Cite as Det. No. 05-0376, 26 WTD 40 (2007)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment and Refund of	)	D E T E R M I N A T I O N
	)	
	)	No. 05-0376
. . .	)	
	)	Registration No. . . .
	)	Doc. No. . . .
	)	Docket No. . . .
	)	

[1] RULE 194; RCW 82.04.220: SERVICE B&O TAX – ENGAGING IN BUSINESS – INDEPENDENT CONTRACTORS -- NEXUS. For purposes of service B&O tax liability, an out-of-state corporation that provides independent contractor physicians to hospitals in Washington on a temporary basis is engaging in business in Washington.

[2] RULE 111: SERVICE B&O TAX – ADVANCES AND REIMBURSEMENTS – EXCLUSION – TEMPORARY STAFFING – LIABILITY FOR PAYMENT OF SALARIES. A corporation that provides independent contractor physicians to hospitals on a temporary basis is not entitled to a Rule 111 exclusion for amounts received from the hospitals, where the corporation is liable for payment of the physicians' salaries regardless of whether it receives payment from the hospitals.

[3] RULE 111: SERVICE B&O TAX – ADVANCES AND REIMBURSEMENTS – EXCLUSION – TEMPORARY STAFFING –EQUAL PROTECTION. The Department's administration of Rule 111 in the temporary staffing context does not violate the Equal Protection Clause where, for a prior period, the Department agreed to allow taxpayers to exclude amounts received for wages from their income if they had reported in that manner (regardless of whether they satisfied the requirements for Rule 111 exclusion), but required taxpayers who did not report any income to include wages in their income (unless they met the requirements for Rule 111 exclusion).

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.

C. Pree, A.L.J. -- The taxpayer, an out-of-state corporation that provides physicians to hospitals in Washington on a temporary basis, protests the imposition of B&O tax on its receipts. The taxpayer argues: 1) it is not subject to Washington taxation because it does not do business in Washington; 2) if taxable, it is entitled to exclude amounts received for physician salaries under WAC 458-20-111 (Rule 111); [and] 3) the Department's administration of Rule 111 in the temporary staffing context violates the Equal Protection Clause . . . . We conclude that the taxpayer is engaged in business in Washington and is liable for service B&O tax on its gross receipts. The Department's administration of Rule 111 does not violate the Equal Protection Clause, and the taxpayer's receipts do not qualify for exclusion. . . . Accordingly, we deny the taxpayer's petition [on these issues].[1]

ISSUES:

1. For purposes of service B&O tax liability, is an out-of-state corporation that provides independent contractor physicians to hospitals in Washington on a temporary basis engaging in business in Washington?
2. Is a corporation that provides independent contractor physicians to hospitals on a temporary basis entitled to a Rule 111 exclusion for amounts received from the hospitals, where the corporation is liable for payment of the physicians' salaries regardless of whether it receives payment from the hospitals?
3. Does the Department's administration of Rule 111 in the temporary staffing context violate the Equal Protection Clause because, for periods prior to January 1, 2003, the Department agreed to allow taxpayers to exclude amounts received for wages from their income if they had reported in that manner (regardless of whether they satisfied the requirements for Rule 111 exclusion), but required taxpayers who did not report any income to include wages in their income (unless they met the requirements for Rule 111 exclusion)? . . .

FINDINGS OF FACT:

The taxpayer is an out-of-state corporation that contracts with Washington hospitals and other health care providers to provide physicians on a temporary basis. The taxpayer explains that it acts as an intermediary between hospitals seeking physicians to serve on a temporary basis as independent contractors and physicians looking for temporary employment as independent contractors. The taxpayer performs all of its administrative duties from its [out-of-state] headquarters. Specifically, the taxpayer conducts its contractual negotiations with Washington clients and its search and administrative services from its headquarters.

The taxpayer is responsible for locating physicians for clients. The taxpayer's contract with its physicians provides that the taxpayer "contracts with Clients to accept medical services on a

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410. Nonprecedential portions of this determination have been redacted.

Locum Tenens Basis," and the physician "desires to provide medical services on a Locum Tenens basis to clients of [the taxpayer]."

In the contract, the taxpayer agrees to pay the physician for the physician's services, including payment for holidays if the physician "remains in a community" for that holiday. The contract does not relieve the taxpayer from payment of the physician's salary if the client fails to pay the taxpayer. To the contrary, the contract states, "If the physician is required to [perform a specified service], the Physician will be compensated at [a specified rate]." Further, the contract provides that if a client "cannot meet its financial obligations" the taxpayer will compensate the physician "only for work actually performed." The contract also precludes the physician from discussing "[the taxpayer's] remuneration with clients, physicians, patients, or third parties."

The taxpayer also pays for and assists the physician in requesting documentation necessary for hospital privileging and state licenses.

The contract further states that the physician is an independent contractor, not an employee, of the taxpayer. Further, the taxpayer agrees not to "in any way attempt to influence or direct Physician's professional medical judgment or Physician's relationship with patients."

The taxpayer does not make payments or deductions for state or federal entities unless required by law. In the contract, the physicians acknowledge that they are responsible for filing and paying all federal, state, and local income taxes and employment taxes due on the remuneration received from the taxpayer, and the taxpayer agrees to provide the physicians with a Form 1099.

With respect to insurance, the contract provides: "When providing services to Clients of [the taxpayer] . . . Physician shall be insured under the terms of [the taxpayer's] group malpractice insurance policy." However, if the physician incurs liabilities not covered by the insurance, the physician agrees to indemnify the taxpayer. The contract further provides that because the physician is not an employee, the taxpayer does not provide health insurance, worker's compensation, or unemployment insurance.

The taxpayer's contracts with its clients provide that the taxpayer will present a physician to the client for its review, and the client will decide whether to accept that physician. The taxpayer is responsible for screening, reference checking, and checking licensure of the physicians. The client is responsible for paying the taxpayer for the physician's services, but the client does not know the amount the taxpayer pays the physician. Similarly, the physician does not know the amount the taxpayer receives from the client.

The client is responsible for providing the work facilities and items necessary for the physician to do the work. The client also determines the physician's work schedule. The client can terminate its use of any physician with 30 days' notice. However, if the physician is not performing properly, the taxpayer agrees to attempt to replace the physician without the 30 days' notice. The agreement between the taxpayer and the client states that the physician is an independent contractor, not an employee.

In 2003, the Compliance Division of the Department of Revenue identified the taxpayer as a potential unregistered business. Based on information the taxpayer subsequently provided, the Compliance Division issued an assessment . . . .

On January 21, 2005, the Department addressed a letter to "The Staffing Industry." In pertinent part, the letter provides:

> The Department of Revenue has recently concluded meetings with representatives of the staffing industry. These meetings were aimed at resolving confusion that has existed for some time related to proper reporting of state excise taxes . . . .
>
> If you have reported net of payroll expenses, the Department will not assess additional taxes for these amounts deducted *prior to January 1, 2003.* We refer to this as a limited "look-back" period. If you did not file tax returns, you are liable for unpaid taxes. In this case, the limited look-back period will not apply, and taxes are due based on gross receipts of the business. . . . .
>
> **Q: Can I get a refund if I reported gross receipts, including payroll and related costs, prior to January 1, 2003?**
>
> **A:** Charges to your customers to recover your payroll and related costs are properly included as part of your taxable income for B&O tax purposes. The Department cannot refund taxes that were properly due and paid . . . .

The letter clarified that although staffing companies historically reported their income under the service classification, commencing July 1, 2005, they must report their income based on the predominant activity of their workers.

ANALYSIS:

1. **For purposes of service B&O tax liability, is an out-of-state corporation that provides independent contractor physicians to hospitals in Washington on a temporary basis engaging in business in Washington?**

[1] The taxpayer first argues that because it performed all services on behalf of the hospitals outside Washington, it is not liable for B&O tax. The taxpayer notes that the only services that were performed within the state were performed by the independent contractor physicians. We conclude that the services performed in Washington by the taxpayer's independent contractor physicians provide sufficient nexus to this state for imposition of the service B&O tax.

The B&O tax "is levied and . . . collected from every person . . . for the act or privilege of engaging in business activities." RCW 82.04.220. The B&O tax is "extensive and is intended to impose . . . tax upon virtually all business activities carried on in the State." *Analytical Methods,* *Inc. v. Department of Rev.*, 84 Wn. App. 236, 241, 928 P.2d 1123 (1996), *quoting, Palmer v. Department of Rev.*, 82 Wn. App. 367, 371, 917 P.2d 1120 (1996).

For purposes of the B&O tax, "business" is broadly defined to include "all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly." RCW 82.04.140. However, a state cannot tax transactions that do not have sufficient connection or "nexus" with the state. *See, e.g.*, *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977); *Tyler Pipe Indus., Inc. v. Washington Department of Rev.*, 483 U.S. 232 (1987); *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992); *Dravo Corp. v. Tacoma*, 80 Wn.2d 590, 496 P.2d 504 (1972); *General Motors v. Seattle*, 107 Wn. App. 42, 25 P.3d 1022 (2001); Det. No. 01-188, 21 WTD 289 (2002).

Thus, if the taxpayer's independent contractor physicians provide sufficient nexus with Washington, the taxpayer is engaged in business in Washington because it provides physicians to Washington hospitals "with the object of gain." *See* RCW 82.04.140. If taxable, this activity is properly classified as a service business. *See* RCW 82.04.290, WAC 458-20-194 (Rule 194).

Rule 194 does not use the word "nexus," but rather references rendering services in the state and having a place of business in a state. Specifically, in interpreting statutory and constitutional limitations on the state's power to impose gross receipts tax on services, the Department has held there is no requirement that a taxpayer maintain a physical place of business in Washington. *See* Det. No. 01-188, 21 WTD 289 (2002); Det. No. 87-186, 3 WTD 105 (1987). Instead, the Department has held that a seller of services has taxable nexus with a state by entering its marketplace to sell its services. Det. No. 98-196, 19 WTD 19 (2000). Performing services in a state for accounts located in that state, or at customer locations in that state, usually creates nexus with that state. *See, e.g.*, Det. No. 01-188; Det. No. 93-276, 13 WTD 392 (1994).

For sufficient nexus to exist, a person need not send employees into Washington. Nexus may be created through employees or independent contractors. *See Tyler Pipe*, 483 U.S. 232 (Holding that a showing of sufficient nexus cannot be defeated by the argument that the seller's representative was properly characterized as an independent contractor instead of as an agent.)*; Scripto, Inc. v. Carson*, 362 U.S. 207 (1960) (Holding that nexus was established by a seller's in-state solicitation performed through independent contractors); Det. No. 01-074, 20 WTD 531 (2001).

Rule 194 provides:

> Persons domiciled outside this state who . . . render services to others herein, are doing business in this state, irrespective of the domicile of such persons and irrespective of whether or not such persons maintain a permanent place of business in this state.

We conclude that because the taxpayer sent its independent contractor physicians into Washington with the object of gain, the taxpayer is engaging in business in Washington and has sufficient nexus with Washington for imposition of the B&O tax. Accordingly, the taxpayer is subject to Washington's B&O tax under the service classification.

2. **Is a corporation that provides independent contractor physicians to hospitals on a temporary basis entitled to a Rule 111 exclusion for amounts received from the hospitals, where the corporation is liable for payment of the physicians' salaries regardless of whether it receives payment from the hospitals?**

[2] The taxpayer argues it is entitled to exclude amounts received from the Washington hospitals, which it used to pay the physicians' salaries. We conclude that because the taxpayer was primarily liable for payment of the physicians' salaries, it is not entitled to exclude its receipts under Rule 111.

Persons engaged in a service business in Washington are required to pay B&O tax measured by the "gross income of the business." *See* RCW 82.04.290. The term "gross income of the business" is broadly defined by RCW 82.04.080 as:

> . . . the value proceeding or accruing by reason of the transaction of the business engaged in and includes . . . compensation for the rendition of services . . . fees, . . . and other emoluments however designated, all without any deduction on account of . . . labor costs . . . or any other expense whatsoever paid or accrued . . . .

Under this broad definition, a service provider may not deduct any of its own costs of doing business, including its labor costs, from its gross income. *See, e.g., Pilcher v. Department of Rev.,* 112 Wn. App. 428, 49 P.3d 947 (2002), *citing, Rho Co. v. Department of Rev., 113 Wn. 2d 561, 570, 782 P.2d 986 (1989).* Thus, unless a specific exclusion, exemption, or deduction applies, the taxpayer's gross income, *i.e.,* 100% of its receipts, is subject to service B&O tax without any deduction on account of labor costs or any other expense paid or accrued. *See* RCW 82.04.080, .220.

With respect to the Rule 111 exclusion, we previously observed:

> Not all amounts a business receives are consideration for services it provided. Rule 111 articulates the Department's recognition that sometimes a business'[s] receipts can include amounts a customer (the principal) advances or reimburses the business (the agent) for paying a third-party (the provider) for the service.

Det. No. 99-013, 20 WTD 471 (2001). Rule 111 provides in pertinent part:

> The words "advance" and "reimbursement" apply only when the customer . . . 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 . . . .

> There may be excluded from the measure of tax amounts representing money or credit received by a taxpayer as reimbursement of an advance in accordance with the regular and usual custom of his business or profession.
>
> The foregoing is limited to cases wherein the taxpayer, as an incident to the business, undertakes, on behalf of the customer . . . , the payment of money, either upon an obligation owing by the customer . . . to a third person, or in procuring a service for the customer . . . 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 . . . 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.

In short, under Rule 111:

> These “advances or reimbursements” from a customer for procuring property or services which the business could not provide itself are excluded from the measure of the B&O tax, provided the business was not primarily nor secondarily liable for the payment to the third-party. In those instances, the business is said to have been acting as the client’s agent and, as such, has no liability other than that of the agent of the principal on whose behalf it acted in procuring services from third-parties.

Det. No. 99-013. Recently, the Washington Supreme Court issued *City of Tacoma v. The William Rogers Co.,* 148 Wn.2d 169, 60 P.3d 79 (2002), which explains the application of Rule 111 to temporary staffing firms. In the following excerpt from *William Rogers*, the Court clarifies the holding of a previous decision and sets out the elements that the taxpayer must prove to qualify for exclusion under Rule 111:

> Rule 111 provides that there may be excluded from taxable amounts any money or credits received by a taxpayer as reimbursement of an advance in accordance with the regular and usual custom of his business or profession. In *Rho* we explained that the taxpayer had to prove that the advance in question was made pursuant to an agency relationship. The existence of that agency relationship is not controlled by how the parties described themselves in their contract documents, and standard agency definitions should be used in analyzing the existence of the agency relationship.
>
> When a taxpayer meets its burden and establishes the existence of an agency relationship, a second question must be asked: whether the taxpayer’s liability to pay the advance “constituted solely agent liability.” *Rho*, 113 Wn.2d at 573. If a taxpayer assumes any liability beyond that of an agent, the payments it receives are not “pass through” payments, even if the taxpayer uses the payments to pay costs related to the services it provided to its client.

William Rogers, 148 Wn.2d at 177-78; *see also* ETA 2016.04.111. Thus, if the taxpayer assumes any liability beyond that of an agent for the payment of salaries to the physicians, the payments it receives from the hospitals are not pass through payments.

In this case, it is clear that the taxpayer had primary liability, not "solely agent liability" for paying its physicians' salaries. In its contract with the physicians, the taxpayer specifically agrees to pay the physician for the physician's services, including payment for holidays in certain circumstances. The contract does not relieve the taxpayer from payment of the physician's salary if the client fails to pay the taxpayer. To the contrary, the contract states, "If the physician is required to [perform a specified service], the Physician will be compensated at [a specified rate]," and if a client "cannot meet its financial obligations" the taxpayer will nonetheless compensate the physician. The contract also precludes the physician from discussing **"[the taxpayer's remuneration** with clients, physicians, patients, or third parties." (Emphasis added.)

The *William Rogers* court reached a similar conclusion, stating in part:

> [The temporary staffing firm] argues that in paying its workers it acts within the scope of its authority as an agent, and the client is ultimately liable for the obligation. This argument fails because [the temporary staffing firm] has sole liability to pay the workers. … [W]here a client is for any reason unable or unwilling to pay the worker, [the temporary staffing firm] is liable for making the payment. If [the temporary staffing firm] had only agency liability, it would not be making payments that were unauthorized by the principal.

149 Wn.2d at 179-80.

In summary, we conclude that through the above provisions, the taxpayer assumed liability beyond that of an agent for the payment of salaries to the physicians.[2] Accordingly, the taxpayer cannot exclude amounts the taxpayer received from the hospitals as payment for the physicians' services under Rule 111.

3. **Does the Department's administration of Rule 111 in the temporary staffing context violate the Equal Protection Clause because, for periods prior to January 1, 2003, the Department agreed to allow taxpayers to exclude amounts received for wages from their income if they had reported in that manner (regardless of whether they satisfied the requirements for Rule 111 exclusion), but required taxpayers who did not report any income to include wages in their income (unless they met the requirements for Rule 111 exclusion)?**

[3] The taxpayer argues the Department's administration of Rule 111 violates the Equal Protection Clause of the Washington and Federal Constitutions because it results in disparate

[2] Because the taxpayer failed to demonstrate that it had "solely agent liability" for payment of its independent contractor physicians, we need not address the remaining requirements for Rule 111 exclusion.

treatment of similarly situated taxpayers. We conclude that the Department's administration does not violate the Equal Protection Clause.

. . .

The taxpayer . . . challenges the Department's administration of the Rule 111 exclusion, as described in the Department's January 21, 2005, letter to the staffing industry. The taxpayer argues:

> No authority exists which allows the Department to determine which taxpayers within a legislatively-designated classification should be subject to the enforcement of the B&O tax. Once the legislature determined the classes of persons subject to the B&O tax, the Department's task was straightforward: enforce the tax applicable to each member of the classification equally.

The taxpayer cites *Gosnell Development Corp. v. Arizona Dep't of Rev.,* 154 Ariz. 539, 744 P.2d 451 (1987),[3] in support of its argument. We find *Gosnell* unpersuasive. In *Gosnell,* The Arizona Court of Appeals addressed the issue of whether a taxpayer was entitled to a tax refund where the Department "refuses or fails to collect similar taxes from others." The Arizona Department of Revenue refused to grant Gosnell a refund, despite the fact that it had a policy of not enforcing a statute against taxpayers who had not paid the tax. The court in *Gosnell* described the history surrounding the administration of the statute as "bizarre." Specifically, in a prior case regarding the same statute, the trial court, on remand from the appellate court, applied the appellate court's holding prospectively only, not only with respect to the taxpayer before it, but with respect to the entire industry impacted by the statute because "there exists unique circumstances of great hardship." The Arizona Department of Revenue did not appeal the trial court's ruling, and did not attempt to collect the taxes. The court in *Gosnell* stated, "We have searched . . . in vain to find any cases which give the court the power to relieve the taxpayer from payment of taxes which are due and owing because it would be a hardship to pay them." The court concluded, "The Department does not dispute that it is treating identically classified taxpayers differently. It does not dispute that it will permit Gosnell's competitors to claim an improper deduction . . . . Prospective application of tax rulings with that result are unconstitutional." 744 P.2d at 454.

Contrary to the unusual situation addressed by the Arizona court in *Gosnell,* we find the analysis of the Washington Court of Appeals in *Stroh Brewery Co. v. Department of Rev.,* 104 Wn. App. 235, 240, 15 P. 3d 692 (2001), to be persuasive. In *Stroh,* the Washington Court of Appeals

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[3] The Arizona Court of Appeals declined to apply the holding in *Gosnell* in *People of Faith, Inc. v. Arizona Dep't of Rev.,* 171 Ariz. 140, 829 P.2d 330 (1992). In *People of Faith,* the court recognized that the facts in *Gosnell* were "unique," and concluded that People of Faith had not been the "victim of a blanket discriminatory policy of DOR." (People of Faith had been audited prior to the audit of a similarly situated taxpayer, and accordingly had been required to pay taxes due under the contested provision for an earlier period.)

concluded that when the Department changes its interpretation of a tax exemption, a taxpayer may not obtain a refund unless it relied on the prior interpretation. The court reasoned:

> Where the Department changes its interpretation of a tax, it cannot retroactively assess the tax. But a taxpayer who has paid the tax without objection cannot show that it relied upon the Department's previous interpretation. . . . Stroh did not rely on what it contends was the Department's previous interpretation. Rather, Stroh paid the B&O tax for several years without objection and later petitioned for a refund. We conclude that although the Department changed its interpretation, Stroh does not show that it relied upon any earlier interpretation.

(Citations omitted.)

Although the court in *Stroh* was not faced with an Equal Protection Clause challenge, the court recognized that the Department may properly consider taxpayers' reliance interests in administering taxes. Specifically, as the *Stroh* court explained, when the Department changes its interpretation of a tax, it cannot retroactively assess the tax because taxpayers relied on the previous interpretation. However, if a taxpayer, like the taxpayer in *Stroh,* cannot show that it relied on the Department's previous interpretation, the Department need not refund taxes.

Consistent with *Stroh,* in its January 21, 2005, letter, the Department stated that it would not retroactively assess taxes against temporary staffing companies who had paid B&O tax net of wages. The Department reached this administrative decision based on its recognition that there was possibly unclear precedent in this area. On the other hand, the Department, in issuing the letter, recognized that temporary staffing companies who had not paid any B&O, such as the taxpayer here, could not argue that they relied on any previous interpretations.

Accordingly, in contrast to the facts in *Gosnell*, where the Arizona court concluded the Arizona Department of Revenue was treating identically classified taxpayers differently, we conclude that the Washington Department of Revenue did not treat identically classified taxpayers differently in its administration of Rule 111 in the temporary staffing context. To the contrary, the Department recognized that there was a reasonable basis for distinguishing between temporary staffing companies who had paid tax and those who had not. In assessing the tax against the taxpayer in this case, the Department is administering the tax consistent with the letter. . . . .

DECISION AND DISPOSITION:

The taxpayer's petition is . . . denied . . . .

Dated this 30th day of December 2005.