

Cite as Det. No. 98-004, 17 WTD 231 (1998)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Correction of	)	<u>D E T E R M I N A T I O N</u>
Assessment of	)	
	)	No. 98-004
	)	
...	)	Registration No. . . .
	)	FY. . . /Audit No. . . .
	)	
	)	

- [1] RULE 159: B&O TAX -- AGENCY -- AUTHORITY FOR. In order for one party to be considered the agent of another, there must be an agreement between the two that one will act on behalf of the other.
- [2] RULE 114 & RULE 169: B&O TAX -- EXEMPTION -- DONATION -- GRANTS FOR MEDICAL RESEARCH. A grant received by the corporate affiliate of a VA Hospital for medical research may be excluded from the measure of the affiliate's B&O tax if the three requirements of ETB 572.04.169 are met. Amounts excluded include those used to defray administrative expenses, as well as amounts used directly for the qualifying charitable purpose.

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.

NATURE OF ACTION:

VA hospital affiliate seeks B&O exemption for grants received.<sup>1</sup>

FACTS:

Dressel, A.L.J. -- . . . (Taxpayer) is a non-profit corporation that conducts medical research. Its books and records were examined by the Department of Revenue (Department) for the period January 1, 1991 through March 31, 1995. As a result a tax assessment, identified by the above-captioned numbers, was issued for \$. . . . The taxpayer appeals a minority amount of that assessment.

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<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

The taxpayer is closely affiliated with the . . . (VA Hospital) in . . . . Pursuant to Public Law 100-322, the taxpayer was formed to receive funds in support of the research and development activities of the VA Hospital. In creating this entity, Congress sought a more flexible mechanism for administering research funds from sources other than the Veteran's Administration itself.

The taxpayer has an office at the VA Hospital. About 55 people are employed by the taxpayer. They include 52 researchers and 3 administrative personnel. These employees provide support for the primary researcher(s) who, typically, is a staff member of the VA Hospital. The employees include research administrators, research nurses, laboratory technicians, Ph.D.s, M.D.s, biostatistical people, and others. The taxpayer is governed by an eight person board of directors, 3 of whom are high-ranking staff members of the VA Hospital. The taxpayer is heavily regulated by the Department of Veteran's Affairs (DVA), a federal agency. It is required to file various annual reports to that agency and is subject to scrutiny by the DVA Inspector General. The taxpayer is exempt of federal income tax pursuant to § 501(c)(3) of the Internal Revenue Code. According to the federal statute(s) that authorize it, the only purpose of the taxpayer is to facilitate VA research, and it may not receive or administer funds for any other purpose. The taxpayer does not own or maintain its own research facilities. Those utilized belong to the VA Hospital.

Grants comprise at least 85 percent of the income realized annually by the taxpayer. The rest comes from individual donations and interest. For the most part the Audit Division of the Department (Audit), in the audit, recognized the grants received as exempt of the business and occupation (B&O) tax under RCW 82.04.4282. However, approximately 10 percent of grant monies received were used for "administrative expenses". This amount is used to pay what the taxpayer labels "indirect costs" that include the salaries of the taxpayer's officers and executive director. Other administrative expenses that fall under these headings are "expenses for board meetings, general legal services, accounting, auditing, personnel, and general liability insurance".<sup>2</sup>

In disallowing this portion of the grant monies for the exemption of RCW 82.04.4282, Audit stated:

The portion of the grant retained by [Taxpayer] does not qualify for the deduction since [Taxpayer] is providing administrative services to the [Va Hospital]. [Taxpayer] does not directly receive any contribution, donation, or endowment from the grantors for the administrative services. The fee is received from the grantee. The fee represents an expense for the grantee and is not an expense of [Taxpayer].<sup>3</sup> . . .

The taxpayer maintains that under ETB 572.04.169 not only are its grant monies legitimately exempted from the business and occupation (B&O) tax, but, more specifically, the portion of

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<sup>2</sup> Taxpayer's Petition for Correction of Assessment, page 9.

<sup>3</sup> Auditor's Detail of Differences and Instructions to Taxpayers, page 1.

those monies used for administrative expenses, as opposed to expenses for direct research, are exempt. Further, it contends that the administrative expenses at issue are not those of the VA Hospital but, rather, are those of the taxpayer itself. Finally, it states that no payments are made from the VA Hospital to the taxpayer to cover these expenses. The taxpayer denies Audit's contention that it is providing management services to the VA Hospital for a fee.

#### ISSUE:

Are portions of grant monies received by a non-profit corporation on behalf of a VA hospital exempt from the B&O tax when used to pay administrative expenses?

#### DISCUSSION:

Audit claims that the real grantee here is the VA Hospital, as opposed to the taxpayer. Audit suggests that the taxpayer is acting as an agent on behalf of the VA Hospital. WAC 458-20-159 reads, in pertinent part:

AGENTS AND BROKERS. Any person who claims to be acting merely as agent or broker in promoting sales for a principal or in making purchases for a buyer, will have such claim recognized only when the contract or agreement between such persons clearly establishes the relationship of principal and agent and when the following conditions are complied with: . . . .

[1] While we acknowledge that the taxpayer here is neither promoting sales for a principal nor making purchases for a buyer, we observe the necessity in the above-quoted rule that a contract or agreement exist between the purported principal and the purported agent. In this case we know of no such agreement. Indeed, the authority for the taxpayer is the United States Code. The taxpayer is a product of federal legislation that was codified in 38 U.S.C. §§ 4161-4168.

“Agency includes every relation in which one person acts for or represents another by latter’s authority”.<sup>4</sup> *Black’s Law Dictionary, Fourth Edition*, p. 84. An “agent” is “[a] person authorized by another to act for him, one intrusted with another’s business”.<sup>5</sup> *Id.* at 85. The taxpayer here is not authorized by the VA Hospital to act on its behalf. It is authorized to receive and administer research grants by an act of Congress. Absent some specific authority from the VA Hospital *per se*, we fail to see how the taxpayer is an agent of same. We conclude that it is not.

Next, we will consider the previously-quoted statement by the Audit Division. For convenience, we repeat it here.

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<sup>4</sup> Citing *Saums v. Parfet*, 270 Mich. 165, 258 N.W. 235.

<sup>5</sup> Citing *Downs v. Delco-Light Co.*, 175 La. 242, 143 So. 227.

The portion of the grant retained by [Taxpayer] does not qualify for the deduction since [Taxpayer] is providing administrative services to the [VA Hospital]. [Taxpayer] does not directly receive any contribution, donation, or endowment from the grantors for the administrative services. The fee is received from the grantee. The fee represents an expense for the grantee and is not an expense of [Taxpayer].

Especially in light of the conclusion we reach above with regard to the purported agency relationship, we believe this statement is incorrect. Contrary to what Audit has written, the taxpayer *does* directly receive “donations” for administrative services. As a matter of fact, in a sample grant agreement,<sup>6</sup> sent to us by Audit, the taxpayer received \$. . . to be used for reimbursement of costs, “including indirect costs”.<sup>7</sup> Furthermore, the “fee” or grants are not received from the grantee.<sup>8</sup> As repeatedly emphasized by the taxpayer, no payments flow between it and the VA Hospital. The grants are paid to the order of the taxpayer, not to the VA Hospital.<sup>9</sup>

Nor do we believe that the “fee” represents an expense of the VA Hospital, as opposed to an expense of the taxpayer. The taxpayer employs about 55 people who aid the medical research and, otherwise, provide administrative assistance. Considering the corporate structure of the taxpayer as previously referenced and the fact that it employs 55 persons, it is very reasonable to assume that the taxpayer has its own administrative expenses to defray. That is, in fact, what it says it does with the indirect expense amounts at issue. Audit, without any support of which we are aware, has simply concluded that these administrative expenses are those of the VA Hospital. We find the taxpayer’s testimony on this point more persuasive and conclude that, indeed, the expenses at issue are those of the taxpayer, not those of the VA.

The authority for excluding contributions, donations, or endowments from the B&O tax is RCW 82.04.4282. More specifically as to grants, ETB 572.04.169 is instructive. It reads, in part:

#### GRANTS RECEIVED BY NONPROFIT OR GOVERNMENTAL ENTITIES

Bona fide contributions and donations may be taken as a deduction in computing the business and occupation (B&O) tax. Grants may be a form of donation, contribution, or endowment. This Excise Tax Bulletin explains the Department's position regarding the taxation of grants received by nonprofit or governmental entities from governmental or

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<sup>6</sup> The “grantor” in this agreement is the . . . .

<sup>7</sup> *Id.* at ¶ 4.

<sup>8</sup> We are assuming, based on the context in which the word is used, that by “grantee”, Audit is referring to the VA Hospital.

<sup>9</sup> We acknowledge that the grant agreement with the . . . and, presumably, others mention the VA as a party, notwithstanding the fact that the same agreement(s) specifies that all grant payments will be made directly to the taxpayer. Recognizing this as a source of confusion, the taxpayer has revised its agreements to clearly reflect it as the party with whom the grantor is contracting.

private sources. This represents a clarification and not a change in the Department's position.

RCW 82.04.4282 provides in part:

In computing tax there may be deducted from the measure of tax amounts derived from . . . (3) contributions, (4) donations, . . . and (8) endowment funds.

Though "grants," which may be referred to as "gifts" or "awards," are not specifically included in RCW 82.04.4282, the Department will presume that a grant consisting of an award of money, goods, property or services is a bona fide "contribution," "donation," or "endowment" within the scope and spirit of the deduction intended by the legislature when: (1) the grantor receives no significant goods, services, or benefits in return for making the grant; (2) the grantee is a nonprofit or governmental entity; and (3) the grants are used to promote, advance, or fulfill charitable purposes, *including the administrative expenses related to the charitable purposes*, within the meaning of sections 501(c)(3) of the Internal Revenue Code and the regulations and case law administering and interpreting that section.

[2] (Italics ours.) There is no dispute about the taxpayer being a legitimate 501(c)(3) corporation. Further, it has demonstrated that it enjoys tax-exempt status for property tax purposes from the Department and for B&O purposes from [City]. Inasmuch as the administrative expenses at issue are its own and inasmuch as it has no purpose other than to support medical research at the VA Hospital, we conclude that these expenses should be excluded from the measure of the taxpayer's B&O tax, just as were those grant amounts used directly for medical research.

In coming to this conclusion, we recognize the close relationship between the taxpayer and the VA Hospital. Nevertheless, we believe that the Congressional purpose in creating the taxpayer was to establish an entirely separate, legal entity and that the practice of the parties has been consistent with that intent. Absent abuse of those separate forms, as is inferred in WAC 458-20-203, the Department will recognize each entity individually for purposes of the taxes it administers.

#### DECISION AND DISPOSITION:

The taxpayer's petition is granted.

DATED this 30th day of January, 1998.