

Cite as Det. No. 01-016, 23 WTD 147 (2004)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON<sup>1</sup>

In the Matter of the Petition	)	<u>D E T E R M I N A T I O N</u>
For Correction of Assessment of	)	
	)	No. 01-016
. . .	)	
	)	Registration No. . . .
	)	Docket No. . . .
	)	FY . . . /Audit No. . . .

- [1] RULE 168(3)(a); RCW 82.04.260(12): B&O TAX - SPECIAL PUBLIC AND NONPROFIT HOSPITAL RATE -- "SERVICES TO PATIENTS" – HOSPITAL CLINICS AND SERVICES. As demonstrated by the phrase "services to patients" in Rule 168, the Department has determined that the legislature's intent was to extend the special rate to hospitalization services previously entitled to the RCW 82.04.4289 deduction, which includes hospitalization services rendered by nonprofit hospitals to inpatients. Additionally, for departments and services available to both inpatients and outpatients (e.g., emergency rooms, radiology services, and laboratories) the public and nonprofit rate will be applicable to those that are an "integral, interrelated and essential part" of the hospital using the Group Health analysis.
- [2] RULE 168(3)(a); RCW 82.04.260(12): B&O TAX - SPECIAL PUBLIC AND NONPROFIT HOSPITAL RATE–FAMILY PRACTICE CLINIC. 168(3)(a). Because a hospital's family practice clinic does not render services to hospital inpatients, and because it is not an "integral, interrelated, and essential part" of the hospital under the Group Health analysis, its revenues are not eligible for the special public and nonprofit hospital rate after July 1, 1993.
- [3] RULE 168(3)(a); RCW 82.04.260(12): B&O TAX - SPECIAL PUBLIC AND NONPROFIT HOSPITAL RATE– EDUCATIONAL OFFERINGS AND SERVICES OPEN TO, OR PROVIDED TO, THE GENERAL PUBLIC. Educational offerings and services open to, or provided to, the general public will qualify as being an "integral, interrelated, and essential part" of the hospital

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<sup>1</sup> Non precedential portions of this determination have been deleted.

operation only if they are unique and incidental to the provision of hospitalization services (i.e., services which will be, have been, or are currently being provided to the students or participants.). The mere fact that only a hospital might offer these educational services in a community is insufficient grounds for exemption if the services are of the type that could be offered by others outside the hospital setting.

Only those educational programs and services offered by a hospital that would be very difficult or impossible to duplicate by a non-hospital because of the specialized body of knowledge, facilities and equipment required will qualify as a hospitalization service. Other educational programs and services will not be eligible for the public and nonprofit hospital classification rate when any physician, clinic, or even trained lay persons could offer them.

- [4] RULE 168(3)(a); RCW 82.04.260(12): B&O TAX – SPECIAL PUBLIC AND NONPROFIT HOSPITAL RATE -- LABORATORY SERVICES FOR PATIENTS AT ANOTHER HOSPITAL. A hospital laboratory, under Group Health, even though it may serve both inpatients and outpatients, is an "integral, interrelated and essential part" of the hospital. Therefore, revenues from its operations should generally be reportable under the RCW 82.04.260(12) public and nonprofit hospital B&O tax classification. We can perceive no violation of the Group Health analysis to hold that laboratory revenues stemming from patients in a sister nonprofit hospital are so taxable.
  
- [6] RCW 82.04.4297: B&O TAX - DEDUCTION -- GOVERNMENT-PAID SERVICES FOR HUMANS. A laboratory service is deductible from the B&O tax if it is pursuant to any of the "health and social welfare services" enumerated in RCW 82.04.431(2), which include and are limited to "(a) mental health, drug, or alcoholism counseling or treatment; . . . (c) health care services; (d) therapeutic, diagnostic, rehabilitative, or restorative services for the care of the sick, aged, or physically, developmentally, or emotionally-disabled individuals."
  
- [7] RCW 82.04.4297: B&O TAX – DEDUCTION – RESEARCH AND PHYSICIAN TRAINING GRANTS. Because grants for research and physician training are not for the purposes described under RCW 82.04.431(2)(a), (c), and (d) – i.e., various services and treatments rendered to patients -- they are not deductible by a hospital under RCW 82.04.4297 as "health and welfare services."

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:

Petition concerning the taxability of various facets of a non-profit hospital.<sup>2</sup>

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<sup>2</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

FACTS:

Bauer, A.L.J. – Taxpayer's business records were reviewed by the Audit Division (Audit) of the Department of Revenue (Department) for the period January 1, 1990 through June 30, 1994. As a result, the above-referenced tax assessment was issued on December 20, 1995 in the total amount of \$ . . . , which amount included interest calculated to that date.

Taxpayer is a nonprofit corporation which, during the audit period, operated "Hospital A" ( . . . ), "Hospital B" ( . . . ), "Hospital C" ( . . . ), and a support services division. It was affiliated with another hospital ("affiliated hospital"), with whom it merged after the audit period.

ISSUES:

. . .

Taxpayer has raised the following substantive issues concerning the taxation of:

8. . . . Family Practice. Were patient service revenues from the . . . Family Practice Residency Program deductible under RCW 82.04.4289 before July 1, 1993, and were they taxable under the RCW 82.04.260(12)<sup>3</sup> public or nonprofit hospital rate after July 1, 1993?

9. Revenues generated by clinics and other services: Were revenues from the following clinics and services taxable under the public or nonprofit classification of the B&O tax after July 1, 1993: Gynecology/Oncology, Perinatal Clinic, Cardiac Rehabilitation, OB Access Clinic, Medical Oncology, . . . , Prenatal Education, and Geriatrics, and diabetic and patient nutritional services and education?<sup>4</sup>

10. . . .

11. Laboratory Services for Patients of Another Hospital. Were revenues received for laboratory services performed by one of Taxpayer's wholly-owned hospitals for patients in another of its wholly-owned hospitals deductible prior to July 1, 1993 under RCW 82.04.4289, and taxable under RCW 82.04,269(12) after that time, because these services were rendered to patients of a non-profit hospital?

12. Government-paid laboratory services for humans. Were certain laboratory revenues for services performed after July 1, 1993 entitled to be deducted as amounts received by a health or social welfare organization when they were received from a government agency under RCW 82.04.4297.

<sup>3</sup> Originally codified as RCW 82.04.260(15), which was effective July 1, 1993. This classification is currently codified as RCW 82.04.260(12), and will be referred to as such herein.

<sup>4</sup> Schedule 2, accounts 5572-6200, 5583-2000, 5583-2030.

13. Grants. Were cancer research funds received from the federal government, a state grant for Taxpayer's perinatal services, and state grants to the . . . Family Practice Residency Program subject to B&O tax?

#### DISCUSSION:

As to the substantive issues raised in issues 8-12 above, Taxpayer argues that, prior to July 1, 1993, the RCW 82.04.4289 nonprofit hospital deduction was clearly for revenue received for services rendered to patients. When amending the law to provide, instead, for a non-profit hospital B&O tax rate, the legislature was aware of the narrow language of the previous exemption. Had it been the legislature's intent to tax under the new classification only those activities previously exempt from tax, the it would have used such restrictive language. Instead, the legislature adopted a broader definition for revenue for the new tax classification. Those hospitals that supported the tax agreed to this language as a way to get the most tax into the health services account and be the least confusing to implement.

According to Taxpayer, the language adopted by the legislature reflects the changing nature of hospitals in the modern health care environment. Hospitals are very active in all areas of the health care delivery system. Hospitals see a growing share of revenue coming from outpatient services. Many community health services are only available if a community hospital is willing to provide it. This pressure on hospitals to do more and more with ever scarcer resources is unrelenting. The tax on hospitals was seen as part of the solution to broaden the umbrella of health coverage to those unable to secure health insurance or receive health services.

Taxpayer alleges that when Audit performed the audit, Audit attempted to differentiate between various types of hospital activities based upon the repealed language of the non-profit hospital exemption,<sup>5</sup> which required services to be rendered to patients. Audit then, according to Taxpayer, relied on determinations that applied to RCW 82.04.4289, even though the legislature clearly changed the wording and intent of the law.

Taxpayer argues that it is important to understand the Washington Supreme Court's holding in Group Health Cooperative v. Washington State Tax Commission, 72 Wn.2d 422, 433 P.2d 201 (1967) (Group Health). Taxpayer sees the Supreme Court in this case as being very liberal in including the specialty clinic under the umbrella of the hospital exemption. It seems likely, according to Taxpayer, that that the Supreme Court, or any court, would now be drawn to a conclusion that RCW 82.04.260(12) has defined new grounds which are much more inclusive than the case law and regulations that arose out of RCW 82.04.4289.

Taxpayer points out that the audit period straddles July 1, 1993 (the "change in the law"), when the RCW 82.04.4289 nonprofit hospital deduction was eliminated and the RCW 82.04.260(12) nonprofit hospital tax rate was established.

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<sup>5</sup> RCW 82.04.4289.

Taxpayer argues that revenues received by its family practice clinic are for patient services. Taxpayer argues that prior to the change in the law, this revenue was exempt either as amounts received for services rendered to patients or as monies from the state government paid to a health or social welfare organization. Taxpayer asserts that this matter was addressed in Swedish Hospital Medical Center v. Department of Rev., Docket No. 87-2-2482-7 (Thurston Co. Sup. Ct., 1988) (Swedish). According to Taxpayer, the court in Swedish drew a parallel with the specialty clinic in Group Health. Taxpayer asserts that the residency program run by Taxpayer is set up in nearly identical fashion to the Swedish clinic. The residents are required to spend varying amounts of time seeing patients in the hospital and the office. After the July 1, 1993 change in the law, revenue from services rendered should have been either reportable under the new public or non-profit hospital classification of the B&O tax, or exempt as to those revenues from the state government paid to a health or social welfare organization.

Effective July 1, 1993, the legislature removed the nonprofit hospital deduction contained in RCW 82.04.4289<sup>6</sup> and replaced it with a special "Public or Nonprofit Hospital" rate under RCW 82.04.260(12):

(12) Upon every person engaging within this state in business as a hospital, as defined in chapter 70.41 RCW, that is operated as a nonprofit corporation or by the state or any of its political subdivisions, as to such persons, the amount of tax with respect to such activities shall be equal to the gross income of the business multiplied by the rate of 0.75 percent through June 30, 1995, and 1.5 percent thereafter. The moneys collected under this subsection shall be deposited in the health services account created under RCW 43.72.900.

Taxpayer argues that Washington hospitals agreed to support the July 1, 1993 change in the law, whereby they became subject to the B&O tax under RCW 82.04.260(12), only because the taxes were to be deposited in the health services account. Taxpayer argues the wording of RCW 82.04.260 would have exactly reflected the language of the prior nonprofit hospital exemption if the legislature intended to merely tax in-patient service revenue. Instead, according to Taxpayer, the language adopted was very broad and was intended to extend the special Public and Nonprofit Hospital rate to all business activities conducted by hospitals, and not just services to their inpatients.

WAC 458-20-168 (Rule 168),<sup>7</sup> however, implements RCW 82.04.260(12) as follows:

(3)...There are two B&O tax classifications which can apply to persons providing medical services through the operation of a hospital, with the tax classification dependent on the organizational structure of the hospital. The B&O tax classifications are:

(a) Public or nonprofit hospitals. This B&O tax classification applies to gross income derived from personal and professional services to patients by hospitals that are operated as nonprofit corporations, operated by political subdivisions of the state, or operated but not owned by the state. These hospitals became taxable for hospital services under this B&O tax classification on July 1, 1993. These hospitals were required to report

<sup>6</sup> Before that, the deduction was contained in RCW 82.04.430(9).

<sup>7</sup> Filed May 17, 1994 and effective 31 days later.

under the service B&O tax classification prior to July 1, 1993, but were entitled to a deduction for services rendered to patients.

(b) Service. The gross income derived from personal and professional services of hospitals (other than hospitals operated as nonprofit corporations or by political subdivisions of the state), nursing homes, convalescent homes, clinics, rest homes, health resorts, and similar health care institutions is subject to business and occupation tax under the service and other activities classification. This classification also applies to nonprofit hospitals for personal or professional services which are performed for persons other than patients and not otherwise tax classified.

(Emphasis added.) As demonstrated by the phrase "services to patients" in Rule 168(3)(a), the Department has determined that the legislative intent of RCW 82.04.260(12), as discussed below, was to extend the special rate only to services rendered by nonprofit hospitals to its inpatients.

Taxpayer argues it may rely on the Swedish decision because the operation of its Family Practice Clinic is identical to that in Swedish. Taxpayer argues Swedish relied heavily upon the Washington Supreme Court case, Group Health Cooperative v. Washington State Tax Commission, 72 Wn.2d 422, 433 P.2d 201 (1967) (Group Health), and that Taxpayer's medical residents are even more intimately involved in the operations of the hospital than were the physicians in the "central clinic" in Group Health.

Taxpayer argues the family residency was found to be integrated into the hospital in Swedish because the residency program/clinic at that time was next to the emergency room. Although four years ago Taxpayer moved the clinic to another building on the campus, it was still connected to the hospital by a walkway and, despite another move since the audit, the main clinic is still on Taxpayer's main campus.

The Supreme Court's 1967 decision in Group Health, upon which decision Swedish purportedly relied, concerned Group Health's entitlement to a B&O tax deduction under RCW 82.04.430(9)<sup>8</sup> for the revenue from Group Health's "central clinic." RCW 82.04.430(9) at that time provided as follows:

In computing tax there may be deducted from the measure of tax the following items:

...

(9) Amounts derived as compensation for services rendered to patients by a hospital, as defined in chapter 70.41 RCW, which is operated as a nonprofit corporation . . . . RCW 70.41.020(3) provided the following definition of "hospital":

"Hospital" means any institution, place, building, or agency which provides accommodations, facilities and services over a continuous period of twenty-four hours or

<sup>8</sup> This deduction was later re-codified as RCW 82.04.4289.

more, for observation, diagnosis, or care, of two or more individuals not related to the operator who are suffering from illness, injury, deformity, or abnormality, or from any other condition for which obstetrical, medical, or surgical services would be appropriate for care or diagnosis. "Hospital" as used in this chapter does not include . . . clinics, or physician's offices where patients are not regularly kept as bed patients for twenty-four hours or more.

The Supreme Court in Group Health, combining the pertinent portions of both these statutes, concluded that the legislature basically had in mind that the deduction applied to amounts received for services furnished to patients by a hospital, as such facilities and services are ordinarily comprehended." Group Health first reasoned that the RCW 82.04.430(9) deduction did not contemplate ordinary medical consultation and treatment, such as one seeks and obtains in a doctor's office or clinic.<sup>9</sup> The Court then went on to conclude that, even though Group Health was organizationally integrated and its various activities interrelated, that its "services to patients" could still be broken down into two different categories:

*medical* consultation, diagnosis, treatment, and care by way of home or office calls,  
and  
*hospitalization* together with the usual services accompanying such a confinement.

(Group Health, 72 Wn.2d at 432, italicized emphasis in original text.) The Court noted that the bulk of the first type of service -- "medical" -- was essentially furnished and performed in respondent's outlying clinics. The second type of service -- "hospitalization" -- was supplied through respondent's central or hospital facility, including in some measure, at least, "the central clinic which served the central complex on a basis akin to the ordinary intake or emergency room in the average hospital":

[T]he line of demarcation between the character of the services supplied by respondent is reasonably discernible. Likewise, the division between the facilities which afford the respective services is, with the exception of the central clinic, fairly observable. . . . [T]he outlying clinics are staffed, equipped, administered, and provide that type of medical service to the members which one would expect to find and receive in the average private physician's office or clinic. They are open only during regular business hours, provide no domiciliary care or overnight facilities, and are physically separate and apart from the central or hospital complex. And, as with the ordinary doctor's office, when the patient's needs exceed the resources at hand referral to specialists or to the hospital, as the case may be, is recommended and becomes available. . . .

On the other hand, the central facility, including the central clinic, furnishes modern as well as all of the traditional hospital services, i.e., bed wards, surgery rooms, laboratories, X-ray equipment, pharmaceutical supplies, specialized professional staff, nursing staff, catering services, and 24 hour intake and emergency facilities. These services differ in no substantial way, except in their over-all organizational scheme, from the ordinary hospital. Within the

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<sup>9</sup> Group Health, 72 Wn.2d at 431.

framework of this aspect of respondent's service, the central clinic truly forms an integral, interrelated and essential part of the central facility, for, although it undertakes to provide some out-patient services akin to the outlying clinical service, it nevertheless provides the round-the-clock intake and emergency services which form a constituent part of the normal hospital operation. In this sense, then, the central clinic is no more separable from the central or hospital facility than the surgery rooms, the bed wards, the laboratory or the other components of the hospital activity, all of which might incidentally perform some out-patient service.

(Group Health, 72 Wn.2d at 432, 433, emphasis added.) The Group Health decision therefore found the "central clinic" to be, functionally, an integral part of the "hospital" portion of that entity's hospital activities.<sup>10</sup> It was thus rendering a deductible "hospitalization" service, as opposed to a nondeductible "medical" service."

In arriving at its conclusion that the "central clinic" was part of Group Health's "hospital," the Supreme Court considered both (1) the clinic's location in the central facility and, (2) its "round-the-clock intake and emergency services" function for patients who needed immediate hospitalization.<sup>11</sup>

The Thurston County Superior Court in Swedish identified three criteria – regular business hours, proximity to central hospital, and exemption from property tax<sup>12</sup> -- to have been "significant" in the Group Health analysis.<sup>13</sup> Unlike the Supreme Court in Group Health, the Superior Court did not look to these criteria in order to determine whether the nature of the clinic's patient services was "medical" or "hospitalization." Instead, it simply gave them equal weight and determined that, because the clinic shared two out of the remaining three criteria with Group Health's "central clinic" (proximity to central hospital and exemption from property tax) – the deduction should apply.

Further, Taxpayer has been unable to provide any legislative history or other documentation in support of its argument that the legislature intended to extend the special Public and Nonprofit Hospital rate to all business activities conducted by hospitals, and not just services to their inpatients.

In fact, fiscal notes and other documents in the legislative history files<sup>14</sup> indicate an intent, or at least a legislative understanding, that the new special Public and Nonprofit Hospital tax rate (initially at .75%) would be imposed on only that non-profit hospital revenue which had previously been deductible, i.e., revenue received from hospital services to inpatients as previously interpreted by Group Health.<sup>15</sup>

<sup>10</sup> As opposed to the outlying clinics. Group Health, 72 Wn.2d at 430.

<sup>11</sup> We also note the Court did not address the clinic staff's employment or training relationship to the hospital.

<sup>12</sup> We note, however, that Group Health, at 433, noted that it did not consider the exemption from property taxes to be decisive.

<sup>13</sup> A fourth criteria – overnight facilities -- was discounted in the analysis because neither the Group Health nor the Swedish clinic provided them.

<sup>14</sup> Archives Division, Office of the Washington Secretary of State.

<sup>15</sup> Representative language is as follows: "This bill . . . removes the B&O tax exemption for nonprofit hospitals. . . . Currently, . . . nonprofit hospitals do not pay B&O tax at all." See, Fiscal Note, Bill Number E2SSB 5304 as passed by the Legislature, dated 5/4/93. We also note the Washington Supreme Court's observation in In re Sehome Park Care Center, 127 Wn.2d 774, 781, 903 P.2d 443 (1995), as follows: "Turning to the 1993 amendment to RCW

The Department historically took the position that the RCW 82.04.4289 nonprofit hospital deduction applied to gross receipts by otherwise qualifying institutions when they rendered traditional hospitalization services to patients, and did not apply to income from outpatient medical clinics, even though such clinics might be owned and operated by a nonprofit hospital. Det. No. 92-192, 12 WTD 377 (1992). Departments and services available to both inpatients and outpatients -- e.g., emergency rooms, radiology services, and laboratories -- that were an "integral, interrelated and essential part" of the hospital were evaluated using the Group Health analysis. Det. No. 90-245, 10 WTD 033 (1990).

[1] As demonstrated by the phrase "services to patients" in Rule 168(3)(a), the Department has determined that the legislative intent of RCW 82.04.260(12), as discussed above, was to extend the special rate to hospitalization services previously entitled to the RCW 82.04.4289 deduction. This would include hospitalization services rendered by nonprofit hospitals to inpatients. Additionally, for departments and services available to both inpatients and outpatients -- e.g., emergency rooms, radiology services, and laboratories -- the public and nonprofit hospital rate will be applicable to those that are an "integral, interrelated and essential part" of the hospital using the Group Health analysis.<sup>16</sup>

8. Family Practice Clinic. We note, from the Yellow Pages listings, that Taxpayer's family practice clinic is not co-located with any of Taxpayer's hospitals. It is separately advertised and, according to the telephone receptionist, it is a normal family practice doctors' office with regular office hours currently staffed by . . . medical residents and six faculty members from the . . . Medical School. Appointments are required.

[2] Because Taxpayer's Family Practice Clinic does not render services to hospital inpatients, and because it is not an "integral, interrelated, and essential part" of any hospital under the Group Health analysis, Taxpayer's petition to deduct its revenues under RCW 82.04.4289 before July 1, 1993, and classify them under the RCW 82.04.260(12)<sup>17</sup> public or nonprofit hospital rate after July 1, 1993, is denied.

9. Other Clinics/Services. Taxpayer argues revenues from the following clinics and services were properly taxable under the public or nonprofit classification of the B&O tax after the July 1, 1993 change in the law: Gynecology/Oncology, Perinatal Clinic, Cardiac Rehabilitation, OB Access Clinic, Medical Oncology, . . . , Prenatal Education, and Geriatrics, and diabetic and patient nutritional services and education.

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82.04.4289, we see that the legislature deleted hospitals from the statute entirely . . . . These [published bill summary] documents reveal that the thrust of the bill was to increase, rather than decrease, taxes in order to pay for health care reform."

<sup>16</sup> We note that Thurston County Superior Court in Empire Health Services v. Department of Rev., No. 99-2-00312-5 (Superior Ct., December 17, 1999), similarly concluded that, in order to qualify for taxation at the nonprofit hospital rate, a taxpayer must provide a service that relates to treatment in the hospital and must provide services that are unique to those provided in a hospital (Conclusion of Law No. 1, emphasis the Court's)

<sup>17</sup> Originally codified as RCW 82.04.260(15), which was effective July 1, 1993. This classification is currently codified as RCW 82.04.260(12), and will be referred to as such herein.

Audit's rationale for denying the Public and Nonprofit Hospital rate to these clinics and services for periods after June 30, 1993 is not clearly articulated in the audit report. We believe, looking at the account names given, that Audit may have considered these departments/services to be either remote medical clinics not located in the hospital itself, and/or essentially outpatient clinics/services which were not an "integral, interrelated, and essential part" of the hospital operation. If the latter, the Public and Nonprofit Hospital rate was correctly denied.

[3] Educational offerings and services open to, or provided to, the general public will qualify as being an "integral, interrelated, and essential part" of the hospital operation only if they are unique and incidental to the provision of hospitalization services (i.e., services which will be, have been, or are currently being provided to the students or participants.). The mere fact that only a hospital might offer these educational services in a community is insufficient grounds for exemption if the services are of the type which could be offered by others outside the hospital setting. Only those educational programs and services offered by a hospital that would be very difficult or impossible to duplicate by a non-hospital because of the specialized body of knowledge, facilities and equipment required will qualify as a hospitalization service. Other educational programs and services will not be eligible for the public and nonprofit hospital classification rate when any physician, clinic, or even trained lay persons could offer them.

Taxpayer will be given the opportunity, upon remand, to present further arguments relative to this issue.

10. . . .

11. Laboratory Services for Patients of Another Hospital. Taxpayer argues revenues received for laboratory services performed by one of Taxpayer's wholly-owned hospitals for patients in another of its wholly-owned hospitals should have been deductible prior to July 1, 1993 under RCW 82.04.4289, and taxable under RCW 82.04.260(12) after that time, because these services were rendered to patients of a non-profit hospital. We agree.

[4] A hospital laboratory, under Group Health, even though it may serve both inpatients and outpatients, is an "integral, interrelated and essential part" of the hospital. Therefore, revenues from its operations should generally be reportable under the RCW 82.04.260(12) public and nonprofit hospital B&O tax classification. We can perceive no violation of the Group Health analysis to hold that laboratory revenues stemming from patients in a sister nonprofit hospital are so taxable.

Taxpayer's petition as to this issue is granted.

12. Government-paid laboratory services for humans. Taxpayer does not object to the imposition of B&O tax under the service and other activities classification on those amounts not received from government agencies prior to July 1, 1993. However, slightly over fifty percent of the accounts . . . are for services rendered to the State of Washington, . . . County, or the City of .

. . which Taxpayer believes are lawfully not taxable as revenue received by a health or social welfare organization.

According to Taxpayer, such laboratory services are common to hospitals generally, and there is an expectation in the health care industry that a full service hospital contains a sophisticated laboratory and that it is available to those in the community that require such services. Furthermore, argues Taxpayer, it is in the best interests of all those served that Taxpayer make the best use of existing resources in order to keep the cost of care to a minimum by not allowing equipment to lie idle. Therefore, after the July 1, 1993 change in the law, all laboratory service revenues should be properly reportable under the new public or non-profit hospital classification with a deduction for those amounts received by a health or social welfare organization from a government agency.

RCW 82.04.4297 provides as follows:

In computing tax there may be deducted from the measure of tax amounts received from the United States or any instrumentality thereof or from the state of Washington or any municipal corporation or political subdivision thereof as compensation for, or to support, health or social welfare services rendered by a health or social welfare organization or by a municipal corporation or political subdivision, except deductions are not allowed under this section for amounts that are received under an employee benefit plan.

[5] RCW 82.04.431(2) provides a definition of "welfare services":

- (2) The term "health or social welfare services" includes and is limited to:
- (a) Mental health, drug, or alcoholism counseling or treatment; . . .
  - (c) Health care services;
  - (d) Therapeutic, diagnostic, rehabilitative, or restorative services for the care of the sick, aged, or physically, developmentally, or emotionally-disabled individuals . . . .

A laboratory service is thus deductible from the B&O tax if it is pursuant to any of the above-enumerated categories in RCW 82.04.431(2).

This matter will be remanded to Audit for a determination of which charges are deductible "health or social welfare services."

13. Grants. Taxpayer claims that cancer research funds received from the federal government, a state grant for Taxpayer's perinatal services, and state grants to the . . . Family Practice Residency Program, were not subject to B&O tax. Taxpayer submits that all such funds should be treated as deductible because Taxpayer is a health or welfare organization, and that there is no requirement under RCW 82.04.4297 or RCW 82.04.431 that health or social welfare revenue be for services to patients.

RCW 82.04.4297 (quoted above) provides that amounts received from the federal and state governments "to support health or social welfare services rendered by a health or social welfare organization" are deductible from the B&O tax.

Taxpayer claims to be a health or social welfare organization, and claims that amounts received from government grants do, in fact, "support" the health services it provides. Taxpayer further notes that the . . . "program is a cancer research program," and that it is irrelevant that there is no actual treatment of patients because the research program is a health service rendered by Taxpayer. Taxpayer likewise argues the grants to Taxpayer's Family Medicine Clinic were grants from the State of Washington for the residency training program.

[6] RCW 82.04.431(2)(a), (c), and(d), also as quoted above, provides that the term "health and welfare services" includes, and is limited to, various services and treatments rendered to patients. Any grants, then, to be deductible under RCW 82.04.4297, must have been designated for, and used, for such purposes. Contrary to Taxpayer's assertion, it is not irrelevant that the grants at issue were for research (as in the cancer research grant) or for physician training (as in the grant for the residency training program). Because the grants were not for the purposes described under RCW 82.04.431, they are not deductible under RCW 82.04.4297.

Taxpayer's petition as to this issue is denied.

#### DECISION AND DISPOSITION:

Taxpayer's petition is granted for the following issues:

- Laboratory services provided to inpatients of another nonprofit hospitals

Taxpayer's petition is denied relative to the following issues:

- Family practice clinic
- . . .
- Grants for cancer research and residency training

The following issues are remanded to Audit for further analysis and adjustment, if appropriate, in accordance with this decision:

- . . .
- Revenues generated by clinics (other than the family practice clinic) and other services
- Government-paid laboratory services

Dated this 31<sup>st</sup> day of January, 2001.