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Health and Physical Fitness Clubs Receiving Initiation Fees and Dues Income

For purposes of determining what income is attributable to and deductible as bona fide initiation fees or dues, subsection (4)(c) of WAC 458-20-183 (Rule 183) provides alternative methods of allocating between taxable and deductible income. Before using one of these methods, a health and physical fitness club must first show that it receives some income from dues and/or initiation fees solely for the social benefits associated with the privilege of membership and not for services rendered. It is important to note that tax deductions are narrowly construed. *Budget Rent-a-Car of Washington-Oregon, Inc. v. Department of Rev.*, 81 Wn.2d 171, 174, 500 P.2d 764 (1972) and *Rainier Bancorporation v. Department of Rev.*, 96 Wn.2d 669, 638 P.2d 575 (1982). The burden of proof is upon the taxpayer to provide evidence in support of a claim for a deduction. *Budget Rent-a Car*, 81 Wn.2d at 174-75, and *Group Health v. Tax Commission*, 72 Wn.2d 422, 433 P.2d 201 (1967).

Determination No. 97-146R, 17 WTD 133 (1998) addresses the taxation of health and physical fitness clubs. It denies the deduction provided by RCW 82.04.4282 for dues and initiation fees where a taxpayer fails to demonstrate that a portion of its membership fees are for a social benefit as opposed to the fitness services that membership provides. Det. No. 97-146R says:

[W]e find that the taxpayers' initiation fees are not "bona fide initiation fees" because the payments were in exchange for services and use of the clubs' facilities. The payments were not merely for the privilege of membership. Before members can use the exercise facilities, they must pay both the initiation fees and the monthly dues. As noted, the members do not have proprietary interests or operational control in the clubs. There are no social memberships. We do not find that members would pay initiation fees merely to visit a vending machine area or a television lounge. (Underlining supplied.)

The continued validity of Det. No. 97-146R has been questioned because of the January 31, 1996, cancellation of excise tax bulletin 503.04.114\183 (ETB 503). ETB 503 explained that organizations whose members have no proprietary interest or operational control may not avoid tax by designating taxable charges as initiation fees or dues. A later determination, Det. No. 98-186R, 19 WTD 319 (2000) also holds that the requirement set out in ETB 503 is not controlling.

Det. No. 97-146R did not rely solely on ETB 503 for its reasoning. Det. No. 97-146R held that the statute, rule, and case law requires a health and physical fitness club to prove that a portion of its dues

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and initiation fees are received for something other than fitness services. Det. No.98-186R in fact, reinforces Det. No. 97-146R's reasoning. In Det. No. 98-186R, a dining club member paid full market value for all the meals and drinks provided at the club and, in addition, paid initiation fees and monthly dues to belong to the club. This fact led to the determination's conclusion that the dues and initiation fees paid by the members were, indeed, for something other than food or drink. The same conclusion would be applicable to a health and physical fitness club that charged its members market value for use of its facilities, trainers, and or fitness machines and separately charged initiation fees and monthly dues solely for the social benefits associated with the privilege of membership.

The fact that the club may have parties or other events for its members at no separate charge does not demonstrate that the member pays a portion of his or her dues for social benefits. Merely providing a juice bar or a lounge where members can sit, away from exercise equipment, also does not meet the club's burden of showing that its members pay a portion of their membership fees solely for social benefits, as opposed to access to the club's exercise facilities. Finally, leave of absence policies that allow a member to pay reduced dues while the member is unable to use the services do not demonstrate the presence of a social benefits component. Such policies inherently contradict a social benefits component. If the member is on leave because of travel, for example, he or she is not obtaining access to the club for its social benefits.
