

BEFORE THE BOARD OF TAX APPEALS.
STATE OF WASHINGTON.

SWEDISH HOSPITAL MEDICAL
CENTER,

Docket No. 86-28

Appellant,

Re: Appeal of Department
of Revenue Final
Determination No. 85-51A

v.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,

PROPOSED FINDINGS OF
FACT, CONCLUSIONS OF
LAW AND DECISION

Respondent.

This matter came before the Board of Tax Appeals (Board) for formal hearing on June 15, 1987, pursuant to determinations of the Department of Revenue denying refunds of business and occupation tax and sales and/or use taxes. The appellant, Swedish Hospital Medical Center (Swedish), was represented by Randall L. Stamper and Raymond G. Dodge, Jr., of Stamper & Taylor, P.S., Attorneys at Law. The respondent, Department of Revenue (Department), was represented by the Attorney General through Mary E. Fairhurst and John Gray, Assistant Attorneys General.

The Board heard testimony on behalf of the appellant by Carol Jean Poole, Douglas Weigelt, Allan Hanson, and Doctor Peter Taylor. Testimony on behalf of the respondent was provided by Tony Kopczynski, Auditor, Department of Revenue.

The Department audited appellant's business records for the periods including, but not limited to, tax years 1979 through 1981.

PROCEDURAL HISTORY

Swedish was assessed the following business and occupation taxes and sales and/or use taxes:

(a) Business and occupation taxes on revenue derived from services and related sales of prescription drugs for patients treated at appellant's Family Practice Residency Program;

(b) Business and occupation taxes assessed against tuition fees received by appellant from students who undertook courses offered in appellant's Registered Nurse Baccalaureate Program;

(c) Sales and/or use taxes on various orthotic devices.

Swedish petitioned the Department for relief from the imposition of these taxes. On December 10, 1984, an original appeal hearing was held by the Department on Swedish's challenge to tax liability. On March 29, 1985, the Department issued its Determination No. 85-51. Swedish appealed to the Director. Final Determination No. 85-51A was issued on June 30, 1986. In Final Determination No. 85-51A, the Department denied the requested relief for the items at issue in this appeal. 1

1 We take official notice of each of these determinations.

On July 25, 1986, Swedish filed its Notice of Appeal with the Board of Tax Appeals challenging determinations made by the Department.

The Board originally docketed this hearing with the 38 Hospitals and Deaconess hearing heard on March 16 and 17, 1987. By agreement of the parties, the Swedish hearing was separated from the other hospital appeals and continued until April 30, 1987.

ISSUES.

The issues presented will be discussed in the following order:

1. Whether revenues from the Family Practice Residency Program clinic and pharmacy are entitled to Swedish's "hospital" exemption from service business and occupation tax.

2. Whether Swedish must pay business and occupation tax on tuition fees which are collected by Swedish from its employees and forwarded by Swedish to Seattle Central Community College (SCCC) and Seattle Pacific University (SPU) along with its own substantial funds when the credits for these courses are accepted by SCCC and SPU and are part of a bachelor's degree program in nursing cooperatively administered by Swedish and SPU and SCCC.

3. Whether pelvic traction belts, post-operation shoes and cast shoes are orthotic devices and entitled to tax exempt status when they are resold to patients.

FINDINGS OF FACT.

1. The Department of Revenue is an agency of the State of Washington that administers the sales and use tax laws contained in Chapters 82.08 and 82.12 RCW.

2. Swedish Hospital Medical Center is a nonprofit hospital located in Seattle, Washington.

HOSPITAL EXEMPTION.

3. Swedish offers a Family Practice Residency Program (FPRP) through the University of Washington for medical school graduates. It is a three-year, post-graduate, comprehensive residency training program for family practitioners.

4. The FPRP program must be conducted by a hospital in order to gain accreditation from the American Medical Association.

5. The American Medical Association requires that the FPRP program include training at an outpatient facility "clinic" so that the training physicians can have patients and patient charts at their disposal.

6. Swedish claims that the FPRP is an integral and inseparable part of the total hospital facility and that the family practice program is no less an integral part of the hospital than is the physical therapy department. Further, Swedish claims that the services performed by the FPRP physicians constitute "services rendered to patients" by the hospital.

7. Swedish further claims that prescription drugs issued by the FPRP are also entitled to the hospital's exemption for prescription drugs.

8. The FPRP clinic is located inside the hospital building, adjacent to the hospital's emergency room. It shares an outside public entrance with the emergency room and has its own lockable inside entrance. 2

9. The physical plant area utilized by the FPRP clinic has been exempted from real property taxation.

10. The FPRP is staffed by Swedish personnel who are also faculty of the University of Washington School of Medicine and those in residency training who are supervised by those faculty members.

11. The FPRP utilizes Swedish equipment.

12. As part of the FPRP training, the resident doctors do more than work in the clinic. They work in the emergency room, on the hospital floors, and in doctors' offices outside the hospital or clinic.

13. Swedish is liable for any malpractice award resulting from treatment received at the FPRP.

14. The clinic only treats outpatients. It does not have facilities for overnight stays by patients.

15. The clinic operates only during regular working hours. The clinic is not open 24 hours a day; its hours are 9 a.m. to 5:30 p.m., Monday through Friday, and 9 a.m. to

2 In some FPRP programs, like the one offered in Spokane, the clinic is located outside the hospital facility.

12:30 p.m. on Saturday.

16. The clinic has its own business office and billing system. Payments are received and recorded by the clinic before being deposited with the Swedish cashier.

17. The Department has granted business and occupation tax exemptions to appellant's Pain Clinic and Tumor Institute, which are operated by appellant in the same manner as the FPRP. The Institute treats both inpatients and outpatients.

18. In all instances when an FPRP patient receives medication, a written prescription is utilized.

TUITION AND FEES.

19. Between January 1, 1979 and December 31, 1981, appellant and SCCC and SPU jointly operated a Registered Nurse Baccalaureate Program (Program) . Under the terms of the contractual arrangement that existed between SPU and the appellant during the period September 31, 1981 through August 31, 1986 (covering part of the audit period), the two entities were to cooperate in the administration of a bachelor's degree program at the hospital and university. Also according to the agreement,

Recitals

. . .

2. University is dedicated to providing a quality Bachelor of Science degree program with a major in nursing
.

III. The courses offered for credit remain under the sole and direct control of the University to assure the courses and their delivery meet the University's standards.

IV. The approval of lecturers for courses shall remain under the sole and direct control of the University.

IX. Hospital and University agree to be publicly identified as cooperating agencies with respect to the conduct of the Program. . . .

X. Hospital and University may use the other's name in describing the Program in advertising.

Agreement between Seattle Pacific University and Swedish Hospital Medical Center, at 1-3 (July 1981).

20. Almost all of the courses were taught at Swedish and the courses were essentially the same as those taught by SCCC or SPU on their respective campuses.

21. Some of the courses were taught by SPU faculty and some by Swedish staff. SPU paid its instructors, and Swedish adjunct faculty were expected to teach as part of their duties.

22. Swedish collected tuition fees from the students; it then paid all of it to SPU along with its own substantial supplemental funds.

23. Swedish collected the student tuition rather than SPU because the tuition charged the students amounts to approximately only 20 percent of the cost of the program. For accounting purposes, Swedish collects from students, then adds its own funds to pay SPU.

24. Participants in the professional nursing classes at Swedish were given college credits towards a bachelor's degree from SPU upon completion of the course.

25. The Department is inconsistent with its arguments as to who is providing the schooling and charging the fees. In its Final Determination No. 85-51A, at 5, the Department states

It is the taxpayer itself, not Seattle Pacific University, which is providing this educational training and charging the fees to students. . . . The program is not

accredited by any recognized accrediting agency. The established curriculum and disciplines of recognized educational institutions are lacking here.

The Department, in its Proposed Findings of Fact and Conclusions of Law, at 4, states

22. Swedish did not offer a degree in nursing; SCCC or SPU did.

24. Swedish did not charge tuition for the Program. Instead, Swedish collected a portion of the tuition on behalf of SCCC and SPU, which actually charged the tuition.

25. SCCC and SPU did not challenge the credits from courses taught at Swedish because the courses were SCCC or SPU courses.

ORTHOTIC DEVICES.

26. Items described as orthotic devices are exempt from sales tax under RCW 82.08.0283 and use tax under RCW 82.12.0277. To substantiate a claim for exemption, the Department requires proof that a sale has occurred and in the course of an audit, it seeks billings to the patient that would include a "line item" for the sale of and a prescription for the orthotic device under the provisions of WAC 458-20-18801.

27. The orthotic devices in question include postoperation shoes, pelvic traction belts, cast shoes, pulley clamp assemblies, and traction cords. At the hearing, Swedish withdrew premium pelvic traction pads and block foam from this Board's consideration.

28. RCW 82.08.0283 provides that the sales tax "shall not apply to sales of . . . orthotic devices prescribed for an individual by a person licensed under Chapters 18.25, 18.57, or 18.71 RCW"

29. RCW 82.12.0277 is virtually identical in its wording except it provides an exemption for use tax.

30. There is no statutory definition of what constitutes an orthotic device. Doland's Illustrated Medical Dictionary, 26th Edition, defines "orthotics" as "the field of knowledge relating to orthosis and their use." Doland's defines "orthosis" as "an orthopedic appliance or apparatus used to support, align, prevent, or correct deformities or to improve the function of moveable parts of the body."

31. Mosby's Medical and Nursing Dictionary (1983) defines "orthosis" as "a forced system designed to control, correct, or compensate for a bone deformity, deforming forces, or forces absent from the body. Orthosis often involves the use of special braces."

32. WAC 458-20-18801(7) defines orthotic devices as

fitted surgical apparatus designed to activate or supplement a weakened or atrophied limb or function. They include braces, collars, casts, splints, and other specially fitted apparatus as well as parts thereof. Orthotic devices do not include durable medical equipment such as wheelchairs, crutches, walkers, and canes nor consumable supplies such as elastic stockings, arch pads, belts, supports, bandages, and the like, whether prescribed or not.

33. All of the items in question are dispensed to a patient upon a physician's order written in the chart of the patient.

34. No evidence was presented of any separate accounting reflecting retail sales to patients for whom they were prescribed.

35. Pelvic traction belts, post-operation shoes, cast shoes, pulley clamp assemblies, and traction cords are not devices that are unique or specially fitted to one patient.

36. Any Finding of Fact deemed to be a Conclusion of Law is hereby adopted as such.

CONCLUSIONS OF LAW.

1. The Board has jurisdiction over the parties and the subject matter of this litigation.

2. Sales and use taxes apply to transactions in Washington unless the legislature has provided an express exemption. RCW 82.08.020 and RCW 82.12.020.

3. This Board holds that statutes that provide for exemption from taxation must be strictly and fairly construed.

[I] It is well established in this state that "an exemption in a statute imposing a tax must be strictly construed in favor of the application of the tax and against the person claiming the exemption . . ." In re

All-State Constr. Co., 70 Wn.2d 657, 665, 425 P.2d 16 (1967). Further, "the burden of showing qualification for the tax benefit afforded . . . rests with the taxpayer. And, statutes which provide for [exemption] are, in case of doubt or ambiguity, to be construed strictly, though fairly and in keeping with the ordinary meaning of their language, against the taxpayer." Group Health Cooperative v. State Tax Comm'n, 72 Wn.2d 422, 429, 433 P.2d 201 (1967).

(Emphasis added.) Catholic Archbishop v. Johnston, 89 Wn.2d 505, 507-08, 573 P.2d 793 (1978).

HOSPITAL EXEMPTION.

4. Swedish is a "hospital" as defined in RCW 70.41.020.

5. RCW 82.04.4289 provides hospitals a deduction from business and occupation tax for amounts received

as compensation for services rendered to patients or from sales of prescription drugs as defined in RCW 82.08.0281 furnished as an integral part of services rendered to patients by a hospital, as defined in Chapter 70.41 RCW, which is operated as a nonprofit corporation, . . . but only if no part of the net earnings received by such an institution inures directly or indirectly, to any person other than the institution entitled to deduction hereunder. In no event shall any such deduction be allowed, unless the hospital building is entitled to exemption from taxation under the property tax laws of this state.

(Emphasis added.)

6. If a qualified hospital provides services to patients, then any compensation derived as a result of those services is deductible from the measure of tax.

7. The term "hospital" is defined in RCW 70.41.020(2) as any institution, place, building, or agency which provides accommodations, facilities and services over a continuous period of twenty-four hours or more, for observation, diagnosis, or care, of two or more individuals not related to the operator who are suffering from illness, injury, deformity, or abnormality, or from any other condition for

which obstetrical, medical, or surgical services would be appropriate for care or diagnosis.

8. The statute goes on to exclude hotels, or similar places furnishing only food and lodging, or simply domiciliary care; nor does it include clinics, or physicians' offices where patients are not regularly kept as bed patients for 24 hours or more.

9. The court in Group Health Cooperative v. Tax Commission, 72 Wn.2d 422, 431, 433 P.2d 201 (1967), found that the legislature in granting the deduction had in mind amounts as were derived as compensation for services furnished to patients by a hospital, as such facilities and services are ordinarily comprehended. In Group Health, the court addressed the application of the statute to three clinics: two outlying clinics and one central clinic attached to the hospital. The court found that the two outlying clinics were not entitled to the exemption.

The two outlying clinics in Group Health provided the type of medical service one would expect to find and receive in the average private physician's office or clinic. "They are open only during regular business hours, provide no domiciliary care or overnight facilities, and are physically separate and apart from the central or hospital complex." Group Health, at 432.

The central clinic in Group Health, on the other hand, served "the central complex on a basis akin to the ordinary intake or emergency room in the average hospital." Group Health, at 432. The court explained that

the central clinic truly forms an integral, interrelated and essential part of the central facility, for, although it undertakes to provide some outpatient services akin to the outlying clinical service, it nevertheless provides the round-the-clock intake and emergency services which form a constituent part of the normal hospital operation.

Group Health, at 433.

10. The Swedish FPRP, although attached to the hospital, has the same characteristics as the outlying clinics in Group Health, offers the same services as an average private physician's office or clinic, is excluded from the definition of "hospital" in 70.41.020:

"Hospital" . . . does not include . . . clinics, or physician's offices where patients are not regularly kept as bed patients for twenty-four hours or more . . .

and is therefore not exempt.

11. Because the clinic does not qualify for the hospital exemption, the clinic's pharmacy does not qualify for the exemption.

TUITION FEES.

12. RCW 82.04.4282 provides a deduction from the business and occupation tax for "amounts derived from bona fide . . . tuition fees"

13. "Tuition fees" are defined in RCW 82.04.170 as amounts charged by an educational institution for library, laboratory, health service, and other special fees, plus room and board.

14. In order to have a tuition deduction, the tuition fees must be paid to an "educational institution." WAC 458-20114 (1970), as in effect during the early tax years in question, elaborates upon what constitutes an educational institution. That Administrative Code provision provides as follows:

Educational institutions which are entitled to the deduction include the following:

(b) Parochial schools and private schools accredited to schools of the "uniform school system" by the State Board of Education or the State Department of Education, and which are not specialty schools, business colleges, other trade schools or similar institutions;

(c) Schools whose students and credentials are accepted without examination by the schools referred to in "a" and "b" above, and which are not specialty schools, business colleges, other trade schools or similar institutions.

15. The relevant part of WAC 458-20-114 says, "The term 'tuition fees' refers only to fees charged by educational institutions" Swedish and SCCC and SPU jointly operate a program where they provide courses which are developed as a result of their joint efforts. In SPU's case, the credits obtained from the courses are credits toward a bachelor's degree at SPU. The sponsoring SCCC and SPU are the educational institutions. Swedish is not entitled to an "educational institution" exemption of income it receives from the students because it does not meet the definition of educational institution as required by WAC 458-20-114.

16. Under the agreement with its educational partners, the tuition fees collected by Swedish were collected on behalf of the sponsoring "educational institution," and no part of the \$18 per credit paid by the student was retained by Swedish. To gain a perspective on the tax structure, RCW 82.04.080 is instructive:

"Gross income of the business" means 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

The intent of the statute is to tax compensation or consideration received:

The language in Rule 111 is consistent with the statute if it is read to reflect the statute's obvious intent to tax only gross income which is "compensation for the rendition of services" (RCW 82.04.080) or "consideration . . . actually received or accrued" (RCW 82.04.090). Rule 111 excludes those reimbursements for advances which are merely passthroughs, where the taxpayer liability, if any, to the third party provider is solely agent liability

Walthew v. Department of Revenue, 103 Wn.2d 183, 188, 691 P.2d 559 (1984). Similarly, Swedish gained nothing in terms of compensation or consideration for any sales or services. The tuition fees received on behalf of the educational institution were not compensation for any services or other thing rendered by Swedish. The tuition fees received from the students were not retained, but instead, forwarded by Swedish to the educational institution to secure the students' registration requirements with such institution pursuant to an agreement. Such payments involved services that Swedish could not render as an educational institution" (See Conclusion No. 15). Moreover, Swedish was not liable for payment of the students' tuition. The responsibility to pay tuition remained always with the student. Basically, Swedish's role regarding students' tuition fees was simply passing through payments from the students to the educational institution. It received no income for acting in this fashion; there was no compensation or consideration received or accrued. It is apparent that where there was no compensation or consideration received or accrued from pass-through payments, such amounts would not be taxable under the state's business and occupation tax. Consequently, the tuition fees collected by Swedish for the educational institution should not be taxable to Swedish.

ORTHOTIC DEVICES.

17. The legislature did not define "orthotic devices" in RCW 82.08.0283 and RCW 82.12.0277. The Department is empowered to promulgate rules and regulations pursuant to the authority of RCW 82.32.300. WAC 458-20-18801 was promulgated by the Department and is entitled to weight.

There is a presumption that WAC 458-20-18801 is valid:

[1] In determining the validity of WAC 173-24, we first note that where the legislature specifically delegates to an administrative agency the power to make rules, there is a presumption such rules are valid. . . . Thus, this court's review of such rules should normally go no further than to ascertain whether the rule is reasonably consistent with the statute it purports to implement

The court should not invalidate a legislative rule merely because it believes the rule is unwise

[2] Furthermore, this court has consistently given weight to an interpretation of an ambiguous statute by the agency charged with its administration:

When a statute is ambiguous, the construction placed upon it by the officer or department charged with its administration, while not binding on the courts, is entitled to considerable weight in determining the intention of the legislature.

(Citations omitted.) *Weyerhaeuser v. Department of Ecology*, 86 Wn.2d 310, 314-15, 545 P.2d 5 (1976).

18. WAC 458-20-18801 allows exemption for "specially fitted apparatus." The items under appeal are not specially fitted nor are they unique to one patient. These items, which are not fitted, do not constitute tax exempt "orthotic devices."

19. Although there is evidence that the orthotic devices are prescribed for patients, there is no evidence that billings to patients include a "line item" for the sale of the orthotic devices as required by WAC 458-20-18801. This Board concluded in Docket No. 85-186, Deaconess Medical Center, that hospitals consume items rather than resell items unless a resale is evidenced on the patient's billing by means of a specific "line item" entry identifying the name of the item, the price of the item, and the name of the patient.

20. Any Conclusion of Law deemed to be a Finding of Fact is hereby adopted as such.

DECISION.

The Board sustains the determination of the Department of Revenue except in the taxation of "tuition fees" which this Board concludes were not compensation to Swedish for any services rendered by Swedish.

DATED this 25 day of November, 1987.

BOARD OF TAX APPEALS

* * * * *

WAC 456-08-540. Petition for Rehearing. (I) Any party may after a final decision of the board file a petition for rehearing. A petition for rehearing must be filed within fifteen days of service of notice of final decision in the hearing. The petition for rehearing, and an answer, if called for, must be served on the other parties in the hearing, and three copies filed with the board.

(2) The filing of a petition for rehearing shall suspend the final decision of the board until it is denied by the board or a modified decision is entered by the board.

(3) In response to a petition for rehearing, the board may (a) deny, (b) call for an answer, (c) modify its decision, or (d) permit a rehearing.