Cite as Det. No. 20-0325, 41 WTD 243 (2022)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 20-0325
. . .	)	Registration No. . . .
. . .	)	Registration No. . . .

[1] RCW 82.04.320 – B&O TAX – GROSS INCOME – EXEMPTION FOR BUSINESS OF INSURANCE. The business of insurance exemption from B&O tax does not apply where the taxpayer cannot show it paid gross premiums tax on the gross income it received from engaging in the business of insurance.

[2] COLLATERAL ESTOPPEL – ELEMENTS. The doctrine of collateral estoppel does not apply to a taxpayer when the issue decided in the prior adjudication is not identical to the one presented in the taxpayer's action.

[3] WAC 458-20-111; RCW 82.04.220; RCW 82.04.080: GROSS INCOME – ADVANCES AND REIMBURSEMENTS. A taxpayer, when not acting solely as an agent, may not exclude from taxable gross income the payments for network pharmacy claims it receives from insurers and pays to network pharmacies.

[4] WAC 458-20-18801; RCW 82.04.250; RCW 82.04.050. A taxpayer's mail order and specialty pharmacy revenues, where the pricing arrangements are separate from its other contractual pharmacy benefit manager services, are properly classified under the retailing B&O tax classification.

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.

Peña, T.R.O. – Two pharmacy benefit managers protest business and occupation tax assessed on their business activities on multiple grounds. First, they argue that amount received from affiliated entities should be exempted from business and occupation tax under RCW 82.04.320 as gross income from "insurance business" upon which a gross premiums tax has been paid to the state. The pharmacy benefit managers also argue the Department is bound by the holding of an unpublished Washington Court of Appeals opinion that RCW 82.04.320 is not limited to insurance companies under the doctrine of collateral estoppel. Next, they argue that payments received as "reimbursement" for amounts paid to pharmacies for dispensing prescription drugs should be

excluded from gross income as "pass-through payments" under WAC 458-20-111. Finally, the two taxpayers assert that the Department improperly reclassified amounts they derived from the sale of prescription drugs as subject to business and occupation tax under the "service and other activities" tax classification. We deny the petition in part, grant it in part, and remand it for adjustment to the tax assessments.[1]

ISSUES

1. Are amounts taxpayers received from affiliated entities for pharmacy benefit manager services exempt from business and occupation (B&O) tax under RCW 82.04.320?

2. Is the Department bound by the holding of an unpublished Washington Court of Appeals opinion that RCW 82.04.320 is not limited to insurance companies under the doctrine of collateral estoppel?

3. Are amounts taxpayers received for payments to network pharmacies excluded from their gross income as an advance or reimbursement under WAC 458-20-111?

4. Are the amounts received by taxpayers from the sale of prescription drugs to consumers subject to B&O tax under the service and other activities tax classification?

FINDINGS OF FACT

[Taxpayer A] is the successor-in-interest of [Taxpayer B]. [Taxpayer A and B merged]. Because [Taxpayer A] is the surviving entity from the . . . merger, we refer to both entities as "Taxpayer."

Taxpayer's business activities in Washington during the audit period included providing pharmacy benefit management (PBM) services to affiliated and non-affiliated entities that provide healthcare insurance coverage to members. Non-affiliated insurers include large employer groups, unions, trusts, managed care organizations, third-party administrators, and government entities. Affiliated insurers were . . . (Affiliates), who, along with Taxpayer, are all subsidiaries of [Parent company].

The healthcare insurance coverage offered by the insurers included a prescription drug benefit plan. Taxpayer was hired to manage these prescription drug benefit plans.

Additionally, Taxpayer provides mail-order and specialty pharmacy services to plan members. When Taxpayer sells a drug covered under a plan to a plan member through its mail-order or specialty pharmacy, Taxpayer receives both the co-payment made by the plan member and the remaining balance owed from the insurer.

The services Taxpayer provides to each insurer is set out in a PBM agreement. Not every agreement includes all of the same services. According to the Taxpayer, it offers a suite of PBM services that may be included in the PBM agreement, including:

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

- Administrative, management, consultative, and general support services to insurers to assist client implementing its plan;
- Assisting insurer with implementing an electronic prescribing program;
- Providing "special project" services for insurers;
- Establishing and maintaining a network of pharmacies to service the plan members, which includes credentialing network pharmacies;
- Processing claims;
- Paying network pharmacies on insurers' behalf, less any cost sharing amounts the network pharmacy is entitled to retain;
- Developing and managing formularies;
- Developing utilization management standards and programs;
- Providing prior authorization services;
- Conducting rebate programs, including entering into rebate agreements with drug manufacturers, and collecting and verifying rebates;
- Providing specialty prescription drug services in its capacity as a specialty pharmacy; and
- Providing mail order pharmacy services.[2]

The Department's Audit Division (Audit) conducted partial audits of [Taxpayer B's] records for the period of January 1, 2006, through November 30, 2010, and [Taxpayer A's] for the period of April 1, 2010, through December 31, 2013. Both audits' scopes were limited to a review of Taxpayer's revenues.

Audit determined that Taxpayer's PBM activities were subject to the service and other activities B&O tax classification. Audit further determined that Taxpayer did not meet the requirements under RCW 82.04.320, which provides an exemption from B&O tax for certain insurance business income. Audit also determined that Taxpayer was not entitled to exclude any of its gross income under WAC 458-20-111 (Rule 111) because it had not met the necessary elements required under that administrative rule and related court decisions.

Regarding Taxpayer's activities as mail-order and specialty pharmacies, Audit concluded Taxpayer received two distinct sources of revenue: amounts received directly from plan members in the form of co-pays and amounts received from insurers for the balance owed on the dispensed prescription drugs. Taxpayer previously reported both revenue sources under the retailing B&O tax classification. Audit concluded that both sources of revenue were subject to service and other activities B&O tax classification. In Audit's view, the contracted copayment amounts Taxpayer received from plan members and the amounts received from the insurers were not derived from distinct business activities separate from the revenues Taxpayer's received for the remainder of its PBM services. In the Audit Detail of Differences, the auditor explained:

> That [Taxpayer] operates a mail order pharmacy as a separate business division to fulfill some of the services required under contract with the client does not alter the character of the revenues. The costs incurred by [Taxpayer], whether they relate to dispensing prescription drugs, establishing a network of pharmacies or fulfilling their other required services, remain costs associated with generating revenue. In

[2] Taxpayer Supplemental Memorandum at 2.

> accordance with RCW 82.04.080, the "[g]ross income of business means the 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, . . . and other emoluments however designated, all without any deduction on account of the cost of tangible personal property sold, the cost of materials used, labor costs, . . . or any other expense whatsoever paid or accrued . . . ."

Audit Detail of Differences at 5 (quoting RCW 82.04.080(1)). Audit reclassified both the amounts received directly from plan members in the form of co-pays and the amounts received from insurers for the balance owed on the dispensed prescription drugs from the retailing B&O tax classification to service and other activities B&O tax classification.

On January 3, 2018, Audit issued assessment . . . in the amount of $. . . against [Taxpayer B]. The assessment included $. . . in service and other activities B&O tax, a $. . . credit for retailing B&O tax, a $. . . assessment penalty, and $. . . in interest. On January 9, 2018, Audit issued tax assessment . . . in the amount of $. . . against [Taxpayer A]. The assessment included $. . . in service and other activities B&O tax, a $. . . credit for retailing B&O tax, a $. . . delinquent payment penalty, a $. . . assessment penalty, and $. . . in interest.

On March 19, 2018, Taxpayer petitioned for review of tax assessments . . . and . . . . Taxpayer provided the following documents with the petitions and subsequent supplemental memoranda:

- Medicare Prescription Drug Benefit Administration Agreement, effective . . . , between [Insurance Company] and certain affiliates . . . .
- [Taxpayer's] Pharmacy Network Agreement with . . . , a brick and mortar pharmacy in . . . Washington.
- State of Washington E-Tax Forms for [Insurance Company and affiliates] showing the payment of gross premium taxes to the Washington State Office of Insurance Commissioner for 2013.
- Medicare Prescription Drug Benefit Administration Agreement, effective . . . , between [Insurance Company] and its affiliates and [Taxpayer].
- Letter from Auditor to . . . , dated . . . .
- Letter from Auditor to . . . , dated . . . .

Taxpayer argues that Audit erred in concluding that Taxpayer's PBM services were not functionally related to Affiliates' insurance business and were not exempt from B&O tax under the insurance business exemption set out in RCW 82.04.320. According to Taxpayer, the Department has interpreted this exemption to include all activities functionally related to insurance business, citing Det. No. 88-311A, 9 WTD 293 (1990). Taxpayer argues that the functions that they are required to perform under contracts with the Affiliates are part of the provision of health insurance. Taxpayer also argues that it is required to perform the following services under Washington insurance regulations:

- Establish and maintain provider networks – WAC 284-170-200;
- Credential participating providers – WAC 284-170-431;
- Reimburse healthcare providers – WAC 284-170-470;

- Comply with the formulary requirements – WAC 284-43-5060-5110, 5640(6)(f);
- Develop and maintain a drug utilization review program – WAC 284-43-2020; and
- Charge premiums based on estimates of prudently incurred expenses – WAC 284-43-6040(2)(b)

Furthermore, Taxpayer argues that the Board of Tax Appeals acknowledged that PBMs are involved in the insurance business and perform administrative functions for insurers, citing *Wellpartner v. Dep't of Revenue*, BTA Dkt. No. 10-228 (2011). It is Taxpayer's position that amounts it receives for performing administrative functions for its Affiliates are "functionally related" to the business of insurance and should be exempted from B&O tax under RCW 82.04.320. Taxpayer argues that the test regarding whether premiums tax has been paid on the "insurance business" revenue is based on the activity of the corporate group as a whole. Taxpayer also argues the gross premiums tax must only be paid by someone, not necessarily the same entity claiming the exemption.

Taxpayer also argues the Department is bound by the holding in the unpublished Washington Court of Appeals opinion *Factory Mutual Engineering Assoc. v. Dept. of Revenue*, 70 Wn. App. 1057 (1993) that RCW 82.04.320 is not limited to insurance companies under the doctrine of collateral estoppel.[3]

Next, Taxpayer argues that amounts it receives from the insurers to pay the network pharmacies are merely reimbursements for expenses advanced for the insurer and excludable from gross income under Rule 111. Taxpayer offers three reasons in support of its Rule 111 claim.

First, Taxpayer states it procures retail pharmacy services from the network pharmacies for the insurers. Taxpayer states that it advances payment for claims initiated by plan members purchasing prescription drugs from the network pharmacies and is reimbursed for the payments by the insurers.

Second, Taxpayer states that the payments are for local pharmacy services that Taxpayer did not and could not render because it does not own and operate any pharmacies physically located in Washington. Therefore, argues Taxpayer, it could not provide the local pharmacy services that insurers must provide under WAC 284-170-200 and 280(e)(i)(H). Taxpayer also did not contract with the insurers to perform the local pharmacy services and states that it only contracted to provide administrative functions, such as processing claims submitted by the network pharmacies that provide the local pharmacy services to plan members.

Third, Taxpayer argues it is not liable for paying the network pharmacies except as the agent of the insurers. Taxpayer states that both the Prescription Drug Benefit Administration Plan Agreements with the insurers and the Pharmacy Network Agreements with the network pharmacies acknowledge that Taxpayer will have no liability or financial responsibility for the payment of claims. The relevant portions of these agreements state:

[3] Taxpayer made an additional argument based on the holding in *Factory Mutual* relying on the precedential value of the holding. We do not address his argument because unpublished Court of Appeals opinions have no precedential value and are not binding. GR 14.1(a).

> (d) Financial Responsibility for Claims. [Taxpayer] shall not be financially responsible for paying claims submitted by Network Pharmacies or Members, except that [Taxpayer] shall be financially responsible for claim liabilities to the extent and proportion that such claims liabilities arise out of or relate to any [Taxpayer] error. In the event that [Taxpayer] adjusts any Prescription Claim in any manner that affects the amounts owed by the [Medicare Advantage prescription drug plan] and [Medicare Part D] Plans, [The Centers for Medicare & Medicaid Services], or the Member, [Taxpayer] will reflect such adjustment in the monthly invoice to [Insurance Company]. Under no circumstance will [Taxpayer] hold [Insurance Company] liable for claims liability that [Insurance Company] has previously paid.

Exhibit C, Core Part D Services, Medicare Prescription Drug Benefit Administration Agreement between [Insurance Company] and Taxpayer.

> 8.8 Independent Contractors. The Parties and their respective personnel are and shall continue to be independent contractors with respect to each other. Each Party and its personnel and contractors shall not, by virtue of any provision of this Agreement, become, and under no circumstances shall be construed as being, an employee, agent, joint venturer, partner of the other Party or standing in any relationship with respect to the other Party that would impose liability on the other Party for the actions or omissions of such Party or its personnel or contractors.

Medicare Prescription Drug Benefit Administration Agreement between [Insurance Company] and [Insurance Company Affiliate] and [Taxpayer].

> Prescription Drug Compensation Amounts. [Taxpayer] acting on behalf of such Clients, will process the Prescription Drug Compensation owed to Company for each Covered Prescription Service dispensed to Members based on the rates and under the terms and conditions of the applicable attached Compensation Exhibits. [Taxpayer] may modify Prescription Drug Compensation upon sixty (60) days prior notice to Company. Company understands and agrees that [Taxpayer] is not responsible for the funding of Claims, is not a guarantor or insurer of the funding for Claims, payment, and is not financially responsible or liable in any respect for the payment of Claims.

[Taxpayer] Pharmacy Network Agreement with . . . [Pharmacy].

Taxpayer argues that the terms of these agreements illustrate that Taxpayer is acting under the direction of the insurer and has no financial liability to pay claims to the network pharmacies other than as an agent of the insurer.

Similarly, Taxpayer argues the pharmacy network agreements between it and the network pharmacies acknowledge that the network pharmacy is providing prescription drugs services to the insurers and their plan members. Furthermore, Taxpayer argues that the network pharmacies

are fully aware that Taxpayer is acting on behalf of the insurers and that Taxpayer has no liability to the network pharmacies.

. . . .

Finally, Taxpayer disputes the Department's reclassification of Taxpayer's mail-order pharmacy sales from the retailing B&O tax classification to service and other activities B&O tax classification. Taxpayer states Audit admits that the co-payments Taxpayer receives from plan members for its mail-order pharmacy services are subject to retailing B&O tax and that standalone mail-order pharmacy services are subject to retailing B&O tax, citing the Auditor's Detail of Differences and Instructions to Taxpayer.[4] Taxpayer disputes Audit's position that PBM's gross income is subject to service and other activities B&O tax; therefore, the gross income from the mail-order pharmacy services are also subject to service and other activities B&O tax because they are part of the PBM services that taxpayer provides. Taxpayer argues that it performs two separate and distinct activities under the PBM agreements, which are charged separately: the PBM services and the mail-order pharmacy service. Taxpayer states its PBM services are an insurance function that involves the administration and payment of claims from network pharmacies, and does not involve the sale of prescription drugs. Taxpayer argues that, in its capacity as a PBM, it is not in the purchasing chain. In contrast, Taxpayer claims, the mail-order pharmacy services it provides involves Taxpayer taking direct title to the prescription drugs and the direct sales of prescription drugs to plan members. Taxpayer argues that while it receives both a copayment from the plan members and payments from the insurers, it does not change the fact that all of the compensation relates to the retail sale of prescription drugs.

The Medicare Prescription Drug Benefit Administration Agreement between [Insurance Company] and Taxpayer provides in section 3.1 that "[i]n consideration of the Services performed by [Taxpayer] pursuant to this Agreement, [Insurance Company] shall pay [Taxpayer] those fees, costs and expense reimbursements set forth on Exhibits C-1, D-1 and E." Taxpayer redacted the information contained in Exhibit C-1 before submitting it with the petition. Consequently, we do not know what payments Taxpayer is entitled to under the provisions of that Exhibit. However, Exhibit C-3, which was not redacted by Taxpayer, provides in relevant part:

> 2. PRICING TERMS AND CONDITIONS
> Prescription Drug Compensation. All Administrative Fees and Prescription Drug Compensation rates for Group Plans shall be those set forth in Exhibit C-1 to this Amendment, unless specifically agreed to by Exhibit C-3a Rate Appendix to this Exhibit C-3. Prescription Drug Compensation Rates represent target average rates. The actual rates may vary by pharmacy type, by drug and based upon utilization, and are subject to change as required by applicable Laws and Regulations, where required by a Network Pharmacy for its continued participation in the Pharmacy Network and/or based upon local market conditions including geographic distinctions.

[4] The Auditor's Detail of Differences for both audits stated that "the taxpayer also receives co-payment mail and specialty revenue amounts received from individuals. These are classified as retailing revenues." This is inconsistent with the audit schedules, which taxed all of Taxpayer's income under the service and other activities B&O tax classification, including payments for drugs via its mail-order pharmacy.

Exhibit D, [Pharmacy] Services, states Exhibit D-1 contains Prescription Drug Compensation for specialty pharmacy services but Exhibit D-1 was also redacted. Exhibit E, Medicare Prescription Drug Benefit Mail Order Network Agreement provides:

> 4. COMPENSATION. [Insurance Company] will process the compensation owed to [Taxpayer] for each Covered Prescription Service dispensed to Members based on the rates set forth in Exhibit B and under the following terms and conditions. The Parties acknowledge and agree that for year 2007 and each year succeeding 2007, [Taxpayer] is the preferred provider of mail order services to Members, for so long as permitted by [The Centers for Medicare & Medicaid Services] and/or the Medicare Laws and Regulations. In the event that [Taxpayer] no longer serves as [Insurance Company's] preferred provider of mail order services to Members, the rates set forth on Exhibit B shall be renegotiated by the Parties. In the event Specialty Drugs, as defined under Exhibit D to that certain Medicare Prescription Drug Benefit Administration Agreement . . . are filled through [Taxpayer's] Mail Order services, the Specialty Drug Pricing under Exhibit D shall control.

Exhibit B was redacted in the version of the agreement Taxpayer submitted to the Department.

Taxpayer argues that when a variety of activities are performed under a single contract, the activities should be taxed under the corresponding B&O tax classification where there are reasonable grounds to bifurcate the payments, citing Det. 89-433A, 11 WTD 313 (1992). Here, Taxpayer argues that the charges for the mail-order pharmacy services were separate from the charges for PBM services and this was a reasonable basis for Taxpayer to bifurcate the payments made by the Insurers.

ANALYSIS

1. Insurance Business Exemption

Washington's 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. "Business" for B&O tax purposes includes "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. "Gross income of the business" is broadly defined and means:

> [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 tangible property sold, 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. The phrase "value proceeding or accruing" is defined as "the consideration, whether money, credits, rights, or other property expressed in terms of money, actually received or accrued." RCW 82.04.090. Under this broad definition, a service provider may not deduct any of its costs of doing business from its gross income. *See Pilcher v. Dep't of Revenue*, 112 Wn. App. 428, 49 P.3d 947 (2002) (citing *Rho Co. Inc. v. Dep't of Revenue,* 113 Wn.2d 561, 570, 782 P.2d 986 (1989)). Thus, unless a specific exemption, deduction, or exclusion applies, all of Taxpayer's gross income is subject to B&O tax without any deduction for overhead or other expenses. 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) (quoting *Time Oil Co. v. State*, 79 Wn.2d 143, 146, 483 P.2d 628 (1971)).

RCW 82.04.320 provides an exemption for insurance business as follows:

> This chapter shall not apply to any person in respect to *insurance business upon which a tax based on gross premiums is paid to the state*: PROVIDED, That the provisions of this section shall not exempt any person engaging in the business of representing any insurance company, whether as general or local agent, or acting as broker for such companies . . . .

RCW 82.04.320 (emphasis added); *see also* WAC 458-20-163(2)(a). The tax "based on gross premiums" mentioned in RCW 82.04.320 is the tax on premiums imposed under Chapter 48.14 RCW. RCW 48.14.080 states that "the taxes imposed by this title are in lieu of all other taxes, except as otherwise provided in this section." The gross premiums tax is imposed under RCW 48.14.020 and 48.12.0201 on "all premiums" with certain exclusions.

On October 2, 2019, the Department issued interim guidance (Interim Guidance) to explain the application of the insurance business exemption under RCW 82.040.320,[5,6] excerpted in relevant part below:

> **Who may claim the exemption?**
>
> The exemption is limited to persons engaged in the insurance business that receive gross income that is taxed under a gross premium tax paid to Washington.
>
> **What income is exempt?**
>
> The exemption only applies to amounts received in respect to insurance business upon which a gross premium tax is paid to Washington. Amounts received in respect to other activities are not exempt.
> . . .

[5] While the Interim Guidance was published after the Audit Period, it provides additional information and examples in construing the rules and statutes at issue, which were in effect during the Audit Period.

[6] On October 31, 2019, the Department also issued Excise Tax Advisory ETA 3133.2019, which withdrew from publication Det. No. 88-311A, 9 WTD 293 (1990), a determination that misapplied RCW 82.04.320, along with other unrelated published decisions.

Premium tax payment

> The person claiming the exemption must show proof of payment of Washington premium tax with respect to the gross income the person is claiming to be exempt from B&O tax.[7]

Here, Taxpayer argues that under RCW 82.04.320, insurance business is exempt from B&O tax so long as the gross premiums tax has been paid to the state and that insurance business includes all activities functionally related to insurance business.

In determining the meaning of statutes, we must ascertain and carry out the Legislature's intent. *G-P Gypsum Corp. v. Dep't of Revenue*, 169 Wn.2d 304, 309, 237 P.3d 256 (2010); *City of Spokane v. County of Spokane*, 158 Wn.2d 661, 672-73, 146 P.3d 893 (2006). Washington courts employ a "plain meaning" approach to interpreting statutes. Where a statute's meaning is "plain on its face," we must "give effect to the plain meaning as an expression of legislative intent." *Dep't of Ecology v. Campbell & Gwinn, LLC,* 146 Wn.2d 1, 9-10, 43 P.3d 4 (2002); Det. No. 13-0191, 33 WTD 116 (2014). The "plain meaning" of a statute "is discerned from all that the Legislature has said in the statute." *Jongeward v. BNSF R. Co.*, 174 Wn.2d 586, 594, 278 P.3d 157 (2012) (quoting *Campbell & Gwinn*, 146 Wn.2d at 9-10).

Here, the statute is plain on its face. Under the plain language of RCW 82.04.320 , a person must show two things to qualify for the insurance business exemption: (1) it engages in insurance business and (2) it receives gross income from that insurance business that is taxed under a gross premium tax paid to Washington. The Interim Guidance supports the requirements in the statute.

Generally, exemptions from tax are narrowly construed, and the party claiming the exemption has the burden of showing that it qualifies for the deduction. *Budget Rent-A-Car of Wash.-Oregon v. Dep't of Revenue*, 81 Wn.2d 171, 173, 500 P.2d 764 (1972).

In support of the second requirement, Taxpayer submitted evidence that [Insurance Company and its affiliate] paid gross premiums taxes for 2013. However, those entities paid gross premiums taxes on their respective insurance business gross incomes. Taxpayer argues the test regarding whether a gross premiums tax has been paid on the insurance business is based on the activity of the corporate group as a whole, but this runs counter to established Washington law. In general, transactions between affiliated entities are fully subject to tax. *Dep't of Revenue v. Nord Northwest Corp*, 164 Wn. App. 215, 230 (2011); *Washington Sav-Mor Oil Co. v. State Tax Commission*, 58 Wn.2d 518, 364 P.2d 440 (1961); RCW 82.04.030; Det. No. 17-0269, 37 WTD 130 (2018); *see also* WAC 458-20-203 (regarding affiliated corporations); WAC 458-20-106 (regarding capital contributions). It is also settled law that a parent and subsidiary are treated as separate entities. *Nord*, 164 Wn. App. at 230; 28 WTD 076; Det. No. 10-0062, 30 WTD 40 (2011); 37 WTD 130.

Here, Taxpayer receives gross income from its Affiliates in exchange for PBM services. That transaction and Taxpayer's resulting gross income are fully taxable unless a specific exemption applies. The insurance business deduction of RCW 82.04.320 does not provide an exemption for

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[7] https://dor.wa.gov/get-form-or-publication/publications-subject/tax-topics/interim-guidance-statement-regarding-application-insurance-business-exemption (last visited February 26, 2020).

Taxpayer because Taxpayer has not shown it, or anyone else, paid gross premiums tax on the gross income Taxpayer received from engaging in business. The only evidence we have before us of any gross premiums tax being paid was paid by [Insurance Company and affiliate] for those Affiliates' own insurance business. The Affiliates' payment of a gross premiums tax does not entitle Taxpayer to exempt its gross income upon which no premiums tax has been paid.

Because Taxpayer has not met the second requirement of RCW 82.04.320, we conclude that it does not qualify for the insurance business exemption and decline to address its contention that it was actually engaged in insurance business.

2. Collateral Estoppel and *Factory Mutual*

The elements of collateral estoppel are well established. The party asserting the defense must prove four elements: (1) the issue decided in the prior adjudication is identical with the one presented in the second action; (2) the prior adjudication must have ended in a final judgment on the merits; (3) the party against whom the plea is asserted was a party or in privity with the party to the prior adjudication; and (4) application of the doctrine does not work an injustice. *Thompson v. Dep't of Licensing*, 138 Wn.2d 783, 790, 982 P.2d 601 (1999) (quoting *Nielson v. Spanaway Gen. Med. Clinic, Inc.*, 135 Wn.2d 255, 262–63, 956 P.2d 312 (1998)). "Because all four elements must be proved, the proponent's failure to establish any one element is fatal to the proponent's claim." *Lemond v. Dep't of Licensing*, 143 Wn. App. 797, 805, 180 P.3d 829, 833 (2008).

Here, Taxpayer argues the Department is bound by the holding in *Factory Mutual* that RCW 82.04.320 is not limited to insurance companies under the doctrine of collateral estoppel. However, Taxpayer does not meet the first element of collateral estoppel. Under that element, "the party seeking to have the doctrine applied must specifically identify the issues and the underlying legal principles litigated in the prior proceeding" through competent evidence "in order for the decisionmaker in the subsequent proceeding to undertake the necessary analysis of whether the issues in each proceeding are, in fact, identical." *Id.* at 803.

The issue in the *Factory Mutual* litigation centered on the meaning of the term "person" as used in RCW 82.04.320. The Department had argued that the term should be limited to insurers. In rejecting the Department's argument, the Court of Appeals made three fairly limited holdings:

- At page 13 of the opinion, the court held that "[t]he insurance business exemption . . . exempts certain insurance activities from the tax, not certain persons (insurance companies)."
- At page 9 the Court held that on the facts presented "[t]he activities of the Association are part of the 'insurance business': investigating claims, negotiating settlements, defending contested claims, and making payments are all essential to the conduct of an insurance business."
- At page 10 the Court held that the premiums tax paid with respect to a person's insurance business can be paid by a third party. The exemption "simply required that such a tax must be paid by someone."

The present case involves a different issue—whether a person can claim the insurance business exemption on service activity upon which no premiums tax has been paid to the state. That issue was not raised or decided in the *Factory Mutual* litigation. We deny Taxpayer's petition on this issue.

3. Rule 111

The next issue is whether the payments for network pharmacy claims Taxpayer receives from the insurers are excludable from gross income of the business under Rule 111, which permits an exclusion from gross income for certain advances and reimbursements that a taxpayer receives solely in its capacity as an agent. Rule 111 provides, in relevant part:

> 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.
> . . .
>
> 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.

Rule 111 (emphasis added).

Rule 111 requires the existence of a true agency relationship between the client and the taxpayer. *Washington Imaging Services, LLC v. Dep't of Revenue,* 171 Wn.2d 548, 562, 252 P.2d 885 (2011). Agency requires a factual determination that both parties consented to the agency relationship and that the principal exercised control over the agent. *Id.; see also Nordstrom Credit, Inc. v. Dep't of Revenue,* 120 Wn.2d 935, 941, 835 P.2d 1331 (1993); Det. No. 05-0206E, 25 WTD 72 (2006); Det. No. 03-0128, 24 WTD 168 (2005); Restatement (Third) of Agency § 1.01 (2006). The *Washington Imaging* court emphasized that "[t]he proper focus is on the facts and whether they show a true agency relationship that requires payment to a third party on behalf of the recipient (e.g., client or patient) paying for the goods or services." *Washington Imaging*, 171 Wn.2d at 565, 252 P.3d 885.

An agency relationship can exist "even if the parties execute contracts expressly disavowing the creation of an agency relationship." *Rho Co.*, 113 Wn.2d at 570, 782 P.2d at 991. However, the contractual labeling of the parties' relationship remains a factor in making the determination if an agency relationship exists. *Id*. at 571.

The burden of establishing an agency relationship is on the party asserting its existence. *Hewson Const., Inc. v. Reintree Corp.,* 101 Wn.2d 819, 823, 685 P.2d 1062 (1984). An agency relationship is not presumed. *Blodgett v. Olympic Savings & Loan Assn,* 32 Wn. App. 116, 128, 646 P.2d 139 (1982). Nor does it come into existence out of thin air. Rather, facts or circumstances must "establish that one person is acting at the instance of and in some material degree under the direction and control of the other." *Washington Imaging,* 171 Wn.2d at 562 (quoting *Matsumura v. Eilert,* 74 Wn.2d 362, 368-69, 444 P.2d 806 (1968)).

Once an agency relationship has been established, an inquiry must be made into whether the taxpayer's liability to pay constituted "solely agent liability." *City of Tacoma v. William Rogers Co.*, 148 Wn.2d 169, 178, 60 P.3d 79, 83 (2002). [I]f a taxpayer assumes any liability beyond that of an agent, payments made pursuant to such liability are not excludable under Rule 111. *Id*. Therefore, for Rule 111 to apply in this case, Taxpayer must establish that it had an agency relationship with the insurers and that its liability to pay the network pharmacies was solely in its capacity as the insurers' agent.

Here, Taxpayer has not met its burden of establishing the existence of an agency relationship with the insurers. The PBM agreement between Taxpayer and the insurers includes language that expressly denies the existence of an agency relationship. Exhibit C, Core Part D Services, Medicare Prescription Drug Benefit Administration Agreement between [Insurance Company]. and Taxpayer. While this is not completely dispositive of an agency relationship, it is [a factor indicating] that an agency relationship did not exist. *Rho*, 113 Wn.2d at 571. Additionally, under the terms of the PBM agreement, Taxpayer is personally liable for paying claim liabilities to the extent and proportion that such claims liabilities arise out of or relate to an administrator error. Exhibit C, Core Part D Services, Medicare Prescription Drug Benefit Administration Agreement between [Insurance Company] and Taxpayer. Were this an agency relationship, under common law concepts of agency, the insurer would be bound by the actions of Taxpayer acting under the authority of the insurer. Restatement (Third) Of Agency § 6.11(2). The terms of the PBM agreement make clear, however, that this is not the case, as Taxpayer is the only party liable for paying claim liability arising from *any* mistake on the part of Taxpayer. Moreover, the same terms make clear that Taxpayer's liability to the network pharmacies is sometimes personal liability and therefore, not *solely* agent liability. . . . For these reasons, Rule 111 is inapplicable.

4. Classification of Gross Income from Mail-Order Pharmacy

Persons "engaged within this state in the business of making sales at retail" are subject to retail sales tax and also a retailing B&O tax. RCW 82.08.020; RCW 82.04.250. "Sales at retail," for both retail sales tax and B&O tax purposes are defined in RCW 82.04.050. The gross proceeds from the sale of prescription drugs to consumers in this state are taxable under the retailing classification of the B&O tax. WAC 458-20-18801(201), (301)(a); Det No. 08-0158ER, 29 WTD 10 (2010). The sale of prescription drugs is exempt from retail sales tax. RCW 82.08.0281.

Here, Audit determined that because Taxpayer contracted to perform specialty and mail-order pharmacy services and other PBM services in the same contract, both would be taxed under the service and other B&O tax classification.

Chapter 82.04 RCW imposes B&O tax on various classifications, including the two at issue here: the retailing B&O tax classification in RCW 82.04.250 and the services and other activities B&O tax classification in RCW 82.04.290. Here, Taxpayer provides activities that are subject to both of these classifications, but Audit imposed service B&O tax on all of Taxpayer's income.

Generally, when a taxpayer engages in more than one taxable activity and each activity is subject to different B&O tax classifications, that taxpayer would owe B&O tax separately on each taxable activity. *See* RCW 82.04.440(1) ("Every person engaged in activities that are subject to tax under two or more provisions of RCW 82.04.230 through 82.04.298, inclusive, is taxable under each provision applicable to those activities."). There are, however, instances where the Department or the courts are required to determine the "true object" of a transaction in order to determine which B&O tax classification applies. *See generally*, *Qualcomm, Inc. v. Dep't of Revenue*, 171 Wn.2d 125, 249 P.3d 167 (2011).

Here, Taxpayers had PBM agreements in place with its client insurers. Those agreements provided separate payment arrangements for Taxpayer's mail-order pharmacy and specialty pharmacy revenues and the other PBM services Taxpayer provides to the Client. Medicare Prescription Drug Benefit Administration Agreement: Sections 3.1; Exhibit C-3 Section 2; and Exhibit D Section 4. We find that these agreements provided a reasonable basis to determine the value of the separate activities. Because the sale of prescription drugs to consumers in this state is taxable under the retailing B&O classification, we find Taxpayer's mail order and specialty pharmacy revenues, where the pricing arrangements are separate from its other contractual PBM services, are properly classified under the retailing B&O tax classification. This includes both amounts received directly in the form of co-pays from plan members and amounts received from insurers for which Taxpayer also provided comprehensive PBM services. We grant Taxpayer's petition as to this issue.

DECISION AND DISPOSITION

We deny Taxpayer's petition in part and grant in part.

Dated this 7th day of December 2020.