Cite as 8 WTD 373 (1989)

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

In the Matter of the Petition For Refund	)	D E T E R M I N A T I O N
	)	No. 89-512
. . .	)	Registration No. . . .
	)	. . . /Audit No. . . .

[1] WAC 458-20-111 (RULE 111): B&O TAX -- ADVANCES AND REIMBURSEMENTS -- CONTRACT PHYSICIANS IN PUBLIC HOSPITALS -- PUBLIC HOSPITAL/PATIENT FINANCIAL RELATIONSHIP. Public hospital, as principal and not as agent for patients, engaged independent physician corporation to staff hospital facilities for a fixed fee subject to adjustments for hours worked.

[2] WAC 458-20-233 (RULE 233): B&O TAX -- HEALTH CARE ORGANIZATIONS -- PUBLIC HOSPITALS -- CONTRACT STAFF PHYSICIANS ACTING AS AGENTS. Public hospital having no subscribers or members is not a medical service or similar health care organization. Even if such hospital did qualify as a health care organization, hospital payments to contract physicians engaged by hospital to staff hospital facilities for the benefit of all patients do not qualify for deduction.

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 3, 1989

NATURE OF ACTION:

Petitioner challenges imposition of B&O tax on service revenues received by taxpayer for independent contractor physician services rendered at taxpayer's hospital.

FACTS AND ISSUES:

WRIGHT, A.L.J. - . . . , a Washington corporation doing business as . . . Hospital, (hereinafter taxpayer), was audited for the period between January 1, 1983 and June 30, 1987. As the result of this audit, the taxpayer was assessed for a number of different tax deficiencies, which the taxpayer paid, together with interest and penalties.

On or about March 4, 1988, however, taxpayer and its parent corporation . . . , requested refund of business and occupation tax amounts not previously identified or itemized. The following question was thereby raised for appeal: Is B&O tax appropriate on that portion of taxpayer revenues derived from third-party contract medical services provided at, and billed and collected by, taxpayer's hospital?

At hearing and on review of the audit records, the following evidence was considered: The taxpayer operates, equips, supplies, maintains, and staffs a full service public hospital facility certified as such by the state of Washington. A few medical services are provided not by the taxpayer but by a professional medical service organization, [Association]. The taxpayer has engaged [Association] under written contract to provide professional staffing for 24-hour emergency room (ERP), "weekend" psychiatric, and EKG testing and evaluation services.

The written contract between the parties recites that the taxpayer's hospital provides exclusively to [Association], and to the [Association's] professional personnel acting as "independent contractors", appropriate facilities, equipment, supplies, support staff, fiscal management of time and billings, professional liability insurance, and either i) a guaranteed minimum hourly sum for the performance by the [Association's] physicians of the contract services, or ii) 73% of services billed, whichever is the greater amount.

The physicians of [Association], for their part, have agreed to provide the contract services required in a manner consistent with the standards of their profession and in

accordance with all laws. They are self-regulating in the performance of their work, they arrange their own scheduling, they report to their own supervisor, and they are paid by [Association], which is, in turn, paid by taxpayer.

Under this arrangement, the physicians of [Association] are required to keep time and service records. Those records are turned over to the taxpayer which, based thereon, computes the amount to bill the patients for the contract physicians' services. The taxpayer's hospital then adds the same to the hospital bills for all hospital services provided to the patients, and pays to [Association] contemporaneously therewith a lump sum constituting the total of monthly pay minimums or 73% of contract service billings, whichever is greater. Finally, the taxpayer collects the billings, to the best of its abilities, and retains payments of all hospital charges billed to the patients, including the [Association] physician billing totals.

The billing statements consist of line item accountings, of which the charge for [Association] physicians, though not identified as such, is one. The [Association] physician's name is noted on the bill, but there is no indication whether the physician is either a taxpayer employee or an independent-contractor physician. Finally, the billing does not state that the hospital is acting as collection agent for the independent physician or for [Association], allowing thereby the patients to assume that the [Association] physician billings are, in reality, taxpayer's hospital billings.

The taxpayer does not argue that the contract physicians are employees of the hospital. Rather, it insists by word and by deed that the same are independent contractors, as stated in the written contract and as reported to Medicare and the Washington State Hospital Commission.

There are other independent physician organizations in existence that could provide the contract services to taxpayer under the same or similar terms and conditions. However, neither taxpayer nor [Association] appears dissatisfied with the present contractual arrangement between them.

On Review, there are two (2) issues: First, in making payment to [Association] for the contract physician services, is the taxpayer "advancing" those sums as agent for the patients and is it, for reason thereof, entitled to deduct patient "reimbursements"? Secondly, and alternatively, in making payments to [Association], is taxpayer's hospital a medical

health care organization acting merely as agent for the independent [Association] physicians in the collection of fees?

TAXPAYER'S EXCEPTIONS:

[1] The taxpayer maintains that it has advanced moneys on behalf of patients to prepay the contract physicians' portion of the hospital billings. Thus, taxpayer argues, under WAC 458-20-111, it is entitled to deduct from its subsequent taxable receipts patient payments in the form of "reimbursements", for purposes of computing B&O tax.

[2] The taxpayer alternatively argues that its Hospital is a hospital service association or similar organization acting solely as the agent of the contract physicians providers in offering services to patient subscribers. It contends it is entitled, under WAC 458-20-233, to deduct from gross receipts the amounts paid over to said contract physicians, for purposes of computing B&O tax.

DISCUSSION:

According to the testimony in this case, it is apparent that the taxpayer tries to "wear three hats", ie., act in three different capacities: First, it acts as the provider of a myriad of hospital services for which it collects fees and costs on its own behalf. Secondly, it purports to act as the agent of the contract physicians of [Association] in its payment to those physicians of the greater of 73% of the patient billings or the monthly pay minimums, and in its subsequent collection of those patient billings. Finally, the taxpayer insists that it is acting as agent of the patients in advancing payment to [Association] on the contract physicians service portion of the hospital bills.

The above claims are clearly inconsistent. The reality of this situation is that taxpayer acts primarily on its own behalf and only secondarily, if at all, in other roles. This reality is significant in light of the two questions raised for review.

[1] WAC 458-20-111 provides guidelines for identifying the requisites of revenue deductible as "reimbursements". . . . . Several provisions contained therein reveal that the receipts sought by the petitioner to be characterized as deductible "reimbursements" do not qualify and may not, as such, reduce the taxpayer's tax measure.

> The words "advance" and "reimbursement" apply only when the customer or client alone is liable for the payment of the fees or costs and when the taxpayer making the payment has no personal liability therefor, either primarily or secondarily, other than as agent for the customer or client.
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> . . .
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> The foregoing is limited to cases wherein the taxpayer, as an incident to the business, undertakes, on behalf of the customer, guest or client, the payment of money, either upon an obligation owing by the customer, guest or client to a third person, or in procuring a service for the customer, guest or client which the taxpayer does not or cannot render and for which no liability attaches to the taxpayer. It does not apply to cases where the customer, guest or client makes advances to the taxpayer upon services to be rendered by the taxpayer or upon goods to be purchased by the taxpayer in carrying on the business in which the taxpayer engages.

First, there is no "reimbursement" because the taxpayer has no responsibility for the financial obligations <u>of the patients</u> to the independent physicians. Prior to being paid itself, the taxpayer has no responsibility to pay on behalf of the patient a medical bill owed for independent physician services.

Instead, the taxpayer has acknowledged it has, by contract, an independent obligation to pay the contract physicians either a guaranteed minimum for each month of service, or an amount greater than the minimum based on the hours of physician service rendered. This obligation is fixed and independent of whether the taxpayer ultimately bills or collects the service fees from the patients. In fact, when and if patient payments are ultimately received, the taxpayer keeps the same, paying <u>no</u> portion over to the contract physicians for the prior services rendered.

In brief, the taxpaying hospital is independently and primarily liable for the physician payments; its responsibility to pay the physicians is, by contract, totally separate from the patients' responsibility to pay the physicians or the hospital for the services rendered. Under

Section 458-20-111, no deduction for "reimbursement" is allowed.

[2] The Petitioner's second contention is that it is a medical service organization, acting as agent for the various contract physician service providers. The hospital argues that it is only making payments to those "member" physicians of the organization, and is entitled to deduction of those payments under WAC 458-20-233 (Rule 233). . . . .

The first question is, of course, whether or not the taxpayer corporation can be considered a medical service bureau, medical service corporation, hospital service association or similar health care organization, within the meaning of Rule 233. In reviewing the language of that section, and after surveying the determinations of this Department implementing the same, it is apparent that an essential requirement of such organizations is that they have a membership or group of subscribers. Then, for a fee or premium, the medical service or hospital service organization provides to its members or subscribers a range of medical and/or surgical services.

> The term "gross income" as defined in RCW 82.04.080 is construed to include the total contributions, fees, premiums or other receipts paid in by the members or subscribers. (WAC 458-20-233.)

The taxpayer in the instant case does not have a membership or subscriber list. Rather, as a hospital open to the public, it provides services to the general public, conditioned only upon financial eligibility, not on pre-payment of any fees or premiums.

The second question that must be raised regarding application of Rule 233 is whether the taxpayer acted solely as agent for the contract physicians. In light of the fact pattern in this case, the taxpayer's argument regarding its purported agency relationship to the contracting physicians is without merit. The relationship of the taxpayer's hospital to the contract physicians is not one of agent to principals, but that of principal to agents. The taxpayer is, after all, in the business of providing medical services itself. The hospital sought out and hired the physician corporation to provide the supplemental contract services in question. The hospital owns, maintains, staffs, equips, cleans, and otherwise provides the facilities and support staff for its own employees as well as for the contract physicians. And finally, the hospital is the billing party, sending out under

its business name statements of charges of which the contract physicians' services are listed in common with all other hospital services.

No deduction of amounts paid by a principal to its agents is deductible under Rule 233.

. . .

> Under contracts wherein these organizations furnish to their members medical and surgical, hospitalization and ambulance services as a principal and not as an agent, no such deduction is allowed.

For these reasons, the taxpayer's petition that moneys paid over to the contracting physicians be held deductible under WAC 458-20-233 as qualifying payments by a qualifying medical service or similar organization to its principal physicians is denied.

DECISION AND DISPOSITION:

The taxpayer's request for refund of Service classification business and occupation taxes on Hospital receipts paid to [Association] for services of independent contractor physicians is denied. The taxpayer having previously paid the original tax assessment, together with interest and penalties, no further determination of tax liability is made.

DATED this 22nd day of November, 1989.