

Cite as 2 WTD 65 (1986)

BEFORE THE INTERPRETATION AND APPEALS SECTION  
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. 86-305
)	
. . . )	Registration No. . . .
)	Tax Assessment No. . . .
)	

**RULE 111, RCW 82.04.140, RCW 82.04.290 AND RCW 82.04.080:**  
SERVICE B&O TAX -- SERVICES RENDERED AT COST -- REIMBURSEMENT  
OF PAYROLL COST -- GROSS INCOME OF THE BUSINESS. Where  
taxpayer's employees rendered billing, collection, management,  
technical and professional services to another entity which  
paid for the services in proportion to the actual cost to the  
taxpayer on an allocated basis, the amounts received by the  
taxpayer are subject to Service B&O tax. Whether or not the  
taxpayer makes a profit, or whether taxpayer only does the  
services for one entity, is immaterial and irrelevant. There  
is no deductible "reimbursement" because taxpayer alone was  
personally liable for payment of salaries to its employees.

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 HEARING: July 30, 1986

NATURE OF ACTION:

Petition for refund of Service business and occupation (B&O)  
tax assessed on amounts received for services rendered to  
another entity.

FACTS AND ISSUES:

Krebs, A.L.J.--. . . (taxpayer) is engaged in the business of  
doing medical laboratory tests for physicians and hospitals.

The taxpayer is also engaged in providing billing, collection, management, technical and professional services to another entity.

The Department of Revenue examined the taxpayer's business records for the period from January 1, 1981 through June 30, 1985. As a result of this audit, the Department issued Tax Assessment No. . . . on November 26, 1985 asserting excise tax liability in the amount of \$13,072 and interest due in the amount of \$1,856 for a total sum of \$14,928 which has been paid in full.

The taxpayer's protest involves Schedule II of the audit report where the taxpayer's receipt of unreported amounts from [a corporation] which incorporated a predecessor partnership (. . . ) were subjected to Service B&O tax. The tax was assessed on the basis that the taxpayer received the amounts for services rendered to the [Pathological corporation]. Such services included billing, collection, management, technical and professional services.

On January 3, 1979, the taxpayer entered into a written agreement with the Pathologists which provided in pertinent part for the following:

1. The taxpayer is to provide the facilities, personnel, equipment and supplies for operation of a clinical laboratory service.
2. The Pathologists will direct the laboratory.
3. The Pathologists agreed to perform all anatomical pathology services requested by the patients' physicians as a part of their partnership practice and not as a part of the services of the taxpayer.
4. The Pathologists agreed to supervise the laboratory and assist in test interpretation to physicians who refer patients to the taxpayer.
5. The taxpayer agreed to provide the non-physician, technical, secretarial, and janitorial personnel.
6. The taxpayer agreed to provide its personnel with "salaries, vacation, and sick-leave arrangements and retirement benefits" as mutually agreed upon by the taxpayer and the employees.

7. Pathologists agreed to assist in training of the taxpayer's personnel and could recommend actions of hiring, discipline, and discharge to the taxpayer, but only the taxpayer had the final decision as to such actions.

8. The taxpayer agreed to serve as billing and collecting agent for the Pathologists' direct patient services including tissue diagnosis and bone marrow studies. Such services are to be billed and receipts deposited in the Pathologists' name.

9. The taxpayer agreed to provide personnel, technical services and physical facilities required for the cervical cytology testing.

10. The Pathologists agreed to reimburse the taxpayer for such billing services and technical cytology support at a rate equal to the costs of providing such services. Payments would be made monthly and reflect the number of individual patient accounts processed and services provided by the taxpayer.

11. The taxpayer's employees would provide management, technical and/or professional services to the Pathologists and the taxpayer would be paid monthly.

12. The Pathologists at all times would act as independent contractors.

A supplement effective January 1, 1981 (the audit period covered by the tax assessment commenced January 1, 1981) was added to the January 3, 1979 Agreement and provided in pertinent part for the following: the Pathologists would "reimburse" the taxpayer for "billing and other services," and "reimburse" the taxpayer at the rate of (as stated in the supplement):

1. 50% of Business Manager's salary and related expenses.
2. 50% of Bookkeeper's salary and related expenses.
3. 5% of Lab Manager's salary and related expenses.
4. 25% of Chemist's salary and related expenses.
5. 90% of Bacteriologist's salary and related expenses.

6. 50% of Client Services Representative's salary and related expenses.
7. Courier expense per . . . formula.
8. Other employee salaries will be allocated as necessary.

The taxpayer furnished the following information and explanation as a background to the arrangement between the taxpayer and the Pathologists. Prior to 1981, the Pathologists had no employees. There was a benefit to the Pathologists in that it did not have to file payroll tax reports or make payroll tax deposits. After 1981, the Pathologists considered the taxpayer's employees in the nature of "joint" employees and agreed to reimburse the taxpayer for the employees' salaries and expenses in proportion to the services rendered by them which would be allocated as done for the Pathologists. The taxpayer and the Pathologists decided that to issue two separate paychecks to one employee based on allocation of work would be more administratively inconvenient than to calculate what was due to the taxpayer as a reimbursement. The taxpayer asserts that if it had known that its arrangement exposed it to B&O tax liability it would have changed the method of compensating the employees. The taxpayer further asserts that there was no intent of any gain or advantage by not shifting employees to the payroll of the Pathologists. The taxpayer reports that it is currently shifting employees to the Pathologists as they perform most of their services for the Pathologists and that supports its contention that there was no gain to the taxpayer in the prior arrangements.

The taxpayer further asserts that the Service B&O tax should not apply to the amounts received from the Pathologists for the following reasons:

1. The taxpayer is not in the "business" of providing services to the Pathologists.
2. It was strictly an expense reimbursement arrangement, not compensation for services rendered.
3. There is no mark-up nor management fee added to the actual expenses incurred by the taxpayer.

4. The taxpayer does not hold itself out to the public as a provider of administrative services as do persons listed in WAC 458-20-224.

5. Personnel expenses were not prorated according to "gross sales" of the taxpayer and the Pathologists but allocated based on actual time spent by the employees on the activities of each corporation.

6. If the employees had been paid some percentage of their salary directly by each corporation, there would have been no B&O tax assessed. The substance of the transaction should be considered more important than the form.

#### DISCUSSION:

The taxpayer has presented extensive detailed and pointed oral and written statements. While the main arguments have been acknowledged in the foregoing section, the taxpayer may be assured that all of the argument details have been carefully considered. Thus, if an item raised by the taxpayer is not specifically discussed hereinafter, it is not to be interpreted or construed that it has been overlooked or ignored but, rather, that it is not deemed to be a critical factor in determining the issue to be decided.

The issue presented is whether amounts billed to the Pathologists and received by the taxpayer from the Pathologists for billing, collection, management, technical and professional services rendered by the taxpayer are subject to Service B&O tax. Details of the arrangement between the taxpayer and the Pathologists are described in the Facts and Issues part of this Determination and need not be repeated here. It is sufficient to state that the Pathologists were billed based on the portion of time spent by the taxpayer's employees in doing work (billing, collection, management, technical and professional) for the Pathologists.

RCW 82.04.140 defines the term "business" as follows:

"Business" includes all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly.

Washington B&O tax is based on gross receipts, not net income. Thus, whether or not a profit is made is immaterial and irrelevant. Where the taxpayer asserts that it is not in the

"business" of providing services to the Pathologist, it is sufficient that either party has sought a benefit from the arrangement in question. The Pathologists benefited by having the taxpayer do its billing and collection, and providing management, technical and professional services. Surely the Pathologists would not have paid for these services if they were of no benefit to it. Ordinarily, persons do not enter into an agreement, as the taxpayer and the Pathologists have in this case, unless they seek and perceive gains, benefits or advantages to result.

Because making a profit from the business activity is immaterial and irrelevant to B&O taxation, the absence of any mark-up or any other fee added to the expenses incurred by the taxpayer does not exempt from B&O taxation the amounts received for its services rendered.

Whether or not the taxpayer holds itself out to the public as a provider of administrative services does not remove it from being engaged in the business activity of rendering services even though done for a select private group.

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.)

We are convinced that under the law the "gross income" received by the taxpayer under the described arrangement with the Pathologists is subject to the Service and Other Activities classification of the B&O tax. This tax is imposed by RCW 82.04.290 which in pertinent part provides:

Upon every person engaging within this state in any business activity other than or in addition to those enumerated in RCW 82.04.230, 82.04.240, 82.04.250, 82.04.260, 82.04.270, 82.04.275 and 82.04.280; as to such persons the amount of tax on account of such activities shall be equal to the gross income of the business multiplied by the rate . . . This section includes, among others, and without limiting the scope hereof . . . , persons engaged in the business of rendering any type of service . . . (Emphasis supplied.)

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.)

Thus, under this definition, the taxable "gross income of the business" includes "value proceeding or accruing," from the taxpayer's business activity of rendering service, to cover both the cost of furnishing its employees and receiving payment for the resulting payroll costs and fees charged. The only possibility of exemption is if the amounts received from the Pathologists to cover the payroll costs could be said to be "reimbursements" for "advances" made by the taxpayer on behalf of the Pathologists under WAC 458-20-111 (Rule 111), copy attached. This rule, however, provides that:

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

In this case, the taxpayer alone was personally liable for payment of salaries to its employees. The payroll is clearly a nondeductible cost of the taxpayer's doing business. The contractual provisions of the January 3, 1979 Agreement specifically stated that the taxpayer was to provide the employees and pay them "as mutually agreed upon by the taxpayer and the employees." (See numbers 1, 5, 6, 9 and 11 relevant to the Agreement in the Facts and Issues part of this Determination.)

The fact that the Pathologists supervised and trained the taxpayer's employees or made recommendations of hiring, discipline and discharge of taxpayer's employees has no legal significance as far as the taxpayer's sole and primary liability for the payroll is concerned. Therefore, we must

reject the taxpayer's and/or the Pathologists' perception of the taxpayer's employees as being in the nature of "joint" employees.

Where the taxpayer asserts that it would have changed the method of compensating employees to avoid exposure to B&O tax liability, it must be noted that the Department has consistently imposed and levied excise taxes upon transactions as they are actually conducted, not as they might have been arranged. Furthermore, the Department, as an administrative agency, cannot simply overlook the requirements of the statute and regulations to satisfy "substance over form" arguments as raised by the taxpayer in this case. To do so we would have to exercise legislative authority which we are forbidden to do.

Where the taxpayer reports that it is currently shifting employees to the Pathologists as they perform most of their services for the Pathologists, it must be noted that if the taxpayer then compensates the Pathologists for services rendered by the Pathologists' acquired employees, then the Pathologists will incur Service B&O tax liability on the amounts received from the taxpayer.

For the reasons expressed and the law set forth, we conclude that the assessment of Service B&O tax on the amounts in question was proper.

DECISION AND DISPOSITION:

The taxpayer's petition for refund is denied.

DATED this 25th day of November 1986.