

Cite as Det. No. 14-0226, 34 WTD 164 (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. 14-0226
. . .)	
)	Registration No. . . .
)	

[1] RULE 183; RCW 82.04.4282; ETA 3080.2009: B&O TAX – MEMBER DUES – WEIGHTED AVERAGES – MARKET COMPARISON – DEDUCTION. ETA 3080 does not require a taxpayer only compare itself to golf courses with eighteen holes, when seeking a deduction under RCW 82.04.4282. It only requires that a taxpayer use the weighted averages of eighteen holes of golf at the ten closest public courses and the ten closest private courses. Courses that are physically only nine holes, but offer an eighteen hole rate, should be included in the weighted average pool.

[2] RULE 183; RCW 82.04.4282; RCW 82.32.100; ETA 3080.2009: B&O TAX – MEMBER DUES – ACTUAL RECORDS OF FACILITIES USAGE METHOD – DEDUCTION. A taxpayer seeking to use the “actual records of facilities usage method” to calculate its deduction under RCW 82.04.4282 must maintain actual records of the facilities usage. In the event a Taxpayer does not maintain adequate records, the Department is authorized to estimate the Taxpayer’s income.

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.

Pardee, A.L.J. – A private golf club (Taxpayer) appeals the Department of Revenue’s (Department’s) estimated assessment of deductible member dues. We grant the petition in part, and remand to the Department’s Audit Division for adjustments consistent with this determination.¹

ISSUE

Did the Department’s Audit Division correctly apply the actual records of facilities usage method in calculating the amount of member dues Taxpayer could deduct under RCW 82.04.4282, WAC 458-20-183(4)(c)(i), and ETA 3080.2009?

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

FINDINGS OF FACT

[Taxpayer] operates a private golf course in . . . Washington. Taxpayer also operates a retail pro shop, and a restaurant on the golf course. [Taxpayer charges dues to its members and the dues cover members' rounds of golf, as well as access to the country club for social events.] The Department of Revenue's (Department's) Audit Division (Audit) examined Taxpayer's books and records for the period January 1, 2008, through March 31, 2012 (audit period). On February 20, 2013, the Department issued Taxpayer an assessment for the audit period totaling \$. . . , [including] . . . \$. . . in retail sales tax, \$. . . of retailing B&O tax, use tax and/or deferred sales tax of \$. . . , and interest of \$. . .² Taxpayer timely appealed the Assessment.

With regards to Schedules 2A and 2B of the Assessment, which assesses Taxpayer for retailing B&O tax and retail sales tax it underreported during the audit period, Audit's "Detail of Differences and Instructions to Taxpayer" (Detail) notes that Taxpayer elected the actual records of facilities usage method to report the taxable portion of its dues related to golfing activity. Both the Detail, and Audit's April 4, 2013 response to Taxpayer's appeal of the Assessment (Response), explain that Taxpayer's calculation of amounts it reported to the Department during the audit period was flawed for several reasons:

- Contrary to ETA 3080.2009, Taxpayer did not use linear map distance in selecting ten private and ten public golf courses for comparison. Audit had to replace three private golf courses, and one public golf course used by the taxpayer during the audit period, based on linear map distances. Audit also replaced two of the private courses (. . .) and one of the public courses (. . .) because they were 9-hole courses;
- Also contrary to the same ETA, Taxpayer did not annually calculate the average price per round, and instead calculated it less frequently than every other year. Audit used average price per round of golf calculated from a previous audit of Taxpayer to find the annual increase rate, and from that obtained the estimated price per round for each year in the audit period;
- Per the same ETA, Taxpayer did not maintain proper records for the period January 2008 through September 2010, such as worksheets, documents, and any other information, in making its market comparison. For the period January 2008 through September 2010, Taxpayer purged records of rounds played (i.e., tee sheets). Because of inaccuracy, Taxpayer did not accept either a tabulation of rounds played from either the Washington Golf Association, or a manual recalculation by Taxpayer's members based on existing tee sheets. With respect to manual recalculation, Audit notes that in 1995, 1996, 1997, and 1998, Taxpayer reported total member rounds of 14,485, 13,491, 12,291, and 12,565 respectively. Taxpayer now asserts that member rounds were only 11,155 for 2008, 11,069 for 2009, and 9,646 for 2012. Audit explains that Taxpayer has not shown that its total number of members declined from the prior audit period to the current audit period. Also, Audit explains that the number of rounds Taxpayer reported for October 2010 through December 2010 was far more than its recalculated figures (i.e., manual counting of tee sheets). Therefore, Audit questioned the reliability of the recalculated figures. Finally, Audit emphasizes that,

² The full amount of the Assessment is still outstanding.

even if it accepted Taxpayer's recalculated figures, it is not able to reconcile estimated taxable membership dues with reported membership dues, since Taxpayer has no excise tax return work papers to compare. Without these, Audit would not know which portion of retailing income is for taxable membership dues, or other retail income from the restaurant or pro shop. Given these considerations, Audit estimated Taxpayer's underreported income for the period January 2008 through September 2010, based on the error rate found for October 2010 through March 2012; a period in which Taxpayer maintained the necessary records.

The three nine hole golf courses Audit replaced in the course of preparing the Assessment are rated as 18-hole courses by the United States Golf Association (USGA). A 9-hole course is able to secure an 18-hole course rating by establishing for each hole two sets of tee boxes, two sets of flag positions, and different yardage and slope ratings. The USGA recognizes the three golf courses in question as 18-hole golf courses, even though they have only nine holes.

The website for the . . . the public golf course Audit excluded, contains a course layout map which identifies the course as having eighteen holes.³ That same website lists the charge for nine holes of golf as \$. . . , and for eighteen holes of golf as \$. . .⁴

The website for . . . , one of the private courses Audit excluded, contains a men's scorecard which shows par for eighteen holes of golf is 72, which is normal for most eighteen hole courses.⁵ Even though the course physically has only nine holes, holes 1-9 have different yardages than holes 10-18, and have different tee boxes.⁶

Finally, the website for . . . , the other private course Audit excluded, contains a map of the course that lists eighteen holes of golf (even though the map only physically shows nine holes of golf), with a par of 71 (also normal for an eighteen hole course).⁷ Again, holes 1-9 have different yardages and tees than holes 10-18.⁸

Taxpayer explains that its membership in the prior audit period was 370, whereas its membership during the audit period gradually declined from a high of 276 in 2008, to a low of 192 in 2012. Taxpayer cites economic reasons as the cause of its decline in membership. Taxpayer also notes that it provided Audit with copies of financial statements for the period January 2008, through September 2010, which it asserts provides a breakdown of retailing income attributable to the restaurant and pro shop, versus their golf course.

³ <http://...> (site last visited March 25, 2014).

⁴ <http://...> (site last visited March 25, 2014).

⁵ <http://...> (site last visited March 25, 2014).

⁶ *Id.*

⁷ <http://...> (site last visited March 25, 2014).

⁸ *Id.*

ANALYSIS

RCW 82.04.4282 permits taxpayers to deduct bona fide fees and dues from the measure of their B&O tax liability, if they are not in exchange for a significant amount of goods and services:

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

(Emphasis added).⁹

WAC 458-20-183(4)(a) (Rule 183(4)(a)) explains that 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:”¹⁰

(i) RCW 82.04.4282 provides for a business and occupation tax deduction for amounts derived from activities and charges of essentially a non-business 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.

(Emphasis added).¹¹

Department precedent emphasizes that golf clubs, because of their substantial social component have historically been given the opportunity to allocate their fees and dues income into both taxable and deductible amounts. *See* Det. No. 07-0254, 28 WTD 1 (2009).

⁹ A person claiming a tax exemption, exception, or deduction has the burden of proving he or she qualifies for the tax benefit. *Group Health Cooperative of Puget Sound, Inc. v. State Tax Comm'n*, 72 Wn.2d 422, 433 P.2d 201 (1967).

¹⁰ There is no dispute that Taxpayer provides amusement and recreation services subject to retail sales tax. Golf is specifically listed as an amusement and recreation service subject to retail sales tax. RCW 82.04.050(3)(a)(i); Rule 183(2)(b). Taxpayer must also report retailing B&O tax measured by gross proceeds from such sales, minus any deduction per RCW 82.04.4282. RCW 82.04.250(1).

¹¹ RCW 82.32.070 mandates that taxpayers keep and preserve suitable records as necessary to determine the amount of tax for which they are liable. [RCW 82.32.070(1);] *see also* WAC 458-20-254(3) ; [RCW 82.32A.030].

Persons who receive initiation fees and/or dues may report their tax liabilities by use of two alternative allocation methods, the actual records of facilities usage method, and cost of production method. Rule 183(4)(c). A taxpayer may only change its selected allocation method annually, and all changes are prospective only. *Id.* For the audit period, Taxpayer and Audit agreed upon the actual records of facilities usage method. Rule 183(4)(c)(i) explains the actual records of facilities usage method as follows:

(i) Actual records of facilities usage.

(A) Persons may allocate their income based upon such actual records of facilities usage as are maintained. This method is accomplished by either: The allocation of a reasonable charge for the specific goods or services rendered; or, the average comparable charges for such goods or services made by other comparable businesses. In no case shall any charges under either method be calculated to be less than the actual cost of providing the respective good or service. When using the average comparable charges method the term "comparable businesses" shall not include subsidized public facilities when used by a private facility.

(B) 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.

(C) Organizations which provide more than one kind of "goods or services" as defined in subsection (2)(g) of this section, may provide such actual records for each separate kind of goods or services rendered. Based upon this method, the total of apportioned "taxable" income may be subtracted from total gross income to derive the amount of gross income which is entitled to deduction as "bona fide initiation fees and dues" under RCW 82.04.4282; . . .

(Emphasis added).

Excise Tax Advisory 3080.2009 (ETA 3080), issued February 2, 2009,¹² explains how to apply the actual records of facilities usage method articulated in Rule 183 to golf courses as follows:

....

Under the "actual records of facilities usage" method the taxpayer is required to maintain actual records of the facilities usage. The taxpayer's records must reflect the nature of the specific goods and services provided and the frequency of use by the membership. The

¹² Prior to February 2, 2009, and effective August 20, 1990, golf courses consulted ETA 548.04.114. This ETA was cancelled on February 2, 2009, and reissued as ETA 3080 on that date.

frequency may be shown either from a tally of times used or a periodic study of the average membership use of facilities. The taxpayer multiplies the usage by the fair market value of a round of golf to arrive at the taxable amount. A taxpayer may determine the fair market value of a round of golf by market comparison.

In order to administer this particular section of Rule 183 and to maintain uniformity among this class of taxpayers, the Department has determined that taxpayers who wish to use a market comparison must follow the procedure outlined below.

Both public and private golf courses must be considered in the market comparison. The taxpayer must use the weighted averages (weekend and weekday rates should be weighted by a factor of two and five respectively) of **eighteen holes of golf** at the ten closest public courses, and the ten closest private courses (including itself as one of the courses). Linear map distances (as opposed to road mileage) will be used to select the courses for comparison; however, courses across major bodies of water not accessible by bridge will not be considered. The average will be recalculated as of April 1 of each calendar year, and may be used until the next recalculation.

If the taxpayer is located in a less populated area of the state with relatively few golf courses, the Department may, at the request of the taxpayer, approve the use of five public and five private courses in making the market comparison.

The taxpayer must retain the worksheets, documents, and any other information which was used in making the market comparison as part of its business records for a period of five years.

[ETA 3080] (Underlined emphasis in original, bolding emphasis added).

Audit's exclusion of 3 comparison golf courses

For the audit period, Audit replaced 3 golf courses (2 private; 1 public) because they were 9-hole courses, even though they were close enough based upon linear map distance to be included in the pool of golf courses for comparison. However, ETA 3080 does not require that Taxpayer only compare itself to golf courses with 18 holes. It only requires that Taxpayer use the weighted averages (weekend and weekday rates should be weighted by a factor of two and five respectively) of eighteen holes of golf at the ten closest public courses, and the ten closest private courses (including itself as one of the courses). The three courses Audit excluded all maintain an eighteen hole layout of golf, even though they are physically only nine holes. This is accomplished through varying tee boxes and yardages on holes 1-9, versus holes 10-18. Even if we read ETA 3080 as requiring that comparison courses be 18-hole courses, the three courses Audit excluded from the pool of ten private and ten public courses are in fact USGA rated 18-hole courses. On this point, we find Taxpayer's argument persuasive, and find that the three courses Audit excluded should be included in the pool of ten private and ten public courses for comparison.

Audit's rejection of Taxpayer's calculation of member rounds

For the period January 2008 through September 2010 Taxpayer purged records of rounds played (i.e., tee sheets). Per Rule 183(4)(c)(i) and ETA 3080, and the actual records of facilities usage method, Taxpayer had to calculate rounds played either from an actual tally of times used or a periodic study of the average membership use of facilities. Also, Taxpayer was required to maintain adequate records for a period of five years it used in making its comparisons. Even though Taxpayer later attempted to reconstruct the actual tally of rounds played by members, Audit concluded that the data was unreliable for a number of reasons, including: lower totals of member rounds for Taxpayer in comparison with a prior audit; Taxpayer reporting more total rounds of golf for the period October 2010 through December 2010 than the recalculation resulted in; and even if Audit accepted Taxpayer's recalculations, it would be unable to reconcile Taxpayer's estimated taxable membership dues with reported membership dues, since Taxpayer has no excise tax return work papers to compare to. Since Taxpayer did not maintain adequate records, the Department was required to estimate Taxpayer's tax liability for the audit period in accordance with applicable law:

(1) If any person fails or refuses to make any return or to make available for examination the records required by this chapter, the department shall proceed, in such manner as it may deem best, to obtain facts and information on which to base its estimate of the tax; and to this end the department may examine the records of any such person as provided in RCW 82.32.110.

RCW 82.32.100.

We conclude that Audit's estimation of Taxpayer's underreported income for the period January 2008 through September 2010, based on the error rate found for October 2010 through March 2012, a period during which Taxpayer maintained necessary records concerning comparisons it made, was lawful under RCW 82.32.100(1). While Taxpayer explains that its membership declined from a high of 370 in a prior audit, to a low of 192 in 2012, even if true, this does not make Taxpayer's recalculation of the number of rounds of golf its members played during the audit period reliable. As Audit explains in its Response:

[N]umber of rounds played for October through December 2010 were originally included in taxpayer's available excise tax return workpapers. The numbers were 1,510 for October, 590 for November, and 509 for December. However, [Taxpayer's] recalculated numbers based on recount of tee sheets only showed 600 for October, 434 for November, and 262 for December. This discrepancy, together with the comparison to the numbers from the previous audit period, makes the reliability of the recalculated numbers questionable.

Even if [Audit] accepted the recalculated numbers, and as a result, were able to calculate estimated taxable membership dues, as [Taxpayer] required in the appeal, it was not possible to reconcile the estimated taxable membership dues with reported membership dues to get the under or over reported taxable amount. This is because for this period, January 2008 through September 2010, no excise tax return workpaper was available to

do the comparison. Without such workpaper, [Audit] would not know out of the total retailing income reported, how much was accounted for by taxable membership dues, as there were other retailing activities, such as restaurant income, catering income, etc, reported under Retailing B&O and Retail Sales tax classifications.

(Brackets added).

Therefore, we conclude that any decline in Taxpayer's membership does not substitute for the reliability of Taxpayer's recalculated figures, and conclude that Taxpayer did not maintain sufficient records per Rule 183(4)(a) and ETA 3080 to alter the Assessment.

We also agree with Audit that Taxpayer's financial statements for the period January 2008, through September 2010, which Taxpayer asserts provides a breakdown of retailing income attributable to the restaurant and pro shop, versus its golf course, are insufficient for reconciliation purposes, and do not equate to "actual records for each separate kind of goods or services" that Taxpayer renders per Rule 183(4)(c)(i)(C).

DECISION AND DISPOSITION

We grant Taxpayer's petition as to the three nine hole (9-hole) golf courses Audit excluded from the pool of comparison golf courses. Audit shall make the necessary adjustments to Schedules 2A and 2B of the Assessment. We deny Taxpayer's petition as to the other issues.

Dated this 15th day of July 2014.