

NO. 39487-1-II

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**COURT OF APPEALS, DIVISION II  
OF THE STATE OF WASHINGTON**

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ST. JOSEPH GENERAL HOSPITAL,

Appellant,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

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**RESPONDENT'S BRIEF**

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FILED  
COURT OF APPEALS  
DIVISION II  
10 JAN -4 AM 10:12  
STATE OF WASHINGTON  
BY \_\_\_\_\_  
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PM 12-31-09

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## **I. INTRODUCTION**

This Court should affirm the Board of Tax Appeals (“Board”) because it correctly held that St. Joseph Medical Center (“the Hospital”) was not entitled to a deduction from revenue subject to business and occupation (B&O) tax for money received as payment for Medicare co-payments and deductibles and was not entitled to treat payments received for emergency room services performed by physicians as “pass through” payments. The Hospital claims that the Medicare co-payment and deductible revenue qualifies for a B&O tax deduction under RCW 82.04.4297, which allows certain hospitals to deduct from taxable gross income money “received from the United States or any instrumentality thereof.” The Board correctly held that money received from patients or private insurance companies was not money received “from the United States or any instrumentality thereof.”

The Board also correctly held that revenue the Hospital received as compensation for emergency room services was not entitled to “pass through” treatment because the Hospital was liable to pay the emergency room physicians regardless of whether the Hospital received payment for these services.

## II. COUNTERSTATEMENT OF THE ISSUES

- A. Washington's business and occupation tax applies to all gross income of a business unless an exemption or deduction applies. The Legislature has provided a deduction in RCW 82.04.4297 for certain hospitals for monies "received from the United States or any instrumentality thereof." Do payments received not from the United States, but from patients or their insurers, to satisfy patients' personal obligations to pay a Medicare co-payment or deductible, qualify for this deduction?
- B. May a hospital exclude from its gross income money received for emergency room services performed by physicians, where it billed patients for these services in its own name, was obligated to pay emergency room physicians regardless of whether it received payment for the services, was not acting as an agent for its patients in paying emergency room physicians, and had no obligation to "pass through" to the emergency room physicians the money it collected?

### III. COUNTERSTATEMENT OF THE CASE

During 1997-2000 (the “tax period”), the Hospital provided medical services to patients, including Medicare patients and patients who received care at the Hospital’s emergency room. BTA Doc. 669.<sup>1</sup> The Hospital received payments from patients or their insurance companies for the deductible or co-insurance payments not covered by the Medicare program and also received payments related to emergency room physician services. *Id.* These two types of revenue are at issue in this case.

#### A. Medicare Deductibles And Co-Payments Are Paid By Patients Or Private, Supplemental Insurance.

The material facts in this case are undisputed. The Hospital provides medical services to patients, some of whom are insured under the federal Medicare program. BTA Doc. 669. The Hospital bills Medicare for services provided, and after receiving payment from Medicare, the Hospital sends a statement to the patient or the patient’s supplemental insurance for any co-payment or deductible owing. BTA Doc. 318-22. Generally, the Hospital receives payments for these co-payments and deductibles from the patient or the patient’s supplemental insurance

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<sup>1</sup> The appellate record in this case consists of Clerk’s Papers and the administrative record at the Board of Tax Appeals. The Department of Revenue will refer to “CP” when citing to Clerk’s Papers and to “BTA Doc.” when referring to the administrative record.

provider. BTA Doc. 308. The only revenue at issue in this case, other than money received for emergency room services provided by physicians (discussed below), is these payments for Medicare patient co-payments or deductibles. BTA Doc. 668.

Undisputed facts in the record show that it is the patient's responsibility to pay the co-payment or deductible. BTA Doc. 324-25, 340, 348-49, 351. There is no evidence in the record that documents provided to patients, such as billing statements or consent forms, indicated in any way that Medicare was responsible for the co-payment or deductible or that the patient was satisfying any obligation of the Medicare program. *See generally* BTA Doc. 324-25, 327, 350-51, 371. Rather, the documents indicate that the amounts due are the patient's obligation and are owing to the Hospital. *Id.*

The Hospital's discussion of the Medicare program is not fully accurate. The Hospital does not cite to any factual evidence in the record in its discussion of Medicare co-payments and deductibles. App. Br. at 4-5. Rather, the Hospital cites only to its oral argument or the Board's order, which was decided on summary judgment and therefore contained no findings of fact. Accordingly, this Court should give no weight to the Hospital's assertions since they are not supported by citation to the record. RAP 10.3(a)(5). For example, there is no factual evidence in the record

that payments received from patients to pay a co-payment or deductible are “Medicare payments,” (App. Br. at 4); that Medicare regulations and billing instructions are designed to lead to “total recovery” of Medicare cost (App. Br. at 4); that Medicare “directs” its beneficiaries to pay co-payments or deductibles (App. Br. at 4); or that supplemental health insurance covering co-payments and deductibles is sold by “Medicare-contracted” insurance companies (App. Br. at 5).

Furthermore, Medicare does not reimburse the Hospital for all uncollected Medicare co-payments and deductibles, as the Hospital suggests. App. Br. at 5. Only a small portion of these deductibles and co-insurance payments became “bad debt” for which the Hospital sought payment from Medicare. BTA Doc. 360-61. Provided that the Hospital had complied with Medicare regulations and had first sought payment from patients, Medicare paid only a portion of the “bad debt” from Medicare deductibles and co-insurance payments owed to the Hospital. BTA Doc. 356-57. *See also* 42 C.F.R. § 413.89(h) (limiting payment by Medicare of bad debt by varying percentages based on year). Medicare determined the percentage of bad debt it would pay based primarily on federal budgetary considerations. BTA Doc. 359-60. Therefore, Medicare was not responsible for all co-payments and deductibles but paid only a portion of the uncollectible co-payments and deductibles and only

if the Hospital had made efforts to first collect those amounts from patients. The Department of Revenue (“Department”) did not assess B&O tax on these bad-debt payments from Medicare because, unlike payments from patients or private insurance companies, these payments are received from the United States.

**B. The Hospital Billed Patients For Emergency Room Services.**

During the tax period, the Hospital operated an emergency room and held itself out to the community as having emergency room services available. BTA Doc. 328. As a Hospital witness testified, a reasonable person would assume that an emergency room would have physicians available. BTA Doc. 328-29. Rather than employ emergency room physicians to staff its emergency room, the Hospital hired a group of physicians, Northwest Emergency Physicians (“NEP”), as independent contractors to provide emergency room physician services for the Hospital. BTA Doc. 406-14. Under the terms of the Hospital’s Agreement with NEP, NEP agreed to provide emergency room physicians “as are necessary for the provision of emergency services at Hospital.” BTA Doc. 407. The agreement specifically stated that the reason for the agreement was that the Hospital was in need of a Medical Director and physicians “to develop and deliver *the [Hospital Emergency] Department’s* services.” BTA Doc. 406 (emphasis added). In addition to

providing emergency room services, NEP was required by its contract with the Hospital to perform various administrative duties such as participating in quality assurance reviews, participating in management meetings, assisting in teaching physicians, and supervising hospital personnel. BTA Doc. 406-07.

In exchange, the Hospital agreed to provide the necessary space, utilities, supplies and equipment for an emergency department. BTA Doc. 409. The Hospital also agreed to pay NEP 66.7% of the “gross professional charges for the prior month.” BTA Doc. 411. Thus, the Hospital did not agree to pass on a percentage of what it collected; instead, the Hospital was obligated by its contract to pay a percentage of the amount billed regardless of whether the Hospital actually collected payment from the patients. *Id.*; BTA Doc. 337, 365-67.

Emergency room patients and insurance companies had no input into what NEP was paid. BTA Doc. 335-36, 369. Similarly, the Hospital had no input into how much the individual emergency room physicians were paid by NEP. BTA Doc. 368.

The Hospital provided no documents to patients that explained the relationship it had with emergency room physicians. BTA Doc. 423 (answer to request for production No. 12). Thus, the Hospital did not advise the patients that it was acting merely as a billing agent for the

emergency room physicians. The Hospital's witnesses similarly could provide no evidence that patients were ever told that the Hospital was acting as a collecting agent for the emergency room physicians. BTA Doc. 332-34.

The Hospital mistakenly claims that invoices sent to patients by St. Joseph "identified ER Physicians as the party billing for emergency-room services." App. Br. at 7 (citing BTA Doc. 17, R-5-1).<sup>2</sup> As noted above, this statement is contradicted by the testimony of Hospital witnesses, answers to interrogatories, and Hospital documents.

Moreover, the Hospital has not shown that the document to which it refers is an invoice sent to patients or that it identified ER Physicians as the party billing for emergency room services. BTA Doc. 544. The document itself seems to be an invoice sent to the Nooksack Indian Health Services. *Id.* Other documents provided by the Hospital in discovery as representative of patient account statements do not indicate in any way that the Hospital is billing on behalf of the emergency room physicians. BTA Doc. 371. Moreover, a Hospital witness testified that the Hospital sent forms similar to the one cited by the Hospital with the same information in circumstances where the Hospital admits it was not acting

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<sup>2</sup> The Hospital uses a different citation method than the Department in its brief. Using the Department's citation method, the document cited by the Hospital can be found at BTA Doc. 544.

as a billing agent for the physician. BTA Doc. 200-01. Thus, according to the Hospital's own witness, the document does not indicate that the physician is the one billing for emergency room services.

**C. Procedural History**

Pursuant to an audit, the Department determined that the Hospital had not reported nor paid tax on income received from patients and supplemental insurance companies for Medicare co-payments and deductibles and for emergency room services performed by physicians for the period January 1, 1997, through June 30, 2000 (the "tax period"). BTA Doc. 670-72. The Department assessed the Hospital for the unpaid B&O taxes, and upheld the assessment in an administrative review process. BTA Doc. 669-83. The Hospital appealed to the Board, which affirmed the assessment, reasoning that "Medicare patients and their insurers are not agents or instrumentalities of the federal government (Medicare) under RCW 82.04.4297. . . . The patients' insurers are making payment on behalf of the patient (patients voluntarily pay for supplemental insurance policies with their funds), not Medicare." BTA Doc. 48. The Board also upheld the B&O tax assessment on gross income for emergency room services provided by physicians. BTA Doc. 49. The Hospital appealed the Board's decision to Thurston County Superior Court, which affirmed the Board's decision. CP 140-41.

#### **IV. SUMMARY OF ARGUMENT**

The Hospital may not deduct income received from patients and private insurance companies paying Medicare co-payment and deductibles. The plain language of the statutory deduction applies only to monies received directly from the United States or an “instrumentality thereof.” The ordinary meaning of an instrumentality of the government, the accepted meaning of the phrase in case law, and the structure of the deduction all show that payments received from patients or private insurance companies to pay co-payments or deductibles do not qualify for the deduction.

Legislative history of the deduction and subsequent statutory amendments confirm that patients and private insurance companies are not “instrumentalities” of the federal government. Finally, the Hospital’s expansive interpretation of the term “instrumentality” absurdly robs the deduction of any meaning and leads to an incongruous statutory scheme.

Payments received by the Hospital for emergency room services are also taxable gross revenue to the Hospital. The money was received by the Hospital for services rendered by the Hospital through its independent contractor physicians. The Hospital did not “pass on” the money it received but instead paid its independent contractors a monthly

fee based on the amount billed (not collected). Accordingly, the revenue was properly included in the Hospital's taxable gross income.

## **V. ARGUMENT**

### **A. Standard of Review**

The Administrative Procedure Act (APA) governs judicial review of a Board of Tax Appeals decision. RCW 82.03.180. "The burden of demonstrating the invalidity of agency action is on the party asserting invalidity." RCW 34.05.570(1)(a). The court reviews the Board's legal conclusions under the error of law standard. RCW 34.05.570(3)(d). Since the Board decided this matter on summary judgment and did not enter findings of fact, the Court's review is limited to whether the Board erroneously interpreted or applied the law.

### **B. The B&O Tax Generally**

The B&O tax is imposed on every person "for the act or privilege of engaging in business activities" and is measured by the "gross income of the business." RCW 82.04.220. A business may not deduct from "gross income" costs such as labor costs or other costs of doing business. RCW 82.04.080. The Legislature "intended to impose the business and occupation tax upon virtually all business activities carried on within the state." *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wn.2d 139, 149, 3 P.3d 741 (2000). As a result, unless an exemption or deduction applies, a

taxpayer owes B&O tax on all income received for the rendition of services, including services related to health care. Tax deduction statutes are narrowly construed. *United Parcel Serv., Inc. v. Dep't of Revenue*, 102 Wn.2d 355, 360, 687 P.2d 186 (1984). Any ambiguity in such a statute is construed strictly, but fairly, against the taxpayer. *Group Health Coop. v. Washington State Tax Comm'n*, 72 Wn.2d 422, 429, 433 P.2d 201 (1967). The taxpayer has the burden of proving that it qualifies for a tax deduction. *Id.* at 429.

**C. Medicare Co-Payments And Deductibles Are Taxable.**

The Hospital argues that the B&O tax deduction in RCW 82.04.4297 should apply in this case. The Hospital improperly stretches the statutory language of “monies received from the United States or any instrumentality thereof” in an attempt to apply it to payments received not from the United States, but from patients and patients’ private insurance providers. The Hospital’s interpretation is contrary to the ordinary understanding of the statutory language, case law interpreting the term “instrumentality of the United States,” the structure of the deduction, and legislative history. Accordingly, the Hospital has failed to meet its burden to show that the Board erroneously interpreted or applied the law.

**1. The hospital is not entitled to the deduction because monies received from patients and patients' private insurers are not monies "received from the United States or any instrumentality thereof."**

At all times during the tax period, the Hospital was entitled to deduct from its taxable gross income money "received from the United States or any instrumentality thereof . . . as compensation for, or to support, health or social welfare services rendered by a health or social welfare organization . . . ." RCW 82.04.4297 (2000) (Attached as Appendix 1).<sup>3</sup> It is undisputed that the revenue at issue in this appeal was received from patients and private insurance companies – not from the United States or the Medicare program. Thus, applying a common understanding of the words of the statute, the Hospital's revenue does not qualify for the deduction.

The Hospital argues that patients and private insurance companies become instrumentalities of the United States when paying Medicare co-payments and deductibles. Case law discussing instrumentalities of the federal government for tax purposes, the plain words of the deduction, and the structure of the statute all show that patients and their insurance carriers are not instrumentalities of the United States.

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<sup>3</sup> As discussed below, the statute was amended after the tax period at issue here.

Several cases address the issue of what is an “instrumentality” of the United States for tax purposes in other contexts. For example, in *United States v. Spokane*, 918 F.2d 84 (9th Cir. 1990), *cert. denied*, 501 U.S. 1250 (1991), the court held that the American Red Cross was an “instrumentality” of the federal government because it was created to carry out functions of the government itself and was virtually an arm of the government. *Id.* at 88. (Attached as Appendix 2). The court thus distinguished the Red Cross from mere contractors that were hired to act as agents of the government. *Id.* See also *McAvoy v. Weber*, 198 Wash. 370, 88 P.2d 448 (1939) (Home Owners’ Loan Corporation was an “instrumentality” of the federal government where it was created by federal statute, the act authorizing its creation specifically stated that it “shall be an instrumentality of the United States,” the act required that it be under the direction of a federal agency and operated by the federal agency under such rules and regulations as the agency prescribed, and all of the capital stock of the corporation was owned by the United States). While these cases address the term “instrumentality of the United States” for purposes of tax immunity, this well-developed legal term sheds light on what the Legislature meant when using the phrase.

These cases discussing “instrumentalities” of the United States for tax purposes are also consistent with dictionary definitions of

“instrumentality,” which include “a part, organ, or subsidiary branch esp. of a governing body <the judicial *instrumentalities* of the federal government>.” *Webster’s Third New International Dictionary* 1172 (2002).<sup>4</sup> In every dictionary entry for “instrumentality” cited in its brief, the Hospital omits language that specifically addresses an “instrumentality” of a government or governing body:

- From the Webster’s Third New International Dictionary entry for “instrumentality,” the Hospital omits “a part, organ, or subsidiary branch esp. of a governing body <the judicial *instrumentalities* of the federal government> <a Chilean government ~ devoted to developing the country’s national resources – *Ethyl News*>.” Webster’s Third New International Dictionary 1172 (1981) (attached as Appendix 3) (quoted by the Hospital at App. Br. at 11). The 1981 edition of this dictionary, cited by the Hospital, and

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<sup>4</sup> The complete dictionary entry is:

**1** : the quality or state of being instrumental : a condition of serving as an intermediary <the agreement was reached through the ~ of the governor > **2 a** : something by which an end is achieved : MEANS <precious metals purified through the ~ of heat> <*instrumentalities* of production> <mechanical *instrumentalities*> **b** : something that serves as an intermediary or agent through which one or more functions of a controlling force are carried out : a part, organ, or subsidiary branch esp. of a governing body <the judicial *instrumentalities* of the federal government> <a Chilean government ~ devoted to developing the country’s natural resources – *Ethyl News*>.

*Webster’s Third New International Dictionary* 1172 (2002). Webster’s Third New International Dictionary is the dictionary generally used by Washington courts. *State v. Glas*, 106 Wn. App. 895, 905, 27 P.3d 216 (2001), *rev’d on other grounds*, 147 Wn.2d 410, 54 P.3d. 147 (2002).

the 2002 edition, cited by the Department above, have identical entries for “instrumentality.”

- From the American Heritage Dictionary entry for “instrumentality,” the Hospital omits “3. A subsidiary branch, as of a government, by means of which functions or policies are carried out.” *American Heritage Dictionary* 908 (4th ed. 2000) (attached as Appendix 4) (quoted by the Hospital at App. Br. at 11).
- From the end of the Black’s Law Dictionary entry for “instrumentality,” the Hospital omits, “. . ., such as a branch of a governing body.” *Black’s Law Dictionary* 814 (8th ed. 2004) (attached as Appendix 5) (quoted by the Hospital at App. Br. at 11).

As these dictionary definitions and the cases cited above show, an instrumentality of a government is not anything that merely assists in achieving a government purpose, but must be more closely associated with the government itself so as to be considered a part of it.

These dictionary and case law definitions are also consistent with the statutory deduction as a whole. The deduction applies to “amounts received from the United States or any instrumentality thereof or from the state of Washington or any municipal corporation or political subdivision thereof . . . .” RCW 82.04.4297 (2000). The parallel language involving

payments from the State and its political subdivisions shows that the deduction was designed to apply to monies received from governments and governmental agencies. Otherwise, the deduction would improbably allow deductibles and co-payments for a federal insurance program to qualify, but not deductibles and co-payments for a state insurance program.

In the present case, patients and patients' private insurers are not carrying out government functions when making payments to the hospital. As the Board recognized, they are simply paying a bill to satisfy the patients' financial obligations to the hospital. BTA Doc. 48. The record before the Board includes deposition testimony and answers to interrogatories in which the Hospital admits that the patient co-payments and deductibles are the responsibility of patients and the vast majority of these payments come from patients or patients' private, supplemental insurance companies. BTA Doc. 308, 324-25, 340, 348-49, 351. There is no indication that patients or patients' insurers were carrying out government functions or even acting under the direction of the government.

The Hospital makes much of the fact that insurance providers must comply with Medicare regulations when offering for sale to patients supplemental insurance to cover Medicare co-payments and deductibles.

App. Br. at 12-14. The Hospital mistakenly asserts that these regulations essentially make insurance companies agents of the Medicare program, rather than simply being regulated by Medicare. The Hospital's argument would absurdly make any business operating in a highly regulated industry an agent of the government.

Nor does the process by which the hospital can recover "bad debt" transform patients and their insurers into instrumentalities of the United States. Medicare does not simply agree to pay patient co-payments and deductibles. Rather, the Hospital is required to engage in reasonable collection efforts and only if those efforts fail does Medicare make any payments. 42 C.F.R. 413.89. Medicare does not cover all of this "bad debt," but determines a set percentage that it will pay. 42 § C.F.R. 413.89(h) (limiting coverage of bad debt by varying percentages depending on year); BTA Doc. 357-59. The overwhelming majority of patient co-payments and deductibles are paid by patients or their private insurers. BTA Doc. 308, 360-61. As the Board properly concluded, when the private insurers make a payment, they do so not because of any governmental requirement but because they have contracted with the patient to make the payments. BTA Doc. 48.

Under these circumstances, it stretches reason to suggest that Medicare is responsible for the patient co-payments and deductibles. The

“bad debt” reimbursement by Medicare is simply a feature of the Medicare program, not an admission that Medicare is responsible for all patient co-payments and deductibles. This feature does not make patients into instrumentalities of the federal government. Accordingly, payments from patients and their insurers are not entitled to the deduction set forth at RCW 82.04.4297.

**2. The legislative history of the deduction and rules of statutory construction show that the deduction applies only to governmental payments.**

Even if this Court were to determine that the language of the deduction is ambiguous, the legislative history of the deduction reinforces the conclusion that the deduction applies only to governmental payments.<sup>5</sup> The deduction for amounts received “from the United States or any instrumentality thereof” was originally enacted in 1979. Laws of 1979, 1st Ex. Sess., ch. 196, § 5 (former RCW 82.04.430(16), now codified at RCW 82.04.4297) (attached as Appendix 6). The final bill report for this enactment describes the language added in former subsection (16) as “[a]mounts received from the United States or any governmental unit.” Final Bill Report, on Substitute H. B. 302 (attached as Appendix 7).

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<sup>5</sup> Although the Hospital claims to rely on “legislative history” of the deduction, it does not cite or discuss any legislative history of the actual deduction in effect during the tax period, but discusses only later amendments of the deduction. App. Br. at 15-16. As shown below, to the extent that later amendments to the statute show anything about the meaning of the deduction during the tax period, those amendments show exactly the opposite of what the Hospital argues.

Giving further indication of what the Legislature meant in using the term “instrumentality,” the law at that time exempted from B&O tax compensation for services rendered to patients by hospitals operated “by the United States or any of its instrumentalities.” See Laws of 1979, 1st Ex. Sess., ch. 196, § 5 (former RCW 82.04.430(8)).<sup>6</sup> The Hospital’s expansive interpretation of “instrumentality” would make any hospital that accepted Medicare patients into “instrumentalities” of the United States, contrary to the obvious meaning of this other, former exemption.

Furthermore, courts construe ambiguous tax deductions strictly, but fairly, against a taxpayer. *Group Health Coop. v. State Tax Comm’n*, 72 Wn.2d 422, 429, 433 P.2d 201 (1967). Thus, even if the Court ultimately concludes that the language of the statute is ambiguous, the court should strictly construe the deduction against the taxpayer.

The plain meaning of the deduction, the parallel language in the deduction limited to state and local government payments, case law addressing what is an “instrumentality” of the United States, dictionary definitions, rules of statutory construction, and legislative history all show that payments from patients and private insurance companies are not

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<sup>6</sup> Former RCW 82.04.430(8) was recodified as former RCW 82.04.4288 in 1980. Laws of 1980, ch. 37, § 9. Former RCW 82.04.4288 was repealed in 1993. Laws of 1993, ch. 492, § 306.

included within the deduction in RCW 82.04.4297. As shown below, subsequent amendments to the statute further reinforce this conclusion.

**3. Legislative amendments after the tax period demonstrate the taxability of Medicare deductibles and co-payments.**

The Hospital argues that subsequent legislation demonstrates that Medicare deductibles and co-payments received from patients or their insurance companies are entitled to the tax deduction in RCW 82.04.4297. App. Br. at 15-17. To the contrary, amendments to the deduction after the tax period at issue show that later Legislatures viewed the deduction exactly as the Department does here.

During the tax period, RCW 82.04.4297 provided:

In computing tax there may be deducted from the measure of tax amounts received from the United States or any instrumentality thereof or from the state of Washington or any municipal corporation or political subdivision thereof as compensation for, or to support, health or social welfare services rendered by a health or social welfare organization or by a municipal corporation or political subdivision, except deductions are not allowed under this section for amounts that are received under an employee benefit plan.

The statute was amended effective July 13, 2001, adding the following language:

For purposes of this section, “amounts received from” includes amounts received by a health or social welfare organization that is a nonprofit hospital or public hospital from a managed care organization or other entity that is under contract to manage health care benefits for the federal medicare program authorized under

Title XVIII of the federal social security act; for a medical assistance, children's health, or other program authorized under chapter 74.09 RCW; or for the state of Washington basic health plan authorized under chapter 70.47 RCW, to the extent that these amounts are received as compensation for health care services within the scope of benefits covered by the pertinent government health care program.

Laws of 2001, 2d Sp. Sess., ch. 23, §2 (Substitute House Bill 1624) (attached as Appendix 8). The stated purpose of this amendment was to preserve and enhance the government's purchasing power of health care services in light of changes in the way that Medicare and other government programs provided health care benefits. Laws of 2001, 2d Sp. Sess., ch. 23, § 1. These government programs had changed from simply paying hospitals for services to encouraging beneficiaries to participate in government-funded managed care programs, operated by intermediaries (such as Group Health) between government entities and hospitals. *Id.* The Legislature concluded that even though these intermediaries were acting on behalf of the government, and paying for services with money they received from the government, the payments to hospitals from the intermediaries would not be entitled to the existing deduction because the payments were not received directly from the government. *Id.*; Final Bill Report on Substitute House Bill 1624 (describing the statute before amendment as allowing deduction "only for payments made directly by federal, state, or local governments.") (attached as Appendix 9). In order

to maintain the government's purchasing power with respect to health care services in light of these changes, the Legislature amended RCW 82.04.4297 to include in the deduction payments from managed-care organizations under contract with a governmental entity. Laws of 2001, 2d Sp. Sess., ch. 23, § 2.

If the deduction as it existed during the tax period applied to all payments associated with the Medicare program, as the hospital argues, this amendment would have been wholly unnecessary. Similarly, if the deduction as it existed during the tax period applied to payments made on behalf of the Medicare program, the amendment would have been wholly unnecessary. In contradiction to the Hospital's argument, the Legislature felt it necessary to specifically include managed-care organizations within the deduction, even though these managed-care organizations were obviously operating on behalf of the Medicare program.

The deduction for governmental health care payments was amended again in the following legislative session. And again, the amendment is inconsistent with the Hospital's theory. The new amendment deleted the language that had been added to RCW 82.04.4297 in 2001 and created a new section:

A public hospital that is owned by a municipal corporation or political subdivision, or a nonprofit hospital that qualifies as a health and social welfare organization as defined in RCW

82.04.431, may deduct from the measure of tax amounts received as compensation for health care services covered under the federal medicare program authorized under Title XVIII of the federal social security act; medical assistance, children's health, or other program under chapter 74.09 RCW; or for the state of Washington basic health plan under chapter 70.47 RCW. The deduction authorized by this section does not apply to amounts received from patient co-payments or patient deductibles.

Laws of 2002, ch. 314, §2 (House Bill 2732) ) (codified at RCW 82.04.4311 (2002)) (attached as Appendix 10). Unlike the deduction in RCW 82.04.4297, this deduction does not require that the money be received "from the United States or any instrumentality thereof." Rather, the language more broadly applies to amounts received as compensation for "health care services covered under the federal medicare program . . . ." RCW 82.04.4311 (2002). This broader language, unlike that in RCW 82.04.4297, arguably might have included Medicare deductibles and co-payments received from patients and insurance companies. Consistent with the language in RCW 82.04.4297 and the statute's purpose (increasing *governmental* purchasing power), the Legislature thus specifically excluded from the new deduction patient deductibles and co-payments.<sup>7</sup> RCW 82.04.4311 ("The deduction authorized by this section

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<sup>7</sup> Accordingly, the Hospital may not take advantage of this deduction even though it is retroactive to 1998. Laws of 2002, ch. 314, § 4. The revenue at issue in this case is limited to payments for patient co-payments and deductibles. Some of those payments were made by patients and some were made by a patient's private insurance carrier. In either event, the payment was for the patient's co-payment or deductible. BTA Doc. 668 (Notice of Appeal identifying revenue as Medicare co-payments and

does not apply to amounts received from patient co-payments or patient deductibles.”) By adding the language specifically excluding patient co-payments and deductibles, there is no indication in the 2002 act or its legislative history that the Legislature was removing a previously available deduction. Rather, patient co-payments and deductibles have never been included in RCW 82.04.4297, and the broader statutory language in RCW 82.04.4311 required that the Legislature make the exclusion explicit in RCW 82.04.4311. The legislative history of this amendment, just like the legislative history of the 2001 amendment, shows that the deduction in RCW 82.04.4297 as it existed during the tax period applied only to payments “made directly by federal, state, or local governments.” Final Bill Report on House Bill 2732, (attached as Appendix 11).

#### **4. The Hospital’s interpretation leads to absurd results.**

In construing statutes, a court seeks to harmonize the statutory scheme and give effect to all statutory language.<sup>8</sup> *Dep’t of Ecology v.*

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deductibles); BTA Doc. 320-23 (deposition testimony regarding billing of co-payments and deductibles); BTA Doc. 308 (answer to interrogatory No. 7, “Island Hospital receives Medicare deductibles and co-payments either from the beneficiary (patient) or supplemental insurance.”)

<sup>8</sup> The Hospital argues that the Washington Supreme Court in *Homestreet, Inc. v. Dep’t of Revenue*, 166 Wn.2d 444, 452, 210 P.3d 297 (2009), discarded the longstanding principle that courts construe a statute in the context of related statutes and the statutory scheme as a whole. App. Br. at 10. While the Court in *Homestreet* apparently concluded that the overall statutory scheme did not preclude its interpretation of the statute at issue there, it did not reject the rule of statutory construction. Decisions subsequent to

*Campbell & Gwinn, L.L.C.*, 146 Wn.2d 1, 11, 43 P.3d 4 (2002); *Kilian v. Atkinson*, 147 Wn.2d 16, 21, 50 P.3d 638 (2002). A court avoids unlikely, absurd, or strained consequences when interpreting statutory language. *Tingey v. Haisch*, 159 Wn.2d 652, 664, 152 P.3d 1020 (2007). The Hospital's interpretation would make the statutory scheme incongruous and lead to absurd results.

Under the Hospital's interpretation, RCW 82.04.4297 allows a deduction for Medicare co-payments and deductibles paid by patients. Yet after the statutory amendments discussed above, RCW 82.04.4311 specifically states that its deduction for monies received for services covered by the Medicare program does not apply to patient co-payments or deductibles. The Hospital's interpretation thus results in two different statutory deductions, each applicable by its terms to payments received under the Medicare program, but only one of which allows a deduction for patient co-payments and deductibles. This result is not only incongruous but contrary to the express intent of the Legislature in enacting RCW 82.04.4311. *See* Laws of 2002, ch. 314, §1 ("the tax status of these amounts should not depend on whether the amounts are received directly

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*Homestreet* continue to apply this bedrock principle of statutory construction. *E.g.*, *City of Seattle v. Winebrenner*, 167 Wn.2d 451, 456, 219 P.3d 686 (2009); *Post v. City of Tacoma*, 167 Wn.2d 300, 310, 217 P.3d 1179 (2009).

from the qualifying program or through a managed health care organization under contract to manage benefits for a qualifying program.”) The Hospital’s expansive reading of “instrumentality” to include any means to an end would also seem to make virtually every individual in this state who pays contributions to the Medicare system through a payroll deduction or otherwise into a federal instrumentality. The Department respectfully requests that this Court not endorse such an absurd result.

**D. Revenue Received By The Hospital For Emergency Room Services Is Taxable.**

The hospital is not entitled to exclude income it received for emergency room services performed by physicians because the revenue is part of its taxable gross income and it cannot satisfy the requirements of WAC 458-20-111 (“Rule 111”) regarding “pass-through” payments.

**1. Washington’s B&O tax is a gross receipts tax that is designed to be a pyramiding tax.**

As noted above, Washington’s B&O tax applies to all business activity in the state and applies to gross, rather than net, income. Accordingly, a taxpayer may not deduct its costs, including labor costs, from the income subject to the tax. RCW 82.04.080. This type of tax is known as a “pyramiding” tax because it taxes all transactions, including intermediate business-to-business transactions, and not just the final value

of a product or profit to a business. *See, e.g.,* Andrew Chamberlain and Patrick Fleenor, *Special Report, Tax Pyramiding: The Economic Consequences of Gross Receipts Taxes*, Tax Foundation No. 147, at 1, 6 (Dec. 2006), (available at <http://www.taxfoundation.org/files/sr147.pdf>).<sup>9</sup> Gross receipts taxes such as the Washington B&O tax have been criticized for this feature, but it is the tax system adopted by the Legislature over 70 years ago. *Id.* at 2, 4.

In applying a gross receipts tax it may be difficult under some circumstances to identify exactly what should be considered the “gross income” of a business that is subject to tax. One such instance, presented in this case, is when the taxpayer bills a client for services personally performed by a third party. *E.g., Pilcher v. Dep’t of Revenue*, 112 Wn. App. 428, 49 P.3d 947 (2002), *review denied*, 149 Wn.2d 1004 (2003) (attached as Appendix 12). Given the pyramiding nature of the B&O tax, generally if the taxpayer bills a client and receives money for these services, the money should be included as gross income regardless of the fact that the taxpayer may have to pay the third party for the services, because this is a cost to the taxpayer that cannot be deducted. However, there may be circumstances where the client is not remitting money to the

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<sup>9</sup> The Department does not agree with all of the opinions expressed in the article, but cites it as an explanation of a gross receipts tax and an example of criticism that the tax has received.

taxpayer as payment to the taxpayer, but is merely asking that the taxpayer “pass on” the money to the person to whom the client owes money.

Washington courts have addressed this circumstance on numerous occasions. *See City of Tacoma v. William Rogers Co.*, 148 Wn.2d 169, 175, 60 P.3d 79 (2003); *Rho Co., Inc. v. Dep’t of Revenue*, 113 Wn.2d 561, 782 P.2d 986 (1989); *Walthew, Warner, Keefe, Arron, Costello & Thompson v. Dep’t of Revenue*, 103 Wn.2d 183, 691 P.2d 559 (1984); *Christensen, O’Connor, Garrison & Havelka v. Dep’t of Revenue*, 97 Wn.2d 764, 768-69, 649 P.2d 839 (1982); *Washington Imaging Services, Inc. v. Dep’t of Revenue*, No. 38247-4-II, 2009 WL 4815583 (Wa. Ct. App. Div. 2 Dec. 15, 2009); *Pilcher*, 112 Wn. App. at 430-31; *Medical Consultants Northwest, Inc. v. State*, 89 Wn. App. 39, 947 P.2d 784 (1997). The Department over 70 years ago also promulgated a rule applicable to this circumstance, now set forth at WAC 458-20-111 (“Rule 111”) (attached as Appendix 13).<sup>10</sup>

Both the Department’s Rule 111 and every case cited above consider as a deciding factor, along with other deciding factors, whether the taxpayer had liability to the third party beyond merely “passing on” as

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<sup>10</sup> Actually, the Department’s predecessor, the Washington State Tax Commission, created this exclusion, in a rule that has been in place since 1936. *See* Washington State Tax Commission, *Rules & Regulations relating to Revenue Act of 1935* at 49 (1936) (then Rule 112).

an agent the money received.<sup>11</sup> If the taxpayer has liability beyond that of an agent, the money is considered gross income. *E.g., William Rogers*, 148 Wn.2d at 178 (“If a taxpayer assumes any liability beyond that of an agent, the payments it receives are not ‘pass through’ payments, even if the taxpayer uses the payments to pay costs related to the services it provided to its client.” (citing *Walthew*, 103 Wn.3d at 189)). In the present case, because the Hospital was liable to pay the emergency room physicians whether or not it was paid, it had more than agent liability. Accordingly, this dispositive fact means that the money is considered gross income to the Hospital and the Hospital cannot satisfy Rule 111.

**2. Monies received for emergency room services are part of the Hospital’s gross income.**

The Department agrees with the Hospital that RCW 82.04.080, the statutory definition of gross income, is applicable to this case.<sup>12</sup> “Gross income of the business” is defined by statute as:

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<sup>11</sup> *William Rogers*, 148 Wn.2d at 178; *Rho*, 113 Wn.2d at 569-70; *Walthew*, 103 Wn.2d at 188-89; *Christensen*, 97 Wn.2d at 769-70; *Washington Imaging*, 2009 WL 4815583 at \*5; *Pilcher*, 112 Wn. App. at 437, 441; *Medical Consultants*, 89 Wn. App. at 48. Other jurisdictions with gross receipts taxes similarly consider whether the taxpayer has liability to pay the third party in determining whether money received is gross income. *E.g., Brim Healthcare, Inc. v. Taxation and Revenue Dep’t*, 119 N.M. 818, 896 P.2d 498, 500 (1995).

<sup>12</sup> Rule 111 is also applicable to this case because it is an explanation of situations in which a business may receive money that nevertheless will not be considered gross income for taxation purposes. *See City of Tacoma v. William Rogers Co.*, 148 Wn.2d 169, 175 n.4, 60 P.3d 79 (2003) (determining whether amounts actually received by taxpayer—as in this case—were gross income by applying Tacoma’s version of Rule 111); *Rho Co., Inc. v. Dep’t of Revenue*, 113 Wn.2d 561, 782 P.2d 986 (1989) (remanding to determine if taxpayer was acting as agent for customers when paying temporary employees). Moreover,

[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.

RCW 82.04.080 (attached as Appendix 14).

In this case, payments to the Hospital from patients receiving care at the Hospital's emergency room were "value proceeding or accruing by reason of the transaction of the business engaged in." It is undisputed that the Hospital received money as compensation for emergency room services performed by physicians when patients or insurance companies paid the bill sent by the Hospital. The Hospital's contract with NEP also described the physicians as delivering Hospital services. BTA Doc. 406. Nevertheless, the Hospital argues that the payments must have been "owned" by the physicians because the physicians performed the service and the money is thus not attributable to the Hospital. The Hospital ignores that money received by a taxpayer for services is taxable gross income even if the services were physically performed by another entity,

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numerous Washington courts have applied Rule 111 to determine whether money received by a business is taxable in situations similar to that presented here. *Id.*; *Pilcher v. Dep't of Revenue*, 112 Wn. App. 428, 49 P.3d 947 (2002), *review denied*, 149 Wn.2d 1004 (2003).

such as an independent contractor. *Pilcher*, 112 Wn. App. at 436, 440-41; *cf. Impehoven v. Dep't of Revenue*, 120 Wn.2d 357, 841 P.2d 752 (1992) (reasoning that entire commission paid to insurance agent is gross income despite 60% of commission paid to independent contractor, sub-agent); *City of Seattle v. Paschen Contractors, Inc.*, 111 Wn.2d 54, 65, 758 P.2d 975 (1988) (payments for sub-contractor work part of taxable gross income of general contractor).

In *Pilcher*, the court rejected the same argument that the Hospital makes here. *Pilcher*, 112 Wn. App. at 436-37 (rejecting argument that physicians hired by Pilcher as independent contractors provided the services for which Pilcher was paid and that the money therefore did not belong to him and was not “received or accrued” by him). Thus, the fact that the services were performed by another entity does not answer the question of whether the revenue is taxable gross income to the Hospital.<sup>13</sup> *See also William Rogers*, 148 Wn.2d at 172-173, 181 (holding that money paid by clients to taxpayer to pay temporary workers who performed services for clients was gross income to the taxpayer because taxpayer had employer liability to temporary workers).

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<sup>13</sup> The fact that the taxpayer did not personally perform the services for which payment is made is a necessary but not sufficient condition for “pass through” treatment. *E.g.*, WAC 458-20-111; *Pilcher*, 112 Wn. App. at 436. Therefore, this factor can be relevant in some cases addressing “pass through” treatment.

Of far more significance to courts that have examined similar issues is whether the taxpayer merely “passed on” the fees as an agent or whether the taxpayer had more than agent liability to the third-party contractor.<sup>14</sup> *E.g., Pilcher*, 112 Wn. App. at 437, 441. *See also William Rogers*, 148 Wn.2d at 178. No Washington case has ever held that money is excluded from taxable gross income where the taxpayer had more than agent liability to the physical provider of services. This result makes sense because if a taxpayer has more than agent liability to the provider of services, then the taxpayer, not the person paying the taxpayer, is hiring the provider.

In this case, it cannot reasonably be disputed that the Hospital has more than agent liability. Pursuant to a contract with NEP, the Hospital paid NEP a percentage of gross billings – not receipts – for the prior month. Thus, the Hospital was not passing through payments it received from patients and insurance companies but paying NEP pursuant to its contract – a

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<sup>14</sup> *See also* WAC 458-20-168(2)(g):

When a hospital contracts with an independent contractor (service provider) to provide medical services such as managing and staffing the hospital’s emergency department, the hospital may not deduct the amount paid to the service provider from its gross income. If, however, the patients are alone liable for paying the service provider, and the hospital has no personal liability, either primarily or secondarily, for paying the service provider, other than as agent for the patients, then the hospital may deduct from its gross income amounts paid to the service provider.

This portion of the rule was added in 2008 and so was not in effect during the tax period. Nevertheless, as an interpretive rule, it is an application of the statute, rules, and appellate case law.

contract that required NEP to provide services for the hospital in return for the payment of gross billings. If the Hospital failed to collect any payment for the services provided, the Hospital would still be obligated to pay NEP a percentage of gross billings. BTA Doc. 337, 366-67, 411. The Hospital never made any attempt to reconcile the payments to NEP with past collections. BTA Doc. 365. Accordingly, the *Pilcher* and *William Rogers* holdings dictate the result here: the revenue is not a “pass through” and is therefore taxable gross income to the Hospital.

The fact that the Hospital has more than agent liability to NEP also distinguishes this case from *Medical Consultants*.<sup>15</sup> In *Medical Consultants*, a key premise for the court’s conclusion that the revenue at issue was not taxable was the court’s conclusion that the taxpayer had no more than agent liability to the physicians performing the services. 89 Wn. App. at 48. The *Medical Consultants* court looked to Rule 111 to determine whether the revenue was taxable, as numerous prior court decisions also had done. *Id.* Since Rule 111 requires that a taxpayer have no more than agent liability to the third party contractor in order to qualify for “pass through” treatment, it is clear that the outcome in *Medical Consultants* would have been different if the taxpayer there had more than agent liability, as is the case here.

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<sup>15</sup> While the Hospital sets out in table format various facts that it alleges makes *Medical Consultants* similar, it ignores the most significant conclusion in that court’s analysis – that the taxpayer in that case had no more than agent liability to the physicians. *Medical Consultants*, 89 Wn. App. at 45, 48.

Accordingly, *Medical Consultants* provides no support for the Hospital's argument in this case.<sup>16</sup>

The *Walthew* opinion similarly provides no support for the Hospital's argument. The Court in *Walthew* did not suggest that a taxpayer may *always* exclude money it receives for services rendered by a third party, as the Hospital argues. Rather, in *Walthew*, the Court's holding in favor of the law firm turned on the fact that the clients, and not the law firm, were liable for paying the third parties. *Walthew*, 103 Wn.2d at 186-90. As a factual matter, the clients assumed the obligation when they signed contracts with the law firm confirming they would pay those third-party costs. *Id.* at 185. And as a legal matter, the rules of professional responsibility applicable to lawyers required clients to retain ultimate liability for those expenses. *Id.* at 185, 188-89. Thus, when the law firm received funds from clients as an advance or reimbursement of those expenses, the law firm was acting "solely as agent for the client." *Id.* at

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<sup>16</sup> The fact that the Hospital is obligated by contract to pay the emergency room physicians whether or not it receives payment also distinguishes this case from the recently published opinion, *Washington Imaging Services, Inc. v. Dep't of Revenue*, No. 38247-4-II, 2009 WL 4815583 \* 1 (Wa. Ct. App. Div. 2 Dec. 15, 2009). For reasons expressed in briefing in the *Washington Imaging* case and an anticipated petition for review, the Department disagrees with the Court's conclusion in *Washington Imaging* that the taxpayer there had no more than agent liability to the third-party contractor. The Court need not consider those reasons in this case, however, because in this case it is clear that the Hospital must pay the emergency room physicians even if it has not been paid.

188. In contrast, in the present case the Hospital itself was liable to the physicians for payment.

The Hospital also argues that it was merely a collection agent for the emergency room physicians, and therefore the money it collected was not its gross revenue. But the Hospital was not a collecting agent for the emergency room physicians. Instead, the Hospital entered into a contract with NEP under which NEP was to perform physician services at the Hospital's emergency room. BTA Doc. 406. As noted in that agreement, the hospital hired NEP to "develop and deliver *the [Emergency] Department's services.*" *Id.* See also BTA Doc. 407-08 (¶ 2.1) ("[NEP] shall provide such professional services as are necessary for the provision of emergency services at Hospital.") In addition to performing services for which the hospital billed patients, NEP had additional duties relating to hospital administration. BTA Doc. 406. Unlike a collection agency, the Hospital was receiving the payments for services it provided to the community. BTA Doc. 328-330, 406. Moreover, as noted above, the Hospital was obligated to pay NEP regardless of whether it had been able to "collect" the fees for emergency room services. Accordingly, the Hospital was not a collection agent for NEP. The fact that the contract claimed to appoint the Hospital as a collection agent is not dispositive. *Rho*, 113 Wn.2d

at 570 (“Determination of an agency relationship is not controlled by the manner in which the parties contractually describe their relationship.”)

The Hospital also incorrectly states that invoices sent to patients “identified ER physicians as the party billing for emergency-room services.” App. Br. at 7. To the contrary, undisputed facts in the record show that the Hospital made no effort, either in billing documents or otherwise, to inform patients that it was acting as a billing agent for NEP or its physicians. BTA Doc. 332-34, 423 (answer to request for production no. 12). Bills sent to insurance companies for emergency room physician services may have indicated the name of the physician, but payment was made not to the physician, but to the Hospital. The insurance company making the payment had no input or knowledge of how much (if any) of its payment to the Hospital was paid to the named physician and how much to the Hospital. BTA Doc. 335-36, 369.

Moreover, the Hospital was not merely collecting a revenue stream that belonged to NEP and passing it through to NEP, as the Hospital argues. Instead, the Hospital paid NEP a percentage of the amount billed for the prior month pursuant to its contract with NEP. BTA Doc. 411. All of the money that the Hospital collected from patients and insurance companies belonged to the Hospital and the Hospital had no obligation to pass it on.

### 3. The hospital cannot meet the requirements of Rule 111.

As noted above, Rule 111 does not create an exemption but is an application of the definition of “gross income of the business” to a common and recurring situation in which a taxpayer bills for services it has not itself physically performed. Courts have often applied Rule 111 to determine whether money received by a taxpayer for services performed by another should be included in the taxpayer’s gross income. *E.g., Medical Consultants Northwest, Inc. v. Dep’t of Revenue*, 89 Wn. App. 39, 47-48, 947 P.2d 784 (1997); *Walthew*, 103 Wn.2d at 187-88. Tellingly, every one of the cases the Hospital cites in its discussion of the revenue associated with emergency room physicians applied Rule 111 to determine whether the money at issue was taxable gross income. *Medical Consultants*, 89 Wn. App. at 47-48; *Walthew*, 103 Wn.2d at 187-88. Because Rule 111 explains and applies B&O taxing statutes, there is considerable overlap between an analysis based on the statutory definition of “gross income of the business” and one based on Rule 111. Rule 111 allows a taxpayer to exclude from gross income advances<sup>17</sup> or reimbursements<sup>18</sup> that merely “pass through” a business when the taxpayer acts as an agent. An exclusion is allowed

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<sup>17</sup> An “advance” occurs when the taxpayer receives money from the client to pay a future debt of the client. WAC 458-20-111.

<sup>18</sup> A “reimbursement” occurs when the taxpayer pays the client’s debt and then receives reimbursement from the client. WAC 458-20-111.

because “pass-through” income is not attributed to the business activities of the agent. WAC 458-20-111; *William Rogers*, 148 Wn.2d at 175.

Washington courts have paraphrased the requirements of Rule 111 as a three-part test: (1) the payments are customary reimbursements for advances made by the taxpayer to procure a service for the client; (2) the payments involve services that the taxpayer did not or could not render; and (3) the taxpayer is not liable for paying, except as the agent of the client. *Christensen, O'Connor, Garrison & Havelka v. Dep't of Revenue*, 97 Wn.2d 764, 768-69, 649 P.2d 839 (1982).

It is not surprising that the Hospital does not argue that Rule 111 allows the Hospital to exclude its revenue from emergency room physician services, since it is indisputable that the Hospital cannot meet the third prong of the *Christensen* test.<sup>19</sup> The Hospital admitted in answers to interrogatories that it did not act as an agent of its patients receiving care from emergency room physicians. BTA Doc. 192. Moreover, its contract with NEP established more than agent liability to NEP. As discussed above, the

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<sup>19</sup> The Department believes that the Hospital cannot meet any prongs of the *Christensen* test but focuses on the third prong because it is dispositive in this case and is the part of the test that recent court opinions focus on. The Hospital cannot meet the first part of the test because the payments by patients were not advances or reimbursements but were payments to the Hospital for Hospital services received. *See Pilcher*, 112 Wn. App. at 439. The Hospital cannot meet the second part of the test because, as the *Pilcher* court noted, a taxpayer can provide services through an independent contractor, as the Hospital did here. *Id.* at 440. The agreement between the Hospital and NEP specifically stated that NEP was hired to develop and deliver Hospital services. BTA Doc. 406. Moreover, the Hospital held itself out to the community as providing emergency medical services, which a reasonable person would assume includes physician services. BTA Doc. 328-30.

Hospital was obligated to pay NEP regardless of whether it received payment from patients. If the Hospital had only agent liability, it could not be liable for more than what the patients (as the principals) actually paid. *See Pilcher*, 112 Wn. App. at 437, 441; *William Rogers*, 148 Wn.2d at 178. Accordingly, the Hospital's contractual obligation to pay NEP, regardless of what patients and their insurers actually paid to the Hospital, establishes more than agent liability.

**4. Prior Board of Tax Appeals decisions support the Department.**

In addition to the Board decision appealed in this case, the Board has held in other recent cases with nearly identical facts that money collected by hospitals for emergency room physician services is taxable gross income of the hospitals. *See Northwest Hospital Medical Center v. Dep't of Revenue*, No. 01-144; *Sacred Heart Medical Center v. Dep't of Revenue*, No. 01-147; *Dominican Health Services dba Holy Family Hospital v. Dep't of Revenue*, No. 01-149 (final decision entered November 30, 2005).<sup>20</sup> Board decisions can be persuasive authority to this Court. *Seattle FilmWorks, Inc. v. Dep't of Revenue*, 106 Wn. App. 448, 459, 24 P.3d 460 (2001). In each of these cases, the Board held that the hospitals had more than mere agent liability to the emergency room physicians because the hospitals paid the

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<sup>20</sup> All three cases were addressed in a single order. The order can be found at BTA Doc. 482-96.

physicians a percentage of gross billings rather than the amount the hospital actually collected. BTA Doc. 493. The Department respectfully requests that this Court follow the correct reasoning of the Board in this case.

**E. The Hospital Is Not Entitled to Attorney Fees.**

If the Court affirms the Board of Tax Appeals, it need not reach the issue of the Hospital's request for costs and reasonable attorney fees. Nevertheless, the Department addresses the Hospital's request for costs and reasonable attorney fees on appeal.

The Hospital fails to comply with RAP 18.1 by failing to cite any applicable authority supporting its request for attorney fees. Instead, the Hospital cites only RAP 18.1 itself as support for its fee request. App. Br. at 24. A party seeking reasonable attorney fees must support its request by citing to authority and providing argument to the court. *Just Dirt, Inc. v. Knight Excavating Inc.*, 138 Wn. App. 409, 420, 157 P.3d 431 (2007) (“Argument and citation to authority are required . . . to advise us of the appropriate grounds for an award of attorney fees as costs.”) (quoting *Wilson Court Ltd. P'ship v. Tony Maroni's, Inc.*, 134 Wn.2d 692, 710, n.4, 952 P.2d 590 (1998)). Because it failed to cite to any applicable law creating a right to recover attorney fees, the Hospital's request for attorney fees should be denied. *See also Whidbey Gen. Hosp. v. Dep't of Revenue*,

143 Wn. App. 620, 637, 180 P.3d 796 (2008) (Hospital's request for attorney fees denied because it failed to cite applicable law and devote a section of its brief to the request for attorney fees).

Under Washington law, "a court has no power to award attorney fees in the absence of contract, statute, or recognized ground of equity providing for attorney fees." *Union Elevator & Warehouse Co., Inc. v. Dep't of Transp.*, 152 Wn. App. 199, 208, 215 P.3d 257 (2009) (citing *Wagner v. Foote*, 128 Wn.2d 408, 416, 908 P.2d 884 (1996)). Even though the Hospital fails to cite to any applicable authority authorizing an award of attorneys fees in its opening brief, as required by RAP 18.1, it might attempt to rely on the Equal Access to Justice Act ("EAJA") in its reply brief.<sup>21</sup> That statute provides, "[A] court shall award a qualified party that prevails in a judicial review of an agency action fees and other expenses, including reasonable attorneys' fees, unless the court finds that the agency action was substantially justified." RCW 4.84.350. The requirement of "judicial review of an agency action" would be met in this case.

However, the Hospital must also demonstrate that it is a "qualified party that prevails." Even if the Hospital were to prevail in this matter, it

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<sup>21</sup> The Hospital cited the EAJA, RCW 4.84.350, in its Petition for Judicial Review before the superior court. CP 8. However, nowhere in its briefing before the superior court did it devote a section of its brief to a request for attorney fees. *See* CP 38-54; 128-37.

would also need to establish that it is a “qualified party” as defined under RCW 4.84.340(5). Even if it could satisfy that requirement, the Hospital still should not be entitled to a fee award because the Board’s action was at least “substantially justified” under RCW 4.84.350(1). Here, the Department must demonstrate that the Board’s position is reasonable in law and fact. *Union Elevator & Warehouse Co., Inc. v. Dep’t of Trans.*, 144 Wn. App. 593, 608, 183 P.3d 1097 (2008). The Board’s decision denying the Hospital the deduction for Medicare co-payments and deductibles was reasonable in law and fact, in that three different Superior Court Judges affirmed the Board on this issue. CP 107-08 (Order on Petition for Judicial Review (May 29, 2009) (McPhee, J.)); *St. Joseph General Hospital v. Dep’t of Revenue*, Thurston Cy. Super. Ct. No. 08-2-02054-9, Order on Petition for Judicial Review (June 8, 2009) (Hicks, J.); *Skagit County Public Hospital Dist. No. 1 dba Skagit Valley Medical Center v. Dep’t of Revenue*, Thurston Cy. Super. Ct. No. 08-2-02527-3, Order on Petition for Judicial Review (July 10, 2009) (Murphy, J.). Moreover, the Board’s decision that money received for emergency room physician services is taxable gross income was substantially justified given the previous Board decisions cited above, none of which has been reversed. The Board’s action was substantially justified and attorney fees and costs should not be awarded to the Hospital under the EAJA.

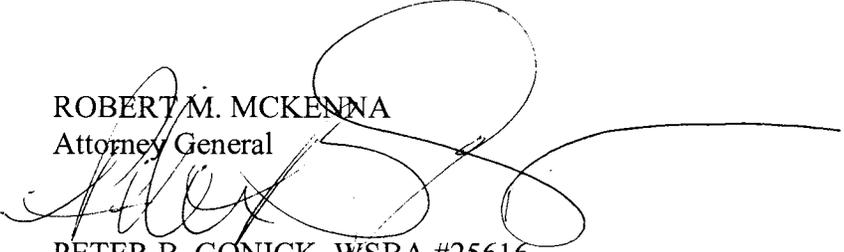
## VI. CONCLUSION

Hospital patients who pay their own bills are not instrumentalities of the federal government. Nor are patients' insurance companies that make payments on behalf of the patients instrumentalities of the federal government. Accordingly, the Hospital is not entitled to a deduction from gross income that applies only to monies received "from the United States or any instrumentality thereof." Furthermore, money the hospital received for emergency room services performed by physicians is taxable gross income because the Hospital did not "pass on" the collected money to the physicians but instead paid the physicians a contractually agreed upon amount regardless of the amount actually collected.

The Department respectfully requests that this Court affirm the decisions of the Superior Court and Board of Tax Appeals.

RESPECTFULLY SUBMITTED this 31<sup>st</sup> day of December, 2009.

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# APPENDIX 1

Intent—1980 c 37: See note following RCW 82.04.4281.

**82.04.4295 Deductions—Manufacturing activities completed outside the United States.** In computing tax there may be deducted from the measure of tax by persons subject to payment of the tax on manufacturers pursuant to RCW 82.04.240, the value of articles to the extent of manufacturing activities completed outside the United States, if:

- (1) Any additional processing of such articles in this state consists of minor final assembly only; and
- (2) In the case of domestic manufacture of such articles, can be and normally is done at the place of initial manufacture; and
- (3) The total cost of the minor final assembly does not exceed two percent of the value of the articles; and
- (4) The articles are sold and shipped outside the state. [1980 c 37 § 15. Formerly RCW 82.04.430(14).]

Intent—1980 c 37: See note following RCW 82.04.4281.

**82.04.4296 Deductions—Reimbursement for accommodation expenditures by funeral homes.** In computing tax there may be deducted from the measure of tax that portion of amounts received by any funeral home licensed to do business in this state which is received as reimbursements for expenditures (for goods supplied or services rendered by a person not employed by or affiliated or associated with the funeral home) and advanced by such funeral home as an accommodation to the persons paying for a funeral, so long as such expenditures and advances are billed to the persons paying for the funeral at only the exact cost thereof and are separately itemized in the billing statement delivered to such persons. [1980 c 37 § 16. Formerly RCW 82.04.430(15).]

Intent—1980 c 37: See note following RCW 82.04.4281.

**82.04.4297 Deductions—Compensation from public entities for health or social welfare services—Exception.** In computing tax there may be deducted from the measure of tax amounts received from the United States or any instrumentality thereof or from the state of Washington or any municipal corporation or political subdivision thereof as compensation for, or to support, health or social welfare services rendered by a health or social welfare organization or by a municipal corporation or political subdivision, except deductions are not allowed under this section for amounts that are received under an employee benefit plan. [1988 c 67 § 1, 1980 c 37 § 17. Formerly RCW 82.04.430(16).]

Intent—1980 c 37: See note following RCW 82.04.4281.

*"Health or social welfare organization" defined for RCW 82.04.4297—Conditions for exemption—"Health or social welfare services" defined: RCW 82.04.431.*

**82.04.4298 Deductions—Repair, maintenance, replacement, etc., of residential structures and commonly held property—Eligible organizations.** (1) In computing tax there may be deducted from the measure of tax amounts used solely for repair, maintenance, replacement, management, or improvement of the residential structures and commonly held property, but excluding property where fees or charges are made for use by the public who are not guests accompanied by a member, which are derived by:

(a) A cooperative housing association, corporation, or partnership from a person who resides in a structure owned by the cooperative housing association, corporation, or partnership;

(b) An association of owners of property as defined in RCW 64.32.010, as now or hereafter amended, from a person who is an apartment owner as defined in RCW 64.32.010; or

(c) An association of owners of residential property from a person who is a member of the association. "Association of owners of residential property" means any organization of all the owners of residential property in a defined area who all hold the same property in common within the area.

(2) For the purposes of this section "commonly held property" includes areas required for common access such as reception areas, halls, stairways, parking, etc., and may include recreation rooms, swimming pools and small parks or recreation areas; but is not intended to include more grounds than are normally required in a residential area, or to include such extensive areas as required for golf courses, campgrounds, hiking and riding areas, boating areas, etc.

(3) To qualify for the deductions under this section:

(a) The salary or compensation paid to officers, managers, or employees must be only for actual services rendered and at levels comparable to the salary or compensation of like positions within the county wherein the property is located;

(b) Dues, fees, or assessments in excess of amounts needed for the purposes for which the deduction is allowed must be rebated to the members of the association;

(c) Assets of the association or organization must be distributable to all members and must not inure to the benefit of any single member or group of members. [1980 c 37 § 18. Formerly RCW 82.04.430(17).]

Intent—1980 c 37: See note following RCW 82.04.4281.

**82.04.431 "Health or social welfare organization" defined for RCW 82.04.4297—Conditions for exemption—"Health or social welfare services" defined.** (1) For the purposes of RCW 82.04.4297, the term "health or social welfare organization" means an organization, including any community action council, which renders health or social welfare services as defined in subsection (2) of this section, which is a not-for-profit corporation under chapter 24.03 RCW and which is managed by a governing board of not less than eight individuals none of whom is a paid employee of the organization or which is a corporation sole under chapter 24.12 RCW. Health or social welfare organization does not include a corporation providing professional services as authorized in chapter 18.100 RCW. In addition a corporation in order to be exempt under RCW 82.04.4297 shall satisfy the following conditions:

(a) No part of its income may be paid directly or indirectly to its members, stockholders, officers, directors, or trustees except in the form of services rendered by the corporation in accordance with its purposes and bylaws;

(b) Salary or compensation paid to its officers and executives must be only for actual services rendered, and at levels comparable to the salary or compensation of like positions within the public service of the state;

# APPENDIX 2

Westlaw

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**H**

United States Court of Appeals,  
Ninth Circuit.  
UNITED STATES of America, Plaintiff-Appellee,  
v.  
CITY OF SPOKANE, Defendant-Appellant.  
No. 90-35118.

Argued and Submitted Oct. 5, 1990.  
Decided Oct. 31, 1990.  
As Amended on Grant of Appellee's Motion For  
Clarification Nov. 27, 1990.

United States brought action against city to preclude its collection of tax on lawfully conducted gambling activities of local unit of Red Cross and to recover back taxes. The United States District Court for the Eastern District of Washington, Justin L. Quackenbush, Chief Judge, 734 F.Supp. 919, granted summary judgment in favor of United States, and city appealed. The Court of Appeals, Fernandez, Circuit Judge, held that: (1) Red Cross was instrumentality of United States that was immune from local taxation, and (2) city had to return taxes collected.

Affirmed.

West Headnotes

**[1] Federal Courts 170B ⇨776**

170B Federal Courts  
170BVIII Courts of Appeals  
170BVIII(K) Scope, Standards, and Extent  
170BVIII(K)1 In General  
170Bk776 k. Trial De Novo. Most  
Cited Cases  
Grant of summary judgment is reviewed de novo.

**[2] Federal Courts 170B ⇨776**

170B Federal Courts  
170BVIII Courts of Appeals

170BVIII(K) Scope, Standards, and Extent  
170BVIII(K)1 In General  
170Bk776 k. Trial De Novo. Most  
Cited Cases

**Federal Courts 170B ⇨850.1**

170B Federal Courts  
170BVIII Courts of Appeals  
170BVIII(K) Scope, Standards, and Extent  
170BVIII(K)5 Questions of Fact, Verdicts  
and Findings  
170Bk850 Clearly Erroneous Findings  
of Court or Jury in General  
170Bk850.1 k. In General. Most  
Cited Cases

(Formerly 170Bk850)

On constitutional questions, Court of Appeals reviews findings of fact for clear error, and mixed questions of fact and law de novo.

**[3] Federal Courts 170B ⇨776**

170B Federal Courts  
170BVIII Courts of Appeals  
170BVIII(K) Scope, Standards, and Extent  
170BVIII(K)1 In General  
170Bk776 k. Trial De Novo. Most  
Cited Cases  
Questions of law are reviewed de novo.

**[4] Taxation 371 ⇨2006**

371 Taxation  
371I In General  
371k2004 Power of State  
371k2006 k. United States Entities, Property, and Securities. Most Cited Cases  
(Formerly 371k5)  
No state can impose tax upon instrumentality of United States Government.

**[5] Taxation 371 ⇨2006**

371 Taxation

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## 371I In General

371k2004 Power of State

371k2006 k. United States Entities, Property, and Securities. Most Cited Cases  
(Formerly 371k6)

Red Cross was instrumentality of United States that was immune from state and local taxation on lawfully conducted gambling activities despite city's reference to fact that Red Cross was not considered agency for purposes of Freedom of Information Act. 5 U.S.C.A. § 552.

## [6] Courts 106 ⇌ 100(1)

## 106 Courts

106II Establishment, Organization, and Procedure

106II(H) Effect of Reversal or Overruling

106k100 In General

106k100(1) k. In General; Retroactive or Prospective Operation. Most Cited Cases  
Court of Appeals' decision striking down city's tax on Red Cross' lawfully conducted gambling activities could be applied retroactively; decision did not establish new principle of law but merely restated fundamental principle that precluded taxation of United States governmental functions, and retroactive application would foster respect for such principle and would not result in inequity even though city might have already used some tax money.

## [7] Taxation 371 ⇌ 3555

## 371 Taxation

371VIII Income Taxes

371VIII(H) Payment

371k3555 k. Refunding Taxes Paid. Most Cited Cases  
(Formerly 371k1097)

City that improperly taxed Red Cross' lawfully conducted gambling activities had to return taxes collected.

\*85 Laurie Flinn Connelly and Michael A. Nelson, Asst. City Attys., Spokane, Wash., for defendant-appellant.

Gary R. Allen, David English Carmack, and Kenneth W. Rosenberg, Attys., Tax Div., U.S. Dept. of Justice, Washington, D.C., for plaintiff-appellee.

Appeal from the United States District Court for the Eastern District of Washington.

Before SKOPIL, O'SCANNLAIN and FERNANDEZ, Circuit Judges.

FERNANDEZ, Circuit Judge:

The United States brought this action against the City of Spokane ("the City") and Spokane's Manager of Finance, Peter Fortin, to preclude the collection of a tax on the gambling proceeds of a local unit of the American National Red Cross, and to recover back taxes, together with interest. The district court granted summary judgment in favor of the United States<sup>FN1</sup> and the City appealed. We affirm.

FN1. *United States v. City of Spokane*, 734 F.Supp. 919 (E.D.Wash.1989).

## BACKGROUND

The American National Red Cross is a unique charitable institution. It was created by the United States to perform such exceedingly important public functions as aiding "the sick and wounded of Armed Forces in time of war," and carrying on "a system of national and international relief in time of peace" to mitigate "the sufferings caused by pestilence, famine, fire, floods, and other great national calamities..." 36 U.S.C. § 3. Eight of its fifty governors are appointed by the President of the United States and one of those eight acts as the principal officer of the corporation. 36 U.S.C. § 5(a). While the organization must support itself from public donations and other sources, the United States does supply it with a permanent headquarters\*86 building. 36 U.S.C. § 13. The financial reports of the organization are audited by the Department of De-

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fense. 36 U.S.C. § 6.

The Inland Northwest Chapter of the American National Red Cross has been a chartered local organization since 1914. As such it is a local unit of the American National Red Cross. 36 U.S.C. § 4a. We will hereafter refer to the American National Red Cross as the "Red Cross" and the Chapter as the "INC." However, since the INC is a unit of the Red Cross, what we say about the rights and duties of the Red Cross also applies to the INC.

The State of Washington authorizes bona fide charitable or non-profit organizations to conduct bingo, pull-tab, and punchboard games. Wash.Rev.Code § 9.46.0311 (1988).<sup>FN2</sup> The Red Cross is an organization that comes within that definition. Wash.Rev.Code § 9.46.0209. At the same time, the State of Washington authorizes cities to tax certain of the proceeds of those gambling activities—Wash.Rev.Code § 9.46.110—and since 1982 the City has levied a gambling tax upon the INC. Spokane, Wash.Ord. § 8.40.020 (1982).

FN2. The citations to the Washington Code are to the current version of that law. Earlier versions were to the same effect, as far as the issues on this appeal are concerned.

For some time, the INC paid that tax without apparent protest, but in February of 1986 it did protest and requested a refund of all gambling taxes paid since July 1, 1980. The request was denied. The United States then brought this action to obtain the refund, with interest, and to enjoin any further levies.

Cross motions for summary judgment were filed, and the district court ultimately entered a judgment which required the disgorgement of prior exactions by the City, together with prejudgment interest from the date of the demand for refund. The district court further directed that the City cease further imposition of the tax. This appeal followed.

#### JURISDICTION AND STANDARD OF REVIEW

The district court had jurisdiction pursuant to 28 U.S.C. § 1331, and we have jurisdiction pursuant to 28 U.S.C. § 1291.

[1][2][3] We review the grant of summary judgment de novo. *Kruso v. International Tel. & Tel.*, 872 F.2d 1416, 1421 (9th Cir.1989), *cert. denied*, 496 U.S. 937, 110 S.Ct. 3217, 110 L.Ed.2d 664 (1990). On constitutional questions, this court reviews findings of fact for clear error, and mixed questions of fact and law de novo. *State of Nevada Employees Ass'n Inc. v. Keating*, 903 F.2d 1223, 1226 (9th Cir.1990); *La Duke v. Nelson*, 762 F.2d 1318, 1322 (1985), *modified*, 796 F.2d 309 (9th Cir.1986). Questions of law are reviewed de novo. *United States v. McConney*, 728 F.2d 1195, 1201 (9th Cir.) (en banc), *cert. denied*, 469 U.S. 824, 105 S.Ct. 101, 83 L.Ed.2d 46 (1984).

#### DISCUSSION

Two major issues confront us. First, is the Red Cross an instrumentality of the United States which is immune from this kind of taxation? Second, if it is, should the INC have been granted a refund of the back taxes? We will discuss each of these issues in turn.

##### A. *The Red Cross Is Immune from This Tax*

[4][5] One of the hoariest principles of federal-state governmental relations is that no state can impose a tax upon an instrumentality of the United States Government. As the Supreme Court, speaking through Chief Justice Marshall, eloquently stated in *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 431, 4 L.Ed. 579 (1819), that principle is bottomed upon certain important axioms:

That the power to tax involves the power to destroy; that the power to destroy may defeat and render useless the power to create; that there is a plain repugnance in conferring on one government a power to control the constitutional measures of another, which other, with respect to those very

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measures, is \*87 declared to be supreme over that which exerts the control, are propositions not to be denied.

Nor can it be said that a little taxation, or taxation of just one function or instrumentality, is proper. *M'Culloch* also dealt with those possibilities. The Court said:

We are not driven to the perplexing inquiry, so unfit for the judicial department, what degree of taxation is the legitimate use, and what degree may amount to the abuse of the power. The attempt to use it on the means employed by the government of the Union, in pursuance of the constitution, is itself an abuse, because it is the usurpation of a power which the people of a single state cannot give.

*M'Culloch*, 17 U.S. (4 Wheat.) at 430. The Court continued:

If the states may tax one instrument, employed by the government in the execution of its powers, they may tax any and every other instrument. They may tax the mail; they may tax the mint; they may tax patent-rights; they may tax the papers of the custom-house; they may tax judicial process; they may tax all the means employed by the government, to an excess which would defeat all the ends of government. This was not intended by the American people. They did not design to make their government dependent on the states.

*M'Culloch*, 17 U.S. (4 Wheat.) at 432.

Nothing could be more forcefully established, and while those principles alone do not demonstrate that the Red Cross is an instrumentality of the United States, there can be no doubt that it is. The Supreme Court made that clear in *Department of Employment v. United States*, 385 U.S. 355, 358, 87 S.Ct. 464, 467, 17 L.Ed.2d 414 (1966) where it said, "[W]e hold that the Red Cross is an instrumentality of the United States for purposes of immunity from state taxation levied on its operations, and that this immunity has not been waived by congressional enactment."

At first blush that would appear to dispose of this issue, but the City claims that accretions to the *M'Culloch* doctrine make it inapplicable to the INC activities which were taxed here. That claim is based upon a misreading of the authorities.

The City first points to *Federal Land Bank v. Board of County Comm'rs*, 368 U.S. 146, 82 S.Ct. 282, 7 L.Ed.2d 199 (1961), a case in which the Supreme Court struck down a tax levy on the Federal Land Bank, an instrumentality of the United States. In so doing, the Court indicated that if the activity being performed is not within the authority granted to the instrumentality, for example if it were illegal, taxation may be appropriate. *Federal Land Bank*, 368 U.S. at 152-56, 82 S.Ct. at 287-89. That, however, has no application whatever to this case. There can be no doubt that the Red Cross can engage in activities designed to earn money. In fact, because it is not, for the most part, funded with tax dollars, it must engage in many fund raising activities if it is to survive. While we do not suggest that the Red Cross can engage in illegal activities in pursuit of its goals, there is nothing illegal about the gambling activities the INC engaged in here.

But the City claims that there is still another string to its bow, for some activities of agencies of the United States can be taxed. Here again, when gazing upon the authorities cited one must be purblind if one is to overlook the distinctions between those authorities and this case.

Thus, in *James v. Dravo Contracting Co.*, 302 U.S. 134, 58 S.Ct. 208, 82 L.Ed. 155 (1937), a private independent corporation that had contracts with the United States complained about the taxation of its gross receipts. The Court declined to find that a tax on the private entity was a tax upon the government or its instrumentalities, even though the effect of the tax could, in theory, be felt by the government. *James*, 302 U.S. at 161, 58 S.Ct. at 221. That is not this case; the Red Cross is no mere private contractor, it is a United States instrumentality. The same analysis applies to *United States v. New Mexico*, 455 U.S. 720, 102 S.Ct. 1373, 71 L.Ed.2d 580

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(1982). There, too, a tax on the receipts of private contractors was attacked; there, too, the tax was sustained. The Court indicated \*88 that the mere fact that a contractor acts as an agent of the government does not mean that it is an agency or instrumentality of the government. It does not mean that the contractor stands in the government's shoes. 455 U.S. at 735-36, 102 S.Ct. at 1383. The entities in question were not so integrated into the structure of the government that its tax immunity devolved upon them. Rather, it was realistic to view them as the private entities they were—entities “independent of the United States.” 455 U.S. at 738, 102 S.Ct. at 1385. When dealing with entities of that stripe, it is necessary to be extremely careful about parsing their various activities when they claim that a tax falls directly on the United States. The same does not apply when one is dealing with an acknowledged government instrumentality such as the Red Cross. To do so in that instance would engage the courts in the unfit inquiry that *M'Culloch* warned against. 17 U.S. (4 Wheat.) at 430. Private independent contractors may be agencies because they act as agents. They are not to be confused with instrumentalities like the Red Cross which are agencies because they were created to carry out functions of the government itself and are, therefore, imbedded in the structure of the government to that extent. <sup>FN3</sup> As the Supreme Court has said, “both the President and Congress have recognized and acted in reliance upon the Red Cross' status virtually as an arm of the Government.” *Department of Employment*, 385 U.S. at 359-60, 87 S.Ct. at 467. The Court agreed with that characterization.

FN3. *California State Bd. of Equalization v. Sierra Summit, Inc.*, 490 U.S. 844, 109 S.Ct. 2228, 104 L.Ed.2d 910 (1989), and *Washington v. United States*, 460 U.S. 536, 103 S.Ct. 1344, 75 L.Ed.2d 264 (1983), which also uphold taxation of a bankruptcy trustee's sales and private construction contractors' income, respectively, apply the same principles and are to the same effect.

In a final bid to deflect the inexorable force of the law in this area, the City asserts that the Red Cross is not really a tax exempt instrumentality of the government, because we have said that it is not an agency for the purposes of the Freedom of Information Act. See *Irwin Memorial Blood Bank v. American Nat'l Red Cross*, 640 F.2d 1051, 1057 (9th Cir.1981). That is an astonishing proposition. It suggests that we, in effect, overturned *Department of Employment* when we decided *Irwin Memorial Blood Bank*. We did no such thing. What we did decide was that given the purposes and the background of the Freedom of Information Act, the Red Cross was not an agency within the meaning of that statute. To extrapolate from that holding to the area of the law which we must deal with here would be a serious logical and semantic error. It would insist that an entity incorporated by an act of Congress to carry out essentially public functions is not exempt from taxation as it struggles to accomplish those purposes. It would insist upon that even when the entity's activities are lawful, necessary and in pursuit of its duties as an instrumentality of the United States. It would insist upon that based on the fallacy that a word which has a meaning in one context must have the selfsame meaning when transplanted to an entirely different context. We must eschew that extrapolation.

It follows that the City improperly imposed the gambling tax upon INC.

#### B. *The City Must Disgorge the Taxes It Collected*

The City asserts that even if the tax is invalid, it should not be required to reimburse the INC for the taxes which have already been collected. Discussion of that claim requires analysis of two sub-issues. Should the decision here be given retroactive effect, and, if so, what remedy is proper?

While the issues sometimes seem to be entangled, the Supreme Court has recently been at some pains to untangle them. See *American Trucking Ass'ns, Inc. v. Smith*, 496 U.S. 167, 110 S.Ct. 2323, 110

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(Cite as: 918 F.2d 84)

Page 6

L.Ed.2d 148 (1990). In *American Trucking*, the Court pointed out that retroactivity must be decided by use of the analysis outlined in *Chevron Oil Co. v. Huson*, 404 U.S. 97, 92 S.Ct. 349, 30 L.Ed.2d 296 (1971). That does not, however, answer the remedy \*89 question, a question usually left to the states themselves to work out. *American Trucking*, 110 S.Ct. at 2330. See also *Probe v. State Teachers' Retirement Sys.*, 780 F.2d 776, 782-84 (9th Cir.), cert. denied, 476 U.S. 1170, 106 S.Ct. 2891, 90 L.Ed.2d 978 (1986), where we, in effect, recognized and applied the distinctions.

[6] Because we need not consider the question of remedy if the effect of our decision is not retroactive, we will first consider retroactivity.<sup>FN4</sup>

FN4. There is much jurisprudential debate about the propriety of any such analysis in the area of the constitution. See *American Trucking*, 110 S.Ct. at 2343 (Scalia, J., concurring). We, of course, cannot enter the arena. We leave the battle to other gladiators.

Our retroactivity analysis must apply the three-part *Chevron Oil* test:

First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied ... or by deciding an issue of first impression whose resolution was not clearly foreshadowed.... Second, it has been stressed that "we must ... weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." ... Finally, we have weighed the inequity imposed by retroactive application, for "[w]here a decision ... could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity."

404 U.S. at 106-07, 92 S.Ct. at 355 (citations omit-

ted).

Our decision striking down this tax does not meet the tests of nonretroactivity. We overrule no precedent here and we do not decide an issue of first impression. As we have shown, our determination regarding the status of the Red Cross does not proceed from some obscure and half-formed idea only now wrested into the light of day. Rather, it proceeds from a long, if sometimes wavy, line of Supreme Court authority. This alone indicates that retroactivity is required. See *Ashland Oil, Inc. v. Caryl*, 497 U.S. 916, 110 S.Ct. 3202, 3205, 111 L.Ed.2d 734 (1990) (per curiam). However, we will also look to the other elements. We are dealing with a fundamental principle that precludes the taxation of United States governmental functions. Retroactive operation of our decision will surely foster a proper respect for that principle by encouraging local entities to tread carefully when they impose taxes on entities like the Red Cross. Finally, no inequity results from retroactive application. It is true that the City may already have used the tax money, but at the very least it should have entertained the gravest doubts about its right to collect the tax in the first place. Against that is the inequity to the INC which would be wrought were it forced to forego its claim to recover.<sup>FN5</sup> Therefore, this decision will apply retroactively.

FN5. There is no assertion that this action is barred by the statute of limitations. Nor is there a claim that payment under protest was required by Washington law. Cf. *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18, 110 S.Ct. 2238, 2243-44 n. 4, 110 L.Ed.2d 17 (1990).

[7] We turn then to the question of relief. That the INC is entitled to relief can hardly be questioned. It is true that the exact form of relief is often left to the local governmental entity when a tax is struck down as unconstitutional. However, that is typically done in cases where there is a commerce clause violation which can be remedied in any one of a num-

918 F.2d 84  
(Cite as: 918 F.2d 84)

ber of ways. See, e.g., *Ashland Oil*, 110 S.Ct. at 3205; *American Trucking*, 110 S.Ct. at 2330; *McKesson Corp.*, 110 S.Ct. at 2252. That approach has no application here, for here, purely and simply, a tax has been exacted from a federal instrumentality. The only logical relief, aside from precluding further taxation, is to order the improperly taken monies refunded. That was the course adopted in *Department of Employment*, 385 U.S. at 357, 87 S.Ct. at 466. It is the course the district court adopted; it is the course we adopt today.

**\*90 CONCLUSION**

The Red Cross is a United States Government instrumentality which is immune from state and local taxation when it is lawfully pursuing its mandated purposes. Here, the INC was engaged in fundraising by lawfully conducting certain gambling activities. The City erred when it levied a tax on those activities.

Thus, the City must cease making that levy and must refund back taxes paid by the INC since November 21, 1982, together with interest from February 28, 1986, the date that the INC made its demand.

AFFIRMED.

C.A.9 (Wash.), 1990.  
U.S. v. City of Spokane  
918 F.2d 84

END OF DOCUMENT

# APPENDIX 3

# New International Dictionary

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Library of Congress Cataloging in Publication Data  
Main entry under title:

Webster's third new international dictionary of  
the English language, unabridged.

Includes index.  
I. English language—Dictionaries. I. Gove,  
Philip Babcock, 1902-1972. II. G. & C. Merriam Company.  
PE1625.W36 1981 423 81-16878  
ISBN 0-87779-201-1 (blue Sturdic)  
ISBN 0-87779-206-2 (imperial buckram) AACR2

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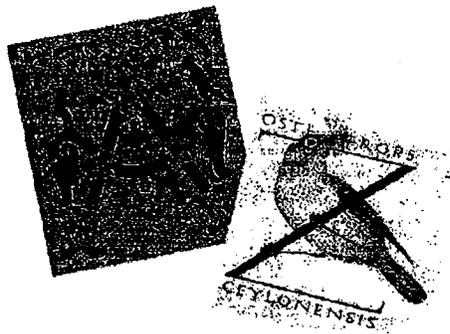
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# APPENDIX 4

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*of the English Language*

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*Library of Congress Cataloging-in-Publication Data*

The American Heritage dictionary of the English language.—4th ed.  
p. cm.  
ISBN 0-395-82517-2 (hardcover) — ISBN 0-618-08230-1  
(hardcover with CD ROM)  
1. English language—Dictionaries  
PE1628 .A623 2000  
423—dc21

00-025369

Manufactured in the United States of America

*instans*, *instans*, present. See INSTANT.] —*in'stan'tə'ne'osity* (in-stān'-tə-nē'ōs-ē-tē, in'stān'-tə-nē'ōs-ē-tē) *n.* —*in'stan'tə'ne'ously* *adv.* —*in'stan'tə'ne'ous'ness* *n.*

**in'stan'ter** (in-stān'tēr) *adv.* Without delay; instantly. [Medieval Latin, from Latin, urgently, from *instans*, *instans*, present. See INSTANT.]

**in'stan'tiate** (in-stān'tshē-āt) *v.* -at-ed, -at-ing, -ates To represent (an abstract concept) by a concrete or tangible example: "Two apples . . . both instantiate the single universal redness" (J. Holloway). [Latin *instans*, example; see INSTANCE + -ATE.] —*in'stan'ti'a'tion* *n.* —*in'stan'ti'a'tive* (-stān'shā-tiv) *adj.*

**in'stant'ly** (in'stān-tlē) *adv.* 1. At once. 2. With insistence; urgently. *☞ conj.* Chiefly British As soon as.

**instant replay** *n.* 1a. The recording and immediate playback of part of a live television broadcast, as of a sports play. b. The part so recorded and replayed. 2. Informal Something repeated directly or soon after its original occurrence.

**in'star'** (in-stār') *v.* -starred, -star'ring, -stars To stud with or as if with stars.

**in'star'** (in'stār') *n.* A stage of an insect or other arthropod between molts. [New Latin *instans*, from Latin *instare*, *instare*, to press.]

**in'state** (in-stāt) *v.* -stat-ed, -stat'ing, -states To establish in office; install.

**in'stau'ra-tion** (in'stō-rā'shən) *n.* 1. Renovation; restoration. 2. The institution or establishment of something. [Latin *instauratio*, *instauratio*, from *instaurare*, past participle of *instaurare*, to renew. See *stā* in Appendix I.]

**in'stead** (in-stēd') *adv.* 1. In the place of something previously mentioned; as a substitute or an equivalent: *Having planned to drive, we walked instead.* 2. In preference; as an alternative: *yearned instead for a home and family.* [Middle English *in sted*, in place of: *in*, *in*; see *in'* + *stede*, place; see *stead* + *of*, *off*; see *OF*.]

**instead of prep.** In place of; rather than: *ordered chicken instead of fish.*

**in'step** (in'stēp') *n.* 1. The arched middle part of the human foot between the toes and the ankle. 2. The part of a shoe or stocking covering the instep. [Middle English.]

**in'sti-gate** (in'stī-gāt') *v.* -gat-ed, -gat'ing, -gates 1. To urge on; goad. 2. To stir up; foment. [Latin *instigare*, *instigare*. See *steig-* in Appendix I.] —*in'sti-ga'tion* *n.* —*in'sti-ga'tive* *adj.* —*in'sti-ga'tor* *n.*

**in'still** also **in'stil** (in-sūl') *v.* -stilled, -stille'ing, -stills also -stils 1. To introduce by gradual, persistent efforts; implant: "*Morality . . . may be instilled into their minds*" (Thomas Jefferson). 2. To pour in (medicine, for example) drop by drop. [Middle English *instilleren*, from Latin *instillare*: *in-*, into; see *in-* + *stilla*, to drip, drop (from *stilla*, drop).] —*in'stū'la'tion* (in'stō-lā'shən) *n.* —*in'stū'lar* *n.* —*in'stū'lar'y* *adj.*

**in'stinct** (in'stīngkt') *n.* 1. An inborn pattern of behavior that is characteristic of a species and is often a response to specific environmental stimuli: *the spawning instinct in salmon; altruistic instincts in social animals.* 2. A powerful motivation or impulse. 3. An innate capability or aptitude: *an instinct for tact and diplomacy.* *☞ adj.* (in-s'tīngkt') 1. Deeply filled or imbued: *words instinct with love.* 2. Obsolete Impelled from within. [Middle English, from Latin *instinctus*, impulse, from past participle of *instigare*, to incite: *in-*, intensive pref.; see *in-* + *stingere*, to prick; see *steig-* in Appendix I.]

**in'stinc'tive** (in-s'tīngkt'iv) *adj.* 1. Of, relating to, or prompted by instinct. 2. Arising from impulse; spontaneous and unthinking: *an instinctive mistrust of bureaucrats.* —*in'stinc'tive'ly* *adv.*

**Synonyms** *instinctive, instinctual, impulsive, visceral* These adjectives mean derived from or prompted by a natural tendency or impulse: *an instinctive fear of snakes; instinctual behavior; an impulsive perception; visceral revulsion.* See also synonyms at *spontaneous*.

**in'stinc'tu'al** (in-s'tīngkt'chō-əl) *adj.* Of, relating to, or derived from instinct. See synonyms at *instinctive*. —*in'stinc'tu'al'ly* *adv.*

**in'stitute** (in'stī-tūt', -tyōt') *v.* -tut-ed, -tut'ing, -tutes

1a. To establish, organize, and set in operation. b. To initiate; begin. See synonyms at *found*. 2. To establish or invest in an office or a position. *☞ n.* 1a. Something instituted, especially an authoritative rule or precedent. b. Institutes A digest of the principles or rudiments of a particular subject, especially a legal abstract. 2. An organization founded to promote a cause: *a cancer research institute.* 3a. An educational institution, especially one for the instruction of technical subjects. b. The building or buildings housing such an institution. 4. A usually short, intensive workshop or seminar on a specific subject. [Middle English *instituten*, from Latin *instituere*, *instituere*, to establish: *in-*, *in*; see *in-* + *statuere*, to set up; see *stā-* in Appendix I.] —*in'sti'tut'er*, *in'sti'tu'tor* *n.*

**in'stitu'tion** (in'stī-tū'shən, -tyōt'-) *n.* 1. The act of instituting. 2a. A custom, practice, relationship, or behavioral pattern of importance in the life of a community or society: *the institutions of marriage and the family.* b. Informal One long associated with a specified place, position, or function. 3a. An established organization or foundation, especially one dedicated to education, public service, or culture. b. The building or buildings housing such an organization. c. A place for the care of persons who are destitute, disabled, or mentally ill.

**in'stitu'tion'al** (in'stī-tū'shən-əl, -tyōt'-) *adj.* 1. Of or relating to an institution or institutions. 2. Organized as or forming an institution: *institutional religion.* 3. Characteristic or suggestive of an institution, especially in being uniform, dull, or unimaginative: *institutional*

*furniture; a pale institutional green.* 4. Of or relating to the principal institutes of a subject such as law. —*in'stitu'tion'al'ly* *adv.*

**in'stitu'tion'al-ism** (in'stī-tū'shən-əl-iz'm, -tyōt'-) *n.* Adherence to or belief in established forms, especially belief in dogmatic religion. 2. Use of public institutions for the care of people who are physically or mentally disabled, criminally delinquent, or incapable of independent living. —*in'stitu'tion'al'ist* *n.*

**in'stitu'tion'al-ism** (in'stī-tū'shən-əl-iz'm, -tyōt'-) *v.* -iz-ing, -izes 1a. To make into, treat as, or give the character of an institution to. b. To make part of a structured and usually well-established system: *a society that has institutionalized injustice.* 2. To place (a person) in the care of an institution. —*in'stitu'tion'al'ist* *n.* —*in'stitu'tion'al'ism* *n.*

**instr.** *abbr.* 1. instructor 2. instrument 3. instrumental

**in'stroke** (in'strōk') *n.* An inward stroke, especially a platoon moving away from the crankshaft.

**in'struct** (in-strūkt') *v.* -strūct-ed, -strūct'ing, -strūct-s —*v.* To provide with knowledge, especially in a methodical way. See synonyms at *teach*. 2. To give orders to; direct. —*instr.* To serve as an instructor. [Middle English *instrucen*, from Latin *instruere*, *instruere*, to prepare, instruct: *in-*, on; see *in-* + *struere*, to build; see *ster-* in Appendix I.]

**in'struc'tion** (in-strūk'shən) *n.* 1. The act, practice, or profession of instructing. 2a. Imparted knowledge. b. An imparted or acquired item of knowledge; a lesson. 3. *Computer Science* A sequence of bits that tells a central processing unit to perform a particular operation and to contain data to be used in the operation. 4a. An authoritative direction to be obeyed; an order. Often used in the plural: *had instructions to home by midnight.* b. instructions Detailed directions on procedures read the instructions for assembly. —*in'struc'tion'al* *adj.*

**in'struc'tive** (in-strūkt'iv) *adj.* Conveying knowledge; informative; enlightening. —*in'struc'tive'ly* *adv.* —*in'struc'tive'ness* *n.*

**in'struc'tor** (in-strūkt'or) *n.* 1. One who instructs; a teacher. 2. A college or university teacher who ranks below an assistant professor. —*in'struc'tor'ship* *n.*

**in'strument** (in'strə-mənt) *n.* 1. A means by which something is done; an agency. 2. One used by another to accomplish a purpose; a dupe. 3. An implement used to facilitate work. See synonyms at *tool*. 4. A device for recording, measuring, or controlling, especially such a device functioning as part of a control system. 5. *Music* A device for playing or producing music: a keyboard instrument. 6. A legal document, such as a deed, will, mortgage, or insurance policy. *☞ v.* (-mēnt')

**in'strument'al** (in'strə-mən'tl) *adj.* 1. Serving as a means or agency; implemental: *was instrumental in solving the crime.* 2. Of, relating to, or accomplished with an instrument or tool. 3. *Music* Performed on or written for an instrument. 4. *Grammar* Of, relating to, or being the case used typically to express means, agency, or accompaniment. 5. Of or relating to instrumentalism. *☞ n.* 1a. *Grammar* The instrumental case. b. A word or form in the instrumental case. 2. *Music* A composition for one or more instruments, usually without vocal accompaniment. —*in'strument'al'ly* *adv.*

**in'strument'al-ism** (in'strə-mən'tl-iz'm) *n.* A pragmatic theory that ideas are instrumental that function as guides of action, their validity being determined by the success of the action.

**in'strument'al-ist** (in'strə-mən'tl-ist) *n.* 1. *Music* One who plays an instrument. 2. An advocate or a student of instrumentalism. *☞ adj.* Of, relating to, or advocating instrumentalism.

**in'strument'al-ity** (in'strə-mən'tl-ē-tē) *n.* *pl.* -ties 1. The state or quality of being instrumental. 2. A means; an agency. 3. A subsidiary branch, as of a government, by means of which functions or policies are carried out.

**in'strument'a-tion** (in'strə-mən-tā'shən) *n.* 1. The application or use of instruments. 2. *Music* a. The study and practice of arranging music for instruments. b. The arrangement or orchestration resulting from such practice. c. A list of instruments used in an orchestration. 3a. The study, development, and manufacture of instruments, as for scientific or industrial use. b. Instruments for a specific purpose. 4. Instrumentality.

**Instrument board** *n.* See *Instrument panel*.

**Instrument flying** *n.* Aircraft navigation by reference to instruments only.

**Instrument landing** *n.* An aircraft landing made by means of instruments and ground-based radio equipment only.

**Instrument panel** *n.* A mounted array of instruments used to operate a machine. Especially the dashboard of an automotive vehicle, aircraft, or motorboat. Also called *instrument board*.

**In'sub-or-di-nate** (in'sə-bōr'dī-n-ēt) *adj.* Not submissive to authority: *has a history of insubordinate behavior.* —*in'sub-or-di-nate'ly* *adv.* —*in'sub-or-di-nate'ness* *n.*

**Synonyms** *insubordinate, rebellious, mutinous, factious, seditious* These adjectives mean in opposition to and usually in defiance of established authority. *Insubordinate* implies failure or refusal to recognize or submit to the authority of a superior: *was fired for being insubordinate.* *Rebellious* implies open defiance of authority or resistance to control: *rebellious students demonstrating on campus.* *Mutinous* pertains to revolt against constituted authority, especially that of a naval or military command: *mutinous sailors defying the captain.* *Factious* implies divisive dissent, or disunity within a group or an organization: *"The army has*



Instrument variety of medical instruments

# APPENDIX 5

# Black's Law Dictionary®

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810 Opperman Drive

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St. Paul, MN 55164-0526

1-800-328-9352

Printed in the United States of America

ISBN 0-314-15199-0

ISBN 0-314-15234-2—deluxe



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§ 3-104(a). See NEGOTIABLE INSTRUMENT. 3. A means by which something is achieved, performed, or furthered <an instrument of social equality>.

**inchoate instrument.** An unrecorded instrument that must, by law, be recorded to serve as effective notice to third parties. • Until the instrument is recorded, it is effective only between the parties to the instrument.

**incomplete instrument.** A paper that, although intended to be a negotiable instrument, lacks an essential element. • An incomplete instrument may be enforced if it is subsequently completed. UCC § 3-115. [Cases: Bills and Notes § 144. C.J.S. *Bills and Notes; Letters of Credit* §§ 127, 129-130, 143.]

**indispensable instrument.** The formal written evidence of an interest in intangibles, so necessary to represent the intangible that the enjoyment, transfer, or enforcement of the intangible depends on possession of the instrument.

**perfect instrument.** An instrument (such as a deed or mortgage) that is executed and filed with a public registry.

**sealed instrument.** See SEALED INSTRUMENT.

**instrumental crime.** See CRIME.

**instrumentality, n.** 1. A thing used to achieve an end or purpose. 2. A means or agency through which a function of another entity is accomplished, such as a branch of a governing body.

**instrumentality rule.** The principle that a corporation is treated as a subsidiary if it is controlled to a great extent by another corporation. — Also termed *instrumentality theory*.

**instrumenta noviter reperta** (in-stro-men-tə nov-er-tə ri-por-tə). [Law Latin] *Hist.* Instruments newly discovered. See EX INSTRUMENTIS DE NOVO REPERTIS.

**instrument of accession.** *Int'l law.* A document formally acknowledging the issuing state's consent to an existing treaty, and exchanged with the treaty parties or deposited with a designated state or international organization. See ACCESSION (3).

**instrument of appeal.** *Hist. English law.* A document used to appeal a judgment of divorce rendered by a trial judge of the Probate, Divorce and Admiralty Division to the full panel of the court. • The use of the instrument of appeal ended in 1881, when appeals were taken to the Court of Appeal rather than the full panel of the Probate, Divorce and Admiralty Division.

**instrument of crime.** See CRIMINAL INSTRUMENT.

**instrument of ratification.** *Int'l law.* A document formally acknowledging the issuing state's confirmation and acceptance of a treaty, and exchanged by the treaty parties or deposited with a designated state or international organization. See RATIFICATION (4).

**instrumentum** (in-stroo-men-təm). [Latin] *Hist.* A document, deed, or instrument; esp., a document that is not under seal, such as a court roll.

**insubordination.** 1. A willful disregard of an employer's instructions, esp. behavior that gives the employ-

er cause to terminate a worker's employment. [Cases: Master and Servant § 30(5). C.J.S. *Employer-Employee Relationship* §§ 65, 71.] 2. An act of disobedience to proper authority; esp., a refusal to obey an order that a superior officer is authorized to give.

**in subsidium** (in səb-sid-ee-əm). [Latin] *Hist.* In aid of.

**insufficient evidence.** See EVIDENCE.

**insufficient funds.** See NOT SUFFICIENT FUNDS.

**insula** (in-s[y]ə-lə). *n.* [Latin] *Roman law.* 1. An island. 2. A detached house or block of apartments leased to tenants.

**insular, adj.** 1. Of, relating to, from, or constituting an island <insular origin>. 2. Isolated from, uninterested in, or ignorant of things outside a limited scope <insular viewpoint>.

**insular area.** A territory or commonwealth. • The phrase is used by some writers to denote the geographical area of which the terms *territory* and *commonwealth* are species. See COMMONWEALTH (2); TERRITORY (1).

**insular court.** See COURT.

**insular possession.** See POSSESSION.

**in suo** (in s[y]oo-oh) [Latin] *Hist.* In reference to one's own affairs.

**in suo genere** (in s[y]oo-oh jen-er-ee). [Latin] *Hist.* In their own kind. • The phrase usu. referred to certain writings that were binding even though they lacked the formal requirements.

**in suo ordine** (in s[y]oo-oh or-da-nee). [Latin] *Hist.* In his order.

"In suo ordine . . . A cautioner who is entitled to the benefit of discussion can only be called upon, for fulfillment of the obligation which he guaranteed, in his order — that is, after the principal creditor has been discussed. So, an heir can only be made liable for the moveable debt of his ancestor, after the executor who succeeded to the moveable estate has been discussed, and where the moveable estate has proved insufficient to meet those debts." John Trayner, *Trayner's Latin Maxims* 277 (4th ed. 1908).

**insurable, adj.** Able to be insured <an insurable risk>. — **insurability, n.**

**insurable interest.** See INTEREST (2).

**insurable value.** The worth of the subject of an insurance contract, usu. expressed as a monetary amount. [Cases: Insurance § 2171. C.J.S. *Insurance* §§ 1108-1109, 1204.]

**insurance.** 1. A contract by which one party (*insurer*) undertakes to indemnify another party (*insured*) against risk of loss, damage, or liability arising from the occurrence of some specified contingency, and usu. to defend the insured or to pay for defense regardless of whether the insured is ultimately found liable. • An insured party usu. pays a premium to the insurer in exchange for the insurer's assumption of the insured's risk. Although indemnification provisions are most common in insurance policies, parties to any type of contract may agree on indemnification arrangements. [Cases: Insurance § 1001. C.J.S. *Insurance* § 2.] 2. The amount for which someone or something is covered by such an agreement. — **insure, vb.**

"Insurance, or as it is sometimes called, assurance, is a contract by which one party, for a consideration, which

# APPENDIX 6

property at the time of the granting of the option, as determined by the department of revenue or when the option is held by the United States, or by an appropriate agency thereof.

Passed the House May 9, 1979.

Passed the Senate May 7, 1979.

Approved by the Governor May 17, 1979.

Filed in Office of Secretary of State May 17, 1979.

#### CHAPTER 194

[Substitute House Bill No. 761]

#### CITIES AND COUNTIES—HOME RULE—LEGISLATIVE STUDY

AN ACT Relating to local government; and adding a new chapter to Title 35 RCW.

Be it enacted by the Legislature of the State of Washington:

**NEW SECTION.** Section 1. The Legislature finds that confusion and ambiguity exists in relation to "home rule" powers of cities and counties. The legislature further recognizes that expansion of home rule powers creates questions of conflict and duplication of laws and ordinances, the effects of which are of concern to all the citizens of the state of Washington.

Therefore, the legislature hereby empowers and directs that a joint committee composed of six members of the Senate and six members of the House of Representatives be appointed to study the issue of "home rule." The committee shall be composed of three members of the majority and three members of the minority from each house of the legislature appointed by the President of the Senate and the Speaker(s) of the House of Representatives. The joint committee shall hold hearings and report to the legislature their findings and recommendations on or before February 1, 1981.

Passed the House May 11, 1979.

Passed the Senate April 12, 1979.

Approved by the Governor May 24, 1979.

Filed in Office of Secretary of State May 24, 1979.

#### CHAPTER 195

[House Bill No. 100]

#### STATE ROUTE NUMBER 27

AN ACT Relating to state highway routes; and amending section 24, chapter 51, Laws of 1970 ex. sess. as amended by section 2, chapter 63, Laws of 1975 and RCW 47.17.115.

Be it enacted by the Legislature of the State of Washington:

Section. 1. Section 24, chapter 51, Laws of 1970 ex. sess. as amended by section 2, chapter 63, Laws of 1975 and RCW 47.17.115 are each amended to read as follows:

[ 1754 ]

A state highway to be known as state route number 27 is established as follows:

Beginning at a junction with state route number ((270-at)) 195 in the vicinity of Pullman, thence northerly to a junction with state route number 271 in the vicinity of Oakesdale; also

From a junction with state route number 271 at Oakesdale, thence in a northerly direction by way of Tekoa, Latah, Fairfield, and Rockford to a junction with state route number 90 in the vicinity of Opportunity.

Passed the House March 21, 1979.

Passed the Senate May 11, 1979.

Approved by the Governor May 24, 1979.

Filed in Office of Secretary of State May 24, 1979.

#### CHAPTER 196

[Substitute House Bill No. 302]

#### TAXATION—RATES—EXEMPTIONS—DEDUCTIONS

AN ACT Relating to business and occupation taxation; amending section 82.02.020, chapter 15, Laws of 1961, section 10, chapter 236, Laws of 1967, and section 8, chapter 94, Laws of 1970, 1st ex. sess., and RCW 82.02.020; amending section 82.04.240, chapter 15, Laws of 1961 as last amended by section 3, chapter 281, Laws of 1971 ex. sess. and RCW 82.04.240; amending section 82.04.260, chapter 15, Laws of 1961 as last amended by section 7, chapter 291, Laws of 1975 1st ex. sess. and RCW 82.04.260; amending section 82.04.300, chapter 15, Laws of 1961 as last amended by section 41, chapter 278, Laws of 1975 1st ex. sess. and RCW 82.04.300; amending section 82.04.430, chapter 15, Laws of 1961 as last amended by section 1, chapter 105, Laws of 1977 ex. sess. and RCW 82.04.430; amending section 2, chapter 169, Laws of 1974 ex. sess. and RCW 82.04.447; amending section 7, chapter 37, Laws of 1974 ex. sess. as amended by section 1, chapter 25, Laws of 1977 ex. sess. and RCW 35.21.755; amending section 14, chapter 61, Laws of 1975-76 2nd ex. sess. and RCW 84.36.451; amending section 2, chapter 61, Laws of 1975-76 2nd ex. sess. and RCW 82.29A.020; adding new sections to chapter 82.04 RCW; providing an effective date; and declaring an emergency.

Be it enacted by the Legislature of the State of Washington:

Section 1. Section 82.04.240, chapter 15, Laws of 1961 as last amended by section 3, chapter 281, Laws of 1971 ex. sess. and RCW 82.04.240 are each amended to read as follows:

Upon every person except persons taxable under subsections (2), (3), (4), (5), (6), ((or)) (8), (9), or (10) of RCW 82.04.260 engaging within this state in business as a manufacturer; as to such persons the amount of the tax with respect to such business shall be equal to the value of the products, including byproducts, manufactured, multiplied by the rate of forty-four one-hundredths of one percent

The measure of the tax is the value of the products, including byproducts, so manufactured regardless of the place of sale or the fact that deliveries may be made to points outside the state.

[ 1755 ]

Sec. 2. Section 82.04.260, chapter 15, Laws of 1961 as last amended by section 7, chapter 291, Laws of 1975 1st ex. sess. and RCW 82.04.260 are each amended to read as follows:

- (1) Upon every person engaging within this state in the business of buying wheat, oats, dry peas, corn, rye and barley, but not including any manufactured or processed products thereof, and selling the same at wholesale; the tax imposed shall be equal to the gross proceeds derived from such sales multiplied by the rate of one one-hundredth of one percent.
- (2) Upon every person engaging within this state in the business of manufacturing wheat into flour, soybeans into soybean oil, or sunflower seeds into sunflower oil, as to such persons the amount of tax with respect to such business shall be equal to the value of the flour or oil manufactured, multiplied by the rate of one-eighth of one percent.
- (3) Upon every person engaging within this state in the business of splitting or processing dried peas; as to such persons the amount of tax with respect to such business shall be equal to the value of the peas split or processed, multiplied by the rate of one-quarter of one percent.
- (4) Upon every person engaging within this state in the business of manufacturing seafood products which remain in a raw, raw frozen, or raw salted state at the completion of the manufacturing by that person; as to such persons the amount of tax with respect to such business shall be equal to the value of the products manufactured, multiplied by the rate of one-eighth of one percent.
- (5) Upon every person engaging within this state in the business of manufacturing by canning, preserving, freezing or dehydrating fresh fruits and vegetables; as to such persons the amount of tax with respect to such business shall be equal to the value of the products canned, preserved, frozen or dehydrated multiplied by the rate of three-tenths of one percent.
- (6) Upon every person engaging within this state in the business of manufacturing aluminum pig, ingot, billet, plate, sheet (flat or coiled), rod, bar, wire, cable or extrusions; as to such persons the amount of the tax with respect to such business shall be equal to the value of the products manufactured multiplied by the rate of four-tenths of one percent.
- (7) Upon every nonprofit corporation and nonprofit association engaging within this state in research and development, as to such corporations and associations, the amount of tax with respect to such activities shall be equal to the gross income derived from such activities multiplied by the rate of forty-four one-hundredths of one percent.
- (8) Upon every person engaging within this state in the business of slaughtering, breaking and/or processing perishable meat products and/or selling the same at wholesale; as to such persons the tax imposed shall be equal to the gross proceeds derived from such sales multiplied by the rate of thirty-three one-hundredths of one percent.

- (9) Upon every person engaging within this state in the business of making sales, at retail or wholesale, of nuclear fuel assemblies manufactured by that person, as to such persons the amount of tax with respect to such business shall be equal to the gross proceeds of sales of the assemblies multiplied by the rate of twenty-five one-hundredths of one percent.
- (10) Upon every person engaging within this state in the business of manufacturing nuclear fuel assemblies, as to such persons the amount of tax with respect to such business shall be equal to the value of the products manufactured multiplied by the rate of twenty-five one-hundredths of one percent.
- (11) Upon every person engaging within this state in the business of acting as a travel agent; as to such persons the amount of the tax with respect to such activities shall be equal to the gross income derived from such activities multiplied by the rate of twenty-five one-hundredths of one percent.
- (12) Upon every person engaging within this state in business as an international steamship agent, international customs house broker, international freight forwarder, vessel and/or cargo charter broker in foreign commerce, and/or international air cargo agent; as to such persons the amount of the tax with respect to only international activities shall be equal to the gross income derived from such activities multiplied by the rate of thirty-three one-hundredths of one percent.
- (13) Upon every person engaging within this state in the business of stevedoring and associated activities pertinent to the movement of goods and commodities in waterborne interstate or foreign commerce; as to such persons the amount of tax with respect to such business shall be equal to the gross proceeds derived from such activities multiplied by the rate of thirty-three one hundredths of one percent. Persons subject to taxation under this subsection shall be exempt from payment of taxes imposed by chapter 82.16 RCW for that portion of their business subject to taxation under this subsection. Stevedoring and associated activities pertinent to the conduct of goods and commodities in waterborne interstate or foreign commerce are defined as all activities of a labor, service or transportation nature whereby cargo may be loaded or unloaded to or from vessels or barges, passing over, onto or under a wharf, pier, or similar structure; cargo may be moved to a warehouse or similar holding or storage yard or area to await further movement in import or export or may move to a consolidation freight station and be stuffed, unstuffed, containerized, separated or otherwise segregated or aggregated for delivery or loaded on any mode of transportation for delivery to its consignee. Specific activities included in this definition are: wharfage, handling, loading, unloading, moving of cargo to a convenient place of delivery to the consignee or a convenient place for further movement to export mode; documentation services in connection with the receipt, delivery, checking, care, custody and control of cargo required in

the transfer of cargo; imported automobile handling prior to delivery to consignee; terminal stevedoring and incidental vessel services, including but not limited to plugging and unplugging refrigerator service to containers, trailers, and other refrigerated cargo receptacles, and securing ship hatch covers.

Sec. 3. Section 82.02.020, chapter 15, Laws of 1961, section 16, chapter 236, Laws of 1967, and section 8, chapter 94, Laws of 1970, 1st ex. sess., and RCW 82.02.020 are each amended to read as follows:

Except only as expressly provided in RCW 67.28.180 and 67.28.190 and the provisions of chapter 82.14 RCW, the state preempts the field of imposing taxes upon retail sales of tangible personal property, the use of tangible personal property, parimutuel wagering authorized pursuant to RCW 67.16.060, conveyances, and cigarettes, and no county, town, or other municipal subdivision shall have the right to impose taxes of that nature.

Sec. 4. Section 82.04.300, chapter 15, Laws of 1961 as last amended by section 41, chapter 278, Laws of 1975 1st ex. sess. and RCW 82.04.300 are each amended to read as follows:

This chapter shall apply to any person engaging in any business activity taxable under RCW 82.04.230, 82.04.240, 82.04.250, 82.04.260, 82.04.270, 82.04.275, 82.04.280 and 82.04.290 other than those whose value of products, gross proceeds of sales, or gross income of the business is less than ~~((three hundred))~~ one thousand dollars per month: PROVIDED, That where one person engages in more than one business activity and the combined measures of the tax applicable to such businesses equal or exceed ~~((three hundred))~~ one thousand dollars per month, no exemption or deduction from the amount of tax is allowed by this section.

Any person claiming exemption under the provisions of this section may be required to file returns even though no tax may be due: PROVIDED, FURTHER, That the department of revenue may allow exemptions, by general rule or regulation, in those instances in which quarterly, semiannual, or annual returns are permitted. Exemptions for such periods shall be equivalent in amount to the total of exemptions for each month of a reporting period.

Sec. 5. Section 82.04.430, chapter 15, Laws of 1961 as last amended by section 1, chapter 105, Laws of 1977 ex. sess. and RCW 82.04.430 are each amended to read as follows:

In computing tax there may be deducted from the measure of tax the following items:

(1) Amounts derived by persons, other than those engaging in banking, loan, security, or other financial businesses, from investments or the use of money as such, and also amounts derived as dividends by a parent from its subsidiary corporations;

(2) Amounts derived from bona fide initiation fees, dues, contributions, donations, tuition fees, charges made for operation of privately operated kindergartens, and endowment funds. This paragraph shall not be construed to exempt any person, association, or society from tax liability upon selling tangible personal property or upon providing facilities or services for which a special charge is made to members or others. ~~((Dues which are for, or graduated upon, the amount of service rendered by the recipient thereof are not permitted as a deduction hereunder.))~~ If dues are in exchange for any significant amount of goods or services rendered by the recipient thereof to members without any additional charge to the member, or if the dues are graduated upon the amount of goods or services rendered, the value of such goods or services shall not be considered as a deduction hereunder.

(3) The amount of cash discount actually taken by the purchaser. This deduction is not allowed in arriving at the taxable amount under the extractive or manufacturing classifications with respect to articles produced or manufactured, the reported values of which, for the purposes of this tax, have been computed according to the provisions of RCW 82.04.450;

(4) The amount of credit losses actually sustained by taxpayers whose regular books of account are kept upon an accrual basis;

(5) So much of the sale price of motor vehicle fuel as constitutes the amount of tax imposed by the state or the United States government upon the sale thereof;

(6) Amounts derived from business which the state is prohibited from taxing under the Constitution of this state or the Constitution or laws of the United States;

(7) Amounts derived by any person as compensation for the receiving, washing, sorting, and packing of fresh perishable horticultural products and the material and supplies used therein when performed for the person exempted in RCW 82.04.330, either as agent or as independent contractor;

(8) Amounts derived as compensation for services rendered or to be rendered to patients or from sales of prescription drugs as defined in RCW 82.08.030 furnished as an integral part of services rendered to patients by a hospital, as defined in chapter 70.41 RCW, devoted to the care of human beings with respect to the prevention or treatment of disease, sickness, or suffering, when such hospital is operated by the United States or any of its instrumentalities, or by the state, or any of its political subdivisions;

(9) Amounts derived as compensation for services rendered to patients or from sales of prescription drugs as defined in RCW 82.08.030 furnished as an integral part of services rendered to patients by a hospital, as defined in chapter 70.41 RCW, which is operated as a nonprofit corporation, nursing homes and homes for unwed mothers operated as religious or charitable organizations, but only if no part of the net earnings received by such an institution inures directly or indirectly, to any person other than the institution entitled to deduction hereunder. In no event shall any such deduction

be allowed, unless the hospital building is entitled to exemption from taxation under the property tax laws of this state;

(10) Amounts derived by a political subdivision of the state of Washington from another political subdivision of the state of Washington as compensation for services which are within the purview of RCW 82.04.290;

(11) By those engaged in banking, loan, security or other financial businesses, amounts derived from interest received on investments or loans primarily secured by first mortgages or trust deeds on nontransient residential properties;

(12) By those engaged in banking, loan, security or other financial businesses, amounts derived from interest paid on all obligations of the state of Washington, its political subdivisions, and municipal corporations organized pursuant to the laws thereof;

(13) Amounts derived as interest on loans to bona fide farmers and ranchers, producers or harvesters of aquatic products, or their cooperatives by a lending institution which is owned exclusively by its borrowers or members and which is engaged solely in the business of making loans ((for agricultural production)) and providing finance-related services to bona fide farmers and ranchers, producers or harvesters of aquatic products, their cooperatives, rural residents for housing, or persons engaged in furnishing farm-related or aquatic-related services to these individuals or entities;

(14) By persons subject to payment of the tax on manufacturers pursuant to RCW 82.04.240, the value of articles to the extent of manufacturing activities completed outside the United States, if

(a) any additional processing of such articles in this state consists of minor final assembly only, and

(b) in the case of domestic manufacture of such articles, can be and normally is done at the place of initial manufacture, and

(c) the total cost of the minor final assembly does not exceed two percent of the value of the articles, and

(d) the articles are sold and shipped outside the state;

(15) That portion of amounts received by any funeral home licensed to do business in this state which is received as reimbursements for expenditures (for goods supplied or services rendered by a person not employed by or affiliated or associated with the funeral home) and advanced by such funeral home as an accommodation to the persons paying for a funeral, so long as such expenditures and advances are billed to the persons paying for the funeral at only the exact cost thereof and are separately itemized in the billing statement delivered to such persons.

(16) Amounts received from the United States or any instrumentality thereof or from the state of Washington or any municipal corporation or political subdivision thereof as compensation for, or to support, health or social welfare services rendered by a health or social welfare organization or by a municipal corporation or political subdivision.

(17) Amounts used solely for repair, maintenance, replacement, management, or improvement of the residential structures and commonly held property, but excluding property where fees or charges are made for use by the public who are not guests accompanied by a member, which are derived by:

(a) A cooperative housing association, corporation, or partnership from a person who resides in a structure owned by the cooperative housing association, corporation, or partnership;

(b) An association of owners of property as defined in RCW 64.32.010, as now or hereafter amended, from a person who is an apartment owner as defined in RCW 64.32.010; or

(c) An association of owners of residential property from a person who is a member of the association. "Association of owners of residential property" means any organization of all the owners of residential property in a defined area who all hold the same property in common within the area.

For the purposes of this subsection "commonly held property" includes areas required for common access such as reception areas, halls, stairways, parking, etc., and may include recreation rooms, swimming pools and small parks or recreation areas; but is not intended to include more grounds than are normally required in a residential area, or to include such extensive areas as required for golf courses, campgrounds, hiking and riding areas, boating areas, etc.

To qualify for the deductions under this section:

(a) The salary or compensation paid to officers, managers, or employees must be only for actual services rendered and at levels comparable to the salary or compensation of like positions within the county wherein the property is located;

(b) Dues, fees, or assessments in excess of amounts needed for the purposes for which the deduction is allowed must be rebated to the members of the association;

(c) Assets of the association or organization must be distributable to all members and must not inure to the benefit of any single member or group of members.

NEW SECTION. Sec. 6. There is added to chapter 82.04 RCW a new section to read as follows:

(1) For the purposes of RCW 82.04.430(16), the term "health or social welfare organization" means an organization which renders health or social welfare services as defined in subsection (2) of this section, which is a not-for-profit corporation under chapter 24.03 RCW and which is managed by a governing board of not less than eight individuals none of whom is a paid employee of the organization or which is a corporation sole under chapter 24.12 RCW. In addition a corporation in order to be exempt under RCW 82.04.430(16) shall satisfy the following conditions:

(a) No part of its income may be paid directly or indirectly to its members, stockholders, officers, directors, or trustees except in the form of services rendered by the corporation in accordance with its purposes and bylaws;

(b) Salary or compensation paid to its officers and executives must be only for actual services rendered, and at levels comparable to the salary or compensation of like positions within the public service of the state;

(c) Assets of the corporation must be irrevocably dedicated to the activities for which the exemption is granted and, on the liquidation, dissolution, or abandonment by the corporation, may not inure directly or indirectly to the benefit of any member or individual except a nonprofit organization, association, or corporation which also would be entitled to the exemption;

(d) The corporation must be duly licensed or certified where licensing or certification is required by law or regulation;

(e) The amounts received qualifying for exemption must be used for the activities for which the exemption is granted;

(f) Services must be available regardless of race, color, national origin, or ancestry; and

(g) The director of revenue shall have access to its books in order to determine whether the corporation is exempt from taxes within the intent of RCW 82.04.430(16) and this section.

(2) The term "health or social welfare services" includes and is limited to:

(a) Mental health, drug, or alcoholism counseling or treatment;

(b) Family counseling;

(c) Health care services;

(d) Therapeutic, diagnostic, rehabilitative, or restorative services for the care of the sick, aged, or physically, developmentally, or emotionally-disabled individuals;

(e) Activities which are for the purpose of preventing or ameliorating juvenile delinquency or child abuse, including recreational activities for those purposes;

(f) Care of orphans or foster children;

(g) Day care of children;

(h) Employment development, training, and placement; and

(i) Legal services to the indigent.

**NEW SECTION. Sec. 7.** There is added to chapter 82.04 RCW a new section to read as follows:

(1) This chapter does not apply to amounts derived by a nonprofit organization as a result of conducting or participating in a bazaar or rummage sale if:

(a) The organization does not conduct or participate in more than two bazaars or rummage sales per year; and

(b) Each bazaar or rummage sale does not extend over a period of more than two days; and

(c) The gross income received by each organization from each bazaar or rummage sale does not exceed one thousand dollars.

(2) For purposes of this section, "nonprofit organization" means an organization that meets all of the following criteria:

(a) The members, stockholders, officers, directors, or trustees of the organization do not receive any part of the organization's gross income, except as payment for services rendered;

(b) The compensation received by any person for services rendered to the organization does not exceed an amount reasonable under the circumstances; and

(c) The activities of the organization do not include a substantial amount of political activity, including but not limited to influencing legislation and participation in any campaign on behalf of any candidate for political office.

Sec. 8. Section 2, chapter 169, Laws of 1974 ex. sess. and RCW 82.04-.442 are each amended to read as follows:

For each of the calendar years 1974 through 1983, a percentage as set forth below, of any personal property taxes paid before delinquency after May 10, 1974 by any taxpayer upon business inventories during the same calendar year or paid after delinquency under extenuating circumstances if approved by the department of revenue shall be allowed as a credit against the total of any taxes imposed on such taxpayer or its successor by chapter 82.04 RCW (business and occupation tax), as follows:

Inventory taxes paid in 1974	ten percent
Inventory taxes paid in 1975	twenty percent
Inventory taxes paid in 1976	thirty percent
Inventory taxes paid in 1977	forty percent
Inventory taxes paid in 1978	fifty percent
Inventory taxes paid in 1979	sixty percent
Inventory taxes paid in 1980	seventy percent
Inventory taxes paid in 1981	eighty percent
Inventory taxes paid in 1982	ninety percent
Inventory taxes paid in 1983	one hundred percent

Sec. 9. Section 7, chapter 37, Laws of 1974 ex. sess. as amended by section 1, chapter 35, Laws of 1977 ex. sess. and RCW 35.21.755 are each amended to read as follows:

A public corporation, commission, or authority created pursuant to RCW 35.21.730 or 35.21.660 shall receive the same immunity or exemption from taxation as that of the city, town, or county creating the same: PROVIDED, That, except for any property listed on, or which is within a district listed on any federal or state register of historical sites, any such public

corporation, commission, or authority shall pay to the county treasurer an annual excise tax equal to the amounts which would be paid upon real property and personal property devoted to the purposes of such public corporation, commission, or authority were it in private ownership, and such real property and personal property is acquired and/or operated under RCW 35.21.725 through 35.21.755, and the proceeds of such excise tax shall be allocated by the county treasurer to the various taxing authorities in which such property is situated, in the same manner as though the property were in private ownership: **PROVIDED FURTHER**, That the provisions of chapter 82.29A RCW(~~(, and RCW 84.36.451 and 84.40.175)~~) shall not apply to property within a district listed on any federal or state register of historical sites and which is controlled by a public corporation, commission, or authority created pursuant to RCW 35.21.730 or 35.21.660, which was in existence prior to January 1, 1976(~~(, and the exemption set forth in this proviso shall be allowed in accordance with the following schedule:~~

Year	Percentage Exemption of	
	Tax	Otherwise Due
1977 to 1981	100 percent	
1982 to 1985	66 2/3 percent	
1986 to 1989	33 1/3 percent	

and shall expire on December 31, 1989)).

Sec. 10. Section 14, chapter 61, Laws of 1975-'76 2nd ex. sess. and RCW 84.36.451 are each amended to read as follows:

The following property shall be exempt from taxation: Any and all rights to occupy or use any real or personal property owned in fee or held in trust by:

(1) The United States, the state of Washington, or any political subdivision or municipal corporation of the state of Washington(~~(,);~~); or

(2) A public corporation, commission, or authority created under RCW 35.21.730 or 35.21.660 if the property is listed on or is within a district listed on any federal or state register of historical sites; and

(3) Including any leasehold interest arising from ((such)) the property identified in subsections (1) and (2) of this section as defined in RCW 82.29A.020: PROVIDED, That ((this)) the exemption under this section shall not apply to any such leasehold interests which are a part of operating properties of public utilities subject to assessment under chapter 84.12 RCW nor be construed to modify the provisions of RCW 84.40.230.

Sec. 11. Section 2, chapter 61, Laws of 1975-'76 2nd ex. sess. and RCW 82.29A.020 are each amended to read as follows:

As used in this chapter the following terms shall be defined as follows, unless the context otherwise requires:

(1) "Leasehold interest" shall mean an interest in publicly owned real or personal property which exists by virtue of any lease, permit, license, or any other agreement, written or verbal, between the public owner of the property and a person who would not be exempt from property taxes if that person owned the property in fee, granting possession and use, to a degree less than fee simple ownership: **PROVIDED**, That no interest in personal property (excluding land or buildings) which is owned by the United States, whether or not as trustee, or by any foreign government shall constitute a leasehold interest hereunder when the right to use such property is granted pursuant to a contract solely for the manufacture or production of articles for sale to the United States or any foreign government. The term "leasehold interest" shall include the rights of use or occupancy by others of property which is owned in fee or held in trust by a public corporation, commission, or authority created under RCW 35.21.730 or 35.21.660 if the property is listed on or is within a district listed on any federal or state register of historical sites. The term "leasehold interest" shall not include road or utility easements or rights of access, occupancy or use granted solely for the purpose of removing materials or products purchased from a public owner or the lessee of a public owner.

(2) "Taxable rent" shall mean contract rent as defined in subsection (a) of this subsection in all cases where the lease or agreement has been established or renegotiated through competitive bidding, or negotiated or renegotiated in accordance with statutory requirements regarding the rent payable, or negotiated or renegotiated under circumstances, established by public record, clearly showing that the contract rent was the maximum attainable by the lessor: **PROVIDED**, That after January 1, 1986, with respect to any lease which has been in effect for ten years or more without renegotiation, taxable rent may be established by procedures set forth in subsection (b) of this subsection. All other leasehold interests shall be subject to the determination of taxable rent under the terms of subsection (b) of this subsection.

(a) "Contract rent" shall mean the amount of consideration due as payment for a leasehold interest, including: The total of cash payments made to the lessor or to another party for the benefit of the lessor according to the requirements of the lease or agreement; expenditures for the protection of the lessor's interest when required by the terms of the lease or agreement; and expenditures for improvements to the property to the extent that such improvements become the property of the lessor. Where the consideration conveyed for the leasehold interest is made in combination with payment for concession or other rights granted by the lessor, only that portion of such payment which represents consideration for the leasehold interest shall be part of contract rent.

"Contract rent" shall not include: (i) Expenditures made by the lessee, which under the terms of the lease or agreement, are to be reimbursed by

the lessor to the lessee; (ii) expenditures made by the lessee for the replacement or repair of facilities due to fire or other casualty or for alterations, additions made necessary by an action of government taken after the date of the execution of the lease or agreement; (iii) improvements added to publicly owned property by a sublessee under an agreement executed prior to January 1, 1976, which have been taxed as personal property of the lessee prior to January 1, 1976, or improvements made by a sublessee of the same lessee under a similar agreement executed prior to January 1, 1976, and such improvements shall be taxable to the sublessee as personal property; (iv) improvements added to publicly owned property if such improvements are being taxed as personal property to any person.

Any prepaid contract rent shall be considered to have been paid in the year due and not in the year actually paid with respect to prepayment for a period of more than one year. Expenditures for improvements with a useful life of more than one year which are included as part of contract rent shall be treated as prepaid contract rent and prorated over the useful life of the improvement or the remaining term of the lease or agreement if the useful life is in excess of the remaining term of the lease or agreement. Rent paid prior to January 1, 1976, shall be prorated from the date of prepayment.

With respect to a "product lease", the value of agricultural products received as rent shall be the value at the place of delivery as of the fifteenth day of the month of delivery; with respect to all other products received as contract rent, the value shall be that value determined at the time of delivery under terms of the lease.

(b) If it shall be determined by the department of revenue, upon examination of a lessee's accounts or those of a lessor of publicly owned property, that a lessee is occupying or using publicly owned property in such a manner as to create a leasehold interest and that such leasehold interest has been established through competitive bidding, or negotiated in accordance with statutory requirements regarding the rent payable, or negotiated under circumstances, established by public record, clearly showing that the contract rent was the maximum attainable by the lessor, the department shall establish a taxable rent computation for use in determining the tax payable under authority granted in this chapter based upon the following criteria: Consideration shall be given to rental being paid to other lessors by lessees of similar property for similar purposes over similar periods of time; consideration shall be given to what would be considered a fair rate of return on the market value of the property leased less reasonable deduction for any restrictions on use, special operating requirements or provisions for concurrent use by the lessor, another person or the general public.

(3) "Product lease" as used in this chapter shall mean a lease of property for use in the production of agricultural or marine products to the extent that such lease provides for the contract rent to be paid by the lessee

of a stated percentage of the production of such agricultural or marine products to the credit of the lessor or the payment to the lessor of a stated percentage of the proceeds from the sale of such products.

(4) "Renegotiated" means a change in the lease agreement which changes the agreed time of possession, restrictions on use, the rate of the cash rental or of any other consideration payable by the lessee to or for the benefit of the lessor, other than any such change required by the terms of the lease or agreement. In addition "renegotiated" shall mean a continuation of possession by the lessee beyond the date when, under the terms of the lease agreement, the lessee had the right to vacate the premises without any further liability to the lessor.

(5) "City" means any city or town.

**NEW SECTION.** Sec. 12. There is added to chapter 82.04 RCW a new section to read as follows:

"This chapter shall not apply to school districts and educational service districts as defined in Title 28A RCW, in respect to materials printed in the school district and educational service districts printing facilities when said materials are used solely for school district and educational service district purposes.

**NEW SECTION.** Sec. 13. There is added to chapter 82.04 RCW a new section to read as follows:

The tax imposed by RCW 82.04.270(1) does not apply to any person who manufactures alcohol with respect to sales of said alcohol to be used in the production of gasohol for use as motor vehicle fuel. As used in this section, "motor vehicle fuel" has the meaning given in RCW 82.36.010(2), and "gasohol" means motor vehicle fuel which contains more than nine and one-half percent alcohol by volume.

**NEW SECTION.** Sec. 14. There is added to chapter 82.04 RCW a new section to read as follows:

This chapter does not apply to any county, city or town as defined in Title 35 RCW and Title 36 RCW, in respect to materials printed in the county, city or town printing facilities when said materials are used solely for said county, city or town purposes.

**NEW SECTION.** Sec. 15. This act is necessary for the immediate preservation of the public peace, health, and safety, the support of the state government and its existing public institutions, and shall take effect on July 1, 1979.

Passed the House May 14, 1979.

Passed the Senate May 11, 1979.

Approved by the Governor May 24, 1979.

Filed in Office of Secretary of State May 24, 1979.

# APPENDIX 7

environment to residents of substantially polluted areas.

**SUMMARY:**

The Department of Ecology is required to conduct a voluntary vehicle emission inspection program. The implementation of public education and notification programs is required. These programs are to provide information regarding vehicle emissions, noncompliance and emission contributing areas, and restrictions imposed on those areas. The Department of Ecology is to develop, with the Superintendent of Public Instruction and the State Board for Community College Education, a program for granting certificates of instruction to persons who successfully complete training courses regarding engine maintenance and emission control systems.

If the Director of the Department of Ecology determines that the air quality standards for vehicle-emission contaminants are likely to be exceeded in an area after December 31, 1982, the Director is required to designate the area as a noncompliance area for motor vehicle emissions. The geographic area, including the noncompliance area within whose boundaries are registered vehicles that contribute significantly to the violation of the standards within the noncompliance area, is to be designated as an emission contributing area.

The Department is required to administer a vehicle emission inspection system for all motor vehicles registered within each emission contributing area. The inspection stations must be established and operated by one or more private contractors who secure contracts by competitive bid. Such contractors may not be in the business of repairing vehicles for compensation. Owners or operators of fleets of motor vehicles and used motor vehicle dealers may be authorized by the Director of the Department of Ecology to inspect their vehicles.

The Department of Ecology must review consumer complaints regarding the inspection system and repair service utilized to meet the emission standards.

After January 1, 1982, motor vehicle licenses for vehicles registered in emission contributing areas may not be issued or renewed unless the applications are accompanied by:

1. A certificate of compliance issued for vehicles passing the emission test by meeting the emission standards; or
2. A certificate of acceptance issued to a vehicle owner whose vehicle failed the inspection test, who then spent more than \$50 on repairs and/or parts to pass the inspection, but whose vehicle nonetheless failed to pass the inspection test upon retesting.

The following motor vehicles are exempted from this requirement: new vehicles (first licensing);

vehicles fifteen years old or older; those powered by electricity or by diesel engines; motorcycles and motor driven cycles; certain farm vehicles; and classes of vehicles designated by the Director of the Department of Ecology. An area may no longer be designated as a noncompliance area if the air quality standards are no longer being violated in the area and termination of the area inspection system does not result in violations of the standards.

Any rules proposed by the Department of Ecology to implement this act, including those designating noncompliance and emission contributing areas and their boundaries, must be submitted to the House and Senate Ecology Committees for review and approval before adoption.

The provisions of the bill expire on January 1, 1990, unless extended by law for an additional period of time.

The state operating budget authorizes the expenditure of not more than \$500,000 by the Department of Ecology to implement this program during the 1979-81 biennium.

House: (a)	62	36	Effective: Sept. 1, 1979
Senate: (a)	25	22	C 163 L 79 1st ex. sess.
H. Concur:	55	36	

**SHB 302**

**SPONSORS:** Committee on Revenue.  
(Originally Sponsored by Representatives Whiteside, Thompson, Adams, Barr, Burns, Brekke, Fancher, Maxie, Taylor, Williams, North and Ehlers)  
(By Department of Social and Health Services Request)

**COMMITTEE:** Revenue  
Modifying the B&O tax.

**ISSUE:**

Exemptions and reductions in the business and occupation tax statute are necessary in order to make the statute more equitable, reflect inflation, and encourage the development of certain products in Washington State.

**SUMMARY:**

A business and occupation (B&O) tax rate of one-eighth of one percent is imposed upon manufacturers of soybean oil and sunflower oil.

A B&O tax rate of thirty-three hundredths of one percent is imposed upon steamship agents, customs house brokers, freight forwarders, cargo charter brokers and air cargo agents engaged in international trade activities.

B&O tax rate of thirty-three hundredths of one percent is imposed upon persons engaged in the

business of stevedoring and associated activities. The portion of income of public ports and other public service businesses derived from these activities is exempt from the 1.8% public utility tax rate and subject to the .33% rate.

Counties, towns, and other municipal corporations may not impose any excise taxes on parimutuel wagering.

Hospitals selling prescription drugs as an integral part of services rendered are exempted from B&O tax on amounts received from the sale of such drugs.

An exemption from B&O tax on interest on loans to producers of aquatic products is extended to cooperative lending institutions.

Funeral homes are exempted from B&O tax for indirect costs incurred, such as providing flowers, soloists, ministers and transportation services, paid in advance by the funeral home for the convenience and accommodation of its customers. Customers must be billed at the exact cost to the funeral home and such costs must be separately itemized in the billing statement.

Amounts received from the United States or any governmental unit for support of health and social welfare services are exempted from business and occupation tax assessed upon private, nonprofit health and social welfare organizations, but only if the organizations comply with several specified conditions.

A deduction is allowed from the B&O tax for amounts received by condominium owners' associations, cooperative housing associations, and other associations of owners of residential property for the repair, maintenance, and management of residential structures and common areas.

Credit for property taxes paid on business inventories is allowed to delinquent taxpayers under extenuating circumstances if approved by the Department of Revenue.

The income level at which a business activity becomes subject to the appropriate business and occupation tax is raised from \$300 to \$1,000.

Amounts derived by a nonprofit organization as a result of conducting or participating in a bazaar or rummage sale are exempted from B&O tax if certain specified conditions are followed.

The tax-exempt status of the Pike Place Market in Seattle is clarified.

The B&O tax does not apply to the printing facilities of schools, counties, cities, or towns when the printed materials are used solely for school, county, city, or town purposes.

The B&O tax on wholesalers does not apply to persons who manufacture alcohol to be used in the production of gasoline.

The B&O tax status of amounts received by clubs and other organizations which are designated as dues to their members is clarified.

The bill contains an emergency clause and takes effect July 1, 1979.

House:	98	0	Effective: July 1, 1979
Senate: (a)	46	1	C 196 L 79 1st ex. sess.
H. Concur:	85	7	

**HB 307**

SPONSORS: Representatives Newhouse and Knowles

COMMITTEE: Judiciary

Revising the criminal code.

**ISSUE:**

In 1975 a comprehensive revision of the criminal code was enacted, codified as the Washington Criminal Code (Title 9A RCW). The 1975 revision, which was the product of an extended criminal code revision process in this state, was principally based upon a proposal developed by the Criminal Code Revision Committee of the State Bar Association. The Committee has continued in existence in order to develop whatever follow-up housekeeping amendments appear to be necessary. The Committee's first proposal was introduced in 1976 and enacted as Chapter 38, Laws of 1975-76, 2nd ex. sess.

**SUMMARY:**

This is the second housekeeping bill developed by the Criminal Code Revision Committee as a follow-up to the 1975 criminal code revision. It makes the following changes in the criminal law:

1. The rape and statutory rape statutes, which are now in Title 9, and the communicating with a minor for immoral purposes and indecent liberties statutes, are recodified into a new chapter in Title 9A. The purpose of this recodification is to gather all of the sex crimes statutes into a single chapter within Title 9A.
2. Some language in the excusable homicide statute is revised to eliminate some uncertainty caused by the revision in the manslaughter statutes in 1975. The problem is that the mental state requirement in the lowest degree of felony homicide (manslaughter second) is "criminal negligence" which is defined as "gross negligence." The excusable homicide statute, however, requires that the actor acted "with ordinary caution" which leaves open the question of whether someone acting with simple negligence can take advantage of the excusable homicide statute. To eliminate this uncertainty, the phrase "without criminal negligence" is

# APPENDIX 8

CERTIFICATION OF ENROLLMENT

SUBSTITUTE HOUSE BILL 1624

Chapter 23, Laws of 2001

(partial veto)

57th Legislature  
2001 Second Special Legislative Session

HEALTH OR SOCIAL WELFARE SERVICES--TAX DEDUCTION

EFFECTIVE DATE: 7/13/01

Passed by the House June 4, 2001  
Yeas 87 Nays 0

FRANK CHOPP  
Speaker of the House of  
Representatives

CLYDE BALLARD  
Speaker of the House of  
Representatives

Passed by the Senate June 14, 2001  
Yeas 48 Nays 0

BRAD OWEN  
President of the Senate

Approved July 13, 2001, with the  
exemption of section 3, which is  
vetoed

GARY LOCKE  
Governor of the State of Washington

CERTIFICATE

We, Timothy A. Martin and Cynthia  
Zehnder, Co-Chief Clerks of the House  
of Representatives of the State of  
Washington, do hereby certify that the  
attached is SUBSTITUTE HOUSE BILL 1624  
as passed by the House of  
Representatives and the Senate on the  
dates hereon set forth.

TIMOTHY A. MARTIN  
Chief Clerk

CYNTHIA ZEHNDER  
Chief Clerk

FILED

July 13, 2001 3:14 p.m.

Secretary of State  
State of Washington

SUBSTITUTE HOUSE BILL 1624

Passed Legislature - 2001 2 Special Session

State of Washington 57th Legislature 2001 Regular Session

By House Committee on Finance (originally sponsored by Representatives Morris, Cairnes, Reardon, Conway, Dunshee, Ogden, Pennington, Van Luven, Doumit, Voloria, Dickerson, Fromhold, Anderson and Edwards)

Read first time . Referred to Committee on .

1 AN ACT Relating to the business and occupation tax deduction for  
2 health or social welfare services as applied to government-funded  
3 health benefits paid through managed care organizations; amending RCW  
4 82.04.4297; creating new sections; and declaring an emergency.

5 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

6 NEW SECTION. Sec. 1. The legislature finds that the deduction  
7 under the business and occupation tax statutes for compensation from  
8 public entities for health or social welfare services was intended to  
9 provide government with greater purchasing power when government  
10 provides financial support for the provision of health or social  
11 welfare services to benefited classes of persons. The legislature also  
12 finds that both the legislature and the United States congress have in  
13 recent years modified government-funded health care programs to  
14 encourage participation by beneficiaries in highly regulated managed  
15 care programs operated by persons who act as intermediaries between  
16 government entities and health or social welfare organizations. The  
17 legislature further finds that the objective of these changes is again  
18 to extend the purchasing power of scarce government health care  
19 resources, but that this objective would be thwarted to a significant

1 degree if the business and occupation tax deduction were lost by health  
2 or social welfare organizations solely on account of their  
3 participation in managed care for government-funded health programs.  
4 In keeping with the original purpose of the health or social welfare  
5 deduction, it is desirable to ensure that compensation received from  
6 government sources through contractual managed care programs also be  
7 deductible.

8       Sec. 2. RCW 32.04.4297 and 1988 c 67 s 1 are each amended to read  
9 as follows:

10       In computing tax there may be deducted from the measure of tax  
11 amounts received from the United States or any instrumentality thereof  
12 or from the state of Washington or any municipal corporation or  
13 political subdivision thereof as compensation for, or to support,  
14 health or social welfare services rendered by a health or social  
15 welfare organization or by a municipal corporation or political  
16 subdivision, except deductions are not allowed under this section for  
17 amounts that are received under an employee benefit plan. For purposes  
18 of this section, "amounts received from" includes amounts received by  
19 a health or social welfare organization that is a nonprofit hospital or  
20 public hospital from a managed care organization or other entity that  
21 is under contract to manage health care benefits for the federal  
22 medicare program authorized under Title XVIII of the federal social  
23 security act; for a medical assistance, children's health, or other  
24 program authorized under chapter 74.09 RCW; or for the state of  
25 Washington basic health plan authorized under chapter 70.47 RCW; to the  
26 extent that these amounts are received as compensation for health care  
27 services within the scope of benefits covered by the pertinent  
28 government health care program.

29       \*NEW SECTION. Sec. 3. This act applies to taxes collected after  
30 the effective date of this act, including taxes collected on reporting  
31 periods prior to the effective date of this act.

32       \*Sec. 3 was vetoed. See message at end of chapter.

33       NEW SECTION. Sec. 4. This act is necessary for the immediate  
34 preservation of the public peace, health, or safety, or support of the  
35 state government and its existing public institutions, and takes effect  
36 immediately.

Passed the House June 4, 2001.  
Passed the Senate June 14, 2001.  
Approved by the Governor July 13, 2001, with the exception of  
certain items that were vetoed.  
Filed in Office of Secretary of State July 13, 2001

1 Note: Governor's explanation of partial veto is as follows:

2 "I am returning herewith, without my approval as to section 3,  
3 Substitute House Bill No. 1624 entitled:

4 "AN ACT Relating to the business and occupation tax deduction for  
5 health or social welfare services as applied to government-funded  
6 health benefits paid through managed care organizations;"

7 Substitute House Bill No. 1624 authorizes a business and occupation  
8 (B&O) tax deduction for amounts received by a health or social welfare  
9 organization that is a non-profit hospital or a public hospital, from  
10 a managed care organization or other entity that is under contract with  
11 the federal or state government to manage certain health care benefits.  
12 The deduction is equal to the amount of payments the entity receives  
13 for health benefits for Medicare; medical assistance, children's  
14 health, or other programs authorized pursuant to RCW 74.09; or the  
15 Washington Basic Health Plan. The credit amount is limited to the  
16 extent these payments are received as compensation for health care  
17 services within the scope of benefits covered by the pertinent  
18 government health care program.

19 Section 3 of this bill would have applied the deduction to taxes  
20 collected in the future, on reporting periods prior to the effective  
21 date of this act. The retroactive nature of the provision is not fair  
22 to taxpayers who have timely reported and remitted their taxes.  
23 Taxpayers who failed to pay their taxes due before the effective date  
24 of this bill would have been rewarded for being delinquent, while those  
25 who paid on time would not receive a refund (such refunds are  
26 prohibited by Article VIII, Section 7 of the Washington Constitution as  
27 interpreted by the Washington Supreme Court).

28 For this reason, I have vetoed section 3 of Substitute House Bill  
29 No. 1624.

30 With the exception of section 3, Substitute House Bill No. 1624 is  
31 approved."

# APPENDIX 9

**FINAL BILL REPORT**  
**SHB 1624**

**PARTIAL VETO**

C 23 L 01 E 2

Synopsis as Enacted

**Brief Description:** Clarifying the taxation of amounts received by public entities for health or welfare services.

**Sponsors:** By House Committee on Finance (originally sponsored by Representatives Morris, Cairnes, Reardon, Conway, Dunshee, Ogden, Pennington, Van Luven, Doumit, Veloria, Dickerson, Fromhold, Anderson and Edwards).

**House Committee on Finance**  
**Senate Committee on Ways & Means**

**Background:**

Washington's major business tax is the business and occupation (B&O) tax. This tax is imposed on the gross receipts of business activities conducted within the state. Nonprofit organizations pay B&O tax unless specifically exempted by statute. Exemption from federal income tax does not automatically provide exemption from state taxes.

Specific B&O exemptions and deductions, covering all or most income, exist for several types of nonprofit organizations. The eligibility conditions vary for each exemption. The B&O tax deduction for nonprofit organizations or local government jurisdictions for the support of health or social welfare programs is provided only for payments made directly by federal, state, or local governments.

**Summary:**

Nonprofit hospitals and public hospitals are exempt from B&O tax on payments they receive from organizations under contract with the federal or state government to manage health benefits for medicare, medical assistance, children's health, or the basic health plan.

The exemption applies to taxes collected after the act's effective date, including amounts from reporting periods before the act's effective date.

**Votes on Final Passage:**

First Special Session  
House 93 2

Second Special Session  
House 87 0  
Senate 48 0

**Effective:** July 13, 2001

**Partial Veto Summary:** The Governor vetoed the section which provided an exemption for tax amounts from reporting periods before the act's effective date.

# APPENDIX 10

able and potentially major impact on causes of poverty in communities of the state. [1986 c 261 § 6; 1985 c 431 § 3; 1983 1st ex.s. c 66 § 1; 1980 c 37 § 80; 1979 ex.s. c 196 § 6.]

**Intent—1980 c 37:** See note following RCW 82.04.4281.

**Effective date—1979 ex.s. c 196:** See note following RCW 82.04.240.

**82.04.4311 Deductions—Compensation received under the federal medicare program by certain nonprofit and municipal hospitals.** A public hospital that is owned by a municipal corporation or political subdivision, or a nonprofit hospital that qualifies as a health and social welfare organization as defined in RCW 82.04.431, may deduct from the measure of tax amounts received as compensation for health care services covered under the federal medicare program authorized under Title XVIII of the federal social security act; medical assistance, children's health, or other program under chapter 74.09 RCW; or for the state of Washington basic health plan under chapter 70.47 RCW. The deduction authorized by this section does not apply to amounts received from patient copayments or patient deductibles. [2002 c 314 § 2.]

**Findings—2002 c 314:** "The legislature finds that the provision of health services to those people who receive federal or state subsidized health care benefits by reason of age, disability, or lack of income is a recognized, necessary, and vital governmental function. As a result, the legislature finds that it would be inconsistent with that governmental function to tax amounts received by a public hospital or nonprofit hospital qualifying as a health and social welfare organization, when the amounts are paid under a health service program subsidized by federal or state government. Further, the tax status of these amounts should not depend on whether the amounts are received directly from the qualifying program or through a managed health care organization under contract to manage benefits for a qualifying program. Therefore, the legislature adopts this act to provide a clear and understandable deduction for these amounts, and to provide refunds for taxes paid as specified in section 4 of this act." [2002 c 314 § 1.]

**Refund of taxes—2002 c 314:** "A public hospital owned by a municipal corporation or political subdivision, or a nonprofit hospital that qualifies as a health and social welfare organization under RCW 82.04.431, is entitled to:

(1) A refund of business and occupation tax paid between January 1, 1998, and April 2, 2002, on amounts that would be deductible under section 2 of this act; and

(2) A waiver of tax liability for accrued, but unpaid taxes that would be deductible under section 2 of this act." [2002 c 314 § 4.]

**Effective date—2002 c 314:** "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and takes effect immediately [April 2, 2002]." [2002 c 314 § 5.]

**82.04.432 Deductions—Municipal sewer service fees or charges.** In computing the tax imposed by this chapter, municipal sewerage utilities and other public corporations imposing and collecting fees or charges for sewer service may deduct from the measure of the tax, amounts paid to another municipal corporation or governmental agency for sewerage interception, treatment or disposal. [1967 ex.s. c 149 § 17.]

**82.04.4322 Deductions—Artistic or cultural organization—Compensation from United States, state, etc., for artistic or cultural exhibitions, performances, or programs.** In computing tax there may be deducted from the measure of tax amounts received from the United States or

any instrumentality thereof or from the state of Washington or any municipal corporation or subdivision thereof as compensation for, or to support, artistic or cultural exhibitions, performances, or programs provided by an artistic or cultural organization for attendance or viewing by the general public. [1981 c 140 § 1.]

*"Artistic or cultural organization" defined: RCW 82.04.4328.*

**82.04.4324 Deductions—Artistic or cultural organization—Deduction for tax under RCW 82.04.240—Value of articles for use in displaying art objects or presenting artistic or cultural exhibitions, performances, or programs.** In computing tax there may be deducted from the measure of tax by persons subject to payment of the tax on manufacturing under RCW 82.04.240, the value of articles to the extent manufacturing activities are undertaken by an artistic or cultural organization solely for the purpose of manufacturing articles for use by the organization in displaying art objects or presenting artistic or cultural exhibitions, performances, or programs for attendance or viewing by the general public. [1981 c 140 § 2.]

*"Artistic or cultural organization" defined: RCW 82.04.4328.*

**82.04.4326 Deductions—Artistic or cultural organizations—Tuition charges for attending artistic or cultural education programs.** In computing tax there may be deducted from the measure of tax amounts received by artistic or cultural organizations as tuition charges collected for the privilege of attending artistic or cultural education programs. [1981 c 140 § 3.]

*"Artistic or cultural organization" defined: RCW 82.04.4328.*

**82.04.4327 Deductions—Artistic and cultural organizations—Income from business activities.** In computing tax there may be deducted from the measure of tax those amounts received by artistic or cultural organizations which represent income derived from business activities conducted by the organization. [1985 c 471 § 6.]

**Severability—Effective date—1985 c 471:** See notes following RCW 82.04.260.

*"Artistic or cultural organization" defined: RCW 82.04.4328.*

**82.04.4328 "Artistic or cultural organization" defined.** (1) For the purposes of RCW 82.04.4322, 82.04.4324, 82.04.4326, 82.04.4327, 82.08.031, and 82.12.031, the term "artistic or cultural organization" means an organization which is organized and operated exclusively for the purpose of providing artistic or cultural exhibitions, presentations, or performances or cultural or art education programs, as defined in subsection (2) of this section, for viewing or attendance by the general public. The organization must be a not-for-profit corporation under chapter 24.03 RCW and managed by a governing board of not less than eight individuals none of whom is a paid employee of the organization or by a corporation sole under chapter 24.12 RCW. In addition, to qualify for deduction or exemption from taxation under RCW 82.04.4322, 82.04.4324, 82.04.4326, 82.04.4327, 82.08.031, and 82.12.031, the corporation shall satisfy the following conditions:

(a) No part of its income may be paid directly or indirectly to its members, stockholders, officers, directors, or

# APPENDIX 11

# FINAL BILL REPORT

## HB 2732

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C 314 L 02

Synopsis as Enacted

**Brief Description:** Excluding government subsidized social welfare compensation from taxation.

**Sponsors:** By Representatives Gombosky, Cairnes, Berkey, Nixon, Morris, Armstrong, Esser, Fromhold, Ogden, Conway, Hunt, Van Luven, Veloria, Romero, Reardon, Edwards, Chase, Morell, Santos, Kenney and Wood.

**House Committee on Finance**  
**Senate Committee on Ways & Means**

### **Background:**

Washington's major business tax is the business and occupation (B&O) tax. This tax is imposed on the gross receipts of business activities conducted within the state. Nonprofit organizations pay B&O tax unless specifically exempted by statute. Exemption from federal income tax does not automatically provide exemption from state taxes.

Specific B&O exemptions and deductions, covering all or most income, exist for several types of nonprofit organizations. The eligibility conditions vary for each exemption or deduction.

SHB 1624, adopted in 2001, provided a deduction for nonprofit hospitals and public hospitals from B&O tax on payments they receive from organizations under contract with the federal or state government to manage health benefits for medicare, medical assistance, children's health, or the basic health plan. A deduction already existed for these payments when made directly by federal, state, or local governments.

SHB 1624 contained a section that applied the deduction to taxes collected after the act's effective date, including amounts from reporting periods before the act's effective date.

The Governor vetoed this section of SHB 1624 stating that: "The retroactive nature of the provision is not fair to taxpayers who have timely reported and remitted their taxes. Taxpayers who failed to pay their taxes due before the effective date of this bill would have been rewarded for being delinquent, while those who paid on time would not receive a refund..."

### **Summary:**

The tax deduction available to nonprofit hospitals and public hospitals for payments for health benefits under medicare, medical assistance, children's health, or the basic health plan is restated in a new section. The deduction does not apply to patient copayments or deductibles.

Nonprofit hospitals and public hospitals are entitled to retroactive relief for B&O taxes on payments for health benefits under medicare, medical assistance, children's health, or the basic health plan. Taxpayers who remitted tax are entitled to a refund dating back to January 1, 1998. Tax liability for unpaid taxes is waived.

**Votes on Final Passage:**

House 97 1  
Senate 48 0

**Effective:** April 2, 2002

# APPENDIX 12

Westlaw.

49 P.3d 947  
 112 Wash.App. 428, 49 P.3d 947  
 (Cite as: 112 Wash.App. 428, 49 P.3d 947)

Page 1

▷

Court of Appeals of Washington,  
 Division 2.  
 Charles A. PILCHER, M.D., Appellant,  
 v.  
 STATE of Washington, Department of Revenue,  
 Respondent.  
 No. 27043-9-II.

July 2, 2002.

Taxpayer filed excise-tax-refund appeal after the Department of Revenue audited taxpayer and assessed additional business and occupation taxes of \$49,166, plus statutory interest. The Superior Court, Thurston County, Christine Pomeroy, J., entered judgment in the Department's favor. Taxpayer appealed. The Court of Appeals, Hunt, C.J., held that taxpayer did not qualify for pass-through payment exemption.

Affirmed.

West Headnotes

**[1] Appeal and Error 30 ↪1010.1(6)**

30 Appeal and Error  
 30XVI Review  
 30XVI(I) Questions of Fact, Verdicts, and Findings  
 30XVI(I)3 Findings of Court  
 30k1010 Sufficiency of Evidence in Support  
 30k1010.1 In General  
 30k1010.1(6) k. Substantial Evidence, Most Cited Cases  
 Challenged findings will be binding on appeal if they are supported by substantial evidence in record.

**[2] Administrative Law and Procedure 15A ↪791**

15A Administrative Law and Procedure  
 15AV Judicial Review of Administrative Decisions

15AV(E) Particular Questions, Review of  
 15Ak784 Fact Questions

15Ak791 k. Substantial Evidence.

Most Cited Cases

Substantial evidence exists where there is a sufficient quantity of evidence in record to persuade a fair-minded, rational person of truth of finding.

**[3] Appeal and Error 30 ↪900**

30 Appeal and Error

30XVI Review

30XVI(G) Presumptions

30k900 k. Nature and Extent in General.

Most Cited Cases

On appeal, an appellate court views evidence in the light most favorable to prevailing party.

**[4] Appeal and Error 30 ↪996**

30 Appeal and Error

30XVI Review

30XVI(I) Questions of Fact, Verdicts, and Findings

30XVI(I)1 In General

30k996 k. Inferences from Facts

Proved. Most Cited Cases

**Appeal and Error 30 ↪1008.1(4)**

30 Appeal and Error

30XVI Review

30XVI(I) Questions of Fact, Verdicts, and Findings

30XVI(I)3 Findings of Court

30k1008 Conclusiveness in General

30k1008.1 In General

30k1008.1(4) k. Credibility of

Witnesses; Trial Court's Superior Opportunity.  
 Most Cited Cases

**Appeal and Error 30 ↪1010.1(6)**

49 P.3d 947  
 112 Wash.App. 428, 49 P.3d 947  
 (Cite as: 112 Wash.App. 428, 49 P.3d 947)

Page 2

30 Appeal and Error  
 30XVI Review  
 30XVI(I) Questions of Fact, Verdicts, and Findings  
 30XVI(I)3 Findings of Court  
 30k1010 Sufficiency of Evidence in Support

30k1010.1 In General  
 30k1010.1(6) k. Substantial Evidence. Most Cited Cases

Under substantial evidence standard, an appellate court will not substitute its judgment for that of a fact finder; instead, it accepts the fact finder's views regarding credibility of witnesses and weight accorded to reasonable but competing inferences.

[5] Licenses 238 ↪28

238 Licenses  
 238I For Occupations and Privileges  
 238k27 License Fees and Taxes  
 238k28 k. In General. Most Cited Cases  
 The business and occupation tax applies to virtually all business activities conducted in state. West's RCWA 82.04.220.

[6] Licenses 238 ↪29

238 Licenses  
 238I For Occupations and Privileges  
 238k27 License Fees and Taxes  
 238k29 k. Amount. Most Cited Cases  
 In determining business and occupation tax, under broad definition of gross income of business, a service provider may not deduct any of its own costs of doing business, including its labor costs, from its gross income. West's RCWA 82.04.080, 82.04.220.

[7] Licenses 238 ↪29

238 Licenses  
 238I For Occupations and Privileges  
 238k27 License Fees and Taxes  
 238k29 k. Amount. Most Cited Cases  
 Taxpayer, who hired independent contractors to help staff emergency room, was not entitled to de-

duct his labor costs or any other expenses related to his business before paying the business and occupation tax on gross income he received from hospital, his employer, as compensation for his services; taxpayer was not acting solely as agent for physicians he hired, and taxpayer was not acting solely as pass-through for payments from hospital to physicians, rather, taxpayer could pay physicians amount they agreed upon. West's RCWA 82.04.080, 82.04.090, 82.04.220.

[8] Licenses 238 ↪29

238 Licenses  
 238I For Occupations and Privileges  
 238k27 License Fees and Taxes  
 238k29 k. Amount. Most Cited Cases  
 Taxpayer, who was challenging assessment by Department of Revenue that taxpayer owed additional business and occupation taxes, did not qualify for pass-through payment exemption, where taxpayer's payments to physicians under his contract with hospital, that hired taxpayer to hire independent contractors to help staff emergency room, were not excludable; payments from hospital were neither advances nor reimbursement for monies taxpayer owed his retained physicians, taxpayer did not receive payments from hospital for services which he did not or could not render, and taxpayer's liability was not solely that of agent. West's RCWA 82.04.080, 82.04.090, 82.04.220.  
 \*\*948 \*429 George Carl Mastrodonato, Lane Powell Spears Lubersky, Olympia, Michael Barr King, Lane Powell Spears Lubersky, Seattle, for Appellant.

Anne Elizabeth Egeler, Cameron Gordon Comfort, Assistant Attorneys General, for Respondent.

Dirk Jay Giseburt, Settle, for Amicus Curiae.

HUNT, C.J.

Dr. Charles A. Pilcher appeals a judgment for the Washington Department of Revenue (Department) in his business and occupation (B & O) tax refund

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action. He \*430 argues that the Department wrongfully required him to pay B & O tax on that portion of his gross receipts from Evergreen Hospital that he had paid to the physicians he hired to staff the hospital's emergency department. We hold that (1) substantial evidence supports the trial court's findings of fact, and (2) Pilcher's payments to the physicians under his contract with Evergreen are not excludable from income as pass-through payment exemptions. We affirm.

## FACTS

Evergreen Hospital (the Hospital) provides emergency services to patients through its emergency department. Evergreen contracts out its emergency department physician services, rather than hire the necessary emergency room physicians itself.

### I. EMERGENCY SERVICES CONTRACTS

#### A. HOSPITAL-PILCHER CONTRACT

Dr. Pilcher is a licensed physician and Certified Specialist in Emergency Medicine. During the 1986-89 audit period at issue here, he contracted with the Hospital (the Hospital/Pilcher contract) to serve as Medical Director and as the providing physician for the Hospital's emergency department.

<sup>FN1</sup>

FN1. The Hospital's strategy was that its emergency department could be "managed most efficiently and effectively if medical direction and professional services are provided by a single responsible individual." CP at 662 (Finding 4). The Hospital wanted to ensure accountability by having "Dr. Pilcher be solely responsible for the provision of emergency physician services." Report of Proceedings (RP) at 176. The Hospital understood that it was entering into a contract solely with Dr. Pilcher

and did not think that Dr. Pilcher was representing other parties. CP at 297.

As part of the Hospital/Pilcher contract, Dr. Pilcher agreed that he "or one or more of his agents or employees, shall be in attendance and on duty as a physician in the emergency department of the Hospital at all times, so as to provide the Hospital 24-hour on-duty coverage." Clerk's \*431 Papers (CP) at 662 (Finding 5.1). Because it would be physically impossible for Dr. Pilcher to be on duty 24 hours a day, seven days a week, CP \*\*949 at 664 (Finding 6), the Hospital agreed that Dr. Pilcher could "from time to time associate competent, licensed, physicians or associates, in his sole discretion [.] CP at 664 (Finding 5.10).

The Hospital/Pilcher contract provided that (1) the relationship of Dr. Pilcher "and his agents and employees to the Hospital shall be that of an independent contractor," CP at 209, and (2) neither he "nor his employees or agents shall be deemed employees of the hospital for any purpose whatsoever...." CP at 209. The contract held Dr. Pilcher directly responsible if the medical care rendered by the physicians he retained was not consistent with the hospital's "intent of supplying a high degree of quality medical care." CP at 663 (Finding 5.5). The contract further provided that "failure to maintain said quality care and failure to correct the situation will constitute a breach by the Doctor [Pilcher]." CP at 212.

#### B. PILCHER-INDEPENDENT PHYSICIANS CONTRACTS

Dr. Pilcher hired at least five other physicians to work in the Hospital's emergency department. He prepared and required each physician to sign a contract (Pilcher/physician contract),<sup>FN2</sup> specifying the terms of their relationship. None of these physicians entered into contracts with the Hospital for emergency room services.<sup>FN3</sup> Rather, the physicians worked as "independent contractor[s] to [Dr. Pilcher]," CP at 221, and Dr. Pilcher could termin-

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ate the physicians as he saw fit.

FN2. The Hospital had no role in drafting or signing these contracts; nor did Dr. Pilcher have authority to enter into contracts on the Hospital's behalf. Rather, it was solely Dr. Pilcher's obligation to supply the physicians sharing the emergency department's workload. Thus he, not the Hospital, contracted with the emergency room physicians.

FN3. The Hospital expressly agreed with Dr. Pilcher that it would not negotiate with any physician whom he retained for emergency services.

\*432 Under the Pilcher/physician contracts, each retained physician acknowledged that Dr. Pilcher was "responsible for all administrative matters pertaining to their practices in the Emergency Department." CP at 665 (Finding 7.4).<sup>FN4</sup> Each agreed, however, to accept delegated administrative assignments by Dr. Pilcher "for the benefit of [individual] professional growth or of the department as a whole." CP at 222.

FN4. The Hospital/Pilcher contract likewise provided: "The Doctor [Pilcher] shall be responsible for all administrative matters appertaining to his physician agents and employees." CP at 211.

#### C. EMERGENCY ROOM FEES

Under the Hospital/Pilcher contract,

Charges for the professional services rendered by [Dr. Pilcher] pursuant to this agreement shall be made on a fee-for-service basis ... in accordance with a fee schedule to be prepared by [Dr. Pilcher] and approved in advance by the Hospital.

CP at 212. On a monthly basis, Dr. Pilcher and his retained physicians submitted their emergency services fees for the Hospital to bill its patients.<sup>FN5</sup>

Dr. Pilcher, his retained physicians, and the Hospital agreed that all of the emergency room physicians' submitted "charges shall be considered the gross charges by [Dr. Pilcher] during that one-month period." CP at 214. Once a month, the Hospital compensated Dr. Pilcher by paying him the charges he and his retained physicians had submitted to the Hospital, "less 18.7 percent thereof for costs of collection, billing, and general overhead." <sup>FN6</sup> CP at 664, Finding 5.7.

FN5. Emergency department patients were not informed of the nature of the relationships between the Hospital, Dr. Pilcher, and the physicians whom Dr. Pilcher retained to provide services.

FN6. The Hospital's payments to Dr. Pilcher did not depend on the hospital's first receiving payments from the emergency department's patients or their insurers.

The Evergreen/Pilcher contract provided that Dr. Pilcher was solely responsible for paying the physicians he retained:

\*433 [Dr. Pilcher] shall be exclusively responsible for the payment of all wages and salaries ... and the filing of all necessary documents, forms and returns pertinent to all of the foregoing. *In the event that [Dr. Pilcher] fails to make any such payment or filing, he shall hold harmless and provide\*\*950 the Hospital with a defense against any and all claims that the Hospital is responsible for such payment or filing.*

CP at 218 (emphasis added). This provision fairly reflected the actual relationship and practices of the Hospital and Dr. Pilcher.

The physicians Dr. Pilcher retained likewise acknowledged in their contracts that Dr. Pilcher was exclusively responsible for paying them.<sup>FN7</sup> The amount of their compensation was strictly between Dr. Pilcher and the individual physicians. Under the

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Pilcher/physician contracts, Dr. Pilcher paid each physician his or her total billed charges for providing emergency department medical services each month, "less 22.7 percent."<sup>FN8</sup> If for some reason the physicians were not paid, the Hospital "would have expected Dr. Pilcher to resolve the issue." Report of Proceedings (RP) at 216.

FN7. Regarding the Hospital/Pilcher contract provision that Dr. Pilcher "shall be exclusively responsible for the payment of all wages and salaries ...," the Pilcher/physician contracts noted: "As an independent contractor, you agree to file all necessary forms and pay all amounts for which you might be liable as provided in this paragraph." CP at 218; CP at 223.

FN8. Evergreen did not restrict Dr. Pilcher with respect to what he paid the physicians or the amount he retained as his administrative fee.

## II. AUDIT

The Washington Department of Revenue audited Dr. Pilcher and determined that (1) he had underreported payments he received from the Hospital; (2) "[t]he difference was the amounts deducted which represented amounts [Dr. Pilcher] paid to other physicians which [he] subcontracted with to staff the emergency room in [his] absence"; CP at 637, and (3) WAC 458-20-111 (Rule 111)<sup>FN9</sup> \*434 did not apply or allow an exemption. The Department assessed additional business and occupation (B & O) taxes of \$49,166, plus statutory interest.

FN9. WAC 458-20-111 excludes certain "pass through" payments from gross income.

Dr. Pilcher filed an administrative appeal with the Department's Appeals Division, which upheld the Department's assessment. Dr. Pilcher paid the assessment, then filed for a refund. He next appealed to the Board of Tax Appeals (BTA), which also up-

held the Department's assessment.<sup>FN10</sup> Dr. Pilcher filed a de novo, excise-tax-refund appeal under RCW 82.32.180, and the parties had a bench trial in Thurston County Superior Court.

FN10. Attachment # 1 to Respondent's Brief indicates the BTA agreed that Dr. Pilcher provided services as an independent contractor to the Hospital and not solely as the agent of the other emergency department physicians for collection of fees; the BTA sustained the Department's assessment of B & O tax. *See Pilcher v. Dep't of Revenue*, Docket No. 46920 (August 23, 1996).

Dr. Pilcher admitted that the Hospital had issued I.R.S. Forms 1099 to him that "include[d] the gross income or the gross amount that was paid to [him]," RP at 64-65, which gross amounts he reported as his gross income for federal income tax purposes. On his federal income tax return, Dr. Pilcher also deducted, as a business expense (labor cost), the amounts he paid to the physicians he retained to staff the Hospital's emergency department "[b]ecause [he] was entitled to it." RP at 154.

In a letter opinion denying Dr. Pilcher's refund claim, the trial court stated:

This court will uphold the Board of Tax Appeal decision. Dr. Pilcher was the sole contracting agent with Evergreen Hospital and ultimately responsible for the hiring and firing of the contracting ER physicians. Although he considered himself a conduit for all the physicians and in practice the ER physicians made decisions as a group, by the terms of the contract with Evergreen, Dr. Pilcher could have overridden their collective decisions. The court is not persuaded that the practice overrides the clear and unambiguous terms of the contract.

CP at 640. The trial court filed findings of fact and conclusions of law consistent with its letter opinion, and entered \*435 judgment in the Department's fa-

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vor, from which Dr. Pilcher now appeals.

## ANALYSIS

### I. STANDARD OF REVIEW

[1][2] “[C]hallenged findings will be binding on appeal if they are supported by substantial\*\*951 evidence in the record.” *In the Matter of the Contested Election of Schoessler*, 140 Wash.2d 368, 385, 998 P.2d 818 (2000) (citation omitted). “Substantial evidence exists where there is a sufficient quantity of evidence in the record to persuade a fair-minded, rational person of the truth of the finding.” *Schoessler*, 140 Wash.2d at 385, 998 P.2d 818 (citation omitted).

[3][4] On appeal, we view the evidence in the light most favorable to the prevailing party. *Bennett v. Dep't of Labor & Indus.*, 95 Wash.2d 531, 534, 627 P.2d 104 (1981). Under the substantial evidence standard, we “will not substitute our judgment for that of the fact finder. Instead, [this Court] accept[s] the fact finder’s views regarding the credibility of witnesses and the weight accorded to reasonable but competing inferences.” *Isla Verde Int'l Holdings, Inc. v. City of Camas*, 99 Wash.App. 127, 133-34, 990 P.2d 429 (1999), *review granted*, 141 Wash.2d 1011, 10 P.3d 1071 (2000) (citation omitted).

### II. BUSINESS & OCCUPATION TAX LIABILITY

Dr. Pilcher argues that any doubt as to the imposition of a tax must be resolved in his favor and that the trial court’s decision in favor of the Department is not sustainable in light of controlling case law.

#### A. B & O TAX IMPOSITION

[5][6][7] The B & O tax applies to virtually all business activities conducted in this state. *Simpson*

*Inv. Co. v. Dep't of Revenue*, 141 Wash.2d 139, 149, 3 P.3d 741 (2000). RCW 82.04.220 provides, in pertinent part:

\*436 Business and occupation tax imposed.

There is levied and shall be collected from every person a tax for the act or privilege of engaging in business activities. Such tax shall be measured by the application of rates against ... gross income of the business. ...

(Emphasis added.) RCW 82.04.080 defines “gross income of the business” as:

[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.

(Emphasis added.) Under this broad definition, a service provider may not deduct any of its own costs of doing business, including its labor costs, from its gross income. *Rho Co., Inc. v. Dep't of Revenue*, 113 Wash.2d 561, 566-67, 782 P.2d 986 (1989).

Under the Evergreen/Pilcher contract, Dr. Pilcher was in the business of providing services to Evergreen: his management services and the services of the physicians he hired as his independent contractors to help staff the emergency room. He was not entitled to deduct his labor costs or any other expenses related to his business before paying the B & O tax on the gross income he received from the Hospital as compensation for his services. That the amount of his compensation was dependent on the hours of emergency room services that his physi-

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cians provided does not entitle him to deduct the amounts he paid them for performing those services.

Dr. Pilcher argues broadly that fees earned by other physicians for treatment they provided to patients "obviously did not constitute compensation paid to [him] for services he rendered to patients and therefore did not \*437 belong to [him] and were neither "received" nor "accrued" (RCW 82.04.090) by him," citing *Walthew, Warner, Keefe, Arron, Costello & Thompson v. Dep't of Revenue*, 103 Wash.2d 183, 691 P.2d 559 (1984). In *Walthew*, the court found that a law firm was not liable for B & O tax on the firm's advances to third party service providers for services that the firm itself did not provide, such as court reporters and expert witnesses, when acting solely as an agent for the client and a conduit for such payments, which fell \*\*952 within the exemption of WAC 458-20-111 (Rule 111).

But such is not the case here. First, unlike in *Walthew*, Dr. Pilcher was *not* acting solely as an agent for the physicians he hired to staff the Hospital's emergency room; on the contrary, the contracts specifically stated that he was not their agent. Second, Dr. Pilcher was not acting solely as a pass-through for payments from the Hospital to the physicians; rather, under their contracts, Dr. Pilcher could pay the physicians any amount they agreed upon, independent of what the Hospital paid him. Thus, unlike in *Walthew*, Dr. Pilcher was *not* entitled to a Rule 111 exemption.

#### B. RULE 111 B & O TAX EXEMPTION

[8] Although a taxpayer may not deduct business costs from its gross income for B & O tax purposes, at times in the regular course of business, a taxpayer may receive money to pay costs that are its client's obligation. The Department has promulgated WAC 458-20-111 (Rule 111) to distinguish between (1) those instances when a taxpayer receives payment for services provided or work per-

formed, and (2) those instances when a taxpayer receives money to use for a "pass through" payment to satisfy its client's obligation. Rule 111 provides in pertinent part:

#### Advances and reimbursements.

The word "advance" as used herein, means money or credits received by a taxpayer from a customer or client with which the taxpayer is to pay costs or fees for the customer or client. \*438 The word "reimbursement" as used herein, means 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 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.*

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

The foregoing is limited to cases wherein 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. It does 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

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taxpayer engages.

WAC 458-20-111 (emphasis added).

Our Supreme Court has adopted a three-part test to determine whether a payment received by a taxpayer qualifies as a "pass through" payment under Rule 111: (1) "[T]he repayments received by the taxpayer must be reimbursements or advances made as part of the regular and usual custom of the taxpayer's business or profession"; (2) "the payments made by the taxpayer to associate firms are for services that the taxpayer does not or cannot render"; and (3) "the taxpayer is not liable for paying the associate firms except as the agent of the client." *Christensen, O'Connor, Garrison & Havelka v. Dep't of Revenue*, 97 Wash.2d 764, 769, 649 P.2d 839 (1982).

\*439 Dr. Pilcher relies on *Christensen*, and subsequent cases,<sup>FN11</sup> to argue that Rule 111 \*\*953 supports a deduction or exemption for the payments he made to the physicians he retained for the emergency room.<sup>FN12</sup> But the facts do not support a Rule 111 exemption for Dr. Pilcher, nor do they support that Dr. Pilcher, the Hospital, and subcontracting physicians contradicted the stated terms of their respective contracts in actual practice.

FN11. *Walthew*, 103 Wash.2d at 183, 691 P.2d 559 (law firm not taxable on reimbursements for some litigation expenses that firm paid and client ultimately remained liable for); *Rho*, 113 Wash.2d at 561, 782 P.2d 986, (wages paid temporary workers excludable only if obligation to pay resulted solely from capacity as an agent for the clients); *Med. Consultants N.W., Inc. v. State*, 89 Wash.App. 39, 947 P.2d 784 (1997), *review denied*, 136 Wash.2d 1002, 966 P.2d 901 (1998) (services that cannot be performed by the taxpayer, but rather taxpayer contracted for on behalf of client who remains liable for payment, not taxable to the taxpayer).

FN12. He also cites case law for the proposition that "substance rather than form should be used to assess tax classifications." Brief of Appellant at 32-33; see *First Am. Title Ins. Co., v. Dep't of Revenue*, 144 Wash.2d 300, 27 P.3d 604 (2001); *Time Oil Co. v. State*, 79 Wash.2d 143, 146, 483 P.2d 628 (1971).

#### I. Advances or Reimbursements for Clients

Under the first part of the *Christensen* test, Dr. Pilcher had to prove that the Hospital's payments to him were "advances or reimbursements." But the record supports the trial court's finding that these payments were neither advances nor reimbursement for the monies he owed his retained physicians. Rather, the record shows that the Hospital made these payments exclusively to Dr. Pilcher for providing medical coverage and management for the Hospital's emergency department.

It is undisputed that the Hospital purposefully chose to contract for emergency services solely with Dr. Pilcher. The Hospital's only legal obligation was to Dr. Pilcher. The Hospital had no separate contract with the physicians Dr. Pilcher retained. Dr. Pilcher had no authority to enter into contracts on the Hospital's behalf. Dr. Pilcher was solely liable for paying the physicians. In effect, the Hospital was purchasing physician services and management from Dr. Pilcher.

\*440 The record further reflects that Dr. Pilcher did not pay his retained physicians until after they performed their services, after he submitted the charges to the Hospital, and after he received his monthly payment from the Hospital. Thus, such payments from the Hospital to Dr. Pilcher were neither advancements to him nor reimbursements for money he had paid his emergency room physicians.

The trial court did not err in concluding that Dr. Pilcher failed the first prong of the test. Rather, the

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evidence supports its conclusion that “the payments Pilcher received from Evergreen were for the professional services he rendered to the Hospital under the Evergreen/Pilcher contract,” and they were neither advances nor reimbursements. CP at 669 (Conclusions 9-10).

## 2. Payments for Services the Taxpayer Did Not or Could Not Render

The trial court concluded,

Regarding the second prong of the *Christensen* test, Pilcher rendered the professional services required by the Evergreen/Pilcher contract either personally or through his physician subcontractors. Pilcher thus did not receive payments from Evergreen for services which he did not or could not render.

CP at 669. The Hospital agreed to pay Dr. Pilcher for “professional medical coverage” and for serving as the emergency department’s medical director. The Hospital’s intent in entering into the contract with Dr. Pilcher was to have “*one individual* to hold accountable for the services provided in the Emergency Department.” CP at 662, Finding 4 (emphasis added). Although the Hospital/Pilcher contract contemplated that Dr. Pilcher would provide some emergency medical coverage through hired associate physicians, those associates clearly worked for Dr. Pilcher; only he entered into contracts with them.

In contrast, the Hospital specified in the Hospital/Pilcher contract that it would “*not negotiate* with any of the other emergency room physicians, for the use of their services \*441 during the term of this contract.” CP at 215 (emphasis added). If the Hospital was displeased with the quality of care provided by any of Dr. Pilcher’s retained physicians, he was responsible to correct the problem or he would be in breach of his contract with the Hospital. He alone was responsible for firing the offending physician, if required, and finding a re-

placement.

The trial court did not err in finding that Dr. Pilcher failed the second prong of the \*\*954 test; the services for which the Hospital paid him were for services that he could and did provide.

## 3. Taxpayer Liable Only as Agent of Client

The third part of the *Christensen* test specifies that Dr. Pilcher must not be liable for the money in issue, “except as the agent of the client.” On this point, the trial court concluded that Dr. Pilcher was solely responsible for paying the physicians he retained, regardless of whether the Hospital paid him or whether the patients paid the Hospital. The trial court’s findings of fact, and the evidence in the record on which those findings are based, support this conclusion. The Hospital/Pilcher contract stated, “[Dr. Pilcher] shall be exclusively responsible for the payment of all wages and salaries....” CP at 218. In practice, the Hospital did not pay Dr. Pilcher for only those charges that had already been collected by the patients; rather, it paid him the gross amount he billed each month, less 18.7 percent, which represented the Hospital’s projected costs for collection, billing, and general overhead. The trial court did not err in concluding that Dr. Pilcher failed the third prong of the *Christensen* test because his liability was not solely that of an agent.

Substantial evidence in the record supports the trial court’s findings, and those findings, in turn, support the trial court’s conclusions of law and judgment in this case. On appeal Dr. Pilcher continues to argue another meaning of the evidence presented; but in so doing, he is asking us to \*442 make credibility determinations that we cannot properly make because to do so would supercede the judgment of the trier of fact.

Under the statutes, Dr. Pilcher is liable for B & O tax on the gross income that he received from the Hospital, without any deduction for his costs for hiring the extra emergency room physicians. He

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does not qualify for an exemption under Rule 111 because he fails one or more prong of the *Christensen* test. The Department properly denied his refund.

Affirmed.

We concur: SEINFELD and ARMSTRONG, JJ.  
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# APPENDIX 13

WAC 458-20-111

Advances and reimbursements.

The word "advance" as used herein, means money or credits received by a taxpayer from a customer or client with which the taxpayer is to pay costs or fees for the customer or client.

The word "reimbursement" as used herein, means 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 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.

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

The foregoing is limited to cases wherein 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. It does 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.

For example, where a taxpayer engaging in the business of selling automobiles at retail collects from a customer, in addition to the purchase price, an amount sufficient to pay the fees for automobile license, tax and registration of title, the amount so collected is not properly a part of the gross sales of the taxpayer but is merely an advance and should be excluded from gross proceeds of sales. Likewise, where an attorney pays filing fees or court costs in any litigation, such fees and costs are paid as agent for the client and should be excluded from the gross income of the attorney.

On the other hand, no charge which represents an advance payment on the purchase price of an article or a cost of doing or obtaining business, even though such charge is made as a separate item, will be construed as an advance or reimbursement. Money so received constitutes a part of gross sales or gross income of the business, as the case may be. For example, no exclusion is allowed with respect to amounts received by (1) a doctor for furnishing medicine or drugs as a part of his treatment; (2) a dentist for furnishing gold, silver or other property in conjunction with his services; (3) a garage for furnishing parts in connection with repairs; (4) a manufacturer or contractor for materials purchased in his own name or in the name of his customer if the manufacturer or contractor is obligated to the vendor for the payment of the purchase price, regardless of whether the customer may also be so obligated; (5) any person engaging in a service business or in the business of installing or repairing tangible personal property for charges made separately for transportation or traveling expense.

Revised May 1, 1947.

[Order ET 70-3, § 458-20-111 (Rule 111), filed 5/29/70, effective 7/1/70.]

# APPENDIX 14

RCW 82.04.080

"Gross income of the business."

"Gross income of the business" means the 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.

[1961 c 15 § 82.04.080. Prior: 1955 c 389 § 9; prior: 1949 c 228 § 2, part; 1945 c 249 § 1, part; 1943 c 156 § 2, part; 1941 c 178 § 2, part; 1939 c 225 § 2, part; 1937 c 227 § 2, part; 1935 c 180 § 5, part; Rem. Supp. 1949 § 8370-5, part.]

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DEPUTY

NO. 39487-1-II

**COURT OF APPEALS, DIVISION II  
OF THE STATE OF WASHINGTON**

ST. JOSEPH GENERAL  
HOSPITAL v. DOR,

Appellant,

v.

STATE OF WASHINGTON,  
DEPARTMENT OF REVENUE,

Respondent.

DECLARATION OF  
SERVICE

I, Carrie A. Parker, state and declare as follows:

I am a citizen of the United States of America and over 18 years of age and not a party to this action. On December 31, 2009, I caused a true and correct copy of RESPONDENT'S BRIEF and this DECLARATION OF SERVICE to be served electronically by email and via U.S. mail (through Consolidated Mail Services), with proper postage affixed to:

Carla DewBerry  
Roger L. Hillman  
Jamal N. Whitehead  
Garvey Schubert Barer  
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**ORIGINAL**

I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

Executed this 31st day of December, 2009, in Tumwater, Washington.

  
Candy Zilinskas, Legal Assistant