

Cited as 1 WTD 469 (1986)

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

In the Matter of the Petition for) D E T E R M I N A T I O
N
Correction of Assessment)
)
) No. 86-290
)
)
 . . .) Registration No. . . .
) Tax Assessment No. . .
 .)
)

- [1] **RCW 82.04.030:** SERVICE B & O -- MEDICAL CENTER.
A medical center is not a separate taxable business if it has no employees and performs no management or other services. Use of the medical center name on a checking account for accounting purposes only does not give rise to separate business tax liability.
- [2] **RULE 105 AND RCW 82.04.140:** ENGAGING IN BUSINESS.
A taxable business is an activity or enterprise for gain, benefit, or advantage. A person engaging in business is generally one who is (1) recognized by the public as engaging in business, (2) one who receives the gross income and incurs the liabilities of the business, and/or (3) one who acts as an employer.

These 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: July 31, 1986

NATURE OF ACTION:

The taxpayer's account was examined for the period February 16, 1984 through December 31, 1985, resulting in Assessment

No. . . . for \$19,379. The taxpayer protests the entire assessment on the grounds it is not a separate business.

FACTS AND ISSUES:

Anne Frankel, Administrative Law Judge -- The auditor determined . . . was a separate "person" under RCW 82.04.030, engaged in business as defined in RCW 82.04.140, and subject to Service business and occupation tax. The auditor relied on language in an amendment to the management contract, the fact that [the taxpayer] had its own checking account, telephone listing, and that billing for services and supplies are addressed to [taxpayer]. Service tax was assessed on unreported management service fees received from independent doctors. (Schedule II.)

Use tax and/or deferred sales tax was assessed on the purchases of consumable supplies on which retail sales tax had not been paid. (Schedule III.)

The taxpayer protests the assessment of Service business tax, contending it does not exist as an entity and it is not engaged in business. The taxpayer explained its name as follows:

The name (. . . Center) belongs to . . . , a large hospital [Hereinafter HC]. The . . . Center is a specific portion of the first floor in [hospital's] medical building. The medical building is attached to the hospital and is rented entirely to physicians. The physicians who rent space in the [center] are physicians who are sole practitioners. They share space in an area of the building designated by [the hospital] as the . . . Center. Any or all of the physicians can leave and the Center remains.

. . .

. . . [the center] files no federal, state, or local tax returns. [The center] has no employees. At the end of the calendar it does not issue Forms 1099 to the physicians. Each physician is a sole practitioner.

Approximately 10 physicians have each entered into a contract with [HC]. Pursuant to its terms, [HC] provides a variety of services, the [taxpayer's] space, certain equipment, and certain supplies.

More specifically, the employees of [HC's] Practice Management Department provide nursing, reception, telephone answering, and accounting services to each physician. The physicians have no employees. Since each physician has entered into a contract with [HC] for substantially similar services, space, equipment, and supplies the physicians must share them. In order for the sharing to be fair, equitable, and predictable, the physicians have entered into an agreement among themselves which outlines the rules with respect to the sharing.

. . .

Pursuant to the contract which [HC] has entered into with each physician, [HC] manages each physician's practice on a cost-plus basis. That is, [HC] provides all necessary personnel, the space, utilities, accounting and computer services, equipment, and certain supplies at [HC's] cost plus a \$3,200 fee per month.

Perhaps the following general description of the process will help. Patient X makes an appointment with [HC's] employee to see his or her specific physician. At the designated time the patient arrives and is directed to the physician. The physician performs the medical services and advises [HC's] accounting personnel as to the services rendered. [HC's] accounting personnel bills the patient or the patient's insurance carrier. As each physician receives payment for his or her services, [HC] records the receipt, deposits the money in a bank account for clearing purposes only. Then, 55% of each month's receipts are retained by [HC] for the purpose of paying the physician's share of expenses. The balance of each physician's receipts (45%) is distributed to him or her. Periodically, the account of each physician is adjusted to take into account whether 55% of his receipts exceed or is less than his cost plus his share of his \$3,200 fee.

The 55% is applied by [HC's] to reimburse itself for the cost of its employees and employee benefits, the cost of shared surgical and medical supplies, and the use of its computer for scheduling, inventory, rent, and accounting services. In addition, the

physicians are each charged their respective share a month \$3,200 fee for PMC's management of their practice. And finally, each physician is charged for the following items which the physician individually uses; professional journals, laboratory fees, special medical supplies, office supplies, telephone charges and rental, medical and dental insurance premiums, and each physician's B&O taxes based on 100% of the individual physician's receipts.

The taxpayer also stated that when [HC] first entered into practice management contracts with physicians, it contacted the Department and described the arrangement in detail. It stated [HC] has been reporting the income from the practice management contracts as instructed. Each physician pays business and occupation tax on 100 percent of the gross income received for his or her services. [HC] pays business and occupation tax in the amounts received for management fees (\$3,200/physician/month) and for the payments for shared expenses, as salaries, supplies, rent, telephone, and equipment rental. [HC] does not pay business and occupation tax on the portion of the 55 percent retained and/or the additional amount collected from the individual physicians for paying their individual costs.

The taxpayer does not protest the assessment of use tax if it is on consumable supplies for which no retail sales tax was paid; however, it contends the use tax should be the obligation of either [HC] or the individual physicians, depending on who "used" the supplies.

DISCUSSION:

The Association and Office Sharing Agreement which was executed between the individual physician and [HC] in February of 1984 clearly provides that [HC] shall manage the Center pursuant to management contracts with the individual physicians. The individual management contract contains the following provisions indicating the agreement was between the individual physicians and [HC] and that Seattle Medical Surgical Center is only the name of the leased space:

WHEREAS, Physician wishes to engage [HC] as an independent contractor to perform management services for Physician in connection with Physician's medical practice in certain office space

provided by [HC], effective the date set forth below; and

WHEREAS, [HC] wishes to assume the management responsibilities for Physician as an independent contractor upon the terms and conditions set forth; now, therefore,

THE PARTIES AGREE:

1. SCOPE. Physician will provide professional medical services to patients in the health care clinic facility located in leased space at 550-16th Avenue, Seattle, Washington, and known as Seattle Medical Surgical Center (hereinafter "Center"). PMC will provide office space, office and medical supplies, account collections, equipment, and support and management services associated with Center.

3. [HC] RESPONSIBILITIES. PMC, at its expense, shall be responsible for the following:

a. To provide reasonable space for Physician to provide services to patients.

b. [HC] shall furnish and maintain in good repair, for use by Physician, items of medical and office equipment as may be deemed reasonably necessary by PMC for the providing of said services.

c. [HC] shall furnish Physician with utilities and such services and supplies as may be deemed reasonably necessary by [HC] for the proper operation and conduct of said services. [HC] shall also provide reasonable medical malpractice insurance and health care coverage for Physician. Physician's dependents are not covered by such health insurance, but dependent coverage may be arranged at Physician's expense. [HC] shall also furnish King County Medical Communication Center paging and exchange services, and dues for AMA, King County Medical Society, WSMA; and either one specialty society or American Group Practice Society at Physician's election.

The agreement further defined the physician's responsibilities, the status of the parties (the physicians

are independent contractors), and termination procedures. The compensation formulas were set out in an exhibit to the agreement.

The auditor contends that the parties did not operate according to the original management agreement, but operated according to an unsigned amendment to the agreement. The amendment was drafted to clarify the original intent of the parties. The amendment provides:

The new enterprise is organized as an association of independent entrepreneurial physicians sharing expenses and operating under the style [center name]."

It was discovered that the language of the agreement could be construed to mean that the entire amount of monthly payment by physicians to cover the expenses as numerated above was "compensation to [the hospital center]," and therefore revenue of [HC]. The intention of the parties, however, was that only those amounts which paid [HC] for its management services, for rental of space and utilities, and for payment to [HC] of its expense under the lease to . . . use of the furniture, fixtures and equipment, and to [HC] for its payment of the employee payroll and benefits of the employees and medical director. All amounts are intended to go into a fund from which the day-to-day business expenses of the enterprises, doing business as Seattle Medical Surgical Center, including those enumerated above, were to be paid. This included accounts payable, benefits provided to physicians in the agreement such as malpractice insurance, health and dental insurance, etc., appropriate business taxes, as well as the accumulation of funds for working capital. It is recognized that in practice, the Center receives all payments which are directed to physicians for physician services to patients. While the accounting and bookkeeping work to allocate the final destination of these monies is underway, the entire receipts are deposited to Center's accounts, and after calculation of allocations, the physician's portion is remitted directly to him from these accounts as well.

The auditor concluded the language in the amendment indicated [taxpayer] is a separate business. We do not agree. The

amendment also contains language indicating the physicians contracted with [HC] for "space, facilities, equipment, and management services." (. . . .)

[1] As the amendment stated, and as was further clarified by the taxpayer's attorney at the hearing, the amendment was to clarify the intent that only the amounts paid to [HC] for its management service, for rental of space and utilities, and for other payments that benefit the group as a whole, were to be considered the revenue of [HC]. The portion of the 55% retained to cover individual physician's expenses, expenses for which the physicians were personally liable, would not be income to [HC].

The individual fees include such items as professional journals ordered by an individual physician, laboratory fees, special medical supplies, medical and dental insurance premiums, and each physician's business and occupation taxes based on 100 percent of the individual physician's receipts. In those cases, the physician is solely liable for payment. The fact that the bills are paid from the funds retained in the joint checking account does not make them a shared obligation. Where books and records maintained by [HC] employees for [the center] showed the transactions were made in the name of and for the individual physician's account, [HC] is making the payments as the physician's agent. See WAC 458-20-159. Clearly the agreement between [HC] and the individual physician stated [HC] was only responsible for paying for shared costs. [HC] charged a management fee, in part, as compensation for providing the billing service for the individual costs.

As indicated above, each physician pays Service business and occupation tax on 100 percent of his or her gross receipts and PMC pays Service business and occupation tax on the amount paid for shared costs and management fees. That part of the income is taxed twice and we do not find it should be taxed a third time because it is funneled through a joint account.

The auditor relied on previous Determinations by the Department which found that a medical association was a separate taxable "person" under RCW 82.04.030. In those cases, the purpose of the association was recognized as the purchase of goods and services on a consolidated basis to simplify the management of the individual physicians' practices.

In this case, the management functions are provided by [HC], and [HC] has been paying Service business and occupation tax. As the facts indicate, however, [the taxpayer] has no employees and performs none of the above services. It exists as a leased space. The fact that the individual physicians practicing in that space are listed in the phone book under [the center's name] does not mean [the taxpayer] is a separate business. Nor does the fact that a separate checking account was set up for the physicians' expenses necessarily indicate [the taxpayer] is a separate business.

[3] RCW 82.04.140 defines "business" to include "activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class directly or indirectly." WAC 458-20-105 defines persons engaging in business as:

A person engaging in business is generally one who holds himself out to the public as engaging in business either in respect to dealing in real or personal property or in respect to the rendition of services; one to whom gross income of the business inures; one upon whom liability for losses lies or who bears the expense of conducting a business; one, generally, acting in an independent capacity, whether or not subject to immediate control and supervision by a superior, or one who acts as an employer and has employees subject to his control and supervision. (Emphasis added.)

The taxpayer's petition addressed the above factors as evidence it is not engaging in business. As the taxpayer stated,

[The center] does not hold itself out to the public as engaging in business. [the center] neither inures to the gross income of the individual physician's practices nor bears the expense of conducting the various practices. Each individual physician inures to the benefits of his practice and bears the risk and expense of conducting it. [the center] has no employees.

As we do not find that [the taxpayer] is a "business" as defined in RCW 82.04.140, it does not need to be registered as a separate entity and is not liable for Service business tax. The use tax assessed on the consumable items should be assessed against [the hospital center] or the individual

physician who "used" the item, unless proof is presented indicating retail sales tax has already been paid by [HC] or the physician.

DECISION AND DISPOSITION:

The taxpayer's petition is granted. Assessment No. . . . is cancelled.

DATED this 7th day of November 1986.