

Seattle Rule 5-066

Non-business income - Grants - Bona fide initiation fees, dues, contributions, tuition fees and endowment funds.

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(1) Introduction. SMC 5.45.100 B provides a business license tax deduction for amounts derived from activities and charges of essentially a non-business nature. Thus, outright gifts, donations, contributions, endowments, tuition, and initiation fees and dues which do not entitle the payor to receive any significant goods or services in return for the payment are not subject to the business license tax. The scope of this statutory deduction is limited to situations where no 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 rule, 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). For purposes of distinguishing between these kinds of income, the law requires that tax exemption provisions must 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 legal requirements is that all persons must keep adequate records sufficient to establish their entitlement to any claimed tax exemption or deduction.

Persons providing amusement, recreation, and physical fitness services should also refer to Rule 5-700 (Amusement, recreation, and physical fitness services).

(2) Contributions, Donations, and Endowments. SMC 5.45.100 B provides in part: "In computing tax, there may be deducted from the measure of tax amounts derived from . . . (3) contributions; (4) donations; . . . and (8) endowment funds. Only amounts which are received as outright gifts are entitled to deduction. Any amounts, however designated, which are received in return for any goods, services, or business benefits are subject to business license tax under the appropriate classification depending upon the nature of the goods, services, or benefits provided. SMC 5.45.100 F provides for a specific deduction for compensation from public entities for health or social welfare services. Bona fide contributions, donations, and endowments may be taken as a deduction in computing the business license tax.

(3) Grants received by nonprofit organizations from governmental entities or other nonprofit organizations. Though "grants," which may be referred to as "gifts" or "awards," are not specifically included as a deduction in SMC 5.45.100 B, the Director will presume that a grant consisting of an award of money, good, property or service is a bona fide "contribution," "donation," or "endowment" within the scope and spirit of the deduction intended by the City Council when: (1) the grantor receives no significant good, services, or benefits in return for making the grant; (2) the grantor is a governmental entity; (3) the grants are used exclusively to promote, advance, or fulfill charitable purposes such as food, shelter, medical services, or job training for the poor and needy, including the administrative expenses related to the charitable purposes, within the meaning of section 501(c)(3) of the Internal Revenue Code and the regulations and case law administering and interpreting that section; or (4) the grants are given with limited guidelines or requirements as to how the money is to be used, and are not governed by specific instructions similar to language contained in a "contract for services."

It is not unusual for the person making a gift, whether by contribution, donation, grant, or endowment, to require some accountability for how the gift is used as a condition of receiving the gift or future gifts. This "accountability" can take the form of conditions or restrictions on the use of the gift or grant for specific charitable purposes or can take the form of certain written reports. Financial reports which simply indicate by category how the funds were used are an example of an "accountability report." Reports which discuss the nature of the project performed are also considered to be "accountability reports." General requirements to expend grant funds in a certain way or to provide written reports will not be solely used to determine whether a taxable service was performed. Grants in which the grantor receives public acknowledgement of the grant or gift are not taxable simply by reason of acknowledgment or the gift. The preceding accountability reports or similar reports required by the grantor does not constitute a service or good received by the grantor nor make the grant taxable.

In the few instances when governmental agencies or others provide grants to nonprofits with specific services required, or for specific tangible personal property, or for altering or constructing real property, or similar activities, such moneys will generally be viewed as a contract for services and taxable even though the nonprofit is not directly the benefactor.

(4) Grants to for-profit organizations. Generally, money's received by for-profit organizations from non-profit organizations or governmental agencies are not considered grants since a report or study is usually required by the grantor and

such report or study constitutes a significant good or service. However, if the for-profit can show that the money received was in fact a donation, gift, or endowment, then the amount will be deductible.

(5) Bona fide Initiation fees and dues. The law does not contemplate that the business license tax deduction should be granted merely because the payments required to be made by members or customers are designated as "initiation fees" or "dues." The statutory deduction is not available for outright sales of tangible personal property or for providing facilities or services for a specific charge. Neither is it available if dues are in exchange for any significant amounts of goods or services rendered by the recipient thereof to members without any additional charge to the member, or if the dues are graduated upon the amount of goods or services rendered (SMC 5.45.100 B). Thus, it is only those initiation fees and dues which are paid for the express privilege of belonging as a member of a club, organization, or society, which are deductible.

Also, the statute does not distinguish 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, joint venture, sole proprietorship, or cooperative group. They may be of a charitable, fraternal, social, political, benevolent, commercial, or other nature. However, none of these characteristics determines the entitlement to tax deduction. The availability of the deduction is determined solely by the nature of the activity or charge which generates the "amounts derived" as defined in this rule.

(6) Definitions. For purposes of this rule the following definitions will apply:

(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 RCW 82.04.070 and 82.04.080, respectively. It shall also include income attributable to bona fide initiation fees and bona fide dues.

(b) "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 to qualify other income denominated as "dues" to be deductible. The reasonableness of any additional charge will be based on one of the following two criteria: (1) It must cover all costs reasonably related to furnishing the goods or services, or (2) it must compare with charges made for similar goods or services by other commercial businesses.

(c) "Bona fide" shall have its common dictionary meaning, i.e., in good faith, authentic, genuine.

(d) "Dues" are those amounts paid solely for the privilege or right of retaining membership in a club or similar organization. "Bona fide dues" within the context of this rule shall include only those amounts periodically paid by members which genuinely entitle 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.

(e) "Goods or services rendered" 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.

(f) "Initiation fees" are those initial amounts which are paid solely to 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.

(g) "Nonprofit tax-exempt organization" means an organization, corporation, or association in which no part of the income can be distribute to its members, directors, or officers and is currently recognized by the United States of America as exempt from federal income taxation pursuant to Section 501(c)(1), (3), (4), or (6) of the Internal Revenue Code of 1954, 26 U.S.C. section 501, as now existing or hereafter amended. (Also see SMC 5.30.040).

(h) "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 important meaning or the quality of being important.

(i) "Value of such goods or services" shall mean the market value of similar goods or services or computed value based on costs of production.

(7) Methods of Reporting.

(a) Persons who receive any "amounts derived" from initiations fees and/or dues may report their tax liabilities and determine the amount of tax reportable under different classifications (retailing or service) by use of the following methods:

(i) Actual records method; or,

(ii) Cost of production of facilities and benefits.

Refer to Seattle Rule 5-700 (4) for instructions on how to calculate taxable income from dues and initiation fees under the actual records method or cost of production of facilities and benefits method.

(b) 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 additional factors shown to be unique to certain kinds of organizations.

(c) Unless income accounting and reporting are accomplished by one or a combination of methods outlined in this rule, 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.

(8) Nonprofit tax-exempt youth organizations. Nonprofit tax-exempt youth organizations which, as such, are exempt from property tax under RCW 84.36.030 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. (See SMC 5.45.100 A.)

(9) Tuition fees. The term "tuition fees" refers to fees charged by educational institutions, and, in addition to instruction fees, includes library, laboratory, health and other special fees and amounts charged for room and board when the property or service for which such charges are made is furnished exclusively to the students or faculty of such institutions. Refer to Seattle Rule 5-600 for the reporting or deductibility of tuition fees.

(10) Selling of tangible personal property. The right to deduct bona fide initiation fees, dues, contributions, donations, tuition fees and endowment funds does not exempt any person, association or society from tax liability upon selling tangible personal property or upon providing facilities or services for which a special charge is made to members or others. However, agencies or institutions of the state of Washington, such as the University of Washington and community colleges are exempt from payment of the business license tax.

Effective: January, 2009.

DIRECTOR'S CERTIFICATION

I, Dwight Dively, Finance Director 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 _____ day of January, 2009

CITY OF SEATTLE,

a Washington municipality

By: _____

Dwight Dively, Director

Finance Department

Jan 23, 2009