Cite as Det. No. 87-340, 4 WTD 221 (1987)

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. 87-340[1]
. . .	)	Registration No. . . .
	)	Tax Assessment No. . . .

[1] **RULE 102, RULE 151, RULE 18801 AND RCW 82.04.0281:** B&O TAX -- RETAIL SALES TAX -- PHYSICIANS -- DRUGS. When a physician administers a drug via injection to treat an allergic patient, the physician is considered to have sold the drug as tangible personal property if he itemizes the change. Such activity is considered a retail sale, separable, for state tax purposes, from the rendering of his/her professional services. The physician's acquisition of the drug is for resale so is not subject to retail sales tax.

[2] **RULE 111, RCW 82.04.080, RCW 82.04.090 AND RCW 82.04.140:** B&O TAX --PHYSICIANS -- SHARED EXPENSES -- REIMBURSEMENT OF -- COMMON PAYMASTER DISTINGUISHED. Where two physicians share office space and expenses, a bookkeeping credit to one for the overhead responsibility of the other constitutes taxable gross income to the beneficiary. This situation is distinguishable from a common paymaster in that there exists no separate payor third party entity.

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: February 11, 1987

[1] The reconsideration determination, Det. No. 87-340A, is published at 5 WTD 251 (1988).

NATURE OF ACTION:

Petition by physician contesting disallowance of the prescription drug sales tax exemption as well as the inclusion in his gross income of reimbursement money for supplies paid to the taxpayer's professional service corporation by another physician with whom the taxpayer shared office space.

FACTS AND ISSUES:

Dressel, A.L.J. -- . . . , M.D., Inc., P.S. (taxpayer) is the professional service corporation designation of . . . , M.D., a physician who specializes in the treatment of allergies. The taxpayer's books and records were audited by the Department of Revenue (Department) for the period January 1,1982 through September 30, 1985. As a result the above- captioned tax assessment was issued for excise tax and interest totaling $ . . . . The taxpayer has made partial payment of that amount but withheld the balance pending the resolution of this appeal.

In the course of its medical practice the taxpayer treats many of its patients by administering by injection varying doses of substances which are known as antigens or allergy extracts. The purpose of these is to build up in the patient antibodies which will resist the particular allergic agent(s) to which the patient is sensitive. The taxpayer purchased the antigens from several pharmaceutical companies. On some of those purchases the taxpayer paid sales tax. On others it did not. Whether tax was paid depended on the form of the bill. If the supplier billed for sales tax, the taxpayer paid it, but if the statement did not include tax, the taxpayer did not voluntarily add tax on to its remittance.

The Department's auditor has assessed deferred sales tax or use tax on the antigen purchases on which the taxpayer did not pay retail sales tax. The taxpayer has opposed the assessment, because it resells these substances as prescription drugs to its patients and such sales are not subject to sales tax because of a statutory exemption. It is not entirely clear if the taxpayer also contends that its acquisition of the antigens is not subject to tax based on the same exemption, or if such transactions are not sales taxable because the drugs are purchased for resale. In any event we think both arguments are, at least, implied and will respond to both.

In addition, it is worthy of note that the taxpayer itemizes the antigen charge in its statements to patients. Separate amounts are listed for the office call, administration of the injection and the antigen itself.

Whether sales tax is due on all allergy extract (antigen) purchases made by the taxpayer is the first issue to be decided herein.

The second issue has to do with the reimbursement of certain expenses incurred by the taxpayer in the conduct of its medical practice. During the course of the audit period, Dr. . . . shared the office space of his corporate equivalent with a Dr. . . . who is also an allergist. The two physicians had an arrangement under which rent, employee payroll, supplies and other assorted expenses were shared. Exactly how they were shared was determined by the monthly income of each doctor. The percentage of total office income generated by each was ascertained. These same percentages were

then used in setting each doctor's overhead responsibility. For instance, if, in a particular month, Dr. . . . was responsible for 60% of total office income, he was also charged with responsibility for 60% of the shared expenses while Dr. . . . covered the remaining 40%. At the end of each month an entry was made in the corporation's books to reflect the contribution made to overhead by Dr. . . . for that particular period of time. Although there was no actual payment of money accompanying this entry, the effect of it was that the taxpayer took a larger draw and Dr. . . . took a smaller draw from total office income. The journal adjustment was necessary because all expenses were billed to and paid out of the taxpayer's checking account for the sake of simplicity. Although Dr. B ordered supplies and incurred expenses just like Dr. A did, the supplies were ordered under the taxpayer's name to avoid duplicate paperwork. Dr. B, incidentally, was independent of the taxpayer in that he was not an employee nor did he have any ownership interest in Dr. A's professional service corporation.

The auditor has assessed B&O tax on this end-of-the-month adjustment. The taxpayer protests asserting that Dr. B was jointly responsible for expenses and that this adjustment of the taxpayer's books was simply a reimbursement of what it advanced for Dr. B's share of the overhead. Whether this entry in the taxpayer's journal constitutes taxable gross income to the taxpayer is the second issue.

DISCUSSION:

[1] The first issue is whether a retail sale of drugs and medications takes place when they are directly administered to patients rather than being delivered to patients as tangible personal property, over the counter so to speak. In other words, does it make any difference, at law, whether physicians sell a drug to a patient outright or inject such a substance into a patient in rendering medical services?

Clearly, medical treatment of patients by physicians differs significantly from professional services rendered by all other persons taxable under the Service classification of business and occupation tax. Medical practitioners administer tangible personal property to patients (drugs, prescribed medications, etc.) sometimes by injection, infusion, application, and other modes of direct delivery upon and into the human body. It is clearly the patient who directly consumes such things and derives the entire medicinal benefit of their administration. Such things are not administered to the patient for the benefit of the doctors so that they may perform their services. The patient purchases and consumes such prescribed drugs and other substances delivered by the injection or other mode of direct medical application just as surely as purchasing such things in a hospital or other pharmacy and ingesting them orally or by other self application means. The actions of administering such things to patients do not constitute intervening use by the physician. This is not "intervening use" as contemplated by RCW 82.04.050, nor is it "use" as defined by RCW 82.12.010(2). Thus, hospitals and medical practitioners are not themselves the users/consumers of prescription drugs and other substances administered to patients. However, hospitals and physicians clearly are the users/consumers of medical applications, apparatus, operating aids, cleansing agents, and the like which enable them to perform their medical services. This is true whether or not such things are strictly regulated and can be dispensed only by physicians' prescriptions or doctors' written orders. Therefore, we conclude that where tangible personal property is purchased by physicians or

hospitals for either direct, outright sale to patients or for delivery to patients by injection, infusion, and other modes of direct administration to patients, and where the patients are the ultimate physical consumers, such purchases do not incur sales or use tax liability by the physicians or hospitals. In short, all such purchases are for resale and resale certificates must be provided to suppliers (pharmaceutical houses, etc.). This is true whether the tangible personal property will ultimately be prescribed for the patient's use or not. In this respect "prescription drugs" are no different from any other kind of property which is purchased by hospitals for resale.

Based on this analysis, we agree with the taxpayer's contention that the drugs it administers to its allergy patients are purchased by the taxpayer for resale. That fact qualifies the taxpayer to issue to the pharmaceutical companies, from which it buys the antigens, resale certificates pursuant to WAC 458-20-102 (Rule 102). Under this Rule all sales are presumed to be retail sales unless accompanied by a properly executed resale certificate. In this case that presumption has been overcome for the audit period by virtue of the evidence presented. No sales tax is owed by the taxpayer on its acquisition from pharmaceutical companies of antigen drugs for resale and that part of the tax assessment which assesses same is hereby cancelled. Further, upon the presentation of supporting documentation the taxpayer will be granted a refund or credit for those purchases of drugs for resale on which it has already paid sales tax.

In the future the taxpayer is directed to provide resale certificates to its antigen suppliers in compliance with Rule 102. It is also directed to heed the section within Rule 102 titled "Purchases for Dual Purposes." If there are instances where the taxpayer consumes rather than resells antigens or other drugs, the taxpayer must report use tax on the quantities consumed. The taxpayer is further cautioned that the resale treatment afforded these prescription drugs presumes that the charge for same is separately itemized on customer billings. Documentation provided at the hearing demonstrates that this is presently being done and was also during the audit period. Authority for this requirement can be found in WAC 458-20-151 (Rule 151) which reads in part:

> Sales of drugs, medicines, and other substances prescribed by dentists and physicians are deductible by the seller from gross retail sales where the written prescription bearing the signature of the issuing medical practitioner and the name of the patient for whom prescribed is retained, and such sales are separately accounted for. See WAC 458-20-18801. (Emphasis added.)

Additionally, we observe that the taxpayer is also not bound to collect sales tax on its sales of antigens to patients because of the prescription drug exemption. The statute in which the exemption is contained provides:

> **RCW 82.08.0281 Exemptions--Sales of prescription drugs.** The tax levied by RCW 82.08.020 [retail sales tax] shall not apply to sales of prescription drugs, . . . (Brackets added.)

This exemption is limited by administrative Rule[2] and Department case law to sales of drugs to patients. It is not available to those farther up the selling chain, for example, on sales to those who sell to patients. Such sales may still be exempt, as those in this case from the pharmaceutical companies to the physician. Those sales are exempt, however, on a completely different basis, i.e., resale[3] as opposed to prescription drug. In any event, in the transaction under discussion, the antigens are prescribed as well as administered to patients by a medical practitioner so that sale qualifies for the prescription drug sales tax exemption. Notations made by a physician in the patient's chart are deemed sufficient written manifestations of the prescriptions.

Our disposition of this sales tax issue has business and occupation tax ramifications as well. Because the taxpayer has been found to have sold tangible personal property to a consumer, its sales of drugs, as discussed above, are retail sales.[4] RCW 82.04.250 states:

> **Tax on retailers.** Upon every person except persons taxable under RCW 82.04.260(8) engaging within this state in the business of making sales at retail, as to such persons, the amount of tax with respect to such business shall be equal to the gross proceeds of sales of the business, multiplied by the rate of forty-four one-hundredths of one percent.

This is the statute that establishes the Retailing business and occupation tax classification. The taxpayer's sales of antigen drugs are reportable for B&O purposes under this category. The taxpayer's B&O classification for other sources of income, however, is primarily Service and Other Business Activities which is levied at a higher rate.[5] It is our understanding that all taxpayer income including that specifically attributable to drug sales has been reported under the Service category. Inasmuch as properly itemized drug sales should have been reported under Retailing, the taxpayer has overpaid its B&O obligation. The Department's Audit Section will calculate the extent of that overpayment and will issue an amended assessment in which credit for same is given.

The taxpayer's petition is granted on the issue of sales/use tax on antigens. An adjustment of its B&O obligation will be made as well, based on the immediately preceding paragraph.

The second issue concerns the reimbursement of office overhead expenses to the taxpayer corporation by Dr. B. The measure of the Service and Other Activities business and occupation tax is the "gross income of the business" which term is defined by RCW 82.04.080 to mean:

> . . . 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, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the

[2] WAC 458-20-18801.
[3] See RCW 82.04.050.
[4] See RCW 82.04.050 and RCW 82.04.190.
[5] 1.5 percent per RCW 82.04.290.

> cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses. (Emphasis added.)

"Value proceeding or accruing" is defined by RCW 82.04.090, in pertinent part, to mean:

> . . . the consideration, whether money, credits, rights, or other property expressed in terms of money, actually received or accrued.
> . . . (Emphasis added.)

Finally, "business" is defined by RCW 82.04.140 to include:

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

[2] Thus, since the arrangement was created for convenience in sharing common expenses, it clearly qualifies as a "business" for excise tax purposes as it is engaged in with "the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly." Under the quoted statutes the amounts received by the taxpayer from the other doctor to cover his share of business costs incurred clearly constitute "value proceeding or accruing by reason of the transaction of the business engaged in" and are correctly subject to the business and occupation tax as such amounts are "gross income of the business." The fact that no actual payment is made by Dr. B to the taxpayer is not important because value has accrued to the taxpayer per RCW 82.04.090 in that it receives what is in effect a "credit" which gives it the "right" to take a larger draw. The expense adjustment is properly a part of the taxpayer's "gross income of the business" under the broad statutory definition of that term and was properly included in the measure of the taxpayer's B&O tax obligation.

The credit recorded on the books of the taxpayer also does not qualify as a "reimbursement" exempt of business and occupation tax under WAC 458-20-111 (Rule 111). An exempt "reimbursement" only occurs where the recipient has no personal responsibility, either primarily or secondarily, for payment of the initial costs for which reimbursement is received. In the case at hand, the taxpayer has at least partial, if not total, liability for employee salaries. While we recognize that the two doctors agreed to share that element of expenses, as well as others, no evidence has been presented that both are actual employers of the employees whose salaries are shared. The fact that the salary costs are shared does not establish that a true employer-employee relationship exists between both the taxpayer and Dr. B and the other workers in the office. Those employees may look solely to the taxpayer for their salaries even though they also perform working tasks for Dr. B as well. Inasmuch as their paychecks are written on an account bearing the taxpayer's name and not that of Dr. B, we do not think it unreasonable to assume that the taxpayer is primarily responsible for their pay.

The same argument may be made with regard to other items of overhead expense. It is our understanding that office and medical supplies including drugs are ordered in the name of Dr. A, P.S. It follows that the various vendors will look for payment to the same entity notwithstanding that Dr. B may have actually been the individual who did the ordering. Even though as between the

two physicians there may have been joint liability, it is not clear to us that the employees, vendors, and landlord recognized that status or even knew about it because of the exclusive use of the taxpayer's name in incurring and paying the various business expenses. As principals in the transactions their understanding of the business relationships in which they were involved was more important in establishing actual liability than what was probably, as to them, an undisclosed agreement between the taxpayer and Dr. B. The advance/reimbursement exemption of Rule 111 may not be applied where there is primary or secondary liability on the part of the recipient/payor (taxpayer), which clearly exists here.

Finally, we think it useful to distinguish this case from some which have been given the general label of "common paymaster" cases. Those primarily involve the creation of a third party entity solely to pay shared expenses of various principals. That entity is often simply a checking account bearing a separate name or the names of all the individuals who are sharing expenses. Each contributes to the account on which checks are written to pay common or shared expenses. The business of the individuals is carried on under their own names and B & O taxes reported under their own names. The Department has held in such cases where the only purpose of such a separate fund is to pay shared expenses that the account itself is not a person doing business "with the object of gain, benefit, or advantage."[6] It is, therefore, not required to register as a separate entity where its owners have their own tax accounts to which they report all business income. The bank account in such a situation is deemed a mere conduit for payment of expenses, and contributions received into it are not taxable.[7] If there existed in this case such a clearly defined and separate account or entity whose purpose was limited as explained above, the result would be similar. Here, however, such purpose has not been established and, indeed, is presumed not to exist because the account in question bears only the name of one of the two participants in the expense-sharing arrangement.

The taxpayer's petition is denied on the reimbursement issue.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part and denied in part.

DATED this 4th day of November 1987.

[6] See RCW 82.04.140.
[7] See Determination 86-234, 1 WTD 103 (1986).