Cite as 12 WTD 263 (1992)

BEFORE THE BOARD OF TAX APPEALS
STATE OF WASHINGTON

SEQUIM FAMILY PRACTICE CENTER,	)	
Appellant,	)	Docket No. 41700
v.	)	Re: Excise Tax Appeal
STATE OF WASHINGTON DEPARTMENT OF REVENUE,	)	FINAL DECISION
Respondent.	)	

This matter came before the Board of Tax Appeals (Board) for an informal hearing on May 4, 1992. Dr. Charles Sullivan appeared for Sequim Family Practice Center (SFPC). David DeLuca, Administrative Law Judge, appeared for Respondent, Department of Revenue (Department).

This Board heard the testimony, reviewed the evidence, and considered the arguments made on behalf of both parties. This Board now makes its decision as follows:

I. FACTS AND ISSUES

SFPC is a partnership comprised of three physicians. Its radiology work is performed by Sequim Diagnostic Services (laboratory partnership) which is a twelve-physician partnership. SFPC's partners are also partners in the laboratory partnership. SFPC referred its patients to the laboratory partnership for laboratory services. In turn, the laboratory partnership billed SFPC monthly for the work performed on SFPC patients. SFPC then billed its patients for its services and the laboratory partnership services without indicating on the billings that it was collecting the laboratory charges on behalf of the laboratory partnership. The laboratory partnership billed and continues to bill patients separately when referred by doctors who do not have the arrangement in question with the lab.

The issue in this appeal is whether the money the SFPC collected from patients and paid the laboratory partnership for services rendered qualifies as a tax-exempt advance under WAC 458-20-111 (Rule 111) or is it part of the appellant's gross income and therefore taxable?

The Department's Audit Division examined SFPC's records for the period January 1, 1982 through September 30, 1985. The Department concluded that SFPC did not meet the agent test. As a result of the audit, on May 15, 1986, the Department issued an

assessment in the amount of $8,406, which included taxes and interest. This assessment consisted of service business and occupation (B&O) tax on money the appellant paid the laboratory partnership for services provided to patients during the audit period.

The SFPC petitioned the Department for a correction of the assessment. The Department's Interpretation and Appeals Division denied the petition in Determination No. 90-179, issued April 26, 1990. Exhibit A. The SFPC next filed an appeal with the Director of the Department of Revenue on May 25, 1990. Exhibit C. The Director through his designee denied the appeal and sustained Determination No. 90-179 in Final Determination No. 90-179A, issued October 14, 1991. Exhibit B. The SFPC appealed Final Determination No. 90-179A to the Board of Tax Appeals.

Until December 8, 1982, SFPC had no written agreement with the laboratory partnership absolving it for uncollected patient debts. Although there was no written agreement, Dr. Sullivan in his capacity as a principal of both the SFPC and the laboratory partnership testified that the understanding (through an "unwritten gentlemen's agreement") between SFPC and the laboratory partnership has always been that SFPC has no liability for unpaid patient debts. He also testified that retroactive adjustments were made for the period prior to the December 8, 1982 agreement. The record of collection for both the SFPC and the laboratory partnership was 90% during 1981 and the first half of 1982. According to Dr. Sullivan, the 10% deduction in the December, 1982 agreement between SFPC and the laboratory partnership was for bad debts. See Exhibit E - a copy of the laboratory partnership's management committee meeting notes of December 8, 1982 - which reads:

> Sequim Diagnostic Services to direct bill physicians [appellant] on account at each month end. Ten percent (10%) will be recognized as allowance for bad-debt and contractual adjustments. This percentage to be reviewed periodically and adjusted accordingly. Payment to be made on a periodic basis of time no greater than sixty (60) days to account for lag time for the insurance, payments to be payable to Sequim Diagnostic Services for services provided.

Subsequent to the December 8, 1982 agreement, the laboratory partnership at its management committee meeting on April 20, 1983 voted "that welfare write-offs for physicians on account billing be passed through to SDS [laboratory partnership]." See Exhibit F.

II. ANALYSIS AND CONCLUSION

RCW 82.04.080 defines "gross income of the business" as:

> ". . . the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, . . . all without any deduction . . . ."

WAC 458-20-111 pertains to advances and reimbursements and provides in part:

> The word "advance" as used herein, means money or credits received by a taxpayer from a customer or client with which the taxpayer is to pay costs or fees for the customer or client.
>
> The words "advance" and "reimbursement" apply only when the customer or client alone is liable for the payment of the fees or costs and when the taxpayer making the payment has no personal liability therefor, either primarily or secondarily, other than as agent for the customer or client.
>
> The foregoing is limited to cases wherein the taxpayer, as an incident to the business, undertakes, on behalf of the customer, guest or client, the payment of money, either upon an obligation owing by the customer, guest or client to a third person, or in procuring a service for the customer, guest or client which the taxpayer does not or cannot render and for which no liability attaches to the taxpayer. It does not apply to cases where the customer, guest or client makes advances to the taxpayer upon services to be rendered by the taxpayer or upon goods to be purchased by the taxpayer in carrying on the business in which the taxpayer engages.

The Washington Supreme Court in Rho Company v. Department of Revenue, 113 Wn.2d 561, 782 P.2d 986 (1989) addressed Rule 111's requirements in order to qualify pass through payments as tax exempt advances or reimbursements. Three conditions exist:

> "(1) the payments are "customary reimbursements for advances made to procure a service for the client"; (2) the payments "involve services that the taxpayer did not or could not render"; and (3) the taxpayer "is not liable for paying the associate firms except as the agent of the client."

113 Wn.2d at 567-568.

The court in Rho found that the first two conditions were not in dispute. Like Rho, the first two conditions are not at issue in the present matter. Only the third condition is in dispute.

In addition to the above, WAC 458-20-159 requires parties claiming to be agents to have contracts or agreements which clearly establish the relationship of principal and agent.

The Department concedes that the first two prongs of the Rule 111 test are met in this case. Yet the Department makes the argument that we should view the lab's services as a part of the doctor's complete medical package and subject to gross receipts tax. The Department's concession to the second prong, "the payments involve services that the taxpayer could not or did not render", forecloses the Department from making that argument.

The gross income of an agent does not include funds the agent collects on behalf of someone else. In order to qualify as an agent, SFPC must show clearly that the laboratory partnership absolved SFPC of the remaining obligation in situations where SFPC did not collect or remit the charges. The evidence (written and sworn testimony) shows that the arrangement actually requires SFPC to pay over all the funds it collects on behalf of the laboratory partnership. The arrangement is based on the SFPC's actual collection experience, as shown by SFPC's practice of adjusting the bad debts percentage to reflect actual practice and "passing through" welfare payments. The laboratory partnership continues to bill patients separately for doctors who do not have the arrangement in question with the lab. The laboratory partnership has appointed SFPC to collect its bills. The evidence demonstrates that SFPC is the agent of the laboratory partnership. SFPC is not liable to the laboratory partnership for bills SFPC does not collect from lab patients.

Finally, the Department argues that SFPC cannot show that the laboratory partnership absolved it of the charges because SFPC has no written contract with the laboratory partnership. WAC 458-20-159 does not require a written agreement. We can understand the Department's concern for a written agreement. However, in this case, we have the sworn testimony of Dr. Sullivan that an oral agreement existed concerning bad debts before the written agreement of December 8, 1982 and that retroactive corrections were made on bad debts prior to December, 1982. Dr. Sullivan testified in his capacity as both a partner in SFPC and a partner in the laboratory.

There are no fixed rules which serve as a test of credibility of a witness. Among the important factors which should be considered are: (1) the opportunity and capacity of the witness to observe the act or event, (2) the character and reputation of the witness for truthfulness, (3) prior inconsistent statements or actions, (4) bias or lack thereof, (5) consistency with or

contradiction by other evidence, (6) inherent improbability, and (7) demeanor of the witness. Henry Bacon v. Department of Revenue, BTA Docket 89-27. While the Department might argue that Dr. Sullivan's testimony is biased, we have no conflicting testimony and we find Dr. Sullivan to be a credible witness. We find that a valid enforceable agreement existed between the SFPC and the laboratory, by the terms of which SFPC was merely the agent of the laboratory for purposes of collecting monies due the laboratory.

IV. DECISION

The Determination of the Department of Revenue is reversed.

DATED this 31st day of July, 1992.

BOARD OF TAX APPEALS

MATTHEW J. COYLE, Chair

LUCILLE CARLSON, Vice-Chair

RICHARD A. VIRANT, Member

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Pursuant to WAC 456-10-755, you may file a petition for reconsideration of this Final Decision. You must file the petition for reconsideration with the Board of Tax Appeals within ten days of the date of mailing of the Final Decision. You must also serve a copy on all other parties. The filing of a petition for reconsideration suspends the Final Decision until action by the Board. The Board may deny the petition, modify its decision, or reopen the hearing.