

Cite as Det. No. 91-280, 11 WTD 463 (1992).

THIS DETERMINATION HAS BEEN OVERRULED OR MODIFIED IN WHOLE OR PART BY DET. NO. 05-0131, 25 WTD 116 (2006)

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

In the Matter of the Petition)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u> <u>N</u>
For Refund of)	
)	No. 91-280
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. . .)	Registration No. . . .
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[1] RULES 119 AND 244, RCW 82.08.0293 AND RCW 82.12.0293: SALES AND USE TAXES -- EXEMPTION -- HOSPITALS -- PATIENT MEALS. A hospital contracts with a food management company for the company to procure unprepared food products which are resold as such to the hospital. The company then supervises the hospital's food service staff on site in preparing patient meals from the unprepared food products. The food service company is not selling prepared foods or meals to the hospital. Instead, it is providing food service management. No sales or use tax is owing on patient meals.

[2] RCW 82.08.0293, RCW 82.12.0293 AND RULE 244: SALES/USE TAX -- NOT-FOR-PROFIT HOSPITAL -- MEALS FOR ELDERLY OR LOW-INCOME PATIENTS. The sales/use tax exemption for meals served by not-for-profit hospital to elderly, disabled or low-income persons does not apply when the meals are provided as part of the services rendered to such patients.

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: . . .

DATE OF TELEPHONE CONFERENCES: . . .

NATURE OF ACTION:

The taxpayer is seeking a refund of use taxes assessed against it when the auditor concluded it was purchasing prepared meals.

FACTS:

De Luca, A.L.J. -- The taxpayer is a not-for-profit hospital located in Washington. The Department of Revenue audited the taxpayer for the period January 1, 1985 through December 31, 1989. The Department issued audit report no. . . . [in April 1990]. The audit resulted in a net credit to the taxpayer. However, the taxpayer filed its refund petition [in July 1990] by claiming the tax credit was improperly reduced by approximately \$ The disputed amount results from a use tax assessment on prepared foods which the Department's Audit Division found the taxpayer purchased from [a food company] (. . .). See Schedule VI of the report.

Audit states that until April 1989 the taxpayer purchased unprepared foods from various suppliers. It then prepared and served meals to its patients. Beginning that month, the taxpayer changed its foodservice procedures. It contracted with [the food company] whereby [the food company] began providing the following services: 1) develop menus, 2) develop and supervise the taxpayer's foodservice staff, 3) procure food products for the taxpayer, and 4) provide a foodservice director and supervisors to direct food preparation at the hospital by the hospital's staff.

Among its other duties, [the food company] does procure and purchase unprepared foods for the taxpayer. Under [the food company]'s supervision, the hospital's staff subsequently prepares those foods for patient meals. The taxpayer states [the food company] bills it for the unprepared foods at cost. Further, Audit found the contract requires [the food company] to bill the taxpayer a charge for its services based on a contractual formula including monthly patient days at the hospital. Audit decided that the invoices reveal a charge for meals rather than for purchases of unprepared food and management fees.

According to the contract, [the food company] does credit the taxpayer's employee expenses incurred in preparing and serving the food and [the food company] reduces its monthly invoices accordingly. Moreover, unlike patient meals, [the food company] reports the retail sales of meals sold directly to customers in the hospital's cafeteria. There is no dispute here about reporting sales and use taxes on prepared food sales to nonpatients.

Citing RCW 82.08.0293, Audit declared the food products sales tax exemption does not apply when a retailer prepares meals. Audit found [the food company] to be a retailer of the meals because it was contractually obligated to provide the food and to direct and supervise its preparation. Audit considered the hospital, as a service provider to its patients, the consumer of the meals because it included the meal charges in its patients' bills.

Audit also held the patient meals did not qualify for certain state administered nutrition programs or programs for meals provided to certain senior citizens, disabled or low-income persons.

ISSUE:

Is the taxpayer purchasing prepared foods from [the food company] or is [the food company] providing only managerial and food purchasing services to the taxpayer which are exempt from sales and use taxes?

TAXPAYER'S EXCEPTIONS:

The taxpayer states it is not purchasing prepared meals from [the food company]. Rather, [the food company] manages the hospital's food service operations. It purchases unprepared foods as the taxpayer's agent and then supervises the hospital's employees in preparing the foods for patient meals. The taxpayer argues the [the food company] contract with its payment formula partly based on monthly patient days is simply a decision to run a more cost-efficient food service through a management company. The formula does not address the purchase of prepared meals by the taxpayer.

Additionally, the taxpayer argues patient meals are exempt from sales and use taxes to the extent such food is served to the aged, poor or disabled persons.

DISCUSSION:

The legislature has exempted from sales and use taxes sales of food products for human consumption. See RCW 82.08.0293 and RCW 82.12.0293. However, there are exceptions to the exemptions. See RCW 82.08.0293 (2) which states the food products exemption shall not apply "... (c) to a food product, when sold by the retail vendor, which by law must be handled on the vendor's premises by a person with a food and beverage service worker's permit"

WAC 458-20-244 (Rule 244) is the Department's rule detailing exempt food products and non exempt nonfood products. It states in part:

Generally, it is the intent of the law ... to provide the exemption for groceries and other unprepared food products with some specific exclusions. It is the intent of the law to tax the sales of meals and food prepared by the seller regardless of where it is served or delivered to the buyer. Again, there are some specific exclusions.

One of those exclusions is prepared food or meals which hospitals, rest homes and similar institutions serve to patients as part of the services they render. See WAC 458-20-119 (Rule 119). Thus, hospital patients are not charged sales or use tax on their meals. Instead, when a hospital includes the meals in its overall billing charges as services rendered, the hospital is taxed at the service business and occupation rate and not the retailing rate.

As the audit report notes, until April 1989, the taxpayer itself purchased unprepared food products and its staff then prepared the patient meals. As far as the Department of Revenue was concerned, neither the hospital's purchase of unprepared food products nor the resulting patient meals were subject to sales or use taxes. RCW 82.08.0293, RCW 82.12.0283 and Rule 119.

However, it is the Department's policy to tax prepared foods sold to a hospital or similar institution by a third party even when those meals are purchased with the intent to serve patients. The Department believes when a hospital or similar institution chooses not to prepare the meals itself, it gives up the option of purchasing sales-tax exempt food and preparing it for service to patients free of sales tax. We note the meal preparer still buys unprepared food products free of sales tax.

We have reviewed the contract between the taxpayer and [the food company], the food management company. The section addressing service states [the food company] will among other items: develop menus and recipes; supervise and train the hospital's food service staff in restaurant-style cooking techniques; procure high-quality food products; establish and manage cost-effective food purchasing agreements; regularly review all areas and aspects of the operation; and have a foodservice director and supervisors directing on-site food preparation by the hospital's foodservice staff.

As noted, the contract requires payment for these services based in relevant part on a charge per patient day according to a scale developed from the hospital's records. [The food company] charges the taxpayer a certain cost per patient day depending on the number of patient days accumulated at the hospital for the month being charged. For example, if there were from 2001 to 2083 patient days in a month, [the food company] will charge the taxpayer [\$24] per patient day for its services with appropriate credits given. If there were 1501 to 1583 patient days, the

charge will be [\$30] per patient day, again with appropriate credits given. Thus, the more patient days accumulated, the lower the charge per patient day billed to the taxpayer.

[1] We do not agree with the argument that, where the billings were based on the number of patient days at the hospital, that fact proves [the food company] sold meals to the taxpayer. Instead, it merely shows the parties have developed a cost-and-billing system which is readily adjustable for monthly variances in the patient population.

Furthermore, the contract nowhere addresses sales of prepared foods by [the food company] to the taxpayer. Rather, the contract provides that [the food company] will procure unprepared foods for the hospital, whose own employees on its own premises will then prepare patient meals from those foods, under the supervision of [the food company]'s director and supervisors. We agree with the taxpayer. The facts and the contract reveal that [the food company] is providing management services only, including procuring unprepared food products for the taxpayer and supervising the taxpayer's employees on site in preparing those foods for patient meals.

[2] However, we disagree with the taxpayer's alternative position that the meals are exempt from sales or use tax because they are served to elderly, disabled or low-income persons per RCW 82.08.0293 (4)(b), RCW 82.12.0293(3)(b) and Rule 244.

We concede the taxpayer is a not-for-profit organization and it cares for elderly, disabled or low income patients. However, we do not view the exemption as applicable to this factual situation. The sales tax exemption applies on meals purchased by a nonprofit organization to distribute to elderly, disabled or low-income persons. Det. No. 87-110, 3 WTD 21 (1987). The exemption does not apply to a not-for-profit organization, such as this hospital, which provides the meals to such patients as part of the services it renders.

DECISION AND DISPOSITION:

The taxpayer's appeal and refund request is granted. This matter is remanded to Audit to make the necessary corrections and determine precisely the amount of refund owing in accordance with this Determination.

DATED this 26th day of September 1991.