

May 8, 2007

Legislative Reference Library  
645 State Office Building  
100 Reverend Dr. Martin Luther King Jr. Blvd.  
St. Paul, Minnesota 55155

Re: In The Matter Of The Proposed Amendment of Rules of the Minnesota Department of Revenue Governing the Application of Sales and Use Tax Laws to Sales of Food Sold With Eating Utensils Provided by the Seller, Amending *Minnesota Rules*, Chapter 8130.

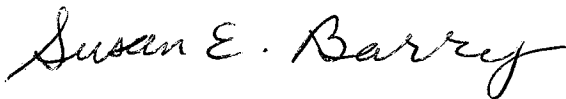
Dear Librarian:

The Minnesota Department of Revenue intends to adopt rules governing the application of Minnesota sales and use tax laws to sales of food sold with eating utensils provided by the seller. We plan to publish a Dual Notice of Intent to Adopt Rules in the May 21, 2007, State Register.

The Department has prepared a Statement of Need and Reasonableness. As required by Minnesota Statutes, sections 14.131 and 14.23, the Department is sending the Library a copy of the Statement of Need and Reasonableness at the time it is available to the public.

If you have any questions, please contact me at (651) 556-4062.

Yours very truly,



Susan E. Barry  
Attorney/ Rules Coordinator  
Appeals & Legal Services Division  
Minnesota Department of Revenue

Enclosure: Statement of Need and Reasonableness

## Minnesota Department of Revenue

### STATEMENT OF NEED AND REASONABLENESS

#### Proposed Rules Governing Application of the Sales and Use Tax Laws to Sales of Food Sold With Eating Utensils Provided by the Seller, *Minnesota Rules*, Chapter 8130

### INTRODUCTION

The Department of Revenue intends to amend sales and use tax rules governing the application of the sales and use tax laws to sales of food sold with eating utensils provided by the seller, within the definition of "prepared food."

Minnesota Statutes, section 297A.61, subdivision 31<sup>1</sup>, clause (2), provides that one of the conditions that meets the definition of "prepared food" is food that is sold in a heated state or heated by the seller, and two or more food ingredients that are mixed or combined by the seller for sale as a single item. Some foods which otherwise meet this condition are specifically excepted from the definition of prepared food in that paragraph at items (i) through (iv) unless they meet the condition of Minnesota Statutes, section 297A.61, subdivision 31, clause (1), "food sold with eating utensils provided by the seller." This rule interprets the phrase "food sold with eating utensils provided by the seller." It recognizes that depending on the facts and circumstances and the type of food business—that is, whether it is more like a grocery store or more like a restaurant—"utensils provided by the seller" either can be broadly interpreted as simply having napkins available on a counter, or can be narrowly interpreted as physically handing the utensil to the purchaser.

The Streamlined Sales Tax Governing Board, of which Minnesota is a member state, adopted an interpretation of this term at their April 18, 2006, meeting. The interpretation was the result of numerous meetings and teleconferences on the subject between states and those in the food industry, which ended with some compromises and an agreement on how to interpret what is meant by terms concerning selling food with eating utensils "provided by the seller." Using this interpretation, adopted by the Streamlined Sales Tax Governing Board to interpret the same statutory language provided at Minnesota Statutes, section 297A.61, subdivision 31, clause (1), will increase the efficiency with which this tax is administered as applied to "prepared food," and will bring

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<sup>1</sup> Minn. stat. 297A.61

Subd. 31. Prepared food. "Prepared food" means food that meets either of the following conditions:

- (1) the food is sold with eating utensils provided by the seller, including plates, knives, forks, spoons, glasses, cups, napkins, or straws; or
- (2) the food is sold in a heated state or heated by the seller or two or more food ingredients are mixed or combined by the seller for sale as a single item, except for:
  - (i) bakery items, including, but not limited to, bread, rolls, buns, biscuits, bagels, croissants, pastries, donuts, danish, cakes, tortes, pies, tarts, muffins, bars, cookies, tortillas;
  - (ii) ready-to-eat meat and seafood in an unheated state sold by weight;
  - (iii) eggs, fish, meat, poultry, and foods containing these raw animal foods requiring cooking by the consumer as recommended by the Food and Drug Administration in chapter 3, part 401.11 of its food code so as to prevent food borne illnesses; or
  - (iv) food that is only sliced, repackaged, or pasteurized by the seller.

consistency in application across states. Additionally, adopting this interpretation means Minnesota will remain in compliance with the Streamlined Sales Tax Agreement on this interpretation<sup>2</sup>.

This document, the Statement of Need and Reasonableness (SONAR), has been prepared to establish the statutory authority for, need for, and reasonableness of the proposed amendments to these rules. It is submitted pursuant to *Minnesota Statutes*, section 14.23, and *Minnesota Rules*, part 1400.2070, requiring a Statement of Need and Reasonableness.

The process that was used to draft the proposed rule and amendments to the rules was internal consultation within the Department of Revenue, as well as working with member states to the Streamlined Sales Tax Agreement.

A Request for Comments was published in the *State Register* on August 28, 2006 (31 S.R. 308). No comments were received.

In November 2006, the Department contacted several groups representing the food industry in Minnesota requesting that they notify the Department whether or not they will bear a cost to implement the rule, and asking whether or not they would support the rule. In February 2007, the Department received a letter jointly signed by the Minnesota Grocer's Association, the Minnesota Petroleum Marketers Association, and the Minnesota Retailers Association, expressing support for the definition of prepared food as it pertains to "food sold with eating utensils," as interpreted by the Streamlined Sales Tax Compliance and Review Committee and as clarified in the Department's November 17, 2006, request for information.

## ALTERNATIVE FORMAT

Upon request, this Statement of Need and Reasonableness can be made available in an alternative format, such as large print, Braille, or cassette tape. To make a request, contact:

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<sup>2</sup> Minnesota adopted statutory language in 2001, codified at Minnesota Statutes, section 297A.995, authorizing the Department of Revenue to enter into, negotiate, and implement a streamlined sales tax agreement; and adopted the prepared food definition in 2001, codified at Minnesota Statutes, section 297A.61, subdivision 33 (amended in 2002).

The Streamlined Sales Tax Project is a multistate effort to simplify and modernize sales and use tax collection and administration, and to remove burdens from business as they conduct business throughout different states.

The project began in 2000. Project participants include state revenue departments and representatives of state legislatures and local governments. Businesses such as national retailers, trade associations, manufacturers, direct marketers and technology companies have participated by offering expertise and input, reviewing proposals, suggesting language, and testifying at public hearings.

The goal of the project is to provide states with a streamlined sales tax system that includes (1) *uniform definitions within tax laws* (Legislatures still choose what is taxable or exempt in their state. However, participating states will agree to use the common definitions for key items in the tax base and will not deviate from these definitions); (2) rate simplification; (3) state administration of all state and local sales taxes; and (4) uniform audit procedures.

Forty-five states, the District of Columbia and Puerto Rico currently impose a sales and use tax. More than 40 states have been working on a streamlined sales tax agreement; in November 2002, 33 states and the District of Columbia voted to approve the multistate agreement. The agreement took effect October 1, 2005, with Minnesota being one of the first 13 full member states. As of January 1, 2007, there are 15 full member states, six associate member states and 21 advisor states. More information is available on the internet at [www.streamlinedsalestax.org](http://www.streamlinedsalestax.org).

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TTY users may call the Department of Revenue at Minnesota Relay 711.

## DEPARTMENT'S STATUTORY AUTHORITY

The Department's general statutory authority to adopt rules is set forth in *Minnesota Statutes*, section 270C.06. It provides that the Commissioner of Revenue shall "from time to time, make, publish, and distribute rules for the administration and enforcement of state revenue laws. The rules have the force of law." As provided in this statute, the Department has the necessary statutory authority to adopt the proposed rules.

## REGULATORY ANALYSIS

As required by *Minnesota Statutes*, section 14.131, the Department consulted with the Commissioner of Finance "to help evaluate the fiscal impact and fiscal benefits of the proposed rule changes on units of local government."

As required by *Minnesota Statutes*, section 14.127, the Department looked at the cost of compliance within the first year after the rule changes take effect and determined that the cost will not exceed \$25,000 for any business that has less than 50 full time employees or for any one statutory or home rule charter city that has less than 10 full time employees.

*Minnesota Statutes*, section 14.131, sets out seven factors for a regulatory analysis that must be included in the SONAR. The Department's response to these seven factors follows:

**"(1) a description of the classes of persons who probably will be affected by the proposed rule, including classes that will bear the costs of the proposed rule and classes that will benefit from the proposed rule."**

The classes of persons who will be affected by this rule are the various groups that make up the food industry. The Department expects there will be little to no costs involved.

As stated above, in November 2006 the Department contacted several groups representing the food industry in Minnesota requesting that they notify the Department whether or not they will bear a cost to implement the rule. While the Department did not receive comments regarding costs to implement the rule, in February 2007, the Department received a letter jointly signed by the Minnesota Grocer's Association, the Minnesota Petroleum Marketers Association, and the Minnesota Retailers Association, expressing support for the proposed rule interpreting one of the conditions to meet the definition of prepared food, "food sold with eating utensils."

The affected parties will benefit from increased clarity and understandability of the terms "provided by the seller" as it relates to eating utensils and prepared food.

**“(2) the probable costs to the agency and to any other agency of the implementation and enforcement of the proposed rule and any anticipated effect on state revenues.”**

There are no anticipated costs to the Department of Revenue or to any other agency to implement and enforce the proposed rule amendments, aside from the usual costs associated with rulemaking and enforcing tax laws, and there is no anticipated effect on state revenues.

Formally adopting this interpretation means Minnesota will remain in compliance with the Streamlined Sales Tax Agreement on this interpretation, so that it may continue to be a member of the multistate agreement, and thus collect taxes from out-of-state vendors that register through the streamlines sales tax central registration system.

**“(3) a determination of whether there are less costly methods or less intrusive methods for achieving the purpose of the proposed rule.”**

The Department does not anticipate costs and therefore is not aware of any less costly methods or less intrusive methods for achieving the purpose of the proposed rule amendments. This rule will tend to increase the efficiency with which this tax is administered as applied to “prepared food,” and will bring consistency in application from state to state, and the Department believes that a rule would be the most effective method to explain the modifications.

**“(4) a description of any alternative methods for achieving the purpose of the proposed rule that were seriously considered by the agency and the reasons why they were rejected in favor of the proposed rule.”**

One alternative method would be to seek legislation to clarify the terms, but this was not seriously considered by the Department of Revenue because the rule is the most effective method to explain the modifications at this time.

**“(5) the probable costs of complying with the proposed rule, including the portion of the total costs that will be borne by identifiable categories of affected parties, such as separate classes of governmental units, businesses, or individuals.”**

The Department of Revenue does not anticipate additional costs of complying.

**“(6) the probable costs or consequences of not adopting the proposed rules, including those costs or consequences borne by identifiable categories of affected parties, such as separate classes of governmental units, businesses, or individuals.”**

If the proposed rules are not adopted, the various groups in the food industry which have eating utensils—including napkins—available at their location(s) will not have the clarity they need as to how “utensils provided by the seller” is to be interpreted. While the Department could issue a revenue notice with the interpretation, a revenue notice is only binding on the Department, potentially resulting in inconsistent application and administration of the law.

Additionally, if this rule is not adopted, the State of Minnesota would run the risk of being substantially out of compliance with the Streamlined Sales Tax Agreement. If that were to happen, the Streamlined Sales Tax Governing Board could impose sanctions on our State. Sanctions could include expulsion or penalties yet to be determined. If expelled, Minnesota would no longer receive

the benefits of membership; for example, revenue from volunteer sellers registered through the streamlined sales tax central registration system.

**“(7) an assessment of any differences between the proposed rule and existing federal regulations and a specific analysis of the need for and reasonableness of each difference.”**

There are no directly applicable federal laws or regulations in the sales tax area.

### **PERFORMANCE-BASED RULES**

Minnesota Statutes, sections 14.002 and 14.131, require that the SONAR describe how the agency, in developing the rules, considered and implemented performance-based standards that emphasize superior achievement in meeting the agency’s regulatory objectives and maximum flexibility for the regulated party and the agency in meeting those goals.

This proposed rule supports the Department’s strategic plan. The Department’s primary objective is to amend for clarity and certainty, which in part can be gained by conformity with multistate interpretations that have been made of any terms that have been or will be incorporated into Minnesota’s statutes. By providing clarity and certainty in this area of the law, the proposed rule will promote the principle that everyone is paying the right amount of tax, no more and no less. The additional clarity and certainty provided by the proposed rule will also help improve the degree to which these particular tax laws are easy to understand and easy to administer.

### **ADDITIONAL NOTICE**

To provide notice to all persons who may be affected by the proposed rule, the Additional Notice Plan consists of:

- (1) posting the Request for Comments, Notice of Intent to Adopt Rules, and SONAR to the Department website at <http://www.taxes.state.mn.us>;
- (2) mailing a copy of the Request for Comments to the regular rulemaking list, and to chairs and minority leads of the House and Senate tax committees; and
- (3) mailing a copy of the Notice of Intent to Adopt Rules, and a copy of the proposed rules and SONAR to the following:
  - the Tax section of the Minnesota State Bar Association,
  - Minnesota Retailers Association
  - Minnesota Grocers Association
  - Minnesota Soft Drink Association
  - Minnesota Bakery Association
  - Minnesota Licensed Beverage Association
  - Minnesota Municipal Beverage Association
  - Minnesota Resort Association
  - Minnesota Restaurant Association
  - Minnesota Bed & Breakfast Guild
  - Minnesota Hotel & Lodging Association
  - Minnesota Association of Innkeepers
  - Minnesota Bed & Breakfast Association

- Minnesota Petroleum Marketers Association
- Minnesota Service Station And Convenience Store Association
- as well as any individual requesting notice who is not already on the agency's regular rulemaking mailing list.

Our Notice Plan also includes giving notice required by statute. We will mail the rules and Notice of Intent to Adopt to everyone who has registered to be on the Department's rulemaking mailing list under *Minnesota Statutes*, section 14.14, subdivision 1a. We will give notice to the Legislature per *Minnesota Statutes*, section 14.116.

## LIST OF WITNESSES

If these rules go to a public hearing, the Department does not anticipate calling any witnesses, although Department employees may be called to testify in support of the rules.

## RULE ANALYSIS

*Minnesota Statutes*, chapter 14, requires the Department to explain the facts establishing the need for and reasonableness of the rules as proposed. "Need" means that a problem exists which requires administrative attention. "Reasonableness" means that there is a rational basis for the Department's proposed action. The need for and reasonableness of the proposed rules, *Minnesota Rules, Part 8130.4705*, is here explained.

### General explanation Part 8130.4705.

This new part is needed to provide an interpretation of the statutory language in *Minnesota Statutes*, section 297A.61, subdivision 31, clause (1), of "eating utensils provided by the seller," within the definition of "prepared food." If any food is sold with "eating utensils provided by the seller," then that food is considered "prepared food," even if the food also meets one of the exceptions in *Minnesota Statutes*, section 297A.61, subdivision 31, clause (2), items (i) through (iv)—for example, "bakery items" in item (i). Nowhere within *Minnesota Statutes*, chapter 297A, or within *Minnesota Rules*, chapter 8130, is there a definition or explanation of when or under what circumstances a seller is considered to "provide" eating utensils with the food sold by the seller.

The need for an interpretation is shown by the fact that states such as Minnesota, which have adopted substantially the same definition of prepared food as it applies to food sold "with eating utensils provided by the seller," have worked with the member states of the ongoing multistate Streamlined Sales Tax project, as well as various businesses within the food industry and business in general, to have a uniform interpretation of what this language means. Some of the businesses that have participated in this process are located within Minnesota.

The interpretation provided by this amendment is in response to that need, and it is reasonable, given it reflects the decision by the Governing Board to adopt the interpretation at its April 18, 2006, meeting; as well as reflecting the recommendations of the various multistate and multi-business committees of the Streamlined Sales Tax Agreement, i.e., the State and Local Advisory Committee, the Business Advisory Committee, and the Compliance Review and Interpretations Committee. The amendment to the rule uses the language of the interpretation as approved by the multistate Governing Board, except where it makes sense to express the concepts using language more consistent with terminology used either in *Minnesota Statutes* or *Minnesota Rules*, or to further clarify terms within the approved interpretation.

Various parts of the rule are also reasonable as they are similar to or consistent with the Department's current interpretation of the statutory language, as is seen by fact sheets and revenue notices. Those similarities will be pointed out below.

The analysis below incorporates the general statements in the paragraphs above regarding need and reasonableness. When the terms "committees" or "Governing Board" are used in the analysis, they refer to the committees and the Governing Board of the Streamlined Sales Tax Agreement.

### **Subpart 1.**

This subpart is introductory and is needed to explain the purpose of the part. It references statutory cites and language. Reference to a "chopstick" is not specifically mentioned anywhere in statute, and is needed to clarify that the statutory lists are not exclusive, and is reasonable as this is a commonly used utensil at some restaurants.

It also provides that "a plate does not include a container or packaging used to transport food." This language is needed to clarify that simply because food is packaged on top of or in material (e.g., a cardboard round, or a plastic or polystyrene foam tray), that does not make the material a utensil. Such material is used for transporting the food, and not as a plate. It is reasonable because that interpretation of the statutory term "plate" (i.e., of what it is not) has been adopted by the Streamlined Sales Tax Agreement. It also is reasonable since common dictionary definitions, through looking at the definitions of the words "plate," "eating" and "utensils" define plate as a shallow dish out of which a person eats or is served, and eating utensils as an article, device, or container used for eating or dining. [See, for example, Webster's New World College Dictionary, 3<sup>rd</sup> ed., 1996.] A package or container whose purpose is to transport food means that the common expectation is that the customer will take the food off or out of the container or packaging once the customer arrives at his or her destination, and then place the food onto an individual plate or a serving dish (whether this actually happens or not).

### **Subpart 2.**

This subpart explains that food sold with utensils "provided by the seller" means that it is the seller's practice for the item to physically give or hand the utensil to the purchaser, and defines in items A through D what is meant by "physically give or hand."

Each item in this subpart refers to the seller's practice. Language concerning the seller's practice is necessary as this is a change from the department's current position which assumes that if food is sold at an eating establishment or is traditionally sold with eating utensils, then the seller provides eating utensils and provides them for all food sold by the seller—that is, unless the seller has adequate records to show the sales of food not traditionally sold with eating utensils.<sup>3</sup>

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<sup>3</sup> Revenue Notice 01-12 "Sales and Use Tax – Prepared Food," published December 2001. Under either test, if the seller maintained adequate records for sale of food that is generally not sold with eating utensils and do not otherwise qualify as prepared food, such as gallons of milk or loaves of bread, then those foods would not be subject to tax. By "adequate records" the Department means that the information shown on invoices, cash register receipts, or sales tickets must provide an adequate description of the food items sold to show that the sale was not of food items that are generally served with eating utensils.



Under the rule, in determining whether a seller should consider its food prepared food or not, when the seller physically gives or hands the utensil to the customer, the department and the seller must look at the seller's "practice" as "represented by the seller." If it is the seller's practice to physically give or hand a utensil to the customer for the food sold, but at any one time the seller's employee does not do this, the food will still be considered prepared food.

**Item A.** This item is needed to explain that one of the meanings of "physically give or hand" is that it is the seller's practice to hand the eating utensil directly to the customer along with the food sold. Item A is reasonable, as it provides a scenario commonly contemplated by the terms "physically give or hand"—to directly give the utensil to the customer, hand-to-hand.

**Item B.** This item is needed to explain that one of the meanings of "physically give or hand" is that it is the seller's practice to place the eating utensil in a package containing the food sold to the customer. This is necessary to show that physically giving a utensil to a customer is not limited by the scenario of item A, but the seller can place the utensil in a package before or after the food is selected by the customer. This is reasonable as the statute does not provide that utensils provided by the seller must be given hand-to-hand, and because it is a common practice by businesses that sell food for take-out to place utensils in a package of food.

**Item C.** This item is needed to explain that one of the meanings of "physically give or hand" is that it is the seller's practice to sell prepackaged food that has utensils in the package, where the food has been prepackaged by someone other than the seller, as long as the utensil was not placed in the package by a person with the North American Industry Classification System (NAICS) classification code of manufacturer, sector 311. This item, along with the examples in subpart 6, item B, is necessary and reasonable to preserve the dichotomy of groceries vs. food sold by an eating establishment, as explained above. The NAIC code listed is reasonable because it matches with the food manufacturer.

The North American Industry Classification System (NAICS), developed in cooperation with Canada and Mexico, groups establishments into industries based on the activity in which they are primarily engaged. Establishments using similar raw material inputs, similar capital equipment, and similar labor are classified in the same industry.

Sector 311 includes establishments in food manufacturing. As stated in the North American Industry Classification System, United States, 2002 manual at page 201 (also found at [www.census.gov/naics](http://www.census.gov/naics)),

Industries in the Food Manufacturing subsector transform livestock and agricultural products into products for intermediate or final consumption. The industry groups are distinguished by the raw materials (generally of animal or vegetable origin) processed into food products.

The food products manufactured in these establishments are typically sold to wholesalers or retailers for distribution to consumers, but establishments primarily engaged in retailing bakery and candy products made on the premises not for immediate consumption are included.

This language is reasonable because the statute does not provide that utensils provided by the seller must be given hand-to-hand, because it covers the situation where a seller resells, for example, box lunches prepared and packaged by a caterer who put utensils in the package, and because, it is a common practice by grocery stores and convenience stores to sell items they purchased from a food manufacturer that has a utensil inside.

This reflects a longstanding position of the department, as seen in its Revenue Notice # 01-12, and in Sales Tax Fact Sheet 102D [Prepared Food], last updated April 2004, which both read in part "If the eating utensil is provided by the manufacturer rather than by the seller, the food is not considered to

be provided with eating utensils. For example, a box of crackers and cheese that includes a spreader is not subject to tax since the spreader is not provided by the seller.” Revenue Notice #01-12 also provides that box lunches with utensils inside are considered prepared food—it does not matter whether the seller placed the utensils inside or a third party, such as a caterer, placed the utensils inside.

#### **Item D.**

This item is needed to explain that one of the meanings of “physically give or hand” is that it is the seller’s practice to place the eating utensil on a table or similar surface for the customer to use. This language is necessary to show that physically giving or handing a utensil to a customer is not limited by the scenario of item A, but the seller can place the utensil on a table or similar surface before or after the customer selects his or her food. This is reasonable as the statute does not provide that utensils provided by the seller must be given hand-to-hand, and because it is a common practice by businesses that have seating available, such as restaurants, to place utensils on a table or counter for the customer to use.

Note that restaurants will typically have a prepared food sales percentage above 75 percent such that under subpart 3 the business need only have utensils available to the customer for the utensils to be considered “provided by the seller,” and therefore it may not matter whether this practice meets the definition of “physically give or hand.” That is, having the utensils on the table, counter, or similar surface would mean that the utensils are available to the customer and, if the prepared food sales percentage is greater than 75 percent, the food would be considered sold with utensils provided by the seller.

#### **Subpart 3.**

This subpart is needed to explain under what conditions food sold with utensils “provided by the seller” would mean that the seller has a utensil or utensils available to the customer. Language in subpart 3 is necessary as this is a change from the department’s current position which does not explicitly provide that “provided by the seller” means either that a seller has to physically hand the utensil to the customer or that a seller has to have the utensil available to the customer. Rather, as stated above in the analysis of subpart 2, the current position generally assumes that if food is sold at an eating establishment or is traditionally sold with eating utensils, then the seller provides eating utensils and provides them for all food sold by the seller (unless the seller has adequate records to show the sales of food not traditionally sold with eating utensils—see Revenue Notice # 01-12, or see footnote 3 above [subpart 2 analysis]).

#### **Item A.**

This item is needed to explain that one of the conditions whereby “provided by the seller” means that the seller makes utensils available; is when a plate, glass, cup, or bowl is necessary to receive the food from the seller. This condition is needed because without it, if a seller’s prepared food sales percentage is 75 percent or less under item B and subpart 5—whereby “provided by the seller” would mean that the seller had to physically hand or deliver the utensil to the customer for the food to be considered prepared food—we would have the illogical result that even though clearly that particular food could not be sold without a utensil, the food dispensed by the customer could not be treated as prepared food unless the seller first gave the plate, glass, cup, or bowl to the customer.

This language is reasonable as it has been adopted by the Streamlined Sales Tax Agreement, as explained above. The language is also reasonable in that its condition is similar to the Department’s current condition found in Revenue Notice #01-12 of food “that is traditionally sold with eating utensils,” and the examples given in that notice of salad bars, “make your own sandwich” bars, and

“make your own ice cream sundae” bars shows situations where a customer would use the utensils listed in this item. It differs from the Department’s current position in that under the proposed language the seller must actually have the utensils available—it is not enough that the food is traditionally sold with a utensil.

**Item B.**

This item is needed to explain that one of the conditions whereby “provided by the seller” means that the seller makes utensils available to the customer is when the amount of prepared food sold by the seller is greater than 75 percent of all the food sold by the seller in Minnesota.

It is reasonable to define “provided” to mean “made available” if the “greater than 75 percent” determination in subpart 5 is made. The Streamlined Sales Tax committees and Governing Board found that if the majority of the seller’s food sales meet the description in subpart 5, item B, subitem (1), then the establishments are more similar to eating establishments than grocery stores, and as such, it would be expected that the customer would purchase food sold with utensils, whether the utensils are made available or physically handed to the customer, so that at a minimum, as long as the utensils are available, they would be considered “provided by the seller.”

The “greater than 75 percent” test also is reasonable as other member states currently use the 75 percent test, and it was adopted by the Streamlined Sales Tax Governing Board at their April 2006 meeting as a reasonable test.

The calculation of the prepared food sales percentage is further explained below in Subpart 5.

**Item C.**

This item explains that the 75 percent rule of item B does not apply when there is a food item with four or more servings sold for a single price. This is needed as that exception is provided in subpart 4. Please see that subpart for the explanation.

**Subpart 4.**

This subpart recognizes a bulk food exemption to the rule in subpart 3, at item C, so that even though the seller’s percentage of prepared food sales is greater than 75 percent—such that ordinarily as long as the seller had utensils available those utensils would be considered “provided by the seller”—if the seller sells a food item that contains four or more servings packaged as one item sold for a single price, then eating utensils are only considered to be provided by the seller if they are physically given or handed to the purchaser (as explained in Subpart 2 above). Bulk foods can include, for example, loaves of bread, gallons of milk, large bags of chips, half gallons of frozen yogurt, packages of cookies, and boxes of cereal.

This subpart deals with the concept of “bulk food,” although that term is not specifically used in the rule, in that bulk food is more like groceries than food served at a restaurant or other eating establishments. It provides that if a food item contains four or more servings and is packaged as one item sold for a single price, then the eating utensils are considered to be provided by the seller only if the seller’s practice is to “physically give or hand the utensils to the purchaser.” This is true for these food items, even if the seller otherwise has a prepared food sales percentage greater than 75 percent (explained in subparts 3 and 5).

Subpart 4 is needed because grocery and convenience stores, as well as department stores selling food, were concerned that otherwise, simply because they had napkins (which is included in the statutory definition of an eating utensil) available somewhere in their store, all food, including bulk food, would be considered prepared food. The food they were concerned about was other than food

that needs to have utensils in order for the purchaser to receive the food, other than food that is served with utensils by a seller, and other than food for which utensils are made available for self-service in an area of the store.

The language is reasonable because these bulk items are more like grocery items, on which there would not be tax if sold in an establishment other than an eating establishment, for example, a grocery store. It is also reasonable because it preserves the dichotomy of similarities to groceries versus similarities to food consumed at an eating establishment.

Likewise, stating that “provided by the seller” means that the seller physically gives the customer the eating utensils when the packaged item has four or more servings is reasonable because it helps to distinguish between items that are more similar to groceries (e.g., milk, loaf of bread, package of cookies) and items that are more similar to food consumed at an eating establishment. If the seller sells a pie that serves six people, the fact that the seller has utensils available in the seller’s establishment, even if available at the checkout counter, is not enough to make the pie “prepared food”—a pie purchased in a grocery store would have the same tax treatment. However, if it is the seller’s practice, for example, to physically hand each customer several paper plates and plastic forks and knives to take with them, then the seller is treating the customer similar to a customer at an eating establishment, in that the pie served at the customer’s table in the eating establishment would be considered “prepared food” and would be subject to tax.

Additionally, it is reasonable as it is consistent with the Compliance Review and Interpretations Committee’s rationale in Interpretation 2006-11, adopted by the Governing Board on December 14, 2006, as follows:

It should be noted that the same provision in Section VI of Interpretation 2006-04, which we are referring to as “bulk serving,” does treat “bulk servings” as prepared food when the seller’s practice for the item (as represented by the seller) is to physically hand the utensil to the purchaser, except that plates, bowls, glasses, or cups necessary for the purchaser to receive food need only be made available.

**Item A.**

This item explains how the seller determines how many servings there are. The language is reasonable since to the extent a label is available stating serving size the serving size is easily identifiable, and when the items sold bulk do not have a label the seller ordinarily has this information.

**Item B.**

This item explains what “packaged” means. It is necessary to define “packaged” to clarify that the food can be packaged before or after the selection of servings and still be bulk food, because this is a change from Minnesota’s long held position that the packaged item has to be pre-packaged to be considered a bulk item.

This issue was raised by the Rhode Island Division of Taxation on October 6, 2006, in a Request of Interpretation sent to the Compliance Review and Interpretations Committee (CRIC) of the Governing Board. The question presented was whether the packaging by a seller of four or more bakery products individually selected by a purchaser and sold for a single price meets the condition of the exception.

After allowing for public comment, CRIC recommended the interpretation as found at item B, and the Governing Board adopted it on December 14, 2006, as Interpretation 2006-11. Therefore, this item is reasonable. The committee’s rationale in Interpretation 2006-11, is as follows:

The "bulk servings" of Interpretation 2006-04 does not provide by whom the item must be packaged, or that the item must be pre-packaged. Thus, for bakery products, all that is required is that the item ultimately sold to the purchaser be a package of bakery products consisting of four or more servings sold for a single price. The fact that the servings are individually selected by the purchaser and packaged by the seller or the purchaser does not affect the transaction. The item does not constitute prepared food even when sold by a seller whose sales percentage is greater than 75% and who makes eating utensils available.

#### **Item C.**

This item defines "single price," a term used in subpart 4, to mean that the seller is only specifying one price when the seller sells the servings in the package as one item. If the seller, instead of giving one price for the entire package, specifies the price for each serving, for instance by providing on the sales receipt what the price for each serving is, then this is not a single price, and therefore, the multi-serving package should not be excepted as one bulk food item. Examples of the application of "single price" are given at subpart 6, item B. This language is reasonable as shown by CRIC's rationale in Interpretation 2006-11, which is as follows:

The Committee wishes to note that if the seller charges for each individual serving in the package, the sale would not be of "one item sold for a single price."

#### **Subpart 5.**

This subpart explains how the seller determines whether the prepared food percentage is greater than 75 percent, or equal or less than 75 percent, of its total food sales throughout Minnesota. It also provides how and when the food sale percentage will be calculated for sellers of food, as well as how often. This method of determining the percentage is part of the interpretation of "utensils provided by the seller" adopted by the Streamlined Sales Tax Governing Board in April 2006.

#### **Item A.**

This item is needed to explain that the prepared food sales percentage calculation must be done annually at all the seller's establishments in the state. It is reasonable to require a seller to calculate on an annual basis. Businesses routinely review or report on their sales on an annual basis, and the calculation must be done periodically as the prepared food sales percentage may increase or decrease over time such that "provided by the seller" will mean either that the utensil has to be handed to the customer or that the utensil must be available. While expecting the seller to continually monitor its prepared food sales percentage may be burdensome, an annual review should not be.

It is also reasonable to require that sellers of food do this for all establishments in the state, as a convenience to sellers that have businesses across the state and have consolidated accounting; for instance, a seller may have hundreds of convenience stores across Minnesota. Furthermore, regardless of the number of food businesses a seller may have in the state, it provides a uniform method from seller to seller.

#### **Item B.**

This item is needed to give the exact calculation called for to determine if the prepared food sales percentage is greater than 75 percent, or equal or less than 75 percent. This item provides that to make this determination a seller must add together the sale of food described in subitem (1) at the seller's establishments in Minnesota, and then in subitem (2) the seller divides the results of subitem (1) by the seller's total sales of all food and food ingredients, as described in subitem (2), at all the seller's establishments in Minnesota combined.

Subitem (1) refers both to food when utensils are necessary to receive the food, and also to food that is sold in a heated state or heated by the seller or two or more food ingredients are mixed or combined by the seller for sale as a single item. It is reasonable to include the food described in subitem (1) as it describes the same condition as in subpart 3, item A, analyzed above, and as it refers to prepared food that meets the condition provided for in Minnesota Statutes section 297A.61, subdivision 31, clause (2).

The statement that the total sales of food and food ingredients does not include alcoholic beverages is needed because otherwise a seller might mistakenly include the sale of alcoholic beverages in the calculation of the prepared food sales percentage, especially those sellers that own eating establishments that serve alcoholic beverages. This is reasonable, not only because the Streamlined Sales Tax Agreement excludes alcoholic beverages, but also because Minnesota Statutes, section 297A.67, subdivision 2, which exempts food and food ingredients, provides that food and food ingredients "do not include alcoholic beverages."

#### **Item C.**

This item is needed to explain that the percentage will be based on data from the prior year's sales and either from a tax year or a business fiscal year. It is reasonable to base the percentage on a prior year's sales; otherwise, the seller would have the burden of constantly having to monitor the percentage. It is reasonable to allow the seller to use either a tax year or a business fiscal year, as different sellers yearly accounting periods will differ.

#### **Item D.**

This item is needed to give guidance as to how soon this calculation must be done. It allows the seller a reasonable time to review its records from the prior year, and sets a specific date by which the seller must make adjustments if a change in the percentage results in changing the application of the tax to food where utensils are provided by the seller.

#### **Item E.**

This item is needed to explain how to determine the prepared food percentage when the business is new, as well as how to determine the percentage when a seller has both existing and new businesses.

Subitem (1), requiring a seller to make a good faith estimate, is reasonable as the seller will not have a prior year on which to depend, and because good faith is a standard of which businesses are familiar.

Subitem (2) is reasonable as it recognizes that sellers with more than one business may have a mixture of new and existing businesses. It combines the features of subitem (1) and item C by combining what is computed using the standard of good faith for the new business with what is computed via requirements of an existing business.

Subitem (3) is reasonable as it recognizes that after the first quarter of a new business the seller will have enough sales information to determine if the prepared food sales percentage the seller used under the good faith standard needs to be adjusted up or down. While the sales for the remainder of the year may fluctuate, the seller will have an opportunity at year's end to determine its percentage for the following year.

The language regarding adjusting the estimate prospectively after three months only if the percentage "decreases from greater than 75 percent down to 75 percent or less, or increases from 75 percent or less to greater than 75 percent," is reasonable as there is no value in adjusting the percentage otherwise. For example, if the seller estimates the percentage to be 76 percent at the beginning of the new business, so that "provided by the seller" means the seller simply has to have

the utensils available; if the percentage changes after three months to 92 percent, the percentage will still be greater than 75, and the change will not be material. However, if after three months the percentage is less than 75, “provided by the seller” will mean that it is the seller’s practice to physically give or hand the utensil to the customer.

**Item F.**

This item clarifies that the phrase “seller’s establishments” is limited to those business operations owned by the same person, as statutorily defined in Minnesota Statutes, section 297A.61, subdivision 2, paragraphs (a) and (b). This is needed as otherwise there is a potential that a seller may incorrectly assume that if the seller is part owner of more than one establishment, even though the persons owning the establishments are different, that all the establishments owned by multiple persons must be included in the prepared food sales percentage calculation. Limiting “seller’s establishments” to business operations owned by the same person is reasonable—when one person owns all the establishments, then the accounting for the various establishments will most likely be done by or for the same person. It is reasonable to use the term “person” as defined at Minnesota Statutes, section 297A.61, subdivision 2, paragraphs (a) and (b), since that is a term defined in the Sales and Use Tax chapter of Minnesota Statutes.

**Subpart 6.** This subpart is needed for further clarification of the rule in subpart 2, item C, subpart 4, item C, and subpart 5, item F.

**Item A.** This item is needed for further clarification of the rule in subpart 2, item C, and is reasonable as it gives common examples of utensils that are originally placed in a package by a person other than the seller and gives both taxable and nontaxable situations.

**Item B.** This item is needed for further clarification of the rule in subpart 4, item C. It is reasonable as it gives examples to give guidance to taxpayers of what is meant by “single price” as it relates to a package containing four or more servings, and in subitems (2) and (3) gives the tax consequences of not being sold or being sold for a single price. The rationale is explained above for subpart 4, item C.

Subitem (1) explains how some items, because they are bulk items, may be exempt from tax, but other food sold at the same time would be subject to tax if the prepared food sales percentage is greater than 75 percent and utensils are available for the purchaser. This subitem is reasonable as it follows the above rules, and is necessary to ensure that taxpayers understand that while certain bulk food items may be excepted from the rule in subpart 3 (that “provided by the seller” means utensils are made available), other food sold by the seller (unless falling under some other exception or exemption) will be governed by that rule.

**Item C:** This item is needed for further clarification of the rule in subpart 5, item F. It is reasonable as it gives guidance to taxpayers of what is meant by “all the seller’s establishments in the state combined” by giving commonly seen examples.

It gives examples of establishments whose sales are combined [and are not combined] for the calculating the prepared food sales percentage. The first two examples involve a partnership and a sole proprietor who is also a partner in the partnership, to show that the partnership’s establishments and the sole proprietor’s establishments are not combined, even though the sole proprietor is a partner in the partnership. The third example shows that while a parent corporation may be a sole shareholder of subsidiary corporations that own establishments, for purposes of this rule the subsidiary corporations are each a “person” and therefore each must do its own prepared food sales percentage calculation. This is reasonable as each subsidiary files its own sales tax returns and pays its own sales tax.

**Subpart 7.** This subpart is needed to make it explicit that even if the application of the various provisions of subparts 1 through 6 means that eating utensils are not provided by the seller with the food sold, nevertheless, the food sold may be prepared food if it meets the other available conditions of Minnesota Statutes, section 297A.61, subdivision 31, clause 2. This language, including the example, is reasonable as it complements subpart 1, where it was explained that utensils provided by the seller was just one of the conditions that would make food "prepared food" and thus subject to tax.

CONCLUSION

Based on the foregoing, the proposed rule changes are both necessary and reasonable.

5-4-07

Date

Ward Einess

Ward Einess  
Commissioner of Revenue