

Cite as Det. No. 14-0292, 34 WTD 114 (2015)

BEFORE THE APPEALS DIVISION
 DEPARTMENT OF REVENUE
 STATE OF WASHINGTON

In the Matter of the Petition for Correction of)	<u>D E T E R M I N A T I O N</u>
Letter Ruling of)	
)	No. 14-0292
...)	
)	Registration No. . . .
)	

[1] RCW 82.04.080: GROSS INCOME OF THE BUSINESS – PRESCRIPTION BENEFIT MANAGEMENT RECEIPTS. Amounts received from customers that are used to pay pharmacies are part of gross income subject to tax.

[2] RULE 100; RCW 82.32A.020: TAXPAYER RIGHTS AND RESPONSIBILITIES – RELIANCE ON SPECIFIC, OFFICIAL WRITTEN ADVICE. A taxpayer cannot rely upon a letter ruling where the facts of the taxpayer’s business activities are not the same as the facts stated in the letter ruling.

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.

Margolis, A.L.J. – A provider of prescription benefit management (PBM) services (Taxpayer) seeks correction of a letter ruling on grounds that its measure of business and occupation (B&O) tax does not include receipts that it uses to pay pharmacies and that the Department is bound by a contrary letter ruling issued to its predecessor. We deny the petition.¹

ISSUES

1. Whether, under RCW 82.04.080, Taxpayer can exclude from its measure of gross income amounts it pays to pharmacies.
2. Whether, under RCW 82.32A.020, Taxpayer can rely on a prior letter ruling issued to its predecessor.

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

FINDINGS OF FACT

Taxpayer provides PBM services that its customers purchase in order to provide prescription drug plans to their employees and other subscribers. These PBM services include establishing and maintaining a pharmacy network, assisting with the design of prescription drug plans, managing formularies, and processing claims. Taxpayer negotiates provider agreements with pharmacies, under which the pharmacies distribute prescription medications to subscribers. When a subscriber claims a benefit by presenting an identification card at a participating pharmacy, the pharmacy contacts Taxpayer, which processes the claim and sends a response to the pharmacy. This response may alert the pharmacist to potential problems with the prescription, such as drug interactions, and if the claim is accepted, will confirm that Taxpayer will pay the pharmacy in accordance with the provider agreement and notify the pharmacy of any co-pay that it should collect from the subscriber. Taxpayer then bills the customer for claims made under the customer's plan, and subsequently pays the pharmacy.

Taxpayer tells us that it negotiates provider agreements with pharmacies under which Taxpayer pays pharmacies an adjusted average wholesale price (AWP) for drugs distributed to subscribers. Some agreements with customers are based on spread pricing, where Taxpayer bills customers an adjusted AWP for drugs that is typically more than what it pays the pharmacies, and Taxpayer generates profit from the spread. Other agreements are fee plans, where Taxpayer bills customers what it pays the pharmacy, plus administrative fees.

Taxpayer provided documents that evidence the relationship between Taxpayer, its customers, and the dispensing pharmacies. Its agreement with customers states that their relationship "will solely be that of independent contractors engaged in the operation of their own respective businesses." Pharmacy Benefit Management Agreement, Page 42. [Taxpayers] Pharmacy Services Manual, which governs its relationship with pharmacies, states as follows (in pertinent part):

6.4 INDEPENDENT CONTRACTORS

[Taxpayer] and Provider are independent contractors engaged in the operation of their own respective businesses and Provider will not represent to anyone anything to the contrary. *Neither party shall be construed to be an agent of the other.*

Pharmacy Services Manual, Page 65. (Italics added.)

On November 15, 2002, Taxpayer's predecessor ("Predecessor") requested a written opinion regarding the proper measure of B&O tax for its PBM business.² Predecessor explained that it paid its parent company to negotiate agreements with customers, and provided a sample agreement with a customer signed by both Predecessor and this parent. Predecessor also stated that it was engaged in the purely administrative task of facilitating payments as an independent contractor, and that pharmacy payments are not part of its gross income because the payments are proceeds of business activities of a separate entity that flowed through Predecessor. Predecessor wrote as follows:

² Taxpayer explained that the request was made using the predecessor's former name, and provided a Certificate of Merger indicating that Predecessor was merged into Taxpayer effective December 28, 2002.

The payments from customers to the pharmacies that flow through [Predecessor] are billed separate from [Predecessor's] administrative services, which are their only business activities. Each pharmacy payment dollar that comes in to [Predecessor] goes out to pharmacies.

[Predecessor] distributes the amount to the pharmacy, for an administrative fee, as a service for its customers. The separately stated administrative fee, as calculated by contract, is the actual and true consideration received by [Predecessor] for facilitating the payments.

On December 20, 2002, the Department's Taxpayer Information and Education Section of its Taxpayer Services Division (TI&E) issued a letter ruling in response. The letter reads as follows (in pertinent part):

[Predecessor] manages a prescription drug employer payment program using a structure similar to that used by credit card companies

[Predecessor] invoices the employer separately for the program management services

Under these facts, you ask for confirmation of the following conclusions, for which you have supplied a detailed analysis.

1. The pharmacy payments received by [Predecessor] do not constitute gross income for [Predecessor] as defined by RCW 82.04.080 and are not subject to Washington tax.

Based on the facts presented, we agree with the above analysis and conclusions. [Predecessor] is neither buying [sic] or selling prescription drugs, a fact of which all parties are fully aware. *Rather, [Predecessor] is acting as an agent for both the actual seller and buyer, managing the transactions for the benefit of both. Thus, amounts it receives from the employers that are used to pay the pharmacies are not taxable.* However, the gross amount charged and/or retained for services provided is fully taxable and subject to the service and other activities classification.

(Italics added.)

On April 26, 2013, Taxpayer requested "reissuance of a tax ruling that you issued in 2002 to [Taxpayer] under its predecessor name," explaining that Taxpayer "continues to operate its business substantially as set forth in the Department's 2002 Ruling Letter." Taxpayer's Letter Request, Page 1. On August 15, 2013, TI&E responded. TI&E ruled that the payments Taxpayer receives from customers that are used to pay pharmacies are not deductible from gross income, and are subject to B&O tax for providing access to prescriptions through establishing and maintaining a retail pharmacy network. On September 12, 2013, Taxpayer appealed this ruling, writing that it "seeks a ruling clarifying that such pharmacy payments are not includable in gross income." On July 17, 2014, we held a hearing during which Taxpayer asserted both that

the payments are not subject to tax under the applicable law, and that the Department must apply the 2002 letter ruling to Taxpayer for periods prior to August 15, 2013.

ANALYSIS

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" similarly is broadly defined as:

[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, . . . 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(1).

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)). Unlike the federal income tax, the B&O tax is not a tax on profit net gain, capital gain, or sales "but a tax on the total money or money's worth received in the course of doing business." *Budget Rent-A-Car of Wash.-Oregon v. Dep't of Revenue*, 81 Wn.2d 171, 173, 500 P.2d 764 (1972). The B&O tax provisions "leave practically no business and commerce free of the business and occupation tax." *Id.* at 175. For the reasons stated below, we conclude that Taxpayer's gross income of the business subject to B&O tax includes the payments it receives from customers, without deduction of the amounts it paid to pharmacies, which are part of its costs of doing business.

Taxpayer asserts that *First American Title Insurance Co. v. Dep't of Revenue*, 144 Wn.2d 300, 27 P.3d 604 (2001) provides authority for deducting amounts it pays to pharmacies from its gross receipts. In *First American Title*, the Court found that a title insurance company was not required to pay B&O tax on the full amount paid by customers purchasing title insurance from underwritten title companies (UTCs). 144 Wn.2d at 305. In *First American Title*, the UTCs collected premiums from insureds, retaining a portion of the premiums for its title search services, and remitting the remainder to First American Title for fees related the insurance policy itself. 144 Wn.2d at 302. The Court permitted the two companies to pay B&O tax only on their respective business operations. *Id.* at 306.

However, that case is distinguishable. In *First American Title* the Court distinguished the unique nature of UTCs from insurance brokers or agents. *Id.* at 304. The Court did so in order to reconcile *First American Title* with *Impecoven v. Dep't of Revenue*, 120 Wn.2d 357, 841 P.2d 752 (1992). In *Impecoven*, the Court held that insurance brokers and insurers are both subject to B&O tax on the same insurance transaction because "the gross receipts of each may ultimately

result from the same source, but each activity is separate and each may be taxed.” *Impecoven*, 120 Wn.2d at 364. We conclude that *First American Title* is limited to the “unique commercial relationship involved in the title insurance business” and that the fundamental B&O taxation rule is that “each B&O taxpayer pays tax based on the value of the business done by that taxpayer, without any reference to the B&O tax liability of any other related taxpayer.” *First American Title*, 144 Wn.2d at 305 (citing *Impecoven*, 120 Wn.2d at 363-64).³

Taxpayer asserts that amounts it receives from customers and subsequently pays to pharmacies are not value proceeding or accruing from the transaction of the business because these amounts are reimbursements that do not constitute proceeds of sales or payment for services. Taxpayer concedes, however, that the amounts received from customers do not qualify for “pass through” treatment under WAC 458-20-111, the administrative rule that explains when amounts used to pay third parties qualify as “reimbursements” or “advances,” as opposed to “gross income of the business.”⁴ We find no grounds under the law for Taxpayer to deduct pharmacy payments from its measure of B&O tax.

With respect to the estoppel issue, RCW 82.32A.020(2) invests the taxpayers of Washington with the right to “rely on specific, official written advice to that taxpayer.” RCW 82.32A.020(2). The written advice at issue here is a letter ruling issued in accordance with WAC 458-20-100 (Rule 100). Rule 100 is the administrative rule that explains letter rulings. It provides as follows (in pertinent part):

The tax ruling *must state all pertinent facts* upon which the opinion is based and, if the taxpayer’s name has been disclosed, is binding upon both the taxpayer and the department *under the facts stated*. It will remain binding until . . . the taxpayer is notified in writing that the ruling is no longer valid. Any change in the ruling will have prospective application only.

Rule 100(2)(b) (Emphasis added).

In this matter, TI&E issued the December 20, 2002 letter ruling to Predecessor, which concluded that amounts paid to pharmacies were not taxable because Predecessor was acting as an agent for customers and pharmacies. However, it is clear from Taxpayer’s agreements with its customers and pharmacies in this case that Taxpayer does not act as such an agent. Indeed, its agreement with pharmacies explicitly states that “no party shall be construed to be an agent of the other.”

³[In this case, Taxpayer provided pharmacy benefit management services to its customers in exchange for an amount that it negotiated independently from the pharmacies. The entire amount TP received constitutes “value proceeding or accruing by reason of the transaction of the business engaged in” by Taxpayer. See RCW 82.04.080(1). The amount Taxpayer paid to the pharmacies is the subject of a separate commercial transaction between Taxpayer and the pharmacies. As in *Impecoven*, even though the gross receipts of both Taxpayer and the pharmacy may ultimately result from the same source, “each activity is separate and each may be taxed.” *Impecoven*, 120 Wn.2d at 364 (citing *Supply Laundry Co. v. Jenner*, 178 Wash. 72, 79, 34 P.2d 363 (1934)].

⁴ A taxpayer may exclude amounts from taxable gross income under WAC 458-20-111 (Rule 111) only if the taxpayer can prove that the advance (i.e., money received by the taxpayer from a customer or client with which the taxpayer is to pay costs or fees for the customer or client) in question was made pursuant to an agency relationship, and that the taxpayer’s liability to pay the advance constituted solely agent liability. *City of Tacoma v. William Rogers Co., Inc.*, 148 Wn.2d 169, 178, 60 P.3d 79, 83 (2002); Rule 111. Taxpayer explained that it is liable for the pharmacy charges, even if its customers fail to pay, and does not assert that payment is made pursuant to an agency relationship.

Further, while Predecessor asserted that “each pharmacy dollar flowed through to pharmacies,” this is clearly not the case under Taxpayer’s spread pricing arrangements.

The facts provided by Predecessor and stated in the 2002 TI&E letter ruling are not the same as the facts of Taxpayer’s business activities, either because of a change in facts or the ruling request did not provide all the pertinent facts. Accordingly, we conclude that Taxpayer cannot rely upon the 2002 letter ruling issued to Predecessor.⁵

DECISION AND DISPOSITION

Taxpayer’s petition is denied.

Dated this 12th day of September, 2014.

⁵ Because of this conclusion, we do not address the issue of whether Taxpayer is a party that can rely on the ruling.