

Cite as Det. No. 03-0252, 23 WTD 223 (2004)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

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| 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. 03-0252 |
| ... |) | |
| |) | Registration No. . . . |
| |) | . . . /Audit No. . . . |
| |) | Docket No. . . . |
| |) | |
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RULE 183; RCW 82.04.4283; ETA 2010.04.08.183: B&O TAX -- HEALTH CLUB INITIATION FEES AND DUES -- DEDUCTABILITY. No deduction is allowed for initiation fees or dues unless a taxpayer shows that the revenue is only received for the privilege of membership.

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.

Lewis, A.L.J. – A fitness club protests the Department of Revenue’s (“Department”) reclassification of its initiation fee and dues income to the retailing and retail sales tax classifications and maintains that its initiation fee and dues income qualify for the “bona fide” initiation fee and dues deduction. We affirm the audit assessment, finding that all of Taxpayer’s initiation fee and dues income was received for providing retail goods and services.¹

ISSUES:

1. Are a portion of Taxpayer’s initiation fee and monthly dues income deductible as “bona-fide” initiation fees and monthly dues?
2. Is Taxpayer entitled to apportionment of initiation fee and monthly dues income between the service other and retailing B&O tax classifications?

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

FINDINGS OF FACT:

Taxpayer is a non-profit, member-owned racquet and fitness club. Taxpayer offers its members a variety of activities. Taxpayer's facility includes indoor and outdoor tennis courts, an indoor basketball court, aerobics studio, physical fitness area, racquetball courts, a daycare, swimming pool, sauna and locker. The facility also includes a pro shop, administrative offices, deli, and seating for the deli customers. In addition, the fitness facilities and outdoor grounds have seating areas where members can meet and visit. According to Taxpayer, members join not only to play tennis or swim:

The [club] offers private and group instructional classes for youth and adult members in swimming, tennis, racquetball, squash, and various other fitness activities, including aerobics, cycle spinning, yoga, tai'chi, karate, and strength training. The club also provides a number of social activities among members, some of which include recreation and others that do not. The recreational oriented social activities include organized group tennis programs . . . racquetball, tennis, and squash mixers; and racquetball, tennis and squash tournaments. The social activities which do not include recreation include seasonal club parties (which incorporate hors 'oeuvres, drinks, dinners, dancing and/or games), membership appreciation days (which incorporates enhanced membership gifts and benefits). (Brackets added.)

Taxpayer's initiation fee and monthly dues charge depends on both who uses the facility and what facilities are used. Taxpayer offers Full (tennis), Racquetball, and Fitness memberships.² Similarly, sub-classifications are offered within each membership category: Family, Couple, Individual, and Junior. Thus, the initiation fees and monthly dues range from a high of \$. . . initiation fee and \$. . . monthly dues for a Family Full membership to \$. . . initiation fee and \$. . . per month dues for a fitness junior membership.

Taxpayer reported service-other B&O tax on its initiation fees. Taxpayer reported retailing B&O tax and retail sales tax on a portion of the member dues and the balance under the service-other B&O tax. Taxpayer used historical data for allocating the amounts subject to each tax classification. Prior to 1985, Taxpayer charged members separate fees for use of its facilities in addition to regular initiation fees and monthly dues. As a convenience to members, [prior to the audit period] monthly dues were increased so members were not required to pay a specific fee every time they used the club's facilities. The average percentage of receipts from per use court charges prior to [this time] ranged between 22% and 29% of total dues. Based on that range, since [this time] Taxpayer has paid retailing B&O tax on 29% of its monthly dues and paid service other B&O tax on the balance.

² A Full (Tennis) membership allows use of all the club's facilities. A Racquetball membership allows use of all the Club's facilities except the tennis courts. A Fitness membership allows use of all the club's facilities except tennis and racquetball courts.

The Department's Audit Division audited Taxpayer's books and records for the period January 1, 1999 through June 30, 2002. On January 28, 2003, the Department issued a \$. . . assessment. Most of the tax arose from the reclassification of initiation fee and monthly due income from the service other B&O tax classification to the retailing B&O tax and retail sales tax classifications. Thus, with the income reclassification, Taxpayer owed retailing B&O and retail sales tax on 100% of its initiation fee and dues income.

ANALYSIS:

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 (1971). 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:

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.

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.³

³ The legislature did not define "bona fide" initiation fees and dues, nor did it define the terms "any additional charge," or "significant amount." WAC 458-20-183 ("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.

"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.

"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

The Department issued Excise Tax Advisory 2010.04.08.183 ("ETA 2010") to further explain the taxability of dues and initiation fees. ETA 2010 quoted Det. No. 97-164R, 17 WTD 133 (1988) in affirming that the dues and initiation fee deduction is only applicable where a portion of the membership fees are for a social benefit:

[W]e find that taxpayers' initiation fees are not "bona fide initiation fees" because the payments were in exchange for services and use of the clubs' facilities. The payments were not merely for the privilege of membership. Before members can use the exercise facilities, they must pay both the initiation fees and monthly dues.

The ETA further states that:

The fact that the club may have parties or other events for its members at no separate charge does not demonstrate that the member pays a portion of his or her dues for social benefits. Merely providing a juice bar or lounge where members can sit, away from exercise equipment, also does not meet the club's burden of showing that its members pay a portion of their membership fees solely for social benefits, as opposed to access to the club's exercise facilities.

Thus, in order to be entitled to deduct bona fide initiation fees or dues, a taxpayer must show that "no business or proprietary activity (including the rendering of goods or services) is engaged in which directly generates the income claimed for the deduction." Rule 183(4)(a)(i).⁴ Or, as the Court of Appeals stated "[t]he 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, 786, 621 P.2d 760 (1980).

Under RCW 82.04.4282, "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

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:

- (i) It must cover all costs reasonably related to furnishing the goods or services; or
- (ii) It must be comparable with charges made for similar goods or services by other comparable businesses.

"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.

⁴ The Department previously 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") and Rule 114 cancelled. Because of objections to a perceived irregularity in the rule-making process, the Department in a letter dated April 23, 1998, confirmed that taxpayers could continue to rely on Rule 114 in determining the deduction of bona fide initiation fees and dues. Rule 183(4)(c)(i)(a) contained a restriction in the manner of reporting income that Rule 114 did not. Accordingly, the Department agreed that Rule 183(4)(c)(I)(A)'s requirement that "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" can be ignored until Rule 183 is amended.

dues are graduated upon the amount of goods or services rendered, the value of such goods or services shall not be considered a deduction hereunder.” In this case, Taxpayer’s members pay dues in exchange for the right to use the facilities “without any additional charge to the member.” The dues are also not deductible under RCW 82.04.4282, because the value of the goods and services “are graduated upon the amount of goods or services rendered.” In this case, Taxpayer offers a variety of membership options. *See Group Health Cooperative of Puget Sound, Inc. v. State Tax Comm’n*, 72 Wn.2d 422, 434, 433 P.2d 201 (1967). In all cases, the amount of initiation fee and monthly dues depends on the availability of the club’s facilities and the dues are graduated accordingly.

As recognized in *Automobile Club*, 27 Wn. App. at 786, the B&O tax is broad in scope and deductions such as the one at issue are to be “construed strictly against the taxpayer. Here, no evidence has been produced to show the fees and increases in fees are not based on the nature and extent of services required or expected by the members of each group. Accordingly, we find that Taxpayer’s initiation fee and monthly dues do not qualify for the “bona fide” initiation fee and dues B&O tax deduction.

Finally, Taxpayer also protests the Audit Division’s position that all of its initiation fees and dues are taxable under the retailing B&O and retail sales tax classifications. Taxpayer argues that it is entitled to apportion dues and initiation fees between the retailing B&O tax and retail sales tax classifications and service other tax classifications.

We have already determined that none of Taxpayer’s initiation fees and dues are exempt from tax. Thus, all initiation fees and dues are subject to tax. Taxpayer’s members may use tennis courts, racquetball courts, swimming pool, and fitness areas with no additional charge.⁵ All are retail activities under Washington law. RCW 82.04.050(3).⁶ Taxpayer’s members receive only

⁵ Taxpayer does not protest the service other tax assessed on separate charges made to its members for tennis, racquetball and swimming lessons, massages, locker rental, special events, and day-care services. Nor does Taxpayer protest the retailing B&O and retail sales tax assessed on separate charges made to its members for members’ guests’ use of tennis, racquetball, swimming pool facilities, towel rental, tanning bed use, and purchases at the pro shop, snack shop, and vending machines.

⁶ RCW 82.04.050(3), includes such activities and services under the definition of retail sale:

(3) The term “sale at retail” or “retail sale” shall include the sale of or charge made for personal, business, or professional services including amounts designated as interest, rents, fees, admission, and other service emoluments however designated, received by persons engaging in the following business activities:

(a) Amusement and recreation services including but not limited to golf, pool, billiards, skating, bowling, ski lifts and tows, day trips for sightseeing purposes, and others, when provided to consumers;

...

(g) The following personal services: Physical fitness services, tanning salon services,

retail services in exchange for the payment of an initiation fee and monthly dues. RCW 82.04.050(3)(b), Rule 183(2)(b), and WAC 458-20-244.

Here there is no possibility of allocating some of the revenue to the service other B&O tax classification, because Taxpayer did not provide within the dues structure, at no additional charge, any services taxable under the services other B&O tax classification.⁷ Accordingly, we conclude that the audit Division correctly taxed all of Taxpayer's initiation fees and monthly dues under the retailing B& O and retail sales tax classifications. Det No. 97-146R, 17 WTD 133 (1998); Det. No. 95-239, 16 WTD 485 (1996).

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

Dated this 29th day of July, 2003.

tattoo parlor services, steam bath services, Turkish bath services, escort services, and dating services.

⁷ Taxpayer makes a separate charge and pays service other B&O tax on the tennis, racquetball, swimming, and massage treatments it offers.