Cite as 3 WTD 387 (1987)

BEFORE THE DIRECTOR
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of)	F I N A L D E T E R M I N A T I O N
)	
)	No. 85-178A
)	
. . .)	Registration No. . . .
)	Tax Assessment No. . . .
)	

[1] **RULE 114:** B&O TAX -- GROSS INCOME -- DUES -- TAX MEASURE -- FORMULARY APPORTIONMENT -- RULE RETROACTIVITY. The alternative tax computation formulas provided by Rule 114 for determining tax measures are available for taxpayers who derive dues income, retroactively until 1979.

[2] **RULE 114:** B&O TAX -- DEDUCTION -- COSTS OF PRODUCTION -- FORMULARY APPORTIONMENT -- STANDARD ACCOUNTING PROCEDURES. Rule 114 provides an optional "costs of production" apportionment method distinguishing taxable dues from bona fide, deductible dues; this method provides for standard accounting procedures which must be followed.

[3] **RULE 114:** B&O TAX -- DEDUCTIONS -- COMPUTATION METHODS -- BONA FIDE DUES. For tax purposes, the fact that a significant amount of "dues" income may be apportioned as tax deductible under the Rule 114 alternative apportionment methods, absent legislative limitations, is immaterial.

[4] **RULE 228:** INTEREST -- WAIVER -- CONVENIENCE OF DEPARTMENT. Interest which accrues against tax deficiency assessments solely for reasons of convenience to the Department may be waived;

interest accruals for reasons of administrative appeal or other taxpayer elections is not waived.

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.

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

DATE OF HEARING: October 22, 1986

NATURE OF ACTION:

The taxpayer has appealed from the conclusions of Determination No. 85-178, issued on August 16, 1985. That Determination sustained the assessment of Retailing business tax and retail sales tax upon gross income derived from "golf dues" paid by members of the taxpayer's fraternal lodge which also operates a golf course. The taxpayer seeks an apportionment of its dues income between taxable golf revenue and tax deductible, "bona fide dues," under RCW 82.04.4282 and WAC 458-20-114 (Rule 114).

FACTS AND ISSUES:

Faker, Sr. A.L.J. -- The taxpayer . . . operates an 18 hole golf course for members and guests. A golfing membership entitles the dues paying member to play golf without paying greens fees on a pay-as-play basis. The taxpayer did not maintain actual records of members' rounds of golf played during the audit period.

The Department's auditor assessed gross golfing dues for both business tax and retail sales tax for the period from January 1, 1981 through December 31, 1984. None of the pertinent facts and background of this case are in dispute and they are reported, to the extent necessary, along with the audit and tax assessment details, in Determination 85-178. The taxpayer has now refined the single issue in this case such that additional factual history is not relevant.

There is a single, complex issue in controversy. That is, is the "cost of production" formulary method provided by Rule 114 for apportioning dues income between taxable amounts and bona fide dues, available for the taxpayer's use for the audit period in question? If so, the taxpayer seeks confirmation of

the appropriate computation method under the facts of this case.

TAXPAYER'S EXCEPTIONS:

Initially, the taxpayer posited several alternative arguments and alternative proposals for tax reporting its golfing dues income. During and subsequent to the Director's level appeal hearing of October 22, 1986, however, the taxpayer refined its position to simply argue that it is entitled to report under the "cost of production" method outlined in Rule 114. The taxpayer asserts that the Department has gone on record, during the public hearing at which Rule 114 was amended (March 27, 1984), as a matter of policy, that the provisions of the amended rule would be allowed for retroactive application back to July 1, 1979. That was when an amendment to RCW 82.04.4282 became effective, which clarified the business tax deduction for "bona fide dues."

Thus, the taxpayer asserts that it is entitled to use the optional, alternative formula of reporting tax upon golfing dues set forth in Rule 114 as the "Cost of Production Method." It is argued that the auditor disallowed this method because the taxpayer charged different dues amounts for lodge members without golfing privileges from those dues charges which included golfing privileges. All of the latter types of dues were taxed.

At the October 22, 1986 hearing the taxpayer understood that the "cost of production" method would be made available for its use. Subsequently, on April 30, 1987, the taxpayer submitted a narrative supplemental memorandum, containing mathematical schedules of its gross receipts and expenditures for the audit period, and containing the specific, proposed computational formula pertinent to the tax years within the audit period. The taxpayer seeks an adjustment of the tax assessment based upon this proposal. Because of the complexity of this specific proposal and the difficulty of extrapolating the results of its application, the supplemental memorandum and respective "Exhibits" are attached to this Final Determination. Correspondence referred to as "Exhibit B" has been deleted because its content is no longer relevant.

DISCUSSION:

[1] The Department has agreed, and hereby confirms, that the alternative tax computation formulas set forth in Rule 114, as amended, are available for use by dues receiving taxpayers

retroactively from 1979. See Final Determination No. 87-218, ___ WTD ___, (1987), issue #5.

[2] Our review of the taxpayer's proposed tax computation formula and support schedules reveals that, with one beneficial adjustment, they comport with the "cost of production method" specified in Rule 114. The rule provides, in pertinent parts, as follows:

> RCW 82.04.4282 provides for a business and occupation tax deduction for amounts derived from activities and charges of essentially a nonbusiness nature. Thus, outright gifts, donations, contributions, endowments, tuition, and initiation fees and dues which do not entitle the payor to receive any significant goods or services in return for the payment are not subject to business and occupation tax.
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> . . .
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> BONA FIDE INITIATION FEES AND DUES.
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> 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.
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> . . .
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> The deduction is limited to business and occupation tax. There is no provision under the law for any deduction from retail sales tax or use tax of amounts designated as initiation fees or dues. Consequently, any club or organization that collects dues or initiation fees from members who in turn

receive tangible personal property or retail services as defined in RCW 82.04.050, or licenses to use real property as defined in RCW 82.04.050, must collect and report retail sales tax on the value of such goods or services sold.

. . .

METHODS OF REPORTING:

Persons who receive any "amounts derived" from initiations fees and/or dues may report their tax liabilities and determine the amount of tax reportable under different classifications (Retailing or Service) by use of alternative methods, based upon:

1. A standard deduction of 20 percent of gross income (This method is available for use only by not-for-profit organizations); or,

2. Actual records of facilities usage; or,

3. Cost of production of facilities and benefits.

All amounts derived from initiation fees and dues must be reported as gross income which then must be apportioned between taxable and deductible income. The alternative apportionment methods are mutually exclusive. . . .

. . .

COST OF PRODUCTION METHOD.

This alternative apportionment method is available only for persons who do not take the standard deduction and when, it is impossible or unfeasible to maintain actual usage records. Under such circumstances apportionment of income may be done based upon the cost of production of goods or services rendered.

. . .

> The cost of production method is performed by multiplying gross income (all "amounts derived") by a fraction, the numerator of which is the cost of providing any specific goods or service, and the denominator of which is the organization's total operating costs. The formula looks like this:
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> $$\frac{\text{Direct and Indirect Costs of Specific Goods or Service}}{\text{Total Business Costs}} \times \text{Gross Income}$$
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> The result is the portion of "amounts derived" which is allocable to the taxable facility (goods or services rendered.) The balance of gross amounts derived is deductible as bona fide initiation fees or dues. If more than one kind of facility (goods or services) is made available to members, this formula must be applied for each in order to determine the total of taxable income to report as either retailing taxable or service taxable.

Thus, Rule 114 contains the standard costs of doing business method of apportionment under accepted accounting principles. It makes no provision for offsetting income items against expense items or vice versa. Modifications may be made, as appropriate, so that the methodology works as a practical, pragmatic system of tax reporting for any kind of organization; however its dues structure may be developed. The methodology works and it satisfies the spirit, scope, and intent of RCW 82.04.4282 because it derives, as best possible, the amount of gross revenues which constitute "bona fide" dues. Those terms are also defined in the rule. Its provisions have the force of the Revenue Act itself unless overturned by a court of record, not appealed. See RCW 82.32.300.

The taxpayer's proposed apportionment method contains an error because it seeks to offset the income from golf shed rentals against both the total costs of operation and the costs of providing golf. Rule 114 makes no provision for adjusting expenses by deducting income items, nor is such an accepted accounting procedure. The proper handling of the golf shed item is to include total costs, including any golf shed maintenance, depreciation, etc., in the divisional formula to derive the percentage of golf costs to total costs, but then simply deduct the golf shed rental income from the "gross

income" factor. Golf shed income is derived from the rental of real property for periods in excess of thirty days. It is expressly excludable from gross income for taxation purposes. See RCW 82.04.050 and RCW 82.04.390. This adjustment happens to work to the taxpayer's benefit in this case.

In all other respects the taxpayer's well ordered apportionment proposal is the correct method under Rule 114. We have not confirmed the reported costs items on the schedules provided nor verified the mathematical computations. Those are exclusively audit functions. Thus, the file will be referred for Audit Section confirmation and verification.

The result of applying the proposed apportionment method is that the taxpayer's gross receipts from all sources, including "dues and other direct income," has been accounted for. Receipts from the lounge, restaurant, pay-as-play greens fees, and other benefits and services for which direct charges are made were already properly tax reported. Now, with the application of the Rule 114 formula to golfing dues income, the non-"bona fide" dues portion of that income has also been included for tax. The remainder of gross receipts is either deductible bona fide dues under RCW 82.04.4282, or deductible income from rentals of real property under RCW 82.04.390.

[3] In this case, the fact that the taxable part of golfing dues income, alone, is not sufficient to cover the total costs of providing golf facilities is not material or dispositive of anything. Clearly, this is because a good part of the golf facilities costs are offset or recovered by income from already taxed greens fees. Moreover, as we said in Final Determination No. 86-55A, ___ WTD ___ (1987), "(u)ntil the State Legislature acts to more specifically define or limit the term 'bona fide dues,' these amounts, however large, are not taxable.

[4] Finally, regarding the taxpayer's request for waiver of interest, we agree that the delay in determining the amount of tax due on golfing dues, under the guidelines of Rule 114 was solely for the convenience of the Department, but only for periods until March 27, 1984. At this later date, when the rule was amended, the taxpayer could have calculated the tax due, under the rule formula, as it has now, finally proposed to do. Thus, no interest will be assessed for periods before April 1, 1984. Interest for periods after that date accrued for reasons which were solely for the benefit of the taxpayer, including the two level administrative appeals. The Department has no authority or discretion to waive interest

which accrues as the result of the taxpayer's own choices and elections. See RCW 82.32.105.

DECISION AND DISPOSITION:

The taxpayer's supplemental petition is sustained. Tax Assessment No. . . . will be adjusted based upon records available or upon further cost records examination if necessary, under the guidelines contained herein. The amended assessment will be due for payment on the date to be shown thereon.

DATED this 17th day of July 1987.