

Cite as Det. No. 15-0039, 34 WTD 406 (2015)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 15-0039
. . .)	
)	Registration No. . . .
)	

[1] RCW 82.04.050(3); WAC 458-20-183: RETAILING B&O TAX AND RETAIL SALES TAX – PHYSICAL FITNESS SERVICES – CROSS-TRAINING. The primary purpose of taxpayer’s cross-training classes is physical fitness, and they are therefore subject to retailing B&O tax and retail sales tax.

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.

Sattelberg, A.L.J. – A provider of [cross-training] classes (“Taxpayer”) disputes the Department of Revenue’s (“Department”) reclassification of its membership fee income from the service & other activities business and occupation (“B&O”) tax classification to the retailing B&O tax classification and the assessment of retail sales tax. We deny the petition.¹

ISSUE

Is the income Taxpayer receives from membership fees to its [cross-training] facility and classes subject to retailing B&O tax and retail sales tax as physical fitness services under RCW 82.04.050(3) and WAC 458-20-183(3)(a) (“Rule 183”), or service & other activities B&O tax under RCW 82.04.290 and Rule 183(3)(b)?

FINDINGS OF FACT

Taxpayer offers [cross-training] classes from its facility in . . . Washington. Taxpayer is an affiliate of [a cross-training company].² Taxpayer licenses [a trademarked name] and employs its methodology.

Taxpayer derives the majority of its income from membership fees it charges for participants to attend classes, and it also sells fitness-related items like sports drinks and protein powder. Taxpayer historically reported its income from membership fees for B&O tax purposes under the

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

² Taxpayer provided a copy of its affiliate agreement. The first sentence of the agreement’s introduction is: “[Cross-training] provides a fitness program for strength and conditioning.”

service & other activities classification, and income from sale of its fitness-related items for B&O tax purposes under the retailing classification. Taxpayer also collected and remitted retail sales tax on sales of fitness-related items.

For the fourth quarter of 2012, Taxpayer reported an uncharacteristically large amount of retail sales and retailing B&O tax. Taxpayer then filed an amended return in April 2013 stating that it had inadvertently reported all of its membership fees under the retail sales tax and retailing B&O tax lines. . . .

The amended return was submitted to the Department's Taxpayer Account Administration Division ("TAA") for processing. In August 2013, TAA contacted Taxpayer seeking additional information about its activities. After correspondence between TAA and Taxpayer, TAA determined Taxpayer's membership fees were retail sales as Taxpayer was providing physical fitness activities. TAA partially audited Taxpayer for the period October 1, 2009, through September 30, 2013, reclassifying Taxpayer's income from the service & other activities B&O tax classification to the retailing B&O tax classification and retail sales tax. The assessment totaled \$. . . .³

Taxpayer timely appealed the assessment arguing that the primary focus of its activities is instruction rather than physical fitness. Taxpayer makes the following contentions:

1. The classes' primary focus is on instruction in [cross-training] techniques and philosophy. Taxpayer states its underlying philosophy is "using constantly varied functional movements performed at high intensity."⁴
2. The classes are offered at a stand-alone instruction facility, not a health or athletic club or other facility devoted to general exercise and fitness.⁵
3. The classes follow a specific curriculum that includes study of the underlying philosophy of the discipline. Taxpayer states that instructors follow a weekly curriculum. Each weekly plan can have a specific focus, and classes can vary from gymnastics, weightlifting, powerlifting, running, kettle bell training, rowing, etc.
4. Advanced classes and an instructor internship course are offered with the purpose of preparing the participant to obtain instructor certification in the discipline. Taxpayer states that it instructs and certifies its own instructors, and has a formal coaching internship for potential instructors.
5. As a participant's skill level increases, as demonstrated in skill assessments by the instructors, the participant may advance to higher levels of instruction in advanced techniques and philosophy. Taxpayer states that it has three levels of achievement: 1) Fundamentals, 2) All Skills Levels, and 3) Competitors. While everyone seems to pass through the week-long Fundamentals level, the beginning training program, on their way to All Skills Levels, not everyone achieves the Competitors level. In All

³ The assessment consists of \$. . . in retail sales tax, \$. . . in retailing B&O tax, a credit of \$. . . for service & other activities B&O tax paid, a net reduction of the small business tax credit of \$. . . , \$. . . in interest, and a \$. . . substantial underpayment penalty.

⁴ Declaration of . . . , #6.

⁵ Taxpayer provided pictures of its facility, which has various exercise equipment . . . at the periphery of the facility and a large open area in the center.

Skills Levels, Taxpayer states there are less and more advanced movements, which instructors need to be aware of when leading a class.⁶ The Competitors level is the elite level, where advanced students and future instructors can take classes.

Taxpayer provided a significant amount of material emphasizing the instructional component of its activities, including, among other documents, a couple of short videos, declarations from eleven of its members,⁷ a declaration from the owner, pictures of its facility, a weekly workout plan,⁸ a copy of [a] June 2014 [cross-training] Journal, and a PowerPoint and dialogue describing the difference between a [cross-training] facility and a traditional gym. . . . Taxpayer's [stated]

⁶ The "Class Level Descriptions" document Taxpayer submitted describes the levels as follows:

Beginner:	For students at an entry skill level and entry fitness level. Time on the Baseline Workout time is slower than 9 minutes. Many movements that are done in a gym and/or in [cross-training] are unfamiliar. Class focus is on basic movement skill and technique.
Level 1:	Student is not a beginner, but is still working on building a base level of strength and conditioning and technical expertise. Baseline Workout time is between 6:00 – 9:00. Starting to get to know the names of movements, but still unsure of the amount of weight to use, and exactly how to do many of the more complex [cross-training] movements.
Level 2:	Student has mastered most of the basic intermediate [cross-training] movements and is working on the more advanced weightlifting and gymnastic movements. Can take a friend through a [cross-training] workout with confidence. Pull ups are done without assistance and Baseline time is between 4:30 – 6:00.
Level 3:	Student is confident and capable with all [cross-training] movements and workouts and has made [cross-training] a regular part of life. He/she is comfortable and confident creating their own workouts and is working on mastering specific skills. Student has attended a [cross-training] seminar or a specialty seminar and can serve as a model for any movement in a class. Level 3 students are looked upon as the leaders at . . . [cross-training] even though they are not necessarily instructors.
Competitor:	Student is learning the finer point of how movements and strategies change for the competitive environment. Emphasis is on high-level skill development and tactics.

⁷ The declarations from [eleven members], read in pertinent part:

3. As a client of .[Taxpayer], I receive instructional lessons from certified [cross-training] instructors in proper form and techniques for [cross-training] movements, nutrition, and the underlying philosophy of [cross-training].
4. The primary focus of the instructional lessons I receive at [Taxpayer] is instruction on how to master the skills of advanced [cross-training] movements and techniques, and nutrition so that certain movements can be performed with minimal risk of injury. Instruction in proper body movement is the primary focus.
5. [cross-training] participants are assessed based on their current skill and placed into the appropriate instruction level, from which we work to progress to more advanced instruction levels. New members must complete the requisite training program, "Fundamentals". Following completion of this program, members can advance to next level of classes, "All Skills Levels". Within this stage, .[Taxpayer] coaches provide instruction based on members' athletic skill level, where each member is instructed to perform varying progressions of specific movements. Members must demonstrate capacity at lower levels of movement progressions prior to being allowed to progress to attempting more advanced movements. The most advanced class level is "Competitors" which is a course designed for advanced athletes. In order for a member to advance to the "Competitors" level, he or she must pass a performance assessment by the [cross-training]. . . instructors.
6. Fitness is a secondary benefit achieved from proper form and movement.

⁸ [. . .]

Supplemental material submitted June 18, 2014, p. 2.

“goal is not to improve the fitness and health of our members but to teach and empower them to improve their own fitness and health.”⁹

ANALYSIS

Persons who charge for services defined as retail sales are required to collect and remit retail sales tax and pay retailing B&O tax. See RCW 82.08.020, 82.08.050; RCW 82.04.250. In contrast, persons who charge for services not otherwise classified for B&O tax purposes, pay service and other activities B&O tax and are not required to collect and remit retail sales tax on those receipts. See RCW 82.04.290.

RCW 82.04.050(3)(g) states that the term “retail sale” includes amounts received by persons providing physical fitness services. Rule 183(2)(l) defines “physical fitness services:”

“Physical fitness services” include, but are not limited to: All exercise classes, whether aerobic, dance, water, jazzercise, etc., providing running tracks, weight lifting, weight training, use of exercise equipment, such as treadmills, bicycles, stair-masters and rowing machines, and providing personal trainers (i.e., a person who assesses an individual's workout needs and tailors a physical fitness workout program to meet those individual needs). “Physical fitness services” do not include instructional lessons such as those for self-defense, martial arts, yoga, and stress-management. Nor do these services include instructional lessons for activities such as tennis, golf, swimming, etc. “Instructional lessons” can be distinguished from “exercise classes” in that instruction in the activity is the primary focus in the former and exercise is the primary focus in the latter.

Rule 183(3)(b) states that “[g]ross receipts from activities not defined to be retail sales, such as tennis lessons, golf lessons, and other types of instructional lessons, are taxable under the service and other activities classification.”

The issue here is whether Taxpayer's services are instructional lessons taxable under the service and other activities B&O tax classification, or physical fitness services taxable under the retailing B&O tax classification and subject to retail sales tax. In Excise Tax Advisory (“ETA”) 3104.2009, the Department clarified the distinction as follows:

Instructional lessons for activities such as Body Pump and Pilates are generally characterized as teaching the participant how to perform certain activities, generally following a specific curriculum that includes the study of the underlying philosophy of the activity. The purpose of the instruction includes the participant obtaining certification as a physical fitness trainer or group fitness instructor, or mastery of the techniques and philosophy with possible advancement in levels of achievement usually associated with martial arts.

The primary purpose of the activity as instructional or physical fitness is the determining factor, not the label. For example, if techniques associated with a martial art or Body Pump are used in a physical fitness exercise context, the service is subject to retail sales

⁹ Response to the Department's Monika Jackson of TAA dated August 22, 2013.

tax. A Pilates “class,” for example, may be instructional (subject to the service and other activities B&O tax) if the class is taken by the participants as part of a curriculum to gain certification as instructors. If the class or activity is primarily to improve flexibility, strength, or general fitness for the participant, the charge for participation is a retail sale.

(Emphasis added.) ETA 3003.2009 (“ETA 3003”) applies the primary purpose test to distinguish between “physical fitness services” from personal services or activities not subject to retail sale tax for Yoga, Tai Chi, and Qi Gong. ETA 3003 provides that a person providing Yoga, Tai Chi, or Qi Gong classes in a “fitness facility” is generally presumed to be providing a “physical fitness service,” but that presumption may be overcome with the following evidence:

Such evidence may include, but is not limited to, lesson plans or other similar materials that identify the specific curriculum followed in the class indicating that physical fitness related activities are not the primary focus of the class. For example, in the case of a Yoga class this would include a class curriculum that places significant emphasis on breath regulation, meditation, and/or discussion of the historical and philosophical origins of Yoga with the incidental physical fitness related activities.

In Det. No. 13-0404, 33 WTD 186 (2014), we considered the issue in the context of physical fitness training services, and held as follows:

ETA 3104 acknowledges that the provision of physical fitness services may often involve some degree of instruction to the participant. We recognize that Taxpayer’s lessons do include some degree of instruction and guidance (e.g., demonstrating proper form, teaching the underlying reason that certain exercises are performed, etc.). However, we conclude that the primary purpose of the lessons is to improve the client’s performance in his or her sport through the strength and conditioning regimen that Taxpayer designs. Thus, the primary focus is for the client to improve “his or her general fitness, strength, flexibility, conditioning, and/or health,” which ETA 3104 makes clear is not instructional. The inclusion of some level of instruction in Taxpayer’s services does not outweigh the primary purpose of the services; nor does it transform such services into an instructional activity. Taxpayer provides physical fitness services on which he must pay retail sales tax.

33 WTD at 191. In Det. No. 13-0270, 32 WTD 18 (2014), we considered the issue specifically in the context of [cross-training] classes, and concluded as follows:

[T]he Taxpayer’s available class descriptions involve both instructional elements and physical fitness activities. As an example the class schedule for August . . . 2013 included [several] one hour classes entitled “All levels – Strength and Conditioning”; one class entitled “Basic . . . Strength Training” and one class entitled The emphasis in describing the classes is on exercise, physical fitness, and improved strength and conditioning. Based on the information available we conclude the Taxpayer’s classes are primarily focused on exercise and therefore are retail physical fitness services under the authority detailed above. Accordingly, we affirm the reclassification of Taxpayer’s

income derived from offering these classes to the public from the service and other actives B&O tax classification to the retailing B&O and retail sales tax classification.

32 WTD at 21-22.

Learning how to become physically fit is different than actually becoming physically fit. A class where the students learn how to exercise their muscle groups without actually exercising them is different than a class where they learn how to and actually exercise muscles. The former is a purely instructional activity. The latter has components of instruction and physical fitness. As explained above, in circumstances like this the Department looks to the primary purpose of the activity when determining how tax it. While Taxpayer has submitted a significant amount of material emphasizing the instructional component of its activities, we do not find this to be the primary purpose of the majority of its [cross-training] program.

The Department specifically addressed the taxation of a business offering [cross-training] classes in 32 WTD 18, finding them to be physical fitness activities subject to retail sales tax and retailing B&O tax. We find that the activities in this case are not sufficiently distinguishable from the activities in that case, and hold, consistent with that case, that the primary purpose of Taxpayer's [cross-training] classes is physical fitness subject to retail sales tax and retailing B&O tax. Accordingly, we deny Taxpayer's petition.¹⁰

DECISION AND DISPOSITION

Taxpayer's petition is denied. .

Dated this 19th day of February, 2015.

¹⁰ . . .