BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessments of	)	D E T E R M I N A T I O N
	)	No. 88-363
. . .	)	Registration No. . . .
	)	Tax Assessment No. . . .
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DATE OF HEARING: September 24, 1986

TAXPAYER REPRESENTED BY: . . .

[1] **RULE 111:** B&O TAX -- DEDUCTIONS -- ADVANCES AND REIMBURSEMENTS -- AMOUNTS RECEIVED FOR LABOR COSTS -- LIABILITY OF TAXPAYER. Amounts received by a taxpayer for labor costs of its own employees is not a non-taxable advance or reimbursement, because the taxpayer is liable for the amounts.

[2] **RULE 167:** B&O TAX -- SERVICE -- SCHOOL DISTRICTS -- TAX EXEMPT ACTIVITY -- ACTIVITIES OF TAXPAYER FOR MANAGING FOOD SERVICE. Amounts received by a taxpayer from a school district which represent the labor costs of the taxpayer are subject to B&O tax under the service and

other category. The taxpayer may not "piggy-back" itself on to the school district's exemption--such exemption belongs to the school and not to entities contracting with it. F.I.D.

[3] **RULE 119:** B&O TAX -- SALES TAX -- SERVICE -- RETAILING -- AGENT -- SALES OF MEALS -- SALES BY TAXPAYER IN HOSPITAL CAFETERIA. Sales of meals by taxpayer in a hospital cafeteria are subject to retailing B&O and retail sales tax. Where the taxpayer is running the hospital cafeteria and is responsible for collecting and remitting the retail sales tax, it is making sales of meals and the gross receipts of the cafeteria are subject to retailing B&O tax. However, where taxpayer is acting as agent for hospital and contractually agrees that it is not the seller of the meals, such income is subject to the service and other category of the B&O tax.

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:

Taxpayers petition for correction of assessment (1) imposing B&O tax on amounts received from school districts for labor costs and (2) reclassifying receipts from cafeteria sales for hospitals to service and other from retailing B&O.

FACTS AND ISSUES:

Hesselholt, A.L.J.,(successor to Dressel, A.L.J.) -- The taxpayers are all subsidiaries of . . . , and are in the business of providing meals and other food services at hospitals and schools. In March, 1983, the assets of . . . , were transferred to . . . . Assessments were issued to the first for the audit period January 1, 1981 through June 30, 1983, and against the second for the period of July 1, 1983 through December 31, 1984. These two taxpayers will be referred to as " . . . Health."

Also in March, 1983, the assets of . . . , were transferred to . . . . The Department of Revenue issued an assessment against the first entity for the period January 1, 1981, through June 30, 1983, and against the second for the period of July 1, 1983 through December 31, 1984. These two taxpayers will be referred to as " . . . Education."

The disputed items for . . . Education center around its agreements with school districts by which it agrees to procure, prepare and serve food and beverages to students and to purchase food and supplies as an agent of the school districts. . . . Education receives management and general and administrative fees,

as well as reimbursements for all food and materials which it purchases on behalf of the school districts. The school districts also pay to . . . Education an amount of money that represents the amount paid by . . . Education to its employees. The management and general and administrative fees were reported by . . . Education as service and other income. The auditor assessed tax on the amount received from the school districts that represents the payment of the employee wages. . . . Education argues that such taxation is improper, because the amounts received are reimbursements to . . . Education and therefore not taxable.

. . . Health manages dietary facilities and operates cafeterias at several different hospitals. The dispute here centers around the cafeteria operations for the various hospitals. For the most part, . . . Health retains the total cash receipts from the cafeteria sales and vending sales. . . . Health pays service B&O tax on the management fees it receives for the other dietary operations, and pays retailing B&O and remits the retail sales tax on the cafeteria sales. At one of the hospitals, in November, 1981, . . . Health agreed to operate the cafeteria as an agent of the hospital. At that hospital,
the hospital collects the cafeteria revenues and pays to . . . Health amounts representing salaries, a percentage of "direct operating costs and reimbursable general expenses" as "support service and administrative overhead expense" and a management fee. The auditor reclassified the gross receipts from the sales of cafeteria meals and vending machine items from retailing to service income. . . . Health disputes this reclassification, arguing that it is the seller of the cafeteria meals and subject to retailing B&O on those amounts.

DISCUSSION:

. . . EDUCATION

. . . Education argues that the amounts it receives for payment of the salaries of its employees is a reimbursement from the school districts. Since under WAC 458-20-167 (Rule 167), school districts are not subject to the B&O tax "with respect to activities directly connected with the educational program, such as operation of a common dining room . . . ," it reasons that it is exempt from tax on those amounts that it considers reimbursements from the school districts. According to . . . Education, if it is required to pay the B&O tax on the amounts received for labor costs, the tax will end up being paid by the districts, because the districts would have to reimburse . . . Education for the tax. . . . Education argues that it is operating the dining rooms as the district's agent, and therefore should be exempt from tax. To support its position, it cites a 1959 Tax Commission order in which the Tax Commission held that . . . Education was not required to collect sales tax from the university because it was "merely standing in the place of a school in providing the service and we

conclude, therefore, that the taxpayer will not be required to collect the Retail Sales Tax from the University on the gross charge made." . . . .

According to the contracts between . . . Education and the school districts, . . . Education acts as the agent of the district to "manage and operate the District's foodservice . . . " . . . Education is authorized to purchase food and supplies in its name, as agent for the district. Some of the contracts provide that all "nonmanagement foodservice employees shall be employees of . . . "; other contracts provide that "all nonmanagement foodservice employees, except nonmanagement foodservice employees on the District's payroll and the student cafeteria workers, shall be employees of . . . ." Those contracts further provide that the wages, hours of work, and fringe benefits will be consistent with that of the school district's employees. If the school district does not provide the labor of its employees, . . . Education has the right to engage other persons and these "additional and direct related costs shall be charged to the foodservice program and reimbursed by the district." The contracts also provide that the school district shall pay to . . . Education, in addition to all other amounts, "applicable taxes, excepting only those calculated on the basis of . . . 's corporate net income, paid by . . . ," and that

> The financial terms of this Agreement were determined based on the interpretation and designation of responsibility for applicable taxes given in the attached Appendix "A". If any portion of that interpretation is ruled incorrect by an appropriate governmental authority, or any taxes are added or deleted, or there is a revision of an existing law or regulation, or the responsibility for any tax is shifted or altered, any of which results in increased or decreased cost to . . . , then the financial terms of this Agreement shall be adjusted to reflect the change in cost retroactive to the commencement of the change. Any interest or penalty assessed because of the change shall be included in the adjustment. The obligations described in this paragraph shall expressly survive any termination of this Agreement and continue until the applicable statute of limitations' period, including any legal extensions, has expired. The District and . . . shall indemnify each other against any (i) liability or assessment, included related interest or penalty, arising from a tax responsibility of the indemnifying party, and (ii) reasonable collection expenses, attorney's fees and costs incurred in connection with the collection of any such amount from the indemnifying party. Nothing herein is intended to absolve . . . from the payment of city, state or federal income taxes.

Appendix A states that

> . . . is responsible for Washington Excise Taxes, based on gross receipts, as follows:
>
> 1. Service tax (.01) is due on . . . 's fees collected from the Client . . . .

All the contracts contain either the exact language regarding taxes, above, or language that is substantially similar to it.

[1] WAC 458-20-111 (Rule 111), defines the word "reimbursement" for excise tax purposes, as "money or credits received from a customer or client to repay the taxpayer for money or credits expended by the taxpayer in payment of costs or fees for the client." The Rule further provides that the word only applies when the "client alone is liable for the payment" of the costs and the taxpayer making the payment has no personal liability, either primarily or secondarily, other than as agent for the customer or client. Since . . . Education receives payment from the school districts for the labor costs of its own employees, the monies it is receiving for that purpose are not "reimbursements" under the Rule.

RCW 82.04.220 imposes the business and occupation tax against "the gross proceeds of sales . . ." RCW 82.04.070 defines the "gross proceeds of sales" to be

> the value proceeding or accruing from the sale of tangible personal property and/or for services rendered, without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

[2] The law provides a number of exemptions from the B&O tax, one of which is included in RCW 82.04.419, which exempting school district activity. That exemption is incorporated into the Washington Administrative Code as 458-20-167 (Rule 167). There is no provision for exemption of an entity doing business with a school district. . . . Education argues that since the school district will have to "reimburse" it for any tax that the Department finds is owing, the Department is essentially taxing the school district and such taxation is impermissible.

. . . Education's analysis is incorrect. All receipts of . . . Education, unless there exists a statutory exemption, are subject to the business and occupation tax. There is no exemption from the tax for the labor costs that . . . Education bills to the school districts. The costs are for . . . Education's own employees and are not a non-taxable "reimbursed" expense.

Second, . . . Education cannot "piggy-back" itself onto the school district's tax exemption. If such a thing were possible, then any receipts of . . . Education from the district would be tax exempt, since all the expenses are connected to the operation of the school district's dining rooms.

The 1959 Tax Commission Ruling is not dispositive, as it was issued to answer the question of whether [that taxpayer] was "selling" the meals to the school, and therefore subject to the retail sales tax, or merely providing a service to the school.

Further, we are not completely convinced that the above cited contract provisions render the school districts liable for this tax. The B&O tax is a tax on gross receipts, and if . . . Education receives the money to pay its own tax obligations from the school districts that money itself will be subject to tax.

. . . HEALTH

. . . Health manages the dietary facilities and operates the cafeterias at [several Washington hospitals]. Under [two of the] contracts, . . . Health operates the cafeteria and vending machines to sell food and beverages to physicians, staff members, employees and guests. . . . Health keeps all receipts from the cafeteria and vending machine operation, and has paid retailing B&O and remitted the retail sales tax collected on such sales. During the first year of the audit period, [a third] contract was similar to that of the other two hospitals. After that, . . . Health operated the cafeteria as an agent of the hospital, and [that] hospital deposited the cafeteria revenues in its own name. . . . Health argues that in all cases, the amounts it received are subject to retailing B&O and retail sales tax. . . . Health argues that under WAC 458-20-119 (Rule 119), it is a retail seller of meals under the rule, and that the auditor's reclassification to service B&O is incorrect.

The auditor classified the cafeteria receipts as service income because he considered the receipts to be additional management income and therefore subject to the service B&O tax.

[3] Rule 119 states that all persons making sales of meals subject to sales tax under the rule, are subject to retailing B&O taxes on the gross proceeds of such sales. Sales of meals through hospital cafeterias are specifically identified as sales of meals on which the retail sales tax is due. In the contracts with [the two hospitals], where . . . Health bears the risk of loss if no profits are made on the cafeteria sales, and on the [third] hospital contract during the first year of the audit period, we agree with . . . Health that it is the seller of meals and that the income is subject to retailing B&O tax and retail sales tax.

However, the amended [third] hospital contract of November, 1981, specifies that the hospital shall be responsible for "deposit[ing] all cafeteria cash revenues in its own name and for the payment of all applicable sales tax on this revenue." Under the February 15, 1982, addendum to the contract, Appendix A specifies that " . . . [Health] makes no direct sales of meals or food products per this Agreement and has no retail sales tax obligation." It also states that service tax is applicable to all "sales or services which are exempted from the retail sales tax." Under its own contract, . . . Health concedes that it is not making sales of meals that are subject to the retail sales tax, and that its income is subject to the service and other category of the B&O tax. It is somewhat disingenuous of . . . to argue that since agents are included under the RCW 82.08.010 definition of "seller," it is a seller and therefore subject to retailing B&O on that income. Under the contract with the hospital, . . . Health is not the seller of the meals, and is therefore subject to service B&O on the income, not retailing.

DECISION AND DISPOSITION:

The taxpayer's petitions are granted in part and denied in part.

Dated this 13th day of September 1988.