

THE CITY OF SEATTLE
DIRECTOR'S RULE
IMPLEMENTING SEATTLE BUSINESS TAX ORDINANCE
RULE 5-700

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CITY OF SEATTLE
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CITY CLERK

Seattle Rule 5-700 **Amusement, Recreation, and Physical Fitness Services.**

- (1) **Introduction.** This section provides tax reporting instructions for persons who provide amusement, recreation, and physical fitness services, including persons who receive their income in the form of dues and initiation fees.
- (a) Local governmental agencies that provide amusement, recreation, and physical fitness services should also refer to Seattle Rule 5-127(Sales to and by the state of Washington, counties, cities, school districts, and other municipal subdivisions).
 - (b) Persons engaged in operating coin operated amusement devices should refer to Seattle Rule 5-400 (Coin operated vending machines, amusement devices and service machines).
 - (c) Persons engaged in providing camping and outdoor living facilities should refer to Seattle Rule 5-530 (Sale or rental of real estate, license to use real estate) and Seattle Rule 5-720 (Hotels, motels, boarding houses, rooming houses, resorts, summer camps, trailer camps, etc...).
- (2) **Definitions.** The following definitions apply throughout this section:
- (a) "Amounts derived" means gross income from whatever source and however designated. It includes "gross proceeds of sales" and "gross income of the business" as those terms are defined by SMC 5.30.035. It shall also include income attributable to bona fide "initiation fees" and bona fide "dues."
 - (b) "Amusement and recreation services" include, but are not limited to: Golf, pool, billiards, skating, bowling, swimming, bungee jumping, ski lifts and tows, basketball, racquet ball, handball, squash, tennis, and all batting cages, day trips for sightseeing purposes, and others, when provided to consumers. "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. The term "amusement and recreation services" does not include instructional lessons to learn a particular activity such as tennis lessons, swimming lessons, or archery lessons.
 - (c) "Any additional charge" means a price or payment other than bona fide initiation fees or dues, paid by persons for particular goods and services received. The additional charge must be reasonable, and any business and/or sales taxes must be paid upon such charges in order for the income designated as "bona fide dues" or "fees" to qualify as deductible. The reasonableness of any additional charge will be based on one of the following two criteria:
 - (i) It must cover all costs reasonably related to furnishing the goods or services; or
 - (ii) It must be comparable with charges made for similar goods or services by other comparable businesses.
 - (d) "Direct overhead costs" include all items of expense immediately associated with the specific goods or services for which the costs of production method is used. For

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example, the salary of a swimming pool lifeguard or the salary of a golf club's greens keeper are both direct overhead costs in providing swimming and golfing respectively.

- (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 or services rendered to the member by the club or similar organization.
- (f) "Entry fees" means those amounts paid solely to allow a person the privilege of entering a tournament or other type of competition. The term does not include any amounts charged for the underlying activity.
- (g) "Goods or services rendered" shall include those amusement, recreation, and physical fitness services defined to be retail sales in (m) of this subsection. Also see, SR 5-720 (Hotels, motels, boarding houses, rooming houses, resorts, summer camps, trailer camps, etc.). The term shall include the totality or aggregate of goods or services available to members. It is not determinative that some members actually receive more goods or actually enjoy more services than others so long as the totality of the goods or services offered are made available to members in general.
- (h) "Indirect overhead costs" means overhead costs incurred by the service provider that are not immediately associated with the specific goods and services. These costs include a pro rata share of total operating costs, including all executive salaries and employee salaries that are not "direct overhead costs" as that term is defined in (d) of this subsection, as well as a pro rata share of administrative expenses and the cost of depreciable capital assets.
- (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 mere nominal membership.
- (j) "League fees" means those amounts paid solely for the privilege of allowing a person or a person's team to join an association of sports teams or clubs that compete chiefly amongst themselves. The term does not include any amounts charged for the underlying activity.
- (k) "Nonprofit youth organization" means a nonprofit organization engaged in character building of youth which is exempt from property tax under RCW 84.36.030.
- (l) "Physical fitness services" include, but are not limited to: All exercise classes, whether aerobic, dance, water, jazzercise, etc., providing running tracks, weight lifting, weight training, use of exercise equipment, such as treadmills, bicycles, stair-masters and rowing machines, and providing personal trainers (i.e., a person who assesses an individual's workout needs and tailors a physical fitness workout program to meet those individual needs). "Physical fitness services" do not include instructional lessons such as those for self-defense, martial arts, yoga, and stress-management. Nor do these services include instructional lessons for activities such as tennis, golf, swimming, etc... "Instructional lessons" can be distinguished from "exercise classes" in that instruction in

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the activity is the primary focus in the former and exercise is the primary focus in the latter.

- (m) "Retail service" includes the sale or charge made by persons engaged in providing "amusement and recreation services" and "physical fitness services" as those terms are defined in (b) and (l) of this subsection. The term "retail service" does not include: The sale of or charge made for providing facilities where a person is merely a spectator, such as movies, concerts, sporting events, and the like; the sale of or charge made for instructional lessons, or league fees and/or entry fees; charges made for carnival rides where the customer purchases tickets at a central ticket distribution point and then the customer is subsequently able to use the purchased tickets to gain admission to an assortment of rides or attractions; or, the charge made for entry to an amusement park or theme park where the predominant activities in the area are similar to those found at carnivals.
- (n) "Significant amount" relates to the quantity or degree of goods or services rendered and made available to members by the organization. "Significant" is defined as having great value or the state of being important.
- (o) "Value of the goods or services" means the market value of similar goods or services or computed value based on costs of production.

(3) Business and occupation tax.

- (a) Retail service classification. Gross receipts from the kind of amusement, recreation, and physical fitness services defined as retail service in subsection (m) of this section are taxable under the retail service classification. Generally, admissions to actively participate in a recreational activity will be reported under the retail service classification. Persons engaged in providing these activities are also taxable under the retail service classification upon gross receipts from sales of meals, drinks, articles of clothing, or other property sold by them.
- (b) Service and other activities classification. Gross receipts from activities not defined to be retail service, such as tennis lessons, golf lessons, and other types of instructional lessons, are taxable under the service and other activities classification. Also, persons providing licenses to use real property, such as locker rentals, gym rentals, pool rentals, and instances where you have the exclusive right to use a recreational facility, are also taxable under this classification. See SR 5-530. (Sale or rental of real estate, license to use real estate).

(4) Calculating taxable income when receiving income in the form of dues and/or initiation fees.

- (a) General principles. For the purposes of the business and occupation tax, all amounts derived from initiation fees and dues must be reported as gross income which then must be apportioned between taxable and deductible income. The following general principles apply to providing amusement, recreation, and physical fitness services when income is received in the form of dues and/or initiation fees:
 - (iii) SMC 5.45.100 (B) provides for a business and occupation tax deduction for amounts derived from activities and charges of essentially a non-business nature. The scope of this statutory deduction is limited to situations where no

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business or proprietary activity (including the rendering of goods or services) is engaged in which directly generates the income claimed for deduction. Many for-profit or nonprofit entities may receive "amounts derived," as defined in this section, which consist of a mixture of tax deductible amounts (bona fide initiation fees and dues) and taxable amounts (payment for significant goods and services rendered). To distinguish between these kinds of income, the law requires that tax exemption provisions be strictly construed against the person claiming exemption. Also, SMC 5.55.060 requires the maintenance of suitable records as may be necessary to determine the amount of any tax due. The result of these statutory requirements is that all persons must keep adequate records sufficient to establish their entitlement to any claimed tax exemption or deduction.

- (iv) The law does not contemplate that the deduction provided for by SMC 5.45.100 (B) should be granted merely because the payments required to be made by members or customers are designated as "initiation fees" or "dues." The statutory deduction is not available for outright sales of tangible personal property or for providing facilities or services for a specific charge. Neither is it available if dues are in exchange for any significant amounts of goods or services rendered by the recipient thereof to members without any additional charge to the member, or if the dues are graduated upon the amount of goods or services rendered. Thus, it is only those initiation fees and dues which are paid solely and exclusively for the express privilege of belonging as a member of a club, organization, or society, which are deductible.
 - (v) In applying SMC 5.45.100 (B), no distinction is made between the kinds of clubs, organizations, associations, or other entities which may be eligible for this deduction. They may be operated for profit or nonprofit. They may be owned by the members, incorporated, or operating as a partnership, limited liability company, joint venture, sole proprietorship, or cooperative group. They may be of a charitable, fraternal, social, political, benevolent, commercial, or other nature. The availability of the deduction is determined solely by the nature of the activity or charge which generates the "amounts derived" as that term is defined in subsection (2)(a) of this section.
 - (vi) Nonprofit youth organizations, as defined in subsection (2)(k) of this section, may deduct fees or dues received from members even though the members are entitled to use the organization's facilities, including camping and recreational facilities, in return for such payments (SMC 5.45.100 (A)).
- (b) Allocation of income. Persons who derive income from initiation fees and dues may find that they have incurred business and occupation tax liability under both the retail service and service and other activities classifications. For example, an organization may furnish exercise equipment for the customer's use as well as provide lessons in martial arts to its members in return for payment of dues. The former is a retail service taxable activity while the latter is taxable under the service and other activities business tax. These taxes are at different rates. Once the income has been allocated between taxable and deductible amounts, the parts of taxable income attributable to either retail service activities or service and other activities must be reported on the combined excise tax return under the appropriate classification.

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- (c) Alternative methods of reporting. Persons who receive any "amounts derived" from initiations fees and/or dues may report their tax liabilities and determine the amount of tax reportable under different classifications (retail service or service and other activities) by use of two alternative allocation methods. The taxpayer may only change its selected allocation method annually and all changes are prospective only. These mutually exclusive methods are:
- (i) Actual records of facilities usage.
 - (A) Actual records of facilities usage may be used to allocate income. 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 charges made by a subsidized public facility.
 - (B) The actual records of facilities usage method must reflect the nature of the goods or services and the frequency of use by the membership, either from an actual tally of times used or a periodic study of the average membership use of facilities. Actual usage reporting may also be based upon a graduated or sliding fees and dues structure. For example, an organization may charge different initiation fees or dues rates for a social membership than for a playing membership. The difference between such rates is attributable to the value of the goods or services rendered. It constitutes the taxable portion of the "amounts derived" allocable to that particular activity. Because of the broad diversification of methods by which "amounts derived" may be assessed or charged to members, the actual records of usage method of reporting may vary from organization to organization.
 - (C) Organizations which provide more than one kind of "goods or services" as defined in subsection (2)(g) of this section, may provide actual records for each separate kind of goods or services rendered. Based upon this method, the total of apportioned "taxable" income may be subtracted from total gross income to derive the amount of gross income which is entitled to deduction as "bona fide initiation fees and dues" under SMC 5.45.100 (B); or
 - (ii) Cost of production method.
 - (A) The cost of production allocation method is based upon the cost of production of goods or services rendered. Persons using this method are advised to seek the department's review of the cost accounting methods applied, in order to avoid possible tax deficiency assessment if the records are audited. In such cases, the cost of production shall include all items of expense attributable to the particular goods or services made available to members, including direct and indirect overhead costs.

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- (B) No portion of assets which have been fully depreciated will be included in computing overhead costs, nor will any costs attributable to membership recruitment and advertising, or providing members with the indicia of membership (membership cards, certificates, contracts of rights, etc...) be included.
 - (C) The cost of production method is performed by multiplying gross income (all "amounts derived") by a fraction, the numerator of which is the direct and indirect costs associated with providing any specific goods or service, and the denominator of which is the organization's total operating costs. The result is the portion of "amounts derived" that is allocable to the taxable goods or services rendered. If more than one kind of goods or services is made available to members, this formula must be applied for each group of goods or services in order to determine the total of taxable and deductible amounts and to determine the amount of taxable income to report as either retail service or service and other activities. The balance of gross amounts derived is deductible as bona fide initiation fees or dues.
 - (D) Under very unique circumstances and only upon advance written request and approval, the department will consider variations of the foregoing accounting methods as well as unique factors.
 - (E) Unless income accounting and reporting are accomplished by one or a combination of methods outlined in this section, or under a unique reporting method authorized in advance by the department, it will be presumed that all "amounts derived" by any person who provides "goods or services" as defined herein, constitute taxable, nondeductible amounts.
- (5) **Admission Tax.** Persons collecting an admission charge for those recreational activities subject to the admission tax per SMC 5.40 should collect and remit the tax on the admission charge.

Effective: July 15, 2005

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DIRECTOR'S CERTIFICATION

I Kenneth J. Nakatsu, Director of the Department of Executive Administration of the City of Seattle, do hereby certify under penalty of perjury of law, that the within and foregoing is a true and correct copy as adopted by the City of Seattle, Department of Executive Administration.

DATED this 15th day of July, 2005.

CITY OF SEATTLE,
a Washington municipality

By:



Kenneth J. Nakatsu, Director
Department of Executive Administration

STATE OF WASHINGTON - KING COUNTY

--SS.

183390
CITY OF SEATTLE:Revenue &

No.

Affidavit of Publication

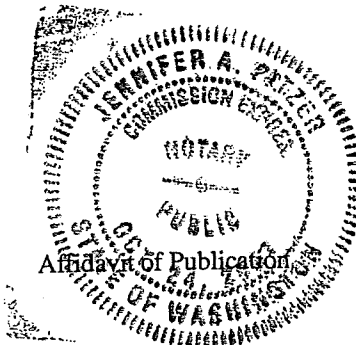
The undersigned, on oath states that he is an authorized representative of The Daily Journal of Commerce, a daily newspaper, which newspaper is a legal newspaper of general circulation and it is now and has been for more than six months prior to the date of publication hereinafter referred to, published in the English language continuously as a daily newspaper in Seattle, King County, Washington, and it is now and during all of said time was printed in an office maintained at the aforesaid place of publication of this newspaper. The Daily Journal of Commerce was on the 12th day of June, 1941, approved as a legal newspaper by the Superior Court of King County.

The notice in the exact form annexed, was published in regular issues of The Daily Journal of Commerce, which was regularly distributed to its subscribers during the below stated period. The annexed notice, a

CT:RULE MAKING HEARING

was published on

3/21/2005



M. D. J.

Subscribed and sworn to before me on

3/21/2005

Jennifer A. Zetler
Notary public for the State of Washington,
residing in Seattle

State of Washington, King County

City of Seattle

NOTICE OF PROPOSED RULE MAKING HEARING AND OPPORTUNITY TO COMMENT

The Director of Finance, acting under the authority of Seattle Municipal Code Chapters 3.02 and 5.55, proposes to adopt new rules for implementing the Seattle Business and Occupation Tax Ordinance (Seattle Municipal Code, Chapter 5.45). Please note that although these rules are applicable to SMC 5.45, the individual rules may also apply to other chapters of the City's Tax Code, including, but not limited to, SMC 5.30 (Definitions), SMC 5.32 (Revenue Code), SMC 5.40 (Admissions Tax), SMC 5.48 (Business Tax -- Utilities) and SMC 5.52 (Gambling Tax). The following rules are proposed for adoption and will become effective as of April 30, 2005:

Seattle Rule 5-006 -- Tax Returns -- Filing and Payment

Seattle Rule 5-007 -- Penalties

Seattle Rule 5-031 -- Measure of Tax -- Retailers and Wholesalers

Seattle Rule 5-032 -- Measure of Tax -- Service and other business activities

Seattle Rule 5-035 -- Freight and Delivery Charges

Seattle Rule 5-040 -- Corporations, Massachusetts trusts

Seattle Rule 5-043 -- Engaging in Business

Seattle Rule 5-063 -- Returned goods, allowances, cash discounts

Seattle Rule 5-100 -- Extracting natural products

Seattle Rule 5-112 -- Commercial or industrial use

Seattle Rule 5-127 -- Sales to and by the State of Washington, counties, cities, school districts, and municipal subdivisions

Seattle Rule 5-130 -- Selling price -- Advertised prices including sales tax

Seattle Rule 5-131 -- Trade-ins, selling price, sellers' tax measures

Seattle Rule 5-132 -- Leased departments

Seattle Rule 5-133 -- Warranties and maintenance agreements

Seattle Rule 5-702 -- Coin operated vending machines, amusement devices and service machines

Seattle Rule 5-404 -- Sales of meals

Seattle Rule 5-405 -- Restaurants, cocktail bars, taverns and similar businesses

Seattle Rule 5-481 -- Motor carriers -- Trucking

Seattle Rule 5-523 -- Sales of precious metal bullion and monetized bullion

Seattle Rule 5-530 -- Sale or rental of real estate, license to use real estate

Seattle Rule 5-531 -- Sales of real property, standing timber, minerals, natural resources

Seattle Rule 5-532 -- Real estate brokers and salesman

Seattle Rule 5-600 -- Educational institutions, school districts, student organizations, and private schools

Seattle Rule 5-700 -- Amusement, Recreation, and Physical Fitness Services

Seattle Rule 5-720 -- Hotels, motels, boarding houses, rooming houses, resorts, summer camps, trailer camps, etc.

Seattle Rule 5-803 -- Consignees, bailees, factors, agents, and auctioneers

Seattle Rule 5-806 -- Advertising agencies

Seattle Rule 5-807 -- Outdoor advertising and advertising display services

PUBLIC HEARING AND COMMENT:
The Department of Executive Administration has scheduled a public hearing on the proposed rule changes for 1:00 p.m. to 3:00 p.m., on Monday, April 4, 2005. The hearing will be held in a conference room on the 40th floor of the Seattle Municipal Tower, Suite 4096, located at 700 5th Avenue. All interested persons are invited to present data, views, or arguments, with regard to the proposed rules, orally at the hearing, or in writing at or before the hearing.

Written comments should be mailed or delivered to:

Department of Executive Administration,
Attn.: Mel McDonald,
Director, Revenue and Consumer
Affairs, 700 5th Avenue - Suite 4250,
Seattle, Washington 98104-5020.

The public may inspect copies of the proposed rules at the Revenue and Consumer Affairs offices, 700 5th Avenue, Suite 4200. If you would like a copy of the proposed rules, please call (206) 684-8300, FAX (206) 684-5170, email rca.bizlict@ci.seattle.wa.us, or submit a written request to the address above.

Dated: March 21, 2005.

DWIGHT D. DIVELY,

Director, Department of Finance.

Date of publication in the Seattle Daily Journal of Commerce, March 21, 2005.

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