Cite as 11 WTD 197 (1991).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

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| In the Matter of the Petition For Request of Ruling on Tax Liability of | ) | D E T E R M I N A T I O N |
| | ) | No. 91-155 |
| . . . | ) | Registration No. . . . |

[1] RCW 82.04.120, .080, RULE 224: B&O TAX -- GROSS INCOME -- NO DEDUCTIONS FOR COSTS AND EXPENSES. Each physician/ independent contractor must report 100% of his gross income for the medical services he renders under Service B&O tax without any deduction for his costs, taxes, or other expenses, including those he pays to the company which provides him management, accounting and administrative services. Accord: Det. 88-377, 6 WTD 439 (1988).

[2] RULE 159, RULE 111 AND RULE 224: B&O TAX -- GROSS INCOME -- AGENT -- MANAGEMENT SERVICES. A taxpayer corporation which has agreements with affiliated physicians/ independent contractors to provide management services, is liable for Service B&O on amounts it receives, without any deduction for costs, taxes, or other expenses, whether the income is paid directly by the doctors or retained from their accounts receivables. The corporation is not liable for Service B&O on amounts collected for the physicians from patients if the money is collected only as agent for the doctors. Accord: Det. 88-377, 6 WTD 439.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

TAXPAYER REPRESENTED BY: . . .

NATURE OF ACTION:

The taxpayer corporation asks if it and five separate physicians with whom it contracts are each liable for business and occupation (B&O) tax. The request was made pursuant to former RCW 458-20-100(18). The taxpayer also has requested refunds of B&O taxes for the individual physicians.

FACTS:

De Luca, A.L.J. -- The taxpayer/management company is a corporation established [in March 1989] and owned by five physician shareholders. Three of the physicians are sole shareholders of individual professional service corporations while the other two are sole proprietors. Each of the five physicians considers himself an independent contractor in his dealings with the taxpayer. Each one has signed a "Practice Management Agreement" with the taxpayer. The taxpayer has provided a sample agreement to the Department of Revenue dated [April 1989] and signed by . . . .

The taxpayer has contracted to provide management, accounting and administrative services to the physicians. The services include providing nurses and other medical support personnel, medical supplies and medicines, telephone answering, appointment scheduling, and maintaining medical records. Also included are bookkeeping, budgeting, billing patients in the physicians' names for medical services rendered and collecting such sums for them.
Furthermore, each physician contributes a certain amount of money to maintain a central cash reserves fund administered by the taxpayer. In turn, the taxpayer pays from the fund the various practice expenses of each physician. The parties have agreed the taxpayer has no obligation to pay the physician's practice expenses in excess of the funds contributed by the physician and the amounts collected from his accounts receivables and deposited in the fund.

The taxpayer charges each doctor monthly a $ . . . fee plus amounts necessary to pay or reimburse it for these services.

ISSUES

Are the taxpayer and the individual physicians (or their corporations) each liable for business and occupation (B&O) taxes?

If the answer is affirmative, what income is taxable to each one?

## TAXPAYER'S EXCEPTIONS

The taxpayer concedes it is obligated to report B&O tax, but disputes the individual physicians should also owe any tax. Moreover, the taxpayer claims it paid tax on the gross earnings of the physicians while the individual physicians paid the tax on their draws after deducting their expenses.

## DISCUSSION

A Department auditor met last year with the taxpayer's representative and afterwards mailed his conclusions to the representative and the parties. The auditor found each of the doctors was conducting business and concluded each one is responsible for reporting his gross fees received from the medical services rendered to patients. The B&O tax classification for them is Service and other. The auditor found the individual physicians had under reported their taxable income because their returns were based on their draws after deducting their business expenses.

The auditor also stated the taxpayer management company should report the money it receives from the doctors for the services provided them under Service and other B&O tax. He found such reimbursements to be gross business income. He then stated the taxpayer appeared to have reported the doctors' net patient receipts or draws on its tax returns rather than the reimbursements received for services rendered. He then concluded the management company over reported its taxable income and was entitled to a refund. However, the taxpayer in its letter to us indicates it has been paying tax on the physicians' gross incomes, rather than on their draws or net incomes.

Whichever, we are concerned presently with how the physicians and management company should report their respective incomes. Whether the management company or the physicians are entitled to a refund or owe more taxes will depend on the facts in light of our decision. The auditor will resolve those facts upon further review of their books and records.

We agree with the conclusions in the auditor's letter. The B&O tax is imposed by RCW 82.04.120 which provides:

> There is levied and shall be collected from every person a tax for the act or privilege of engaging in business activities. Such tax shall be measured by the application of rates against value of products, gross proceeds of sale or gross income of the business, as the case may be. (Emphasis supplied.)

The taxpayer concedes each of the five physicians is engaged in his own business/medical practice. Therefore, by law, each one of them is liable for B&O tax based on his gross income. Gross income of the business is defined by RCW 82.04.080 in pertinent part to mean:

> . . . the value proceeding or accruing by reason of the transaction of the business engaged in and includes . . . compensation for the rendition of services, . . . fees, . . . and other emoluments however designated, all without any deduction on account of . . . labor costs, . . . delivery costs, taxes, or any other expenses whatsoever paid or accrued and without any deduction on account of losses. (Emphasis supplied.)

[1] Under this definition, each physician or professional service corporation must report 100% of his gross income for the medical services he renders to his patients under the Service and other B&O tax classification without any deduction for his costs, taxes or any other expenses, including those he pays to the taxpayer management company. The auditor is correct when he concluded the five doctors under-reported their taxable income if they made deductions for their expenses and reported only their net income or draws. See Det. 88-377, 6 WTD 439 (1988).

[2] Likewise, the management company is a separate entity engaged in business activities. Thus, the gross income/reimbursements it receives from the five doctors for the services it renders to them also is subject to Service B&O tax without deductions for costs, taxes, or other expenses.

However, the auditor correctly states the taxpayer over-reported its taxable income if it included either the physicians' gross or net income or draws (whichever the case may be) on its returns.

Det. No. 88-377, 6 WTD 439, supra, ruled on a similar matter.

> The issue is whether the amounts billed and collected by the taxpayer [management provider] for the partnership represent gross proceeds of the taxpayer's business. ...
>
> This case is distinguishable from those where a business pays costs on behalf of a customer and receives payment from the customer for the costs. In such a case, the amounts received are included as part of the gross proceeds of the business unless the costs are not part of the businesses' costs in performing its services and the business is not primarily or secondarily liable for payment of the costs, other than as agent of the customer. WAC 458-20-111.
>
> In the present case, the agreement between the taxpayer and the partnership provides that the taxpayer shall do the billing for the partnership and be entitled to 5% of the partnership's gross receipts for its billing and other management services. The taxpayer does not have a right to retain the full amount of the invoiced amount. Nor is the taxpayer liable to the partnership if the patient fails to pay the bill. The taxpayer only is liable for service B&O upon the gross income derived from its business--in this case ... the amount received or retained from the partnership's gross receipts for management services. The partnership is liable for B&O tax on l00% of its gross receipts with no deduction for the five percent paid to the taxpayer.

WAC 458-20-111 (Rule 111) provides:

> The words "advance" and "reimbursement" apply only when the customer or client [patient] alone is liable for payment of the fees or costs and when the taxpayer making the payment [to the physicians] has no personal liability therefor, either primarily or secondarily, other than as agent for the customer or client. (Bracketed words and emphasis supplied.)

In the present matter, the taxpayer management company is not liable to compensate the physicians for medical services rendered to patients. The payments received from patients and passed on to the physicians are a deductible cost of the taxpayer's doing business. Therefore, the taxpayer is not

liable for B&O taxes for money received from patients for medical services rendered by the doctors if the money is transferred to the physicians.

However, any amounts the taxpayer retains from such payments, or which it receives directly from the physicians, for its management services are taxable as gross income.

It is important to note the distinction addressed in the quote from 6 WTD 439. Where the taxpayer management company pays the costs on behalf of its customers/physicians and receives payment from the physicians for the costs, the amounts received are taxable as gross proceeds of the business unless the costs are not part of the business' costs in performing its services and the business is not primarily or secondarily liable for payment of the costs.

When the management company provides nurses, a manager and other personnel as well as medical supplies, etc. to the physicians, it is incurring business costs in performing these services for which it is primarily liable. For example, the management company must pay its employees and suppliers. Therefore, the gross income it receives from the doctors, either directly or from accounts receivable, for such services is taxable. This situation is in contrast to the money merely passing through the taxpayer from the patients to the doctors, which, as explained above, is not taxable to the management company.

The money the doctors deposit in the cash reserves account to meet future expenses is not taxable to the taxpayer until the taxpayer is entitled to receive such funds for management services rendered. Until such time the money is not income for services performed.

Finally, we recognize the result is a partial pyramiding of B & O taxes. A certain portion of each payment by the patients is taxable both to the taxpayer and to the individual physician whose services generated the payment. However, it is the intended effect of the Revenue Act to assert a tax on the gross receipts of each separately organized entity doing business in this state.

## RULING

The management company and the individual physicians are separately liable for B & O taxes in accordance with this determination. The management company and the physicians are

to report their taxes as instructed by the auditor in his March 28, 1990 letter and by this determination. This matter is remanded to that auditor to make any necessary adjustments in the taxes of the management company and the individual doctors.

This opinion may be rescinded or revoked in the future, however, any such rescission or revocation shall not affect prior liability and shall have a prospective application only.

DATED this 10th day of June 1991