CMAA Seminar

PRESENTED BY

DAVID HAWTHORNE, CPA AND GEORGE JONSON, CPA
WITH PERMISSION FROM MITCH STUMP, CPA – WWW.CLUBTAX.COM

FEBRUARY 4, 2021

Hawthorne & Co.
Certified Public Accountants

HAWTHORNE & CO. CPAS
17820 1ST AVE S – SEATTLE, WA 98148
HTTPS://HAWTHORNE-CPA.COM
(206) 243-2336

Agenda

1. About Hawthorne & Co. CPAs
2. CARES Act - Employee Retention Credit, Sick Leave Credit
3. Final IRS Regulations on Unrelated Business Income
   a) New IRS Regulations Require Separation of Income, Chimneys
   b) Using NAICS Categories
   c) Portland Golf Club Case, Rev. Rul. 81-69
   d) Separation of Income and Deductions
   e) Using the Adjusted Gross to Gross Method
   f) Using the Actual Use Method
   g) IRS Audits
4. Importance of Record Keeping
   a) Record Keeping
   b) Allocation of Expenses
   c) Golf Rounds – Actual Use
   d) Member Dining, Confirmation from Member
5. Department of Revenue
   a) Annual Survey
   b) 9-Hole Golf Courses
   c) Use Tax, Major Projects, Record Keeping, Those Dreaded DOR Audits
   d) No Free Member Benefits
   e) State Fuel Tax Credit

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

About Hawthorne & Co. CPAs

- Owned by David Hawthorne, CPA
- Recently joined by Ernest Jonson & Company PS
- Dynamic, mid-sized firm serving the Puget Sound Region
- Serves individuals, partnerships, corporations (S-corp. and C-corp.), estates, trusts, and not-for-profit organizations

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

CARES Act

CARES Act, Employee Retention Credit, Sick Leave Credit

Brief History of the COVID Acts

- Family First Coronavirus Response Act (FFCRA) - March 18, 2020
- Coronavirus Aid, Relief and Economic Security Act (CARES) – March 27, 2020
- Coronavirus Tax Relief Act of 2020 (CTRA) – December 27, 2020

** This information is provided for general educational purposes only. Before taking any action based on this information, we strongly encourage you to consult with a professional accounting advisor about your specific situation.

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

Employee Retention Credit

Eligible Employer:

- The credit is available to employers carrying on business during 2020:
  - **Government Mandate**: whose operations for a calendar quarter have been fully or partially suspended as a result of a government order limiting commerce, travel or group meetings; or,
  - **Gross Receipts Test**: employers who have experienced a more than 50% reduction in 2020 quarterly receipts, measured on a year-over-year basis to the corresponding 2019 quarter.

Qualified Wages:

- Wages, including health care costs, (up to $10,000 per employee) paid to any employee during the period operations were suspended or the period of the decline in gross receipts, regardless of whether or not its employees are providing services.

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

Employee Retention Credit

The Credit

- A refundable tax credit against certain employment taxes equal to 50 percent of the qualified wages an eligible employer pays to employees after March 12, 2020, and before January 1, 2021. Eligible employers can get immediate access to the credit by reducing employment tax deposits they are otherwise required to make.

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

Employee Retention Credit

Modifications under CTRA on December 27, 2020:

- Extends credit through June 30, 2021
- Rate increase from 50% to 70% qualified wages
- Limit per employee increases from $10,000 per year to $10,000 per quarter
- Gross receipts test declines from 50% to 20%

IRS Employee Retention Credit FAQ link: https://www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

Sick Leave Credit

Employer's payroll tax credit for required sick leave wages (the payroll sick leave credit)

- The Emergency Paid Sick Leave Act (EPSLA), generally requires private employers with fewer than 500 employees to provide 80 hours of paid sick time to employees who are unable to work for virus-related reasons
- The pay is up to $511 per day with a $5,110 overall limit for an employee directly affected by the virus, and up to $200 per day with a $2,000 overall limit for an employee taking leave to be a caregiver.
- For employers required to provide sick-leave wages required by the EPSLA, a corresponding tax credit is allowed against the employer's 6.2% portion of the Social Security (OASDI) payroll tax The credit tracks the $511/$5,110 and $200/$2,000 per-employee limits described above.
- The paid sick and family leave credits, which previously were available only until the end of 2020, have been extended for periods of leave taken through March 31, 2021.
- IRS Sick Leave Credit FAQ link: https://www.irs.gov/newsroom/covid-19-related-tax-credits-basic-faqs

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

Final IRS Regulations on Unrelated Business Income

New IRS Regulations Require Separation of Income, Chimneys

- The final IRS regulations regarding Unrelated Business Income are effective to taxable years beginning on or after December 2, 2020.

- Applies to all organizations with more than one unrelated trade or business income (UBI).

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

Using NAICS Categories

The Internal Revenue Service will use the first two digits of North American Industry Classification System (NAICS) to report UBI income and deductions.

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

Portland Golf Club Case, Rev. Rul. 81-69

- Portland Golf Club results in IRS Revenue Ruling 81 – 69
- Of the 2,000 NAICS codes, the IRS reduced to 20, we found 5 apply:

NAICS	ACTIVITY
44	Retail, pro shops
53	Rental: golf carts, range balls
71	Guest (green) fees, reciprocal fees
72	Restaurant and rental of dining room
Investment	Bank interest, dividends, gain from taxable sale

- Losses from one NAICS code may not offset profit in another.

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

Separation of Income and Deductions

- Separation of Unrelated Business Income (UBI) requires separation of income and deductions.

- Options available to allocate expenses within a NAICS code
  - Direct
  - Adjusted gross to gross
  - Actual use

- No longer allowed is the weighted daily average percentage of UBI to gross income applied to operating expenses.

- Limits the deduction of indirect expenses to reduce UBI taxable income.

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

Using the Adjusted Gross to Gross (AGG) Method

- AGG is the preferred method for restaurant activity.
  - Required, must adjust retail price of food and bar revenue to member prices. If member meal is $45 and UBI meal is priced at $75, the allocation amount will reset to the $45 price to allocate expenses.
- Will require a spread sheet showing original price, adjusted price and covers.
- Suggest this layout for restaurant UBI
- Date, name of event, original price, adjusted price, covers, adjusted total
- Pro shop sales, discounts given to members apply to UBI too.
- Using the direct method is not recommended, would require use of time clocks to charge employee time to specific duties on a daily basis.

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

Using the Actual Use Method

- Would apply to activity use, golf, tennis, swimming.

For Golf:

- Count the number of UBI play over the total rounds played, that ratio will be used to allocate the departmental expenses. Club must keep actual use records.
- The ratio determined by the AGG and AU will be used to allocate deductions.
- We have found the result to reduce deductions creating taxable income.

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

IRS Audits

- No one likes to be audited. If you are prepared the audit time is reduced.
- The IRS auditor will ask for your supporting documents.
- Best to prepare daily or weekly reports.
- If you do not have time now, how will you have time for an IRS audit?

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

Importance of Record Keeping

Record Keeping

Records that must be kept:

- Member – Non-member revenue. Need supporting documentation of member revenue, all cash sales are non-member.
- New, adjusted gross to gross, arrival at lowering UBI price to adjusted member price. Will need the adjusted pricing sheet on each outside event.
- Pro shop sales during outside event

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

Allocation of Expenses

- The allocation will change annually. May include days open, hours open, golf rounds, calculating AGG.

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

Golf Rounds – Actual Use

- Using AGG some indirect costs can be allocated
- Percentage will be UBI golf rounds over total golf rounds

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

Member Dining, Confirmation from Member

- Dining where more than Eight are attending. An absolute must.
- See insert on Short form and Long form.

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

Department of Revenue

Annual Survey

- Record keeping, record keeping, record keeping
- Annual survey taken every April 1st.
- Do not use Cost of Production method. If you are, you have time to write the Director that your club is electing the “Actual Usage method”.

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

Nine-Hole Golf Courses

- Nine-hole courses are allowed according to a published determination. Not allowed is non-USGA golf courses.
- Best to have a purchase receipt for an 18-hole round and score card showing the USGA course rating.

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

Use Tax, Major Projects, Record Keeping, Those Dreaded DOR Audits

- Again, record keeping.
- We recommend making a copy of each invoice without sales tax and attaching to your copy of the Combined Excise and Sales Tax Report. Save for the auditor.
  - The DOR auditor will ask for your copy of the monthly reports.
- Capital purchases.
- The auditor will ask for invoice of each capitalized purchase recorded on your depreciation schedule. Make a folder of each fixed asset GL account. Place a copy of each invoice in folder.
- Do both will save many hours of your time during a DOR audit.
- Sales tax on employee meals, exemption only applies to food service employees.

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

No Free Member Benefits

- RCW 82.04.4282 attached.
- Applies to member activities:
  - Golf, tennis, swimming
  - Bar snacks
  - Board and committee meals, drinks, and snacks
  - Practice range balls
- Add value of each to retail sales.

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

State Fuel Tax Credit

- State fuel tax credit for off highway use.
- Must have permit to apply for refund.
- Olympia phone number: (360) 664-1838 for questions or applying for credit.
- Most diesel comes dyed, verify on your receipt, will show sales tax.
- Unleaded regular includes highway fuel tax, the refund is net of credit and the sales tax on the fuel. Only allowed to go back 13 months.
- Federal Fuel Tax Credit claimed on Form 990T, both diesel and unleaded regular.

Questions?

Attachments

- DETERMINATION No. 14-0285
- Portland Golf Club v. Commissioner, 497 U.S. 154 (1990)
- Excise Tax Advisory 3080.2009
- RCW 82.04.4282 – Deductions, fees, dues, changes

Presented by David Hawthorne, CPA and George Jonson, CPA
With permission from Mitch Stump, CPA

Cite as Det. No. 14-0285, 34 WTD 557 (2015)

BEFORE THE 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. 14-0285
. . .	)	Registration No. . . .

RCW 82.04.050(3)(a)(i); RCW 82.04.4282; WAC 458-20-183; ETA 3080.2009: RETAIL SALES TAX – USING THE ACTUAL RECORDS OF FACILITIES USAGE METHOD FOR ALLOCATING GOLF FEES BETWEEN DEDUCTIBLE AND TAXABLE AMOUNTS. In using a market comparison of the value of eighteen holes of golf, a private golf course could use a comparable nine hole golf course that is capable of being played twice, but could not use non-USGA certified courses or par-3 courses that don't over the same eighteen-hole layout as the private course.

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. – Private golf and country club protests the exclusion of six nine-hole golf courses from its market comparison for purposes of determining the taxable amount of its membership fees and dues under the actual usage of facilities method pursuant to WAC 458-20-183 and ETA 3080.2009. The petition is granted in part and denied in part.[1]

ISSUE

May a private eighteen-hole golf course include nine-hole golf courses in its market comparison for purposes of determining the taxable amount of its membership fees and dues under the actual usage of facilities method pursuant to WAC 458-20-183 and ETA 3080.2009?

FINDINGS OF FACT

[Taxpayer] operates a private golf course and country club in [Washington]. The majority of Taxpayer's income consists of membership fees and dues.

Taxpayer's facilities include a full-length eighteen-hole golf course, tennis courts, swimming pool, clubhouse with restaurant and bar, snack bar, pro shop, and banquet facility. All club members must first pay a one-time initiation fee to join and then pay monthly dues for

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

continuing membership. Taxpayer offers several types of memberships, including varying levels of golf memberships (proprietary, senior, associate, intermediate, and junior) and social memberships. The golf membership includes access to the golf course, tennis courts, and swimming pool at no additional charge. Social members pay lower dues and have no golf privileges, but have full access to the other facilities at no additional charge. Both golf and social members must pay separately for food and beverage at the clubhouse and snack bar.

The Department of Revenue's (the "Department") Audit Division examined Taxpayer's books and records for the period . . . (the "Audit Period"). On June 7, 2013, the Audit Division issued Assessment No. . . . , in the amount of $ . . . , including $ . . . in tax[2] and $ . . . in interest. The Audit Division disallowed the inclusion of the following private and public golf courses in Taxpayer's market comparison under ETA 3080.2009, arguing that Taxpayer may only use eighteen-hole courses in its market comparison:

Name	Type	Location	No./Type of Holes
. . .	Private	[Washington]	9 holes – certified for 18
. . .	Private	[Washington]	9 holes – certified for 18
. . .	Public	[Washington]	9 holes – par 3
. . .	Public	[Washington]	9 holes – par 3
. . .	Public	[Washington]	9 holes – par 3
. . .	Public	[Washington]	9 holes – par 3

The two private courses listed above (. . .)(the "Private Courses") are both nine-hole courses, but are certified by the United States Golf Association ("USGA") as eighteen holes. The holes at the Private Courses vary from par-3 to par-5. Generally, a nine-hole course is able to secure an eighteen-hole rating by establishing two sets of tee boxes, two sets of flag positions, and different yardage and slope ratings for each hole. The USGA recognizes the Private Courses as eighteen-hole courses, even though they physically only have nine holes.

The four public courses listed above (. . .) (the "Public Courses") are *not* recognized by the USGA as eighteen-hole courses. These courses are "executive" nine-hole, par-3 courses. An executive course is a course with a total par that is significantly less than a traditional eighteen-hole course. Executive courses are designed to be played quickly by those who do not have the time to play a full eighteen-hole course or by beginners who are just learning to play golf.[3]

ANALYSIS

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 ("Rule 183") 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:

[2]The tax included $ . . . in retail sales tax, $ . . . in retailing B&O tax, and credits for litter tax and service and other activities B&O tax in the amounts of $ . . . and $ . . . , respectively.
[3]*See* http://en.wikipedia.org/wiki/Golf_course

> 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 are in exchange for a significant amount of goods or services. 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). The Department has long allowed country clubs, golf clubs, and tennis clubs that have a substantial social component, and derive their income from initiation fees and dues, to allocate their membership fees and dues income between taxable amounts (payment for goods or services rendered) and deductible amounts (bona fide initiation fees and dues). Det. No. 85-178A, 3 WTD 387 (1987); No. 87-218, 3 WTD 295 (1987); Det. No. 87-348, 4 WTD 281 (1987); Det. No. 88-247, 6 WTD 105 (1988).

Rule 183 provides two alternative methods of allocating fees and dues income between taxable and deductible amounts: the actual records of facilities usage; or the cost of production of facilities. During the Audit Period, Taxpayer used the actual records of facilities usage method. Under the actual use method, the taxable amount may be computed in one of two ways: (i) allocation of a reasonable charge for the specific goods or services rendered; or (ii) the average comparable charges for such goods and services made by other commercial businesses. Taxpayer elected to calculate its taxable amount using the average comparable charges made by other comparable businesses. Rule 183(4)(c) provides:

> (i) **Actual records of facilities usage.**
> (A) Persons may allocate their income based upon such actual records of facilities usage as are maintained. This method is accomplished by either: The allocation of a reasonable charge for the specific goods or services rendered; or, the average comparable charges for such goods or services made by other *comparable businesses*. In no case shall any charges under either method be calculated to be less than the actual cost of providing the respective good or service. When using the average comparable charges method the term "comparable businesses" shall not include subsidized public facilities when used by a private facility.

Rule 183(4)(c)(i)(A)(emphasis added).

On February 2, 2009, the Department issued Excise Tax Advisory 3080.2009 ("ETA 3080")[4] to explain how to apply the average comparable charges method allowed by Rule 183(4)(c)(i)(A) to golf clubs. ETA 3080 provides, in relevant part, as follows:

> **Use of Market Comparisons by Golf Businesses**
> **Reporting on the "Actual Records of Facilities Usage" Method**
>
> This excise tax advisory provides a method to calculate the fair market value of a round of golf for the purpose of determining the taxable value of club initiation fees and membership dues.
>
> * * *
>
> In order to administer this particular section of Rule 183 and to maintain uniformity among this class of taxpayers, the Department has determined that taxpayers who wish to use a market comparison must follow the procedure outlined below.
>
> Both public and private golf courses must be considered in the market comparison. The taxpayer must use the weighted averages (weekend and weekday rates should be weighted by a factor of two and five respectively) of **eighteen holes of golf** at the ten closest public courses, and the ten closest private courses (including itself as one of the courses). Linear map distances (as opposed to road mileage) will be used to select the courses for comparison; however, courses across major bodies of water not accessible by bridge will not be considered. The average will be recalculated as of April 1 of each calendar year, and may be used until the next recalculation.

(Underlined emphasis in original, bolding emphasis added).

The Audit Division disallowed the inclusion of the Private Courses and the Public Courses because they only have nine holes. We do not read ETA 3080 to limit the market comparison to eighteen-hole golf courses. Rather, ETA 3080 only requires that Taxpayer use the weighted averages of "eighteen holes of golf." "Eighteen holes of golf" is not necessarily equivalent to an "eighteen-hole golf course."

While we do not interpret ETA 3080 to exclude nine-hole courses from the market comparison, the plain language of Rule 183 still requires that the golf courses included in the market comparison be *comparable* to Taxpayer's golf course. Taxpayer may use "the average comparable charges for such goods or services made by other *comparable businesses*." Rule 183(c)(i)(A)(emphasis added). Because Rule 183 does not define the word "comparable," 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). The dictionary definitions of "comparable" are as follows:

[4] The predecessor to ETA 3080 was Excise Tax Bulletin 548.04.114 ("ETB 548"), effective August 20, 1990. On February 2, 2009, the Department cancelled ETB 548 and reissued it as ETA 3080 in substantially identical form.

1. "capable of being compared: having enough like characteristics or qualities to make a comparison appropriate;" and
2. "suitable for matching, coordinating, or contrasting: EQUIVALENT, SIMILAR"

WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 461 (1993).

The Private Courses maintain eighteen-hole layouts, even though they physically only have nine holes. This is accomplished by playing each of the nine holes twice and using varying tee boxes and yardages. We conclude that the Private Courses are "comparable" to Taxpayer's course. Because of their eighteen-hole layout, they have enough like characteristics and qualities to Taxpayer's traditional eighteen-hole course. Because the Private Courses are "comparable" under Rule 183, they may be included in the market comparison required by ETA 3080. The Public Courses, on the other hand, are not certified by the USGA as eighteen holes and do not offer the same eighteen-hole layout as the Private Courses. They are also shorter, par-3 courses. Even if played twice, the Public Courses are not "comparable" to Taxpayer's full eighteen-hole course and may not be included in the market comparison.

Taxpayer argues that ETA 3080 (and its predecessor, ETB 548.04.111) explicitly eliminated any requirement that the courses chosen for the market comparison be "comparable" or "of like kind." Taxpayer states, "The comparability of courses cannot be considered because [ETA 3080] is mandatory and rejection of a course within the 10 closest public or private courses is not permitted."[5] In support of its position, Taxpayer cites Det. No. 86-55A, 2 WTD 353 (1987), in which a private eighteen-hole golf club included certain "inferior" courses in its market comparison under former WAC 458-20-114. The Department stated:

> [T]axpayers who use the actual usage of facilities method and perform a comparable worth survey or study must include a representative number of all golfing facilities within the survey. It is not appropriate or acceptable to exclude so-called "good" golf courses or "bad" golf courses. The rule seeks to determine the "average" charge for golf, not the charge for golf at a comparably good facility.

Taxpayer argues that the underlined portion in the quoted language above requires the inclusion of, literally, "*all*" golf courses within the linear distance range specified in ETA 3080, regardless of whether such golf courses are "comparable" to Taxpayer's golf course. We disagree with such a broad interpretation of the determination. We conclude that 2 WTD 353 stands for the proposition that the Department may not exclude golf courses from the market study on the grounds that they are "better" or "worse" in quality or condition than the taxpayer's own golf course. Here, the Audit Division did not exclude golf courses from the market comparison based upon such factors. Therefore, 2 WTD 353 is inapplicable.

Taxpayer's petition is granted with respect to the Private Courses and denied with respect to the Public Courses.

[5] Taxpayer's Appeal Petition at 6 (Sept. 3, 2013).

DECISION AND DISPOSITION

Taxpayer's petition is granted in part, denied in part, and remanded to the Audit Division for adjustment to the assessment in accordance with this determination.

Dated this 5th day of September, 2014.

U.S. Supreme Court

Portland Golf Club v. Commissioner, 497 U.S. 154 (1990)

Portland Golf Club v. Commissioner of Internal Revenue

No. 89-530

Argued April 17, 1990

Decided June 21, 1990

497 U.S. 154

Syllabus

As a nonprofit corporation that owns and operates a private social club, petitioner's income derived from membership fees and other receipts from members is exempt from income tax. However, all other income is nonexempt "unrelated business taxable income," defined in § 512(a)(3)(A) of the Internal Revenue Code as

"the gross income (excluding any exempt function income), less the deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income)."

Petitioner has nonexempt income from sales of food and drink to nonmembers, and from return on its investments. During its 1980 and 1981 tax years, petitioner offset net losses on nonmember sales against the earnings from its investments, and reported no unrelated business taxable income. In computing its losses, petitioner identified two categories of expenses incurred in nonmember sales: (1) variable (direct) expenses, such as the cost of food, which, in each year in question, were exceeded by gross income from nonmember sales; and (2) fixed (indirect) overhead expenses, which would have been incurred whether or not sales had been made to nonmembers. It determined what portions of fixed expenses were attributable to nonmember sales by employing an allocation formula known as the "gross-to-gross method," based on the ratio that nonmember sales bore to total sales. The total of these fixed expenses and variable costs exceeded petitioner's gross income from nonmember sales. On audit, the Commissioner determined that petitioner could deduct expenses associated with nonmember sales up to the amount of receipts from the sales themselves, but could not use losses from those activities to offset its investment income because it had failed to show that its nonmember sales were undertaken with an intent to profit. Petitioner sought redetermination, and the Tax Court ruled in petitioner's favor, concluding that petitioner had adequately demonstrated that it had a profit motive, since its gross receipts from nonmember sales consistently exceeded the variable costs associated with those activities. The Court of Appeals reversed, holding that the Tax Court had applied an incorrect legal standard in determining that petitioner had demonstrated an intent to profit, because profit in this context meant the production of gains in excess of all direct and indirect costs. The court remanded the case for a determination whether petitioner engaged in its nonmember activities with the required intent to profit from those activities.

Department of Revenue Washington State

Excise Tax Advisory

Excise Tax Advisories are interpretive statements authorized by RCW 34.05.230.

ETA 3080.2009 Issue Date: February 2, 2009

Use of Market Comparisons by Golf Businesses
Reporting on the "Actual Records of Facilities Usage" Method

This excise tax advisory provides a method to calculate the fair market value of a round of golf for the purpose of determining the taxable value of club initiation fees and membership dues.

It is often difficult for persons who are in the golf business to distinguish the amounts of the initiation fees and dues received which are related to nontaxable membership privileges from the amounts received which are for playing golf (taxable under the retailing B&O and retail sales taxes). WAC 458-20-183 (Rule 183) provides two methods which the business may use to identify the specific taxable amounts. One of these methods is the "actual records of facilities usage".

Under the "actual records of facilities usage" method the taxpayer is required to maintain actual records of the facilities usage. The taxpayer's records must reflect the nature of the specific goods and services provided and the frequency of use by the membership. The frequency may be shown either from a tally of times used or a periodic study of the average membership use of facilities. The taxpayer multiplies the usage by the fair market value of a round of golf to arrive at the taxable amount. A taxpayer may determine the fair market value of a round of golf by market comparison.

In order to administer this particular section of Rule 183 and to maintain uniformity among this class of taxpayers, the Department has determined that taxpayers who wish to use a market comparison must follow the procedure outlined below.

Both public and private golf courses must be considered in the market comparison. The taxpayer must use the weighted averages (weekend and weekday rates should be weighted by a factor of two and five respectively) of eighteen holes of golf at the ten closest public courses, and the ten closest private courses (including itself as one of the courses). Linear map distances (as opposed to road mileage) will be used to select the courses for comparison; however, courses across major bodies of water not accessible by bridge will not be considered. The average will be recalculated as of April 1 of each calendar year, and may be used until the next recalculation.

If the taxpayer is located in a less populated area of the state with relatively few golf courses, the Department may, at the request of the taxpayer, approve the use of five public and five private courses in making the market comparison.

The taxpayer must retain the worksheets, documents, and any other information which was used in making the market comparison as part of its business records for a period of five years.

*****

RCW 82.04.4282

Deductions—Fees, dues, charges.

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.

[**2009 c 535 § 410**; **1994 c 124 § 3**; **1989 c 392 § 1**; **1980 c 37 § 3**. Formerly RCW **82.04.430**(2).]

NOTES:

Intent—Construction—2009 c 535: See notes following RCW **82.04.192**.

Intent—1980 c 37: See note following RCW **82.04.4281**.

Section 277; Rev. Proc. 71-17; Questionnaire

Is there a suggested questionnaire to be used for parties of more than 8 for IRS required Member vs. nonmember recordkeeping?

Because Section 277 taxable Clubs must separate its income between Member and nonmembers, the IRS has indicated that taxable Clubs can use the same questionnaire used by 501(c)(7) tax-exempt Clubs that asks enough questions to meet the requirements of Revenue Procedure 71-17.

Annually, ensure that Member vs. nonmember revenue is identified and use Revenue Procedure 71-17's suggested questionnaire if helpful.

References: Revenue Procedure 71-17.

Further discussion:

Sample Forms
The following two forms have been developed for use by 501(c)(7) tax-exempt Clubs in recording nonmember gross receipts for IRS purposes. Although the IRS does not sanction or endorse any particular forms, the information provided by these forms will satisfy the requirements of Revenue Procedure 71-17. It should be noted that a Club should record this information on group function whether Member or nonmember, in order to demonstrate its careful attention to maintaining a complete record in the event of an IRS audit. Unless appropriate records are kept by the Club, adverse assumptions may be made that could jeopardize its tax-exempt status.

SHORT FORM

_____ _____ $_____
Date Number in Party (complete if more than 8) Total Amount of Check

_____ This check will be paid by me without reimbursement. (Member Income)

_____ This check will be paid by my guest or I will be reimbursed by my guest. (Nonmember Income)

_____ This check will be paid by my employer as a business expense and is deemed to be Member income. (Complete Long Form)

_____75% or more of party are Members.

(Fill in names of Members below or attach a list.)

_____

_____

_____

Member's Signature: _____ Date: _____

Checklists; 501(c)(7); Revenue Procedure 71-17

It is imperative that 501(c)(7) tax-exempt Clubs fully understand and comply with Revenue Procedure 71-17. This Revenue Procedure addresses the requirements that must be followed to properly identify whether income is being received from a Member or a nonmember. On audit, the IRS will ask for copies of your documentation. This checklist summarizes two of the major points made in the ruling. First it discusses one benefit to a 501(c)(7) of assuming that certain income is Member related while the second point discusses when a Club must prove Member related income.

Based upon "Nonmember Income; Revenue Procedure 71-17" topic found in Club Tax Book.

Checklist

ASSUMPTION OF MEMBER INCOME STATUS

_____ **Parties of 8 or Fewer**. A host-guest relationship will be assumed for "Parties of 8 or Fewer" and will be recorded as "Member Income" where:

_____ A group of eight or fewer individuals, and

_____ At least one of whom is a Member, and

_____ Uses club facilities,

It will be assumed for audit purposes that the nonmembers are the guests of the Member, provided

_____ Payment for such use is received by the Club directly from the Member
or
Payment for such use is received by the Club directly from the Member's employer**.

_____ **75% Rule**. A host-guest relationship will be assumed for the "75% Rule" and will be recorded as "Member Income" where:

_____ 75 percent or more of a group using the Club facilities are Members,

_____ It will be assumed for audit purposes that the nonmembers in the group are guests of Members,

_____ Provided payment for such use is received by the Club directly from one or more of the Members
or
Payment for such use is received by the Club directly from the Member's employer**.

**For both "Parties of 8 or Fewer" and the "75% Rule" payment by a Member's employer will be assumed to be for a use that serves a direct business objective of the employee-Member.

MUST PROVE MEMBER INCOME STATUS

In all other situations, a host-guest relationship will not be assumed but must be substantiated and proved. Thus, to prove Member related, for both "Parties of More than 8" and "74 % or Less Rule" the following must be determined:

_____ **Member's Employer Pays.** Where the Member's employer pays and the event does not meet the requirements of the "Parties of 8 or Less" or the "75% Rule" where:

_____ The Member's employer reimburses the Member
or
The Member's employer makes direct payment to the Club,

_____ For the charges attributable to nonmembers,

_____ A statement must be obtained and signed by the Member indicating:
The name of the employer;
The amount of the payment attributable to the nonmember use;
The nonmember's name and business or other relationship to the member***; and
The business, personal, or social purpose of the member served by the nonmember use.

_____ The use of Club facilities must serve some personal or social purpose of the employee-Member
or
Some direct business objective of the employee-Member;

_____ The mere use of Club facilities for the accommodation of the Member's employer does not serve a business, personal, or social purpose of the Member and is recorded as nonmember income.

***If a large number of nonmembers are involved and they are readily identifiable as a particular class of individuals, the member may record such class, rather than all of the names;

_____Other Nonmembers Pay. Where other nonmembers pay for a function, it is possible that a gift is being made to the Member. An example would be a mother gratuitously paying the Club bills for her son. In a gift situation:

_____ Where a nonmember, other than the employer of the Member, makes payment to the Club or reimburses a Member and

_____ A claim is made that the amount was paid gratuitously for the benefit of a Member,

_____ A statement signed by the Member indicating the donor's name and relationship to the Member, and containing information to substantiate the gratuitous nature of the payment or reimbursement.