Cite as Det. No. 21-0011, 41 WTD 318 (2022)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 21-0011
. . .	)	Registration No. . . .

RCW 82.04.080; WAC 458-20-111; ETA 3218.2020 - GROSS INCOME EXCLUSION, COLLECTION AGENT: In order for a taxpayer's income to be excluded from gross income as a collection agent under the guidance of ETA 3218.2020, the patients must have an obligation to pay the practitioners, the taxpayer must not be obligated to perform or render the services to patients, the taxpayer must be acting as an agent for the practitioners, and have no liability for the collected funds other than as an agent.

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.

Callahan, T.R.O. – A mental health medical group protests assessment of service and other activities business and occupation tax on amounts received from third-party payors on behalf of patients for the services the group members provide to the patients. The medical group argues that the payments should be excluded from the measure of its gross income as a collection agent. We grant the petition.[1]

ISSUE

Under RCW 82.04.080, WAC 458-20-111 (Rule 111), and Excise Tax Advisory 3218.2020 (ETA 3218), may a mental health medical group exclude certain gross billings received from third-party payors on behalf of patients from the measure of its gross income as a collection agent for the practitioners?

FINDINGS OF FACT

. . . (Taxpayer) is a mental health medical group that is comprised of licensed mental health practitioners (Practitioners) as members. The Practitioners offer a wide range of specialties from clinical psychologists, mental health counselors to licensed clinical social workers.[2]

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
[2] . . . .

Some third-party payors (Payors), such as insurance companies, health plans, and managed care organizations, require group billing for claims and reimbursements, despite their individual contracts with health care providers.[3] Those Payors will not accept individual claims submitted by the Practitioners. Taxpayer separately contracts with Payors that have contracts with the Practitioners and submits claims from the Practitioners as a group.

Taxpayer and the Practitioners entered into contracts for Taxpayer's billing services, which is to submit the claims to the Payors as a group. Taxpayer hires one employee to bill the Payors. The Practitioners individually collect the co-pay, deductible or co-insurance payments from their patients at the time of the services. If the patients' payments are not covered by the Payors, the patients pay the Practitioners directly at the time of the services.

Taxpayer retains a 12 percent service fee from the gross proceeds collected from the Payors as its billing service fee. Taxpayer remits the rest of the payments collected from the Payors to the Practitioners after taking the 12 percent for the billing services. Taxpayer also charges each Practitioner $. . . per month as group membership dues.

The Department's Audit Division examined Taxpayer's books and records for the period of January 1, 2015, through December 31, 2018 (Audit Period). Taxpayer reported its gross proceeds from the group membership dues and the 12 percent [service fee] under the service and other activities business and occupation (B&O) tax classification. Taxpayer did not report the amounts it collected from the Payors and distributed to the Practitioners.

On November 26, 2019, the Department issued a balance due notice, Letter ID: . . . (Assessment) for the Audit Period for $. . . . The Assessment consisted of service and other activities B&O tax of $. . . , a five percent assessment penalty of $. . ., late payment penalty of $. . ., and interest of $. . . .[4] Audit determined that Taxpayer hired the Practitioners as its independent contractors to provide medical services to the patients on Taxpayer's behalf. Audit assessed service and other activities B&O tax on the amounts Taxpayer collected from the Payors.

Taxpayer did not pay the Assessment and petitioned the Department's Administrative Review and Hearings Division for an administrative review of the Assessment. This administrative review concerns whether Taxpayer may exclude the payments received from Payors on behalf of the patients from the measure of its gross income. We will first examine the contractual relationship between the Practitioners and Taxpayer.

Contract between Practitioners and Taxpayer:
Taxpayer and each individual Practitioner entered into a contract (Practitioner Contract) for Taxpayer's billing services. Attachment II, Agency Agreement is incorporated by reference into the Practitioner Contract. The Agency Agreement in relevant part, states:[5]

[3] *See* Petition, Ex. A2, . . . Application.
[4] Audit assessed a nine percent late payment penalty on the 2015 and 2016 annual returns for $. . . and $. . ., respectively.
[5] Petition dated . . . .

> [Practitioner] hereby designates and appoints [Taxpayer] to receive reimbursement on his/her behalf rendered by him/her under the referenced [Practitioner Contract]. Such receipt by [Taxpayer] shall be as agent only.

Taxpayer revised the Practitioner Contract in 2017, which specifies the contractual relationship between the parties:[6]

> [Practitioner] shall be performing all professional mental health services directly to [patients] and not on behalf of [Taxpayer]. [Practitioner] shall have no right to bind [Taxpayer], transact business in the name of [Taxpayer], or, in any manner or form, make promises or representations on behalf of [Taxpayer].
>
> [Taxpayer's] Services. During the term of this [Practitioner Contract], [Taxpayer] will:
>
> a) Negotiate and maintain [Practitioner] and group billing contracts with selected [Payors] designed to facilitate the provision of behavioral health services to covered [patients] and maximize referrals to [Practitioners] contracted with [Taxpayer]. This shall include negotiation of reimbursement rates, reporting requirements and other issues that [Taxpayer] deems necessary;
>
> b) Develop and maintain relationships with local physician groups and other referral sources;
>
> c) Provide a single point of contact for requests for services with an intake coordinator to triage incoming matters to [Practitioners].
>
> d) Submit [Practitioner's] claims to health plans for services and distribute in a timely manner funds received from health plans to [Practitioners].
>
> e) Coordinate bi-weekly consultation group meetings in accordance with professional requirements that [Practitioners] may attend. Alternatively, [Practitioners] may arrange for other consultation as [Practitioners] may prefer.

Operation:
Below is Taxpayer's new patient intake process:[7]

- New patient calls Taxpayer's intake hotline to discuss the patient's treatment needs.
- Taxpayer's Intake Coordinator will ask about what type of counseling or therapy the new patient is seeking, whether the new patient is covered by insurance, and the new patient's availability for an appointment.
- The Intake Coordinator will not ask the new patient for detailed medical information.

[6] Petition dated . . . .
[7] . . . .

- The Intake Coordinator will then contact one of the Practitioners who has expertise working with the issues the new patient presents, and who has current openings, and can be reimbursed by the new patient's particular insurance.
- The Practitioner will then phone the new patient directly to schedule an appointment.

Each Practitioner is independently licensed and maintains their own practice, including setting work and appointment times, practice policies, treatment planning, and records maintenance. The Practitioners provide the medical services at their own respective office locations. The Privacy and Confidentiality page on Taxpayer's website [explains that each Practitioner has a disclosure statement that is specific to their practice and that each Practitioner will provide that statement to the client at, or prior to, their first appointment].

Each individual disclosure statement (Disclosure Statement) has the Practitioner's name, title, address, and contact information as the letter head and requires the patient to sign and date at the bottom of the page. Taxpayer's name is not on the Disclosure Statement. A copy of the Disclosure Statement provided by one of the Practitioners, . . . [Practioner A], in relevant part, provides:

> **Insurance and Fees:** The fee for a 30-minute session is . . . . Your health insurance plan may pay for or reimburse you for all or part of the cost of your treatment; my services are covered by many insurance plans. . . . Co-pays, co-insurance and payment toward deductibles are expected at the time of service. *As my billing agent, [Taxpayer] will bill your primary and secondary insurance company (if there is one) according to the contracts [Taxpayer] has negotiated and I will collect any co-pays, deductibles or co-insurance payments*. Accounts are to be kept current by paying at the time of service unless prior arrangements have been made with . . . [Practitioner A]. At least 30 days advance notice will be given in the event of a change in fees.

(Emphasis added.)

Another copy of the Disclosure Statement provided by another Practitioner. . . [Practitioner B], a licensed social worker offers similar language in terms of the patients' payment responsibility:

> **Fees and Payment**
> Please refer to my Fee Schedule for session type and charges. *Payment should be made at each appointment,* unless we have specified and agreed to another method of payment. I am also a member of a group of mental health providers called [Taxpayer]. At times my fee varies according to specific contracts.
>
> My services are paid through some insurance plans. Your insurance coverage may include a deductible amount to be paid by you before they will pay for counseling services. Your plan may also include partial payment for counseling services with a co-payment for which are you responsible at each session. You are responsible for knowing the conditions and limits of your insurance coverage. *I will give to you your account statement, if you need it.*

(Emphasis added.)

All of the Practitioners are eligible to accept insurance payments from insurance companies on their own. Each Practitioner has entered into a contract with the insurance companies separately. Taxpayer provides the following payment information on its website . . . :

> **For Payment:**
>
> *Unless you instruct your therapist otherwise, he or she will generally request payment from your health insurance plan. . . .*

(Emphasis added.)[8]

On review, Taxpayer argues that the payments from the Payors should be excluded from its gross income because Taxpayer qualifies under Rule 111 as a billing agent for the Practitioners. Taxpayer asserts that the requirements under Rule 111 are met because it is not a party to the agreements between the patients and the Practitioners. Taxpayer argues that each patient is aware that the Practitioners are the mental health services providers and Practitioners seek payments directly from the patients if the bill for services is not paid.

Taxpayer also argues that it does not sell any goods or services to the patients. Lastly, Taxpayer asserts that it is acting as an agent of the Practitioners as stated in the Practitioner Contract.

ANALYSIS

Washington levies its B&O tax "for the act or privilege of engaging in business activities" in Washington. RCW 82.04.220. "Engaging in business" means commencing, conducting, or continuing in business. RCW 82.04.150. Business activities subject to tax include "all activities engaged in with the object of gain, benefit, or advantage . . . directly or indirectly." RCW 82.04.140. Washington courts have recognized "[t]he legislative purpose behind the B&O tax scheme is to tax virtually all business activity in the state." *Impecoven v. Dep't of Revenue*, 120 Wn.2d 357, 363, 841 P.2d 752 (1992). As a general proposition, "[t]axation is the rule and exemption is the exception." *O'Leary v. Dep't of Revenue*, 105 Wn.2d 679, 682, 717 P.2d 273 (1986) (quoting *Budget Rent-A-Car of Washington-Oregon, Inc. v. Dep't of Revenue*, 81 Wn.2d 171, 174, 500 P.2d 764 (1972)).

The B&O tax measure is "the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be." RCW 82.04.220(1). The rate used is determined by the type of activity in which a taxpayer engages. *See generally* Chapter 82.04 RCW. Income from any business activity that is not expressly classified in Chapter 82.04 RCW is taxed under the service and other activities B&O tax classification, measured by the gross income of the business. RCW 82.04.290(2).

RCW 82.04.080(1) defines "gross income of the business" as:

---

[8] . . . .

> [T]he value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, 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.

Excluded from gross income are amounts received by a business solely in its capacity as an agent for another. *See* ETA 3218, Rule 111. An exclusion from taxable income is allowed because such income is not attributed to the business activities of the agent. *City of Tacoma v. William Rogers Co.,* 148 Wn.2d 169, 175, 60 P.3d 79 (2003). *See* Det. No. 14-0224, 34 WTD 340 (2015). At issue here is whether Taxpayer is collecting a liability owed by the patients to the Practitioners as an agent of the Practitioners. Taxpayer argues that it may exclude amounts received from Payors from its gross income under Rule 111. Rule 111 pertains to advances and reimbursements received by a payment agent. Amounts received by a business solely in its capacity as an agent to pay the costs or fees of a client are not attributed to the business activities of the agent and may be excluded from the measure of tax. *See* Det. No. 05-0139, 26 WTD 6 (2007). Rule 111 does not, however, apply to situations where a business receives funds from a third party on behalf of a client as a collection agent, as Taxpayer alleges is the case here. Therefore, Rule 111 is inapplicable to Taxpayer's situation.

The Washington Supreme Court has addressed the tax implications of being a "collection agent" in *Washington Imaging Services, LLC v. Dep't of Revenue*, 171 Wn.2d 548, 252 P.3d 885 (2011). In that case, Washington Imaging, a medical imaging company, had retained Overlake, [a group of radiologists,] to provide interpretive reports to go along with the medical images generated by Washington Imaging ordered by its patients. *Id.* at 551. Thus, the resulting product for each patient contained the medical image generated by Washington Imaging and the interpretive report generated by Overlake. *Id.* at 553. The patients who ordered this service were not specifically made aware of the arrangement between Washington Imaging and Overlake, and were not otherwise informed that they had any obligation to pay Overlake for its service component. *Id.* Instead, patients signed "an agreement to be financial responsible to Washington Imaging." *Id.* The Court considered whether Washington Imaging was a "collection agent" for Overlake, articulating the following:

> For Washington Imaging to prevail on the argument that *it acted only as a collection agent of Overlake, it must have collected money owed to Overlake*. But the patients contracted solely with Washington Imaging to pay for medical imaging services and have no separate obligation to Overlake. *The patient registration form, Washington Imaging's contracts with patients' insurers, and the bills that Washington Imaging sent to patients all establish that patients owed payment only to Washington Imaging, not Overlake*. Therefore, regardless of what the contract between Washington Imaging and Overlake states, for purposes of its B & O tax liability, Washington Imaging was not acting as an agent of Overlake collecting payments owed by the patients to Overlake. There is no evidence at all that the

> patients owed money to Overlake or that Washington Imaging collected money owed to Overlake. Therefore, based on the undisputed facts we reject Washington Imaging's argument that it acted only as a collection agency and the amounts paid by patients were not its own income.

Wash. Imaging Servs., 171 Wn.2d at 557 (emphasis added). Thus, in order for a taxpayer to be deemed a "collection agent," and, thereby, be able to reduce its gross income by the amount that taxpayer "collected" as an agent, the amounts collected must be actually owed to the principals by the clients from whom the amounts were collected by the taxpayer.

The Department recently provided guidance for collection agents in ETA 3218, incorporating the court's decision in *Washington Imaging Services.* ETA 3218 explains:

> A Taxpayer acting as a collection agent may exclude from its gross income amounts collected from Customers on behalf of a Provider and remitted to the Provider, but only when all three of the following requirements are met:
>
> 1. The Taxpayer is collecting money owed by the Customer to the Provider;
>
> 2. The Taxpayer does not sell the goods or services and has no liability for the quality of the goods or services provided; and
>
> 3. The Taxpayer is acting as a bona fide agent of the Provider and has no liability for the payment except as an agent.[9]
>
> If any one of these requirements is not met, the Taxpayer must include the amounts collected from the Customer in its gross income.

ETA 3218 (footnote omitted).

Here, Taxpayer asserts that it acted as a collection agent for Practitioners and that the funds collected from the Payors on behalf of the patients were money owed to Practitioners for services the Practitioners performed. In order for Taxpayer to be considered a collection agent under the guidance of ETA 3218, the patients must have an obligation to pay the Practitioners, Taxpayer

[9] The Department will recognize a bona fide agency relationship between the Taxpayer and Provider when all of the following are true:

- The Taxpayer and Provider have mutually agreed that the Taxpayer is acting on behalf of the Provider and the Taxpayer acts, in some material degree, under the direction and control of the Provider, i.e., as principal and agent.
- The Taxpayer has no obligation to the Customer. If the Customer pays the Taxpayer but the Provider does not perform the services purchased by the Customer, the Customer would have no recourse against the Taxpayer. The Customer could seek recourse from the Provider.
- The Taxpayer has agency liability to the Provider. Thus, Provider can seek recourse against the Taxpayer for breach of agency duties Taxpayer owes Provider – e.g., to be paid the funds that Taxpayer collected on the Provider's behalf as agent.

ETA 3218. As explained below, all three elements of a bona fide agency relationship exist here.

must not be obligated to perform or render the services to patients, and Taxpayer must be acting as an agent for Practitioners and have no liability for the collected funds other than as an agent.

We addressed a similar situation in Det. No.16-0295, 36 WTD 286 (2017). The taxpayer in 36 WTD 286 was a naturopathic clinic that provided naturopathic medicine, colon hydrotherapy, massage, electric-lymphatic therapy, cranial sacral, and restorative yoga services. Health care services were performed by licensed individuals subject to a contract between the licensed individuals and the taxpayer. The licensed individuals were not given exclusive use of any space but provided their services at the taxpayer's location. The taxpayer remitted to the licensed individuals the amount paid by the customer minus a percentage for "rent" of the space. The Department assessed service and other activities B&O tax on the amounts the taxpayer received from the customers. The taxpayer asserted that it acted as a collection agent for the licensed individuals and that the funds collected were money owed to the licensed individuals for services they performed.

Our holding in 36 WTD 286 rejected the taxpayer's argument and concluded that as in *Washington Imaging,* the agreements between the taxpayer and the licensed individuals do not describe a collection agent relationship. 36 WTD 286, 290. We explained the fact that a business that hires independent contractors to provide services for customers of the business does not make the business an agent of the contractors. *Id.* We further stated that the disclosure and disclaimer FAQ page from the taxpayer's website only made an oblique reference to contractors without providing adequate information for clients to understand that the taxpayer was acting solely as an agent and was not contracting with clients directly. *Id.*

The facts here are distinguishable from 36 WTD 286 because, unlike the clients in 36 WTD 286 who did not know they were not contracting with the taxpayer directly, the patients here know they are contracting directly with the Practitioners. First, the Privacy and Confidentiality page on Taxpayer's website explicitly informs the patient that each Practitioner has their own Disclosure Statement that is specific to their practice. Taxpayer's website informs the patient that they will receive a copy of the Disclosure Statement from their Practitioner and the patients will have an opportunity to review it and ask questions about any particular policies. In addition, the Disclosure Statement given to the patient has the Practitioner's name, title, and address as the letterhead. One sample Disclosure Statement unmistakably tells the patient that "As my billing agent, [Taxpayer] will bill your primary and secondary insurance company (if there is one) according to the contracts [Taxpayer] has negotiated and I will collect any co-pays, deductibles or co-insurance payments."[10] Patients know that they are receiving services from the Practitioners, not Taxpayer, and that Taxpayer is acting only as the Practitioner's collection agent. These facts support the third requirement of ETA 3218, that the Taxpayer is an agent for Practitioners, and has no liability to the patients other than as an agent.

The Practitioner Contract specifies one of Taxpayer's roles is to submit the Practitioners' claims to the Payors and to distribute in a timely manner funds received from the Payors to the Practitioners. The Practitioner Contract specifically identifies Taxpayer as an agent of the Practitioners. This fact further supports the third requirement in ETA 3218 that Taxpayer is acting as a bona fide agent of the Practitioners. In addition, when the patient is not covered by insurance,

[10] . . . .

the patient will pay the full amount directly to the individual Practitioner for the service. This fact implies that Taxpayer does not hire the Practitioners to provide the mental health services on its behalf. While we concluded in 36 WTD 286 that the fact that a business hires independent contractors to provide services for customers of the business does not make the business an agent of the contractors, the flip side of that conclusion is also true: a business that collects amounts owed to practitioners does not mean the practitioners are independent contractors that work for such a business. As Taxpayer is not obligated to render services to patients, only to the Practitioners, Taxpayer has met the second requirement of ETA 3218.

As the *Washington Imaging* Court declared, for Taxpayer to prevail under a collection agent theory, "it must have collected money owed to" the Practitioners by the patients. *Wash. Imaging Servs*., 171 Wn.2d at 557. The evidence here supports such a conclusion. The patients here – unlike the patients in *Washington Imaging* – only contracted with the Practitioners and had no contractual relationship with the Taxpayer that legally obligated the patients to pay Taxpayer. Taxpayer has thus met the first requirement of ETA 3218, that the patients have an obligation to pay the Practitioners, and Taxpayer is collecting the money owed on that obligation.

Therefore, we conclude that Taxpayer has proven that the amounts collected by it from Payors were "money owed to" the Practitioners by the patients, and that Taxpayer acted solely as Practitioners' agent in collecting those amounts. Accordingly, we conclude that Taxpayer is permitted to exclude from its gross income the amounts it distributed to the Practitioners as a collection agent. We grant the petition.

DECISION AND DISPOSITION

We grant the petition.

Dated this 20th day of January 2021.