Supreme Court No. 1017707
(Court of Appeals No. 56478-5-II)

SUPREME COURT
OF THE STATE OF WASHINGTON

ROYAL OAKS COUNTRY CLUB,

Respondent,

v.

WA STATE DEPARTMENT OF REVENUE,

Petitioner.

RESPONDENT'S ANSWER TO PETITION FOR REVIEW

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I. INTRODUCTION

Royal Oaks Country Club (Royal Oaks) appealed the superior court's order granting summary judgment for the Department of Revenue (DOR) and denying summary judgment for Royal Oaks. Royal Oaks argued that the superior court erred by ruling that Royal Oaks' initiation fees for new club members were only partially deductible under RCW 82.04.4282. The Court of Appeals agreed. Accordingly, the Court of Appeals reversed and remanded for the superior court to enter summary judgment for Royal Oaks.

DOR has petitioned for review, but its petition is dedicated almost entirely to its argument that the Court of Appeals erred. DOR devotes only a small part of its petition to arguing that this case merits review and, as shown herein, it does not. Moreover, the Court of Appeals did not err, and its published opinion is a lucid and proper explanation of the law.

II. COUNTERSTATEMENT OF FACTS[1]

After performing a tax audit on Royal Oaks for the tax period January 2011 through March 2016, DOR determined that a portion of Royal Oaks' initiation fees for new members was tax deductible and other portions were non-deductible based on DOR's interpretation of RCW 82.04.4282. Royal Oaks unsuccessfully appealed DOR's determination, paid the taxes, and filed a complaint for a tax refund in superior court.

A. Royal Oaks' Services and Membership Levels

Royal Oaks is a nonprofit corporation that owns and operates a country club. Royal Oaks offers several amenities including a golf course, golf pro shop, fitness center, clubhouse with several dining options, golf practice facility, and swimming facility. Non-member guests must pay "greens fees" to access the golf facilities.

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[1] These are the facts as they were found and articulated by the Court of Appeals. This counterstatement includes many facts omitted by DOR.

Royal Oaks offers several levels of membership. Proprietary members receive full access to all of Royal Oaks' facilities and services. In addition, proprietary members can vote in elections for Royal Oaks' directors and officers and are eligible to serve in those roles. Additionally, Royal Oaks must receive proprietary members' approval for "'extraordinary issues'" specified in the bylaws. Proprietary members can seek approval from Royal Oaks' board to transfer their membership to a family member or business owned by a family member. And only proprietary members who resign can receive a "refund equity" of 25 percent of the current proprietary member initiation fee.[2]

Corporate members receive full access to all of Royal Oaks' facilities and services. Each corporate membership is "owned by a registered business entity for the benefit of a designated employee."

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[2] DOR's petition omits the facts in this paragraph, which were important to the Court of Appeals' decision. Instead of addressing differing types of rights and privileges available to each class of membership, DOR mentions only the levels of "retail services" that they received.

Intermediate members receive full access to all of Royal Oaks' facilities and services. Intermediate members pay half dues until they reach the age of 35, when their memberships are converted to proprietary memberships. Intermediate members cannot vote for or serve as directors or officers. Intermediate members cannot transfer their memberships.

"'Social with golf'" members have unlimited access to Royal Oaks' fitness center, swimming facilities, dining facilities, and all social events. However, social with golf members have limited access to Royal Oaks' golf course and practice facilities. Social with golf members may play one round of golf per month and access the practice facilities on their day of play. Social with golf members may purchase items from the golf pro shop. Social with golf members may purchase additional rounds of golf from November through March, and their children may compete in the junior golf tournament. Social with golf members cannot participate in

tournaments, vote for directors or officers, or serve as directors or officers.

Social members have unlimited access to the fitness center, swimming facilities, dining facilities, and all social events. However, social members cannot use Royal Oaks' golf course or practice facilities. Social members may purchase items from the golf pro shop. Social members cannot vote for or serve as directors or officers.

Dining members have unlimited access to Royal Oaks' dining facilities. However, dining members cannot use Royal Oaks' golf course, practice facilities, fitness center, or swimming facilities. Dining members may purchase items from the golf pro shop. Dining members cannot vote for or serve as directors or officers.

B. Royal Oaks' Initiation Fees

All new members must pay a one-time initiation fee with their application to join Royal Oaks. The initiation fee amounts

vary by membership level. During the tax period at issue, new members paid the following amounts:

Year	Proprietary, Corporate, and Intermediate	Social with golf	Social	Dining
2011	$10,000 (reduced to $5,000 in May and June)	$1,000	$200	
2012	$10,000	$1,000	$200	
2013	$10,000	$1,500	$1,000	
2014	$10,000 (reduced to $5,000 in November and December)	$2,500	$1,500	$200
2015	$10,000	$2,500	$1,500	$200
2016	$10,000	$2,500	$1,500	$200

Members must also pay monthly dues, which vary in amount by membership level.[3] Significantly, members must pay their initiation fee and their first month's dues before they may access any facilities, services, or social events. Members receive a monthly bill that includes charges for dues, food, golf-shop purchases, and other charges, which are separately stated and immediately due and payable. If a member does not pay their bill within 60 days, the member loses all membership privileges until they have fully paid their outstanding bills.

[3] DOR's petition also ignores the ongoing requirement to pay monthly dues in order to continue to enjoy any use of the club and its facilities.

C. Audit and Procedural History

In December 2014, Royal Oaks sought to deduct its initiation fees from its taxable income. DOR audited Royal Oaks for the tax period from January 2011 through March 2016. DOR's auditor calculated the deductible portion of Royal Oaks' initiation fees using former WAC 458- 20-183 (1995) (former Rule 183), which allowed for a partial deduction of bona fide initiation fees and dues. The auditor used the same calculation for both initiation fees and dues. Consistent with its calculation for dues, the auditor determined that only a percentage of Royal Oaks' initiation fees were deductible as bona fide initiation fees and that the remainder of the initiation fees were taxable as goods or services provided to members. DOR then assessed $2,640.00 in business and occupation taxes and $45,245.00 in retail sales taxes arising from Royal Oaks' income related to initiation fees.

III. REASONS WHY THE COURT SHOULD DENY REVIEW

The court should deny review for three main reasons. First, the Court of Appeals correctly applied the law to the undisputed facts and reached the correct decision. Second, the Court of Appeals' decision does not conflict with any other decision by the Supreme Court or the Court of Appeals because DOR's cited cases are inapposite. And third, while all taxation cases involve some issue of public interest, this case does not involve any issue of ***substantial*** public interest; it is just one of many appellate decisions interpreting Washington's tax laws.

A. The Court of Appeals Correctly Determined the Legislature's Intent Based on the Plain and Unambiguous Language in the Statute.

The Court of Appeals engaged in a de novo review of the proper interpretation of RCW 82.04.4282. The following is the full text of the statute, but—for the sake of clarity—it has been

broken down into the three sentences that make up the whole, and some emphasis has been added.

> 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, (5) tuition fees, (6) charges made by a nonprofit trade or professional organization for attending or occupying space at a trade show, convention, or educational seminar sponsored by the nonprofit trade or professional organization, which trade show, convention, or educational seminar is not open to the general public, (7) charges made for operation of privately operated kindergartens, and (8) endowment funds.
>
> This section may not be construed to exempt any person, association, or society from tax liability upon selling tangible personal property, digital goods, digital codes, or digital automated services, 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.

The Court of Appeals endeavored to determine the legislature's intent based on the statute's plain language. If the plain language is unambiguous, the courts "give the words their common and ordinary meaning."[4] Moreover, as the Court of Appeals observed: "Where statutory language is plain and unambiguous, courts will not construe the statute but will glean the legislative intent from the words of the statute itself, regardless of contrary interpretation by an administrative agency."[5]

1. The Court of Appeals Correctly Interpreted the First Sentence of the Statute

The Court of Appeals then analyzed each sentence of the statute. With respect to the first sentence, the court noted that the legislature did not define the terms "bona fide" or "initiation fees." The court then looked to the dictionary definitions of those terms. Citing WEBSTER'S THIRD NEW

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[4] Slip Op., p. 6, quoting *Tesoro Refining & Mktg. Co. v. Dep't of Revenue*, 173 Wn.2d 551, 556, 269 P.3d 1013 (2012).
[5] Slip Op., pp. 6-7 (citation and internal quotation marks omitted).

INTERNATIONAL DICTIONARY (2002), the court defined "bona fide" as "made in good faith without fraud or deceit," "SINCERE," or "not specious or counterfeit: GENUINE." Similarly, the court defined "initiation" as "the act or an instance of formally initiating (as into an office, sect, or society)." Taken together, the court defined "bona fide initiation fees" as "fees paid genuinely for the act or instance of formally initiating someone."[6]

Based on the "ordinary, everyday meaning" of these terms, the Court of Appeals found that the first sentence of the statute was unambiguous. Moreover, the court noted that the term "bona fide initiation fees" did not include dues, because dues were listed separately in the first sentence, and dues are addressed separately in the third sentence of the statute. Thus, the court found the statute allows for the deduction of initiation fees that "genuinely related to the allowance of a person into club membership," and it was "undisputed that new members

[6] Id. at p. 9.

pay a one-time initiation fee to become a member at Royal Oaks."[7]

The Court of Appeals then rejected the same argument that DOR presents in its petition—that the initiation fees are not bona fide because their amounts correlate to the level of facilities and services available to different membership levels.

> While the membership level determines the members' ability to access more services and facilities, the membership level also determines a member's ability to participate in tournaments, vote for leaders, serve in leadership positions, transfer memberships, and receive refund equities in the event of member resignation. Further, payment of the initiation fee does not automatically entitle new members to use Royal Oaks' facilities and services. Rather, Royal Oaks' new members must pay their first month's dues along with the initiation fee before they are allowed to use the club's facilities and services.

In its petition, DOR argues that the club's initiation fees are just like a "down payment on a new car…, because the purchaser must also pay their first month's loan payment before

[7] Ibid.

driving the car off the lot."[8] But this analogy is fraught with problems. First, as a factual matter, there is no reason a buyer cannot drive the car off the lot after making the down payment on a loan; the "first month's loan payment" does not ordinarily become due until the following month. Second, a down-payment on a car cannot be said to be a "bona fide initiation fee" because it does not admit the buyer into any club or organization. Third, even after the monthly loan payments have been made, the buyer is still able to enjoy the use of the car, whereas members of Royal Oaks who stop making monthly dues payments will lose their use of the club's facilities.

DOR seeks to bolster its argument by pointing out that the dining members pay only $200 in initiation fees, the implication being the additional $9,800 paid by proprietary members must be for nothing more than additional "retail services." But this point suffers from two fundamental flaws. First DOR's auditor did not tax $9,800 of the $10,000

[8] Petition for Review ("PR"), p. 17.

proprietary membership fee, he taxed a much smaller percentage using a method allowed under former Rule 183. Second, it ignores the fact that proprietary members receive many other rights and privileges—besides increased use of the facility—that warrant a higher initiation fee.

DOR continues its poor analogizing by arguing that, under the Court of Appeals' reasoning, businesses "may broadly deduct up-front payments made in exchange for retail goods and services, so long as members must also pay their first month's dues before accessing those goods or services."[9] This analogy is inapt, however, because Royal Oaks members do not receive any "goods or services" in exchange for their initiation fees or dues—they merely receive the right to pay monthly dues to use the facilities. Moreover, using initiation fees as a tax-evasion strategy would fail because the initiation fees must be "bona fide," meaning the fee does nothing more than allow a

[9] PR, pp. 17-18.

person to be admitted to a certain level of membership in a club or organization.

In sum, the Court of Appeals correctly interpreted the first sentence of RCW 82.04.4282, and based on this interpretation, the court correctly determined that Royal Oaks' initiation fees qualify as "bona fide initiation fees."

> Royal Oaks' initiation fees are for new members to become members of the club, not for their use of club facilities or services. Therefore, Royal Oaks' initiation fees fall within the plain language of the deduction for "bona fide initiation fees" allowed in the first sentence of RCW 82.04.4282.[10]

2. The Court of Appeals Correctly Interpreted the Second Sentence of the Statute

Although it did not raise this argument to the trial court, DOR argued to the Court of Appeals that the second sentence of the statute limited Royal Oaks' ability to deduct its initiation fees. The Court of Appeals disposed of this argument, and

[10] Slip Op., p. 10.

DOR has not renewed its argument in its petition. As a result, Royal Oaks will not belabor the point.

3. The Court of Appeals Correctly Interpreted the Third Sentence of the Statute

As a reminder, the third sentence of RCW 82.04.4282 provides as follows:

> 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.)

This is the sentence upon which DOR hangs its hat. DOR argued to the Court of Appeals that "the instance of the word 'dues' in the third sentence is illustrative, rather than exclusive of, the other categories of receipts listed in the first sentence…."[11] But this argument violates numerous rules of statutory interpretation, first and foremost the "judicial doctrine

[11] Respondent's Brief, p. 23.

expressio unius est exclusio alterius: the expression of one is the exclusion of the other."[12]

The DOR freely admits it has a long-standing practice of treating dues and initiation fees interchangeably. But this approach ignores the plain and unambiguous language of the statute, which evinces the legislature's intent to impose the limitation set forth in the third sentence on dues, and only dues. If the legislature had intended the limitation of the third sentence to also apply to all of the payment categories, then it would have written the statute thus:

> If [any of the amounts listed above] 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 [any of the amounts listed above] 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.

[12] *Landmark Development, Inc. v. City of Roy*, 138 Wn.2d 561, 571, 980 P.2d 1234 (1999).

But the legislature did not use those words, nor did it choose to impose the limitation on initiation fees. As the Court of Appeals observed:

> The plain language of the third sentence applies only to "dues" and does not mention any of the other payments listed in the first sentence of the statute. Because we must not add words where the legislature chose to not include them, we decline to extend the application of the third sentence to other payments that are not dues.

The Court of Appeals noted the only other adjudicated decision addressing the application of the statute's third sentence to initiation fees, *Black Diamond Gun Club v. Dep't of Revenue*, No. 70949, 2010 WL 3944939 (Wash. Bd. of Tax Appeals Sept. 14, 2010).[13] In Black Diamond, the gun club charged its members an "initiation fee of $150" and "annual dues of $75." Like Royal Oaks, the gun club objected to DOR's refusal to allow initiation fees to be deducted in full.

DOR advanced its same argument to the Board of Tax Appeals—that RCW 82.04.4282 treats initiation fees and dues

[13] For the court's convenience, a copy of this decision is attached as the appendix to this Answer.

the same, and they are both subject to the proviso contained in the third sentence of the statute. DOR also relied on the same regulation that it relies on in this case, former Rule 183, in support of its position. The Board of Tax Appeals soundly rejected DOR's argument.

> There are eight categories of payments or charges that may be deducted from B&O and sales taxes pursuant to RCW 82.04.020,.050, and .220. Initiation fees and dues are listed separately. Only one of the eight categories subject to a proviso is that of dues. The last sentence of RCW 82.04.4282 indicates that if dues are in exchange for any significant amount of goods and services, then they shall not be deductible. ***There is no such proviso for the category of initiation fees.*** [14]

The BTA held that the initiation fee of $150 paid to the gun club was qualitatively different from the periodic dues the members must pay each year.

> Upon joining the Club, new members pay a one-time initiation fee of $150. The Board finds that, like many clubs, that fee is distinguishable from the monthly or annual dues, which members

[14] *Black Diamond Gun Club*, *supra*, at p. 8 (emphasis added).

> pay for the "goods and services rendered by" the club to its members."[15]

In reaching this holding, the BTA took DOR to task for failing to distinguish between initiation fees and dues and for throwing them into the same pot.

> RCW 82.04.4282 clearly contemplates that the deductible portion of dues payments depends upon the extent to which goods and services have been received from the club/taxpayer by the dues payer. Notwithstanding this dichotomy, the Department consistently, and in the Board's view ***erroneously, bundles both initiation fees and monthly or periodic dues*** when referring to inclusion or exclusion under the statute.[16]

DOR now argues that because it has a long-standing policy of treating dues and initiation fees interchangeably, it should be allowed to continue to make the same mistake. But the fact that a misguided policy has been long-standing does not warrant perpetuating it. Instead, the Court of Appeals properly corrected DOR's mistake and made clear that—so long as a fee

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[15] *Ibid*.
[16] *Id*. (emphasis added).

is a "bona fide initiation fee"—the legislature intended it to be fully deductible.

DOR's reliance on former Rule 183 is also misplaced, however, because this rule is based on DOR's misinterpretation of the governing statute. When the meaning of the plain language of a taxation statute is clear, the courts do not defer to agency rules or regulations that are inconsistent with the statute. "Where statutory language is plain and unambiguous, courts will not construe the statute but will glean the legislative intent from the words of the statute itself, ***regardless of contrary interpretation by an administrative agency***."[17]

In sum, the Court of Appeals correctly decided "bona fide initiation fees" are fully deductible, and they are not subject to the limitation the legislature imposed on the deductibility of dues. Hence, the Supreme Court should let the published opinion of the Court of Appeals stand as the correct

[17] Slip Op., pp. 6-7 (emphasis added) (citation and internal quotation marks omitted).

statement of the law, and there is no reason for the Supreme Court to grant DOR's petition for review.

B. The Decision Does Not Conflict with any Decision by the Supreme Court or the Court of Appeals

As demonstrated above, the Court of Appeals' decision reaches the correct result. Moreover, contrary to DOR's argument, the decision does not conflict with any prior decision of the Supreme Court or the Court of Appeals. DOR cited the same three cases to the Court of Appeals, but the court dismissed them as inapposite; all of them involved a dispute over the deductibility of dues, and none of them involved a dispute over the deductibility of initiation fees.

First, DOR cites the Supreme Court decision in *Group Health Co-Op v. Tax Comm'n*.[18] But *Group Health* did not address in any way the deductibility of initiation fees—it only addressed periodic dues. According to the court, the "issue

[18] *Group Health Co-Op v. Tax Comm'n*, 72 Wn.2d 422, 433 P.2d 201 (1967) (emphasis added).

presented [was] whether the ***monthly fees*** paid by respondent's members fall within the 'bona fide ***dues***' deduction permitted by [the former] RCW 82.04.430(2)."[19] The *Group Health* court noted that the taxpayer also collected a "$200 entrance fee, a portion of which is refundable following termination of membership."[20] There is no indication that this initiation fee was taxed, nor was its deductibility discussed anywhere in the court's opinion. Thus, the Court of Appeals' decision below does not conflict in any way with the Supreme Court's decision in *Group Health*.

The same is true for the other Supreme Court decision cited by DOR, *Red Cedar Shingle Bureau v. State*.[21] But that is also inapposite, for several reasons. First and foremost, as DOR fails to mention, the state did not impose any tax on the initiation fees imposed by the trade association. "The Tax Commission has ***excluded from the tax base amounts received***

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[19] *Id*. at 433.
[20] *Id.* at 424.
[21] 62 Wn.2d 341, 382 P.2d 503 (1963).

by the Bureau for initiation fees which fee is based on the number of machines used by the manufacturer-member times $100.00."[22] Thus, the Supreme Court did not address the issue of initiation fees in *Red Cedar* because the taxpayer was allowed to deduct them fully, and there was no dispute between the parties as to their deductibility.[23] It is disingenuous, then, to argue that the decision below conflicts with the decision in *Red Cedar*.

Moreover, in *Red Cedar*, the tax was imposed on payments that were not dues. The description of these payments, from the trade association's bylaws, demonstrated clearly that the revenues received by the trade association were for services rendered. "'Each member ***in consideration of the services rendered and to be rendered by the corporation*** shall pay to said corporation twelve cents (12cents) for every four-bundle roof square of No. 1 grade shingles, seven cents (7cents)

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[22] *Id*. at 345.
[23] This fact also belies DOR's argument regarding its long-standing policy of limiting the deductibility of initiation fees.

for every four-bundle roof square of second grade shingles….'"[24]

Based on this language, it is neither surprising nor remarkable that the Supreme Court rejected the trade association's argument that it could deduct these amounts as "dues." "We believe the word 'dues,' given its ordinary everyday meaning does not connote payments such as those made herein…."[25] In sum, there is no conflict between the decision below and the decision in *Red Cedar*.

Finally, DOR cites the case of *Auto. Club of Wash. v. Dep't of Revenue*.[26] That decision, however, is also inapposite. The statute at issue in *Auto. Club* was RCW 82.04.430, which is similar to the current statute. The former statute provided: "***Dues*** which are for, or graduated upon, the amount of service rendered by the recipient thereof are not permitted as a deduction hereunder." Based on this provision, the Court of

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[24] Id. at 346 (emphasis added).
[25] *Id.* at 346-47.
[26] *Auto. Club of Wash. v. Dep't of Revenue*, 27 Wn. App. 781, 621 P.2d 760 (1980)

Appeals described the issue before it as follows: "Our analysis then, is limited to whether the evidence supports the trial court's conclusion that 'the totality of the services provided by the Club is geared financially to the aggregate of dues.'"[27]

Thus, *Auto. Club* did not address, in any way whatsoever, the deductibility of initiation fees. The court mentioned only in passing the fact that the members paid "a one-time enrollment fee,"[28] but there is no indication that DOR assessed any tax on this fee. The dispute concerned only the taxation of the periodic dues paid by the members. Thus, it cannot be said that the decision below conflicts with the Court of Appeals' decision in *Auto. Club*.

The Court of Appeals' decision succinctly disposed of these three cases:

> While DOR argues that other published cases support its position, the cases that DOR cites are inapposite because they analyze the

[27] *Id*. at 785.
[28] *Id*. at 782.

predecessor to the current statute and address only dues.[29]

C. This Case Does Not Involve an Issue of Substantial Public Interest

All decisions concerning the interpretation and application of Washington's taxing statutes involve issues of some "public interest" because the outcome could have an impact on the amount of tax revenues the state collects. But not every such case involves an issue of ***substantial*** public importance, and this court has routinely denied petitions for review in other cases involving tax issues.

A helpful contrast can be drawn between this case and the Supreme Court's recent *Quinn* decision regarding the taxability of capital gains. That case has garnered tremendous media attention, both statewide and nationally, because it involved an important issue of constitutional law and it could have far-reaching implications for the state's ability to create new revenue streams in the future. Given its substantial public

[29] Slip Op. at p. 12.

interest, the *Quinn* case attracted no less than eight amicus curiae briefs, whereas there were zero motions to file an amicus curiae brief in the Court of Appeals, nor did the court request any be filed.

DOR has failed to demonstrate this case "involves an issue of substantial public interest that should be determined by the Supreme Court.[30] In an effort to meet this criterion for review, DOR grossly overstates the potential impact of the Court of Appeals' decision below. It is true that the decision will have an impact on the taxation of all "bona fide initiation fees" in Washington, but it does not fundamentally affect the state's collection of retail sales tax or B&O tax.

Even though this is the sole arguable criteria for review, DOR devotes only one paragraph at the very end of its petition to this topic. In it, DOR warns that—left unchecked—the Court of Appeals' decision will allow businesses to "shield

[30] RAP 13.4(b)(4).

thousands of dollars from B&O and retail sales taxation by shifting them from recurring to up-front charges."[31]

But DOR's doomsday scenario ignores the fact that the statute limits the deduction to only "bona fide initiation fees;" the deduction would not apply to down-payments on the sale of goods, and any attempt to evade taxes by calling payments for services "initiation fees" would not find support in the Court of Appeals' decision. The court cut off any such potential abuse by holding that "bona fide initiation fees" are only those "fees paid genuinely for the act or instance of formally initiating someone."[32] Retailers cannot realistically structure or characterize their sales receipts to qualify as "bona fide initiation fees."

Finally, to the extent DOR is no longer able to collect taxes on "bona fide initiation fees," this merely brings its collection practices in line with the legislature's intent when it enacted RCW 82.04.4282 and its predecessors. The legislature

[31] PR, p. 29.
[32] Slip Op. at p. 9.

recognized that certain types of payments are different and should be free from taxation. The statute is not limited to initiation fees or dues—it includes six other categories: contributions, donations, tuition, certain payments related to trade shows, charges for private kindergartens, and endowments.

It is the legislature's prerogative to decide which categories of payments shall be free from taxation, and it is improper for DOR to override the legislature's decision by misinterpreting the subject statute in a way that eliminates any portion of a duly enacted deduction.

IV. CONCLUSION

For the foregoing reasons, the decision of the Court of Appeals does not merit this Court's review. DOR's petition should be denied.

Respectfully submitted March 29, 2023

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I hereby certify that, according to word count calculation tool of the word processing software used to generate this brief, the number of words contained in the document, exclusive of words contained in the appendices, the title sheet, the table of contents, the table of authorities, the certificate of compliance, the certificate of service, signature blocks, and pictorial images (e.g., photographs, maps, diagrams, and exhibits), this brief contains approximately 4,908 words.

APPENDIX

Black Diamond Gun Club v. Dep't of Revenue, No. 70949, 2010 WL 3944939 (Wash. Bd. of Tax Appeals Sept. 14, 2010)

BEFORE THE BOARD OF TAX APPEALS
STATE OF WASHINGTON

BLACK DIAMOND GUN CLUB, Appellant,	)	Docket No. 70949
v.	)	RE: Excise Tax Appeal
STATE OF WASHINGTON DEPARTMENT OF REVENUE, Respondent.	)	FINAL DECISION

This matter came before the Board of Tax Appeals (Board) on March 26, 2010, for an informal hearing pursuant to the rules and procedures set forth in chapter 456-10 WAC (Washington Administrative Code). Malcolm Shave represented Appellant, Black Diamond Gun Club (Appellant or Club). Craig Weaver, Tax Policy Specialist, represented Respondent, State of Washington Department of Revenue (Department). Phil Erickson, Frank Mammano, Marion F. Dukes, John J. Mullhall and Philip Shave were witnesses for the Appellant. Frank Hardin, Excise Tax Examiner, was a witness for the Respondent. Also present were Mark A. Downing, Clem Novinski, and John Thimmesch.

The Board heard the testimony, reviewed the evidence, and considered the arguments made on behalf of both parties. The Board now makes its decision as follows:

FACTS

Black Diamond Gun Club is a non-profit organization that provides both its members and non-members with educational and recreational shooting privileges, including target practice and trap shooting. The Department audited the Appellant for the period of January 1, 2004, through September 30, 2007. The Appellant had reported all its fees and dues income under the service and other activities B&O classification. The Appellant paid no retail sales tax on any fees or dues it collected from members during the audit period.

After the audit, the Department reclassified Appellant's member initiation fees and annual dues income from the service and other B&O tax classification, as reported, to the retailing B&O tax classification. This resulted in a tax deficiency for uncollected retail sales tax and retailing B&O tax. Consequently, the Department issued an assessment against the Appellant on April 7, 2008, for $16,996 after applying a credit of $3,690 for service and other activities B&O tax paid. The assessment consisted of retail sales tax of $17,461, retailing B&O tax of $933, use tax of $474, and interest of $1,818. The Appellant appealed the assessment, and the petition was denied in Det. No. 09-0196. The Appellant then appealed to this Board.

The Appellant's facilities, located in Black Diamond, Washington, consist of a rifle and pistol range, five trap fields, and a clubhouse with a kitchen and club meeting rooms. The rifle and pistol ranges cannot be used unless there is a Range Safety Officer (RSO) present. RSOs are members who volunteer to supervise shooting activities as prescribed by the Appellant's range operating procedures. A copy of the membership application states that there is an initiation fee of $150, and annual dues of $75.

The Appellant is open (to both members and non-members) for target and trap shooting every Wednesday from 7:00 a.m. to 10:00 p.m., every Saturday from 10:00 a.m. to 3:00 p.m., and the 2nd and 4th Sundays of each month from 10:00 a.m. to 3:00 p.m. Members' benefits and rights include free rifle and pistol range shooting and a reduced fee for trap fields shooting. Gun safety and other education classes are available for a separate fee. Non-members, however, have to pay a $10.00 daily usage fee to use the ranges, and larger fees for trap fields shooting. On its excise tax returns, the Appellant treated non-member fee income, as well as member trap shooting usage income, as retail taxable. With respect to member fee and dues, the Appellant did not include that income as retail taxable, instead including it only under its service and other B&O measure. On appeal, the Appellant has failed to provide documentation sufficient to delineate between the fees and dues attributable to membership, and the fees and dues attributable to its members' benefits, including access to target and trap shooting services.

The Appellant acknowledges that it "erred in reporting 100 percent of the dues and initiation fees as service and other activities income."[1] The Appellant only offers a full membership including shooting rights and does not offer a separate "social" membership. The Appellant submitted a handwritten summary for the years 2006 and 2007 and two months of 2008, claiming that it fairly represents its members' usage of shooting privileges. The Appellant presented actual sign-in sheets that support that summary at the hearing.

ISSUE

The issue is whether, under the authority of RCW 82.04.4282 and WAC 458-20-183 and the facts of this case, all or a portion of the Club's (1) membership dues and (2) initiation fees may be deducted from the measure of its business and occupation (B&O) taxes, and correspondingly reduce its retail sales tax obligation.

CLUB'S CASE AND ARGUMENT

The Club exists as a private not-for-profit organization formed in 1942. According to the Club's website, its mission is:

> To protect, propagate, and increase fish and game, the natural food thereof, and improve the habitat of all wildlife.
>
> To procure the enactment of laws for the protection and restoration of fish and game and their natural food, forests, marshes, streams, lakes, and to promote the observance and enforcement of such laws.
>
> To create and foster public sentiment in favor of protection and restoration of fish and game and their natural foods of woods, water, and wildlife.
>
> To promote sportsmen-like methods in hunting and fishing, and proper respect for the rights of land owners.

In furtherance of its mission, the Club engages in a number of activities to promote wildlife habitat and resources, game management, and responsible and safe use of guns. These activities include publication of newsletters, providing hunter education classes, and providing

[1] These additional facts supplement the facts as provided in Respondent's Trial Brief.

use of the Club premises for 4H and other youth organizations, as well as local law enforcement agencies.

In addition to these activities, the Club provides various social and community events, including Easter egg hunts for over 800 children, maintaining a nature preserve with animal salt licks, a July 4th picnic, "Jakes Events" (a National Wild Turkey Foundation event held primarily for children), a Christmas Party, scouting events, a free web based newsletter, training in trapshooting, free expert rifle and pistol advice, free classified ads, and free Range Safety Officer (RSO) training.

The Club facilities on 56 acres located near the City of Black Diamond include a 200 yard rifle and pistol range, a 100 meter rifle range, five trap fields, a clubhouse with a kitchen and club meeting room. Also located on the property are a storage building and living accommodations for the caretaker at the entrance to property. The Club facilities serve as the meeting place for most Club activities, and provide a place for the Club members to socialize and enjoy their common interests.

Members use this land as a picnic area, a clubhouse for socializing and eating, a place for families to play Frisbee, touch football, horseback riding, or walking/playing with their dogs.

The Club reported their income under both service and retail. They reported the dues and initiation fees as service and other income. They also reported under this classification special event income. They reported sales of food and beverage, ammunition, targets, clay pigeons, and trap shooting under both retailing and retail sales tax.

The Club always paid retailing and retail sales tax on the trapshooting, and members received "free" use only of the rifle/pistol range. Non-members paid the $9.25 plus sales tax for use of the pistol/rifle range, which the Club reported.

In summary, the Club requests that all initiation fees be treated as fully deductible, that the Club be allowed to apportion the annual dues based on their members' actual usage, and that they be allowed to take a dues deduction for the social and community component.

DEPARTMENT'S CASE AND ARGUMENT

It is uncontested that the dues and fees paid by Appellant's members entitle the members access to target and trap shooting. Target and trap shooting are unquestionably retail-taxable amusement and recreation activities under RCW 82.04.050(3) and WAC 458-20-183(2)(b) (Rule

183(2)(b)). The Appellant's initial reporting of its member fees and dues under the service and other activities B&O classification was in error. The question on appeal to this Board is whether the Appellant can prove that it is entitled, per RCW 82.04.4282, to deduct any of the initiation fees or dues paid as *bona fide* fees and dues from its taxable gross income. If it cannot, then the member fees and dues are subject to the retail sales tax, just like the non-member fees. Because the Appellant's proposed allocation method is not based on adequate books and records as required by Rule 183(4) and RCW 82.04.070, the assessment should be affirmed.

The Appellant requires its members to pay a one-time $150 initiation fee and $75 in annual dues. These fees and dues entitle the Appellant's members unlimited use of the rifle and pistol target range and reduced rates on the trap ranges. The Appellant requires non-members to pay $10 per visit to use the target range. Using these figures, a first-year member, paying a total of $225 in fees and dues, need only use the target range 23 times in the course of a year to break even. In subsequent years, a dues-paying member needs to use the target range only 8 times in the course of a year to exceed the amount they would pay as a non-member for use of the target range.[2] Given the minimal amount of target shooting sessions necessary to justify a member's fees and dues, the Appellant's argument that shooting privileges make up only a fraction of the value of the allocable fees and dues is unsupported by the facts.

The Appellant has submitted summaries and spreadsheets purporting to document members' monthly range usage. The Appellant did not support these items, however, with any independent, corroborative, and objective documentation from the audit period prior to the hearing. *See* Exhibits A10-1, A-11-1. One glaring problem with these documents is that they only show if a member used the facilities in a given month. They do not show *how many times* the member utilized their member benefits in that month. The only actual objective data the Appellant provided are sign-in sheets for 2008 and 2009, which are for post-audit periods. *See* Exhibits R6-1; R7-1. The Appellant asks the Board to use these post-audit sign-in sheets and undocumented summaries to

[2] Of course, these simple calculations relating to the "target range" do not take into account the discounts members receive on the trap ranges or any other taxable services that members receive in exchange for their dues and fees.

segregate its income between non-taxable *bona fide* fees and dues, and taxable fees and dues paid with respect to services for the full three-year audit period.

The Appellant's position is that it is entitled to allocate fees and dues under the "actual records of facilities usage" methodology in Rule 183(4)(c)(i). The four months of sign-in sheets for post-audit periods does not constitute "a periodic study" of the "nature of the services . . . and the frequency of use of the membership" sufficient to constitute a reliable measure of members' activities for the three-year audit period. *See* Exhibits R6-1; R7-1. Even more fundamentally, the two months of sign-in sheets and summaries of members' monthly range usage without supporting data are not sufficient to meet the RCW 82.32.070 recordkeeping standard required by Rule 183(4)(a).[3] Nothing was provided for the audit period under appeal. Because the Appellant was unable to provide suitable records to calculate the tax due, the audit properly characterized the "initiation fees" and "dues" as retail-taxable payment for services not subject to the *bona fide* fees and dues deduction. *See Automobile Club of Washington v. Dep't of Revenue*, 27 Wn. App. 781, 786, 621 P.2d 760, 763 (1980).

ANALYSIS AND CONCLUSIONS

Applicable statutes and regulations.

Washington imposes a B&O tax "for the act or privilege of engaging in business" in the state of Washington.[4] Different B&O rates apply, depending upon the activity. Generally, the measure of the tax is gross receipts. Washington levies a retail sales tax on each retail sale in this state.[5] Washington tax law defines a "sale at retail" to include:

> [T]he 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:

[3] Select months of post-audit sign-in sheets and self-generated summaries without supporting documentation does not constitute "maintenance of suitable records as may be necessary to determine the amount of any tax due." Rule 183(4)(a); RCW 82.32.070.
[4] RCW 82.04.220.
[5] RCW 82.048.020 and 82.04.050.

(a) Amusement and recreation services . . . when provided to consumers.[6]

RCW 82.04.4282 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, (5) tuition fees, (6) charges made by a nonprofit trade or professional organization for attending or occupying space at a trade show, convention, or educational seminar sponsored by the nonprofit trade or professional organization, which trade show, convention, or educational seminar is not open to the general public, (7) charges made for operation of privately operated kindergartens, and (8) endowment funds. This section may not be construed to exempt any person, association, or society from tax liability upon selling tangible personal property, digital goods, digital codes, or digital automated services, 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. (Emphasis added.)

Rule 183(2) defines "initiation fees" and "dues" as follows:

> . . .
>
> (e) "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 and services rendered to the member by the club or similar organization.
>
> (i) "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 the mere nominal membership.

Rule 183(4) provides that a taxpayer may apportion its receipts between deductible and taxable amounts. According to the rule, this apportionment may be done using one of two prescribed methods. One method is referred to as the "actual records of facilities usage method." Under this method, the taxpayer may allocate its income based on the actual records of facilities usage as maintained by the organization. The other method is known as the "cost of production method."

[6] RCW 82.04.050(3).

Initiation Fees.

There are eight categories of payments or charges that may be deducted from B&O and sales taxes pursuant to RCW 82.04.020, .050, and .220. Initiation fees and dues are listed separately. Only one of the eight categories subject to a proviso is that of dues. The last sentence of RCW 82.04.4282 indicates that if dues are in exchange for any significant amount of goods and services, then they shall not be deductible. There is no such proviso for the category of initiation fees. Notwithstanding the language of the Department's rule, this statute makes it clear that: (1) initiation fees are deductible, and (2) dues may or may not be deductible depending upon whether services were received in exchange.

Upon joining the Club, new members pay a one-time initiation fee of $150. The Board finds that, like many clubs, that fee is distinguishable from the monthly or annual dues, which members pay for the "goods and services rendered by" the club to its members. Rule 183(4)(i) appears to contemplate that entities such as the Club may receive funds that consist of a mixture of fees and dues. That is not the situation here. The initiation fee is received upon a party joining the Club. Thereafter only dues are received.

RCW 82.04.4282 clearly contemplates that the deductible portion of dues payments depends upon the extent to which goods and services have been received from the club/taxpayer by the dues payer. Notwithstanding this dichotomy, the Department consistently, and in the Board's view erroneously, bundles both initiation fees and monthly or periodic dues when referring to inclusion or exclusion under the statute.

Rule 183(2) describes how dues are different from initiation fees, and instructs the taxpayer that some receipts may be deductible and others not. This rule, however, in no way directs that initiation fees are not deductible, either in whole or in part.

Dues.

Referring to the statutory provision for allocating dues between taxable and nontaxable receipts, the Department acknowledges that "[i]t is not uncommon that through the application of these formulary methods, a substantial portion of gross dues/fees receipts is entitled to a deduction."[7]

[7] Det.. No. 81-104A, 8 WTD 19 (1989).

Because the statute provides a portion of the dues payments may be deductible, the question is then how the portion to be deducted is computed or ascertained.

Rule 183(4)(c) provides two mutually exclusive methods to calculate the includable and excludable receipts. The first is the actual records of facilities usage and the second is the cost of production method. In this case, the Club chose to use the first method, namely the disclosure of actual records reflecting the nature of goods and services used by the membership, and the frequency thereof. The rule provides that this information can be gathered from either an actual tally of times used or periodic study of the average membership use of facilities.

The audit period covered 45 months from January 1, 2004, through September 30, 2007. The records that the Club provided from the use of the rifle and pistol range covered the last 21 months of the audit and continued thereafter into the year 2008.

The uncontroverted evidence presented through longtime Club member Phil Erickson was that in any given year only half of the members use the rifle and pistol range. Sign-in sheets presented at the hearing disclosed that the range had been used by 240 of the 500 total members in the year 2007. Historically, the membership has ranged from 452 to 650 members. These records were available at the initiation of the audit, but according to witness Frank Hardin of the Department, there was a determination not to examine those records. Because only one-half of the membership was using the rifle and pistol range, it follows that the other half of the membership, while paying dues, was not receiving a significant amount of goods and services from the club. Therefore, one-half of the dues received each year of the audit are not deductible, and one-half of the dues are taxable.[8]

The evidence from the testimony of witnesses and members Erickson, Mulhall, Mammamo, and Duke was clear that there is a prominent social aspect to the membership, which is evidenced both by using the facility as a gathering place, and by arranging for and sponsoring community events.[9] The testimony showed that the membership is significantly impacted by older, retired members looking for socialization, though many have common background in the use of firearms. The statute's test is not how much socialization occurs, but rather what portion

[8] The Board cautions the Club that the finding of this ratio for the audit years must not be construed as a finding for all later years. The Club must document the usage continuously and report and pay taxes on dues each year in accordance with recorded usage each year.

[9] The Board reminds the Club that the question in this excise tax audit is not whether the property is exempt from taxes because of its charitable uses. The question is whether members are receiving significant goods and services from the Club in exchange for their dues.

of the Club dues can be shown to be in exchange for any "significant amount of goods or services."

Conclusion.

The Board finds that initiation fees are not paid in return for goods and services, and that a portion of dues should be allocated between those that are retail - taxable and those that are deductible.

The Board finds that all initiation fees and one-half of the dues for the period of time from January 1, 2006, to September 30, 2007, are deductible under RCW 82.04.4282.

DECISION

The Department of Revenue's Determination No. 09-0196 is set aside, and the Department is hereby directed to recalculate the Appellant's tax liability in accordance with the provisions of this decision.

DATED this 14 day of September, 2010.

BOARD OF TAX APPEALS

KAY S. SLONIM, Vice Chair

STEPHEN L. JOHNSON, Member

Petition for Reconsideration of a Final Decision

Pursuant to WAC 456-10-755, you may file a petition for reconsideration of this Final Decision. You must file the petition for reconsideration with the Board of Tax Appeals within 10 business days of the date of mailing of the Final Decision. You must also serve a copy on all other parties. The filing of a petition for reconsideration suspends the Final Decision until action by the Board. The Board may deny the petition, modify its decision, or reopen the hearing.

CERTIFICATE OF SERVICE

I hereby certify that on **March 29, 2023**, I served the foregoing **Respondent's Answer to Petition for Review** on:

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by the following indicated method or methods:

- ☒ **E-mail**
- ☐ **First-class mail, postage prepaid.**
- ☐ **Hand-delivery.**
- ☐ **Overnight courier, delivery prepaid.**

s/ Steven E. Turner
Steven E. Turner, WSBA No. 33840
Attorney for Respondent
Royal Oaks Country Club

STEVEN TURNER LAW PLLC

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