Cite as Det. No. 93-136, 14 WTD 015 (1994).

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

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 93-136
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

[1] RULE 105: MEDICAL CLINICS -- PHYSICIANS -- INDEPENDENT CONTRACTORS. Physicians were independent contractors when contracting with a hospital to provide services at either hospital-owned clinics or physician-owned clinics which were subsidized by the hospital because the physicians exercised full control over making medical judgments, set their own fees and hours, obtained their own patients, and received gross payments without deductions for employment taxes.

[2] RULE 111: SERVICE B&O TAX -- ADVANCE/REIMBURSEMENT -- PATIENTS' PAYMENT OF NON-PHYSICIAN COSTS -- MEDICAL CLINICS. Revenue from patient billings for non-physician services, supplies, drugs, etc. provided at medical clinics either owned or subsidized by a hospital is taxable to the hospital because it either rendered the services or was personally liable, either primarily or secondarily, to third party providers.

[3] RULE 111: SERVICE B&O TAX -- EXCLUSION -- ADVANCE OR REIMBURSEMENT -- PHYSICIANS' FEES -- GUARANTEED MINIMUM PROFIT. Although a hospital guaranteed independent contractor physicians minimum profits, the amounts received from patients for physicians' fees were pass-throughs or advances for the hospital because it had no personal liability to pay specific fees to the physicians except as an agent.

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.

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NATURE OF ACTION:

Taxpayer hospital protests an assessment of service business and occupation (B&O) tax against income earned for services provided to patients at medical clinics.

FACTS:

De Luca, A.L.J. -- The Department of Revenue audited the taxpayer for the period January 1, 1988 through September 30, 1991. The taxpayer is a public hospital district in an area which lacked a sufficient number of physicians. Consequently, the taxpayer contracted with several doctors, agreeing to subsidize them for one to two years while they established their practices in the district. The contracts were similar and followed either one of two forms.

The first type required the doctor to conduct a full-time medical practice at a clinic which the taxpayer provided. The physician established what his hours would be, subject to a minimum of four and one-half days per week. The clinic included the necessary space, equipment, supplies, drugs, maintenance, utilities, telephone, laundry, house-keeping and record-keeping services. The taxpayer also provided all non-physician personnel needed for the delivery of the physician's services. The contract specified that "such personnel shall be employed by the District and shall be under the administrative and executive control of the District and under the technical and medical supervision of the physician."

The contract described the physician as an independent contractor. It declared the taxpayer neither had nor exercised any control over the professional medical judgment or methods used by the physician other than he follow its bylaws and regulations and perform competently according to professional standards. The physician was responsible for paying his taxes because the taxpayer did not withhold income tax, employment tax, Social Security, etc.

The contract required the physician to prepare a fee schedule for his professional services. Accordingly, the taxpayer was responsible for billing all of the physician's patients for his services together with any other charges for the services provided in the clinic. The physician's fees and charges were

separately identified on the taxpayer's billings, which advised the patients to make payment to the taxpayer. The physician reassigned to the taxpayer all third party reimbursement benefits from insurers and Medicare which were assigned to the physician from his patients. The taxpayer maintained separate accounting records for the receipt and deposit of the revenue for the physician's services.

Moreover, the taxpayer agreed to pay the physician an annual fee payable in twelve equal monthly installments. The taxpayer also paid the doctor's professional liability insurance premiums. When the agreement concluded, the taxpayer determined total costs incurred and revenue received from the clinic's operation. The taxpayer then used funds held in the clinic's account and funds collected from accounts receivable relating to the physician's billed fees and charges to reimburse itself for all unpaid costs. After all costs were paid, the taxpayer assigned any remaining funds in the clinic's account and accounts receivable to the physician as additional compensation.

The second type of contract was similar in its results, but used a different approach in obtaining the professional services needed. The taxpayer contracted with existing private physicians' offices. For example, such a proprietorship agreed to recruit and hire another physician. In return, the taxpayer agreed to reimburse the proprietorship for expenses incurred in obtaining space, equipment, utilities, supplies, office and nursing staffs, professional dues, professional liability insurance, automobile and paging services, accounting and legal services necessary to operate the office. The taxpayer also paid the proprietorship amounts for B&O tax obligations, employee benefits for and employment taxes relating to the recruited physician. Furthermore, the taxpayer paid the proprietorship in twelve monthly installments for the recruited physician payment.

Like the other contract, the taxpayer was responsible for billing the patients for services provided by the recruited physician, but not for services provided by other physicians in the proprietorship. We note the taxpayer asserts that, in practice, the recruited doctors frequently did their own billings. The proprietorship maintained a separate account for the recruited physician and reassigned to the taxpayer all third party reimbursement benefits which had been assigned to it from the patients. Again, the taxpayer first used all money collected by it to pay expenses. The taxpayer then transferred and assigned any remaining cash and accounts receivable to the proprietorship as additional compensation for professional services rendered.

Similarly, the second contract states that the recruited physician is an independent contractor who is not entitled to

typical employee benefits like sick leave, medical insurance, vacation, etc. The taxpayer did not withhold income tax, employment tax or Social Security from any payments made to the proprietorship. The contract declared the taxpayer did not exercise any control over the recruited physician or the proprietorship concerning the professional medical judgment or methods used in rendering services except as stated in the taxpayer's regulations and bylaws.
The taxpayer was assessed service B&O tax on all income earned by the clinics and the recruited physicians under both contracts.[1]

ISSUE:

Do the taxpayer's billings to patients for expenses and physicians' fees subject it to service B&O tax for all amounts received?

DISCUSSION:

The taxpayer contends the gross receipts earned by the doctors with whom it has contracted should not be included in its gross revenue for B&O tax purposes. Instead, it argues the physicians should be liable for the taxes because they are operating the clinics independent of it. The taxpayer explains it is merely subsidizing the doctors:

> . . . in the form of expense reimbursements or minimum profit guarantee. The doctor sets up and operates a clinic just as any physician would, but the hospital will reimburse that portion of his expenses necessary to provide that the doctor makes a guaranteed minimum profit on the clinic. Any profit generated above the guaranteed minimum is his to keep.

The taxpayer relies on Det. No. 88-208, 5 WTD 403 (1988). That matter concerned an assessment of service B&O tax on a hospital's billing and receipt of physicians' professional fees which it transferred in full to the doctors. The contracts in 5 WTD 403 were similar in many ways to the first type of contract in the present matter. Both hospitals owned clinics. Both hospitals agreed to provide clinic space, facilities, supplies, and services to the physicians. Both hospitals agreed to provide skilled support staff to assist the physicians. The support staffs were employees of the hospitals and compensated by the hospitals.

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[1]Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

The hospital in each case billed all of the physicians' patients. Their billings separately identified the physicians' professional fees and charges from the taxpayers' charges for services, supplies and equipment. 5 WTD 403 references the physician's services as the "professional component" and the taxpayer's clinic services as the "technical component" of the taxpayer's billings. In return, the physicians agreed to provide quality medical care to patients and be present and available either at certain times or for certain numbers of hours each week. Each doctor agreed to submit his professional fee schedule to the hospital.
However, the taxpayer in 5 WTD 403 did not guarantee minimum profits to the physicians. Furthermore, the taxpayer in that case paid without protest the B&O tax on income it earned for the "technical components" charges. The hospital contested only the B&O tax on the "professional component" revenue which it collected and transferred in full to the physicians.

The determination held that under WAC 458-20-105 (Rule 105) the physicians were independent contractors and not employees or subcontractors of the hospital. It ruled that the hospital's receipt of the physicians' professional fees did not subject it to service B&O tax. The determination was persuaded by the amount of control the physicians had over their medical practices, including setting fees charged, making medical judgments, and obtaining patients. The determination found the physicians alone, and not the hospital, contracted with the patients for the physicians' professional medical services. Additionally, the determination noted the taxpayer had no liability, other than as an agent, to pay the physicians their fees. If a patient failed to pay the physician's fee, the physician suffered the loss without recourse against the hospital.

[1] In the present matter, the audit report found the physicians to be subcontractors of the hospital and then taxed the income to the hospital. However, we find the physicians were independent contractors similar to the ones in 5 WTD 403 for the same reasons. For example, the doctors exercised full control over their own work when making medical judgments. They obtained their own patients, set their fees and hours, received gross pay without deductions for employment taxes, and their contracts state an intent to be independent contractors.

[2] We do not end our inquiry here because of remaining questions. First, in contrast to 5 WTD 403, the present taxpayer insists all revenue which it billed and received is not taxable to it, including the "technical components" of the billings. As noted, such charges were for non-physician services, supplies, equipment usage, etc. provided to patients at the clinics. In

order for such revenue to be excluded from the taxpayer's measure of tax, the money had to be either an "advance" or "reimbursement" under WAC 458-20-111 (Rule 111). Rule 111 makes clear it is applicable only in limited circumstances:

> 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 Washington Supreme Court in Rho Company v. Department of Rev., 113 Wn.2d 561, at 567-568, 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.

The taxpayer does not meet all of Rule 111's requirements in order to exclude from tax the revenue billed and collected for the "technical components." First, the payments received from patients did involve services which the taxpayer itself rendered, at least at the clinics it owned. Under the first type of contract, the taxpayer provided the clinic space, the nursing and office staffs (who were its employees), medical equipment, supplies, drugs, cleaning and other types of services, etc.

Second, the taxpayer was personally liable either primarily or secondarily for paying the clinic expenses under both types of contracts and clinics discussed. The taxpayer was not collecting revenue from patients and paying the costs of its employees and suppliers or those of the privately owned clinics merely as an agent. It was contractually obligated to pay those costs itself either directly to the third parties or indirectly by reimbursing the proprietorship. Therefore, revenues received by the taxpayer for "technical components" contained in the billings for either type of clinic were not pass-throughs and are taxable to it.

[3] The remaining question is whether the doctors' fees collected by the taxpayer and transferred in full to them are taxable to the hospital or whether they were merely pass-throughs. Following 5 WTD 403, we have already ruled that the physicians were independent contractors. We also noted that the physicians' fees in 5 WTD 403 were pass-throughs and not taxable to the

hospital. However, the physicians in that matter did not have guaranteed minimum incomes.
We do not believe the guaranteed income changes the outcome from 5 WTD 403. The physicians' fees which were billed and collected by the taxpayer belonged to the doctors for services they provided their patients. These payments were customarily collected from the patients by the taxpayer. The taxpayer itself could not and did not provide the physician services. Lastly, the physicians have no recourse against the taxpayer to collect specific bad debts. If a doctor's revenue exceeds the minimum guaranteed income, he is entitled to all of it, but the taxpayer has no liability to the doctor for uncollectible fees.

If the doctor's earnings fall short of the minimum guaranteed income, he alone is entitled to the receipts for physician services as his fee. The taxpayer then subsidizes the physician for the balance. The subsidy is simply a cost of doing business to obtain professional services and would also not be considered income to the taxpayer. Of course, the subsidy is income to the physician along with his earned patient fees.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part and denied in the remainder. Fees received by the taxpayer for physician services rendered to patients and transferred to physicians are excluded as income to the taxpayer and not subject to service B&O tax. The remaining income received by the taxpayer for services provided at the medical clinics is taxable to it. We remand this matter to the Audit Division to make the necessary adjustments to the assessment.

DATED this 14th day of May, 1993.