Cite as 10 WTD 362 (1990).

BEFORE THE INTERPRETATION AND APPEALS DIVISION

DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of . . .	)	D E T E R M I N A T I O N No. 91-002 Registration No. . . . . . ./Audit No. . . . . . ./Audit No. . . .

[1] RULE 114: B&O & RETAIL SALES TAX -- MEMBERSHIP DUES -- SQUASH. A private social and luncheon club which also allowed its membership to utilize its squash facilities for no additional charge, was found subject to B&O and retail sales tax on a portion of its membership dues.

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:

A taxpayer protests additional taxes and interest assessed in an audit report.

DATE OF ORIGINAL HEARING: September 30, 1987
(Conducted by Potegal, A.L.J.)

DATE OF SUPPLEMENTAL HEARING: December 10, 1990
(Conducted by Okimoto, A.L.J.)

TAXPAYER REPRESENTED BY: . . .
. . .
. . .
. . .

FACTS:

Okimoto, A.L.J. (Successor to Potegal, A.L.J.) -- [Taxpayer] is a private luncheon and social club located in . . ., Washington. A Department of Revenue (Department) auditor originally examined the taxpayer's books and records for the period January 1, 1978 through September 30, 1982. As a result of this audit examination, a tax assessment was issued [in April 1983] for additional taxes and interest in the amount of $ . . . . The taxpayer paid the unprotested portion of the assessment at that time. Because of a subsequent revision of the Department's rule on club fees and dues, WAC 458-20-114, (Rule 114) the original assessment was adjusted and reissued as Document No. . . . [in March of 1987], reducing the original assessment to $ . . . . Concurrent with the reissued assessment, a second auditor conducted an audit of the taxpayer's books and records for the period January 1, 1983 through June 30, 1986 and Document No. . . . was also issued [March 1987] for additional taxes and interest of $ . . . . The taxpayer also paid the unprotested portion of this assessment and the balance remains due.

Although the taxpayer is primarily a private social and luncheon club, it also has 2 squash courts, locker facilities, a pool table, and a parking garage in addition to its dining facilities. The taxpayer described its membership fee schedule during the audit period as follows:

1. Suburban membership = $16/mo.
2. Resident membership = $25/mo.
3. Life membership = $0/mo.
4. Retired resident = $14/mo.

An initiation fee which varies from $25 to $250 is also charged to new members. Members are entitled to utilize the club's dining room and bar, squash courts, meeting rooms, pool table and parking garage. Although members must separately pay for dining room, bar, parking garage charges, and meeting rooms, no additional charge is made for use of the squash courts and pool table.

During the audit periods, the taxpayer considered all monthly membership dues to be deductible from gross income as bona fide initiation fees and dues.

TAXPAYER'S EXCEPTIONS:

<u>January 1, 1979 through September 30, 1982 audit period</u>.

Schedule III: Reconciliation of Retail Income

Because the auditor concluded that a portion of the monthly dues was received for the privilege of using the pool table and squash courts, the auditor assessed tax on that portion of the dues found to be allocable to those activities. A percentage of taxable monthly dues was derived by taking the approximate square footage dedicated to each activity and applying that to the total square footage of the building. This formula resulted in 3% of monthly dues being taxed as a retail sale. A subsequent post-audit assessment adjusted the original audit and reclassified that portion of dues attributable to squash privileges to the Service and Other Activities tax classification but left amounts attributable to the pool table under Retailing and retail sales tax.

January 1, 1983 through June 30, 1986 audit period

Schedule III: Reconciliation of Retail Income

Again, because the auditor concluded that a portion of the taxpayer's monthly dues were attributable to using the squash facilities, he asserted tax on that portion of the dues. In this audit, the auditor examined the taxpayer's squash court reservation records for 1984 and determined that 4,702 man/court hours were utilized during that year. From this he divided that number by 12 to arrive at a monthly total of 392. Because the taxpayer charges each nonmember a $3 guest fee, the auditor used that figure as the fair market value for the services provided. By multiplying the $3 value by the total projected man/court hours, the auditor arrived at the total value of squash court usage over the entire audit period. Because of the general confusion by all clubs over the taxability of dues and initiation fees, the auditor further followed Department policy and asserted tax on squash court usage under the Retailing and retail sales tax classifications only for the periods after July 1, 1984.[1] Tax was assessed under the Service and Other Activities tax classification for prior periods.

Because the second auditor conceded that the pool table was never used, no portion of the monthly dues was allocated to the pool table during this audit period.

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[1]ETB 531.04.08.183 was issued on July 1, 1984 and clearly stated that providing squash court facilities was included within the definition of a retail sale under RCW 82.04.050.

The taxpayer makes the following arguments in support of its contention that the monthly dues are not "in exchange for any significant amount of goods or services."

First, the taxpayer argues that access to the squash facilities is not significant to the vast majority of its membership because they do not use them. In support of this position, the taxpayer refers to the following statistics.

During the test year 1984, only [3% of its] members used the squash facilities on a regular basis (more than 50 times per year). The taxpayer further stated that during 1984 only [15% of its members] used the courts at all. In essence, the taxpayer argues that for 85% of its members the squash courts have no significance since they do not use them.

Second, the taxpayer argues that the total income and expenses generated by the squash courts are insignificant when compared to the total income and expenses of the entire club. The taxpayer points out that during the audit period, direct squash expenses amounted to [less than 2%] of total club expenses, (exclusive of dining room and bar expenses).
Finally, the taxpayer argues that the $3 per man/court hour valuation for court time is unreasonable because for those 13 members who used the courts most frequently, a $3 per hour charge would exceed their total yearly dues.

ISSUE:

Where a private social and luncheon club also allows its general membership to utilize its squash facilities for no additional charge, is a portion of the club's membership dues subject to B&O and retail sales tax.

DISCUSSION:

[1] RCW 82.04.4282 allows clubs such as the taxpayer's, to deduct from gross income those amounts derived from bona fide initiation fees and dues, provided;

> ... 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, ... the value of such goods or services shall not be considered as a deduction hereunder.

WAC 458-20-114 (Rule 114) is the lawfully promulgated rule implementing the above statute and it has the full force and effect of law until overturned by a court of record not appealed from. RCW 82.32.300. It states in part:

> The law does not contemplate that the deduction 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 . . ." (RCW 82.04.4282). Thus, it is only those initiation fees and dues which are paid for the express privilege of belonging as a member of a club, organization, or society, which are deductible. (Emphasis ours)

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. We must therefore determine whether access to the squash courts constitutes "any significant amount of goods or services rendered."

Rule 114 defines "significant amount" as relating:

> ... to the quantity or degree of goods or services rendered and made available to members by the organization. "Significant" is defined as having important meaning or the quality of being important. (Emphasis ours)

The Department has further stated that "any significant amounts of goods or services" refers to "...commercially compensable products or benefits for which any consumer

expects to pay, and does pay a charge when they are procured in the commercial marketplace."
2 WTD 353, 359 (1987)

We believe that the availability of the taxpayer's two squash courts and related facilities does meet the above definition. We take administrative notice that squash facilities are simply not available to the general public except through the membership of an athletic club or similar organization. Consequently, if one desires to play squash, one must join this type of organization and pay the appropriate dues. To this extent, the dues can not be considered solely "... for the express privilege of belonging as a member of a club, organization, or society" but merely constitute the manner in which those members, desiring access to squash courts, must pay for those commercially compensable benefits received.

Nor are we persuaded by the taxpayer's argument that because only 15% of its membership utilize the squash courts, that for the remaining 85% no significant amount of services have been rendered. Rule 114 specifically states that:

> ... It is not determinative that some members actually receive more goods or actually enjoy more services than others so long as the totality of the goods or services offered are made available to members in general. (Emphasis ours)

Neither are we persuaded by the fact that direct expenses attributable to squash activities only amount to approximately 1.6% of the club's total operating expenses. We believe that "any significant amount of goods or services" refers only to the amount of goods or services received from the club in respect to individual members that use those goods or services. The fact that individual goods or services received by the total membership may be only a small percentage of the total club expenses or income is irrelevant. To hold otherwise would allow extremely large clubs to deduct million dollar activities merely because it was a small percentage of their total activity. We do not believe the Legislature intended such a broad interpretation.

Finally, we can not sustain the taxpayer's objection to the valuation method utilized by the auditor. We note that RCW 82.04.4282 and Rule 114 specifically allow the taxpayer to determine its tax liability by making a reasonable additional charge to its members for those goods or services rendered. Although additional charges were made for dining, bar, and

parking services, no such charges were made for squash activities. Under such circumstances, Rule 114 allows the taxpayer to report under the "actual records of facilities usage." This requires that the taxpayer either:

a) Make an allocation of a reasonable charge for the specific goods or services rendered or

b) Compute the value of such goods and services rendered by multiplying average comparable charges made by other commercial businesses times actual usage by the membership.

In computing the amount of squash services rendered, the auditor used method (b) but instead of using "comparable charges made by other commercial businesses" he used the taxpayer's own $3 guest fee. We recognize that such guest fees may be artificially inflated and do not necessarily reflect the fair market value of the services rendered. To this extent, the auditor's valuation of squash services rendered may be in error. The burden of preparing a market study or of presenting evidence that the taxpayer's own guest fees are not fair market value, however, is on the taxpayer and absent such evidence, the assessment will be sustained.[2]

Since the second auditor and the taxpayer both agree that no dues were received for a significant amount of services related to the pool table, the first audit shall also be adjusted to reflect this fact.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part.

DATED this 3rd day of January, 1991.

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[2]We further note that one of the examples included in Rule 114 used a valuation method very similar to the one employed by the auditor. This example utilized a nine month study of racquetball court reservations to arrive at a usage factor of 1,250 hours. It then applied the nonmember charge of $4 per hour to arrive at a total taxable income of $5,000.