

Cite as Det No. 08-0233E, 28 WTD 100, (2009)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund and)	<u>F I N A L E X E C</u>
Correction of Assessment of)	<u>L E V E L D E T E R M I N A T I O N</u>
)	
)	No. 08-0233E
. . .)	
)	Registration No. . . .
)	Document No. . . /Audit No. . . .
)	Docket No. . . .

RULE 168, RULE 151, RULE 18801, RULE 224; RCW 82.04.290, RCW 82.08.020: B&O TAX -- MEDICAL CLINIC -- PRESCRIPTION DRUGS -- TRUE OBJECT. A medical clinic that administers chemotherapy drugs is taxable under the Service & Other B&O tax classification. Under the true object test, the clinic is performing a medical service, rather than engaging in the sale of tangible personal property subject to retailing B&O tax.

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.

C. Pree, A.L.J. – The taxpayer, an oncology and hematology clinic, petitions for correction of assessment and refund with respect to its receipts from administering chemotherapy drugs to patients We conclude that the Audit Division properly classified the taxpayer's receipts from administering chemotherapy drugs to patients under the Service & Other Activities business and occupation (B&O) tax classification and deny the taxpayer's petition

ISSUE

Whether the taxpayer's receipts from administering chemotherapy drugs to patients are properly classified under the Retailing or Service & Other Activities B&O tax classification. . . .¹

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410. Nonprecedential portions of this determination have been deleted.

FINDINGS OF FACT

The taxpayer is a for-profit medical clinic specializing in the treatment of blood disorders (hematology) and cancer (oncology). The clinic offers chemotherapy appointments, laboratory tests, family conference appointments, and drug refills.

In response to a refund request the taxpayer filed, the Audit Division reviewed the taxpayer's records for the period of . . . through As a result, the Department issued an assessment in the total amount of

The taxpayer raises [the issue of] the proper B&O tax classification for the taxpayer's receipts from administering chemotherapy drugs to patients; the taxpayer erroneously reported these receipts under the Public or Nonprofit Hospital B&O tax classification, and the Audit Division reclassified this income to the Service & Other Activities B&O tax classification. The taxpayer argues on appeal that this income should have been reported under the Retailing B&O tax classification.

The taxpayer notes that over 60% of its clinic revenue comes from providing drugs to patients, and it separately charges its patients for these drugs. Further, the taxpayer notes that often the patients are not seen by physicians on the day the taxpayer administers the drugs. In addition, the cost of administering the drugs is approximately 16% of the cost of the drugs. Finally, the taxpayer notes that its average gross profit margin on these drugs is approximately 7%, which does not include the cost to acquire or dispense the drugs, or the costs incidental to writing off uncollectible accounts. . . .

ANALYSIS

. . . Washington imposes a B&O tax "for the act or privilege of engaging in business" in the State of Washington. RCW 82.04.220. The B&O tax measure and rate are determined by the nature of the business activity in which a person is engaged. Chapter 82.04 RCW. With respect to retail sales, the B&O tax is imposed "[u]pon every person engaging within this state in the business of making sales at retail" measured by the "gross proceeds of sales of the business." RCW 82.04.250. In addition, Washington generally requires persons engaged in making retail sales in Washington to collect the retail sales tax from purchasers and to remit that tax to the state. *See* RCW 82.08.020.² In contrast, persons engaged in a service activity that is not classified as a retail sale, or otherwise classified for B&O tax purposes, report their receipts under the service & other activities classification and do not collect and remit retail sales tax on those receipts. *See* RCW 82.04.290; WAC 458-20-224 (Rule 224).

² RCW 82.08.0281 provides a retail sales tax exemption for sales of some prescription drugs.

WAC 458-20-168(2)(b) (Rule 168(2)(b))³ provides additional guidance regarding the proper classification of a medical clinic's income. Specifically, it explains:

The gross income derived from personal and professional services of hospitals, clinics, nursing homes, and similar health care facilities [other than certain hospitals not relevant here] is subject to service and other activities B&O tax.

See also WAC 458-20-151 (Rule 151); WAC 458-20-18801 (Rule 18801). With respect to a medical clinic's sales of tangible personal property used in providing medical services to patients, Rule 168(4)(a) explains:

Retailing B&O and retail sales taxes do not apply to charges to a patient for tangible personal property used in providing medical services to the patient, even if separately billed. Tangible personal property used in providing medical services is not considered to have been sold separately from the medical services simply because those items are separately invoiced. These charges, even if separately itemized, are for providing medical services and are subject to B&O tax under either the public or nonprofit hospital B&O tax classification or the service and other activities classification depending on the person making the charge. For example, **charges for drugs physically administered by the seller are subject to B&O tax under either the public or nonprofit hospital classification or the service and other activities classification depending on the person making the charge.** On the other hand, charges for drugs sold to patients or their caregivers, either for patient self-administration or administration by a caregiver other than the seller, are subject to retailing B&O tax and retail sales tax unless specifically exempt by law.

(Emphasis added.) Thus, Rule 168 is clear in its application of the retailing and service and other activities B&O tax statutes. Where a medical clinic, such as the taxpayer, physically administers drugs to a patient, these receipts are considered part of the medical services provided and are subject to the service and other activities B&O tax.

We applied Rule 168 in reaching this conclusion in Det. No. 90-35A, 9 WTD 289 (1990). That determination also involved an oncology clinic at which doctors or staff administered chemotherapy drugs as part of the clinic's services. The taxpayer separately accounted for the drugs and itemized the drug charges separately from services rendered when billing patients. Like the taxpayer here, the taxpayer contended it was entitled to report receipts from the sale of drugs under the Retailing B&O tax classification because it separately accounted for and separately billed the patients for them. We disagreed. We reasoned:

The way taxpayer bills its patients for the drugs administered by the doctors or staff does not control whether its income is subject to the retailing or service and other rate. The transaction or service must be examined as a whole to determine the proper classification.

³ Rule 168 was amended effective July 31, 2005, to read as quoted above. Prior to its amendment, the provisions of Rule 168 regarding the proper classification of the taxpayer's income were similar.

. . . [T]he contractual relationship between taxpayer and its patients is not one of sale, but one of service, even though such transfer or administration of drugs may result in separate charges.

(Emphasis original.) *See also* Det. No. 98-210, 19 WTD 109 (2000).

In support of the taxpayer's argument that when it administers drugs to a patient its receipts should be subject to retailing B&O tax, the taxpayer reasons that the intention of Washington's rules stating that all physician revenue should be classified as service and other activities was to make it easier for physicians to pay their taxes, because it provided one rate for all income. However, the taxpayer urges, this rule was written at a time when the majority of income generated by physicians was from services, and not the sale of tangible goods. The taxpayer notes that since that time, the cost of chemotherapy drugs has escalated enormously and that the tax burden associated with providing chemotherapy drugs does not leave it with a sufficient rate of return. The taxpayer argues that because the bulk of its income is from the retail sale of the drugs, not the service of administering the drugs, the revenue should be considered to derive from a retail sale.

While we understand the taxpayer's focus on the economics of its transactions, we conclude that the true object of the transaction is not the sale of tangible personal property, *i.e.*, the chemotherapy drugs, which could be subject to the Retailing B&O tax classification, but is instead the provision of medical services subject to the Service & Other Activities B&O tax classification. As we explained in Det. No. 03-0170, 24 WTD 393 (2005), "When determining whether a retail sale of tangible personal property or some other type of property or service has been purchased, the Department has frequently focused on the 'true object' of the transaction sought to determine the proper tax classification." *Citing* Det. No. 89-009A, 12 WTD 1 (1992); Det. No. 94-115, 15 WTD 019 (1994). As we have stated, the inquiry as to the true object of a transaction "should focus on what the buyer is seeking in exchange for the amount paid to the seller." Det. No. 03-0170, *quoting* Hellerstein, Significant Sales and Use Tax Developments During the Past Half Century, 39 Vand. L. Rev. 961, 970 (1986); *and citing* Det. No. 94-115.

In this case, the taxpayer's patients, the buyers, are seeking medical services, specifically the medical treatment of cancer, in their transactions with the taxpayer. While these medical services require the use of tangible personal property (the chemotherapy drugs), the true object of the transaction is the taxpayer's provision of medical services. As we stated in Det. No. 90-35A, "[T]he contractual relationship between taxpayer and its patients is not one of sale, but one of service, even though such transfer or administration of drugs may result in separate charges."

The taxpayer further argues that the services of the physicians rarely, if ever, directly involve the infusion of drugs to a patient. Thus, the taxpayer urges, the sale of the drugs should be separately classified as a retail sale. However, as quoted above, Rule 168 uses the term "medical services," for purposes of determining the proper classification of income; the services are not narrowly confined to "physician" services, as the taxpayer urges. Further, we note that Det. No. 90-35A concluded that the medical clinic's receipts from administering drugs to patients were

subject to the Service & Other Activities B&O tax classification where either “doctors or staff” administered the drugs.

In addition, the taxpayer argues that it is being treated inconsistently with ophthalmologists and optometrists. In support of this argument, it notes that the sale of glasses by an ophthalmologist or optometrist is treated as a retail sale, even though their services are subject to the service classification. The taxpayer urges this is the same situation as its sale of chemotherapy drugs – both require a prescription in order to be given to a patient, and the glasses and chemotherapy drugs “become part of them.” Further, the taxpayer reasons, the transactions are similar because optometrists are treating poor eyesight with the sale of tangible goods, and oncologists are treating cancer with the sale of tangible goods. We disagree with the taxpayer’s analogy for several reasons. First, at the time the ophthalmologist or optometrist prescribes the glasses, their medical services have generally concluded. In contrast, the administration of the chemotherapy drugs is part of the actual medical treatment the taxpayer provides. Further, the glasses are a separate, identifiable piece of tangible personal property given to the patients at the conclusion of the services. In contrast, at the conclusion of the taxpayer’s medical services, the chemotherapy drugs are no longer separate from the patient – they become a part of the patient in the course of the medical services.

Finally, the taxpayer argues that a new B&O tax deduction, RCW 82.04.620, effective October 1, 2007, supports its position that its receipts from administering chemotherapy drugs to patients should be classified under the Retailing B&O tax classification or should be deductible. RCW 82.04.620 provides a deduction for certain amounts received by physicians or clinics for drugs administered by infusion. The taxpayer argues this statute was a clarification of prior law, and not a change. The taxpayer urges this clarification was made because “prior administrative determinations were overbroad and exceeded the authority granted and intended by the legislature.” However, we found nothing in the legislation to indicate that it was simply a clarification, rather than a new deduction, and because the effective date is outside the period at issue here, we will not analyze whether the taxpayer’s activities would qualify for this new deduction. However, we further note that the new deduction clearly provides that the deduction is “from the measure of tax imposed by RCW 82.04.290(2),” which is the Service & Other Activities, not the Retailing B&O tax classification. Accordingly, this new statute supports our conclusion that the Service & Other Activities B&O tax classification, not the Retailing B&O tax classification, is the proper classification for the taxpayer’s receipts from administering chemotherapy drugs to its patients.

In sum, we conclude that the taxpayer’s receipts from the administration of chemotherapy drugs to patients are properly reported under the Service & Other Activities B&O tax classification. Accordingly, we must deny the taxpayer’s petition . . .

DECISION AND DISPOSITION

The taxpayer’s petition is . . . denied. . .

STATE OF WASHINGTON DEPARTMENT OF REVENUE