

Hospital industry

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We know that tax reporting for hospitals can be a challenge. That's why we have compiled a list of common problems found during Department of Revenue audit examinations, as well as solutions to avoid these common pitfalls.

For medical clinics not operated by a hospital or under a hospital license, please refer to our [Medical Clinics Guide](#).

If you have additional questions, please [e-mail us](#) or call 360-705-6705.

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Select one of the following for problems in these specific areas and tips to avoid them:

Contents

Excise taxes

Excise taxes

Problem

Income is often reported under the wrong tax classification on the excise tax return.

Solution

Hospital income is subject to different tax classifications, depending on the:

- activity/service performed that generated the income
- source of the income
- type of hospital (public, for profit, nonprofit, etc.)

To report your income correctly, become familiar with the common tax classifications for hospitals:

- [Public or nonprofit hospital B&O tax](#)
- [Service and other activities B&O tax](#)
- [Retailing B&O tax](#)
- [Retail sales tax](#)

For more information, see [WAC 458-20-168](#).

Public or nonprofit hospitals B&O tax

Applies to gross income from personal and professional services to patients by hospitals operated as nonprofit corporations, operated by political subdivisions of the state, or operated but not owned by the state.

Income reported under this classification includes, but is not limited to:

- L&I self insured plans
- Educational programs
- Emergency room physician payments
- Miscellaneous income from providing classes, data processing, clerical, etc.
- Professional services contracted out to independent contractors such as pulmonary or EKG

Champus/Tricare income should also be reported under public or nonprofit hospitals B&O tax classifications. However, [RCW 82.04.4297](#) allows a B&O tax deduction for any amounts received from the United States or any of its instrumentalities, the state of Washington, or any municipal or political subdivision of the state as compensation for health or welfare services. The deductible amounts should be included in the gross income reported on the return, then deducted out by taking an "other" deduction and writing in the explanation "Champus/Tricare income."

For more information, see [WAC 458-20-168](#); [RCW 82.04.260](#).

Service and other activities B&O tax

Applies to gross income from personal and professional services of hospitals (except hospitals subject to the public or nonprofit hospital B&O tax), nursing homes, convalescent homes, clinics, rest homes, health resorts, and similar health care institutions.

Also applies to nonprofit hospitals for personal/professional services performed for nonpatients that are not specified as taxable under another classification.

Income reported under this classification includes:

- Data processing services
- Accounting, auditing, actuarial, bookkeeping, tax preparation, and similar services
- Interest on accounts receivable
- Fees for classes provided
- Stenographic, secretarial, and clerical services
- Income from licenses to use real property
- Vending machine commission receipts
- Other revenue not specifically classified elsewhere

Retailing B&O tax

Applies to sales by hospitals of tangible personal property that are sold and billed separately from services rendered.

Does not include charges to patients for tangible personal property used in providing medical services to the patient, even if separately billed. Income from medical services is taxable under either the Public or Nonprofit Hospitals B&O classification or the Service and Other Activities B&O tax classification.

Income reported under this classification includes, but is not limited to:

- Sales of medical records, patient account records, and radiology film copies
- Sales of meals (other than to hospital patients) ([WAC 458-20-119](#))
- Sales of meals to employees ([WAC 458-20-119](#))
- Casual sales ([WAC 458-20-106](#))

Retail sales tax

Applies to sales of tangible personal property by hospitals that are sold and billed separately from services rendered.

Does not include charges to patients for tangible personal property used in providing medical services to the patient, even if separately billed. Charges for medical services are taxable under either the Public or Nonprofit Hospitals B&O classification or the Service and Other Activities B&O tax classification.

Income reported under this classification includes, but is not limited to:

- Sales of medical records, patient account records, and radiology film copies
- Sales of meals (other than to hospital patients) ([WAC 458-20-119](#))
- Sales of meals to employees ([WAC 458-20-119](#))
- Casual sales ([WAC 458-20-106](#))

Possible exemptions from retail sales tax for sales of ([WAC 458-20-18801](#)):

- Drugs, medicines, prescription lenses and frames, orthotic devices, medical oxygen, or other substances prescribed by medical practitioners where a written prescription with the issuing medical practitioner's signature and the patient's name for whom the items are prescribed are kept
- Prosthetic devices
- Hearing aids (as defined in [RCW 18.35.010\(3\)](#))
- Ostomeric items

Use the form [*Sales Tax Exemption Certificate for Health Care Providers*](#) (pdf)

Problem

Retail sales tax is not paid on many items that are subject to sales tax.

Solution

Generally, only items that are purchased for the purpose of being resold to patients may be purchased without paying sales tax. Hospitals should take care to determine those items that they will use themselves, as opposed to those items that will be resold to customers or that are otherwise not subject to retail sales tax at the time of purchase. Certain exemptions for prescription drugs and related items exist ([see list above](#)). ([WAC 458-20-18801](#))

Purchases of tangible personal property for resale without intervening use are not subject to retail sales tax. Hospitals purchasing tangible personal property for resale must furnish a reseller permit to the seller to document the wholesale nature of the sale.

Hospitals must pay retail sales tax on items purchased for their own use, including, but not limited to:

- Medical supplies:
 - Lab supplies
 - Empty tubes, syringes, and vials used for diagnosis
- Durable medical equipment:
 - Medical gas tanks, pump machines, and related parts, except oxygen delivery systems for patients
 - Reusable delivery syringes
- Consumables:
 - Masks, synthetic gloves
 - Toilet paper
 - Items sent home with patients

- Office supplies:
 - Computers, printers
 - Charts, paper

If a hospital purchases items from catalogs, the Internet, or other sources and does not pay Washington sales tax at the time of purchase, they owe use tax on the value of the tangible personal property purchased for use in Washington. ([WAC 458-20-178](#))

Problem

Hospitals report and pay tax on activities or income that are exempt or that may be deducted from the taxable gross income.

Solution

Hospitals should become familiar with those activities that are exempt from taxation or deductible and identify such income so it is properly handled for excise tax reporting. Income from certain activities performed by specific types of health care facilities or organizations and certain types of income are exempt from B&O and retail sales tax, including, but not limited to:

Income exempt from B&O tax for services provided to patient (RCW 82.04.4289)

- Kidney dialysis facilities operated by nonprofit organizations and nonprofit hospitals if the hospital accurately identifies and accounts for this specific income
- Nursing homes operated by nonprofit organizations
- Homes for unwed mothers operated by nonprofit organizations

Other exempt income

- Amounts received as contributions, donations, or endowment funds, so long as no specific service is performed as a condition for receiving the funds. ([WAC 458-20-169](#))

Grant income is taxable if specific services are performed as a condition of receiving the grant. ([WAC 458-20-169](#))

Problem

Hospitals do not take deductions allowed for payments from certain government programs.

Solution

Hospitals should become familiar with the government program payments that are deductible, so that the amounts may be deducted from the taxable gross income. Receipts from the following must be included in gross income reported for B&O tax, but then may be deducted from the measure of tax. ([RCW 82.04.4297](#))

- Medicaid Healthy Options
- Washington Basic Health Plan
- Medicaid MI/GAU

Problem

Not-for-profit hospitals do not take B&O tax deductions allowed for government payments made to health and social welfare organizations.

Solution

Not-for-profit hospitals whose governing board meets the requirements set for a health or social welfare organization ([RCW 82.04.431](#)) should become familiar with which government payments made to health and social welfare organizations are deductible and identify such income so it is properly deducted from the taxable gross income. To determine whether the governing board meets the statutory requirements, review your hospital's charter and bylaws.

Receipts from the following must be included in gross income reported. However, not-for-profit hospitals whose governing board meets the health or social welfare organization requirements may take a B&O tax deduction for income from services rendered when the payment is received from:

- The federal government or any instrumentality of the federal government, including Champus and Tricare
- The state of Washington
- Any city, county or political subdivision of the state of Washington

The hospital or clinic should include the amounts in its gross receipts, then take a deduction under the "other" classification, noting "Champus/Tricare."

Problem

Not accounting for various adjustments made to income.

Solution

Many hospitals perform medical care without making a charge or cancel a portion of the charge. In other cases, medical care is billed to patients at "standard" rates, but later adjusted to reduce the charges to rates established by contract with Medicare, Medicaid, or private insurers.

In these situations, hospitals must report the total amount billed to the patient as gross income, unless their records clearly note the amount of income the hospital is entitled to under contracts with insurance carriers. Adjustments may be taken on future tax returns, after the hospital adjusts its records to reflect the actual amount collected. If the tax rate changes, the hospital must file an [amended return](#) for the tax return upon which the income was initially reported.

Problem

Overlooking amounts that should be reported for litter tax.

Solution

As retail and wholesale sellers of certain products, hospitals are subject to litter tax on sales of certain products in Washington. You should become familiar with those items subject to litter tax and identify and track sales of

such products, so that the amounts are properly reported on their excise tax return. ([WAC 458-20-243](#)) Examples of items subject to litter tax include:

- Cafeteria "to go" food sales
 - Toiletries
 - Glass, metal, plastic, or fiber containers
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Problem

Hospitals do not report in-house printing of invoices, etc., for manufacturing B&O tax purposes.

Solution

If a hospital produces its own invoices, letterhead, envelopes, etc., it incurs a liability for manufacturing B&O tax and use tax on internal printing charges. The value of such items produced in-house must be tracked and reported under the Manufacturing B&O tax classification. The value of the invoices, letterhead, etc., produced is also subject to use tax for printing charges. ([WAC 458-20-134](#))

Problem

Hospitals may not pay brokered natural gas use tax that is owed.

Solution

Hospitals should track any natural gas they purchase through a broker. They are required to pay brokered natural gas use tax based on the full amount invoiced from their broker, including, but not limited to:

- Agency fees
- Broker fees
- Mark-up

Transportation charges upon which Washington public utility tax has already been paid may be deducted from the taxable amount, as well as brokered natural gas taxes paid on behalf of and billed to the hospitals as clients. ([WAC 458-20-17902](#))

Unclaimed property

Unclaimed property

Problem

Hospitals often overlook uncashed checks and do not report them as unclaimed property.

Solution

When a hospital issues a high volume of checks, uncashed checks are sometimes missed. Unclaimed property can become "buried" in your outstanding check report because:

- Your system reuses check numbers before a stale-dated check is reviewed and transferred to a liability account for reporting.
- Older checks may move from the top of the report to the middle, if your outstanding check report sorts by month and day but not by year.

To avoid this problem:

- Ensure that you review and research your outstanding checks regularly.
 - Document your adjustments to remove aged outstanding checks.
 - A check is likely to become unclaimed property if it remains outstanding for six months or more. Consider setting up a liability account to control and track such checks.
 - For proper aging, keep a listing of the check by payee, amount, and issue date, rather than the date removed from the bank account.
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Problem

Hospitals do not report payroll timely (after one year) for unclaimed property purposes.

Solution

For payroll checks, the abandonment period is one year, rather than three years. Ensure payroll checks are tracked using this shorter timeframe.

If you use a payroll service, verify that the outside paying agency properly reports uncashed checks on your behalf.

Problem

Small amounts of patient credits are not reported as unclaimed property.

Solution

There is no minimum amount of unclaimed property that may be retained.

Small credit balances should be segregated and reported as unclaimed property after three years. Items under \$50 may be reported to the Department in an aggregate to simplify reporting.

Problem

Unmatched cash receipts are not reconciled.

Solution

Because money may be received from several sources to pay a patient bill, occasionally payments cannot be matched to an amount owed. Such payments are often suspended in some manner.

Review these suspended cash receipts regularly. Those that cannot be matched and are not returned to the issuer should be reported as unclaimed property.

Problem

Hospitals do not review to determine that unclaimed bonds or interest payments are properly reported.

Solution

Unclaimed matured bonds or any unclaimed interest or coupons related to bonds issued by hospitals must be reported after three years. This type of property is often handled by a paying agent, but the hospital is responsible to ensure it is reported as unclaimed property.

In some cases, the paying agent may have returned the unclaimed bond monies to the hospital. Hospitals should:

- Research your historic debt service to determine a list of bond issues.
 - Contact your paying agent(s)* to determine if they report unclaimed bond monies for the hospital. Keep a copy of their response in your unclaimed property working file.
 - If they have not reported, obtain a list of any unclaimed bond monies and arrange the filing of an unclaimed property report.
 - Report any unclaimed bond monies you have received.
 - * The Bank of New York reports unclaimed local government bond monies if a Public Hospital District (PHD) requests it. Bond monies, if held by the PHD, are reportable two years after they become payable.
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Problem

Public hospital districts fail to report unclaimed property properly.

Solution

Most property held by public hospital districts ("PHDs") is presumed abandoned after two years. The exception is uncashed payroll checks, which are presumed abandoned after one year.

PHDs must report all unclaimed property, but have the option of retaining some types of unclaimed property. Generally, PHDs may retain unclaimed property that is issued in check or warrant form.

See below for a list of property types and their specific reporting requirements.

PHDs must report and remit the following property types:

- Coupons and interest payments on bonds
- Unidentified and unclaimed matured bonds

- Unidentified and unmatched cash receipts
- Small patient credits (not in check form)
- Patient credits (not in check form)

PHDs must report and retain the following property types:

- Uncashed checks
- Warrants

After five years, PHDs may:

- Transfer remaining unclaimed funds to their general fund. However, retained funds must always be available to refund.
- Refer claimants of retained property to the local government to pursue their claim.
- Archive records for retained property.

Property taxes

Property taxes

- [Nonprofit Property Tax Exemption Audits](#)
 - [Ratio Program Audits and Advisory Appraisals](#)
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Nonprofit Property Tax Exemption Audits**Problem**

Hospitals do not understand what is covered under the nonprofit property tax exemption.

Solution

Hospitals are typically the most complex nonprofit property tax exemption. The exemption includes:

- Property owned and leased by nonprofit hospitals
- Property leased to a public hospital district

The property must be used for qualified hospital purposes.

Problem

Differences in definitions for exempt hospital property cause confusion.

Solution

Definitions used to determine eligibility for property tax exemptions frequently differ from those used by other government agencies or within the hospital industry.

For nonprofit exemptions, a "hospital" is generally defined as property used for 24-hour inpatient care, ambulatory surgery centers, emergency rooms, and property used for the necessary administration of inpatient

care. (See definition contained in [RCW 84.36.040](#) and [WAC 458-16-270; Board of Tax Appeals](#) decisions; and Superior Court Decisions.) For more information, contact our Property Tax Division at (360) 570-5870

Problem

Applications for exemption or changes in use are not made timely.

Solution

To claim an exemption, hospitals must file an application with the Department by March 31 or within 60 days of acquisition or conversion to an exempt use.

Changes in the use of exempt property must be reported to the Department's Property Tax Division prior to each assessment year.

Applications may be filed up to three years late but may take longer to process. Historical records may be difficult to locate, and historical uses of property are difficult for the Department to confirm.

Problem

Hospital property usage is not properly documented.

Solution

Keep an accurate and current description of all programs and usage of hospital property.

Changes in property use must be reported to the Department.

Problem

Use of hospital facilities for non-hospital use does not generally qualify for property tax exemption.

Solution

Using hospital facilities for non-hospital use may affect the exempt status, as noted by the following examples. To avoid the problems, limit (to the extent possible) commercial, physician, retail, and other external uses of exempt hospital property.

Outpatient clinics

Using hospital facilities for outpatient clinic care does not qualify as a hospital use.

Exemptions are available for:

- Charitable clinics providing free or low-cost care ([RCW 84.36.030](#))

- Nonprofit cancer clinics ([RCW 84.36.046](#))

Private physician practices

Using hospital facilities for private physician practices does not qualify as a hospital use.

Retail pharmacies

Retail pharmacies serving clinic patients and the general public do not qualify for exemption.

- Pharmacies limited only to inpatient service are generally exempt
- Limiting retail pharmacy use maximizes your exemption

Laboratories

Hospital labs that only serve qualified patients are typically exempt.

Labs that provide services to physician offices and clinics do not qualify for exemption.

Commercial laboratories contracting with hospitals also do not qualify for exemption.

Problem

Lease agreements do not pass on an exemption to the hospital.

Solution

Hospitals must receive the benefit of the property tax exemption.

If a lease requires the hospital to pay property taxes, the lessor must pass any reduction or exemption of property taxes on to the hospital. A statement from the lessor stating that the benefits of an exemption will be passed to the hospital helps to resolve any questions that may arise.

Problem

Insufficient recordkeeping.

Solution

The Department must confirm property is used for exempt activities. Commonly, we review records to confirm inpatient care, administrative functions, and exclusive use of property for qualified activities. Current and accurate records in the areas noted below will help ensure an accurate determination of your exemption.

Floor plans and site plans

Accurate and current floor plans are essential in determining how much of a building and the associated land qualify for exemption. We commonly calculate how many square feet of property are exempt.

Building use and changes in use

An accurate and current description of all programs is necessary to determine how much property is exempt. Changes in the use of property must be reported to the Department.

Charity care

Charity care records are not typically necessary to administer the exemption for hospitals, but are important for determining exemptions for charitable clinics and social service programs, which are exempted under [RCW 84.36.030](#). Sliding fee scales for services are also commonly requested.

Mixed use of property

To qualify for exemption, hospital property must be exclusively used for qualified activities.

When property is used for both qualifying and disqualifying uses, the exemption must be denied.

To avoid problems, limit mixed uses of exempt hospital property and maintain accurate floor plans and descriptions of property use.

Physically separating exempt uses and disqualifying uses makes it possible for the Department to grant an exemption.

We can segregate property that partially qualifies for exemption, as long as the exempt areas are exclusively used by the hospital.

Ratio Program Audits and Advisory Appraisals

Problem

Hospital depreciation schedules may be inaccurate or incomplete.

Solution

Depreciation schedules should include detailed descriptions, including:

- Description of assets
- Date of purchase
- Cost (including freight and installation)
- Itemized sales tax, if possible
- Location of the asset
- A list of vehicles and their use
- Trade-in allowances and their amounts
- Details for grouped or generic assets such as miscellaneous equipment

Depreciation schedules also must include a description of assets fully depreciated but still in use.

Retired assets no longer in existence at the location being audited should be removed from the depreciation schedule to avoid over assessment.

Problem

Listings of personal property may be incomplete or inaccurate.

Solution

Personal property listings should include detailed descriptions of the property, including:

- Ensuring leased personal property is listed as leased, instead of listed as owned by the hospital. Equipment that was previously leased but currently owned must also be listed.
- Details for grouped or generic assets, such as miscellaneous equipment.
- Listing homemade or self-manufactured assets.
- Listing vehicles and their use.

Exempt nonprofit hospitals may not be required to file an annual affidavit with their county assessor. Check with your county assessor to determine your reporting requirements.

Problem

Equipment is not listed on the depreciation schedule.

Solution

A detailed listing and description of equipment that is not listed on the depreciation schedule should be provided. The list should also contain a description, the date of purchase, and cost. Some examples include:

- Leased equipment with the name of the leasing company
 - Expensed equipment
 - "Homemade" or "self-manufactured" items
 - Fully depreciated assets (Note if an asset is no longer in use and the reason for it.)
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Problem

"Fixed assets" balances do not match the depreciation schedule amounts.

Solution

Provide an explanation of why balance sheets do not match the depreciation schedule amounts.

Problem

Leasehold improvements are not properly documented on the depreciation schedule.

Solution

All leasehold improvements must be clearly described and itemized. Necessary details include the year of acquisition and the cost, including freight and installation.

Problem

Amounts spent on supplies are not properly documented on the schedule.

Solution

Amounts spent on consumable supplies for the year, such as office supplies, cleaning supplies, etc., must be clearly detailed, and copies of receipts or invoices preserved.

Problem

Tools and spare parts are not noted on the depreciation schedule.

Solution

Provide a detailed list of all tools and spare parts not listed on the depreciation schedule or expensed listing.