BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	D E T E R M I N A T I O N
	No. 88-208
. . .	Registration No. . . . Tax Assessment No. . . .

[1] **RULE 105 AND RULE 168:** SERVICE B&O TAX -- EMPLOYEE -- PRIMARY CONTRACTOR -- SUBCONTRACTOR -- PHYSICIAN -- PATIENT. Where a taxpayer, operator of a hospital and health center, bills the patient for physician's professional services rendered, the amounts received and transmitted to the physicians are not subject to Service B&O tax liability by the taxpayer unless the physicians were employees or subcontractors of the taxpayer. In this case, the physicians were held not to be employees nor subcontractors of the taxpayer. The physicians were held to be primary contractors with the patients and paid Service B&O tax on fees received.

[2] **RULE 111:** SERVICE B&O TAX -- ADVANCE/REIMBURSEMENT -- PATIENT'S PAYMENT OF FEES -- PHYSICIAN -- TAXPAYER AS CONDUIT OF PAYMENT. Where taxpayer receives payment from a patient to pay the fees owed by the patient to a physician, the payment meets the definition of "advance." The taxpayer had no personal liability for payment of the fee to the physician except as a conduit for the payment. Held, the taxpayer's receipt of the fees as a conduit for transmission to the physicians is not subject to Service B&O tax.

[3] **RULE 178:** USE TAX -- MEASURE OF TAX -- VALUE OF ARTICLE USED -- TOTAL OF CONSIDERATION -- RETAIL SELLING PRICE -- CREDITS PAID OR DELIVERED -- GRANT DELIVERED AS A CREDIT -- DISCOUNT. The measure of the use tax is the "value of the article used" which is the total of the consideration paid or given by the purchaser to the seller. In effect, where the article was purchased without payment of sales tax, it is the selling price that is the measure of the tax. The selling price includes money, credits, rights,

> or other property paid or delivered by a buyer to a seller. Where taxpayer received a grant from the seller for participation in the seller's . . . campaign and the grant was used as a credit deducted from the seller's selling price, the amount of the grant is includible in the measure of the tax as part of total consideration paid. The grant was held not to be a discount which is a reduction of the seller's selling price before the sale is made. Furthermore, the taxpayer depreciated the article purchased on a cost basis which included the amount of the grant.

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: October 1, 1986

NATURE OF ACTION:

Petition protesting (1) assessment of Service B&O tax on taxpayer's billing and receipt of physicians' professional fees transmitted to the physicians, (2) use of such physicians' fees in computing bad debt losses, (3) assessment of use tax on a purchase previously subjected to retail sales tax, and (4) assessment of use tax (deferred sales tax) on a purchase where the measure of tax included a grant that was credited against the purchase price.

FACTS AND ISSUES:

Krebs, A.L.J. -- . . . (taxpayer) operates a privately owned hospital and clinic. The taxpayer's facilities consist of two buildings, a hospital and the health center which has office space for four physicians.

The Department of Revenue examined the taxpayer's business records for the period from January 1, 1981 through December 31, 1984. As a result of this audit, the Department issued Tax Assessment No. . . . on March 26, 1985 asserting excise tax liability in the amount of $ . . . and interest due in the amount of $ . . . for a total sum of $ . . . which has been paid in full.

The taxpayer seeks a refund of taxes paid which involves Schedules IV, V, VI and VII of the audit report.

In Schedule IV, the auditor assessed Service business and occupation (B&O) tax on physicians' fees billed to their patients by the taxpayer and not reported by the taxpayer as subject to tax.

The taxpayer entered into a written agreement with a number of physicians. The agreement is entitled " . . . Agreement for the Provision of Physician Services." Pursuant to the Agreement, the taxpayer pertinently agreed to:

> 1. Provide adequate space and facilities to the physician in the taxpayer's health center and same is available to other physicians on an allocated basis.
>
> 2. Provide sufficient skilled personnel to assist the physician in his/her medical practice. Such personnel are employees of the taxpayer and compensated by the taxpayer.
>
> 3. Bill all patients of the physician. The bill is to consist of a "professional component" representing the physician's services and a "technical component" representing the taxpayer's contribution toward the service rendered which consisted of medical/surgical/ pharmaceutical supplies plus equipment rental.
>
> 4. Furnish office supplies, telephone service, utilities, housekeeping and laundry service.
>
> 5. Make payment to physician for professional services rendered.

Pursuant to the Agreement, the physician pertinently agreed to:

> 1. Provide quality medical care to patients.
>
> 2. Be present and available at all hours scheduled.
>
> 3. Prepare and submit a written professional fee schedule itemizing the fee for each professional service. The professional fee does not include the charge for "technical" services rendered by the taxpayer (the "technical component" added by the taxpayer in its billing the patient). The "technical" charge is $7 per visit by the patient to the physician at the . . . , $2.50 per visit by the patient to the physician in the emergency room, and $2.50 per visit by the physician to the patient in the taxpayer's hospital.

The taxpayer reported for taxation purposes the "technical" charges of $7.00 and $2.50 based respectively upon patients' visits to the physicians or visits by the physician to the patient in the hospital. The taxpayer did not report for taxation purposes the physicians' fees which the taxpayer included as a separate item in billing the patients. The name of the physician was indicated on billings to patients. The physicians reported their fees for taxation purposes on their own individual tax returns. However,

the auditor found that there were three physicians not registered with the Department of Revenue and they were to be separately audited for tax liability.

The taxpayer protests assessment of the Service B&O tax on the physicians' fee portion (professional component) of its billing to the physicians' patients for the following reasons:

> 1. The physicians are independent contractors, not employees of the taxpayer. The physician sets his/her own fee that will be charged to the patient. If the patient does not pay the fee, the physician suffers the loss without recourse to the taxpayer for payment. The taxpayer cites WAC 458-20-105 (Rule 105) to support its contention that the physicians were not its employees.
>
> 2. The taxpayer does not provide physicians to the patients. Patients admitted to the taxpayer's hospital must have their own physician. Where a patient is admitted to the hospital on an emergency basis without having a physician, the taxpayer contacts a physician (there are 20 available) who is "on call" and the physician becomes that patient's physician just as if he/she was the physician before the emergency. Patients coming to the emergency room are treated the same way. The taxpayer contends per Rule 105 that it was not "engaged in the business of practicing medicine."
>
> 3. The taxpayer, in business as a hospital and clinic, did not render any personal services of the type rendered by a physician and thus was not entitled to any part of the physicians' professional fees nor actually received any such part. The taxpayer cites the language in WAC 458-20-168 (Rule 168) as subjecting "gross income received from personal or professional services" to the B&O tax.

The issue is whether the taxpayer's billing of patients for the physicians' fees and receipt of the fees are subject to Service B&O tax.

In Schedule V, the auditor established the ratios of net bad debts to the taxpayer's gross income. Using the ratios developed in Schedule V, the unreported physicians' fees were adjusted in Schedule VI by an amount projected to be the bad debt loss on these fees.

The taxpayer asserts that the physicians' fees should not be included because the fees were not part of the taxpayer's gross income subject to Service B&O tax. Exclusion of the physicians' fees would result in elimination of a credit in the amount of $529 per Schedule VI.

The issue is whether the unreported physicians fees assessed per Schedule IV should not be favored with a tax credit for bad debt losses.

On Schedule VII, line 5, the auditor assessed use tax (deferred sales tax) on the taxpayer's purchase in 1981 of an alarm system for the amount of $4,821 without payment of sales tax. The auditor applied the combined state and local tax rate of 5% for a tax due of $241.

The taxpayer protests this assessment on the basis that it paid sales tax to the vendor and has documentary evidence to that effect. The issue is whether the taxpayer can establish such payment of sales tax.

On Schedule VII, line 3, the auditor assessed use tax (deferred sales tax) on the taxpayer's purchase in 1983 of a "gamefield" for the amount of $22,190 without payment of sales tax. The auditor applied the combined state and local tax rate of 7.5% for a tax due of $1,664.

The "gamefield" was purchased from . . . which was conducting a "national . . . campaign." The "gamefield" is a series of exercise areas with equipment and consists of a jogging course, fitness court and walking course. [The seller] charged $22,190 but deducted a $7,500 credit as a grant given in connection with its "national . . . campaign." The taxpayer recorded the $7,500 as grant income and $22,190 as the cost of the "gamefield" for depreciation purposes. The auditor used the taxpayer's Depreciation Schedule as the source for the amount of $22,190 on which to assess use tax (deferred sales tax) liability.

The taxpayer concedes that sales tax was not paid on the purchase but asserts that the measure of the tax should be $14,690; not $22,190 which includes the $7,500 grant.

The taxpayer contends that its total cost was $14,690 and that the $7,500 grant was actually a discount.

The issue is whether the measure of tax is $22,190 or $14,690, that is, whether the $7,500 grant qualifies as a discount from the purchase price so as to lower the use tax liability.

DISCUSSION:

The issues will be discussed in the order presented.

Schedule IV. The issue here is whether the auditor correctly subjected the taxpayer's receipt of professional fees from physicians' patients to Service B&O tax. The taxpayer billed the patients on behalf of the physicians for the physicians' fees. The

taxpayer retained no part of the professional fee payments. They were entirely remitted to the physicians. The billing to the patients included a separately itemized "technical component" for the taxpayer's provision of goods and services to the physician. The "technical component" consisted of medical/surgical/ pharmaceutical supplies, skilled assistants, use of equipment rented by the taxpayer, office supplies, telephone service, utilities, housekeeping and laundry service. The "technical component" also included the cost for billing the patient.

The above billing arrangement was carried out pursuant to written agreements entered into by the taxpayer with a number of physicians. The agreement is entitled " . . . Agreement for the Provision of Physician Services," and its details are provided in the Facts and Issues part of this Determination.

More important than the billing arrangement in ascertaining the tax consequences that flow from the billing arrangement is the business relationship between the taxpayer and the physician. In order for the taxpayer to be held liable for Service B&O tax on its gross billing which included the "professional component," it must be shown that the physician was either an employee or a subcontractor of the taxpayer in the rendition of the medical services to the patient.

[1] Rule 105 distinguishes employees from persons engaged in business. Rule 105 explains that an employee is:

> . . . an individual whose entire compensation is fixed at a certain rate per day, week or month, or at a certain percentage of the business obtained by such employee or servant, payable in all events; one who has no direct interest in the income or profits of the business other than a wage or commission; one who has no liability for the expenses of maintaining an office or place of business, for other overhead or for compensation of employees; one who has no liability for losses or indebtedness incurred in conducting the business; one whose conduct with respect to services rendered, obtaining of, or transacting business, is supervised or controlled by the employer.

In this case, the physician's compensation was not fixed by the taxpayer; rather, the physician set the professional fees to be charged his/her patient. The physician had a direct interest in the income of his professional practice. The physician's conduct of his/her medical practice and obtaining of patients was neither supervised nor controlled by the taxpayer. We conclude that the physician was not an employee of the taxpayer.

A subcontractor is a person who enters into a subcontract and assumes some of the obligations of the primary contractor. In this

case, the physician was the primary contractor with his/her patient. The patient contracted solely with the physician for professional medical care. When the patient visited the physician (16 physicians had their own offices and 4 physicians used the office space provided by the taxpayer), there was no contractual relationship whatsoever between the patient and the taxpayer. When the physician visited his/her patient in the taxpayer's hospital, the physician rendered his professional medical services pursuant to a primary contractual relationship with the patient; not as a subcontractor to the taxpayer because the taxpayer had no obligation to nor could it render professional medical services to the patient. We conclude that the physician was not a subcontractor to the taxpayer.

In the emergency room or hospital emergency admission situation, where the patient is treated by a physician who is "on call," it facially appears that the taxpayer is the primary contractor who has procured professional medical services for the patient which the taxpayer cannot render. But, in these emergency situations, the physician becomes that patient's physician with a retroactive effect as if done in a regular manner.

[2] Furthermore, in the emergency situations and the other situations as well, it appears to us that the taxpayer receives money as an "advance" from the billed patients to pay the fees owed by the patient to the physician. See definition of "advance" in WAC 458-20-111 (Rule 111).

If the patient does not pay the physician's fee, the physician suffers the loss without recourse to the taxpayer for payment. Because the patient alone is liable for payment of the physician's fee and the taxpayer has no personal liability for payment of the fee to the physician except as a conduit for the payment, such money received by the taxpayer is excluded from the measure of tax under the advance/reimbursement principle of Rule 111. We conclude that the taxpayer's receipt of the physicians' professional fees is not subject to Service B&O tax.

Schedules V and VI.

Because in the Discussion part of this Determination with respect to Schedule IV, we have held that the taxpayer's receipt of the physicians' professional fees is excludible from the taxpayer's gross income under the advance/reimbursement principle of Rule 111, the taxpayer is not entitled to the deduction for bad debts arising out of this Determination's reversal of the auditor's action in Schedule IV. The credit of $529 per Schedule VI in favor of the taxpayer is rescinded.

Schedule VII, line 5.

The issue here is whether the taxpayer can establish by documentary evidence that it paid sales tax to its vendor of an alarm system purchased in 1981 for $4,821. The auditor assessed use tax (deferred sales tax) of $241 on this purchase.

The taxpayer submitted a letter dated May 11, 1984, . . . , from [the seller] requesting from the taxpayer payment of $250.69 for Washington sales tax liability due on the contract amount of $4,821.

The taxpayer also submitted a photocopy of its check, . . ., dated April 10, 1984 in the amount of $250.69 payable to . . . . This same document has a notation from . . . requesting a copy of the invoice because it is unable to identify the check.

Apparently, the taxpayer forwarded the check to [the seller] on April 10, 1984 after receiving a first request because [the seller]'s letter dated May 11, 1984 is indicated to be a "second request."

In any event, we are satisfied that the taxpayer paid Washington sales tax to [the seller] in the amount of $250.69 on the $4,821 purchase of the alarm system. Use tax does not apply upon the use of any tangible personal property if the sale to the present user (taxpayer) has been subjected to the Washington retail sales tax. WAC 458-20-178 (Rule 178). Accordingly, the auditor's assessment of use tax in the amount of $241 is rescinded.

The taxpayer is entitled to seek a refund of $9.69 ($250.69 paid to [the seller] less $241 correct amount of sales tax due) from [the seller] who in turn is entitled to a refund or credit upon submission of documentary proof of payment of the refund to the taxpayer if [the seller] applies for the refund or credit before the end of 1988. RCW 82.32.060.

Schedule VII, line 3.

The issue here is whether a $7,500 grant from the seller to the taxpayer-buyer qualifies as a "discount" from the purchase price of $22,190 for a "gamefield." The seller, . . . , deducted the $7,500 grant from the billing to the taxpayer-buyer. The taxpayer paid $14,690 to the seller. The taxpayer recorded the $7,500 as grant income and $22,190 as the cost of the "gamefield" for depreciation purposes. The auditor used the taxpayer's Depreciation Schedule as the source for the amount of $22,190 on which to assess use tax (deferred sales tax) liability.

[3] Rule 178, . . . , in pertinent part provides:

> The use tax supplements the retail sales tax by imposing a tax of like amount upon the use within this state as a consumer of any article of tangible personal property

> purchased at retail or acquired by . . . gift . . . where the user . . . has not paid retail sales tax . . .
>
> . . .
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> (13) Value of the article used. The tax is levied and collected on an amount equal to the value of the article used by the taxpayer. The term "value of the article used" is defined by the law as being the total of the consideration paid or given by the purchaser to the seller for the article used . . . in case the article used . . . was acquired by gift or was sold under conditions where the purchase price did not represent the true value thereof, the value of the article used must be determined as nearly as possible according to the retail selling price, at the place of use, of similar products of like quality, quantity and character. (Emphasis supplied.)

By reference to "tax of like amount" as to sales tax and use tax, "total of the consideration paid or given by the purchaser," and "according to the retail selling price," Rule 178 indicates determinedly that the measure of the use tax is to be based on the "selling price" which is defined in sales tax statute RCW 82.08.010(1) to mean in pertinent part:

> . . . the consideration, whether money, credits, rights, or other property . . . expressed in terms of money paid or delivered by a buyer to a seller without any deduction on account of . . . discount . . . but shall not include the amount of cash discount actually taken by a buyer . . . (Emphasis supplied.)

RCW 82.04.160 defines "cash discount" to mean:

> . . . a deduction from the invoice price of goods or charge for services which is allowed if a bill is paid on or before a specified date.

RCW 82.04.160's "cash discount" is not applicable to the situation because the grant in issue was not a deduction for early payment of a bill.

The taxpayer claims that the $7,500 grant was actually a discount and thus not includible in the measure of the tax.

WAC 458-20-108 (Rule 108) discusses "discounts" and in pertinent part states:

> (5) DISCOUNTS. The selling price of a service or of an article of tangible personal property does not include

> the amount of bona fide discounts actually taken by the buyer . . . (Emphasis supplied.)

Generally, a discount is a deduction from the selling price because of early payment. Note that RCW 82.08.010(1) does not permit a deduction from the "consideration" for a discount except for a "cash discount" that is based on early payment. However, the Department has recognized that bona fide discounts may be granted for reasons other than simply timely payment by the buyer. Thus, the Department has recognized reduced prices to be the selling price where sellers have called the "reduced prices" "discounted prices" which does not mean that there was a deduction on account of a discount. It merely means that the seller's selling price was reduced before the sale is made and the Department looks to the "consideration, whether money, credits, rights, or other property . . . paid or delivered by a buyer to the seller" as the "selling price" which is the measure of the sales/use tax.

In this case, the seller's selling price was not reduced before the sale was made. The $7,500 grant was a gift resulting from the taxpayer's participation in the seller's "national . . . campaign." Indeed, the taxpayer recognized it as such on its records and recognized the cost of the game field as $22,190 for depreciation purposes. Furthermore, the measure of tax for use tax purposes is the "value of the article used," and where the article is acquired by gift the value is determined as nearly as possible according to the retail selling price at the place of use of similar products. In this case, the seller's invoice established the retail selling price (value of the article used) for the "gamefield" in question to be $22,190. The invoice further showed that a credit for the grant in the amount of $7,500 was included in the actual amount to be paid by the taxpayer-buyer. Because the "selling price" is the "consideration, whether money, credits, rights, or other property paid or delivered by a buyer," we view the $7,500 grant received by the taxpayer-buyer to have been a credit which in turn was paid or delivered by the taxpayer-buyer to the seller and is properly included in the measure of the tax. Accordingly, we sustain the use tax (deferred sales tax) as measured by the purchase/selling price of $22,500.

DECISION AND DISPOSITION:

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

Schedule IV. The taxpayer's petition is granted. The taxpayer's receipt of the physicians' professional fees is not subject to Service B&O tax payable by the taxpayer.

Schedules V and VI. The taxpayer's petition is granted. The credit of $529 per Schedule VI is rescinded.

Schedule VIII, line 5. The taxpayer's petition is granted. The assessment of use tax in the amount of $241 is rescinded.

Schedule VII, line 3. The taxpayer's petition is denied.

The file is being referred to the Department's Audit Section for adjustment of the audit in line with the holding of this Determination and authorization of the issuance of a refund including statutory refund interest.

DATED this 3rd day of May 1988.