Cite as Det. No. 14-0286, 34 WTD 563 (2015)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Tax Ruling of	)	D E T E R M I N A T I O N
	)	No. 14-0286
. . .	)	Registration No. . . .

[1] WAC 458-20-106: RETAIL SALES TAX – B&O TAX – CONTRIBUTIONS OF CAPITAL – MANDATORY CAPITAL ASSESSMENT – TENNIS CLUB. A tennis club that requires its members to pay a capital assessment may not deduct the assessment as a contribution of capital.

[2] RCW 82.04.4282; WAC 458-20-183: RETAIL SALES TAX – B&O TAX – DONATION – CONTRIBUTION – MANDATORY CAPITAL ASSESSMENT – TENNIS CLUB. A tennis club that requires its members to pay a capital assessment in order to maintain their memberships could not deduct the payment as a contribution or donation.

[3] RCW 82.04.4282; WAC 458-20-183: RETAIL SALES TAX – B&O TAX – INITIATION FEES – DUES – MANDATORY CAPITAL ASSESSMENT – TENNIS CLUB. A tennis club may treat a portion of a mandatory capital assessment as dues if the taxpayer can show the dues are received solely for the privilege of membership and not in exchange for goods and services per Det. No. 07-0254, 28 WTD 1 (2009).

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.

Sohng, A.L.J. – Tennis club petitions for correction of tax ruling in which the Department of Revenue (the "Department") ruled that mandatory member assessments used to make capital improvements are subject to retail sales tax and retailing [business and occupation ("B&O")] tax. We revise the ruling. A portion of the assessments paid by members is deductible as bona fide dues in accordance with the tennis club's prior determination, Det. No. 07-0254, [28 WTD 1 (2009)].[1]

ISSUES

1. Is a one-time mandatory capital assessment, issued against tennis club members, a tax-free contribution of capital under WAC 458-20-106?

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

2. Is a one-time mandatory capital assessment, issued against tennis club members, deductible as a donation or contribution under RCW 82.04.4282?

3. Is a one-time mandatory capital assessment, issued against tennis club members, deductible as a bona fide membership due or fee under RCW 82.04.4282?

FINDINGS OF FACT

[Taxpayer] operates a private tennis club in [Washington]. Taxpayer is a nonprofit corporation that is prohibited from issuing stock under the Washington Nonprofit Corporation Act.[2] Taxpayer's facilities include . . . indoor tennis courts; . . . outdoor tennis courts; an outdoor swimming pool open during the summer; a fitness center; a pro shop; a social lounge area; and a banquet hall. A number of the . . . [outdoor] tennis courts can be covered . . . during inclement weather. For additional fees, Taxpayer provides tennis lessons, swimming lessons, and regular social events, such as weekly poolside barbecues, wine and cider tasting, and holiday brunches or meals. Taxpayer also allows members to rent the banquet facility and swimming pool for private events.

Club members must pay one-time initiation fees, as well as monthly dues for continuing membership. Taxpayer offers two categories of memberships at issue in this case: tennis memberships and social memberships. Tennis members may reserve two tennis courts per week and have full access to the gym, swimming pool, and social events at no additional charge. Social members pay lower dues and generally have no tennis privileges,[3] but have full access to the gym, swimming pool, and social events.

Taxpayer is governed by a board of directors, all of whom are elected by the club's members at their annual meeting. Members do not own stock in the club, but do have voting rights. The bylaws authorize the board of directors to levy assessments against all members to fund capital improvements to the facility. Taxpayer's bylaws provides as follows:

> **ASSESSMENTS**. From time to time the Board, by the affirmative vote of two-thirds of the membership thereof, may levy assessments in an amount sufficient to pay for the construction of capital additions to, the reconstruction of, or repairs to the Club facilities; provided, however, that the board shall not levy such assessment more often than once each year or in an amount greater than one-third of the annual dues for the classes of memberships assessed unless such action shall be first approved by the membership voting therefore at a special meeting duly called. Such assessments shall be uniform for all classes of membership, except Invitational, which class is not assessable. Assessments may not be avoided by termination of membership after an assessment has been levied. Assessment payments shall be considered delinquent thirty (30) days following the due date which shall be the date of billing.[4]

[2] RCW 24.03.030(1). Taxpayer's Articles of Association states that it "shall have no capital stock." Articles of . . . , Article III (May 10, 1905).
[3] Social members may play tennis with a tennis member up to three times a year, subject to an $. . . guest fee.
[4] Bylaws, Article 2, Section D.

On March 3, 2013, the board of directors approved the expenditure of approximately $ . . . to install a new dome over two outdoor tennis courts and to remodel the gym. Taxpayer raised these funds through a combination of a business loan, reserves from its capital account, and a capital assessment as permitted under the bylaws. Taxpayer levied the capital assessment (the "Capital Assessment") against social and tennis members equal to four months' worth of dues, for a total of $ . . . . If members failed to pay the Capital Assessment, Taxpayer suspended their membership privileges until it was paid. Members who paid the Capital Assessment were still required to continue paying their regular membership dues to have access to the club. Members who paid the Capital Assessment had the same rights to use the club's facilities as they did before they paid the Capital Assessment. Payment of the Capital Assessment did not entitle the members to any additional rights.

The Audit Division previously audited Taxpayer for the period . . . , and issued an assessment in the amount of $ . . . (the majority of which was retail sales tax). The Audit Division disallowed all deductions that Taxpayer claimed as bona fide membership dues and initiation fees under RCW 82.04.4282. Taxpayer appealed the assessment. In Det. No. 07-0254, 28 WTD 1 (2009), the Appeals Division held:

> [A]t least a portion of Taxpayer's initiation fees and dues income, both for tennis memberships and 'social' memberships, is attributable to the privilege of receiving goods and services. Payment of the social membership entitles the member to use the swimming facilities during the months those facilities are open, and to use the exercise equipment, for no additional charge. . . . Taxpayer does not dispute that at least a portion of its initiation fees and dues income is taxable.

28 WTD at 7. With respect to the fitness center, the Appeals Division concluded:

> [Taxpayer] was a tennis and social club that had exercise equipment that was little used. Use of the exercise equipment was not the reason members joined or used the club's facilities. The equipment was an incidental benefit to club membership. Moreover, the social benefits of membership were a primary reason members purchased memberships, rather than using facilities that offered only recreation services. Use of the exercise equipment was not the reason members joined or used the club's facilities.

28 WTD at 8.

On September 19, 2007, the Appeals Division granted Taxpayer's petition and remanded it to the Audit Division to calculate how much of Taxpayer's membership dues and fees were deductible under RCW 82.04.4282. For periods after the audit period at issue in the prior appeal, Taxpayer was instructed to report its fees and dues income consistent with Det. No. 07-0254, [28 WTD 1 (2009)].

On May 21, 2013, Taxpayer requested a ruling from the Department's Taxpayer Services Division, seeking instructions on how it should report the Capital Assessment. On August 8, 2013, Taxpayer Services issued a written ruling (the "Ruling") instructing Taxpayer that the entire amount of the Capital Assessment was subject to retailing B&O tax and retail sales tax. The Ruling stated as follows:

> [Taxpayer's] Capital Assessment is a charge to members for the provision of or access to an amusement and recreational/fitness facility similar to the taxpayer's periodic membership dues. In fact, [Taxpayer's] Bylaws indicate that a delinquency in assessment, like membership dues, will result in the suspension of member privileges. This fact supports the conclusions that the Capital Assessment is a condition of membership (providing access to the facilities) no different than periodic membership dues. Moreover, the Capital Assessment relates to the repair or improvement of facilities for which there is no social component, i.e., providing a new dome over two tennis courts and a gym remodel. . . . The Capital Assessment charge has no "social component" as the assessment is a charge for an improved facility unrelated to social activities.

The Ruling also concluded that the Capital Assessment did not qualify as a non-taxable capital contribution under WAC 458-20-106 because members are not owners, partners, or shareholders who have equity ownership interests in the club. Taxpayer appeals the Ruling on the grounds that the Capital Assessment is (1) a tax-free capital contribution under WAC 458-20-106; or alternatively, (2) fully deductible as bona fide fees and dues under RCW 82.04.4282.

ANALYSIS

1. Capital Contribution Under Rule 106

WAC 458-20-106 ("Rule 106") provides that contributions of capital to business entities are generally not taxable transactions. Rule 106 provides:

> A transfer of capital assets to . . . a business is deemed not taxable to the extent the transfer is accomplished through an adjustment of the beneficial interest in the business.
>
> The following examples are instances when the tax will not apply.
>
> (1) Transfers of capital assets between a corporation and a wholly-owned subsidiary, or between wholly-owned subsidiaries of the same corporation.
> (2) Transfers of capital assets by an individual or by a partnership to a corporation, or by a corporation to another corporation in exchange for capital stock therein.
> (3) Transfers of capital assets by a corporation to its stockholders in exchange for surrender of capital stock.
> (4) Transfers of capital assets pursuant to a reorganization under 26 U.S.C Section 368 of the Internal Revenue Code, when capital gain or ordinary income is not realized.
> (5) Transfers of capital assets to a partnership or joint venture in exchange for an interest in the partnership or joint venture; or by a partnership or joint venture to its members in exchange for a proportional reduction of the transferee's interest in the partnership or joint venture.
> (6) Transfer of an interest in a partnership by one partner to another; and transfers of interests in a partnership to third parties, when one or more of the original partners continues as a partner, or owner.
>
> The burden is upon the taxpayer to establish the facts concerning the adjustment of the beneficial interest in the business when exemption is claimed.

(Emphasis added.)

Tax exemptions are strictly, though fairly, construed against taxpayers. *See Budget Rent-a-Car, Inc. v. Dep't of Revenue*, 81 Wn.2d 171, 500 P.2d 764 (1972); *Group Health Cooperative v. Tax Comm'n*, 72 Wn.2d 422, 429, 433 P.2d 201 (1967). Rule 106 requires that a party making a capital contribution have a "beneficial interest" in the business [. . .]. Because Rule 106 does not define "beneficial interest," we may look to the dictionary meaning for guidance. *See, e.g., Western Telepage, Inc. v. City of Tacoma*, 140 Wn.2d 599, 609, 998 P.2d 884 (2000); *Palmer v. Dep't of Revenue*, 82 Wn. App. 367, 372, 917 P.2d 1120 (1996); *Garrison v. Wash. State Nursing Bd.*, 87 Wn.2d 195, 196, 550 P.2d 7 (1976). In *Christiansen v. Dep't of Social Security*, 15 Wn. 2d 465, 131 P.2d 189 (1942), the Washington Supreme Court determined that a husband did not have a "beneficial interest" in his wife's separate property. Relying on Black's Law Dictionary, the court defined the term as "the profit, benefit, or advantage resulting from a contract, or the ownership of an estate as distinct from the legal ownership or control." *Id.*,15 Wn. 2d at 467; *see also* Det. No. 09-0089, 29 WTD 19 (2010); BLACK'S LAW DICTIONARY 149 (7th ed. 1999)(defining "beneficial interest" as "a right or expectancy in something (such as a trust or an estate), as opposed to legal title to that thing. For example, a person with a beneficial interest in a trust receives income from the trust but does not hold legal title to the trust property").

Applying the definitions set forth above, we conclude that club members do not have "beneficial interests in the business." Although members may exercise limited governing rights by electing the club's board of directors, they are not entitled to any profits, benefits, or advantages from operation of the club as a business enterprise. Club members are not analogous to trust beneficiaries who do not have legal title to a trust's assets, but have beneficial interests in them. Nor are club members equivalent to estate beneficiaries who do not have legal title to the estate's assets, but have beneficial interests in such assets. Club members, by virtue of their memberships, are entitled to receive goods and services from the club. Such right does not rise to the level of a "beneficial interest in the business" under Rule 106. Moreover, Rule 106 also requires that there be an *adjustment* in the beneficial interests, which Taxpayer bears the burden to prove. Taxpayer has not provided any documentation that establishes any adjustments upon payment of the Capital Assessment. We deny the petition as to this issue.

2. Contributions or Donations Under RCW 82.04.4282

Washington imposes retail sales tax on each retail sale in this state. RCW 82.08.020. The term "retail sale" includes the sale of "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." RCW 82.04.050(3)(a)(i). The Department adopted WAC 458-20-183 ("Rule183") to administer the taxation of amusement and recreation services. Rule 183(2)(b) provides that amusement and recreation services include (but are not limited to) the following activities:

> Golf, pool, billiards, skating, bowling, swimming, bungee jumping, ski lifts and tows, basketball, racquet ball, handball, squash, tennis, and all batting cages. "Amusement and recreation services" also include the provision of related facilities such as basketball courts, tennis courts, handball courts, swimming pools, and charges made for providing the opportunity to dance.

(Emphasis added.) RCW 82.04.4282 provides a deduction from certain "amusement and recreation services" for bona fide initiation fees, dues, contributions, and donations, but not if they were paid for or graduated upon services rendered by the recipient of the fees or dues. The statute provides:

> In computing tax there may be deducted from the measure of tax amounts derived from bona fide (1) initiation fees, (2) dues, (3) contributions, (4) donations, ... This section may not be construed to exempt any person, association, or society from tax liability upon selling tangible personal property . . . or upon providing facilities or other 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 (emphasis added).

Having concluded that the Capital Assessment is not a tax-free capital contribution (above), we now examine whether it is a deductible donation or contribution under RCW 82.04.4282. The Department has previously addressed whether special assessments issued by private clubs are donations or contributions. In Determination No. 86-236, 1 WTD 111 (1986), a private athletic club issued a one-time hardship assessment against its members in order to pay its state tax liability. The Department held as follows:

> [T]he emergency assessment here at issue shall be construed as a bona fide contribution or donation rather than an initiation fee or as dues upon which tax may be due. The taxpayer's club members are presumably paying dues and have paid an initiation fee, all of which have been subjected to the appropriate taxes. This is a case of whether the members make a contribution to maintain the club's solvency or else to cease being a member. Consequently, we find that in this instance, the taxpayer's club members are merely making payments for the purpose of being able to continue to belong to the club.

1 WTD at 113.

And in Det. No. 87-348, 4 WTD 281 (1987), the Department held, "If the taxpayer needs to make a special assessment to pay the tax liability and maintain the club's solvency, the Department has construed such an assessment as a contribution or donation rather than an initiation fee or dues upon which tax may be due. 1 WTD 111 (1986)." *See also* Det. No. 87-218, 3 WTD 298 (1987)(holding that a special assessment issued by a golf club was not subject to retail sales tax).

However, in *Analytical Methods v. Dep't of Revenue*, 84 Wn. App. 236, 928 P.2d 1123 (1996), the Washington Court of Appeals clarified the meaning of "donation" and "contribution" in the context of RCW 82.04.4282. That case involved federal legislation[5] that required participating federal agencies to expend a percentage of their budget awarding contracts to small businesses.

[5] The Small Business Innovative Development Act of 1982, 15 U.S.C. § 638.

The legislation required the small businesses to perform certain research and development activities and make progress reports to the federal agencies that awarded them the contracts. The court held that amounts received by the small businesses under this federal program were not deductible under RCW 82.04.4282 as contributions or donations. Relying on the dictionary definitions of the terms, the court stated:

> "Contribution" means "a sum or thing voluntarily contributed." . . . "Donation" means "the action of making a gratuitous gift or free contribution." . . . These definitions require a gratuitous purpose that is missing in the [federal program]. . . . Thus, the agencies cannot reasonably be said to contribute or donate the awards.

Id., 84 Wn. App. at 243. Because the small businesses were contractually obligated to perform research and make periodic progress reports to the federal agencies, the court found that there was no gratuitous purpose. Similarly, the Capital Assessment at issue here was not voluntary or gratuitous. Members were required to pay it in order to maintain their memberships. Thus, the Capital Assessment is not deductible as a contribution or donation under RCW 82.04.4282. Because the *Analytical Methods* case effectively overruled Det. Nos. 86-236, 1 WTD 111 (1986), 87-348, 4 WTD 281 (1987), and 87-218, 3 WTD 298 (1987) with respect to the deductibility of contributions or donations under RCW 82.04.4282, we decline to apply those determinations here.[6]

3. Bona Fide Fees or Dues Under RCW 82.04.4282

[Next], we examine whether the Capital Assessment is an initiation fee or due under RCW 82.04.4282. Rule 183(2)(i) defines "initiation fees" as:

> [T]hose 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.

Rule 183(2)(e) defines "dues" as "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."

The Capital Assessment is not an "initiation fee" because members have already paid their one-time fee that *initially* admitted them to the club. Rather, the Capital Assessment is a "due" because it entitles members to *continued* membership. Failure to pay the Capital Assessment resulted in membership suspension. The next question, then, is whether the Capital Assessment is a *bona fide* due that is deductible under RCW 82.04.4282. We have already addressed at length the deductibility of Taxpayer's dues income in Det. No. 07-0254, [28 WTD 1 (2009)]. Having concluded that the Capital Assessment should be treated as "dues," we hold that

[6] We note that Taxpayer does not claim to rely on Det. Nos. 86-236, 1 WTD 111 (1986), 87-348, 4 WTD 281 (1987), or 87-218, 3 WTD 298 (1987).

Taxpayer must allocate the Capital Assessment in the same manner and in the same proportion as Det. No. 07-0254, [28 WTD 1 (2009)], instructed it to allocate its dues income.[7]

DECISION AND DISPOSITION

We revise the Ruling as set forth in this determination.

Dated this 9th day of September, 2014.

[7] Det. No. 07-0254 concluded that usage of the fitness center was only incidental during the audit period at issue in that appeal, and therefore was not a significant good or service that members received in exchange. We make no ruling here with respect to whether there have been factual changes in the members' usage of the fitness center that would alter the outcome for periods after the audit period at issue in Det. No. 07-0254.