Cite as 10 WTD 390 (1990).

BEFORE THE INTERPRETATION AND APPEALS 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. 91-023
. . .	)	Registration No. . . .
	)	. . ./Audit No. . . .

[1] **RULE 111, RCW 82.04.080 AND RCW 82.04.120:** SERVICE B&O TAX -- PHYSICIANS -- SUBCONTRACTORS -- GROSS INCOME OF BUSINESS -- COMMON PAYMASTER DISTINGUISHED. Where taxpayer/professional services corporation contracts with hospital to provide medical services, gross income received is taxable, including income taxpayer pays to physician subcontractors it has retained to help provide services. There is no deductible reimbursement because taxpayer alone was liable for payment of fees earned by subcontractors. Taxpayer is not a mere conduit/paymaster because its liability to pay the subcontractors does not constitute nontaxable reimbursements. Accord: Det. 86-305, 2 WTD 65 (1986) and Det. 87-340, 4 WTD 221 (1987).

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

The taxpayer petitions for a correction of Service Business & Occupation (B & O) tax assessed against portions of income received from a hospital for which it provides medical services.

FACTS

De Luca, A.L.J. -- The audit period was from January 1, 1985 through June 30, 1988. The assessment was for $ . . . in taxes plus $. . . in interest - amounting to $ . . . . The taxpayer is a professional service corporation comprised of two medical doctors. The taxpayer's shareholders practice emergency medicine. The Audit Division assessed the tax because the taxpayer failed to report revenues earned by physicians with whom it contracted.

The taxpayer had a four year agreement entered into January 1, 1985 with [a hospital] to be generally responsible for and control the hospital's emergency department, including having physicians present on a full-time basis. Such full-time coverage was provided by the taxpayer's shareholders and approximately five other physicians with whom the taxpayer had individually contracted. The contract with the hospital permitted the taxpayer to either employ or contract with physicians to assist the taxpayer in performing its duties. The contract then stated: "[t]he cost of such persons shall be borne solely by Corporation [taxpayer]".

The hospital agreement provides that the taxpayer and its contract physicians shall perform their professional duties as independent contractors, free of any direction or control by the hospital. Thus, the taxpayer and the contract physicians are not employees of the hospital. Furthermore, the taxpayer's individual contracts with the physicians refer to each doctor as a "subcontractor [who], at all times relevant hereto, is acting and performing services as an independent contractor". Similarly, then, the subcontractor physicians are not the taxpayer's employees. Each one of them is separately registered with the Department of Revenue and pays Service B & O tax on 100% of his/her share of receipts. However, physicians retained by the taxpayer are subject to the hospital's review, which can include a binding recommendation for removal from further service in the emergency department.

According to the taxpayer, the hospital had individual contracts with each of the emergency room physicians prior to 1985. In 1984 the hospital requested the taxpayer to enter into the subject contract. The contract provides that the taxpayer, in consultation with the hospital, shall establish reasonable charges for the professional services rendered to emergency room patients. As a service to the taxpayer, the hospital bills patients on the taxpayer's behalf. As an advance against payment of such billings, the hospital pays

the taxpayer 82.5% of gross billings of all physicians serving in the emergency department in the prior month "for services provided by Corporation." The remaining 17.5% is retained by the hospital for billing and collection service and a reserve for bad debts, contractual allowances and discounts.

The typical contract between the taxpayer and an individual physician is entitled "Subcontractor Agreement" and incorporates by reference the agreement between taxpayer and hospital. The compensation paid to the subcontractor physician by the taxpayer reflects the method of compensation defined in the taxpayer's agreement with the hospital. The subcontractor physician receives the same rate as the taxpayer does under the hospital agreement less an additional percentage for administrative costs. The amounts received by the individual doctors vary according to the number of hours each one works in a month. Furthermore, the subcontractor agreement states that the "physician recognizes that he is acting at all times as the agent of Contractor while this agreement is in force."

ISSUE

Is the taxpayer corporation liable for service B & O tax on income it receives from the hospital which the taxpayer then pays to its subcontractor physicians?

TAXPAYER'S EXCEPTIONS

The taxpayer contends it is acting merely as a conduit for the physicians and is not engaging in the business of providing all the required services of their department. Furthermore, the taxpayer argues:

> The Appellant believes that all the independent physicians are parties to the contract. Accordingly, the independent physicians have relieved the Appellant of its contractual liability by becoming prime contractors with [the hospital] in control of their hiring, firing and patient revenues. Also [the hospital] is not being assessed any Business Occupation (sic) Tax for the revenues that are passed to the Appellant. The appellant believes that it should not be taxed on any revenues that are passed onto the independent physician.

DISCUSSION:

The B&O tax is imposed by RCW 82.04.120 which provides:

> There is levied and shall be collected from every person a tax for the act or privilege of engaging in business activities. Such tax shall be measured by the application of rates against value of products, gross proceeds of sale or gross income of the business, as the case may be. (Emphasis supplied.)

Gross income of the business is defined by RCW 82.04.080 in pertinent part to mean:

> . . . the value proceeding or accruing by reason of the transaction of the business engaged in and includes . . . compensation for the rendition of services, . . . fees, . . . and other emoluments however designated, all without any deduction on account of . . . labor costs, . . . delivery costs, taxes, or any other expenses whatsoever paid or accrued and without any deduction on account of losses. (Emphasis supplied.)

Thus, under this definition, the taxable "gross income of the business" includes compensation for rendering services without any deduction for labor costs.

In order to avoid this result, the taxpayer asks us to ignore express provisions of its contracts with the hospital and the individual physicians. The hospital agreement provides that it is the taxpayer corporation, not the several individual physicians, who is contracting to operate the emergency department. The hospital contract allows the taxpayer its choice to either employ or subcontract other physicians in order to perform its duties of providing full-time medical services. The taxpayer, not the hospital, solely has the obligation to pay them for their services whether the taxpayer chooses to hire employees or subcontractors.

The taxpayer's contracts with individual physicians include by reference the terms of its agreement with the hospital. Thus, the individual contracts also require the taxpayer, not the hospital, to pay the physicians for their services. Furthermore, . . . the subcontract states that the physician "is acting at all times as the agent of Contractor [taxpayer] while the Agreement is in force." The taxpayer has the duty to pay its agents.

The taxpayer has offered no evidence, such as an amended contract, to show that the individual physicians became prime contractors or parties to the contract with the hospital, or that they relieved the taxpayer of its contractual duties to pay them. It appears the hospital, the taxpayer and the subcontractors were compensated according to the method described in the contracts.

A possibility of exemption is if the amounts received from the hospital for services rendered by the physicians could be said to be "reimbursements" for "advances" made by the taxpayer on behalf of the hospital under WAC 458-20-111 (Rule 111). This rule, however, provides that:

> The words "advance" and "reimbursement" apply only when the customer or client [hospital] alone is liable for payment of the fees or costs and when the taxpayer making the payment [to its subcontractors] has no personal liability therefor, either primarily or secondarily, other than as agent for the customer or client. (Bracketed words and emphasis supplied.)

In this case, the taxpayer alone was personally liable for compensation to its subcontractor physicians. The payments are clearly a nondeductible cost of the taxpayer's doing business.
The fact that the hospital could make recommendations of discharge of taxpayer's subcontractors has no legal significance as far as the taxpayer's sole and primary liability for the payroll is concerned. Det. 86-305, 2 WTD 65 (1986).

Furthermore, the reason the hospital was not being assessed for the revenues it passed onto the taxpayer is because the hospital complies with Rule 111. It is merely advancing money for the patients who alone are liable for payment to the taxpayer. The patients, in turn, reimburse the hospital.

The subject appeal is factually distinct from some determinations issued by the Department in recent years concerning "common paymasters". Prior determinations have explained the importance of the distinction between those cases and why this taxpayer is not exempt from the B & O tax. See Det. 87-340, 4 WTD 221 (1987):

> Those primarily involve the creation of a third party entity solely to pay shared expenses of various principals. That entity is often simply a

> checking account bearing a separate name or the names of all the individuals who are sharing expenses. Each contributes to the account on which checks are written to pay common or shared expenses. The business of the individuals is carried on under their own names and B & O taxes reported under their own names. The Department has held in such cases where the only purpose of such a separate fund is to pay shared expenses that the account itself is not a person doing business "with the object of gain, benefit, or advantage."[1] It is, therefore, not required to register as a separate entity where its owners have their own tax accounts to which they report all business income. The bank account in such a situation is deemed a mere conduit for payment of expenses, and contributions received into it are not taxable.[2] If there existed in this case such a clearly defined and separate account or entity whose purpose was limited as explained above, the result would be similar.

The taxpayer herein has presented no evidence that such a common paymaster arrangement exists between itself and the other physicians. In fact, the contracts do not even address such a situation and are inconsistent with one anyway.

Finally, we recognize that the result is a partial pyramiding of B & O taxes. A certain portion of each payment by the hospital is taxable both to the taxpayer and to the individual physician whose services generated the payment. However, it is the intended effect of the Revenue Act to assert a tax on the gross receipts of each separately organized entity doing business in this state.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

DATED this 24th day of January 1991.

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[1] See RCW 82.04.140.

[2] See Determination 86-234, 1 WTD 103 (1986).