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. 89-447
)
. . .) Registration No. . . .
) . . . /Audit No. . . .
)

[1] RULE 119 and RULE 244: RETAIL SALES TAX -- HOSPITALS -- MEALS FOR PATIENTS PURCHASED FROM CATERER -- PARENT COMPANY'S CHOICE OF ENTITIES. Where hospital chooses to contract with another corporation to prepare and provide meals for its patients, the caterer is engaging in a retail activity and its sales of meals to the hospital are subject to retail sales tax.

[2] RULE 203: STATE TAXATION -- SEPARATE CORPORATIONS -- CHOICE OF ENTITY -- EFFECT OF CHOICE. Each corporation is separately liable for applicable state taxes. Choice of entity by the parent resulting in a "captive" corporation status does not change the result that the hospital and the taxpayer are separately-taxable corporations.

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: July 27, 1989

NATURE OF ACTION:

Taxpayer petitions for correction of assessment of retail sales tax on meals prepared under contract for a hospital to serve to its patients.

FACTS AND ISSUES:

Johnson, A.L.J. -- Taxpayer is a corporation engaged in the business of providing dietary services to a hospital located in Washington state. Both taxpayer and the hospital, separate corporations, are owned by a single parent corporation. Taxpayer states that the parent is the "sole corporate member" of sixteen nonprofit hospitals located in several states. One of the parent's affiliate corporations is another corporation of which the taxpayer is a wholly-owned subsidiary.

Taxpayer's petition states that the parent corporation determined several years ago that

> the dietary departments of the hospitals within its health care system could be run on a cost-effective, efficient basis and attract quality personnel if the operation, management and staffing of these departments were conducted by a separate, distinct entity.

Consequently, the parent, through its affiliate, acquired the taxpayer to operate its hospitals' dietary departments.

Under the structure utilized by the parent, the hospitals are required to contract out the operation of the dietary departments to the taxpayer. The contract states that "the Hospital finds it prefers not to engage actively in a food service program."

The taxpayer oversees all aspects of the food service operation, and the hospital management reviews the performance of the taxpayer and certain aspects of the operation, such as pricing and variety of items in the hospital cafeteria.

Taxpayer protests the auditor's finding that it was making retail sales of meals to the hospital for its own consumption. It strenuously argues that Washington has adopted a policy that meals provided to patients by hospitals are not intended to be subjected to retail sales tax. WAC 458-20-119 (Rule 119) and WAC 458-20-244 (Rule 244), cited by the taxpayer state that meals furnished by hospitals to patients as a part of the hospital's services are not subject to retail sales tax. However, these rules were interpreted by the auditor to mean that, where the hospital itself was not preparing the meals, the preparer was engaged in a retailing activity and

was required to charge retail sales tax to the hospital on the sales of the meals.

Taxpayer contends that the intended use of the meals, not the identity of the preparer, should determine whether the meal is taxed. Under this theory, taxpayer would not be required to collect and remit sales tax on the value of the meals, because they are going to patients as a part of the hospital's service. It urges that an exemption for such meals is intended by the rules and that the parent's choice entity structure for getting the meals to the patients should not be a consideration.

It additionally contends that, while such a result might not be desired by the Department in all cases, the proposed tax treatment should be granted in its case. Taxpayer contends that the corporate structure is such that it is actually a "captive" corporation solely owned by the parent's affiliate and that the parent's hospitals are all required to use the taxpayer to operate their dietary departments. Because of the parent's choice to impose these restrictions on the hospitals, taxpayer believes that the lack of choice on the part of the hospitals and the related status of the corporations should result in a finding that the hospital is not purchasing the meals from an outside caterer or concessionaire. Therefore, it believes that it should be taxed in the same manner as the hospital would be if it operated its own dietary department.

DISCUSSION:

[1] Hospitals providing meals to patients are not required to collect retail sales tax on the value thereof where the meals are included in the overall charge for services received. Taxpayer contends that this "exemption" from retail sales tax represents a state policy that no patient should be charged retail sales tax on meals received during hospitalization. We disagree with taxpayer's interpretation of the taxing scheme of this state. It correctly acknowledges that it is required to collect sales tax on sales of food to nonpatients through the cafeteria facilities.

The version of Rule 244 in effect from 1983 through May of 1988 was in effect through most of the audit period and is the version on which taxpayer seeks to rely. It provided that

> (13) Certain persons, groups or institutions purchase food products for purposes of serving meals to individuals and historically have been required

> to pay sales tax as consumers on such purchases because of a unique relationship between the food purchases and the nature of the service rendered by such groups. Good sales taxed in this way were the following:
>
> (a) Furnishing of meals by hospitals. . .to patients as a part of the service rendered in the conduct of such institutions. (Emphasis supplied.)

Rule 244, as amended in 1988, refers the reader to Rule 119 for an interpretation of the taxability of patient meals. That rule provides that

> [t]he serving of meals by hospitals. . .as a part of the service rendered. . .is not subject to retail sales tax. (Emphasis and brackets supplied.)

WAC 458-20-168 (Rule 168) states that the gross income of hospitals is subject to Service B&O tax, and that charges billed separately to the patient are taxable under the Retailing B&O tax category and subject to retail sales tax.

WAC 458-20-178 (Rule 178) provides that

> the term "sale at retail" means, among other things, every sale of tangible personal property to persons taxable under the classifications of public road construction, government contracting, and service and other business activities of the business and occupation tax. Hence, persons engaged in such businesses are liable for the payment of the use tax with respect to the use of materials purchased by them for the performance of those activities, when the Washington retail sales tax has not been paid on the purchase thereof, even though title to such property may be transferred to another either as personal or as real property.

The "policy" relied upon by the taxpayer is not embodied in a statutory exemption in the law. What is the law is a reporting formula for use by service providers where meals are served as a part of a service and the charge therefor is included in the overall service charge. In this case, the service provider is not required to separate out the meal values and add sales tax to the patient's bill. This method of taxation is consistent with the taxation of all service providers, many of whom perform various activities as a part

of their overall service. We believe that the taxation method enacted by the legislature is not intended to reflect a policy of tax exemption; it is intended to reflect accommodation for the manner in which a service provider engages in business.

Where a service provider is a consumer, the value of items consumed is included in the service charge billed to its customer, as is the case of hospitals providing meals to patients. What would normally be a retailing activity becomes Service B&O taxable when engaged in by a hospital by virtue of its inclusion in an overall billing charge, not by virtue of any legislative policy. This fact is borne out by the rules on which taxpayer relies.

There is no language anywhere in Rule 244 prior to or following its amendment or in Rule 119 indicating any intent to exempt meals from taxation. Further, taxpayer's reliance on the prior version of 244 is misplaced, because it also specifically stated that

> (14) . . . Further, when such groups [hospitals] do not provide their own meals, but the meals are purchased from caterers or concessionaires, the caterers or concessionaires <u>are making retail sales subject to tax.</u> (Emphasis supplied.)

Finally, RCW 82.08.050 provides that

> In case any seller fails to collect the tax herein imposed or having collected the tax, fails to pay it to the department in the manner prescribed by this chapter, whether such failure is the result of his own acts or the result of acts or conditions beyond his control, he shall, nevertheless, be personally liable to the state for the amount of the tax.

[2] Taxpayer additionally argues that it should not be required to collect retail sales tax because the taxpayer and the hospital share the same parent company and because the corporate structure is such that the hospital "has no choice" but to contract with taxpayer to operate the dietary department and food service facilities. Under its theory that the state never intended meals served to patients to be subject to sales tax, it believes that it acts in the place of the hospital in providing meals which go directly to patients.

We disagree. The tax treatment taxpayer contends hospitals receive is actually a reporting accommodation reserved solely

to the provider of the hospital services. Where the hospital chooses not to be the preparer of the meals, it chooses to engage an outside caterer to conduct those activities. That caterer is making retail sales of prepared meals to the hospital and is required to collect sales tax on the full value of the meals.

Taxpayer contends, additionally, that the situation is one involving a "captive corporation:" the hospital has no choice but to contract with the taxpayer to prepare the meals, and this rigid requirement should dictate the result that the taxpayer is treated as a part of the hospital for state tax purposes.

We strongly disagree with this argument. What has actually occurred in this case is that the parent corporation has chosen to acquire hospitals and to acquire, through the affiliate, a caterer to operate the dietary departments of the hospitals. The decision to not permit the hospitals to operate these facilities was a voluntary corporate one made by the parent and the concerned affiliates or subsidiaries.

Chapter 82.04 RCW imposes a B&O tax upon every person engaging in business. The definition of "person" includes corporations, both for-profit and nonprofit. RCW 82.04.030. Rule 203 provides that

> [e]ach separately organized corporation is a "person" within the meaning of the law, notwithstanding its affiliation with or relation to any other corporation through stock ownership by a parent corporation by the same group of individuals.
>
> Each corporation shall file a separate return and include therein the tax liability accruing to such corporation. This applies to each corporation in an affiliated group, as the law makes no provision for filing of consolidated returns or for the elimination of intercompany transactions from the measure of tax.

Because the law is clear in stating both that taxpayer is a retailer of prepared meals subject to retail sales tax and that the taxpayer and the hospital are separately-organized corporations for state tax purposes, we are without authority to grant taxpayer the benefit of the interpretation it seeks.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

DATED this 30th day of August 1989.