STATE OF WISCONSIN

TAX APPEALS COMMISSION

MINOCQUA COUNTRY CLUB, INC.,	**DOCKET NOS. 05-I-202 AND 05-S-203**
Petitioner,	
vs.	**RULING AND ORDER**
WISCONSIN DEPARTMENT OF REVENUE	**(CORRECTED COPY)**
Respondent.	

DAVID C. SWANSON, COMMISSIONER:

This matter comes before the Commission on cross-motions for summary judgment filed by petitioner and respondent. Petitioner, Minocqua Country Club, Inc., a Wisconsin corporation ("MCC"), appears by Attorneys John R. Austin, Kristina E. Somers and Don M. Millis of Reinhart Boerner Van Deuren S.C. Respondent, Wisconsin Department of Revenue (the "Department"), appears by Attorney Linda M. Mintener. The Department has submitted a brief and affidavits with exhibits and a reply brief with supplemental affidavits and exhibits in support of its motion and in opposition to MCC's cross-motion. MCC has submitted a brief and affidavits with exhibits and a reply brief with supplemental affidavits and exhibits in support of its cross-motion and in opposition to the Department's motion.[1]

[1] The parties both submitted substantial briefs with a number of exhibits in these matters. In this opinion, we discuss only those arguments that were determinative in reaching our decision and do not attempt to cover every argument raised in the Department's initial brief (33 pages), its reply brief (76 pages), MCC's initial brief (65 pages), and its reply brief (70 pages).

Having considered the entire record before it, the Commission finds, concludes, rules and orders as follows:

JURISDICTIONAL AND MATERIAL FACTS

MCC and its Operations

1. MCC is organized as a business corporation under Chapter 180 of the Wisconsin Statutes.

2. MCC's tax year is from April 1 to March 31. The period under review began on April 1, 1998 and ended March 31, 2002 (the "years at issue" or "period at issue"). (Affidavit of Linda M. Mintener dated July 11, 2006 ("Mintener Aff."), Exs. 1 at 2, 2 at 3.)

3. MCC is a private country club that owns and operates an 18-hole golf course. The use of MCC's facilities is limited to its members, their guests and invitees. (Affidavit of Peter Nomm ("Nomm Aff."), ¶¶ 2, 4.)

4. Golf facilities offered by MCC to its members, their guests and other invitees both before and during the period under review include the golf course, a driving range, a practice green, and a pro shop. During the period under review, MCC added a chipping range. (Nomm Aff. ¶¶ 5-6.)

5. In addition to its golf facilities, MCC offered a range of social and recreational facilities and amenities to its members, their guests and other invitees, before, during and subsequent to the period under review, including tennis courts, a private dock and beach on Lake Minocqua, a dining room and bar, and rooms for members to host parties and other social gatherings. (Nomm Aff. ¶ 5.)

6. Up until 2001, MCC also provided cottages for short-term stays. (Nomm Aff. ¶ 6.)

7. Non-golf programs offered by MCC before, during and subsequent to the period under review included social events, and bridge leagues and tournaments. (Nomm Aff. ¶ 7.)

8. In the late 1990's, MCC had fewer than 100 members. MCC concluded that in order to remain viable, it had to attract more members and determined that its existing nine-hole golf course was an obstacle to growth. (Nomm Aff. ¶¶ 10-11.)

9. In addition to the limitations of a nine-hole course, the condition of the existing golf course was substandard. In order to attract more members, MCC concluded that much of the existing nine-hole golf course had to be renovated, the course had to be expanded to an 18-hole course, and the clubhouse had to be updated. MCC concluded that these plans were necessary to ensure the long-term financial viability of MCC. (Nomm Aff. ¶ 12.)

The Project and the Deposits

10. On July 1, 1998, MCC's shareholders authorized a renovation and expansion project in which: (1) the old nine-hole course would be replaced by a new 18-hole course; (2) the driving range and practice green would be reconstructed; (3) a new chipping range, golf cart storage facility and pro shop would be built; and (4) the clubhouse office, clubhouse restrooms and parking lot would be expanded (collectively, the "Project"). (Affidavit of Thomas Baker dated January 31, 2007 ("Baker Aff.") ¶ 4;

Mintener Aff., Ex. 8 at D4.01.)

11. The Project plans were contingent upon MCC raising $2 million to finance the Project. In an effort to raise this $2 million, MCC asked its members to make deposits that were refundable in certain circumstances (hereinafter, the "deposits"). (Baker Aff. ¶ 6.)

12. Each member was required to sign a document entitled "Pledge for Membership Deposit for Membership in the Minocqua Country Club" (the "Pledge Agreement"), which stated that the pledges were irrevocable and that a member who failed to pay his/her pledge or make a deposit would be terminated as a member and his/her shares of stock surrendered. (Affidavit of Connie Pownell dated June 28, 2006 ("Pownell Aff."), Ex. 9 & 11).

13. The Pledge Agreement stated as follows: "**Pledge Not An Investment**. The Deposit payment made pursuant to this Pledge is not intended for nor made as an investment." (Pownell Aff., Ex. 9 § IV.D (2002 version) & 11 § V.E (1999 version)) (emphasis in originals).

14. Social members are those members who enjoy all privileges of MCC facilities other than regular use of the golf course. Social members were asked to make deposits of $2,000 each. (Baker Aff. ¶ 8.) If not paid, the social member lost his/her rights to a continuing MCC social membership and lost any rights to use MCC's non-golfing facilities. (Mintener Aff., Ex. 8, D7.01.)

15. Regular members of MCC—sometimes referred to as golfing members—are members who enjoy all privileges of MCC facilities including use of the

golf course. Regular members were also asked to make deposits. The amount of this deposit varied during the period under review as follows: (a) for regular members electing to make or pledge to make deposits in 1998, the regular member deposit amount was $10,000; (b) at the beginning of 1999, the regular member deposit amount remained $10,000, but later that year was increased to $12,500 and then to $15,000; (c) at the beginning of 2000, the regular member deposit amount was set by the MCC Board of Directors at $17,500, but was increased later that year to $20,000 and then to $25,000; (d) at the beginning of 2001, the regular member deposit amount continued at $25,000, but was reduced to $20,000 later that year, where it remained for the duration of the period under review. (Baker Aff. ¶ 9.)

16. All of the deposits received by MCC were held in separate, segregated accounts (one account for deposits from social members, one for deposits from regular members). (Baker Aff. ¶¶ 13-15.) The deposit accounts were entitled the "Golf Course Expansion Account" and the "Club House Renovation Account," and were subsequently renamed "Member Deposits—Golf Course" and "Member Deposits—Club House." (Pets. for Rev. ¶ 5(d); Mintener Aff. ¶ 10).

17. By virtue of the agreements signed by MCC and the persons making deposits, the use of these funds was restricted. For money collected from regular members, the funds could be used only for capital improvements related to the renovation and expansion of the golf course, clubhouse and related facilities. The agreements with respect to deposits by social members limited the use of those funds to capital improvements related to the clubhouse. (Baker Aff. ¶¶ 12-13.)

18. To become a new member, an individual had to make the required deposit/pledge as well as other required payments, such as for dues and purchase of stock and additional equity. (Mintener Aff., Ex. 11, D6.13, § V.D.; Ex. 8, D7.01-7.02; Pownell Aff. ¶ 5e.)

19. If an existing regular member did not sign a pledge agreement or make a deposit in accordance with his/her agreement, he/she could not continue as a regular member of MCC and lost continuing rights to use the golf course and other MCC facilities. (Mintener Aff., Ex. 11, D6.13, § V.D.; Ex. 8, D7.01-7.02; Pownell Aff. ¶ 5e.)

20. The pledges had to be paid at the time of MCC's call, either in full or over a three-year period with interest. (Mintener Aff., Ex. 8, D7.02.)

21. All of the deposits were used for capital improvement projects related to the Project and consistent with the limitations contained in the agreements between MCC and the individuals who made deposits. (Baker Aff. ¶¶ 14-15.)

22. MCC intended to refund all deposits if it failed to raise $2 million in deposits by June 30, 1999. (Baker Aff. ¶16.)

23. MCC succeeded in raising $2 million for the Project in late 1998. Construction on the new golf course began in 1999, and MCC opened the new golf course in 2001. (Mintener Aff., Ex. 8, D4.01, D5.03-5.04, D7.01-7.02.)

24. Persons making deposits had the ability to obtain refunds in the event of death, permanent disability or termination of membership in MCC. The amount of the refund was set at 80% of the refund amount then in effect when the

death, disability or termination occurred. For example, for a person who contributed $10,000 in 1998, upon resignation from MCC in 2001 when the deposit was set at $20,000, the refund amount would have been $16,000 (i.e., 80% of $20,000). (Baker Aff. ¶17.)

25. The refund calculation was designed to encourage persons to make deposits, since it was contemplated that the deposit amount would increase over time. (Baker Aff. ¶18.)

26. Pursuant to the Pledge Agreement, refunds of deposits would be paid only at the discretion of MCC's Board of Directors. (Pownell Aff., Ex. 9 & 11.)

27. Pursuant to the Pledge Agreement, the right to receive the refund of a deposit was not transferable. (Pownell Aff., Ex. 9 & 11.)

28. The timing of the payment of the refunds depended on a number of factors, including the number of members in the class of the member seeking a refund and the state of MCC's finances. However, for those refunds that were paid during and after the period under review, MCC waived the provisions relating to the timing of refunds. (Baker Aff. ¶¶ 19-21.)

29. Members of MCC who elected not to make deposits could continue their memberships as sustaining members for a limited time. (Baker Aff. ¶¶ 34, 35.) Dues for sustaining social members were 20% higher than other social members and dues for sustaining regular members were 20% higher than dues for other regular members. The length of time that a member could be a sustaining member was equal to the number of years the person was a member in good standing prior to July 1, 1998.

(Baker Aff. ¶ 35.)

30. During the period under review, there were as many as 83 sustaining memberships. (Baker Aff. ¶ 51.)

31. Sustaining members could use the facilities in the same manner as other members. Thus, a sustaining regular member had the same right to use the golf course as regular members who elected to make a deposit. Likewise, a sustaining social member had the same right to use MCC facilities as any social member who elected to make a deposit. (Baker Aff. ¶ 35.)

32. MCC raised its operational revenues through various dues requirements and other charges. (Baker Aff. ¶ 37.)

33. All members, other than honorary members, were required to pay annual dues. (Baker Aff. ¶¶ 11, 37.)

34. The level of dues depended in part upon the type of membership. Regular members paid more than social members. Sustaining regular members and sustaining social members paid more than other regular members and social members, respectively. (Baker Aff. ¶ 38.)

35. The level of dues also varied based on other factors. For example, a family membership cost more than a single membership. (Baker Aff. ¶ 39.)

36. All members, except honorary members, were required to make a minimum amount of purchases from MCC. In some years the annual minimum charge applied only to food and non-alcoholic beverages. In other years, the annual minimum charge also applied to alcoholic beverages. (Baker Aff. ¶ 40.)

37. Making a deposit alone did not allow a person to become a member of MCC or have access to MCC's facilities, including the golf course. (For example, one individual made a deposit of $12,500, but never paid dues. That person did not become a member and was not allowed to use MCC's facilities, including its golf course.) (Baker Aff. ¶ 11.)

38. There was no relationship between the amount of a member's deposit and the level of that member's use of MCC's facilities, including the golf course. Unlike dues, which differed somewhat based on potential use (e.g., family memberships with more potential users cost more than single memberships), there was no such distinction when it came to deposits. (Baker Aff. ¶ 10.)

39. During the period under review, a number of classes of people were allowed to use the MCC golf course who were not required to pay a deposit, including: (a) sustaining members; (b) social members from 1999 to 2000 (could use the golf course once per month); (c) social members in 2001 and after (could use the course as the guest of a regular member); (d) children of regular members under age 25 residing at home who were full-time students or in the military; (e) grandchildren under age 16 of regular members; (f) out-of-town guests of regular members (prior to the Project, for up to four weeks in any 12-month period, with some limitations); (g) local guests of regular members (prior to the Project); (h) beginning in 2001, guests of regular members (up to four times per year without regard to where the guest lived and worked and whether the guest was accompanied by the regular member); (i) prospective members (at the discretion of the MCC professional or any member of the

membership committee); (j) visiting professionals and others (with the permission of the MCC professional or manager); (k) competitors in tournaments held at the MCC golf course; (l) honorary members; (m) persons who had won or purchased gift certificates for rounds of golf at MCC as part of fundraising events for local charities and groups; (n) participants in fundraising outings at the MCC golf course; and (o) in 2001 and 2002, members of Plum Lake Golf Club in Sayner, Wisconsin (in recognition of the decision by Plum Lake Golf Club to allow MCC members to golf at Plum Lake during the Project's construction). (Nomm Aff. ¶ 16.)

40. Of the 10,500 to 11,000 18-hole rounds played on the MCC golf course annually following the Project, about 35% of the rounds were played by persons who did not make a deposit. (Nomm Aff. ¶ 16.)

41. After the Project was completed, MCC's finances improved considerably. Regular and social membership nearly doubled from 1998 to 2001. (Baker Aff. ¶¶ 49, 51.)

42. Because of enhancements to the facilities, the level of dues MCC could charge increased considerably. For example, the dues for a full family membership increased by 61% from 1998 to 2001 and dues for a single membership increased by nearly 68% during the same period. (Baker Aff. Ex. A.)

43. As a result of the Project, the value of MCC's assets increased substantially. (Baker Aff. ¶ 50.)

MCC Stock

44. Prior to and during the period under review, members of MCC generally were required to own 10 shares of MCC stock, which sold for $100 per share. The stock ownership requirement applied to all membership classes, except honorary members and associate members. (Baker Aff. ¶¶ 25-26.)

45. Those who elected to become members of MCC during the period under review and make deposits were required to purchase 10 shares of stock. For those who were already members prior to the period under review and who elected to make deposits, there was no need to purchase additional shares of stock. (Baker Aff. ¶ 30.)

46. Those who elected to become members of MCC during the period under review and purchase stock also were required to make deposits and to execute a document entitled "Stock Ownership and Redemption Agreement" (the "Stock Agreement"). The Stock Agreement provided that a signing member of MCC was required to tender his or her shares of MCC to the corporation upon the termination of his or her membership or failure to pay the deposit required pursuant to the Pledge Agreement. The corporation was required to redeem the shares at par value ($100 per share). (Pownell Aff. Ex. 10.)

47. While MCC does not regularly pay dividends to its shareholders, it has the power to do so. (Baker Aff. ¶ 31.)

Income/Franchise Tax

48. On its Wisconsin franchise tax returns for the years at issue, MCC reported the receipt of the deposits as contributions to capital and excluded these amounts from gross income under Section 118 of the Internal Revenue Code of 1986, as amended (the "IRC"). (Baker Aff. ¶ 13.)

49. The Department included the amounts in MCC's account entitled "Golf Course Expansion Account/Member Deposits—Golf Course" in MCC's gross income for purposes of calculating MCC's income/franchise tax. The amount that the Department included in MCC's gross income included MCC's receipts from the special assessments, pledges, and deposits from both its golfing members and social members. (Ex. 2, Explanations of Adjustments on Exhibit C.) The Department did not include in MCC's gross income the amounts MCC received for purchases of stock or additional equity, or any amounts allocated thereto. (Mintener Aff., Ex. 8, A1.04, A13, A9.01).

50. Under the date of October 22, 2003, the Department issued a franchise tax assessment against MCC in the total amount of $229,121.18, including interest calculated to December 21, 2003. (Mintener Aff. ¶2, Ex. 2.)

51. MCC filed a timely petition for redetermination objecting to the franchise tax assessment. (Mintener Aff. ¶3, Ex. 4.)

52. By Notice of Action dated November 4, 2005, the Department denied MCC's petition for redetermination of the franchise tax assessment. (Mintener Aff. ¶4, Ex. 6.)

53. On December 2, 2005, MCC filed a timely petition for review with

the Commission appealing the Department's action on the petition for redetermination of the franchise tax assessment (Commission Docket Number 05-I-202).

Sales Tax

54. MCC reported and paid sales tax during the period under review on the following items: (a) dues paid by all members, including social members; (b) sales of food and beverages (including sales associated with members' annual minimum charges); and (c) fees paid for the use of MCC facilities and staff, such as guest fees for the golf course, golf cart rental and private lessons. (Baker Aff. ¶ 44.)

55. MCC did not report or pay sales tax on the deposits and proceeds from sales of shares of stock. (MCC Br. at 14.)

56. In its audit report, the Department added the deposits and proceeds from stock sales from all regular—but not social—members to the sales tax base. In addition, the Department deducted from the sales tax base the dues paid by social members. (MCC Br. at 14; Mintener Aff., Ex. 1 at 7 (Ex. C. Explanations).) The Department did not include in MCC's taxable gross receipts or assess any sales tax on the monies from the pledges/deposits that MCC received from its social members for renovation of MCC's clubhouse because social members did not have access to the recreational facilities of MCC's golf course. (Mintener Aff., Ex. 11 at 1, ¶ 3C; Ex. 8, A1.04, A9.01, A13; Pownell Aff. ¶¶ 5a, c).[2]

57. The Department included the monies that MCC received from its

[2] The Department has since reconsidered that position and now believes that deduction should not have been allowed because social members did have some access to the golf course. (Dept. Reply Brief at 11-12.)

golfing members' pledge/deposits in MCC's gross receipts and assessed sales tax on them pursuant to Wis. Stat. § 77.52(2)(a)2. (Mintener Aff., Ex. 1, Schedule 2, "Member Deposits/Pledges").

58. The Department, in each year of the audit period, assessed a 25% negligence penalty in the total amount of $40,495.44, pursuant to Wis. Stat. § 77.60(3). The Department assessed the penalty on the sales tax due of $161,981.72 on an additional sales tax measure of $2,945,122.15, and did not assess any penalty on the use tax assessed or on any portion of the income/franchise tax. (Mintener Aff., Ex. 1, Ex. A-B, Ex. AB-1; Ex. 8, A1.02, ¶ 9, A4; Pownell Aff. ¶ 5a, c.)

59. The Department assessed the penalty on the sales tax deficiency based on its determination that the main portion of the sales tax assessment was for the pledges/deposits and other payments the golfing members were required to make to have use of MCC's golf course and that the taxation of such charges is not a gray area of the law and is supported by Wisconsin case law. (Dept. Brief at 8.)

60. Under date of October 12, 2003, the Department issued a sales and use tax assessment against MCC in the total amount of $331,828.69, including interest calculated to December 11, 2003 and a 25% negligence penalty in the amount of $40,495.44. (Mintener Aff. ¶2, Ex. 1.)

61. MCC filed a timely petition for redetermination objecting to the sales and use tax assessment. (Mintener Aff. ¶3, Ex. 3.)

62. By Notice of Action dated November 4, 2005, the Department denied MCC's petition for redetermination of the sales tax assessment. (Mintener Aff.

¶4, Ex. 5.)

63. On December 2, 2005, MCC filed a timely petition for review with the Commission appealing the Department's action on the petition for redetermination of the sales/use tax assessment (Commission Docket Number 05-S-203).

64. The Department filed answers to both petitions for review on December 22, 2005, (Mintener Aff. ¶ 6), and the Commission consolidated these matters for further proceedings.

CONCLUSIONS OF LAW

1. There are no genuine issues of material fact in dispute in either matter, and these matters are appropriate for summary judgment as a matter of law.

2. The deposits paid to MCC during the period under review did not qualify as contributions to capital under IRC § 118, and thus were includable in MCC's gross income for purposes of calculating its franchise tax under Chapter 71 of the Wisconsin Statutes.

3. The deposits paid to MCC by its members during the period under review constituted receipts that were subject to sales tax under Wis. Stat. § 77.52.

4. The Department properly assessed MCC an additional 25% negligence penalty on its sales tax underpayment pursuant to Wis. Stat. § 77.60(3).

RULING

Summary Judgment

Summary judgment is warranted where "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any,

show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Wis. Stat. § 802.08(2). In these cases, the parties do not dispute any material facts; rather, they differ as to the interpretation of those facts and the legal conclusions to be drawn from the facts. Both parties have moved for summary judgment in both matters, and these matters are appropriate for summary judgment as a matter of law.

Standard of Review

Assessments made by the Department are presumed to be correct, and the burden is on the petitioner to prove by clear and satisfactory evidence in what respects the Department erred in its determination. *Edwin J. Puissant, Jr. v. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶ 202-401 (WTAC 1984); Wis. Stat. § 77.59(1). However, where there is ambiguity and doubt in the statute imposing a tax, any such ambiguity and doubt is to be resolved against the party that seeks to impose the tax. *Kearney & Trecker Corp. v. Dep't of Revenue*, 91 Wis. 2d 746, 753, 284 N.W.2d 61 (1979).

The Department asserts that the deposits paid to MCC by its members during the years at issue were includable in MCC's gross income for purposes of calculating its Wisconsin franchise tax, and also constituted receipts subject to sales tax under Wis. Stat. § 77.52. MCC argues that these payments were instead capital contributions under IRC § 118 and thus not includable in its gross income, and also that they were not receipts subject to Wisconsin sales tax. Both parties have moved for summary judgment, and, under the applicable standard of review for these motions, each party has the burden of proof with respect to its own motion.

Rules of Statutory Construction

When interpreting a statute, we assume that the legislature's intent is expressed in the statutory language. Statutory interpretation "begins with the language of the statute. If the meaning of the statute is plain, we ordinarily stop the inquiry." *State ex rel. Kalal v. Circuit Court*, 271 Wis. 2d 633, 663, 681 N.W.2d 110 (2004). "Statutory language is given its common, ordinary, and accepted meaning, except that technical or specially-defined words or phrases are given their technical or special definitional meaning." *Id*. Context and structure are also important factors, and construction should strive to avoid absurd or unreasonable results. "If this process of analysis yields a plain, clear statutory meaning, then there is no ambiguity, and the statute is applied according to this ascertainment of its meaning." *Id*.

The Income/Franchise Tax Assessment (Docket No. 05-I-202)

The primary issue in Docket Number 05-I-202 is the proper characterization of the deposits for Wisconsin income/franchise tax purposes. MCC argues that these payments were capital contributions made by the members to MCC and were thus properly excluded from MCC's gross income under IRC § 118. The Department claims that the deposits were not contributions to capital, but were instead includable in MCC's gross income.

Wisconsin federalized its income/franchise tax in 1987, and both sides agree that Wisconsin follows federal law on this issue. Apart from the issue of the characterization of the deposits, the remaining adjustments made by the Department

generally are not at issue.[3] Consequently, this matter turns on a single legal issue, which is whether the deposits qualified as contributions to capital under IRC § 118.

1. IRC § 118 and Treas. Reg. § 1.118-1

IRC § 118 excludes capital contributions from gross income as follows:

> CONTRIBUTIONS TO THE CAPITAL OF A CORPORATION
> 118(a) GENERAL RULE. --In the case of a corporation, gross income does not include any contribution to the capital of the taxpayer.
> 118(b) CONTRIBUTIONS IN AID OF CONSTRUCTION ETC. --For purposes of subsection (a), except as provided in subsection (c), the term "contribution to the capital of the taxpayer" does not include any contribution in aid of construction or any other contribution as a customer or potential customer.[4]

The Regulations interpreting IRC § 118 provide the following additional relevant guidance:

> Final Reg. §1.118-1 Contributions to the capital of a corporation. --In the case of a corporation, section 118 provides an exclusion from gross income with respect to any contribution of money or property to the capital of the taxpayer. Thus, if a corporation requires additional funds for conducting its business and obtains such funds through voluntary pro rata payments by its shareholders, the amounts so received being credited to its surplus account or to a special account, such amounts do not constitute income, although there is no increase in the outstanding shares of stock of the corporation. In such a case the payments are in the nature of assessments upon, and represent an additional

[3] MCC's primary objection to the franchise tax assessment is the Department's characterization of the deposits, but resolution of this issue may implicate other adjustments in the franchise tax audit, including carryover of net operating loss, the recycling surcharge and underpayment interest. MCC agrees with the Department that because these secondary issues flow from resolution of the primary issue (i.e., characterization of the deposits), the Commission need not specifically address these items, and thus we do not address those issues herein. (MCC Br. at 13-14; Dept. Br. at 31-32.)

[4] Subsection (c) relates only to water and sewerage disposal facilities, which are not at issue here.

> price paid for, the shares of stock held by the individual shareholders, and will be treated as an addition to and as a part of the operating capital of the company. . . . However, the exclusion does not apply to any money or property transferred to the corporation in consideration for goods or services rendered, or to subsidies paid for the purpose of inducing the taxpayer to limit production. . . .

Treas. Reg. § 1.118-1.

MCC's argument that the deposits were contributions to capital has some initial appeal, because the members who made these payments were paying for improvements to MCC's facilities. In that sense, they were funding certain capital expenditures of MCC and ensuring its future as a going concern. However, MCC cannot overcome the limitations that IRC § 118 imposes on the exclusion it provides.

IRC § 118(b) states that "the term 'contribution to the capital of the taxpayer' does not include any contribution in aid of construction . . . ." The deposits fail this test. There is no dispute that the deposits were made to finance construction of the Project. Under § 118(b), payments made "in aid of construction" cannot be capital contributions, and we must assume that the statute means what it says.[5] MCC correctly notes that neither IRC § 118 nor the Regulations provide detailed guidance regarding when a payment is a "taxable 'contribution in aid of construction,'" (MCC Br. at 20), but that does not mean we can ignore the language of the statute itself, which is quite clear.

[5] IRC Section 118(b) was amended in 1986 to end the treatment as capital contributions of payments made in aid of construction to regulated public utilities. Committee Reports on P.L. 99-514 (Tax Reform Act of 1986). This restriction on contributions of capital to regulated public utilities was eased in 1996 when the current IRC § 118(c) was added to provide an exception to § 118(b) for certain types of contributions of capital to such utilities in aid of construction of water and sewerage disposal facilities. However, the IRC provides no exception to § 118(b) for contributions in aid of construction for other types of organizations or facilities.

The Regulations under IRC § 118 also indicate that MCC's deposits do not qualify as capital contributions. First, Regulation § 1.118-1 states that such contributions must be "voluntary pro rata payments" made by the shareholders. Here, assuming *arguendo* that the payments were voluntary, there is no evidence at all that they were made pro rata. In this sense, "pro rata" means made by the shareholders according to the number of shares each owns. There is no indication that the amount of the deposit required from each shareholder correlated in any way with the number of shares owned. Rather, in setting the amount of the deposits required, MCC's focus was entirely on the type of membership purchased, not on the number of shares.[6]

IRC § 118(b) further provides that "any other contribution as a customer or potential customer" cannot be a capital contribution. The Regulations explain that "the exclusion [from income] does not apply to any money or property transferred to the corporation in consideration for goods or services rendered . . . ." Treas. Reg. § 1.118-1. The members of MCC are also its customers. There is no dispute that they regularly pay MCC for goods and services, and that the dues and most other amounts they pay to MCC are subject to Wisconsin sales tax. Both golfing and social members received improved services from MCC in exchange for their deposits. Golfing members obtained the use of an 18-hole golf course (as opposed to a nine-hole course), and social members received the use of an improved clubhouse and related facilities. This exchange of consideration for services rendered appears to prevent the characterization

[6] Whether and how much the deposits increased the members' basis in their shares of MCC is unstated, but some relationship appears to be required under the Regulations. Treas. Reg. § 1.118-1 (capital contributions "are in the nature of assessments upon, and represent an additional price paid for, the shares of stock held by the individual shareholders").

of these payments as capital contributions.

Although Regulation § 1.118-1 indicates that these payments do not qualify as capital contributions, the current leading case on this question, *Board of Trade of the City of Chicago v. Comm'r*, 106 T.C. 369 (1994) ("*Board of Trade*"), states that the language of Regulation § 1.118-1 is not dispositive. *Id.* at 377 ("the language of the regulation is merely illustrative and does not exhaust the definition of a capital contribution"). Going beyond the Regulations, *Board of Trade* provides a detailed discussion of the various additional factors that should be considered when addressing this issue.

2. *Board of Trade of the City of Chicago v. Commissioner*

Board of Trade involved claimed capital contributions by new members to the Board of Trade of the City of Chicago (the "CBOT"), a taxable membership corporation that operated a futures exchange as its primary business. The CBOT's principal asset was the commercial building in which its exchange facilities were located, which was encumbered by mortgage debt and largely leased to third-party tenants. Ownership of the CBOT was vested in its members. Membership was divided into five classes of transferable memberships, each with specified voting rights, dissolution rights, and trading privileges.[7] The CBOT's members could freely transfer their memberships, so long as the transferee paid a transfer fee to the CBOT. *Id.* at 372.

[7] The five classes were, from least to most restricted, full memberships, associate memberships, Government Instruments Market (GIM) memberships, Commodity Options Market (COM) memberships, and Index, Debt and Energy Market (IDEM) memberships.

The amount of the transfer fee was set by the CBOT's Board of Directors and varied by class of membership.

The CBOT's rules required that the transfer fees be used "to purchase, retire or redeem the indebtedness encumbering the Board of Trade Building." *Id.* at 373. On its federal income tax returns for the years at issue, the CBOT reported all transfer fees received as capital contributions.

During the three years at issue in that case (1988-1990), over 1,500 memberships were sold or otherwise transferred. *Id.* at 372. At the time of the trial, the fair market value of a full membership was approximately $575,000. *Id.* During the years at issue, the transfer fees set by the CBOT's Board of Directors were $1,000 for full and associate memberships, $350 for GIM and COM memberships, and no fee for an IDEM membership. A member who wished to sell a membership would submit to the CBOT an offer to sell, which included an offer price. The CBOT posted all offers to sell and bids to purchase on its bulletin board. A sale was effected when there was a match between an offer and a bid. The CBOT's Member Services Department then collected the transfer fees in connection with the transfers of memberships.[8] *Id.* at 375. New members also were required to submit an application for membership and pay an

[8] When a membership was transferred, the CBOT: (1) maintained and published a list of bids to purchase and offers to sell; (2) received and held bid purchase money and transfer fees while bids to purchase were pending; (3) received and held the authorization of sale submitted by a prospective seller; (4) notified the buyer and seller whenever a bid and offer matched; (5) withheld from the tendered purchase price an amount necessary to pay any outstanding exchange fees or fines of the seller, as well as any trading related debts or membership financing of the seller owed to other members or clearing firms; (6) remitted membership sale proceeds to all parties who submitted claims against the seller for repayment of outstanding debt, that had been "allowed" by the exchange; and (7) kept records of all membership transfers, including intrafirm and intrafamily transfers, and membership exchanges. *Id.*

application fee, as well as abide by the CBOT's other rules and procedures. *Id.* at 375-77.

During the years at issue in *Board of Trade*, the CBOT received transfer fees totaling $319,800, $333,350, and $345,050, respectively. *Id.* at 373. The CBOT's mortgage payments during the same period were substantially greater, amounting to over $2.5 million in each of 1989 and 1990. *Id.* at 374. The fees were deposited into restricted capital accounts, and were reclassified as unrestricted capital only after a mortgage payment had been made. *Id.* The bulk of the CBOT's revenues (over $60 million in each year at issue) were derived from transaction fees paid for each trade executed on the exchange and from rents for the lease of space in the CBOT building. *Id.* at 377.

In *Board of Trade*, the Tax Court focuses on the distinction between investors and customers, because only payments made by individuals acting as investors can be characterized as capital contributions. However, in that case characterization was "complicated by the fact that the payors of the transfer fees become both equity owners of [the CBOT] and its primary customers, and that, by becoming members, the payors of the transfer fees become entitled to use the trading facilities of the exchange." *Id.* at 379. This dual role of the member-shareholders is also present in MCC's case, and the key factor used to distinguish between capital contributions and payments for services in this context is whether the payor had an investment motive in making the payment. *Id.* at 381-82.

After analyzing a number of prior cases that concern this issue, the Tax Court identified "three objective factors whose presence tends to support the existence of an investment motive: (1) the fee in question is earmarked for application to a capital acquisition or expenditure; (2) the payors are the equity owners of the corporation and there is an increase in the equity capital of the organization by virtue of the payment; and (3) the members have an opportunity to profit from their investment in the corporation." *Id.* at 386. The deposits appear to satisfy the first factor, because they were earmarked for the construction of the Project, which required significant capital expenditures.

The deposits also appear to satisfy the second factor. All of the payors were equity owners of MCC, because they were all also shareholders. There was no direct correlation between the amount of a deposit and an increase in the depositor's equity in his or her shares of MCC, but the Tax Court states "there is no requirement that the payments directly increase the individual payor's equity interest on a dollar-for-dollar basis." *Id.* at 389. Instead, this factor requires only that the members' equity as a whole be increased by each payment, *Id.* at 390, which appears to be true in MCC's case.

The third factor is the most problematic for MCC, because it focuses on "whether the payor has an opportunity to profit from the appreciation in his investment." *Id.* In *Board of Trade,* the memberships were freely transferable, and were often held for investment and leased to third parties. *Id.* There was an active market for

memberships, which were regularly transferred. The transfer fees at issue in that case were used to retire the mortgage debt on the CBOT's facility, which was the primary source of nearly all of its revenues.

MCC's facts could not be more different, and any opportunity to profit from the appreciation of a membership in MCC was extremely limited. No evidence of a market for MCC memberships was offered, unlike in *Board of Trade*, where memberships were bought and sold on a regular basis. Shares of MCC were not freely transferable. To be transferred during the period at issue, shares of MCC first had to be offered to the corporation, which could repurchase them for par value, leaving the shareholder with little or no profit. In *Board of Trade*, members were able to sell their memberships to third parties subject only to the CBOT's fairly simple rules and procedures.

In addition to the limits on their stock, MCC members had only a limited right to a refund of their deposits and that right was non-transferable. The timing of the payment of any refund was solely within the discretion of MCC's Board and depended on a number of factors, including the number of members in the class of the member seeking a refund and the state of MCC's finances. For those refunds that were paid during and after the period under review, MCC waived the provisions relating to the timing of refunds. However, according to the Pledge Agreement, any such waiver could only have been granted at MCC's discretion.

MCC emphasizes that persons making deposits also had the ability to obtain refunds in the event of death, permanent disability or termination of

membership in MCC. The amount of the refund was set at 80% of the refund amount then in effect when the death, disability or termination occurred. For example, for a person who contributed $10,000 in 1998, upon resignation from MCC in 2001 when the deposit was set at $20,000, the refund amount would have been $16,000 (i.e., 80% of $20,000). (Baker Aff. ¶17.) The refund calculation was designed to encourage persons to make deposits, since it was contemplated that the deposit amount would increase over time. (Baker Aff. ¶18.)

These facts help MCC's case, but they are hardly dispositive and do not prove that the golfing members' deposits were "primarily paid with an investment motive," as required by *Board of Trade*. 106 T.C. at 391. The evidence that these amounts were not paid primarily with an investment motive is far more direct. MCC's own Pledge Agreement states, partly in boldface type, as follows: "**Pledge Not An Investment**. The Deposit payment made pursuant to this Pledge is not intended for nor made as an investment." (Pownell Aff., Ex. 9 § IV.D (2002 version) & 11 § V.E (1999 version)) (emphasis in originals). In addition, the record contains ample evidence that the deposits were made primarily in exchange for services, particularly since initial and continued access to the new golf course were contingent on payment of the deposits.

MCC cites *Minnequa University Club v. Comm'r,* T.C. Memo 1971-305 (1971), as authority supporting the treatment of the deposits as capital contributions. While the facts in *Minnequa University Club* were somewhat similar to the facts in this case, applicable law has changed significantly since 1971. First, *Minnequa University Club* predates the addition of IRC § 118(b) in 1986, which now generally bars the

treatment of any "contribution in aid of construction" as a capital contribution. Second, the contributions at issue in *Minnequa* were intended to improve the club's facilities in order to maximize their use by nonmembers, whose payments to the club were a substantial source of its income. This income reduced the members' dues, and the Tax Court likened this reduction to a dividend, which is a form of return of capital. In MCC's case, the facts indicate the Project was undertaken to improve the club's facilities for its members, not to increase the club's income from nonmembers.[9]

Both parties also offer competing analyses of *Washington Athletic Club v. U.S.*, 614 F.2d 670 (9th Cir. 1980), which held, on similar facts, that membership fees and dues paid to an athletic club were conditions of entitlement to the club's facilities and were not excludable from income as capital contributions, even though the fees were set aside and used exclusively for capital improvements. In that case, the court rejected the "functional analysis"[10] of claimed capital contributions used in some earlier cases, and applied a "contributor motivation analysis" that has developed into the "investment motive" test described in *Board of Trade*. *Id.* at 674-75; *see also, United Grocers, Ltd. v. U.S.*,

[9] MCC also cites *Wis. Dep't of Revenue v. Lake Wisconsin Country Club*, 123 Wis. 2d 239, 365 N.W.2d 916 (1985), which follows the analysis applied in *Minnequa University Club*. However, *Lake Wisconsin* is of limited precedential value today, because it predates the 1986 amendment to IRC § 118(b), the 1987 federalization of the Wisconsin income/franchise tax, and the Tax Court's 1994 decision in *Board of Trade*, which provides the current analytical framework for this issue. MCC further cites Internal Revenue Service ("IRS") Private Letter Rulings ("PLR's") 200411028 (Dec. 4, 2003), 200027029 (Apr. 4, 2000) and 199952085 (Sep. 30, 1999), in which the IRS determined that certain payments qualified as capital contributions under IRC § 118 and *Board of Trade*. However, these PLR's provide little analysis of investment motive and no discussion of any facts that might cut against a finding of investment motive, many of which are present in MCC's case.

[10] Applying a "functional analysis," the Washington Athletic Club argued that "a service corporation may exclude from gross income fees and dues received from its members if such fees and dues are (1) earmarked and reserved by the corporation's board of directors for capital improvements, (2) segregated from funds used for ordinary operating expenses, and (3) in fact used for capital improvements." 614 F.2d at 673.

308 F.2d 634 (9th Cir. 1962).

Unlike in *Board of Trade*, the facts in MCC's case indicate that the deposits were made primarily in consideration for services provided by MCC, and that any profit motive was an incidental consideration. Thus, under IRC § 118, *Board of Trade* and these earlier cases, the deposits at issue did not qualify as capital contributions and were includable in MCC's gross income for the years at issue.

The Sales Tax Assessment (Docket No. 05-S-203)

MCC's primary objection to the sales tax assessment is the Department's application of sales tax to the golfing members' deposits.[11] MCC's position is that the deposits are not properly included in the sales tax base.[12]

1. **Wis. Stat. § 77.52(2)(a)2**

Wis. Stat. Section 77.52(2)(a)2 defines sales of the following services as taxable sales:

> The sale of admissions to amusement, athletic, entertainment or recreational events or places . . . and the furnishing, for dues, fees or other considerations, the privilege of access to clubs or the privilege of having access to or the use of amusement, entertainment, athletic or recreational devices or facilities, including the sale or furnishing of use of recreational facilities on a periodic basis or other recreational rights, including but not limited to membership rights, vacation services and club memberships.

[11] While the Department also made other adjustments (such as including stock sale proceeds and equity assessments in the sales tax base), MCC did not contest these adjustments.

[12] MCC also argues in the alternative that, if taxable as admissions under Wis. Stat. § 77.52(2)(a)2, the deposits should not have been subject to sales tax until the new golf course was opened on July 4, 2001. However, during the construction of the new golf course, MCC's regular members were given access to the golf course at Plum Lake Golf Club, which indicates that MCC's regular members received the golf course admissions they had purchased during the construction period.

MCC's golf course, clubhouse and related facilities clearly are "amusement, entertainment, athletic or recreational" facilities. To purchase or maintain a golfing membership in MCC during the period at issue, an individual was required to make one of the deposits at issue. In general, only golfing members had access to or use of MCC's golf course. While there were a number of limited exceptions to this rule, the exceptions generally appear to have been designed for the convenience of the golfing members. For example, golfing members were permitted to bring guests to the golf course, and their children and grandchildren also had golfing privileges, subject to certain age restrictions. In short, the golfing members' deposits appear to be taxable under Wis. Stat. § 77.52(2)(a)2.

2. Wis. Admin Code § Tax 11.65(1)

The applicable section of the Wisconsin Administrative Code includes language that more strongly indicates that the deposits are taxable under Section 77.52(2)(a)2 as follows:

> The sales tax applies to the gross receipts of organizations which have as an objective the supplying of amusement, athletic, entertainment or recreational facilities to their members such as country clubs, golf clubs, athletic clubs, swimming clubs, yachting clubs, tennis clubs and flying clubs. Taxable sales include the sale, furnishing or use of recreational facilities on a periodic basis and other recreational rights, including but not limited to membership rights, vacation services and club memberships sold in connection with the sale of time-share properties described in s. 707.02 (32), Stats. The proceeds received from initiation fees, special assessments, dues, and stock sales of clubs supplying amusement, athletic, entertainment or

> recreational facilities to members are charges for the privilege of obtaining access to the clubs and are taxable receipts of the clubs.

Wis. Admin. Code § Tax 11.65(1)(b).

According to this language, MCC's receipts from its members' deposits are taxable. This provision makes it clear that Wisconsin's sales tax applies to the "gross receipts" of country clubs and golf clubs, which describes MCC. Although the Administrative Code does not provide a definition of "special assessments," the deposits easily fit within the commonly-understood meaning of that term. Finally, the Department's Publication 226 further emphasizes that "membership fees" and "[s]pecial assessments, such as for remodeling or capital improvements" are subject to sales tax. (Mintener Aff. ¶ 9, Ex. 12 at 1, § II.A.1.)

3. Wisconsin Cases

Wisconsin case law presents several additional hurdles for MCC.[13] In *Merrill Hills Country Club Inc. v. Wis. Dep't of Revenue*, Wis. Tax Rptr. CCH ¶ 200-428 (WTAC 1968), *aff'd,* Wis. Tax Rptr. CCH ¶ 200-494 (Dane Co. Cir. Ct. 1969), the Commission found that a golf club's receipts from initiation fees, annual dues, special assessments and stock purchases were considerations paid for the privilege of access to the taxpayer's facilities and were thus subject to sales tax. In *Merrill Hills*, the taxpayer was a golf club, and its members were required to pay annual dues and special

[13] In its briefs, MCC analyzes a number of additional cases from other jurisdictions. Because there are several Wisconsin cases that are directly on point, we see no need to address these other cases, particularly when considering a sales tax question that is purely a matter of state law.

assessments and to make purchases of stock to obtain full use of the club's golf course and other facilities. The Commission and the Circuit Court agreed that those payments, including the special assessments, were part of the price paid for continued use of the club's facilities and were thus admission charges that were taxable under Wis. Stat. § 77.52(2)(a)2.

MCC attempts to distinguish *Merrill Hills* by arguing that the case was decided under Wisconsin's former selective sales tax law effective during the years 1962-65, prior to the enactment of Wisconsin's current general sales tax law. However, in this case that is a distinction without a difference, because the applicable statutory language remains virtually the same.[14]

In *Senior Golf Ass'n of Wis., Inc. v. Wis. Dep't of Revenue*, Wis. Tax Rptr. CCH ¶ 202-126 (WTAC 1982), *aff'd,* Wis. Tax Rptr. CCH ¶ 202-389, (Dane Co. Cir. Ct. 1984), *aff'd in unpublished decision,* Wis. Tax Rptr. CCH ¶ 202-658 (Ct. App. 1985), the taxpayer, a private golf club that did not have its own golf course, charged its members a one-time initiation fee and annual dues, which entitled its members to participate in golf outings to private country clubs organized for the taxpayer's members. The Department assessed sales tax on the taxpayer's receipts from its initiation fees and annual dues. The Commission, the Circuit Court and the Court of Appeals all upheld

[14] Under the former statute, sales tax applied to "The sale of admissions to places of amusement, athletic, entertainment or recreational events or places and the furnishing for dues, fees or other considerations, the privilege of access to clubs or the privilege of having access to or the use of amusement, entertainment, athletic or recreational facilities . . . ." Wis. Stat. § 77.52(2)(a)2. (1963).

the tax under § 77.52(2)(a)2, because the payments were required to obtain access to the golf courses.

In *Greenwood Hills Country Club v. Wis. Dep't of Revenue*, Wis. Tax Rptr. CCH ¶ 400-400 (WTAC 1998), the Commission affirmed sales tax assessments on payments made to construct a new golf course. *Greenwood Hills* involved a private golf club that sold memberships prior to construction of its golf course. Membership in the club was a prerequisite to paying the club's annual golfing fees or using its golf course and related facilities. This Commission found that both the initial fee and the annual fee in Greenwood Hills were subject to sales and use tax under § 77.52(2)(a)2 because without the initial fee, "there was no access" to the golf course.

Finally, in *City of Madison v. Wis. Dep't of Revenue*, Wis. Tax Rptr. CCH ¶ 400-100 (WTAC 1995), the Commission held that certain I.D. cards issued by the City of Madison to its residents were designed and issued exclusively to provide purchasers with a lower-cost admission to its golf courses, and that § 77.52(2)(a)2 thus applied to the receipts from the sales of the I.D. cards. Again, the fact that a special type of access to a golf course was contingent upon the payment of the required fee was the determinative factor in the case.

MCC offers a host of arguments for distinguishing these cases from its case, but none are convincing. Taken together, the Statutes, Administrative Code and Wisconsin cases state with a remarkable consistency that if a payment is required to obtain or maintain access to a golf course, then it is subject to sales tax under §

77.52(2)(a)2. To obtain access to MCC's new golf course, golfing members were required to pay the deposits at issue here (and sustaining members, the increased dues), and, as in every prior Wisconsin case, those payments were subject to sales tax.

4. The Penalty

The Department assessed a negligence penalty under Wis. Stat. § 77.60(3) on MCC's underpayment of sales tax, to which MCC objects. Negligence under Wis. Stat. § 77.60(3) is defined as a "failure to use ordinary care," including "violations of statutory duties" and "inadvertence," but does not require "an intentional act or omission." *Reid & Associates, Inc. v. Wis. Dep't of Revenue*, Wis. Tax Rptr CCH ¶ 200-691 (Dane Co. Cir. Ct. 1971).

MCC argues that it had a reasonable basis for its belief that the deposits were not subject to Wisconsin sales tax. In defense of its imposition of the penalty, the Department asserts that "[t]he law is more than clear on the issue of the taxation of golf course fees." (Dept. Br. at 23.) Based on a straightforward reading of the Statutes, the Administrative Code and prior cases, we agree with the Department. Applying a basic negligence standard, MCC knew or should have known that its members' deposits were subject to sales tax. MCC thus should have reported and paid the tax due, and it has shown no good cause for that omission. *See, Parkview Sand & Gravel, Inc. v. Wis. Dep't of Revenue*, Wis. Tax Rptr. CCH ¶ 400-431 (WTAC 1999). Consequently, we affirm the Department's assessment of the penalty.

Conclusion

The Department has satisfied its burden of proof in these matters and is entitled to summary judgment as a matter of law.

IT IS ORDERED

1. In Docket No. 05-I-202, the Department's motion for summary judgment is granted, MCC's cross-motion for summary judgment is denied, and the Department's action on MCC's petition for redetermination is affirmed.

2. In Docket No. 05-S-203, the Department's motion for summary judgment is granted, MCC's cross-motion for summary judgment is denied, and the Department's action on MCC's petition for redetermination is affirmed.

Dated at Madison, Wisconsin, this 7th day of November, 2007.

WISCONSIN TAX APPEALS COMMISSION

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Diane E. Norman, Acting Chairperson

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David C. Swanson, Commissioner

ATTACHMENT: **"NOTICE OF APPEAL INFORMATION"**