Cite as Det. No. 90-297, 10 WTD 87 (1991)

THIS DETERMINATION HAS BEEN OVERRULED OR MODIFIED IN WHOLE OR PART BY DET. NO. 04-0022E, 23 WTD 198 (2004) AND DET. NO. 04-0023E, 23 WTD 206 (2004).

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. 90-297
. . .	)	Registration No. . . .
	)	. . ./Audit No. . . .
	)	. . ./Audit No. . . .

[1] RULE 168: B&O TAX -- HOSPITALS AND MEDICAL CARE FACILITIES -- SIMILAR HEALTH CARE INSTITUTIONS -- GROUP HOME. Facilities which provide residential care to developmentally disabled adults are "similar institutions" to nursing and rest homes for purposes of Rule 168. Therefore, revenues attributable to professional services rendered to residents are taxable under the Service and Other classification of the business and occupation tax. ACCORD: Det. 90-252, __ WTD ___ (1990).

[2] RULE 111: ADVANCEMENTS AND REIMBURSEMENTS -- PRIMARILY LIABLE -- DSHS GROUP HOME PAYMENTS. Amounts paid by the Department of Social and Health Services to the owner of a group home for developmentally disabled adults to cover operating costs are not advances or reimbursements under WAC 458-20-111, because the owner is primarily liable for the costs.

[3] RULE 197: WHEN INCOME "ACCRUES" -- REFUND OF UNEARNED INCOME. Where a taxpayer receives funds to cover costs of performing services and under its contract must refund any amount not spent, the taxpayer is only legally entitled to the amount actually spent and is not taxable on the amount refunded.

[4] RULE 197 and RCW 82.04.080: WHEN INCOME "ACCRUES" -- GROSS INCOME OF THE BUSINESS -- WHAT CONSTITUTES. Amounts received by a taxpayer from the Social Security Administration under the requirement that they be set aside in trust for the exclusive benefit and use of another are not taxable to the taxpayer because the

taxpayer never became legally entitled to the funds. Such amounts do not constitute "gross income of the business" as provided in RCW 82.04.080.

[5] RULE 111: ADVANCES AND REIMBURSEMENTS -- TRANSPORTATION COSTS. Amounts received by the owner of a group home from Department of Social and Health Services to purchase bus passes for residents are deductible reimbursements as the owner does not render bus service and no liability attaches to the owner.

[6] RULE 169 & RCW 82.04.4297: B&O TAX -- DEDUCTION -- HEALTH OR SOCIAL WELFARE SERVICES -- HEALTH OR SOCIAL WELFARE ORGANIZATION -- FOR-PROFIT GROUP HOME. Amounts received from federal, state or local governments are deductible from the measure of B&O tax under RCW 82.04.4297 if the recipient is a nonprofit health or social welfare organization. A for-profit group home, as such, is not a "health and social welfare organization" within the meaning of RCW 82.04.431, and therefore, does not qualify for the deduction.

[7] RULE 118: RENTAL OF REAL ESTATE -- GROUP HOME FOR DEVELOPMENTALLY DISABLED ADULTS. Where a taxpayer furnishes lodging to developmentally disabled adults who have the exclusive control and occupancy of rooms for thirty days or more, the amounts the taxpayer receives directly attributable to furnishing such lodging are revenues from the rental of real estate exempt from the business and occupation tax. ACCORD: Det. 90-252, __ WTD ___ (1990).

[8] RULE 228, RCW 82.32.050 AND RCW 82.32.090: WAIVER OF PENALTIES AND INTEREST -- ORAL MISINFORMATION -- EFFECT OF. Incorrect oral advice by a Department employee relating to tax liability is not binding on the Department due to the difficulty of ascertaining the nature of the taxpayer's inquiry and the content of the advice. The burden is placed on the taxpayer to obtain correct information concerning its tax liability. ACCORD: Det. 86-232, 1 WTD 93 (1986); ETB 419.32.99.

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.

TAXPAYER REPRESENTED BY: . . .

DATE OF TELECONFERENCE: . . . (conducted by Potegal, A.L.J.)

NATURE OF ACTION:

The taxpayer seeks a correction of assessment of business and occupation tax imposed on receipts under contract with state agency to provide congregate care facilities to developmentally disabled persons.

FACTS AND ISSUES:

Heller, A.L.J. (successor to Potegal, A.L.J) -- The taxpayer is a for-profit corporation that owns and operates a 40 bed facility which houses developmentally disabled adults. The taxpayer's facilities consist of two ten-room dormitories that house two residents per room. Each dormitory has bathroom facilities, a small kitchen, dining room, and laundry machines.

The residents care for themselves, clean their own rooms and do their own laundry. The taxpayer provides personnel to cook meals, supervise medication, and to assist the residents in doing their housecleaning duties. One staff member is on duty in each dormitory twenty-four hours per day to respond to problems and supervise the residents.

The taxpayer's facility is licensed by DSHS as a boarding home pursuant to RCW 18.20.020(2). The taxpayer has no medically trained personnel in the facility. Neither does the taxpayer provide any treatment services to the residents. The only requirement imposed under the terms of the DSHS contract in this regard is that the facility administrator hold at least a bachelor's degree.

On admission, each resident is assigned to a room with another resident. Each resident is given a great degree of latitude in selecting a potential roommate and the arrangement is completely consensual. The door to each room has a lock to which the occupants have a key. The facility staff also have a key which they may use to enter the rooms only in the event of an emergency. Each resident is furnished a resident rights form. According to the form, the residents are given the right to exclude others from their rooms, the right to furnish their rooms with their own furniture and decor, and the right to notice before being transferred to another room. According to the taxpayer, a resident's average length of stay is over one year.

The taxpayer receives its funding from the State of Washington Department of Social and Health Service, Division of Developmental Disabilities ("DSHS") and from the federal Social Security Administration. These funds are broken down into the following categories:

1. general funds to pay for the operation of the facility;

2. wage reimbursements for staff wages;

3. resident social security funds; and

4. transportation funds.

The wage reimbursement amounts are paid in advance by DSHS at a predetermined rate to cover the cost of staffing the facility. The taxpayer is required to report to DSHS periodically on the taxpayer's performance under the contract. In the event the taxpayer does not spend the entire staff wage portion of the funds received under the contract, it is required to refund the unspent portion to DSHS. DSHS does not fund any shortfall experienced by the taxpayer.

Most of the amounts paid to the taxpayer by the Social Security Administration are retained by the taxpayer to cover a portion of the cost of operating the facility. However, a specific amount is set aside in trust by the taxpayer for each of the residents for their exclusive use and benefit.

The transportation funds are paid according to the terms of a separate contract between the taxpayer and DSHS pursuant to which the taxpayer agrees to furnish transportation services to the residents for a fixed amount per resident per month. Transportation amounts are specifically earmarked by DSHS for each resident by name and are used by the taxpayer to purchase public transportation bus passes for each of the residents. Apparently, all of the transportation funds are spent in this way and no amount of the monthly figure is retained by the taxpayer.

The Department of Revenue ("Department") conducted an audit of the taxpayer's books and records for the period . . . through . . . . As a result of the audit, Document Nos. . . . and . . . , each dated . . . , were issued in the amounts of $ . . . and $ . . . , respectively, including audit interest and penalties.

Prior to the audit, the taxpayer had not registered with the Department. According to the taxpayer, it had not registered because an unidentified employee of the Department had told the taxpayer that its business activities were not taxable. The auditor concluded that the taxpayer was taxable on its gross receipts under the Service and Other classification of the business and occupation tax under the provisions of WAC 458-20-168, Hospitals and Medical Care Facilities.

TAXPAYER'S EXCEPTIONS:

The taxpayer's principal argument is that it is not subject to the business and occupation tax on the amounts received from DSHS under the above four categories of funds. In support of this position, the taxpayer presented the following arguments in a letter to the Department:

A. GENERAL FUNDS:

[The taxpayer] is a profit organization. The State Agency pays the Corporation funds for the operation of the facility such as utilities, administrative wages, food, etc. . .

B. WAGE REIMBURSEMENT:

These funds are tied directly to the number of staff that the Corporation is to maintain. The current funding is $7.29 per staff hour. This is to include hourly wage, vacation pay and all fringe benefits.

An annual cost report is filed with the State detailing the staff costs. If the wages paid to staff do not meet or exceed the state reimbursement, [the taxpayer] must return the unexpended funds.

I talked with [a Department employee] of the Olympia office on friday. Our conversation revolved around a situation that has occurred in my office which I believe to be of significance to the reigning issue here.

In the past, I have hired college students to work in the office during the tax season. The state reimburses the office for our costs of hiring the employee, including applicable taxes. As I understand the rules, this reimbursement is not taxable to my office under any category because it is directly related to expense reimbursement.

The State reimburses [the taxpayer] on the same basis, only, if they do not spend the allocated money, they must repay. If the Corporation overpays wages, they are not reimbursed.

I see no difference between the wage reimbursement policy in the two situations. It is our contention that funds received from the State for staff is [sic] not subject to the B&O tax but is to reimburse a direct cost for the facility.

C. RESIDENT FUNDS:

Funds from the Social Security do not belong to [the taxpayer]. This money is removed from the general checking account and is placed in a trust account to look after each resident. The funds are identifiable to a specific resident.

D. RESIDENT TRANSPORTATION COSTS:

The State is very interested in "mainstreaming" residents - allowing them to function in society as normally as possible. One of the ways this is accomplished is to allow them to ride public transportation. Therefore, dollars are received each month to purchase . . . Transit bus passes for residents to enable them to have a certain amount of autonomy. Because this money is specifically earmarked and cannot be used for general operations, it is our stand that these funds are not subject to the B&O tax.

The State sometimes overpays [the taxpayer]. When this occurs, the funds are repaid. These refunds have also been deleted from the proceeds subject to tax.

Two and one-half years ago, one of my clients was notified by your agency that they are potentially subject to the B&O tax. This client ran an adult family home. I talked with someone in the . . . office, determining that if the home did not have over four residents [sic] they were not liable for the tax. At that time I inquired about the taxability of [the taxpayer]. I was told that because the funding was from state and federal agencies, [the taxpayer] was not liable for the tax either.

Now we find ourselves in some what of a dilemma. The local office demands to impose the tax on virtually all of the receipts of the Corporation. If we have [sic] been given the proper information two and one-half years ago, the tax would have been paid and everyone, hopefully, would be happy.

I understand that other homes such as ours are now being looked at for the same tax. This indicates that there possible [sic] could have been some confusion regarding this issue.

As mentioned above, [the taxpayer] is a profit corporation. We realize that if they were to change to a not-for-profit organization, they would not be liable for the tax. This paper change in the business status seems unfair in applying the B&O tax. The amount of taxable income would remain the same, but a few pieces of paper allows the not-for-profit company to retain the money that the profit organization would have to expend.

The feeling at [the taxpayer] is that [the owner] has been somewhat singled out by the [local] office. They have called the Department of Developmental Disabilities with whom [the taxpayer] contracts annually. That Department called [the owner] inquiring about what sort of tax problems the organization was having.

The concern with the Department was the stability of the organization in that they have 40 residents to administer.

[The taxpayer] has at best operated on a break even basis. Funds have been provided within the past years to provide working capital.

The tax returns that are enclosed amount to a great deal of money. [The taxpayer] is not in a position financially to expend that amount at one time. They are still liquidating the previous working capital loan.

Because of the circumstances noted above, especially my inquiry into the taxability some time ago we request that all interest and penalties be abated.

(Brackets supplied.) At the hearing on this matter the taxpayer reiterated the above arguments and offered certain documents in support of its position.

DISCUSSION:

Washington's business and occupation tax is imposed on every person for the act or privilege of engaging in business activities in this state. The tax is measured by the application of rates against the value of products, gross proceeds of sales, or gross income of the business. RCW 82.04.220. For purposes of the business and occupation tax, the term "business" includes "all activities engaged in with the object of gain, benefit or advantage to the taxpayer." RCW 82.04.140. "Gross income of the business" means, in part:

. . . [T]he value proceeding or accruing by reason of the transaction of the business engaged in and includes ... compensation for the rendition of services, . . . 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. (Brackets supplied.)

RCW 82.04.080.

[1] According to the Revenue Act, the Department is charged with the responsibility of administering the revenue laws. For this purpose, the legislature has given the Department broad statutory authority to promulgate regulations which have the force of law. See RCW 82.32.300. WAC 458-20-168 ("Rule 168") is the duly adopted regulation governing the taxation of hospitals, medical care facilities, and adult family homes. Rule 168 provides, in pertinent part, as follows:

The gross income derived from personal and professional services of hospitals, nursing homes, convalescent homes, clinics, rest homes, health resorts, and similar health care institutions is subject to business and occupation tax under the service and other activities classification. (Emphasis supplied.)

The Department has consistently held that a congregate care facility such as the one under consideration is a health care institution similar to a sanitarium, nursing home or rest home. As such, revenues generated from the furnishing of services are subject to tax under the Service and Other classification. Here, the taxpayer has trained personnel on staff which supervise the residents and provide a somewhat structured environment for the residents to promote "mainstreaming." In addition, the taxpayer purchases and prepares food for the residents. While these services may not rise to the level of acute health care, they are nevertheless health care services rendered to the residents. In the absence of an applicable exemption, amounts received from DSHS are taxable under the Service and Other classification of the business and occupation tax.

[2] The taxpayer's principal argument appears to be that the amounts received from DSHS should not be taxed because they are in the nature of a reimbursement. Normally, as stated above, the measure of the tax is the gross income of the business without deduction for costs. However, the regulations do allow a deduction for amounts received as advances or reimbursements. WAC 458-20-111 ("Rule 111") provides in part:

There may be excluded from the measure of tax amounts... received by a taxpayer as reimbursement of an advance in accordance with the regular and usual custom of his business or profession.

Rule 111 defines the word "reimbursement" as:

. . . [M]oney 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. (Brackets supplied.)

The rule also provides:

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 . . . . [they do] 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. (Emphasis supplied - brackets ours.)

Id. Here, neither DSHS nor the Social Security Administration have any liability for the amounts expended by the taxpayer to operate the facility. The taxpayer is primarily liable to its employees for the payment of their salaries and to its vendors for other products and services purchased in connection with the business. Based on the foregoing, we conclude that amounts received from DSHS and the Social Security Administration are not deductible from the measure of the tax as a reimbursement. The requirements of Rule 111 are not satisfied where the taxpayer is primarily liable for the payment of the claimed expenses. Moreover, the payments at issue relate directly to services to be performed by the taxpayer or to goods furnished in connection with these services. The fact that the taxpayer may not seek reimbursement from DSHS for shortfalls of staff wages only serves to support the Department's position that the taxpayer is primarily liable for these costs.

[3] However, because the taxpayer is not entitled to the DSHS wage amounts until they are actually earned by payment to the employees, any refunds to DSHS for staff wages would be deductible from the measure of tax. Gross receipts are not included within the measure of the tax until they become the property of the taxpayer. WAC 458-20-197 ("Rule 197") is the administrative regulation governing when tax liability arises. According to Rule 197, taxpayers reporting on the accrual basis are required to include in gross income amounts which they are legally entitled to receive. Here, the staff wage amounts do not belong to the taxpayer until they are paid to employees. Amounts required to be refunded never belong to the taxpayer. To the extent the assessment includes amounts refunded to DSHS for unspent wages, it will be reversed. As to the balance of receipts under the DSHS contract, the assessment will be upheld.

The taxpayer also argues that the remaining two categories of income should be excluded from the measure of tax as advances or reimbursements. These are social security funds received on behalf of the residents and transportation fees.

[4] The taxpayer receives checks from the Social Security Administration for each of the residents which are deposited in its general bank account. Out of these social security funds, the taxpayer sets aside a fixed amount in trust for the exclusive benefit and use of each resident. These set-asides are required by the Social Security Administration. The balance of the social security payments are retained by the taxpayer to offset the operation of the facility. While the amounts retained by the taxpayer are subject to the business and occupation tax, the amounts held in trust for the residents are not receipts from the conduct of its business. As in the case of refunds of unspent staff wages, the taxpayer is never legally entitled to the amounts required to be set aside. Therefore, such amounts are not considered "gross income of the business" under RCW 82.04.080 and should be excluded from the measure of tax.

[5] The transportation fees are paid to the taxpayer pursuant to the terms of a contract with DSHS separate from its main contract. The taxpayer presented copies of the contracts for our review. They disclose only that the taxpayer is required to provide "transportation services" to eligible residents referred to the taxpayer by the Division of Developmental Disabilities. The contracts are standard form DSHS contracts and contain no other description of the services to be performed by the taxpayer. The taxpayer does not operate or maintain vehicles to perform this service. Instead, the taxpayer uses the funds provided to purchase bus passes from the local transit authority. According to the taxpayer, the entire amount received from DSHS is expended on bus passes each month.

According to Rule 111, reimbursements are deductible in those cases where:

. . . 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. (Emphasis supplied.)

Here, the taxpayer does not engage in the business of providing transportation services. The taxpayer merely arranges for the transportation for the residents. In our view, the transportation funds are deductible reimbursements under the terms of Rule 111. The taxpayer's petition is granted as to the taxability of social security benefits and transportation funds.

[6] Next, the taxpayer argues that its revenue should not be taxable because it is received from a state agency for health or social welfare services. RCW 82.04.4297 provides a deduction from the measure of tax for amounts received from the state or federal government by a health or social welfare organization. The term health and social welfare organization is defined in RCW 82.04.431 as any not-for-profit corporation meeting certain specific requirements. For-profit corporations do not qualify for this deduction. The taxpayer acknowledges this nonprofit requirement, but argues that this is unfair. The Department, as an administrative agency, does not have authority to change laws enacted by the legislature. We cannot create a deduction where one does not currently exist. We do not doubt that the taxpayer renders services to the state which are of great social value. However, we do not have the authority to grant the relief which the taxpayer seeks. The taxpayer's petition is denied on this issue.

[7] Although not raised by the taxpayer, the Revenue Act does contain an exemption from tax for amounts received from the sale or rental of real estate. RCW 82.04.390. WAC 458-20-118 ("Rule 118") is the duly adopted administrative regulation pertaining to the sale of real estate. Rule 118 includes the renting of real estate within the exemption provided by RCW 82.04.390. Rule 118 provides in pertinent part as follows:

Amounts derived from the sale and rental of real estate are exempt from taxation under the business and occupation tax. However, there is no exemption of amounts derived from engaging in any business wherein a mere license to use or enjoy real property is granted. . . . A lease or rental of real property conveys an estate or interest in a certain designated area of real property with an exclusive right in the lessee of continuous possession against the world, including the

owner, and grants to the lessee the absolute right of control and occupancy during the term of the lease or rental agreement. . . . It is presumed that the sale of lodging by a hotel, motel, tourist court, etc., for a continuous period of thirty days or more is a rental of real estate. (Emphasis supplied.)

Here, individual rooms are provided to residents. Each occupant has the exclusive right to continuous possession of the room against the world. This conclusion is supported by the rights granted to the residents to control their rooms. Each room has a lock to which the occupants have a key. According to the resident rights form, each resident has the right to exclude others from his or her room. The residents also have the right to furnish their rooms with their own furniture.

Although a resident may be required to share a room in certain cases, the room sharing arrangement is completely consensual between the occupants. The fact that the facility staff has the right to enter the room to handle an emergency is comparable to the rights of entry retained by hotel management. Moreover, the right to enter a room in the event of an emergency operates for the benefit of the taxpayer as well as the residents. The taxpayer has an interest in protecting the facility from damage.

According to the taxpayer, the average stay of a resident is over one year. This is well in excess of the thirty days required under Rule 118 for a presumption that a rental of real estate exists. Although the taxpayer does not operate a hotel, a sufficient basis exists to conclude that the presumption afforded in Rule 118 is also applicable under these facts. For these reasons we conclude that the taxpayer engages in the business of renting real property to its residents. The lodging furnished to the residents does not constitute a mere grant of a license to use real estate.

Our conclusion raises the question of the manner of allocating the amounts received from DSHS and the federal government between the lodging and service functions performed by the taxpayer. To the extent the taxpayer is capable of specifically identifying the amounts received which are directly attributable to the furnishing of lodging, these amounts will fall within the Rule 118 exemption from the business and occupation tax. The burden of proof as to the amount allocable to the rental of real estate is on the taxpayer. If these amounts cannot be identified with reasonable accuracy, all amounts will be treated as received from the performance of services and taxed as such.

[8] Finally, the taxpayer seeks a waiver of penalties and interest based on alleged oral instructions received from the Department. The Department's authority to waive penalties and interest imposed in connection with the assessment of the excise tax is very limited. The imposition of interest on audit assessments is governed by RCW 82.32.050. This statute provides in part as follows:

If upon examination of any returns or from other information obtained by the department it appears that a tax or penalty has been paid less than that properly due, the department shall assess against the taxpayer such additional amount found to be due and shall add thereto interest

at the rate of nine percent per annum from the last day of the year in which the deficiency is incurred until date of payment. (Emphasis supplied.)

The assessment of penalties on late payments of tax is governed by RCW 82.32.090 which states in part:

If payment of any tax due is not received by the department of revenue . . . within sixty days after the due date, there shall be assessed a total penalty of twenty percent of the amount of the tax. No penalty so added shall be less than two dollars. (Emphasis supplied.)

The use of the word "shall" in each of the above statutes indicates that the imposition of penalties and interest on late payments is mandatory.

RCW 82.32.105 provides for the waiver or cancellation of penalties or interest when the Department finds that the late payment of tax was due to circumstances beyond the control of the taxpayer. RCW 82.32.105 directs the Department to prescribe rules concerning the waiver of penalties or interest. The administrative rule dealing with this subject is found in WAC 458-20-228 ("Rule 228"). Rule 228 sets forth the only circumstances which the Department will consider as beyond the control of the taxpayer. Failure to make timely payment of tax based upon alleged misinformation received over the telephone or in personal consultation with a Department employee is not a circumstance listed where the Department has authority to waive penalties or interest. This is a long-standing policy of the Department first officially expressed in Excise Tax Bulletin 419.32.99. . . . . The ETB indicates that the reason for this policy is the difficulty of proving the exact nature of the taxpayer's inquiry and the advice given by Department. Here, there is no proof that the taxpayer represented that it was a for-profit organization to the Department employee. Accordingly, the taxpayer's request for a waiver of penalties and interest is denied.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part and denied in part as follows:

1. The assessment is reversed to the extent amounts included in the measure of tax were subsequently refunded to DSHS during the audit period.

2. The assessment is reversed to the extent the assessment seeks to tax social security benefits set aside in trust for the residents.

3. The assessment is also reversed on the issue of the deductibility of transportation funds.

4. The taxpayer is entitled to exclude from the measure of the business and occupation tax amounts which are directly attributable to the rental of real estate to the extent such amounts can be reasonably segregated from other revenues received.

DATED this 31st day of July, 1990.