Cite as 2 WTD 243 (1986)

THIS DETERMINATION HAS BEEN OVERRULED OR MODIFIED IN WHOLE OR PART BY DET. 12-0126, 32 WTD 144 (2013).

BEFORE THE INTERPRETATION AND APPEALS SECTION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment and Refund of	F I N A L D E T E R M I N A T I O N
	No. 85-306A
. . .	Registration No. . . .

[1] **RULE 183:** SALES TAX -- AMUSEMENT AND RECREATION -- DANCING -- COVER CHARGES -- ALLOCATION OF INCOME. Where service activities consisting of both retail sales taxable amusement services (dancing) and non-sales taxable services are provided at the same place of business, admission to which is charged by a fee, the physical segregation of the facility serves to automatically allocate and apportion the admissions income between sales and services. Technically precise allocation by measuring the respective areas is neither required nor generally practicable.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

We have now thoroughly reviewed the taxpayer's petition of January 4, 1986, the entire excise tax file, and Determination No. 85-306 which was issued on December 20, 1985. That review reveals that the facts of this matter are not in dispute, the issues and arguments are clear and a further hearing of the matter is not necessary.

NATURE OF ACTION:

Excise tax reported under the Service classification of business and occupation tax was reclassified to Retailing business tax and retail sales tax measured by gross income from cover charges

derived by the . . . Disco for the period from January 1, 1981 through June 30, 1984. The taxpayer appealed the assessment of additional tax and sought a refund of overreported retail sales tax paid upon other income, unrelated to cover charge revenues.

An original appeal hearing was conducted on July 8, 1985 in Olympia, Washington which resulted in Determination No. 85-306. The Determination concluded that tax had been properly reclassified and assessed upon cover charges for "dancing" at the . . . Disco and denied the taxpayer's correction and refund request. The taxpayer appealed to the Director.

FACTS AND ISSUES:

Faker, Sr. A.L.J.--The basic facts of this case are not in dispute. They are fully and properly set forth in Determination 85-306, together with the pertinent audit background and tax assessment and credit details.

Issue:

Are gross amounts designated as cover charges for admission to a recreation and amusement place of business which provides dancing for patrons, among other activities, subject to retail sales tax without segregation or allocation of income between the respective activities?

TAXPAYER'S EXCEPTIONS:

The taxpayer's petition to the Director of January 4, 1986 includes the following:

> . . . We respectfully submit that the only amusement or recreational businesses which should be subject to the retail sales act are those "sports or athletic recreations which are participated in primarily for reasons of health or exercise." The Department previously has provided this very same limitation to Rule 183. Mr. . . .'s tavern operation hardly qualifies as (i) an amusement or recreation business or (ii) even if, arguendo, it did, that type of amusement or recreational business subject to the retail sales tax (i.e. a sports or athletic recreation in which the public participates primarily for reasons of health or exercise). In either event, the assessments of the retail sales tax against Mr. . . . are improper and should be vacated.
>
> We further ask that you review [the Administrative Law Judge's] refusal to assess a retail sales tax against

> only that percentage of customers engaging in dancing at the . . . Disco. Approximately 6 percent of the total floor area of the tavern was reserved for dancing. Only one of six different areas of the tavern could be characterized as available for dancing. Far less than 20 percent of all patrons of the tavern engaged in dancing. There are several reliable, alternative bases for assessing a retail sales tax only on that portion of the tavern operation pertaining to dancing. Although we disagree with the assessment of any retail sales tax, we submit that even under the Department's interpretation of the law and facts it would be inequitable and unjust to assess a retail sales tax on 100 percent of the admissions of the . . . Disco when a very small percentage of the operation was related to dancing.
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> . . . [The] determination recognizes that admissions charges may be segregated by retail or nonretail activity, but (i) states that segregation is allowed only if the retail activity exceeds 50 percent of the total charge and (ii) refuses to permit Mr. . . . the opportunity to segregate cover charges retroactively. We submit that a segregation doctrine that in essence grants exemptions from the retail sales act under these circumstances is constitutionally flawed, violating the equal protection and due process rights of Mr. . . . . If segregation is permitted, it should not be arbitrarily extended only to certain classes of multipurpose facilities. Furthermore, [the] refusal to allow a retroactive segregation ignores the fact that Mr. . . . has in good faith failed to make any segregation whatsoever based on this interpretation and construction of the retail sales tax law and rules. In these circumstances, we ask that if the Department will not reconsider its position on the assessment of a retail sales tax, that it at least consider the necessity of allowing a reasonable segregation on admissions charges for the . . . Disco. (Bracketed inclusions provided.)

The taxpayer also reiterates the arguments presented in its original, pre-hearing appeal petition and appended to its petition to the Director, in pertinent parts as follows:

> In this regard, we appreciated your forwarding to us the memorandum opinion dated December 23, 1971, and written by Judge Doran of the Thurston County Superior

Court.[1] However, we believe that that memorandum opinion is addressed to a different fact situation which can be easily distinguished from that of the . . . Disco operation. First, Judge Doran notes on page 3 of his memorandum opinion that dancing was advertised "prominently" for both of the two tavern operations reviewed by him. Second, one of the two taverns, Bill's Tavern, charged an admission fee only for three nights a week (Friday, Saturday and Sunday) when live music was provided. Plainly, in these circumstances dancing was a central focus and primary activity for both taverns. Third, there is no indication that the clientele in issue in the two tavern operations examined by Judge Doran was the same or identical to the rather distinct, more mature clientele that attended the . . . Disco operation. Finally, at the . . . Disco there was a much greater diversity of activities by the patrons, which distinguishes it from some sort of taxable "dance hall".

As Mr. . . . pointed out on July 8, an admission charge was established not because of any dancing activity, but to improve the quality of the clientele. The location of the notorious Monastery two blocks away made this effort essential. Mr. . . . points out that . . . , his successor in interest, has not charged an admissions fee since the King County Superior Court shut the Monastery down. This confirms the reason and need for thE admissions fee to improve the clientele of the . . . Disco.

The second key point we would like to make in this letter is the specific, physical layout of the . . . Disco. As Mr. . . . testified during the July 8 hearing, the . . . Disco has approximately 6,000 square feet, with only an approximately 15' x 25' area available for dancing, or a theater in the round, or for other purposes. Mr. . . . advises that this area was separated by a wrought iron railing, and could be easily distinguished from other areas in the . . . Disco.

Mr. . . . further advises that the . . . Disco operation consisted of three floors, with six separate areas. There was a game and entertainment area, with

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[1]Reference is to the memorandum opinion in Drayton Beverage, Inc. and Crossroads Enterprises, Inc. v. Department of Revenue, Nos. 44319 and 44320 (1971).

> tables and a stand-up bar. There was a balcony area for socializing. There was an upper bar area, with a fireplace, which was strictly for socializing. There were perimeter areas as well, for socializing. The six separate areas are identified, Mr. . . . advises, by floor plans and a layout given to the Washington State Liquor Board at the time of application for the necessary licenses.

The taxpayer's petition suggests several alternative methods for segregating the dancing activity from other, nonretailing activities. It then continues:

> Mr. . . . ability to segregate the percentage of use offers a compelling argument against any suggestion that dancing was a predominate activity at his establishment. It further provides a reasonable basis for the segregation of admission fees by activity, assuming that this small portion of Mr. . . . business was subject to sales tax (which we dispute). The memorandum opinion by Judge Doran indicates that this type of segregation of activities was possible for the Crossroads and Bill's Tavern reviewed by him, but for the fact:
>
> > In the instant case there is no attempt on the part of the plaintiffs to segregate the taxable activities from the non-taxable.
>
> In closing, we would like to reiterate that this is not a case where a party has charged the public with a retail sales tax and then failed to forward such payments to the Department of Revenue. There was no effort to collect the retail sales tax now being assessed by the Department of Revenue. No such retail sales tax was ever reflected on the admission tickets given to patrons.

DISCUSSION:

[1] Determination 85-306 is technically sound and succinct in its findings and conclusions. However, in our view, it fails to identify the dispositive distinction between the cases considered by the Court in Drayton Beverages and Crossroads Enterprises, supra, and the unique circumstances of the taxpayer's case here. The Court's cases, commonly referred to as the "dance hall" cases, involved factual situations where the segregation of activities taking place was physically impossible and the taxpayers had failed to make any segregation or allocation of the cover charges between dancing and any other activity by

separately or distinctly charging for each activity. Dancing was the primary, if not singular activity for which persons paid the cover charge. There was no probative evidence of any other reason for the charge. Dancing was prominently advertised and the cover charge income was used to offset the costs of live music and other dance-related expenses. No cover charges were made on nights when live dance music was not provided. The Court noted that if segregation of income were possible it was the taxpayers' burden to do so, which they had not done. In the instant case, however, there is a clear physical separation of the physical plant itself where the various service activities occurred. Dancing was available on only one of three levels of the taxpayer's establishment. There was no live music provided and the admission fee was charged on all evenings. The taxpayer's testimony that the sole purpose for any admission fee was to discourage undesirable patrons and that this income was insufficient even to cover the expense of security personnel was uncontroverted. The taxpayer did not prominently advertise its establishment as a dance hall, albeit that the business name, "Disco," clearly implies dance activity.

In short, the burden identified by the Court in Drayton, et al., was automatically satisfied in this case by the obvious physical separateness of the various activities engaged in at the taxpayer's establishment. Moreover, WAC 458-20-183 (Amusement and Recreation Businesses) and WAC 458-20-114 (though dealing with dues charges for goods and services) clearly contemplate the separation of activities for which lump-sum charges are made and the separate tax classification and reporting of each.

Though the results of Determination 85-306 and the audit theory in this case cannot be technically faulted, they are conceptually inappropriate for the unique or exceptional factual circumstances of cases such as this. In other words, the law can be technically applied in this manner but to do so defeats the very concept of persons engaging in multiple business activities and, as accurately as possible, reporting tax separately on each activity undertaken.

The overriding consideration in this case is that the taxpayer's facility was physically arranged in such a way as to clearly differentiate between dancing and activities other than dancing which were separately taxed. Thus, the Department, acting within its administrative discretion under the law (RCW 82.32.160 and RCW 82.32.300), will accept the tax classification for general admission charges or cover charges on the basis of the obvious segregation of facilities in this case, whereby one floor was provided for dancing and two floors for other, separately taxed, activities. We expressly reject the proposals that some more technical form of segregation should be accomplished by measuring

the dance floor area or attempting to further compartmentalize the areas in which various amusement and recreational facilities were available. Such technical precision is neither possible nor required.

Accordingly, one-third of gross receipts from cover charges or admission fees will be taxed under Retailing business tax and retail sales tax. The remaining two-thirds are taxable under the Service business tax as originally reported. The credit which was available for overreported retail sales tax for a previous tax period (unrelated to the issue here) will be credited against the retail sales tax computed to be due under the segregation method explained herein. Interest will be assessed upon any balance of sales tax remaining due; however, because this Final Determination was delayed for reasons of convenience to the Department and beyond the taxpayer's control, extension interest will not be assessed beyond March 31, 1986 (three months from the issue date of Determination 85-306). See RCW 82.32.105.

DECISION AND DISPOSITION:

The taxpayer's petition is sustained. Tax Assessment No. 5613500 is remanded to the Audit Section for adjustment according to the guidelines contained herein. The amended assessment must be paid in full on the date to be shown thereon.

DATED this 13th day of February 1987.