Cite as Det. No. 95-239, 16 WTD 48 (1995)

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

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| In the Matter of the Petition For Correction of Assessment and Refund of | ) | D E T E R M I N A T I O N |
| | ) | No. 95-239 |
| . . . | ) | Registration No. . . . |
| | ) | FY. . ./Audit No. . . . |

RULE 114; RCW 82.04.4282; ETB 503.04.114\183: SERVICE AND RETAILING B&O -- RETAIL SALES TAX -- BONA FIDE INITIATION DUES -- ATHLETIC CLUB. When an athletic club required customers to pay member enrollment fees to a fitness center to use the facility, but the membership gave them no other rights, the fitness center may not deduct the enrollment fees as initiation fees.

(1) ETB 412.32.99: ESTOPPEL -- ORAL INSTRUCTIONS FROM THE DEPARTMENT. The Department does not have authority to grant exemption from a proposed, correct tax assessment on the alleged grounds that taxpayer received erroneous oral instructions regarding the deductibility of its receipts.

(1) RULE 114; RCW 82.04.4282: RETAIL SALES TAX -- A fitness club providing only services classified as retail may not deduct dues received from members who did not use facilities if the facilities were available to those members.

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.

NATURE OF ACTION:

An athletic club protests the taxability of its enrollment fee. In addition it requests a refund of retail sales tax based upon actual use by its members.[1]

FACTS:

Pree, A.L.J. -- The taxpayer operates a health and fitness club in Washington. As a result of an audit, on June 21, 1995 the Audit Division assessed tax and interest in for the period January 1, 1991 through December 31, 1994. The taxpayer protested the assessment of service B&O tax on enrollment or initiation fees prior to July 1, 1993, and retailing B&O tax, as well as retail sales tax, on similar receipts after June 30, 1993. The taxpayer also requests a refund of retail sales tax collected and remitted from members who did not use the club during some of the months that they paid dues. Only members could use the club facilities[2]. Prospective members completed a membership agreement. The Audit Division provided a sample agreement that the taxpayer indicates was representative during the audit period. The one-year agreement provided for three types of membership: Single, couple, or family.

The agreement required the a couple to pay a $38 enrollment fee and monthly dues of $51 plus tax. It also required them to pay a one-time card fee of $30. After twelve months, the agreement automatically renewed, requiring monthly dues of $51 plus tax until the members gave 30 days notice to terminate membership. To reinstate a terminated membership, the taxpayer required the member to pay the enrollment fee again. The taxpayer could raise dues upon 30 days notice.

The taxpayer indicated that there were no club members who paid only the enrollment or initiation fee and not the dues. In other words, if customers paid the initiation fee, they paid dues to use the facility. According to the taxpayer, there was an inactive status used by some members when they were gone several months provided that they gave advance notice. They did not have to pay the required enrollment fee to reactivate their membership.

The taxpayer states that members paid a one-time fee for the privilege of membership. According to the taxpayer, other than membership, payment of this fee granted no other rights. A member did not have the right to use the club's facilities or receive any other club services unless they paid the monthly dues. Payment of the enrollment fee did not entitle members to a proprietary interest or operational control of the taxpayer.

Members submitted a check for the enrollment fee and one-time card fee with the application. The taxpayer provided the member two invoices, one for the card fee with retail sales tax, and the other for the enrollment or initiation fee. Customers usually provided the taxpayer a bank authorization for automatic withdrawal of their monthly dues. Otherwise the taxpayer mailed the invoices to the customers on the first of the month. The taxpayer reported the card fees and the enrollment fees separately on the general ledger.

The taxpayer reported the monthly dues and the card fee in its measure of tax, but deducted the enrollment fee from its measure of tax. The Audit Division assessed service business and occupation (B&O) tax on fees received prior to July 1, 1993. For periods after June 30, 1993, the Audit Division assessed retailing B&O tax and retail sales tax.

The taxpayer objected, contending that the enrollment fees constituted bona fide initiation fees deducible under WAC 458-20-114. The Audit Division states that the taxpayer was not entitled to the deduction because members could not use the club or the equipment without paying the enrollment fee. The taxpayer argues that since there was no exchange of goods and services for payment of the enrollment fees, they were bona fide initiation fees.

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[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

[2] Members could bring guests with them to the club for a "guest fee" of $7.50 per visit.

At the time dues became subject to retail sales tax[3], the taxpayer's CPA states that he called the Department twice and inquired about the taxability of these fees. He identified the Department employees, dates, and approximate times of the inquiries. According to his notes, the first Department employee told him that initiation fees charged by health clubs were not subject to retail sales tax. On the second occasion, a different Department employee told him that retail sales taxes were not charged on initiation fees that merely extended the right to belong to the club or organization. Based on those discussions, the taxpayer contends that the initiation fees were deductible from B&O tax and not subject to retail sales tax.

In addition, the taxpayer requests a refund because not all of its dues-paying members used the club and, therefore, it contends, not all of its dues should have been subject to retail sales tax. These members were entitled to use the facilities, but in any given month, 27% - 43% of the members did not visit the club. The taxpayer collected retail sales tax that it remitted to the Department. The Audit Division did not address this in its written report to the taxpayer.

ISSUES:

(1)Were the enrollment or initiation fees in exchange for services, or were they deductible as bona fide initiation fees?

(1)May the taxpayer rely on verbal advice from an employee of the Department?

(1)If members did not use the club, was the taxpayer entitled to a refund of retail sales taxes that it collected and remitted.

DISCUSSION:

The statutory authority for the deduction at issue, RCW 82.04.4282, provides in part:

In computing tax there may be deducted from the measure of tax amounts derived from (1) bona fide initiation fees, . . . . This paragraph shall not be construed to exempt any person, association, or society from tax liability upon selling tangible personal property or upon providing facilities or services for which a special charge is made to members or others. If dues are in exchange for any significant amount of goods or services rendered by the recipient thereof to members without any additional charge to the member, or if the dues are graduated upon the amount of goods or services rendered, the value of such goods or services shall not be considered as a deduction hereunder.

(Emphasis added). We must determine whether the enrollment fee constituted a special charge to the taxpayer's members for providing facilities or services.

The Department explains its interpretation of this deduction in WAC 458-20-114 (Rule 114) which states in part:

RCW 82.04.4282 provides for a business and occupation tax deduction for amounts derived from activities and charges of essentially a nonbusiness nature. Thus, outright gifts, donations, contributions, endowments, tuition, and initiation fees and dues which do not entitle the payor to receive any significant goods or services in return for the payment are not subject to business and occupation tax. The scope of this statutory deduction is limited to situations where no business or proprietary activity (including the rendering of goods or services) is engaged in which directly generates the income claimed for deduction.

The law does not contemplate that the deduction should be granted merely because the payments required to be made by members or customers are designated as "initiation fees" or "dues." The statutory deduction is not available for outright sales of tangible personal property or for providing facilities or services for a specific charge. Neither is it available ". . . if dues are in exchange for any significant amounts of goods or services rendered by the recipient thereof to members without any additional charge to the member, or if the dues are graduated upon the amount of goods or services rendered . . ." (RCW 82.04.4282). Thus, it is only those initiation fees and dues

[3] Effective July 1, 1993, RCW 82.04.050(3)(h) included charges for physical fitness services in the definition of "retail sale" subjecting them to retail sales tax at that time.

which are paid for the express privilege of belonging as a member of a club, organization, or society, which are deductible.

(Emphasis added). Rule 114 defines:

"Bona fide" shall have its common dictionary meaning, i.e., in good faith, authentic, genuine.

"Initiation fees" are those initial amounts which are paid solely to admit a person as a member to a club or organization. "Bona fide initiation fees" within the context of this rule shall include only those one-time amounts paid which genuinely represent the value of membership in a club or similar organization. It shall not include any amount paid for or attributable to the privilege of receiving any goods or services other than mere nominal membership.

"Dues" are those amounts paid solely for the privilege or right of retaining membership in a club or similar organization.

"Significant amount" relates to the quantity or degree of goods or services rendered and made available to members by the organization. "Significant" is defined as having important meaning or the quality of being important.

Interpreting this Rule, The Court of Appeals stated, "The purpose of the dues deduction is to exempt from taxation only revenue exacted for the privilege of membership." Automobile Club vs. Department of Rev., 27 Wn. App. 781, 786, 621 P.2d 760 (1980). ETB 503.04.114\183 issued November 1, 1976 provides in part:

Thus, payments which are in fact consideration for and entitle a person to receive goods, services or use of facilities are subject to excise taxes even though they may be labeled "dues" or "initiation fees". Such payments are not bona fide initiation fees or dues within the meaning of the statute or Rule 114, i.e., they are not truly "dues" or "initiation fees". Thus, so-called "initiation fees" or "dues" paid for the use of recreational or amusement facilities of the kind referred to in Rule 183 (e.g., swimming, skating, tennis, golf, handball, dancing, et al) are subject to the retailing business tax, and the retail sales tax must also be collected thereon.

. . . .

An organization in which the membership has no proprietary interest and operational control and which performs business or commercial services, the charges for which would otherwise be subject to business and occupation tax, may not avoid tax liability by designating such charges as initiation fees, dues or contributions.

It may be that a club or organization is structured in such a way that initiation and dues fees entitle the members to a combination of benefits, some of which are mere membership rights and others which constitute compensable commercial services. In such instances, the amount representing initiation fees and dues will be deductible only if they entitle the member to a proprietary interest and a voice in the operational control of the club or organization and in its facilities.

Payment of the enrollment fees did not entitle members to a proprietary interest or operational control. Other than the right to use the facilities if they remain current on their dues, the taxpayer provides no consideration to members. It offers no social membership, or any limited rights to dine or mix with members such as those offered by some country clubs. Members had no proprietary interest or operational control of the club. Just as members could not use the facilities without paying the monthly dues, nonmembers could not use the facility without paying the enrollment fee. Customers paid both amounts for use of the facility and services. They received those services as consideration for paying fees under both labels. Therefore, since customers paid the enrollment fee for the taxpayer to provide the facility and services, the deduction was not applicable.

[2] The Department of Revenue cannot provide tax relief on the basis of a taxpayer's recollection of oral instructions given by an employee of the Department. Specifically, Excise Tax Bulletin 419.32.99 (ETB 419) issued April 30, 1971 states:

The department cannot give consideration to claimed misinformation resulting from telephone conversations or personal consultations with a department employee.

There are three reasons for this ruling:

(1)There is no record of the facts which might have been presented to the agent for his consideration.

(1)There is no record of instructions or information imparted by the agent, which may have been erroneous or incomplete.

(1)There is no evidence that such instructions were completely understood or followed by the taxpayer.

(Emphasis added).

The first reason of ETB 419 appears applicable in this situation. The statute and rule both provide that bona fide initiation fees are deductible. As discussed above, determining whether or not payment of fees given the label of initiation fees are consideration for services is largely a factual question requiring close review of the agreement as well as other circumstances. The facts here show that the enrollment fees were paid to use the facility. According to the CPA's statement, both employees were told these were initiation fees, and not for services, conclusions that the facts do not bear out. We cannot apply the alleged instructions in this case.

[3] Regarding the taxpayer's refund request, we can find no basis to deduct the dues paid to use facilities which are available to members but not used by them. Rule 114 states that amounts derived for goods or services available to members regardless of the amount of use are not deductible. The section of Rule 114 cited by the taxpayer, refers to apportionment between taxable and nontaxable income provided that the taxpayer provides more than one kind of "goods and services" as defined in the rule. Since there is not a nontaxable component of the services offered for the dues, the dues cannot be apportioned as if a portion were nontaxable.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

DATED this 21st day of December, 1995.