

Cite as Det No. 08-0032, 27 WTD 182 (2008)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 08-0032
)	
...)	Registration No. . . .
)	Document No. . . .
)	Audit No. . . .
)	Docket No. . . .

- [1] RULE 111; RCW 82.04.080; ETA 2016: B&O TAX – ADVANCE – SOLELY AGENT LIABILITY. A corporation, which staffs a government hospital, may not exclude payments to the staff from its measure of B&O tax because the corporation was liable other than as agent to pay the staff.
- [2] RCW 82.32A.020: B&O TAX – PRIOR WRITTEN INSTRUCTIONS – RELIANCE – CHANGE OF FACTS. A taxpayer may not rely on prior audit instructions unless the taxpayer shows its contracts had not substantially changed from the circumstances addressed in the instructions.

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

M. Pree, A.L.J. – A corporation, which provided staff for a [governmental entity] hospital in Washington, protests an assessment of business and occupation (B&O) tax on amounts it paid to medical personnel. Because the corporation was liable other than as agent to pay the staff, we deny the petition. Further, the corporation could not rely on 1994 audit instructions because its situation had changed.¹

ISSUES

1. Under WAC 458-20-111 (Rule 111), may a corporation, which staffs a [government] hospital, exclude payments to the staff from its measure of B&O tax?

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

2. Under RCW 82.32A.020, may the taxpayer rely on prior written audit instructions when facts change?

FINDINGS OF FACT

[Taxpayer] staffed a [governmental entity] hospital emergency room in Washington. The [governmental entity] paid the taxpayer who paid its employees to provide health and administrative services, and paid physicians as independent contractors to provided medical care to the patients

The taxpayer contracted with the [government] to staff the hospital's emergency room. The taxpayer hired employees to provide the administrative services required. The taxpayer also contracted with physicians to provide medical care in the emergency rooms. The physicians' contracts had [terms of limited duration and] renewed automatically. Under the physicians' contracts, the taxpayer was required to pay the [physicians] regardless of whether the government paid the taxpayer.

The Department's Audit Division audited the taxpayer in 1994 for the 1990 – 1994 audit period. The Audit Division examined a U.S. government contract and found that the taxpayer acted as a "paymaster" only. The [governmental entity] hospital hired, fired, and controlled the job duties of the personnel paid by the taxpayer. Concluding that the taxpayer met the requirements of Revenue Policy Memorandum (RPM) 90-1,² the Audit Division instructed the taxpayer to exclude advances it received for payroll. During subsequent periods, the taxpayer excluded from the measure of its Washington B&O tax amounts it paid the physicians, hospital staff and related payroll costs.

The Department's Taxpayer Account Administration Division (TAA) audited the taxpayer for the period from February 1, 2004 through June 30, 2006. TAA assessed service B&O tax on the gross amount the [governmental entity] paid the taxpayer to staff its hospitals.

TAA found that during the audit period, the taxpayer recruited and hired nurses, hospital administrators, and clerks to staff the hospitals. In addition to hiring, the taxpayer set schedules and continued to supervise the staff on its payroll, and was responsible for the quality of services they provided. The taxpayer was responsible for payment of the staffs' wages, salaries, payroll taxes, fringe benefits, liability insurance, and other professional expenses. The taxpayer agreed to hold the government harmless against compensation claims from the staff on its payroll.

The taxpayer also recruited physicians with whom it signed independent contractor agreements for the physicians to work at the [government] hospitals. The physician and the taxpayer were the only parties signing these contracts. The taxpayer agreed to pay each physician an hourly

² RPM 90-1 was converted to Excise Tax Advisory (ETA) 90-1 on July 1, 1998, and cancelled on August 20, 2003.

rate³ for each period the physician provided services at the hospital. Their contracts allowed the physicians to work at other facilities as long as the work did not conflict with the schedule set by the taxpayer. The taxpayer assigned each physician to a hospital, determined their schedule, and paid their professional fees including malpractice insurance. The physicians arranged substitutes if they were not available during a scheduled time, and paid their own taxes. Under the agreement, the taxpayer had no control or direction over the professional conduct of the independent contractor physicians.

The agreement did not designate the taxpayer as an agent of the [government]. In fact, the government's statement of work prohibited the taxpayer from representing it was an agent of the government. The taxpayer was responsible for any liability from the acts or omissions of its agents or employees. The taxpayer was liable to pay the physicians and hospital staff.

The [governmental entity] also had rights and responsibilities. [An official of the governmental entity] maintained operational and administrative responsibility The government provided the facility and equipment. The government trained the staff. The physicians were required to attend . . . orientation, and follow the hospital's rules and regulations as well as [government regulations]. Each physician needed government approval to work at each hospital.

ANALYSIS

[1] The B&O tax applies to virtually all business activities conducted in this state. *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wn.2d 139, 149, 3 P.3d 741 (2000); *Impecoven v. Dep't of Revenue*, 120 Wn.2d 357, 363, 841 P.2d 752 (1992). The measure of the B&O tax is "gross income" or gross receipts." RCW 82.04.220. The definition of "gross income of the business" is:

[T]he value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

RCW 82.04.080 (emphasis added).

Under this broad definition, a service provider may not deduct from its gross income any of its own costs of doing business, including its labor costs. *Rho Co. v. Dep't of Revenue*, 113 Wn.2d 561, 782 P.2d 986 (1989); *Pilcher v. Dep't of Revenue*, 112 Wash. App. 428, 436, 49 P.3d 947 (2002).

³ The taxpayer paid [a percentage] of the rate for on-site non clinical training.

WAC 458-20-111 (Rule 111) provides, in pertinent part:

The word “advance” as used herein, means money or credits received by a taxpayer from a customer or client with which the taxpayer is to pay costs or fees for the customer or client. . . .

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 therefore [sic], either primarily or secondarily, other than as agent for the customer or client.

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, 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.

(Emphasis added.) Excise Tax Advisory No. 2016.04.111 (First Revision, issued on January 4, 2005) (ETA 2016), provides:

In order to exclude these [pass through] payments from the measure of tax, the Washington State Supreme Court has ruled that two conditions must be met. The taxpayer must first establish that it received the funds as the agent of the customer or client. If this first condition is satisfied, the taxpayer must also establish that its use of the funds to pay a third party is solely as an agent of the customer or client. *City of Tacoma v. William Rogers Co.*, 149 [sic] Wn.2d 169, 60 P.3d 79 (2002). . . .

The existence of an agency relationship is not controlled by the labels the parties use to describe themselves in their contract documents. Rather, standard common law agency principles are used in analyzing whether an agency relationship exists. The essential elements of common law agency are mutual consent to the relationship between a principal and an agent, and the right of control over the agent by the principal. If these elements are not satisfied, there is no agency relationship.

If a staffing company assumes any liability to third parties in connection with the receipt of payment, including any liability to the workers, beyond that of an agent of the client, the payments it receives and uses to pay the third parties are not excludable “pass through” payments. These payments must be included in the measure of tax, notwithstanding that the staffing company or its client may designate these payments for paying workers’ wages and benefits. For example, the Washington State Supreme Court held that when a staffing company is the employer of temporary workers, the staffing

company is liable for paying the workers as a principal, not solely as an agent. *City of Tacoma v. William Rogers Co.*, 149 [sic] Wn.2d 169, 60 P.3d 79 (2002).

Tacoma v. The William Rogers Co., 148 Wn. 2d 169, 60 P.3d 79 (2002), the case referenced in ETA 2016, is the Washington Supreme Court's most recent pronouncement on the Rule 111 "pass-throughs." *Rogers* clarified the court's earlier *Rho* decision by holding that an advance received by a taxpayer from its client for payment to a third party is not entitled to the Rule 111 "pass through" unless the taxpayer can first demonstrate that its role is that of an agent. If so, the second query will be "whether the taxpayer's liability to pay the advance 'constituted *solely* agent liability.'" *Rogers* at 178.

In our case, the taxpayer is contractually liable to pay the administrative and medical staff as well as the physicians. The taxpayer's liability is not solely that of agent. To the contrary, the government's statement of work prohibits the taxpayer from representing itself as an agent of the government.

The taxpayer asserts that it was not the principal obligor of the debt owed to the physicians, and should qualify under Rule 111 because the taxpayer does not assume the liability by paying the physicians on behalf of the hospitals. The taxpayer states it has taken on the duty of paying the physicians "with money it receives from the hospitals." We disagree. The taxpayer's obligation to the physicians is not conditioned upon receipt of payment from the hospitals, [the governmental entity], or anyone else. Rather, the physicians' contracts require the taxpayer to pay physicians for providing services. The [governmental entity] is not a party to the taxpayer's contracts with the physicians.

The burden of showing qualification of a tax benefit rests with the taxpayer. *Group Health Cooperative of Puget Sound, Inc. v. Washington State Tax Comm'n.*, 72 Wn.2d 422, 429, 433 P.2d 201 (1967). "Anyone claiming a benefit or deduction from a taxable category has the burden of showing that he qualifies for it." *Group Health Coop. of Puget Sound, Inc. v. State Tax Comm'n.*, 72 Wn.2d 422, 433 P. 2d 201 (1967); *Budget Rent-A-Car Of Washington-Oregon, Inc. v. Dep't of Revenue*, 81 Wn.2d 171, 500 P.2d 764 (1972).

The taxpayer argues that three Washington Supreme Court cases, *Rho*; *Christensen*, *O'Connor, Garrison & Havelka v. Dep't of Revenue*, 97 Wn.2d 764, 769, 649 P.2d 839 (1982); and *Walthew, Warner, Keefe, Arron, Costello & Thompson v. Dep't of Revenue*, 103 Wn.2d 183, 186, 691 P.2d 559 (1984), which allowed pass through under Rule 111, have not been overruled and should apply to the facts in our case. The Court found in each of these cases, that the taxpayer had only agent liability. *Christensen*, *Walthew*, and *Rho* do not assist the taxpayer in proving that it had the role of "agent" vis-à-vis the hospital staff including the physicians. *Rho* remanded the agency issue to the Board of Tax Appeals, while *Christensen* and *Walthew* found an agency relationship between the law firms and their clients because of the "unique" requirements imposed on lawyers by the disciplinary rules of the Code of Professional Responsibility. In *City of Tacoma v. William Rogers Co.*, 148 Wn.2d 169, 60 P.3d 79 (2002), the court said, at 177-178:

Rule 111 provides that there may be excluded from taxable amounts any 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. 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. *Walthew*, 103 Wn.2d at 189.

The taxpayer had no agency relationship in our case. Therefore, the taxpayer's liability was not solely that of agent. Because the taxpayer was liable to pay the staff and the physicians other than as agent, it is not entitled to exclude payments from the [governmental entity] from its measure of B&O tax.

[2] The taxpayer also contends that it had a right to rely on the Audit Division's 1994 reporting instructions. RCW 82.32A.020 states, in part:

The taxpayers of the state of Washington have . . . (2) The right to rely on specific, official written advice and written tax reporting instructions from the department of revenue to that taxpayer, and to have interest, penalties, and in some instances, tax deficiency assessments waived where the taxpayer has so relied to their proven detriment.

As we explained in Det. No. 95-052ER, 17 WTD 278 (1998):

Under this section, only taxpayers: (1) who have been issued specific erroneous written advice/reporting instructions, and (2) who have relied on these instructions to their detriment, have the right to a remedy. The only remedies available are the right to (1) the waiver of interest and penalties on an assessment, and (2) the waiver, "in certain instances," of the tax assessment itself.

The taxpayer states it relied on the instructions in reporting for the period from February 1, 2004 through June 30, 2006, and if the Department does not allow the taxpayer to rely on those instructions, the taxpayer claims harm.

However, there necessarily are limitations to how long and under what circumstances a taxpayer may rely on specific written reporting instructions. Instructions are based on the facts, the law, and the interpretation of the law that existed at the time the instructions were given. When the facts materially change, a taxpayer cannot reasonably expect to continue to rely on instructions

that were based on a different set of facts. The Department's instruction binds the Department only under the facts presented. *See* WAC 458-20-100(9).

Since issuing the instructions, the taxpayer's facts have changed. The taxpayer, not the [governmental entity], now hires the hospital personnel. This was a material change in the taxpayer's business operations. The instructions Audit provided concluded that the hospital maintained complete control over the personnel including hiring. The Department's legal position has also evolved to conform to subsequent decisions.⁴

DECISION AND DISPOSITION

Taxpayer's petition is denied

Dated this 1st day of February, 2008.

⁴ *William Rogers* clarified the Supreme Court's decision in *Rho*, which was the basis for RPM 90-1/ETA 90-001. The *William Rogers* decision clarified the interpretation of the law as it relates to Rule 111. The Department concluded that ETA 90-001 was not consistent with the court's *William Rogers* decision, and therefore ETA 90-001 was an incorrect interpretation of Rule 111 that could no longer be followed. The Department subsequently canceled ETA 90-001, in August 2003. The Department stated its conclusions regarding the effect of the *William Rogers* decision on ETA 90-001, and on instructions that were based on ETA 90-001, in its ETA 2016 cover letter. As is stated above, the Department concluded that ETA 90-001 was at odds with the *William Rogers* decision, and an incorrect interpretation of the law. The Department believes that for it to continue to apply ETA 90-001 after the *William Rogers* decision would have been an *ultra vires* act. *See Washington Printing & Binding Co. v. State*, 192 Wash. 448, 73 P.2d 1326 (1937); *Hansen Baking v. City of Seattle*, 48 Wn.2d 737, 296 P.2d 670 (1956). Taxpayer's arguments in this appeal do not persuade us otherwise. Also note, taxpayers have a statutory responsibility to inform themselves about applicable tax law, so when there is a change in the tax law, that change supersedes any written instructions a taxpayer may have received based on past law. Det. No. 95-093, 16 WTD 29 (1995).