

Cite as Det. No. 12-0023, 36 WTD 139 (2017)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 12-0023
)	
...)	Registration No. . . .
)	

[1] RULE 183; RCW 82.04.4282: B&O TAX – BONA FIDE FEES AND DUES – SERVICES FOR WHICH PERSONS EXPECT TO PAY A CHARGE IN THE MARKETPLACE. If customers would expect to pay a charge for certain services in the marketplace, the charge for such fees cannot qualify as deductible bona fide fees and dues. Instead, charges are only deductible as bona fide fees and dues if such charges are solely for the benefit of being a member of a club or similar organization.

[2] RULE 183; RCW 82.04.4282: B&O TAX – BONA FIDE FEES AND DUES – DEDUCTION ALLOCATION METHODS. Persons who receive any amounts derived from bona fide fees or dues may determine the amounts deductible by the use of two alternative allocation methods described in Rule 183: the “actual records of facilities usage method” and the “cost of production method.” The cost of production method shall include the costs of all items of expense attributable to the particular facility (goods or services) made available to members, including direct and indirect overhead costs.

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.

Eckholm, A.L.J. – A nonprofit physicians association protests a tax assessment that disallowed deduction of a portion of their dues under RCW 82.04.4282. We hold that the portion of the dues received for the value of significant services rendered to its members through its Coordinated Quality Improvement Program is disqualified from the bona fide dues deduction. We affirm the assessment.¹

ISSUES

1. Is the taxpayer providing goods or services to its members in exchange for a portion of the members’ dues rendering that portion nondeductible under RCW 82.04.4282?

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

2. How should the non-deductible portion of the taxpayer's dues be computed under WAC 458-20-183 (Rule 183)?

FINDINGS OF FACT

[Taxpayer] is a nonprofit corporation doing business in Washington. The taxpayer is a membership organization consisting of sixty-four physician members. The taxpayer requires that its members pay dues to maintain their membership in the taxpayer's organization. The Department of Revenue's (the Department's) Audit Division examined the taxpayer's books and records for the period January 1, 2006, through September 30, 2009. As a result of the examination, the Audit Division determined that the taxpayer provided goods or services to its members in exchange for a portion of the members' dues and, therefore, that portion is not deductible under RCW 82.04.4282. The taxpayer had deducted from its income the total amount of the dues on its excise tax returns during the audit period. The Audit Division issued an assessment for the unpaid tax on the nondeductible portion of the dues, which included service and other activities Business and Occupation (B&O) tax in the amount of \$. . . , interest in the amount of \$. . . , and a 5% assessment penalty of \$. . . , for a total amount of \$² The taxpayer appealed the assessment to the Department's Appeals Division.

The taxpayer's membership [Agreement] in effect at the time of the audit defines [Taxpayer] as:

. . . a Washington not-for-profit corporation, organized under Chapter 24.06 RCW, in part for the purpose of coordinating and arranging for the delivery of health and medical care to individuals and ensuring that such delivery is provided in a timely and cost effective manner consistent with good medical practice.³

The taxpayer describes its organization as a membership of physician surgical peers whom:

. . . strive as colleagues to share information, experience, and explore self-improvement strategies. This is achieved through meetings, peer review, identifying areas of risk to patient's safety, and implementing continuous improvement projects annually as peers.⁴

The taxpayer explained to the auditor that the general activities of the taxpayer's organization are governed by the [Taxpayer] Board, and the activities related to the taxpayer's Coordinated Quality Improvement Program (CQIP) are governed by the CQIP Board.⁵ There are nine officers on each board who are compensated on an hourly basis. The boards meet monthly and the entire membership attends once a year, although all members are allowed to attend monthly meetings. Meeting minutes are distributed to each member.

The taxpayer indicated that the primary activity of the organization is the peer review performed according to the taxpayer's CQIP. The taxpayer explained to the auditor that for calendar years 2006 through 2009, the CQIP also gathered member input and selected four to five projects per

² Document No. . . . , issued December 23, 2010.

³ The Agreement at p. 1, section I.

⁴ Appeal Petition, dated February 7, 2011.

⁵ The Agreement references a "CQIP Committee" rather than a "CQIP Board". The Agreement at p. 2, Section I.

year to improve patient care, manage risk and increase patient safety. Some of these projects included initiating and administering a patient satisfaction questionnaire, initiating a safety and complaint reporting system for members' patients and staff, establishing a process to review informed consent forms that were being used by members, and revising and improving patient handouts and brochures used by members in their practices.

The taxpayer's office manager estimated that for the audit period, approximately 50 percent of her time, as well as 50 percent of the Medical Director's time, was associated with administering and performing CQIP activities. The office manager estimated that 25 percent of her time during the same period was associated with the [Taxpayer] Board activities, and the other 25 percent of her time was spent in the field at individual member's offices for services billed separately from the membership dues.⁶

The Agreement describes the membership granted in the taxpayer organization as a "credential." To be credentialed and re-credentialed by the taxpayer, the physician must meet and abide by all of the taxpayer's standards, criteria, and processes.⁷ These standards include maintaining the physician's license to practice medicine and their hospital admitting privileges in good standing.⁸ The Agreement also requires that the physician member allow his or her records to be inspected by the taxpayer's Quality Improvement Coordinator or Medical Director.⁹ The taxpayer indicated that all members receive a review every two years. The Agreement stipulates that if a member does not abide by the taxpayer's standards and the Agreement, the taxpayer may restrict or terminate the membership.¹⁰ The Agreement also provides that "[Taxpayer] may from time to time enter into contractual arrangements with various Health Care organizations."¹¹ The taxpayer indicated that these contractual agreements are not currently in place but the taxpayer may pursue such arrangements in the future.

The taxpayer's CQIP is approved by the Washington State Department of Health (DOH) pursuant to RCW 43.70.510 and Chapter 246-50 WAC. The purpose of the CQIP administered by DOH is "to improve the quality of health care services by identifying and preventing health care malpractice under RCW 43.70.510." WAC 246-50-001(1). The goal of the program is to provide structures and processes that:

- Measure, retrospectively and prospectively, key characteristics of services such as effectiveness, accuracy, timeliness and cost.
- Review categories of services and methods of service delivery to improve health care outcomes.
- Ensure information gathered for the program is reviewed and used to revise health care policies and procedures.¹²

⁶ The taxpayer reported the separately billed field services on their excise tax returns under the B&O services and other activities tax classification.

⁷ The Agreement at p. 3, paragraph II(f).

⁸ *Id.* at pp. 2-3, paragraph II(a).

⁹ *Id.* at p. 3, section IV.

¹⁰ *Id.* at p. 3, paragraph II(d).

¹¹ *Id.* at p. 1, section A.

¹² DOH CQIP Program Overview. <http://www.doh.wa.gov/CQIP/default.htm>.

CQIPs approved by DOH are provided discovery limitations under RCW 43.70.510(3) and (4), and information and documents specifically created for, collected, and maintained by an approved quality improvement committee (such as a peer review committee) are also exempt from disclosure under chapter 42.17 RCW.¹³ Chapter 246-50 WAC sets forth the CQIP application and approval process, and the criteria applied. The many components required of a CQIP are set forth in WAC 246-50-020. Rather than creating its own CQIP, a health care entity may seek approval of a DOH approved alternative program that is employed by an organization, which has certified or accredited the health care entity.¹⁴ DOH approved alternative programs are those employed by the [Joint Commission] and the National Committee for Quality Assurance (NCQA).¹⁵ Both [Joint Commission] and NCQA are accreditation/certification organizations which conduct a rigorous review and charge substantial fees for accreditation and certification.¹⁶

Reviewing the primary components of the [Joint Commission] program provides a good example of a CQIP program that is available to health care entities and programs for a fee, subject to meeting the application requirements. Once an entity completes [Joint Commission's] application and review process and is accredited or certified, [Joint Commission] monitors compliance with its standards.¹⁷ A few of the processes for monitoring compliance include surveys/unannounced visits to the health care entity, requiring the entity to submit treatment procedures every three months, and evaluating the entity's ongoing standards compliance through a yearly performance review.¹⁸

[Joint Commission] describes the benefits patients receive from care provided by an accredited or certified entity:

- Continually working to provide the highest quality services.
- Periodically evaluated by the Joint Commission for compliance with the standards and other requirements.
- Provided with expert advice and education from the Joint Commission about quality improvement.
- Able to attract qualified staff because they have more opportunities to develop their skills and knowledge.¹⁹

Based on the higher standard of care required to maintain certification/accreditation, the entities accredited by organizations such as [Joint Commission] receive the benefit of higher reimbursement rates from insurance carriers.²⁰

¹³ WAC 246-050-001.

¹⁴ WAC 246-50-040.

¹⁵ DOH CQIP Application Instructions. <http://www.doh.wa.gov/CQIP/Instructions.htm>.

¹⁶ See, e.g., Pricing for Surgery Centers. http://www.jointcommission.org/Pricing_Worksheet_Surgery_Centers/.

¹⁷ [Joint Commission] standards are also available to nonmembers for a fee. See http://www.jointcommission.org/standards_information/standards.aspx; <http://www.jcrinc.com/Accreditation-Manuals/PCAH12/4108/>.

¹⁸ <http://www.jointcommission.org/about/JointCommissionFaq.aspx#600>.

¹⁹ See http://www.jointcommission.org/facts_about_the_joint_commission/ ; http://www.jointcommission.org/Value_of_Joint_Commission_Accreditation/.

²⁰ See http://www.jointcommission.org/liability_insurers/default.aspx.

The taxpayer asserts that all of the CQIP activities it conducts are in the interest of improving patient care. The taxpayer also described some of the benefits accorded to physicians credentialed by its organization, including a higher standard of assurance to patients and other medical practitioners of quality of care, and an enhanced reputation of excellence of care attached to membership.

Another benefit a credentialed physician receives as part of the CQIP program is the service the taxpayer provides in communicating with the taxpayer's malpractice insurance provider. The taxpayer relays the results of the physician's CQIP performance review to the malpractice insurance provider, and the insurance provider uses those results in determining whether the physician is eligible to receive a discounted insurance rate. An additional monetary benefit a member physician receives is the right to purchase medical supplies at a discount from a group purchasing organization.

ANALYSIS

The legislature intended to impose the B&O tax on virtually all business activities carried on within the state. *Time Oil Co. v. State*, 79 Wn.2d 143, 146, 483 P.2d 628 (1971). Exemptions and deductions are narrowly construed. *Budget Rent-A-Car, Inc. v. Dep't of Revenue*, 81 Wn.2d 171, 174, 500 P.2d 764 (1972). Taxation is the rule; exemption is the exception. *Spokane County v. City of Spokane*, 169 Wash. 355, 358, 13 P.2d 1084 (1932). But, the goal of any statutory interpretation is to ascertain and carry out the Legislature's intent, and if the statute's meaning is plain on its face, then its plain meaning must be given effect as an expression of legislative intent. *State v. J.M.*, 144 Wn.2d 472, 480, 28 P.3d 720 (2001).

RCW 82.04.4282 allows a deduction for bona fide initiation fees and dues. It provides:

In computing tax there may be deducted from the measure of tax amounts derived from bona fide (1) initiation fees, (2) dues, This section may not be construed to exempt any person, association, or society from tax liability upon selling tangible personal property or upon providing facilities or services for which a special charge is made to members or others. If dues are in exchange for any significant amount of goods or services rendered by the recipient thereof to members without any additional charge to the member, or if the dues are graduated upon the amount of goods or services rendered, the value of such goods or services shall not be considered as a deduction under this section.

(Emphasis added.) The Department adopted WAC 458-20-183 (Rule 183)²¹ to administer RCW 82.04.4282. Rule 183(2)(n) defines "significant amount" as the amount that:

. . . relates to the quantity or degree of goods or services rendered and made available to members by the organization. "Significant" is defined as having great value or the state of being important.

²¹ [As of the publication date of this determination, the current status of Rule 183 has changed, as it was amended by Emergency Rule, WSR Filing No. 17-040006, filed on January 19, 2017]

“The purpose of the dues deduction is to exempt from taxation only revenue exacted for the privilege of membership.” *Automobile Club of Washington v. Dep’t of Revenue*, 27 Wn. App, 781, 786, 621 P. 2d 760 (1980).

In administering the bona fide dues deduction contained in RCW 82.04.4282, the Department has long recognized that fees and dues paid to a nonprofit trade organization are in some part for “the express privilege of belonging as a member of a club, or organization, or society” and entitled to a deduction for bona fide dues. Det. 86-310, 2 WTD 91 (1986). 2 WTD 91 involved an association of independent business and industry enterprises that provided general business information services and legislative awareness programs for its members. The association also provided some specific services for an additional charge, which it acknowledged to be taxable income. At issue were amounts received through monthly dues from members for the express privilege of belonging as a member to the association and for the common and ordinary membership benefits of associating with members of the taxpayer association including, among others:

1. The receipt of newsletters of a general informational nature concerning the economic and business environment of Washington State.
2. Legislative liaison, including nonspecific lobbying activities and legislative watchdog activities.
3. The conduct of business conventions and trade shows for members.
4. The conduct of business meetings and seminars of general and varied commercial and economic interest to members.

2 WTD at 92-93.

In finding that the association was entitled to the deduction for bona fide dues, 2 WTD 91 stated:

In short, amounts which are paid to an organization in return for measurable, compensable goods and services for which persons expect to pay a charge in the marketplace are excluded from the deduction. The test is both quantitative and qualitative. If the services or membership benefits derived from dues payment are both enough and of a kind which are compensated for when purchased by nonmembers of organizations in the business marketplace, then the portion of "dues" income attributable to such benefits do not fall within the ambit of the tax deduction. . . .

Concerning the specific benefits available to members of the [taxpayer], other than those for which special charges are made and upon which tax liability is admitted, we find them to be the ordinary and expected privileges which derive from the mere act of joining together and pursuing common interests in a noncommercial sense. Some esoteric benefits, such as the free flow and exchange of information, will always be realized by persons who join together to share their mutual interests, politically, socially, and economically. Herein lies the very purpose and intent of the tax deduction for bona fide dues.

2 WTD at 94-95.

The Department has considered the organization's efforts involving the "free flow of information" on issues of general interest to its members to be "the ordinary and expected privileges" of membership in the organization:

The expenditure of "bona fide" dues by an organization in furtherance of the free flow of information among members, such as providing newsletters to members and representing general membership interest before legislative bodies, etc., does not render such dues as being less than "bona fide." If common membership interests and concerns could not be shared and freely voiced, there would be no purpose whatever to join together in any organizational undertaking, religious, fraternal, patriotic, or otherwise. ...

2 WTD at 95.

Many of the Department's determinations applying RCW 82.04.4282 involve recreation and social clubs, organizations that have historically required payment of dues. The Department has long allowed country clubs, golf clubs, and tennis clubs that have a substantial social component, and that derive their income from initiation fees and dues, to allocate their initiation fees and dues income between taxable amounts (payment for goods or services rendered) and deductible amounts (bona fide initiation fees and dues). No. 85-178A, 3 WTD 387 (1987); No. 87-218, 3 WTD 295 (1987); Det. No. 87-348, 4 WTD 281 (1987); Det. No. 88-247, 6 WTD 105 (1988). For example, the Department has held that a social and luncheon club that also has squash courts and pool tables for members' use for no additional charge has both deductible and taxable income from initiation fees and dues. Det. No. 91-002, 10 WTD 362 (1990).

On the other hand, the Department has held that a membership athletic club or fitness club that offers no social membership or any limited rights to dine or mix with members, such as those offered by some country clubs, may not deduct any portion of its initiation fees. Det. No. 95-239, 16 WTD 48 (1995); Det. No. 03-0252, 23 WTD 223 (2004).

The taxpayer asserts that its organization should not be compared to business and industry associations or athletic and social clubs. We recognize the difference in the services provided by the organizations, but the principles applied in addressing those memberships are the same: whether amounts paid to an organization in the form of dues is expended "for measurable, compensable goods and services for which persons expect to pay a charge in the marketplace", which are taxable, or whether the amounts paid for membership are for the "express privilege of belonging", such as "the free flow of information among members", which are deductible under RCW 82.04.4282.

In this case, we conclude that the activities of the [Taxpayer] Board involving communication of general interest information, monthly meetings, distributing minutes and encouraging open discussion among members, would fall within the exchange of the "free flow of information" and associated with the "express privilege of belonging" and, therefore, the portion of the dues supporting these activities would be deductible.

In regards to the activities related to implementing the taxpayer's CQIP, and the use of the CQIP in credentialing members, we find that these activities go beyond the free flow of information and provide a service which persons would otherwise expect to pay a charge in the marketplace.

Above, we described the accreditation process employed by [Joint Commission], a DOH approved CQIP. We find that the accreditation process, requirements for maintaining accreditation, and the resultant benefits received by an accredited entity are similar to that provided by the taxpayer in credentialing its members.²² Like [Joint Commission], the taxpayer's members are credentialed and re-credentialed based on the taxpayer's own promulgated standards, the CQIP standards. Both organizations require regular review of the member's practices to ensure continued compliance with their standards, and both organizations accord their members similar benefits: an assurance to patients that its members practice according to a higher standard of care, an enhanced reputation of excellence, and an increase in the likelihood of higher reimbursement rates from insurance providers. In addition, as noted above, the credentialed members also receive a valuable benefit from the taxpayer's assistance in obtaining a reduced malpractice insurance rate.

The services the taxpayer provides to its credentialed members and the benefits gained are similar to those provided through accreditation and certification organizations for which a health care entity is required to pay a charge. We agree with the Audit Division and conclude that the taxpayer's activities related to its CQIP provide a significant service to its members and the value of these services may not be deducted as bona fide dues under RCW 82.04.4282.

In determining the portion of dues that are deductible, the Audit Division employed the cost of production method set forth in Rule 183(4)(c):

(ii) Cost of production method.

(A) The cost of production allocation method is based upon the cost of production of goods or services rendered. Persons using this method are advised to seek the department's review of the cost accounting methods applied, in order to avoid possible tax deficiency assessment if records are audited. In such cases, the cost of production shall include all items of expense attributable to the particular facility (goods or services) made available to members, including direct and indirect overhead costs.

(B) No portion of assets which have been fully depreciated will be included in computing overhead costs, nor will there be included any costs attributable to membership recruitment and advertising, or providing members with the indicia of membership (membership cards, certificates, contracts of rights, etc.).

(C) The cost of production method is performed by multiplying gross income (all "amounts derived") by a fraction, the numerator of which is the direct and indirect costs associated with providing any specific goods or service, and the denominator of which is the organization's total operating costs. The result is the portion of "amounts derived" that is allocable to the taxable facility (goods or services rendered). If more than one kind of facility (goods or services) is made available to members, this formula must be applied for each facility in order to determine the total of taxable and deductible amounts

²² Though [Joint Commission's] accreditation may be geared toward hospitals and programs, and the process for accreditation may be more rigorous than the taxpayer's, this difference in the entities accredited is not significant.

and to determine the amount of taxable income to report as either retailing taxable or service taxable. The balance of gross amounts derived is deductible as bona fide initiation fees or dues.

...

(E) Unless income accounting and reporting are accomplished by one or a combination of methods outlined in this section, or under a unique reporting method authorized in advance by the department, it will be presumed that all "amounts derived" by any person who provides "goods or services" as defined herein, constitute taxable, nondeductible amounts.

As we explained above, the portion of the dues supporting activities involving the general sharing of information, such as the [Taxpayer] Board meetings, distribution of minutes and associated discussions among members, are deductible as bona fide dues under RCW 82.04.4282. The Audit Division applied Rule 183's cost of production method in arriving at the deductible amount of the taxpayer's membership dues. Because the taxpayer's records do not sufficiently identify the costs associated with the general information sharing activities of the [Taxpayer] Board and other administrative credentialing costs, the Audit Division was required to estimate these costs. The Audit Division based its estimate of costs on the percentage of time the Office Manager and Medical Director devoted to supporting those activities, as well as related percentages for other expenses, including administrative and office expenses.

The Audit Division estimated that during the audit period, 25 percent of the taxpayer's total costs were expended for activities associated with the general sharing of information and administrative credentialing tasks related to "the express privilege of belonging" to the taxpayer's organization. The Audit Division applied this percentage to the revenue from dues to determine the portion of the dues deductible pursuant to RCW 82.04.4282. We find this is a reasonable estimate based on the information provided by the taxpayer, and therefore, we affirm the assessment.

DECISION AND DISPOSITION

The taxpayer's petition is denied.

Dated this 8th day of February 2012.