Cite as 2 WTD 353 (1987)

BEFORE THE DIRECTOR
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of)	F I N A L D E T E R M I N A T I O N
)	
)	No. 86-55A
)	
. . .)	Registration No. . . .
)	
)	

[1] **RULE 114:** B&O TAX -- SALES TAX --- DUES BONA FIDE -- GOLF -- TAX MEASURE -- VALUATION FORMULAS. A private golf and country club which receives membership dues from golf "playing" and nonplaying "social" members may elect to report B&O tax and retail sales tax under alternative method 2(a) of Rule 114, if it maintains actual records of play by its membership. The department will not insist upon some other method for determining the value of golf provided.

[2] **RULE 114:** B&O TAX -- SALES TAX -- DUES -- GOLF -- VALUATION FORMULA -- REASONABLE CHARGE -- COST OF PRODUCTION. The allocation of a reasonable charge for golf from golf club members' dues, which exceeds the total cost of providing golf for dues paying members is an expressly allowable tax reporting method under Rule 114.

[3] **RULE 114:** DUES -- COMPARABLE WORTH -- MARKET STUDY -- CHARGES TO NONMEMBERS. Rule 114 does not provide for an independent market study by the department to determine comparable worth of services rendered by dues receiving organizations, nor provide that such value is determined by the charges for such services made to non-dues paying persons who receive such services.

[4] **RULE 114:** DUES -- RECORDS -- ACTUAL USE OF FACILITIES -- BURDEN. Dues charging organizations must maintain actual records of use of facilities by dues paying members in order to use valuation method no. 2 of Rule 114 for determining proper tax measure. The burden rests with such organizations exclusively.

[5] **RULE 114:** DUES -- VALUE OF SERVICES -- ACTUAL USAGE METHOD -- MARKET STUDY. Dues charging organizations which elect the "actual usage of facilities" method for determining their tax measure and who perform comparable worth market study must include the entire range of market facilities, regardless of quality, in order to derive an "average" charge for such facilities.

[6] **RULE 114:** DUES -- TAX MEASURE -- COSTS OF PRODUCTION -- "SIGNIFICANT AMOUNTS" DEFINED. Dues charging organizations which use the cost-of-production method of determining tax measures under Rule 114 must include all costs in separate computations for all kinds of significant goods and services rendered. "Significant amounts" is both qualitative and quantitative and includes everything for which a person pays a charge in the commercial marketplace.

[7] **RULE 114:** DUES -- "BONA FIDE" -- DEDUCTION -- "SELLING PRICE." Income from "bona fide" dues is deductible for B&O tax and is not part of the "selling price" of anything for retail sales tax purposes. "Bona fide" dues, however substantial in amount, are tax deductible.

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.

TAXPAYER REPRESENTED BY: . . .
. . .

HEARING CONDUCTED BY DIRECTOR'S DESIGNEES:

Sandi Swarthout, Assistant Director
Garry G. Fujita, Chief of Interpretation and Appeals
Edward L. Faker, Senior Administrative Law Judge

DATE OF HEARING: October 9, 1986

NATURE OF ACTION:

The taxpayer has appealed from the results of Determination No. 86-55 as applied by the Department's Audit Section, after the tax assessment at issue was referred back to that section for adjustment. The assessment consists of Retailing business tax and (primarily) retail sales tax and interest upon the value of golf privileges provided to dues paying members.

Determination 86-55 sustained the assessment of taxes upon dues income, in principle, but referred the matter for adjustment under the alternative guidelines of WAC 458-20-114 (Rule 114). The taxpayer continues to object to the Department's application of the rule and the Audit Section's denial of the "cost of production" method of reporting tax under the rule.

FACTS AND ISSUES:

Faker, Sr. A.L.J.--The facts and audit/assessment details are fully and properly set forth in Determination 86-55. The taxpayer operates a private golf and country club and assesses members for dues depending on whether they play golf (playing members) or not (social members). Since 1979 the taxpayer reported Retailing business tax and retail sales tax measured by 50ápercent of all membership dues income.
Issue:

May a private golf club which charges for dues on the basis of "playing" or "social" membership elect to report tax under alternative 2(a), "actual usage of facilities," under Rule 114?

TAXPAYER'S EXCEPTIONS:

The taxpayer asserts that neither Determination No. 86-55 nor the Department's auditors have allowed it to report its business tax and sales tax liability under an established valuation formula provided as an available alternative under Rule 114. The taxpayer stipulates that it did not understand precisely how to allocate its total budget costs between its golf operations and other, non-golf-related operations. Thus, it attempted to develop a market survey as authorized by Rule 114(2)(b) as an alternative valuation method. This survey derived a comparable value for golf of $6.73 per round. The taxpayer asserts that this approach was rejected and that the

Department's auditors applied an arbitrary and unreasonable market survey developed by the Department's staff, reflecting a comparable value of $12.31 per round (weekdays) and $14.03 per round (weekends).

The taxpayer stresses that Determination No. 86-55 expressly concluded that the auditors erred in using greens fees charged to social members as the actual value of playing golf. (This was the original basis for the tax assessment before it was referred back for adjustment by Determination 86-55.) The Determination concluded that greens fees charged to social members are artificially inflated to discourage "non-playing members" from golfing. (See Determination 86-55, p. 5, ¶3.) The taxpayer now asserts that if $10 per round (the amount charged as green fees to social members) has been ruled to be artificially inflated and unusable for measuring tax, then the auditor's survey results of $12 to $14 per round must be an even more distorted result.

The taxpayer asserts that it fully reported business tax and retail sales tax upon all greens fees actually charged to social members or others (guests). It reaffirms that the only matter in question here is the appropriate allocation of a golfing value to dues paying "playing members" who do not pay as they play.

At the October 9, 1986 Director's level hearing the taxpayer understood the methodology for computing the value of golf for dues paying members under Rule 114(2)(a). It now asserts that its reporting of tax upon 50ápercent of gross membership dues since 1979 results in a reasonable charge for golf which, records now show, exceeds the cost of providing golf to all players. On Octoberá9, 1986 the taxpayer submitted a letter further explaining this position. It is attached hereto as Exhibit A.

As a collateral matter, and for purposes of determining prospective tax liability, the taxpayer seeks a ruling upon the validity of a comparable worth survey purportedly conducted by the Department's Audit Section for use in valuing all private golf club privileges. The taxpayer also seeks other clarifications of the Rule 114 applications.

DISCUSSION:

Rule 114 provides alternative methods of determining the value of specific goods and services for which no actual charge is made when they are used or enjoyed, because the charge is assessed periodically in the form of dues. Such dues are

charged for the privilege of engaging in amusement and recreation activities ("retail sales" under RCW 82.04.050) among other non-retail services provided. The entire purpose of Rule 114 is to provide the administrative methodology to allocate income between various kinds of sales and services, where specific pay-as-you-play charges or user fees are not collected. It is an administrative rule which must provide reporting guidelines for the myriad of clubs, associations, and organizations which elect to front load their charges or to periodically assess charges to members under the designations "dues" or "initiation fees." Such charges, by whatever name, are made in return for taxable goods and services. Only a limited portion of such amounts are "bona fide" dues within the meaning of RCW 82.04.4282 and allowed for business tax deduction. Under the law, there is no deduction of retail sales tax for any charges made by persons for engaging in any amusement or recreation business, expressly including "golf." RCW 82.04.050.

[1] The alternative valuation methods provided by Rule 114 are available at the election of taxpayers, not at the forced election of the Department. In cases where records of actual usage of facilities are maintained, as in the instant case (the taxpayer kept records of rounds of golf played) either method 2(a) or 2(b) is available. The rule provides, in pertinent part:

> All amounts derived from initiation fees and dues must be reported as gross income which then must be apportioned between taxable and deductible income. The alternative apportionment methods are mutually exclusive. Thus, if a qualifying organization elects to use the standard deduction, neither of the other methods may be used. Organizations which cannot qualify to take the standard deduction, or which elect not to do so, may apportion their income based upon such actual records of facilities usage as are maintained. This method is accomplished by:
>
> a) The allocation of a reasonable charge for the specific goods or services rendered: Provided, That in no case shall any allocation of any separate charge for any goods or services be deemed "reasonable" if the aggregate of such charges is insufficient to cover the costs of providing such goods or services; or,

> b) The average comparable charges for such goods or services made by other commercial businesses.
>
> The actual records of facilities usage method must reflect the nature of the goods or services and the frequency of use by the membership, either from an actual tally of times used or a periodic study of the average membership use of facilities. Actual usage reporting may also be based upon a graduated or sliding fees and dues structure. For example, an organization may charge different initiation fees or dues rates for a social membership than for a playing membership. The difference between such rates is attributable to the value of the goods or services rendered. It constitutes the taxable portion of the "amounts derived" allocable to that particular activity. Because of the broad diversification of methods by which "amounts derived" may be assessed or charged to members, the actual records of usage method of reporting may vary from organization to organization. The following are some examples of this reporting method for several different kinds of facilities. (Emphasis provided.)

These rule provisions are intended as both aids and guidelines for taxpayer groups ranging from golf clubs to garden clubs and camping clubs to trade associations. The various kinds of organizations which derive "dues" income run the gamut of leisure, sports, fraternal, recreational, and commercial activities. Furthermore, the legislature of this state has never expressed any intent that the charge for these activities should be somehow tax exempt, merely because they are designated as "dues." Nevertheless, the allocation of gross income between taxable dues and deductible, "bona fide" dues, as well as between retail sales taxable activities and other, service taxable activities is difficult, at best. The Department has attempted to resolve such difficulty, at the specific request of many dues charging entities, by providing the alternative valuation formulas in Rule 114. Properly applied, this rule works. It derives, as nearly as possible, the proper amounts of taxable income under the proper tax classifications. The rule contemplates that taxpayers and auditors alike aspire to this goal.

[2] In the instant case, though late in the appeal process, the taxpayer understood that its own allocation of a reasonable charge for golf, if greater in the aggregate than

its total costs of providing golf, is the acceptable measure for Retailing business tax and retail sales tax. No one is better suited to determine its costs of golf production than the taxpayer itself. Its own budget and accounting records will reveal such costs. If such records are maintained under standard principles of accounting, and the taxpayer's allocation of a value for golf exceeds such costs, no tax deficiency on this aspect of income should result. The same would be true if a valid comparable worth survey were performed.

The taxpayer's letter of Octoberá9, 1986 reveals that its allocation of a reasonable charge for golf (50 percent of gross dues income) exceeded its aggregate costs of producing golf. There is no evidence to the contrary. Moreover, this value approximates the revenue which would be derived if the taxpayer charged the going rate, based upon its own market comparison survey. We are satisfied that this meets the purpose and intent of Rule 114. The alternative valuation methods provided in the rule are optional, except as expressly limited in the rule, and are available to taxpayers at their election. The Department will not insist upon the election of any method for valuing the goods and services provided. Thus, if a dues receiving taxpayer keeps records of actual usage of facilities, it may elect to report tax based upon either its reasonable allocation of a value (so long as such value exceeds the cost of providing the goods or services) or based upon a comparable worth survey in the marketplace.

[3] Rule 114 does not provide for any independent survey to be performed by the Department, though the Department may verify or validate the survey performed by a taxpayer in order to maintain the integrity of the law and rule. Such authority is inherent in RCW 82.32.110. Thus it was inappropriate for Determination No. 86-55 to refer this matter to the Audit Section for the "opportunity to conduct a market study of its own." Furthermore, as properly concluded in Determination 86-55, Rule 114 does not determine the taxable value of membership services or benefits based upon any charge for such services or benefits made to non-members. As explained in this case, such charges may be artificially inflated for a taxpayer's own reasons, so that they do not compare with the market value of such services or benefits. The Department does not dictate what these charges shall be. It is important to note that when such charges were actually made by the taxpayer the sales tax was collected and reported on the full amounts.

Again, the mathematical formula explained in the taxpayer's letter of Octoberá9, 1986 for determining whether the dues income attributable to golf exceeded the cost of providing golf meets the spirit and intent of Rule 114. The Department's inquiry ends at that point. As always, and as provided by RCW 82.32.110, the Department has the authority to examine the taxpayer's records to authenticate its golf cost accounting figures. Accordingly, we again refer this matter to the Audit Section for the exclusive purpose of such examination.

We turn now to several collateral matters raised by the taxpayer's appeal but which are not dispositive of the tax assessment in this case.

[4] First, dues charging organizations which do not keep records of members' usage of facilities may not use method no. 2 from Rule 114. Obviously, it is of absolutely no value to such organizations to determine the commercial worth of its services, e.g., a round of golf, if there is no record of the number of rounds played by members against which to apply the worth of a round. Moreover, we do not believe the rule gives the Department discretion to use another method, other than those set forth in the rule, for assessing tax. If records of usage or records of costs of production are not maintained, then Rule 114 provides simply that "all amounts derived" constitute taxable, nondeductible amounts. The burden to elect a reporting method and maintain the records to substantiate it is a burden exclusively upon the taxpayer.

[5] Second, taxpayers who use the actual usage of facilities method and perform a comparable worth survey or study must include a representative number of all golfing facilities within the survey. It is not appropriate or acceptable to exclude so-called "good" golf courses or "bad" golf courses. The rule seeks to determine the "average" charge for golf, not the charge for golf at a comparably good facility.

We recognize that a market survey has its flaws. This is true, because a market survey necessarily requires the inclusion of high values and low values to reach an average; this is then called the market value. Businesses who sell in the higher price range will get the benefit of the value of the lower price range when the average is computed. Conversely, businesses who sell in the
lower price range will get the burden of the value of the higher price range when the average is computed.

We further recognize that the Department would like to see a methodology that would eliminate this bias. However, we can perceive of no methodology to accomplish this. We reach this conclusion, because the activities are not fungible and therefore, the values cannot be consistent statewide. What might be considered high values in Moses Lake might be considered low values in Bellingham and what might be considered high market values in Longview might be in the low market values in Seattle. Local economies, geography, club policies, and local customs play a large part in the value of the services rendered by any business. This lack of fixed criteria would require a case by case analysis to determine what factors should be included in the market values for each business. We do not perceive such a case by case policy to be valuable in the administration of and in the taxpayer's duty to comply with the tax laws. Such a methodology would erode this rule's attempt to make liability more predictable. Again, we are not unmindful of the imperfection of such a rule, but we consider this to be a necessary cost to incur for the Department and for the taxpayer in order to achieve a more predictable course of tax compliance.

[6] Third, in order to compute the costs of production for purposes of method no. 3, or to determine if the allocation of a charge under method no. 2(a) is "reasonable," all costs of specific goods or services must be considered. The rule provides,

> The cost of production method is performed by multiplying the gross income (all "amounts derived") by a fraction, the numerator of which is the cost of providing any specific goods or service, and the denominator of which is the organization's total operating costs. The formula looks like this:
>
> $$\frac{\text{Direct and Indirect Costs of Specific Goods or Service (viz: golf)}}{\text{Total Business Costs (viz: annual operating budget)}} \times \text{Gross Income (viz: all dues)}$$
>
> The result is the portion of "amounts derived" which is allocable to the taxable facility (goods or services rendered.) The balance of gross amounts derived is deductible as bona fide initiation fees or dues. If more than one kind of facility (goods or services) is made available to members, this formula must be applied for each in order to determine the total of taxable and deductible

> amounts and to determine the amount of taxable income to report as either retailing taxable or service taxable. (Parenthetical, emphasized explanations added.)

This formula is not difficult to employ, nor does it deviate from standard, cost of doing business apportionment methods. As the rule provides, this kind of computation must be done for each kind of significant services or goods provided to members. The term "significant," as used in both RCW 82.04.4282 and for purposes of Rule 114, means "important" in both the qualitative and
quantitative sense. It is the position of the Department that significant amounts of goods or services means commercially compensable products or benefits for which any consumer expects to pay, and does pay a charge when they are procured in the commercial marketplace. After all such goods or services provided are accounted for under the Rule 114 formulas, the balance of dues income is deductible for tax purposes. This is true for business and occupation tax because of RCW 82.04.4282. It is true for retail sales tax simply because the unaccounted for portion of dues income is not the "selling price" of anything under RCW 82.08.010(1).

[7] Finally, Rule 114 contemplates and recognizes the validity of the statutory deduction for "bona fide" dues. The rule also recognizes that "bona fide" dues do not constitute the "selling price" for anything. When the computation formulas provided in Rule 114 are used for all significant goods and services provided by legitimate dues-charging organizations, it is immaterial that the remainder of dues income may be substantial, compared to gross receipts. Until the State Legislature acts to more specifically define or limit the term "bona fide dues," these amounts, however large, are not taxable.

DECISION AND DISPOSITION:

The taxpayer's petition is sustained. After reexamination of records to authenticate the taxpayer's cost accounting of all golf costs, Tax Assessment No. . . . will be adjusted according to the guidelines contained herein.

DATED this 11th day of March 1987.