

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

In the Matter of the Petition ) D E T E R M I N A T I O N  
For Correction of Assessment of )  
) No. 89-396  
  
)  
. . . ) Registration No. . . .  
) . . . /Audit No. . . .  
)

[1] RULE 224: B&O TAX -- MULTIPLE ACTIVITIES ENGAGED IN BY A SINGLE TAXPAYER -- SERVICE AND RETAILING. Where taxpayer engages in the separate activities of rendering professional services to customers and retail selling of supplies separately from the services, the activities are taxable under different B&O tax rates if the taxpayer has shown that they are treated separately in its billing and accounting system.

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 TELEPHONE CONFERENCE: June 6, 1989

NATURE OF ACTION:

Taxpayer protests reclassification of income from Retailing B&O to Service B&O where it provides services and sells disposable supplies at retail to customers.

FACTS AND ISSUES:

Johnson, A.L.J. -- Taxpayer is a nationwide company which engages in different activities in various states, including Washington.

Taxpayer's brochures and materials list four aspects of business which are available to hospitals and physicians. Essentially, the activities actually break down into two categories: services and retail sales.

## SERVICES

Taxpayer provides perfusion services to hospitals. A perfusionist assists during open-heart and some other types of surgical procedures. The perfusionist arrives at the hospital with the capital equipment necessary to perform his or her part of the surgical procedure and with a "mini-lab" equipped to provide analysis during the procedure.

In some cases, taxpayer contracts with individual hospitals to supply persons certified to perform perfusion services along with the capital equipment necessary to perform such services. It offers hospitals the opportunity to have the same group of perfusionists, for consistency, during the contract period. At all times, the choice of whether to retain a particular perfusionist remains with the hospital; if the hospital is dissatisfied, the person will be replaced by the taxpayer. Perfusionists are always under the direction and supervision of the hospital's operating physician.

Taxpayer also offers an inventory-management service. For a fee, it will assemble disposable supplies into single kits, using a physician's specifications. Then, as a service, it will maintain the inventory at its office or at the hospital, at the customer's option. The kits are billed for and restocked at the time that they are taken from inventory, whether the kit actually is used during the procedure or not. In some cases, the patient does not survive to that point of the procedure or the operation is not performed. A separate charge for the inventory-management service is billed to the hospital, and taxpayer reports the income from this service under the Service B&O category.

## DISPOSABLE SUPPLIES

Taxpayer sells disposable supplies for use during various surgical procedures. These supplies are the subject of taxpayer's protest.

It stressed that not all customers utilize both the perfusion services and the option to purchase their disposables from the taxpayer. For example, taxpayer has contracts with hospitals which purchase their supplies from other distributors; it also

sells disposables to hospitals which obtain perfusion services elsewhere.

Taxpayer contends that, separate and apart from its service activity, it is a retailer of the disposable supplies. It sells supplies in three ways: pursuant to a physician's requirements, it will assemble all of the disposables necessary for a procedure into kits, which are kept either at the taxpayer's location or at the hospital. The buyer is then able to order new kits as opposed to purchasing the items separately. The taxpayer also offers hospitals the opportunity to purchase individual items in bulk.

It further stressed that federal law effectively requires a separation between the service and the retail activities. It supplied letters from two of the manufacturers of the disposable supplies supporting its statements that the perfusionist lacks the authority to select and control the supplies to be used for the procedures, because federal law requires that all supplies used are to be selected by a physician.

Taxpayer stated that the perfusion and sales activities are separate at all times. A sample contract with a hospital using the perfusion service and purchasing disposable supplies contains the following paragraphs:

1. HOSPITAL hereby retains [taxpayer] to furnish to it all perfusion services. . . such service to include communication with physicians and hospital staff, operation of the heart-lung machine, monitoring and autotransfusion equipment, administering drugs as authorized, ordering supplies, maintaining inventory of supplies, supplying necessary and appropriate equipment, maintenance of such equipment in good workable order, and such other functions as are customarily performed.

. . .

3. [Taxpayer] will be responsible to inventory and maintain perfusion supplies required for open heart surgery. All disposable supplies will be billed to HOSPITAL at list plus 15% of such cost with the exception of heart valves which are list plus 55%.

. . .

7. HOSPITAL will make available to [taxpayer] a room to keep supplies in at no cost to [taxpayer]. HOSPITAL agrees to clean and maintain all space utilized by [taxpayer] in Hospital. [Taxpayer] agrees to pay for any damage caused to Hospital property by [taxpayer's] personnel due to negligence.

8. HOSPITAL agrees to supply all syringes, needles and miscellaneous items necessary in the administration of drugs.

Taxpayer bills hospitals on one invoice with separate amounts shown for the professional services rendered and for the disposable supplies. Retail sales tax is charged for the disposables.

In its petition materials, taxpayer states that during the audit period, its gross revenue was broken down as follows:

	<u>% of Sales</u>
Professional Services	38.1%
Service Charge on Disposables	8.1%
Capital Equipment Rental	<u>3.4%</u>
Subtotal	49.6%
Disposables	<u>50.4%</u>
Total sales	100.0%

It has supplied copies of letters sent to hospitals prior to contracting. One such letter details taxpayer's perfusion services:

Two-member team for perfusion effort;  
All related functions during the heart surgery, cardioplegia, monitoring, IABP, set up and cell saving;  
24-hour call at no additional charge;  
No charges for overtime;  
Unlimited back-up for illness, vacation and peak caseload periods;  
Final approval of perfusionists by surgical and administrative staff;  
Staff will be certified or eligible for certification;

Continuing education and development programs;  
Perfusion peer review;  
Liability insurance;  
All costs associated with recruiting and relocating;

The letter separately states that

[Taxpayer] is the largest single consumer of disposable supplies for open-heart surgery. This volume results in discounts which allow us to provide a comprehensive and cost-effective disposable program.

We have initiated a materials management system for disposable supplies which will allow a hospital zero inventory, zero waster. Many of our client hospitals utilize [taxpayer] as a vendor and have found that in most cases we can deliver a significant savings. We additionally have a service which will maintain and carry your valve inventory at a substantial savings.

#### DISCUSSION:

[1] Washington's tax structure clearly contemplates that persons engaged in business can engage in more than one type of activity, and it is also clearly structured to ensure that each activity in which the taxpayer engages will be taxed.

RCW 82.04.290 and WAC 458-20-224 (Rule 224), the administrative rule implementing the statute, both provide that persons engaged in any business activity other than or in addition to those for which a specific rate is provided in the statute, are taxable under the service and other business activities B&O tax classification.

As the taxpayer contends, the legislature's recurrent use of the language "other than or in addition to," or variations thereof, in the Revised Code of Washington clearly indicates its recognition of the fact that one business can engage in more than one taxable activity.

We agree with the taxpayer that it is engaged in service and retailing activities. It has demonstrated this separation in the fact that its customers utilizing the services of perfusion and inventory management are billed therefor on invoices and that billing for disposables is separated and subjected to retail sales tax.

The auditors found that "[taxpayer] does not bill for supplies until they are used in the performance of a procedure. Since all supplies are the property of [taxpayer] until used by [taxpayer's] employee, the perfusionist, in the rendition of the perfusion service, use tax has been assessed on all such supplies and the supply income reported [as] retailing has been reclassified to service."

However, upon supervisory review, the taxpayer apparently persuaded the supervisor that the disposables were not the property of the taxpayer and that they were to be supplied by the hospital, which could, incidentally, have purchased such supplies from the taxpayer in its retailing capacity. We agree. The confusing contract language actually addresses taxpayer's inventory activity and its perfusionist's service activity interchangeably. Further blurring the distinction is the fact that, where the off-premises inventory-management and the perfusion services are both used, the perfusionist will often bring the hospital's kit at the time that the perfusion service is to be rendered.

We find that the distinction is easily blurred in a case such as this, where the taxpayer separately retails a disposable item that its other branch uses in performance of related professional services, especially where both are available to the same customers and appear on a single bill. We believe that the taxpayer has submitted convincing proof that the two activities, however interrelated, actually are separate and should be taxed differently:

Exhibit A, a company brochure, describes the four types of services offered by the taxpayer: perfusion, capital equipment leasing, laboratory services, and inventory-management services of the customer's disposables.

Exhibit B further explains that customers can purchase "kits" of disposable supplies, which can be maintained on or off their premises, as well as ordering individual disposables in bulk quantities.

Exhibit C contains supporting letters from the manufacturers stating that doctors must direct the use of the disposables. Taxpayer also submitted a copy of a letter from the physician for whose patient the sample billing (Exhibit G) was prepared. The letter corroborates the manufacturers' statements.

Exhibit D contains letters from taxpayer to hospitals addressing only the sales of disposables, showing that sales are separately recruited and transacted.

Exhibit E contains taxpayer's letters to hospitals which have inquired about both perfusion and inventory-management services as well as sales of disposables.

Exhibit G shows a sample billing in which professional services and disposables were separately billed and retail sales tax was charged on the disposables.

Exhibit I shows a Fee Schedule in which the services and the disposables are separately listed and priced.

We caution the taxpayer that its laboratory services will continue to be subject to Service B&O, and that supplies which it consumes in the process of rendering its laboratory analyses are subject to use tax under Rule 224(6) if retail sales tax is not paid at the time that such supplies are purchased by the service provider.

Further, we note that, had the outstanding documentation submitted for the hearing been provided to the auditors, it is very likely that this appeal would have been unnecessary.

#### DECISION AND DISPOSITION:

Taxpayer's petition is granted. The file will be remanded to the Audit Section for adjustments consistent with this Determination. Taxpayer is expected to supply records which justify the tax treatment which it seeks by August 28, 1989.

DATED this 27th day of July 1989.