if the value of the carbonated beverage is greater than

10% of the value of the combination. The same rule applies to any combination of food and non-food items, such as combination sales of novelty items and food products.

In summary, except as discussed below (the 80/80 rule) certain of M--- sales of cold foods to go and actually eaten off the premises are exempt from tax. However, the locations which provide seating or are in or adjacent to food courts must be able to verify that the claimed exempt sales of cold food to go were actually taken off the premises.

As noted above, even when M--- makes sales of food products to go and the items are actually eaten off the premises, the sales may be taxable under the 80/80 rule. In essence, the 80/80 rule applies when (1) food products are sold (2) in a form suitable for consumption on the seller's premises and (3) over 80 percent of the seller's gross receipts are from the sale of food products with (4) over 80 percent of the retail sales of food products are subject to tax pursuant to Revenue and Taxation Code section 6359 (d)(1), (d)(2), (d)(3), or (d)(7).

The 80/80 rule is applied on a location by location basis. That is, one location of M--- may be covered by the 80/80 rule while another may not. If a M--- location falls within this rule, then that location must pay sales tax on all retail sales of food products sold in a form suitable for consumption (including, as noted above, sales of bulk of individual items), even if these products are sold to-go and actually eaten off the premises.

I assume that over 80 percent of the gross receipts from each location of M--- is from the sale of food products. Thus, the first three conditions to the application of the 80/80 rule are satisfied for M--- locations which are either in proximity to food courts or provide seating facilities. The remaining question for each of those locations is whether over 80 percent of its sales of food products are subject to tax under certain provisions of section 6359 as discussed above (plus any sales of meals, even if sold to go and eaten off the premises).

Effective April 1, 1996, retailers required to report taxes under the 80/80 rule may make an election not to report tax on qualifying sales of cold food products on a "to go" basis. If this election is made the retailer is required to maintain segregated records in order to support the claimed exempt sales of cold foods, suitable for consumption on the retailer's premises, which are sold on a "to go" basis. If the retailer fails to do so, the election will be revoked. (§6359(f).)

Mr. A--- D. F---

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June 6, 1997
550.0128

If we can be of further assistance, please feel free to contact this office again.

Sincerely,

Patricia Hart Jorgensen
Senior Tax Counsel

PHJ:cl

cc: Out-of-State District Administrator