Cite as Det. No. 98-186R, 19 WTD 319 (2000)

BEFORE THE APPEALS DIVISION
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. 98-186R
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

[1] RULES 114 AND 183; RCW 82.04.4282: B&O TAX -- EXCLUSIVE DINING CLUBS -- INITIATION FEES – MEMBERSHIP DUES. The deduction under RCW 82.04.4282 for "bona fide" initiation fees and dues is available to an entity to the extent it can show the fees and dues are not in exchange for goods and services it renders. There is no requirement under the statute or Rule 183 that membership entitle a member to a proprietary interest or a voice in the operational control of the taxpayer, or that the taxpayer fit a particular profile.

[2] RULES 114 AND 183; RCW 82.04.4282: B&O AND RETAIL SALES TAX -- TENNIS/FITNESS CLUBS -- INITIATION FEES – MEMBERSHIP DUES -- RETAIL SALES TAX. An exclusive private dining club, in which membership has value beyond the opportunity to purchase food and drink, may deduct membership fees and dues that are not in exchange for the goods and services it renders.

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 exclusive dining club requests reconsideration of Det. No. 98-186, which affirmed the assessment of B&O tax and retail sales tax on membership dues.[1]

FACTS:

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

Prusia, A.L.J. -- The taxpayer is a corporation that operates as an exclusive membership dining club in [Washington City]. The club's facility consists of various banquet rooms and a main dining hall. . . . Access is restricted to club members and their guests. Members pay an initiation fee/deposit, plus monthly dues of $ . . ., which entitle them to enter the premises.

The taxpayer offers only dining and beverage services. It offers no amusement, recreation, or physical fitness facilities. It is not a social club, although there are opportunities to socialize . . . . Payment of the initiation fee and dues does not give the member any ownership interest in the club. Payment of the fee and dues does not entitle the member to any discount on meals or drink.

. . .

The Audit Division of the Department of Revenue (Audit Division) examined the taxpayer's books and records for the period January 1, 1993 through June 30, 1997. As a result of the audit, the Audit Division issued an assessment for additional taxes and interest, Document No. FY. . . . The total amount assessed was $. . . .

The taxpayer had started paying B&O tax on its monthly dues receipts, at the service rate, in the eighth month of the audit period (August 1993). The Audit Division concluded that the taxpayer should have paid service B&O tax on the dues throughout the audit period, and assessed additional tax for the seven months taxpayer had not paid the tax. The Audit Division concluded that the taxpayer's monthly dues were not "bona fide" dues that RCW 82.04.4282 allows to be deducted from gross income, but rather were consideration for providing dining facilities, taxable as service income.

. . .

The taxpayer timely petitioned for review of portions of the assessment relating to the taxation of . . . dues, contending the dues were "bona fide" dues and therefore deductible pursuant to RCW 82.04.4282. . . . At the same time, the taxpayer requested a refund of business and occupation (B&O) taxes already paid on . . . dues receipts. . . .

In Det. No. 98-186, we denied the taxpayer's petition for review on all appealed issues. We concluded that the . . . monthly dues were not bona fide dues under RCW 82.04.4282, but rather were charges for the opportunity to purchase goods and services in the future, and were subject to the service and other activities B&O tax. We reasoned that the dues charges have solely a business nature. They entitle the member to nothing more than the opportunity to purchase dining services in the future. Payment of dues does not entitle a member to a proprietary interest or to operational control. We found that unlike a social club or a club that pursues common political or cultural interests, bare membership in the taxpayer has no intrinsic value. The taxpayer is a restaurant and differs from other restaurants only in that access is limited to patrons who have paid a deposit and monthly dues. In support of our conclusion, we relied upon Det. No. 95-239, 16 WTD 49 (1995), and Det. No. 96-114, 16 WTD 188 (1996).

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In requesting reconsideration of Det. No. 98-186, the taxpayer provides additional facts, and alleges errors in the interpretation and application of relevant law.

The taxpayer provides the following additional facts relating to its facilities and activities. Although the facilities are primarily for dining, members can visit the club simply to socialize. The facilities include a library with comfortable furniture where members can socialize, work, or read. There is a waiting/seating area in front of the view windows next to the dining facilities, where members can relax, converse, read, or meet other members and guests. The taxpayer holds various member social events, including wine tastings, holiday parties, and book club meetings. While members do not have an ownership interest in the club, they are given a voice in the taxpayer's activities, through the board of governors, which is comprised of members. They also are given a voice through various member committees, such as the food committee.

The taxpayer contends Det. No. 98-186 erred in stating bare membership has no intrinsic value. It notes there are many fine restaurants in the area where persons can dine without paying membership fees. It states persons pay to be members of the club because they perceive the club to be prestigious, and because it provides access to the company of other individuals in the community whose company members consider socially satisfying or professionally rewarding.

The taxpayer also provides additional facts concerning the prices comparable establishments charge for goods and services, and the taxpayer's charges for, and costs of providing, goods and services. We will discuss this information in greater detail later in this Determination.

The taxpayer argues Det. No. 98-186 erred in interpreting and applying RCW 82.04.4282 and WAC 458-20-183 (Rule 183). It argues RCW 82.04.4282 provides that a taxpayer may deduct from the measure of tax amounts derived from initiation fees and dues, unless the dues or fees are in exchange for any significant amount of goods or services rendered without additional charge to the member, or are graduated upon the amount of goods or services rendered. Rule 183 provides that a charge will be considered "any additional charge" if it covers all costs reasonably associated to furnishing the goods or services, or is comparable with charges made for similar goods or services by other comparable businesses. It argues that the taxpayer meets those requirements, in that amounts it charges for goods and services are comparable to amounts charged for goods and services at comparable establishments, and equal or exceed the taxpayer's costs. Its members receive only the privilege of membership in return for the payment of the initiation fees and dues.

The taxpayer argues the Determination largely ignored the statute and Rule 183 in concluding the taxpayer was not entitled to deduct amounts received as dues and initiation fees. It argues that the two Department determinations upon which the Department relied, Det. No. 95-239, supra, and Det. No. 96-114, supra, are clearly distinguishable on their facts.

The taxpayer argues Det. No. 98-186 erroneously supported its conclusion by noting that the members are not given a proprietary interest or operational control of the club. It argues that Rule 183(4)(a)(iii) provides that no distinction is made between the kinds of clubs which may be eligible for the deduction, and therefore neither proprietary interest nor operational control need lie with the members in order for the dues to be deductible. It argues: "The key fact is that the Club's initiation fees and dues are payments for the privilege of membership and not, in the words of the statute, 'in exchange for any significant amount of services rendered by the recipient thereof to members without any additional charge to the member.'"

The taxpayer argues Det. No. 98-186's position on the deductibility of its dues receipts is inconsistent with the Department's long-standing position and previous instruction to the taxpayer.

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ISSUES:

Were the monthly dues the taxpayer received from its members deductible from its gross income under RCW 82.04.4282?

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DISCUSSION:

The legislature intended to impose the B&O tax on virtually all business activities carried on within the state. Time Oil Co. v. State, 79 Wn.2d 143, 483 P.2d 628 (171). Exemptions and deductions are narrowly construed. Budget Rent-A-Car, Inc. v. Department of Rev., 81 Wn.2d 171, 500 P.2d 764 (1972). Taxation is the rule; exemption is the exception. Spokane County v. City of Spokane, 169 Wash. 355, 13 P.2d 1084 (1932).

The legislature allows a deduction from the B&O tax for "bona fide initiation fees and dues." RCW 82.04.4282. The applicable portions of the deduction statute provide:[2]

> In computing tax there may be deducted from the measure of tax amounts derived from bona fide (1) initiation fees, (2) dues, ... This section 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 under this section.

[2] The legislature amended RCW 82.04.4282 in 1994, during the audit period. The major change was to move the words "bona fide" outside the enumerated sources of income to make it clear that all fees, dues, tuition, and other charges must be "bona fide." The statute quoted here is the version currently in effect.

RCW 82.04.4282 makes clear that fees or dues are subject to the B&O tax if paid in exchange for goods or services. By implication, fees or dues are "bona fide," and not subject to B&O tax, if no goods or services are rendered in exchange.

The Department adopted WAC 458-20-114 (Rule 114) to administer RCW 82.04.4282. Effective December 1, 1995, relevant provisions of Rule 114 were moved to WAC 458-20-183 (Rule 183). Rule 183 provides, in language nearly identical to that in Rule 114:

> (4) **Receiving income in the form of dues and/or initiation fees.**
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> (a) **General principles.** For the purposes of the business and occupation tax, 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 following general principles apply to providing amusement, recreation, and physical fitness services when income is received in the form of dues and/or initiation fees:
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> (i) RCW 82.04.4282 provides for a business and occupation tax deduction for amounts derived from activities and charges of essentially a nonbusiness nature. 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. Many for-profit or nonprofit entities may receive "amounts derived," as defined in this section, which consist of a mixture of tax deductible amounts (bona fide initiation fees and dues) and taxable amounts (payment for significant goods and services rendered). To distinguish between these kinds of income, the law requires that tax exemption provisions be strictly construed against the person claiming exemption. Also, RCW 82.32.070 requires the maintenance of suitable records as may be necessary to determine the amount of any tax due. The result of these statutory requirements is that all persons must keep adequate records sufficient to establish their entitlement to any claimed tax exemption or deduction.
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> (ii) The law does not contemplate that the deduction provided for by RCW 82.04.4282 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. Thus, it is only those initiation fees and dues which are paid solely and exclusively for the express privilege of belonging as a member of a club, organization, or society, which are deductible.
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> (iii) In applying RCW 82.04.4282, no distinction is made between the kinds of clubs, organizations, associations, or other entities, which may be eligible for this deduction. They may be operated for profit or nonprofit. They may be owned by the members, incorporated, or operating as a partnership, limited liability company, joint venture, sole proprietorship, or cooperative group. They may be of a charitable, fraternal, social, political, benevolent, commercial, or other nature. The availability of the deduction

> is determines solely by the nature of the activity or charge which generates the "amounts derived" as that term is defined in subsection (2)(a) of this section.

The legislature did not define "bona fide" initiation fees and dues, nor did it define the terms "any additional charge," or "significant amount." Rule 183 defines those terms as follows:

> "Initiation fees" means those amounts paid solely to initially 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.
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> "Dues" are those amounts periodically paid by members solely for the purpose of entitling those persons to continued membership in the club or similar organization. It shall not include any amounts paid for goods or services rendered to the member by the club or similar organization.
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> "Any additional charge" means a price or payment other than bona fide initiation fees or dues, paid by persons for particular goods and services received. The additional charge must be reasonable and any business and/or sales taxes must be paid upon such charges in order to qualify other income denominated as "bona fide dues" or "fees" to be deductible. The reasonableness of any additional charge will be based on one of the following two criteria:
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> (i) It must cover all costs reasonably related to furnishing the goods or services; or
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> (ii) It must be comparable with charges made for similar goods or services by other comparable businesses.
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> "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 great value or the state of being important.

Interpreting Rule 114, 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 v. Department of Rev., 27 Wn. App. 781, 786, 621 P.2d 760 (1980). It held that dues that were related to services provided by the club were not deductible from gross income.

[1] We largely agree with the taxpayer's criticism of Det. No. 98-186 and its analysis of the applicable statute and rule. . . . Neither the statute nor Rule 183 requires that a member receive an opportunity to socialize, an opportunity to pursue common political or other social interests, a proprietary interest, operational control, or anything in return for dues.[3] They require only that

[3] The only place we find such a requirement is in Excise Tax Bulletin 503.04.114\183 (ETB 503), issued on November 1, 1976, and canceled effective January 31, 1996. ETB 503 provided, in pertinent part:

the dues not be in exchange for any significant amount of goods or services rendered by the taxpayer to members without any additional charge, and not be graduated upon the amount of goods or services rendered. They do not require that the taxpayer fit some concept of a bona fide "club." . . . . When a bare membership only allows the member to get inside the facility, it suggests that the dues are merely part of the charge for the goods or services the taxpayer provides therein, but does not establish that as a fact. [4]

Det. No. 98-186 relies upon Det. No. 96-114, wherein we stated the following: "Under [Rule 114], bona fide dues or initiation fees are those amounts paid to join or continue membership in a club or organization solely for the right to associate with other members or to support the organization's goals." That language in Det. No. 96-114 is dictum . . . In Det. No. 96-114, membership entitled the member to discounts on the cost of car washes and other services. There was an explicit connection between the membership fee and the "club's" charge for goods and services.

We find no Departmental precedent that has held membership fees non-deductible where we did not find that payment of the fees entitled the member to receive goods or services free or at a reduced price. In Det. No. 95-239, supra, also cited in Det. No. 98-186, the payment of "dues" gave members [nothing except] the right to use athletic facilities at no extra cost. In Det. No. 91-002, 10 WTD 362 (1990), involving a private social and luncheon club, we held taxable only those portions of dues attributable to the privilege of using squash facilities for no additional

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> 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.
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> . . . .
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> 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.
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> 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.

[4] Based upon the additional information the taxpayer provided on reconsideration, we find that bare membership does have value beyond the opportunity to purchase food and drink. It confers prestige and an opportunity to socialize with movers and shakers in the community. It also provides opportunities to relax, read, or work.

charge.[5] In Det. No. 97-146R, 17 WTD 133 (1998), we found that the taxpayers' initiation fees were not "bona fide initiation fees" because the payments were [only] in exchange for the free use of exercise facilities.[6]

The approach the Court of Appeals took in Automobile Club illustrates the appropriate approach for resolving the question whether dues are "bona fide." The court held that what is determinative is whether there is a correlation between the totality of services provided and the aggregate dues received. In Automobile Club, the court found evidence of a correlation. Dues accounted for 75 percent of the club's total income, while the cost of providing services and general administrative expenses accounted for 82 percent of the club's expenses, and the club had justified several dues increases because of increased costs of service.

The test [for whether dues are payment for goods and services] as set out in Rule 114 and later Rule 183, is whether the additional charge for goods and services covers all costs reasonably related to furnishing the goods or services, or compares with charges made for similar goods and services by other commercial businesses. If the additional charge meets either criterion, we will not find that the member receives the goods and services in return for the payment of the initiation fees and dues.

[2] The taxpayer offers no amusement, recreation, or physical fitness facilities that the entrant can use free of charge. Payment of the initiation fee and dues only entitles a member to socialize and to use the dining and drinking facilities for an additional charge. If the additional charges for the goods and services provided are "reasonable," as that term is defined in subsection (2)(c) of Rule 183, the initiation fees and dues qualify for the RCW 82.04.4282 deduction.

It does not appear the Audit Division determined whether there is an actual correlation between the price the taxpayer charges for its goods and services and the dues income, or whether the additional charges are "reasonable." Rather, it appears the Audit Division interpreted RCW 82.04.4282 and Department precedent as providing that fees charged for access to goods and

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[5] In that Determination, we did not consider any portion of the monthly dues to be in exchange for dining privileges, because the taxpayer made a reasonable additional charge for that privilege. We made the following distinctions:

> In examining the taxpayer's business activities, it is evident that the taxpayer's members primarily utilize the following club facilities: the dining room and lounge, the parking garage, the squash courts, and, to a lesser extent, the pool room. Because the taxpayer makes a reasonable additional charge for dining, bar and parking privileges, no portion of the monthly dues have been considered in exchange for those goods or services. This is not the case, however, with respect to the squash courts and the pool table [the taxpayer made no additional charge for the use of those facilities]."

[6] In Det. No. 97-146R, payment of the initiation fee alone did not entitle the member to anything, but continued membership required payment of the initiation fee plus monthly dues, and payment of the dues entitled the member to free use of exercise facilities. The taxpayers could not recall anyone who purchased a membership without also paying dues, nor could we conceive that anyone would do so. We found that members paid both amounts for use of the facilities and services.

services never fall within the dues exemption.[7] That interpretation is not supported by rule or published precedent.

In support of its assertion that its additional charges for goods and services are comparable to amounts charged for goods and services at comparable establishments, and equal or exceed the taxpayer's costs, the taxpayer has provided copies of menus and wine lists from several [Washington City] restaurants. It states the restaurants are representative of high-end restaurants comparable to the taxpayer. The taxpayer has provided income and expense reports for its food and beverage department, as well as for the club generally, for the audit period. It appears from this evidence that the additional charges for goods and services are both comparable to amounts charged for goods and services at comparable establishments, and equal or exceed the taxpayer's costs. If the additional charges meet either criterion, they are "reasonable" for purposes of Rule 183. We will remand the file to the Audit Division to verify the accuracy and representativeness of the information provided, and, if necessary, give the taxpayer an additional opportunity to establish that its additional charges are "reasonable." The burden of supporting its claim that its additional charges are "reasonable" rests upon the taxpayer.

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DECISION AND DISPOSITION:

We reverse our prior ruling in Det. No. 98-186 sustaining the Audit Division's denial of the deduction of the taxpayer's . . . dues receipts, and remand the issue to the Audit Division for verification of the authenticity, accuracy, and representativeness of the evidence provided in support of the taxpayer's claim that its additional charges for goods and services covered all costs reasonably related to furnishing the goods and services, or were comparable with charges made for similar goods or services by other comparable businesses, and for possible adjustment of the assessment and refund consistent with this determination.

Dated this 28th day of June 1999.

[7]The only Department precedent to which the Audit Division makes explicit reference is Det. No. 89-426, 8 WTD 165 (1989). That Determination does not stand for such a broad proposition. It stands for the principle that membership fees, when taxable, that merely entitle a member to access to goods and services and not the goods and services themselves, are taxable as service income, rather than retailing income. The case concerned income from membership fees in a merchandise club, where membership entitled a member to purchase goods and services at special (low) prices. The taxpayer in Det. No. 89-426 did not claim a deduction under RCW 82.04.4282.