

Cite as Det. No. 15-0065R, 35 WTD 319 (2016)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition for )	<u>D E T E R M I N A T I O N</u>
Reconsideration of )	
)	No. 15-0065R
)	
... )	Registration No. . . .
)	

[1] RCW 82.04.080: GROSS INCOME OF BUSINESS – NO DEDUCTIONS FOR EXPENSES. A firm billing for an x-ray imaging and interpretation of those images is taxable on the gross income of the business with no deductions for expenses.

[2] RULE 111: B&O TAX – ADVANCES AND REIMBURSEMENTS. An x-ray imaging business may not exclude from taxable gross income funds it receives from patients for providing X Ray interpretation 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.

Lewis, A.L.J. – Taxpayer, a firm that provides medical imaging services, petitions for reconsideration of Det. No. 15-0065, which sustained assessment of business and occupation (“B&O”) tax on fees received from patients that were subsequently paid to physicians who interpreted the medical images. We deny Taxpayer’s petition, finding that Taxpayer neither acted as a billing agent for the physicians nor as an agent of the patients.<sup>1</sup>

ISSUES:

1. Is a firm that provided medical imaging services entitled to exclude from the measure of the B&O tax amounts billed and collected from patients that are paid to a related service provider that interpreted the medical images, because such amounts are not “gross income of the business” [to the medical imaging services firm] as defined in RCW 82.04.080?
2. Is a firm that provided medical imaging services entitled to exclude from the measure of B&O tax fees that it received from patients and paid to physicians who interpreted the medical images, because such amounts are “advances” or “reimbursements” under WAC 458-20-111(Rule 111)?

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

## FINDINGS OF FACT:

[Taxpayer] is a limited liability company. Its two members are [Hospital] and [Manager]. Taxpayer is managed by a six-member [Board]. The Board delegates Taxpayer's day-to-day management to [Radiology].

Taxpayer provides outpatient medical imaging services . . . to patients. Its state license allows it to only image its patients. It is not licensed to interpret the images or give medical advice.

Radiology is composed of a group of [physicians] who are licensed to practice medicine in Washington. Radiology's business activity is to view and interpret the images that are taken by Taxpayer. The two businesses complement each other. Without the imaging the physicians would have nothing to view and interpret. Conversely, without the physicians to interpret the images there would be no need to do the images. In sum, Taxpayer and Radiology are distinct businesses that perform different functions as licensed by the State of Washington.

The charges for both services, imaging and interpretation, are globally billed [by [Manager] to patients and insurers]. The billings have a description of the imaging or interpretation service provided and reference the Healthcare Common Procedure Coding System [The Healthcare Common Procedure Coding System (HCPCS, often pronounced by its acronym as "hick picks") is a set of health care procedure codes based on the American Medical Association's Current Procedural Terminology (CPT).<sup>2</sup>] The manner of billing reflects the standard in the medical industry.

The Washington State Department of Labor & Industries explains CPT and HCPCS code modifiers as:

**-26 Professional component**

Certain procedures are a combination of the professional (**-26**) and technical (**-TC**) components. The modifier should be used only when the professional component is performed. When a global service is performed, neither the **-26** nor the **-TC** modifier should be used.

**-TC Technical component**

Certain procedures are a combination of the professional (**-26**) and technical (**-TC**) components. This modifier should be used when only the technical component is performed. When a global service is performed, neither the **-26** nor the **-TC** modifier should be used.

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<sup>2</sup> [https://en.wikipedia.org/wiki/Healthcare\\_Common\\_Procedure\\_Coding\\_System](https://en.wikipedia.org/wiki/Healthcare_Common_Procedure_Coding_System), last visited 04/12/16.]

## Global radiology services

Global radiology services include both a technical component (producing the study) and a professional component (interpreting the study). If only the:

- **Technical component** of a radiology service is performed, then **modifier –TC** must be used, and only the technical component fees are allowable, and
- **Professional component** of a radiology service is performed, then **modifier -26** must be used, and only the professional component fees are allowable.

Thus, the professional component of a charge covers the cost of the physician's professional services only. When billing for the physician's time and expertise, a 26 modifier is added to certain CPT codes. For example: a patient has a CT scan and the doctor interprets the results. A biller may code 77014-26 to indicate the charge is for the professional services only. By adding the 26 modifier, the biller is alerting the insurance company that the claim is requesting payment for the physician's services **only** and not the use of the facility, the use of the CT equipment or other support staff's services.

The technical component of a charge addresses the use of equipment, facilities, non-physician medical staff, supplies, etc. Technical charges do **not** include the physician's professional fees, but include the use of all other services associated with the visit. Using the same example, a patient has a CT scan and the results are sent to the doctor for interpretation. A biller may code 77014-TC to indicate the charge is for the technical component only. In this case the medical claim is seeking payment for the use of the CT equipment, the facility costs and the costs associated with all supplies and staff **except** for the physician.

A biller will not bill global charges when there is no division of the costs associated with a medical service because the service was provided by a single entity. The global charge includes both the professional services as well as all ancillary services (like use of equipment, facilities, non-physician medical staff, supplies, etc.) associated with a patient's care. Global charges require no modifier.

Taxpayer provided a copy of a billing statement. The statement was issued by [Manager]. The statement in bold print explains:

Your services have been rendered at [Hospital] by [Radiology] (professional services) . . . and [Taxpayer] (technical services). [Manager] is the billing agent for [Taxpayer] and will remit the applicable portion, for [Taxpayer] fees to them on your behalf. . . .

The statement detail contained the date, code for services performed, and description of the services performed:

DATE	CODE	DESCRIPTION OF SERVICE	CHARGE
08/09/12	72110	Lumbosacral Minimum 4 Views	\$ . . .
09/09/12	73510	Complete Hip, 2 Views	\$ . . .
08/09/12	72170	Pelvis 1 or 2 Views	\$ . . .
09/26/12	72148	M.R.I. Lumbar Spine	\$ . . .

The charges were globally billed. Both the imaging (technical services) and professional services are billed under one code that reflects the total procedure performed. The patient billings are issued under [Manager's] name. The description of the charge comes from the description used to describe the CPT code. From the detail on the statements which describe the procedure performed it appears that [Manager] provided the total service and that the total income belongs to [Manager]. That belief is reinforced when patients and insurance providers send their payments to a US Bank lock box.

It is only after the funds are deposited into an account called "[Taxpayer] Agency Account" that the funds are distributed between Taxpayer and Radiology based on an agreement of the percentage split between technical and professional services.

The Department's Audit Division audited Taxpayer's business records for the period January 1, 2009 through December 31, 2011. On June 26, 2013, the Department issued a \$ . . . assessment.<sup>3</sup>

The audit examination found that Taxpayer only included in its financial statements and state excise tax reporting its billing for imaging (technical services). Radiology's professional fees were not included as Taxpayer's income for purposes of financial or tax reporting. The tax deficiency arose when the Audit Division concluded that the bills were issued under Taxpayer's letterhead and the total amount collected from patients was income received by Taxpayer and that the amounts disbursed to Radiology were a non-deductible cost of doing business.

Taxpayer disagreed with the assessment. On August 13, 2013, Taxpayer filed a petition requesting Correction of Assessment. Taxpayer argued that the assessment of tax on the income earned by Radiology, but collected by Taxpayer, should be cancelled because it acted as a collection agent for the medical fees earned by Radiology. Taxpayer also argued that it acted as the patient's agent in obtaining and paying for Radiology's services.

On March 11, 2015, the Department issued Det. No. 15-0065, which sustained the assessment. The Determination concluded that Taxpayer neither acted as a collecting agent or procurement agent. In regard to acting as a collecting agent Det. No.15-0065 stated:

Here, unlike in Washington Imaging, the agreements between Taxpayer and Radiology do not purport to describe a collecting agent relationship. Rather, they indicate that Radiology is an independent contractor that provides some administrative services.

<sup>3</sup> The \$ . . . assessment consisted of \$ . . . tax and \$ . . . interest.

Although there is some evidence in patient contracts and bills that indicate some payment may be due to Radiology, they do not identify what payments are due to Radiology or that patients in fact owed money to Radiology rather than only to Taxpayer for what is billed as a single service. Accordingly, the evidence does not support a deduction for funds received by Taxpayer as a collecting agent.

In regard to acting as a procurement agent Det. No.15-0065 stated:

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.

...

Here, although the term “agent” is used in the financing agreement and in billings, the Taxpayer used the term as a purported agent for Radiology, not as an agent for patients. Moreover, the use of the term is not controlling. The facts do not show the Taxpayer was acting under the direction and control of the patients in choosing radiology services. In fact, Taxpayer had an exclusivity agreement with Radiology, so the use of the services was not under the direction and control of the patients.

In the absence of an agency relationship, taxpayer’s liability to pay is also not “solely agent liability.” *City of Tacoma v. Wm. Rogers Co.*, 148 Wn.2d 169, 178, 60 P.3d 79, 83 (2002). As stated in *Washington Imaging*, at 567:

Given its contractual obligation to pay Overlake, its obligations to pay Overlake could not have been “solely agent liability.” Instead, as the Department argues, Washington Imaging's payments to Overlake were a cost of doing business that cannot be deducted from the gross income on which B& O tax must be paid.

As such, we conclude that the amounts collected from patients and paid to Radiology are not excluded business income under Rule 111.

Taxpayer disagreed with Det. No. 15-0065. On May 8, 2015, Taxpayer filed a petition for reconsideration alleging that it was error for the Department to conclude:

- Patients did not owe Radiology for the professional fees it provided: and,
- Taxpayer did not act as a collection agent for Radiology.

Taxpayer’s request for relief relied on boilerplate language included in certain documents. Taxpayer had provided the Appeals Division . . . prior to the issuance of Det. No. 15-0065.

The “Financial Policy” agreement between Taxpayer, Radiology, and patients states as to billing and payment:<sup>4</sup>

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<sup>4</sup> The document has a Rev 6.2010 notation.

You will receive a combined statement from (i) [Taxpayer] for [Taxpayer's] imaging services, and (ii) for the professional services of [Radiology] (by [Taxpayer] as billing agent). By signing below, you consent to paying [Taxpayer] for its services and for [Taxpayer] to pay [Radiology] on your behalf.

Patients sign and "agree to abide by the terms of this document."

Radiology's Patient Registration form contains the following disclosure:

\*Imaging services performed at [Taxpayer's Imaging Locations] are interpreted and supervised by the physicians of [Radiology]. You will receive a combined statement from [Taxpayer] for (i) [Taxpayer's] imaging services, and (ii) for the professional services of [Radiology].

Invoices, however, may indicate that Radiology is the billing agent for Taxpayer. For example, a December 9, 2009, [Radiology's] patient invoice contained the following explanation:<sup>5</sup>

Thank you for letting us serve your healthcare needs. Your services may have been rendered at [Hospital or at Taxpayer's Imaging Locations] by [Radiology] (professional services) and [Taxpayer] (technical services). [Radiology] is the billing agent for [Taxpayer] and will remit the applicable portion, for [Taxpayer] fees to them on your behalf. When services are provided at [Taxpayer's Imaging Center], this statement may include charges for both [Radiology] and [Taxpayer].  
Relationship between Taxpayer and Radiology.

The "Professional Services Agreement" between Taxpayer and Radiology provides under Section 1.1 that Taxpayer exclusively engaged Radiology to provide Radiology Services. Under Section 1.2, the agreement states that Radiology is an independent contractor. As to billing and collection:

Section 4.1. [Taxpayer] shall submit global bills for diagnostic tests on behalf of both [Taxpayer] and [Radiology]. The total collections shall be deposited into an account separate from the Company's bank account as defined by and in accordance with a separate "Agency Agreement" before distribution to [Radiology] and [Taxpayer].

A separate Administrative Services Agreement of the same date provides Radiology is responsible for billing and collections:

**Billing & Collections.** [Radiology] shall be responsible for performing or contracting with a third party billing company to perform on [Radiology's] behalf, the billing and collection of all accounts receivable related to imaging services provided by the [Taxpayer]. In connection with this Agreement, the [Taxpayer] hereby grants to [Radiology] or, if applicable, its contracted third-party billing company, a special power of attorney and appointment for the following purposes:

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<sup>5</sup> A [Taxpayer] patient billing statement dated December 12, 2011 has the same verbiage.

- i. Billing. To bill for all imaging services performed for patients of the Imaging Center(s).
- ii. Collections. To collect and deposit all revenues, receipts and accounts receivable generated by such billings and claims for payment in a special bank account separate from [Taxpayer's] bank accounts....

Radiology is compensated for its administrative services. The Agreement does not provide Radiology is acting as an agent of Taxpayer or vice versa. The Agreements are silent as to any obligation for uncollected funds.

#### ANALYSIS:

##### 1. Collecting Agent.

The B&O tax is imposed on every person “for the act or privilege of engaging in business activities” and applies to the “gross income of the business.” RCW 82.04.220. The tax is assessed on the “gross income” of the business. “Gross income” of the business is defined as “the value proceeding or accruing by reason of the transaction of the business engaged in” without deductions for business expenses. RCW 82.04.080. Included in gross income is “compensation for the rendition of services.” Thus, the “legislature intended to impose the business and occupation tax upon virtually all business activities carried on within the state.” *Simpson Inv. Co. v. Dep’t of Revenue*, 141 Wn.2d 139, 149, 3 P.3d 741 (2000).

Here, Taxpayer asserts that it acted as a collection agent for Radiology and that the funds collected were money owed to Radiology for services that Radiology performed. Under such a creditor/debtor theory, the taxpayer must be an agent for Radiology, the patients must . . . agree to purchase the services from Radiology and not from Taxpayer, and Taxpayer must not be liable to Radiology for the collected funds other than as an agent.

The basic requirements for a collecting agent were discussed in *Washington Imaging Services, LLC v. Dep’t of Revenue*, 171 Wn.2d 548, 557, 252 P.3d 885, 889 (2011), where the court commented:

**The agreement also declares that Washington Imaging acts as a collection agent for Overlake.** Washington Imaging contends that because it acted only as a collection agent, the amounts it received from patients that were paid to Overlake do not constitute its own income, but rather Overlake's income.

For Washington Imaging to prevail on the argument that it acted only as a collection agent of Overlake, it must have collected money owed to Overlake. But the patients contracted solely with Washington Imaging to pay for medical imaging services and have no separate obligation to Overlake. The patient registration form, Washington Imaging's contracts with patients' insurers, and the bills that Washington Imaging sent to patients all establish that patients owed payment only to Washington Imaging, not Overlake. Therefore, regardless of what the contract between Washington Imaging and Overlake states, for purposes of its B & O tax liability, Washington Imaging was not acting as an agent of Overlake collecting payments owed by the patients to Overlake. **There is no**

**evidence at all that the patients owed money to Overlake or that Washington Imaging collected money owed to Overlake.** Therefore, based on the undisputed facts we reject Washington Imaging's argument that it acted only as a collection agency and the amounts paid by patients were not its own income.

(Emphasis added.)

Here, as in *Washington Imaging*, the arrangements between Taxpayer and Radiology do not describe a collecting agent relationship. Rather, they indicate that Radiology is an independent contractor that provides some administrative services. Although there is some evidence in patient contracts and bills that indicate some payment may be due to Radiology, the documents do not identify what payments are due to Radiology.

The statements issued for the services performed are billed globally with one price charged for both the imaging and professional services. But for the disclaimers included in the documents signed by the patient, the patient would have no reason to question that all services were performed by Taxpayer and that the total charge billed belonged solely to Taxpayer. The billing codes that Taxpayer uses are used by insurance companies and government agencies to describe the services provided. It would be a rare patient that could decipher what either the codes or the brief description of the procedure describes. The one thing that would be clear is that a procedure was performed on a certain date for a total price, which did not have the costs of imaging and interpreting those images broken out.

Taxpayer has neither provided nor would we expect that Taxpayer could provide evidence to support a finding that the patients expressly agreed to purchase the services from Radiology, when the patient was unaware of which physicians were interpreting the images and what they were charging. While Taxpayer has not provided contracts with either insurance providers or government purchasing agencies, from the global coding that is used for a procedure with no break-out of the cost of the component parts, one is left to conclude that Taxpayer is billing for the procedure and the money received belongs to Taxpayer. It is only when one examines the contract between Taxpayer and Radiology that one learns that Taxpayer is splitting the proceeds with Radiology. Based on the evidence presented we cannot conclude that Taxpayer is only liable to Radiology for the collected funds as an agent. Accordingly, the evidence does not support a deduction for funds received by Taxpayer as a collecting agent.

## 2. Procurement Agent.

Taxpayer also argued that it purchased professional services from Radiology for patients, i.e., the flow of the funds was a “pass-through”. The theory . . . is that “amounts that merely pass through a business in its capacity as an agent cannot be attributed to the business activities of the agent” and therefore “such amounts are not taxable.” *City of Tacoma v. William Rogers Co.*, 148 Wash.2d 169, 60 P.3d 79 (2003). [In other words, the amounts are not part of the “gross income of the business” under RCW 82.04.080 and thus not part of the measure of the B&O tax.]

WAC 458-20-111 (“Rule 111”) allows certain “advances” and “reimbursements” to be excluded from the measure of the B&O tax. Under the provisions of Rule 111, treatment of the income collected by Taxpayer and paid to Radiology requires that Taxpayer be an agent of the patients



who receive the medical imaging services. Rule 111 imposes very specific conditions for taxpayers to qualify:

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 word "reimbursement" as used herein, means money or credits received from a customer or client to repay the taxpayer for money or credits expended by the taxpayer in payment of costs or fees for the 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 therefor, 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.

Washington's Supreme Court set out the requirements of Rule 111 in its decision in *Washington Imaging Services, LLC v. Dep't of Revenue*, 171 Wn.2d 548, 252 P.3d 885 (2011). The Court wrote:

[F]or the rule to apply, three conditions must be met: "(1) the payments are 'customary reimbursement for advances made to procure a service for the client'; (2) the payments 'involve services that the taxpayer did not or could not render'; and (3) the taxpayer 'is not liable for paying the [third party] except as the agent of the client.'" *Rho*, 113 Wn.2d at 567-68, 782 P.2d 986 (quoting *Christensen, O'Connor, Garrison & Havelka v. Dep't of Revenue*, 97 Wn.2d 764, 769, 649 P.2d 839 (1982) (emphasis in original)) (hereinafter referred to as "*Christensen*" test). To satisfy the third condition, a true agency relationship between the client or customer and the taxpayer is required. "The existence of that agency relationship is not controlled by how the parties described themselves" and "standard agency definitions should be used in analyzing the existence of the agency relationship." *William Rogers Co.*, 148 Wn.2d at 177-78, 60 P.3d 79.

Exclusion of the payments from tax, which Taxpayer collects for Radiology, requires that all requirements be met.

The third requirement of Rule 111 is that “the taxpayer is not liable for paying the [third party] except as the agent of the client”. The third requirement has two components: a taxpayer must have an agency relationship with its client and also establish that its liability to pay the providers constitutes solely agent liability. As stated in *Washington Imaging*, at 563

To satisfy the third condition, a true agency relationship between the client or customer and the taxpayer is required. “The existence of that agency relationship is not controlled by how the parties described themselves” and “standard agency definitions should be used in analyzing the existence of the agency relationship.” *William Rogers Co.*, 148 Wash.2d at 177–78, 60 P.3d 79.

“An agency relationship generally arises when two parties consent that one shall act under the control of the other.” *Rho*, 113 Wash.2d at 570, 782 P.2d 986; see Restatement (Third) of Agency § 1.01 (2006) (“[a]gency is the fiduciary relationship that arises when one person (a ‘principal’) manifests assent to another person (an ‘agent’) that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act”). Consent may be implied. *Rho*, 113 Wash.2d at 570, 782 P.2d 986. The requirement that the principal must exercise control over the agent, *Nordstrom Credit, Inc. v. Department of Revenue*, 120 Wash.2d 935, 941, 845 P.2d 1331 (1993), means that there must be facts or circumstances that “establish that one person is acting at the instance of and in some material degree under the direction and control of the other,” *Matsumura v. Eilert*, 74 Wash.2d 362, 368–69, 444 P.2d 806 (1968).

The facts do not show the Taxpayer was acting under the direction and control of the patients in choosing radiology services. There is no written agreement between Taxpayer and the patients that appoints Taxpayer as the patients’ agent. In fact there appears to be a conflict because Taxpayer has an exclusivity agreement with Radiology, so that the choice of professional services was not under the control of patients. At the reconsideration hearing, Taxpayer argued that of course the Patient has control because he can choose not to have the procedure done by Taxpayer and Radiology. In such cases there would be no income to tax. Here we are dealing with the situation where the patient did have a procedure performed, Taxpayer and Radiology earned income, and the patient did not have options.

In the absence of an agency relationship, taxpayer’s liability to pay is also not “solely agent liability.” *City of Tacoma v. Wm. Rogers Co.*, 148 Wn.2d 169, 178, 60 P.3d 79, 83 (2002). As stated in *Washington Imaging*, at 567:

Given its contractual obligation to pay Overlake, its obligations to pay Overlake could not have been “solely agent liability.” Instead, as the Department argues, *Washington Imaging's* payments to Overlake were a cost of doing business that cannot be deducted from the gross income on which B & O tax must be paid.

Because Taxpayer bills globally for the services that both it and Radiology performs there is no break-out of the amounts that each party is billing for. We cannot conclude that Taxpayer is acting as the patient’s agent when the patient is not even informed as to the amount it is being

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charged for the services performed. Accordingly, we conclude that the amounts collected from patients and paid to Radiology are not excluded business income under Rule 111.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

Dated this 2nd day of November, 2015.