Cite as Det. No. 99-013R, 20 WTD 481 (2001)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	)	F I N A L
	)	D E T E R M I N A T I O N
	)	
	)	No. 99-013R[1]
. . .	)	
	)	Registration No. . . .
	)	Request for Refund
	)	Docket No. . . .

[1] RULE 111: ADVANCES AND REIMBURSEMENTS – ELEMENTS – SUPERVISION AND CONTROL. In a non-employment placement situation, determining whether the taxpayer acted as an agent in paying third parties generally cannot be resolved by an analysis of supervision and control factors set out in *Rho* and ETA 90-001.

[2] RULE 111: ADVANCES AND REIMBURSEMENTS – ELEMENTS. All three Rule 111 conditions set out in *Christensen* and *Rho* must be met for a receipt to qualify for pass-through treatment.

[3] RULE 111: ADVANCES AND REIMBURSEMENTS – BURDEN. The taxpayer must claim, as well as carry the burden of showing qualification for pass-through treatment under Rule 111.

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.

NATURE OF ACTION:

A medical clinic seeks reconsideration of a determination denying refund of business and occupation (B&O) tax it paid on receipts related to charges by third-party providers of radiology and laboratory services for its patients. The taxpayer contends the receipts were advances or

[1] The original determination, Det. No. 99-013, is published at 20 WTD 471 (2001).

reimbursements excludable from its gross income under WAC 458-20-111 (Rule 111), or were payments it could deduct from gross income under WAC 458-20-233 (Rule 233).[2]

FACTS:

Prusia, A.L.J. -- The taxpayer, . . . provides medical services at several clinics in [Washington]. It primarily provides medical services to patients under contracts with medical plans and health maintenance organizations (HMOs).

On November 12, 1996, the taxpayer requested a ruling from the Taxpayer Information and Education (TI&E) Section of the Department of Revenue (Department) regarding the taxation of amounts the taxpayer received from patients and their insurance companies related to its payments to third-party providers of radiology and laboratory services. On December 30, 1996, the taxpayer filed a formal refund petition for the period January 1, 1992 through December 30, 1996.

On January 13, 1997, TI&E issued a written opinion that amounts the taxpayer received from patients, which were used to pay third-party providers, could be excluded from gross receipts as advances and reimbursements under Rule 111. However, on June 16, 1997, the Department's field auditor assigned to the case denied the refund request, stating that nothing the taxpayer had provided convinced him that the taxpayer was either acting as agent or was exempt under Rule 111 for any of its gross receipts. At the taxpayer's request, the Audit Division further reviewed the refund request. On August 19, 1997, TI&E formally responded to the refund request, denying the request and reversing its January 13, 1997 opinion.

The taxpayer requested review of the refund denial. The Department's Det. No. 99-013 upheld the denial, except for taxes paid on amounts the taxpayer paid to independent third-party labs and radiologists during the period between the first TI&E letter and the auditor's initial letter (i.e., between January 13, 1997 and June 16, 1997). The taxpayer now requests reconsideration, asserting mistakes of law and fact in Det. No. 99-013.

. . .

During the refund period, the taxpayer provided a range of medical and surgical specialties. These included allergy and immunology; family practice; internal medicine (including cardiovascular, endocrinology, gastroenterology, oncology, infectious diseases, pulmonary/critical care, and rheumatology); obstetrics; urology; opthamology; orthopedic surgery; otolaryngology; pediatrics; and surgery (including general surgery, thoracic surgery, plastic surgery, and vascular surgery). The taxpayer also provided laboratory, x-ray, ultrasound, nutrition and diet services, optical and hearing aid centers, and an occupational medicine

[2] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

program.[3] The taxpayer's January 1993 and December 1993 Yellow Pages advertisements stated it provided a "full range of medical and surgical specialties." The taxpayer employed physicians, as well as nurses and other support staff.

The taxpayer had an in-house laboratory, but out-sourced many lab and pathology services because it was not equipped or authorized to perform all tests. Some tests are esoteric and so difficult to perform that only one or two labs in the nation perform them. The taxpayer's in-house lab performed tests requiring less specialized equipment and personnel. The taxpayer used a variety of outside labs, both directly and indirectly, through a "primary reference laboratory." For tests the taxpayer did not perform, it collected the specimen and sent it to the outside lab.

The outside labs provided services for the taxpayer's patients under contracts, which required the taxpayer to pay the lab on a fee-for-service basis, with payment to be made within 30 days of the taxpayer's receipt of an invoice from the lab.

The primary reference laboratory also provided, under contract, an individual who provided Medical Director services to the taxpayer's own clinical laboratory. The Medical Director's contracted services included quality assurance review in the taxpayer's laboratory and microbiology departments. The contract provided that the taxpayer would pay the primary reference lab $ . . . per month for such services.

The taxpayer had in-house X-ray facilities and technical staff who took X-rays. It did not employ any radiologists to read and interpret X-rays. It contracted with an independent radiology firm ("Radiology") to provide the professional component of radiology services (the reading and interpretation). Since the taxpayer had a high-volume in-house radiology department, Radiology provided a radiologist on the taxpayer's premises on a daily basis to provide services. The radiologist read the X-rays and provided a written report of the results. The taxpayer's staff prepared the radiologists' reports.

The taxpayer's contract with Radiology stated the taxpayer "provides comprehensive medical care to patients through its physicians, its support staff, and also by contracting for specialized services." It required Radiology to provide all radiological procedures required by the taxpayer and capable of being performed at the taxpayer's clinics. It labeled the relationship between the taxpayer and Radiology an independent contractor relationship.

Radiology also provided, under contract, an individual who served as the Consulting Medical Director of the taxpayer's imaging services. The individual's duties included overseeing the quality and efficiency of the services provided by the consulting radiologists; serving as the primary contact point for scheduling, planning, and other operational issues between the taxpayer and Radiology; serving as advisor regarding equipment selection, technical issues,

[3] The facts were provided by the taxpayer or derived from its Yellow Pages advertisements . . . , of which we take administrative notice.

staffing and other items of importance to the operation of the taxpayer's imaging department; and, coordinating taxpayer-requested educational programs and participating in taxpayer utilization review activities. The contract provided that the Consulting Medical Director would be "compensated as part of the total Agreement and working relationship with [the taxpayer]."

Billing for services rendered by Radiology and outside labs is explained as follows. In the case of outside lab services, the taxpayer usually billed the patient for the test, and the outside lab billed the taxpayer. However, in some cases, the outside lab billed the patient or the patient's insurance carrier directly. The determination of who billed the patient was dependent upon the patient's insurance carrier. Insurance carriers generally wanted to be billed directly when they had negotiated a special fee arrangement with a lab. Otherwise, they wanted the taxpayer to combine billings for all services related to an occurrence, because one bill was more cost effective for the carrier to process and more understandable for the patient.

In the case of radiologist services, the taxpayer billed the patient a global fee for radiology services, which covered the technical portion of the test (the X-ray) and the professional component (the interpretation by the radiologist). The taxpayer tracked the related revenue by the type of X-ray being done. It paid Radiology a set percentage of the net collections for each type of X-ray.

On reconsideration, the taxpayer provided a copy of its Policy and Procedure # . . . , concerning quotation of fees for medical services. The taxpayer's policy is to make available to the patient, in advance, upon request, the estimated fee or range of fees appropriate to the service or procedure being performed. Its procedure is to explain that the range is for the doctor's services only, and there may be additional charges if lab work or x-rays are required. The fees it quotes are for office visits or consultations.

The taxpayer argued on appeal, and on reconsideration, that the amounts it collected for radiologist services and lab services, which it in turn paid to Radiology and the outside labs, were "advances" that were excluded from the measure of its B&O tax under WAC 458-20-111 (Rule 111). It argued that the payments it received met the three conditions or prongs for exclusion under Rule 111, set out in Christensen, O'Connor, Garrison & Havelka v. Dept. of Revenue, 97 Wn. 2d 764, 769, 649 P.2d 839 (1982), and Rho Company, Inc. v. Dept. of Revenue, 113 Wn.2d 561, 782 P.2d 986 (1989). It also relies upon Medical Consultants Northwest, Inc. v. State of Washington, 89 Wn. App. 39, 947 P.2d 784 (1997).

The taxpayer argued on appeal, and on reconsideration, that on substantially similar facts, the Board of Tax Appeals (BTA) held similar payments to a taxpayer to be excludable under Rule 111, in Group Health Northwest v. Department of Revenue, BTA Docket No. 91-11 (1992). The taxpayer relies upon Group Health and another BTA decision, Sequim Family Medical Center v. Dept. of Revenue, BTA Docket No. 41700, 12 WTD 263 (1992), which also addressed the application of Rule 111 in the medical services context. It argues that pursuant to those decisions, and the Supreme Court's interpretation of Rule 111 in Rho Company, Inc. v. Dept. of Revenue, 113 Wn.2d 561, 782 P.2d 986 (1989), the patients should be deemed employers of the

radiologists and the outside labs, and the taxpayer deemed, at most, the patients' paymaster in paying the respective outside providers.

Det. No. 99-013 concluded that the taxpayer could not exclude from the measure of its taxable income, amounts it received from its patients and used to pay Radiology and the outside labs. It concluded the receipts did not meet the requirements for exclusion under Rule 111.

The taxpayer alleges seven alternative mistakes in law and/or fact in Det. No. 99-013, which it contends require reconsideration and reversal of the decision. The alleged mistakes are as follows. (1) Det. No. 99-013 erred in limiting the refund to amounts paid during the period between the original TI&E opinion letter (January 13, 1997) and the field auditor's June 16, 1997 letter. The taxpayer argues the Department did not revoke the January 13 opinion until August 19, 1997, and it was entitled to rely upon the earlier opinion until the August date. (2) Det. No. 99-013 misinterprets the second condition or prong of Rule 111, in stating that the condition is not met because the taxpayer could have hired radiologists and could have directly performed radiology services. (3) Det. No. 99-013 improperly relies upon BTA decisions as precedent when they are unfavorable to the taxpayer's case, while disavowing their precedential value when they are favorable to the taxpayer. (4) Det. No. 99-013 mischaracterizes the taxpayer's arguments regarding whether the taxpayer acts as the agent of its patients. (5) Det. No. 99-013 erroneously declares that no evidence of the parties' relationship was produced other than the written contracts. (6) Det. No. 99-013 erroneously concluded that the parties' relationship in Rho is not comparable to the facts in the present case. (7) Det. No. 99-013 improperly placed on the taxpayer the burden of establishing that the amounts are excludable.

On reconsideration, the taxpayer raises two additional arguments. It argues Rule 111 should be applied consistent with the unique circumstances and customs of the medical industry. It argues a primary care physician wears two hats. The physician is both a provider of services and an agent procuring services on the patient's behalf. It argues that because of the insurance factor in the medical industry, there is much less up-front discussion with the patient regarding the arranging of services by third parties than there is in most agency relationships, but nonetheless both the patients and their insurers understand that the physician routinely acts as the patient's agent. In support of this argument, the taxpayer provided letters from its liability attorneys and its professional liability insurer, which expressed the opinion that the taxpayer would not be liable for professional negligent acts or omissions by the radiologists or the outside labs.

On reconsideration, the taxpayer also argues that it was entitled to deduct from its gross income the amounts it paid Radiology and the outside labs, under WAC 458-20-233 (Rule 233). It states that although none of the health care organizations the rule expressly references presently operate in Washington, the rule expressly applies to "similar health care organizations." It argues that Rule 233 should be broadly interpreted, and the taxpayer should be found to be a "similar health care organization" under Rule 233.

ISSUES:

1. Has the taxpayer identified mistakes in fact or law that would necessitate reconsideration of Det. No. 99-013 on the Rule 111 issue?

2. Does the taxpayer qualify for treatment as a medical bureau under Rule 233?

DISCUSSION:

Rule 111

Det. No. 99-013 thoroughly considered the taxpayer's facts, arguments, and authority with respect to the Rule 111 issue. The taxpayer has not identified any mistakes in law or fact with respect to Det. No. 99-013's conclusions on that issue that would necessitate the reconsideration of Det. No. 99-013. We incorporate herein, by reference, Det. No. 99-013's findings, conclusions, and discussion on the Rule 111 issue. The additional arguments and facts made on reconsideration do not require reconsideration of Det. No. 99-013's adverse determination.

[1] The Department strongly disagrees with the taxpayer's principal Rule 111 argument. The taxpayer would have the Department disregard the first two Rule 111 prongs, and have it resolve the third by looking at whether the taxpayer controls and supervises the third-party providers. As Det. No. 99-013 points out, the first two prongs are relevant, and the facts require they be resolved against the taxpayer. On the third Rule 111 prong, the Rho/ETA 90-001 supervision and control analysis does not apply in the present context.

Supervision and control are factors we examine to determine whether a person is an employee (servant) or an independent contractor. WAC 458-20-105; see Restatement (Second) of Agency §§ 220, 14N, and 2 (1958). In an employment placement situation, if the worker is an employee, we also examine supervision and control factors to determine who is the employer, as between the procuring company and the company for which the work is performed. Rho; ETA 90-001. Determining who is the employer is critical in applying Rule 111 in the personnel placement context, because an employer cannot be liable for paying its servants solely as an agent. Rho.

The present case is not an employment placement situation. The third party providers are not employees. The supervision and control factors set out in Rho and ETA 90-001 thus are not going to be present in either the taxpayer or its "client." Their absence in the procuring company (the taxpayer) does not have the significance it would have in the personnel placement context.

Other than its supervision and control argument, the taxpayer presented no additional facts or argument that would support a conclusion that the taxpayer acted as its patients' agent in procuring the services of Radiology and the outside labs.
On reconsideration, the taxpayer put forward the alternative theory that primary care physicians always wear two hats, one of which is that of the patient's agent. The taxpayer provided no authority in support of the argument.

[2] Further, as Det. No. 99-013 points out, even if the taxpayer had been acting as the agent of its patients, the taxpayer's liability for payment for outside lab services was not solely that of an agent, and therefore the third Rule 111 condition would not be met with respect to the lab charges. Under the terms of its contracts with the outside labs, the taxpayer was directly and primarily liable for payment of the lab charges. When an agent is personally liable for payment of third-party expenses, such charges are considered the agent's costs of doing business. See, e.g., WAC 458-20-207 (an attorney's advances on behalf of a client for nonlitigation expenses are excludable from B&O tax "only when the attorney does not have any personal liability to the third-party provider for their payment"); WAC 458-20-258 (travel agents and tour operators may have personal liability for rooms and tickets).

[3] Regarding who bears the burden on Rule 111, the characterization of a tax exclusion as either a "deduction" or an "exemption" presupposes a tax status and, therefore, the taxpayer must claim, as well as carry the burden of showing qualification for, the tax benefit afforded. Group Health Co-op. v. Tax Comm'n, 72 Wn.2d 422, 433 P.2d 201 (1967).

For the reasons set out in Det. No. 99-013, the taxpayer was not entitled under Rule 111 to deduct from its gross income payments to Radiologist and outside laboratories.

Rule 233

While the taxpayer based its claim for refund solely upon Rule 111 in its petition, in the reconsideration hearing it argued, in the alternative, that the payments were deductible under Rule 233. Rule 233 provides:[4]

> All medical service bureaus, medical service corporations, hospital service associations and similar health care organizations engaging in business within this state are subject to the provisions of the business and occupation tax and are taxable under the service and other business activities classification upon their gross income. 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. Insofar as tax liability is concerned it is immaterial that such organizations may be incorporated as charitable or nonprofit corporations.
>
> Certain of these organizations operate under contracts by the terms of which the bureau or association acts solely as the agent of a physician, hospital, or ambulance company in offering to its members or subscribers medical and surgical services, hospitalization, nursing, and ambulance services. In computing tax liability such bureaus and associations, therefore, will be entitled to deduct from their gross income the amounts paid to member physicians, hospitals and ambulance companies. No deduction

[4] Rule 233 is significantly outdated as a result of subsequent legislation removing the B&O tax liability for premium payments received by any "health care organization, health care service contractor, or certified health plan" in favor of a premium tax. See RCW 82.04.322 and 48.14.0201.

> will be allowed with respect to amounts retained as surplus or reserve accounts or to amounts expended for the purchase of supplies or for any other expense of the bureau or association other than as provided herein.
>
> 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.

The taxpayer argued as follows:

> None of the entities that Rule 233 expressly covers presently operates in Washington. However, Rule 233 expressly applies to "similar health care organizations." The Department should broadly interpret that term. Under a broad interpretation, the taxpayer is a "similar health care organization." The taxpayer operates under contracts with third-party medical providers by the terms of which it acts solely as their agent in offering its patients medical and laboratory services. In computing its tax liability, therefore, the taxpayer should be entitled under Rule 233 to deduct the amounts it pays the third parties from its gross income.

In Det. No. 87-332, supra, we held that a taxpayer that has no members or subscribers does not come under the specific terms of Rule 233. See also Det. No. 89-512, 8 WTD 373 (1989). Here, the taxpayer does not have members or subscribers. Rather, it is paid by subscriber-based organizations to provide medical services. It is not a "similar health care organization," and therefore does not come within the scope of Rule 233.

For what period is TP entitled to rely upon the first TI&E letter?

We agree with the taxpayer that Det. No. 99-013 erred in identifying the ending date of the period during which it was entitled to rely upon TI&E's favorable ruling [as] June 16, 1997. The Department did not revoke the favorable ruling until August 19, 1997. Accordingly, the taxpayer was not liable for B&O tax on amounts paid to independent third-party radiologists or independent third-party laboratories during the period between January 13, 1997, and August 19, 1997, and should be refunded any B&O tax it paid on those amounts.

DECISION AND DISPOSITION:

The petition for reconsideration is denied, except with respect to the length of the period during which the taxpayer was entitled to rely upon TI&E's favorable ruling of [January 13, 1997]. The taxpayer is entitled to a refund of taxes paid on receipts related to payments it made to third-party radiologists and laboratories, received during the period between January 13, 1997 and August 19, 1997. The file is remanded to the Audit Division for refund of those taxes.

Dated this 31st day of May, 2001.