

84101-2

RECEIVED
SUPREME COURT
STATE OF WASHINGTON

10 FEB 11 PM 4:28

No. 84101-2

BY RONALD R. CARPENTER

Court of Appeals No. 38247-4-II

RRC

CLERK

WASHINGTON STATE SUPREME COURT

WASHINGTON STATE DEPARTMENT OF REVENUE,

Petitioner,

v.

WASHINGTON IMAGING SERVICES, LLC,

Respondent.

ANSWER TO PETITION FOR REVIEW

**Greg Montgomery
Monica Langfeldt
MILLER NASH LLP
4400 Two Union Square
601 Union Street
Seattle, Washington 98101-2352
(206) 622-8484**

**Attorneys for Respondent
Washington Imaging Services, LLC**

TABLE OF CONTENTS

	Page
I. INTRODUCTION	1
II. ISSUES PRESENTED FOR REVIEW	5
III. STATEMENT OF CASE	5
IV. ARGUMENT WHY REVIEW SHOULD BE DENIED.....	10
A. Speculative Assertions Cannot Create An Issue Of Substantial Public Interest.....	10
B. The Decision In This Case Is Not In Conflict With A Court Of Appeals Decision.....	12
C. The WIS Decision Is Not In Conflict With Any Decision Of This Court.....	13
V. CONCLUSION.....	17

APPENDIX – 1998 Petition For Review

TABLE OF AUTHORITIES

	Page
STATE CASES	
<i>Christensen, O'Connor, Garrison & Havelka v. Dep't of Revenue</i> , 97 Wn.2d 764, 649 P.2d 839 (1982)	10, 14, 16-17
<i>City of Tacoma v. Wm. Rogers Co.</i> , 148 Wn.2d 169, 60 P.3d 79 (2003)	4, 11, 13-14
<i>Medical Consultants Northwest, Inc. v. State of Washington</i> , 89 Wn. App. 39, 947 P.2d 784 (1997) review denied 136 P.2d 1002 (1998)	Passim
<i>Pilcher v. Dep't of Revenue</i> , 112 Wn. App. 428, 49 P.3d 947 (2002) review denied 149 Wn.2d 1004 (2003)	4, 11-13
<i>Rho Co. v. Dep't of Revenue</i> , 113 Wn.2d 561, 782 P.2d 986 (1989)	11, 14
<i>Walthew, Warner, Keefe, Arron, Costello & Thompson v. Dep't of Revenue</i> , 103 Wn.2d 183, 691 P.2d 559 (1984)	11, 14-15
<i>Washington Imaging Services, LLC v. Washington State Dep't of Revenue</i> , Case No. 38247-4-II, Slip Opinion (Sept. 22, 2009) ("WIS Decision")	Passim
 STATUTES	
RAP 13.4(b)(1)	1, 4-5
RAP 13.4(b)(1), (2)	17
RAP 13.4(b)(2)	5, 12-13
RAP 13.4(b)(4)	Passim
Rule 111	11

I. INTRODUCTION

The Washington State Department of Revenue (“DOR”) seeks review of the Division II Court of Appeals’ decision in *Washington Imaging Services, LLC v. Washington State Dep’t of Revenue*, Case No. 38247-4-II, Slip Opinion (Sept. 22, 2009) (“WIS Decision”).

In its Petition for Review, the DOR argues that review should be accepted for two reasons. First, there is no direct contractual relation between the patients of Washington Imaging Services (“WIS”) and the Overlake Imaging Associates (“Overlake”) that obligates the patients to pay Overlake for the professional radiology services. Therefore, excluding funds WIS collects for these services and pays to Overlake from the gross income of WIS is contrary to existing case law. This is incorrect. There is no basis for review under RAP 13.4(b)(1) or (2).

Second, allowing the WIS Decision in this case to stand will encourage other businesses to adopt a structure similar to the WIS/Overlake business structure, thereby allowing widespread avoidance of tax. This speculative assertion cannot serve as a basis for review under RAP 13.4(b)(4).

These are essentially the same arguments the DOR presented to this Court twelve years ago when it filed a similar Petition For Review (“1998 Petition” - Appendix 1) of the Court of Appeals’ decision in *Medical Consultants Northwest, Inc. v. State of Washington*, 89 Wn. App. 39, 947 P.2d 784 (1997) *review denied* 136 P.2d 1002 (1998) (“Medical Consultants”). In its 1998 Petition, the DOR argued that this Court should accept review under RAP 13.4(b) (4) because, if the decision in *Medical Consultants* were allowed to stand:

. . . it will encourage taxpayers similarly situated to MCN to structure their contracts with third-parties so as to avoid paying taxes simply by exalting form over substance. That is, taxpayers will be able to avoid paying B&O taxes merely by asserting [sic] into their contracts with third-parties a condition that will never occur.

See Appendix 1 at 20.

Twelve years later, DOR is making the same argument under RAP 13.4 (b)(4).

In other industries, employers would have an incentive to convert employees into independent contractors. In this manner, they could avoid paying B&O taxes on the amounts received from clients that previously were paid to employees, but now would be paid to contract workers. All taxpayers would need to do to avoid paying tax on amounts they pay to their subcontractors is to condition payment to

the subcontractors on receiving payment from their clients.
(footnote omitted)

Petition for Review at 19-20.

There is no more substance behind this “. . . issue of substantial public interest . . .” basis for DOR’s current Petition for Review today than there was twelve years ago. It should be rejected.

With respect to the contractual relationship among the parties, in its 1998 Petition the DOR emphasized the absence of any agreement on the part of the clients of MCN to pay the physicians who contracted with MCN to perform the independent medical examinations.

. . . the Department did not stipulate that MCN’s clients assumed sole liability for paying the physicians or that MCN was acting as the *agent* of its clients. In fact, another part of the stipulation directly refuted any such notion. *See* CP 222 (“L&I has not and would not pay a bill to the individual physician working for a Panel”).⁶

⁶ The obvious reason being that L&I’s contractual relationship was with MCN, and not with the physicians.

Appendix 1 at 11.

In this Petition, the DOR presents the the “contract argument” as follows:

Here, the billing procedure was similar to that in *Medical Consultants* because WIS was not liable to pay Overlake if it did not receive payments from the patients/insurers. CP 50; Slip Op. at 3, 12. What is missing, however, is any finding or even any evidence that the patients or insurers were themselves liable to pay Overlake for the radiology services Overlake performed under contract to WIS.

Petition for Review at 14.

The relevant case law has not changed since the *Medical Consultants* decision. In both *Pilcher v. Dep't of Revenue*, 112 Wn. App. 428, 49 P.3d 947 (2002) *review denied* 149 Wn.2d 1004 (2003) and *City of Tacoma v. Wm. Rogers Co.*, 148 Wn.2d 169, 60 P.3d 79 (2003), the taxpayers were primarily obligated to pay the individuals who provided services to the taxpayers' clients regardless of whether the client paid the taxpayer, a fact which made the compensation of the individuals assisting the taxpayer a true cost of doing business and distinguishes these cases from the WIS Decision and *Medical Consultants*. The DOR's "contract argument" should be rejected as a basis for review under RAP 13.4(b)(1) or (2).

II. ISSUES PRESENTED FOR REVIEW

The DOR frames the issue for review solely in terms of their contract argument. This is not the issue on a Petition for Review. Based on the DOR Petition For Review there are three issues.

1. Does the WIS Decision raise an issue of substantial public interest such that it should be determined by this Court? RAP 13.4(b)(4)
2. Is the WIS Decision in conflict with a decision of the Court of Appeals? RAP 13.4(b)(2)
3. Is the WIS Decision in conflict with a decision of this Court? RAP 13.4(b)(1)

III. STATEMENT OF CASE

DOR's central factual contention is that there was no evidence that patients or insurers were liable to pay for the Overlake services. This is incorrect.

WIS is a Washington limited liability company that operates medical imaging facilities in Bellevue and Issaquah, Washington. (CP 31; 91 L. 14-15) WIS is owned, in part, by a non-physician. (CP 30)

Treating physicians send their patients to WIS to obtain medical image information in the form of a written report that will assist them with diagnosis and treatment of their patients. (CP 92 L. 2-5; 145) To

accomplish this purpose requires both the production of the medical image, which WIS does, and the professional medical interpretation of that image by a radiologist, which WIS does not, and cannot, do. (CP 146)

To provide the necessary professional medical interpretations of the medical images it produces, WIS contracts with Overlake, a Washington professional services corporation that employs radiologists. (CP 31, 146)

WIS and Overlake have two contracts. (CP 37-59; 60-62) The first contract, dating from 1996, governs the terms and conditions under which Overlake provides the professional medical services of its radiologists to interpret the medical images produced by WIS. (CP 37-59)

Under the second Overlake contract, WIS bills for and collects both its fee (technical fee) and Overlake's fee (professional fee). Under this second contract, Overlake's compensation for professional medical services is a percentage of amounts collected. WIS agreed that it would have no ownership interest in that portion of payments agreed to be for Overlake's professional fees, but would merely collect these fees for Overlake. Overlake also agreed that WIS could bill for its fees and Overlake's fees in one global bill. (CP 60-62)

The first contact WIS has regarding a potential patient is a call from the patient's treating physician. (CP 145) Pursuant to the order of the treating physician, WIS contacts the patient and schedules the patient for the requested medical image. (CP 145) Upon arrival at the WIS facility, the patient completes a registration form that states, in part:

I, the undersigned, hereby consent to and permit Washington Imaging Services, LLC (WIS, LLC), their designees, and all other persons caring for me to perform and administer tests, examinations, including but not limited to x-rays, medical and surgical treatment and other procedures which may be deemed necessary or advisable for me. (CP 141; 145)

The registration form also contains the following terms of

Financial Agreement:

PRIVATE PAY: The undersigned agrees, whether signing as agent or as patient to be financially responsible to Washington Imaging Services, LLC for charges not paid by insurance. I understand this amount is due upon billing.

INSURANCE COVERAGE: I hereby assign payment directly to Washington Imaging Services, LLC for benefits otherwise payable to me, but not to exceed the charges for service. Any portion of charges not paid by the insurance company will be billed to me and is then due and payable within 30 days of invoice. (CP 141; 145)

As a matter of practice, patients are informed that the medical image will be interpreted by a qualified physician and that the results of

the interpretation of the image are generally available within 24 to 48 hours. (CP 33; 134) Once the Overlake radiologist has signed the report, WIS transmits it electronically to the treating physician. (CP 146)

For each medical imaging services transaction, WIS issues a single bill that combines both the technical fee and the professional fee into a single charge. This form of billing is referred to as global billing. Global billing is the customary practice in the outpatient medical imaging business. (CP 146-147)

Insurance companies prefer global billing. (CP 147) It is far more efficient and, therefore, less expensive, for the specific health insurance companies to deal with a single bill that contains all charges for a health care service than to deal with two partial bills for the specific health care service.¹ (CP 96; 147) The contracts that WIS has with health insurance companies to be a provider are set up for global billing. (CP 95 L. 12-17)

The patient is informed of this billing through a statement sent by WIS. (CP 94) Each insurance company has a pre-determined allowance for

¹ Insurance companies will not pay a bill for either the technical fee or the professional fee in isolation. Before insurance companies will pay either fee, they must have been billed for both the technical and professional fees and have been able to match the bills to a single procedure. (CP 97 L. 3-19)

reimbursement for medical imaging services provided to their insured and this allowance, not WIS' billed amount, determines what WIS will be paid. (CP 143; 147)

Depending on the provisions of the insurance policy, the patient may have either a co-pay or deductible payment responsibility. (CP 147) The patient is informed of this through an explanation of benefits form sent by his or her health insurance company. (CP 94) If this is the case, WIS will send a secondary bill to the patient for the patient's co-pay or deduction portion. The secondary bill to the patient identifies the radiologist who interpreted the image, the initial charge for all services, the adjustment of that charge by the insurance company, the amount paid by the insurance company, and the amount owing by the patient under his or her policy. (CP 143; 148)

WIS passes through to Overlake, as payment for its professional medical services, an agreed percentage of what WIS collects on a global bill for a medical imaging transaction. (CP 148) WIS has no ownership interest in this portion of the payment. (CP 61) Beyond passing this agreed amount through to Overlake, WIS has no liability for the

professional fees. (CP 34) If the global bill issued by WIS is not paid, WIS has no liability to Overlake for the professional fees. (CP 28)

IV. ARGUMENT WHY REVIEW SHOULD BE DENIED

A. Speculative Assertions Cannot Create An Issue Of Substantial Public Interest.

The DOR argues that the WIS Decision should be reviewed under RAP 13.4(b)(4) because, if the decision is allowed to stand, taxpayers will alter the manner in which they structure their businesses and thereby improperly avoid taxation. As noted above, this is the same argument advanced by the DOR in its 1998 Petition.

Events in the twelve years since the *Medical Consultants* decision have not borne out the DOR's dire prediction. To the contrary, since then Washington's appellate courts have continued to build on a consistent analytical framework in this area. In those situations in which the taxpayer contracted with an independent third party to provide a service for the taxpayer's customer that the taxpayer did not, or could not, provide, and the taxpayer was not required to pay the third-party for the service unless the customer paid the taxpayer for the service, Washington courts have consistently held that amounts paid to the taxpayer for the third party service are not included in the taxpayer's gross income. *Christensen*,

O'Connor, Garrison & Havelka v. Dep't of Revenue, 97 Wn.2d 764, 649 P.2d 839 (1982) (“Christensen”); *Walthew, Warner, Keefe, Arron, Costello & Thompson v. Dep't of Revenue*, 103 Wn.2d 183, 691 P.2d 559 (1984) (“Walthew”); *Medical Consultants v. State*, 89 Wn. App. 39, 947 P.2d 784 (1997). On the other hand, where the taxpayer could, and did, render the service for which compensation was paid, and/or the taxpayer was responsible for paying those who rendered the service even if the customer did not pay, Washington courts have not permitted the taxpayer to exclude from its gross income any portion of the compensation it received for the service, even if it used some portion to pay those who assisted the taxpayer in furnishing the service. *Pilcher v. Dep't of Revenue*, 112 Wn. App. 428, 49 P.3d 947 (2002); *The City of Tacoma v. The William Rogers Co.*, 148 Wn.2d 169, 60 P.2d 79 (2002).

Rho Co. v. Dep't of Revenue, 113 Wn.2d 561, 782 P.2d 986 (1989) resulted in a remand to the Board of Tax Appeals for further consideration. However, the fundamental distinction between the two lines of cases was again made in the decision remanding the case. “If Rho is the employer, then Rho is liable in its own right for the payment [of temporary staff provided to clients], and Rule 111 does not apply.” *Rho* at 569.

The WIS Decision fits within the former category of cases. WIS cannot provide professional medical services to its patients. WIS contracts with a third party, Overlake, for these professional services for its patients. WIS has no obligation to pay Overlake unless the patient or the insurer pays WIS.

This case does not raise an issue of substantial public interest. To the extent the DOR's Petition is based on RAP 13.4(b)(4), it should be denied.

B. The Decision In This Case Is Not In Conflict With A Court Of Appeals Decision.

The DOR asserts that review should be granted under RAP 13.4(b)(2), but does not separately address this argument in its Petition. If this Court is inclined to search the DOR petition for argument in support of this claimed basis for review, it may possibly be contained on page 10 of the DOR Petition. There the DOR appears to suggest that the WIS decision is in conflict with the decisions in *Medical Consultants* and *Pilcher*. All three decisions are Division II decisions.

In *Pilcher*, the appellant-taxpayer, an emergency department physician, argued that he should be relieved of tax liability on amounts he

was paid by the hospital that he then used, in part, to pay the physicians he hired to assist him in providing continuous emergency room medical services. *Pilcher*, 112 Wn. App. at 430. Division II expressly distinguished the *Medical Consultants* decision, noting that, in *Medical Consultants*, the funds paid to the taxpayer for professional medical services were not taxable to the taxpayer because they were for services the taxpayer could not perform but rather contracted for on behalf of its clients who remained liable for payment for the services. *Pilcher*, 112 Wn. App. at 439 n. 11

Division II distinguished the WIS Decision from *Pilcher* and concluded it was similar to *Medical Consultants*. Slip Op. at 13 n.21. The WIS Decision is not in conflict with any court of appeals decision. RAP 13.4(b)(2) cannot be a basis on which to accept review.

C. **The WIS Decision Is Not In Conflict With Any Decision Of This Court.**

The DOR cites four decisions of this Court in support of its contention that the WIS Decision is in conflict with a decision of this Court. In *City of Tacoma v. Wm. Rogers Co.*, 148 Wn.2d 169, 60 P.3d 79 (2003), the individuals whose compensation the taxpayer was trying to

exclude from its gross income were employees of the taxpayer. The taxpayer was primarily liable for paying these employees regardless of whether the taxpayer's clients, for whom the employees worked, paid the taxpayer for the work of its employees. The employees' compensation was a true cost of the taxpayer's business that could not be excluded from its gross income. *Id.* at 179-180.

Similarly, the WIS Decision is not in conflict with *Rho Co. v. Dep't of Revenue*, 113 Wn.2d 561, 782 P.2d 986 (1989) because, although the case was remanded, this Court stated that if the personnel at issue were employees to whom the taxpayer was primarily liable for wages, such amounts, even if paid out of amounts collected from a third party, would not be excludable from the taxpayers gross income. *Id.* at 569.

The WIS Decision is not in conflict with this Court's decisions in *Walthew* and *Christensen*. The services in *Walthew* that the DOR argued were within the "complete package" of services provided by the law firm and, therefore, a "cost of doing business," included services provided by court reporters, process servers, and medical experts.² The law firm did

² The law firm clients had no contracts with process servers or court reporters and did not negotiate the fees charged by these third party providers. *Walthew*, 103 Wn.2d at 185.

not provide these services but retained independent service providers for the benefit of its client because these services were essential to the prosecution of the client's case. *Walthev*, 103 Wn.2d at 185. In rejecting the DOR "complete package/cost of doing business" argument, this Court in *Walthev* stated:

Compensation or consideration for the service is thus the basis for the tax." (Emphasis Added)

...

The language in Rule 111 is consistent with the statute if it is read to reflect the statute's obvious intent to tax only gross income which is "compensation for the rendition of services" (RCW 82.04.080) . . ." (Emphasis Added)

Walthev at 187-88

In the WIS Decision, the service at issue is the professional medical interpretation of WIS images by Overlake radiologists for the benefit of the patient. WIS does not, and cannot, render this service. (CP 31; 146) (RP 36) Instead, patients referred to WIS by their treating physicians provide WIS with written consent for WIS to procure for them such medical procedures or examinations as are deemed necessary or advisable. WIS procures the necessary radiology interpretation of the image it creates through its contract with Overlake.

Each patient also agrees to be financially responsible for the medical services provided. To discharge most or all of this responsibility, each patient assigns to WIS the benefits of his or her health insurance policy. Those benefits include a right of reimbursement for both the technical fee and the professional fee. While WIS and Overlake could submit separate bills for each fee, they submit a global bill for both fees in accordance with industry practice and the preference of the insurers who then pay these bills on behalf of their insured, the WIS patient.

The WIS Decision is not in conflict with *Christensen* which involved exclusion from a law firm's gross income of funds that were reimbursements of expenses paid by the law firm on behalf of its clients. In *Christensen*, there was an understanding between the law firm and the third party services providers that the law firm would be primarily liable for paying them for their services. The third party service providers billed the law firm for their services and the law firm felt it had a professional and ethical obligation to pay these service providers on the bills submitted. The law firm then sought reimbursement from its clients. *Christensen*, 97 Wn.2d at 766-67.

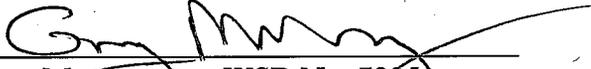
In the WIS Decision, the patients agreed to pay for Overlake's professional services, primarily or exclusively through assignment of health insurance benefits. WIS had no obligation to pay Overlake for its services. The WIS Decision is not in conflict with *Christensen*.

V. CONCLUSION

The DOR has failed to establish that the WIS Decision meets the criteria for review by this Court under RAP 13.4(b)(1), (2), or (4). The Court should deny the DOR Petition for Review.

Dated this 11th day of February, 2010.

MILLER NASH LLP



Greg Montgomery, WSB No. 7985
Monica Langfeldt, WSB No. 36072

Attorneys for Respondent
Washington Imaging Services, LLC

RECEIVED

FEB 17 1998

STOKES LAWRENCE, P.S.

NO. 20489-4-II

Consolidated with
No. 20544-1-II

COURT OF APPEALS
STATE OF WASHINGTON
DIVISION II

MEDICAL CONSULTANTS, NORTHWEST, INC.,

Respondent,

-vs-

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,

Petitioner.

PETITION TO WASHINGTON SUPREME COURT
FOR REVIEW OF COURT OF APPEALS DECISION

CHRISTINE O. GREGOIRE
Attorney General
State of Washington

CAMERON G. COMFORT
WSBA #15188
Assistant Attorney General
Attorneys for Appellant

400 General Admin. Bldg.
P. O. Box 40123
Olympia WA 98504-0123
(360) 753-5528

TABLE OF CONTENTS

A. IDENTITY OF PETITIONER 1

B. COURT OF APPEALS DECISION 1

C. ISSUES PRESENTED FOR REVIEW 1

D. STATEMENT OF THE CASE 1

 1. Factual background. 1

 2. Procedural background. 5

 3. The trial court’s decision. 6

 4. The Court of Appeals’ decision. 7

E. ARGUMENT WHY REVIEW SHOULD BE GRANTED . 8

 1. The decision of the Court of Appeals
 conflicts with numerous decisions of
 this Court and Divisions One and
 Three addressing the question of
 agency. 8

 2. The decision of the Court of Appeals
 conflicts with three decisions of
 this Court and Divisions One and
 Three addressing WAC 458-20-111. 15

 3. Public policy considerations strongly
 support granting review of the decision
 of the Court of Appeals. 19

F. CONCLUSION 20

TABLE OF AUTHORITIES

Cases	Page
<i>Bergin v. Thomas</i> , 30 Wn. App. 967, 638 P.2d 621 (1981)	12
<i>Bering v. Share</i> , 106 Wn.2d 212, 721 P.2d 918 (1986)	8
<i>Christensen, O'Connor, Garrison & Havelka v. Department of Rev.</i> , 97 Wn.2d 764, 649 P.2d 839 (1982)	16, 18, 19
<i>Coombs v. R. D. Bodle Co.</i> 33 Wn.2d 280, 205 P.2d 888 (1949)	9
<i>Costco Wholesale Corp. v. World Wide Licensing Corp.</i> , 78 Wn. App. 637, 898 P.2d 347 (1995)	9
<i>Danielson v. Seattle</i> , 45 Wn. App. 235, 724 P.2d 1115 (1986), <i>aff'd</i> , 108 Wn.2d (1987)	8
<i>Davenport v. Elliott Bay Plywood Machs. Co.</i> , 30 Wn. App. 152, 632 P.2d 76 (1981), <i>review denied</i> , 96 Wn.2d 1025 (1982)	8
<i>Department of Retirement Sys. v. Kralman</i> , 73 Wn. App. 25, 867 P.2d 643 (1994)	9
<i>Hewson Constr., Inc. v. Reintree Corp.</i> , 101 Wn.2d 819, 685 P.2d 1062 (1984)	12
<i>Hollingbery v. Dunn</i> , 68 Wn.2d 75, 411 P.2d 431 (1966)	13
<i>In re Marriage of Stern</i> , 68 Wn.2d 922, 846 P.2d 1387 (1993)	8
<i>In re Riley's Estate</i> , 78 Wn.2d 623, 479 P.2d 1, 48 A.L.R. 3d 902 (1970)	8

<i>Medical Consultants Northwest, Inc. v. State of Washington, Dep't of Rev., ___ Wn.2d ___, 947 P.2d 784 (1997)</i>	1
<i>Moss v. Vadman, 77 Wn.2d 396, 463 P.2d 159 (1969)</i>	9, 12
<i>Nordstrom Credit, Inc., v. Department of Rev., 120 Wn.2d 935, 845 P.2d 1331 (1993)</i>	9
<i>Omni Group, Inc. v. Seattle-First Nat'l Bank, 32 Wn. App. 22, 645 P.2d 727, review denied 97 Wn.2d 1036 (1982)</i>	12
<i>Peter Kiewit Sons' Co. v. Department of Transp., 30 Wn. App. 424, 635 P.2d 740 (1981)</i>	10
<i>Rho Co., Inc. v. Department of Rev., 113 Wn.2d 561, 782 P.2d 986 (1989)</i>	6, 9, 15-20
<i>Ross v. Harding, 64 Wn.2d 231, 391 P.2d 526 (1964)</i>	11
<i>Rusans, Inc. v. State, 78 Wn.2d 601, 478 Wn.2d 724 (1970)</i>	10
<i>Stockdale v. Horlacher, 189 Wash. 264, 64 P.2d 1015 (1937)</i>	10
<i>Uni-Com Northwest, Ltd. v. Argus Pub'g Co., 47 Wn. App. 787, 737 P.2d 304, review denied, 108 Wn.2d 1032 (1987)</i>	9, 13
<i>Walthew, Warner, Keefe, Arron, Costello & Thompson v. Department of Rev., 103 Wn.2d 183, 691 P.2d 559 (1984)</i>	15, 17-19
<i>Zoda v. Eckert, Inc., 36 Wn. App. 292, 674 P.2d 195 (1983), review denied, 101 Wn.2d 1006 (1984)</i>	9

Statutes & Regulations

RAP 13.4(b)(1), (2), and (4) 8
RCW 82.04.290 5
RCW 82.32.180 6, 12
WAC 458-20-111 6, 12, 15, 17, 18

Other Authority

17A Am. Jur. 2d, *Contracts* § 618 (1991) 11
73 Am. Jur. 2d, *Stipulations* § 7 (1974) 10
BLACK'S LAW DICTIONARY 292 (6th ed. 1990) 11
RESTATEMENT (SECOND) OF AGENCY, § 220
(1958) 13, 14

A. IDENTITY OF PETITIONER

Petitioner is the State of Washington, Department of Revenue (the "Department"). Petitioner was the defendant before the Superior Court and the appellant before the Court of Appeals.

B. COURT OF APPEALS DECISION

Petitioner seeks review of the published decision of the Court of Appeals in *Medical Consultants Northwest, Inc. v. State of Washington, Dep't of Rev.*, ___ Wn.2d ___, 947 P.2d 784, and of the Order Denying Motion to Reconsider, filed January 14, 1998. See App. at A-1 to A-12.

C. ISSUES PRESENTED FOR REVIEW

1. Does a de novo standard of review apply when an appellate court reviews a trial court decision based solely on stipulated facts?
2. Did the Court of Appeals erroneously conclude that the Department stipulated that Medical Consultants Northwest, Inc. ("MCN"), was the agent to its clients and, therefore, that WAC 458-20-111 applied?
3. Did the Court of Appeals improperly presume an agency relationship between MCN and its clients?

D. STATEMENT OF THE CASE

1. Factual background.

MCN provides objective medical opinions in the form of written reports to individual clients for a variety of purposes. CP 217. MCN's

clients include public and private industrial insurance companies, casualty claim insurance companies, and law firms representing defendants and plaintiffs. CP 217.

MCN is not licensed to provide medical services. CP 217. MCN instead contracts with independent physicians to conduct independent medical examinations ("IMEs") in a variety of specialties. CP 217-18, 374, 398. Patients are seen individually or as a part of a panel of examining physicians. CP 218. MCN's owner/medical director is a psychiatrist who is qualified to conduct IMEs in his specialty. CP 218.

Physicians contracting with MCN perform as independent contractors. CP 218. They maintain their own staffs and practices, independent of MCN, and have absolute independence in their medical opinions. CP 218-19. MCN publishes and distributes to them a "Physicians' Manual," as well as other documents, which set forth the requirements, duties, and compensation of the physicians. CP 218, 365-77, 389-401. MCN enters into a written agreement with each physician providing "MCN will act on [p]hysician's behalf to facilitate [p]hysician serving as a [c]onsultant in medical matters." CP 218, 402.

MCN employs an administrative staff to market itself, provide support to the physicians, and to perform transcription, accounting, and billing functions. CP 218-19. MCN also ensures for its clients that the

physicians are qualified members in good standing within their professions. MCN periodically sends out questionnaires to panel physicians requesting information regarding their practice, any sanctions or legal actions against them, certificates of licensure, and updated curriculum vitae. CP 219, 375, 399.

MCN usually is contacted by a client who specifies which specialty or specialties are required. CP 219. In some cases, the client may specify or choose from certain physicians to perform the evaluations. CP 219. MCN at times provides advice as to the best approach and specialties in a case, as most clients do not have medical training. CP 219. MCN generally schedules the IME, most of which are conducted on MCN's premises (some take place in the physician's office). CP 219.

MCN's staff converts the results of the physician's completed examination into a final report to be sent to the client. CP 219. The staff proofreads the report and reviews its contents to ensure that the questions posed by the client have been answered. CP 219-20. The report usually is resubmitted to the physician for signature; MCN occasionally has signed a report on a physician's behalf. CP 220.

MCN's bill shows the name(s) of the physician(s) and directs payment to MCN. CP 221, 790-93. The rate is established by MCN (although one of its clients, the Department of Labor & Industries, is

legislatively required to set fees by service). CP 221. The client pays the total fee in one check, as detailed in the billing, which is deposited by MCN. CP 221. MCN then pays the allocable portion to the physician(s). CP 221. MCN's clients understand that MCN pays a portion of the fee it collects to the physician(s) performing the IMEs. CP 222.

MCN's Physicians' Manual provides: "Payment is made to physicians on a monthly basis and physicians are reimbursed for clients seen during the previous month." CP 374. An earlier Physicians' Manual provided: "The physician is paid on a per-patient basis, with payment made at the end of the month during which payment is received from the client." CP 221, 398. Prior to 1995, MCN's administrative staff orally informed physicians that if a client did not pay MCN for an examination performed, MCN would not be obligated to the physician. CP 222. MCN's current Physician/Consultant Agreement, effective in 1995, states that "MCN will make every reasonable effort to collect fees for any consultation services provided by [the physician]. However, if MCN is unable to collect the fee from a client for consultation services provided by [the physician], MCN is not obligated to pay [the physician] for his or her services." CP 222, 795-96. *MCN has never encountered a client which did not pay for an IME.* CP 222.

When one of MCN's clients, L&I, arranges for an IME, MCN bills L&I for that examination and L&I pays MCN for the service. CP 222. L&I has limited knowledge of, but no involvement in, the payment arrangements between MCN and the physicians performing IMEs. CP 222. The fees paid by L&I to MCN for IMEs are paid according to a schedule set by L&I. CP 222. *L&I has not and would not pay a bill to an individual physician working for the Panel.* CP 222.

2. Procedural background.

The Department examined MCN's books and records as part of a routine audit covering the period March 31, 1985 through March 31, 1989. CP 223. The Department's auditor determined that MCN was not including in its gross income for business and occupation ("B&O") tax¹ purposes that portion of the clients' payments which MCN paid to the physicians for performing IMEs. CP 223. The auditor included the fees as a part of MCN's gross income and assessed additional B&O tax. CP 223. MCN appealed to the Department's Interpretation & Appeals Division, contending that it was entitled to deduct the fees as "advances and reimbursements" under the Department's administrative rule WAC

¹Washington's B&O taxes are imposed on the "gross income of the business." RCW 82.04.080. The statutes and rules discussed in this petition are included in the Appendix.

458-20-111 ("Rule 111"). CP 223. Interpretations & Appeals disagreed and upheld the assessment. CP 223, 798-803.

3. The trial court's decision.

Following the denial of its administrative appeal, MCN filed a de novo superior court excise tax refund action under RCW 82.32.180. CP 8-11, 223. MCN subsequently supplemented its appeal to include a later assessment by the Department covering the period January 1, 1990 through June 30, 1994. CP 185-86, 223-24.

At trial, MCN and the Department submitted an agreed Statement of Stipulated Facts. CP 217-25. Based on parties' stipulation, the trial court entered the following conclusion of law:

The plaintiff Medical Consultants Northwest ("MCN") has met the three-prong test gleaned from WAC 458-20-111,² that is:

A. The funds received by MCN from its clients and paid to physicians for performance of independent medical examinations are customary reimbursements for advances made to procure a service for the client;

B. MCN cannot render the service of an independent medical examination because it is not licensed to provide medical services; and

C. MCN has no liability for paying the physicians, except as agent for the client.

²Under Rule 111, genuine "pass through" payments may be excluded from the "gross income of the business" when all the following conditions are met: (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 payment, except as the agent of the client.* *Rho Co., Inc. v. Department of Rev.*, 113 Wn.2d 561, 568, 782 P.2d 986 (1989).

CP 244-45. The trial court's reasoning was stated in a Memorandum

Opinion:

Clearly the Department has stipulated that the third prong - no primary liability for payment - is a fact. The court must find that the third prong of Rule 111 is present by stipulation.

CP 233-34 (footnote omitted; italics added). The trial court also declined to analyze the issue of agency:

This analysis can be done in our case but in light of the factual stipulation that MCN has no liability for payment to the physicians if the client does not pay MCN, the stipulation answers the question.

CP 240 (italics added).

The trial court thus concluded that "MCN's payments to physicians for the rendition of services should not be included in the gross income of MCN for the purposes of B&O tax." CP 245. A judgment in favor of MCN was entered in the amount of \$274,388, plus interest. CP 289-90.

4. The Court of Appeals' decision.

The Court of Appeals affirmed the trial court, concluding that "the finding that MCN's clients assumed sole liability for paying the physicians is clearly supported by the facts," App. at A-5, and that "the sole reasonable inference [from the stipulated facts] is that MCN is not

obligated to pay the physicians unless MCN is first paid by the client."

App. at A-6.³ Consequently, the Court of Appeals found:

The third prong of [Rule 111] is satisfied because MCN is not obligated to pay an independent physician unless MCN is first paid by its client. *If MCN is paid by its client, MCN's obligation to the physician is solely as an agent of its client.*

App. at A-9 (emphases added).

E. ARGUMENT WHY REVIEW SHOULD BE GRANTED

RAP 13.4(b)(1), (2), and (4) provide for review of a decision of the Court of Appeals if (a) it conflicts with a decision of this Court, (b) it conflicts with a decision of another division of the Court of Appeals, or (c) the petition for review involves an issue of substantial public interest that should be determined by this Court. Review of the Court of Appeals' decision in this case is appropriate under each of these criteria.

- 1. The decision of the Court of Appeals conflicts with numerous decisions of this Court and Divisions One and Three addressing the question of agency.**

³It is not clear what standard of review the Court of Appeals applied to the trial court's Findings of Fact and Conclusions of Law. Its opinion sets forth conflicting standards which might apply. See App. at A-4, citing *Bering v. Share*, 106 Wn.2d 212, 220, 721 P.2d 918 (1986); *In re Riley's Estate*, 78 Wn.2d 623, 479 P.2d 1 (1970); and *In re Marriage of Stern*, 68 Wn. App. 922, 928, 846 P.2d 1387 (1993). The appropriate standard of review was de novo review as the record consisted entirely of the parties' stipulated facts with attached exhibits. Thus, the Court of Appeals was "as competent as the superior court to weigh and consider the evidence." See *Danielson v. Seattle*, 45 Wn. App. 235, 240, 724 P.2d 1115 (1986), *aff'd*, 108 Wn.2d 788 (1987); see also *Davenport v. Elliott Bay Plywood Mchs. Co.*, 30 Wn. App. 152, 154, 632 P.2d 76 (1981), *review denied*, 96 Wn.2d 1025 (1982); *In re Riley's Estate*, 78 Wn.2d at 654.

This Court repeatedly has held that essential elements of an agency relationship are mutual consent between a principal and agent, and control by that principal. *See, e.g., Nordstrom Credit, Inc., v. Department of Rev.*, 120 Wn.2d 935, 941, 845 P.2d 1331 (1993); *Rho*, 113 Wn.2d at 561; *Moss v. Vadman*, 77 Wn.2d 396, 402-03, 463 P.2d 159 (1969); *Coombs v. R. D. Bodle Co.* 33 Wn.2d 280, 285, 205 P.2d 888 (1949). Both Division One and Division Three of the Court of Appeals have followed the Supreme Court's rulings: *See, e.g., Costco Wholesale Corp. v. World Wide Licensing Corp.*, 78 Wn. App. 637, 645, 898 P.2d 347 (1995); *Uni-Com Northwest, Ltd. v. Argus Pub'g Co.*, 47 Wn. App. 787, 796, 737 P.2d 304, *review denied*, 108 Wn.2d 1032 (1987); *Department of Retirement Sys. v. Kralman*, 73 Wn. App. 25, 29, 867 P.2d 643 (1994); *Zoda v. Eckert, Inc.*, 36 Wn. App. 292, 296, 674 P.2d 195 (1983), *review denied*, 101 Wn.2d 1006 (1984).⁴

In this case, however, Division Two inexplicably failed to apply the standard agency analysis and, instead, improperly presumed an agency relationship between MCN and its clients based on a stipulation having

⁴Division Two itself previously held that mutual consent and control by the principal are the essential elements of agency. *Bloedel Timberlands Dev., Inc. v. Timber Indus., Inc.*, 28 Wn. App. 669, 674, 626 P.2d 30, *review denied*, 95 Wn.2d 1027 (1981).

nothing to do whatsoever with MCN's relationship with its clients.⁵ Agency, however, cannot be presumed; it must be proven. *Stockdale v. Horlacher*, 189 Wash. 264, 267, 64 P.2d 1015 (1937); *Blodgett v. Olympic Sav. & Loan Ass'n*, 32 Wn. App. 116, 128, 646 P.2d 139 (1982).

Contrary to the Court of Appeals' analysis, the parties' stipulation did not establish that MCN was the agent of its client. Rather, the part of the stipulation upon which agency was based merely provided:

Prior to 1995, in oral discussions with each physician, MCN's administrative staff informed the physician that if a client did not pay MCN for an examination performed, MCN would not be obligated to pay him/her. MCN's current Agreement, effective in 1995, states in pertinent part that:

(8) MCN will make every reasonable effort to collect fees for any consultation services provided by [the physician]. However, if MCN is unable to collect the fee from a client for consultation services provided by [the

⁵The trial court clearly erroneously found that the Department stipulated to an agency relationship between MCN and its clients. See CP 234 ("the third prong of Rule 111 is present by stipulation") and CP 240 ("the stipulation answers the [agency] question"). So did the Court of Appeals. See App. A-6 ("[T]he sole reasonable inference is that MCN is not obligated to pay the physicians unless MCN is first paid by the client") and App. A-9 ("The third prong of [Rule 111] is satisfied because MCN is not obligated to pay an independent physician unless MCN is first paid by its client"). Stipulations, however, are agreements and therefore should be interpreted in a manner consistent with the apparent intention of the parties. "In seeking the intent of the parties, the language used should not be construed so as to give it the effect of an admission of fact obviously intended to be controverted, or the waiver of a right not plainly intended to be relinquished." 73 Am. Jur. 2d, *Stipulations* § 7 (1974); cf. *Rusan's, Inc. v. State*, 78 Wn.2d 601, 606-07, 478 Wn.2d 724 (1970) (interpretation of stipulation that the parties had "stipulated themselves out of court" was unreasonable); *Peter Kiewit Sons' Co. v. Department of Transp.*, 30 Wn. App. 424, 428, 635 P.2d 740 (1981). The Department obviously did not intend to admit that MCN was the agent of its clients when the Department entered into the stipulation regarding the terms of the agreements between MCN and the physicians.

physician], MCN is not obligated to pay [the physician] for his services.

CP 222 (some brackets in original). However, the stipulation that MCN would not be obligated to pay a physician if its client failed to pay plainly involved MCN's relationship with the physicians; it did not address MCN's relationship with its clients. Moreover, it had no tendency to prove that MCN or its clients consented to MCN acting under the control of the clients. Consequently, the Department did not stipulate that MCN's clients assumed sole liability for paying the physicians or that MCN was acting as the *agent* of its clients. In fact, another part of the stipulation directly refuted any such notion. See CP 222 ("L&I has not and would not pay a bill to the individual physician working for a Panel").⁶

The proper inference from the stipulated facts is that MCN's receipt of payment by its clients was a condition precedent⁷ to its

⁶The obvious reason being that L&I's contractual relationship was with MCN, and not with the physicians.

⁷See BLACK'S LAW DICTIONARY 292 (6th ed. 1990) defines "condition" in part as "[a] future and uncertain event upon the happening of which is made to depend the existence of an obligation, or that which subordinates the existence of liability under a contract to a certain future event." Here, of course, the chance of that condition occurring—*i.e.*, non-payment by the client—was virtually nonexistent, if not entirely nonexistent. See CP 222 ("MCN has never encountered a client which did not pay for the IME"). See also *Ross v. Harding*, 64 Wn.2d 231, 236, 391 P.2d 526 (1964) ("'Conditions precedent' are those facts and events, occurring subsequently to the making of a valid contract, that must exist or occur before there is a right of immediate performance, before there is a breach of contract duty, before the usual judicial remedies are available"); see also 17A Am. Jur. 2d, *Contracts* § 618 (1991).

obligation to pay the physicians. However, that MCN conditioned its obligation to pay the physicians for their services upon its receipt of payment from its clients revealed *nothing* whatsoever about whether MCN was the agent of its clients. The Court of Appeals erred in assuming that the Department stipulated to the third prong of Rule 111⁸ and in presuming that MCN was the agent of its clients.

Whether an agency relationship between MCN and its clients existed did not turn on the oral or written terms of MCN's contracts with the physicians, it depended on MCN's relationship with its clients. To correctly ascertain the nature of that relationship, the Court of Appeals should have looked at the facts pertaining to that relationship. The facts alleged by MCN⁹ in support of an agency relationship between MCN and its clients were:

[1] The client specifies the specialty and, at times, the specific physician necessary for an examination. (CP 219.) [2] The client addresses the cover letter to the physician specifying the assignment and the conditions the physician should evaluate. (CP 219.) [3] The physicians have absolute independence in their

⁸Again, the third prong of Rule 111 requires the taxpayer prove that it is not liable for payment, except as the *agent* of the client.

⁹"The burden of establishing the agency relationship rests upon . . . the party asserting its existence." *Hewson Constr., Inc. v. Reintree Corp.*, 101 Wn.2d 819, 823, 685 P.2d 1062 (1984); *Moss*, 77 Wn.2d at 403; *Omni Group, Inc. v. Seattle-First Nat'l Bank*, 32 Wn. App. 22, 28, 645 P.2d 727, review denied 97 Wn.2d 1036 (1982); *Bergin v. Thomas*, 30 Wn. App. 967, 970, 638 P.2d 621 (1981). The burden of proof in excise tax refund actions likewise rests with the taxpayer. See RCW 82.32.180.

medical opinions. (CP 219.) [4] The physicians dictate the report. (CP 219.) [5] The physicians maintain their own separate business and pay their own taxes. (CP 218, 224.) [6] MCN provides only administrative services to the physician, including facilitation and scheduling, transcription and word processing, report collation and billing. (CP 224.)

Resp't's Br. at 21. The first two facts did not establish that MCN was controlled by its clients. Rather, they simply reflected what services the clients were purchasing. Neither fact suggests that the clients controlled the manner of MCN's actual performance. *See Uni-Com*, 47 Wn. App. at 796-97 ("Control is not established if the asserted principal retains the right to supervise the asserted agent merely to determine if the agent performs in conformity with the contract"). The third fact addresses the relationship between MCN and the physicians and, therefore, was irrelevant with respect to the issue of the client's control over MCN. For the same reason, the fourth and fifth facts also were irrelevant. Finally, the sixth fact clearly does not imply that MCN was controlled by its clients, in any manner, in its provision of such services. Thus, it too does not support that MCN was the agent of its clients.

In *Hollingbery v. Dunn*, 68 Wn.2d 75, 80-81, 411 P.2d 431 (1966), this Court turned to the RESTATEMENT (SECOND) OF AGENCY, § 220 (1958), for a more complete list of factors to be considered in

determining whether an agency relationship exists between two parties.

Those factors are:

- (a) the extent of control which, by the agreement, the master may exercise over the details of the work;
- (b) whether or not the one employed is engaged in a distinct occupation or business;
- (c) the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision;
- (d) the skill required in the particular occupation;
- (e) whether the employer or the workman supplies the instrumentalities, tools, and the place of work for the person doing the work;
- (f) the length of time for which the person is employed;
- (g) the method of payment, whether by time or by the job;
- (h) whether or not the work is part of the regular business of the employer;
- (i) whether or not the parties believe they are creating the relationship of master and servant; and
- (j) whether the principal is or is not in business.

See also Comment *h* to § 220 of the RESTATEMENT (App. A-21).

None of the above factors indicating a relation of principal and agent existed here. The record contained no evidence supporting a conclusion that MCN and its clients entered into an agreement for close supervision or *de facto* close supervision of MCN's work. No evidence supported a conclusion that the community regarded MCN as its clients' servant. The work at issue, providing objective IMEs, obviously requires the services of one highly educated and skilled. MCN generally provides the "tools" for the service. *See* CP 219 (most of the medical evaluations

are conducted on MCN's premises). No evidence supported a conclusion that MCN's employment was continuous. Payment was by the job. *See* CP 221. MCN provides its services to a number of different clients. CP 217. Neither L&I nor MCN's clients are in the business of providing IMEs. No evidence supported a conclusion that either MCN or its clients believed that there was a master and servant relation. Finally, some of the work clearly was delegated by MCN to the physicians.

In sum, MCN failed to submit any evidence establishing that it was an agent for its clients or that those clients controlled or had the right to control MCN in the performance of its business. The Court of Appeals therefore erred in concluding that MCN proved the necessary agency relationship to satisfy the third condition of Rule 111. Indeed, to conclude, as the Court of Appeals did, that MCN acts under the control of its clients to provide to them "impartial, objective, and neutral" medical evaluations is contradictory and makes no sense. *See* CP 392.

2. **The decision of the Court of Appeals conflicts with three decisions of this Court and Divisions One and Three addressing WAC 458-20-111.**

On three occasions in the 1980's this Court was called upon to construe Rule 111, and in particular, the third prong of that rule. *Rho Co., Inc., v. Department of Rev.*, 113 Wn.2d 561, 782 P.2d 986 (1989); *Walthew, Warner, Keefe, Arron, Costello & Thompson v. Department of*

Rev., 103 Wn.2d 183, 691 P.2d 559 (1984); and *Christensen, O'Connor, Garrison & Havelka v. Department of Rev.*, 97 Wn.2d 764, 649 P.2d 839 (1982). The Court of Appeals' decision cannot be reconciled with any of these decisions.

In *Rho*, the Department contended that Rule 111 did not apply because Rho's contracts with personnel working for its clients established that Rho "was primarily liable--not just as an agent--for paying the workers." *Rho*, 113 Wn.2d at 569. Rho responded that the Department's reliance on the contracts improperly exalted form over substance and its "payment of the personnel was actually an advance or reimbursement for which Rho was liable only as the clients' agent." This Court agreed with Rho that the Department was exalting form over substance: "Determination of an agency relationship is not controlled by the manner in which the parties contractually describe their relationship. An agency relationship generally arises when two parties consent that one shall act under the control of the other." *Rho*, 113 Wn.2d at 570 (citations omitted).

As the Board of Tax Appeals had limited its analysis to Rho's contracts, *see id.* at 565, this Court remanded to the Board "to determine whether Rho acted as the clients' agent in paying the technical personnel, and if so, whether Rho's liability to the personnel was solely that of an agent." *Id.* at 571 (footnote omitted).

This Court also held that "the standard definition of agency should be used in analyzing Rule 111, absent specific legislative or regulatory statement to the contrary." *Id.* at 573. It further stated:

If any agency relationship is found on remand, then the Board will also have to determine if Rho's obligation to pay the technical personnel constituted *solely* agent liability. Resolution of this issue will require analysis of the control over the contract personnel that was exercised by Rho and by the clients. If the clients' control over the personnel was so pervasive that it should be deemed the employers of the personnel for purposes of B&O taxation, and Rho's control consisted of little more than paying the personnel once they were hired, then Rho should be deemed to be a mere paymaster who pays the personnel only as an agent for the clients. The areas in which control will be important include hiring, compensation, work assignment, supervision and termination.

Rho, 113 Wn.2d at 573.

Here, contrary to this Court's analysis in *Rho*, the Court of Appeals failed to conduct the standard agency analysis. The Court of Appeals instead deferred to the trial court, *see* App. at A-6 ("the trial court properly relied on the stipulated facts and all reasonable inferences drawn therefrom"), which had refused to perform the required agency analysis. CP 240.

In *Walthew*, this Court addressed whether Rule 111 applied to client reimbursements for payments made by the taxpayer law firm to court reporters, physicians, and process servers. This Court held that Rule 111 did:

By excluding agent liability, the rule recognizes pass-through payments of the kind involved here. Reimbursements to attorneys for costs of litigation cannot by rules of this court constitute compensation. Lawyers are bound by the Disciplinary Rules of the Code of Professional Responsibility. DR 5-103 prohibits a lawyer from financing the costs of litigation unless the client remains ultimately liable for those costs. Thus an attorney must because of this rule act solely as agent for the client when financing litigation. Attorneys are unique in this respect. The Department's concern that other professionals will necessarily gain an exemption by our holding is misplaced.

Walthew, 103 Wn.2d at 188. Here, no statute of regulation comparable to DR 5-103 exists and thus the agency analysis required by *Rho* should have been performed.

Finally, in *Christensen*, this Court addressed whether the taxpayer law firm, based on Rule 111, could exclude from its B&O tax payments "amounts it received as reimbursements from its clients to pay the fees of foreign, non-Washington and Washington, D.C., lawyers, the fees of independent professional draftsmen and fees relating to obtaining and maintaining patents in foreign countries." 97 Wn.2d at 765. Regarding the third prong of Rule 111, this Court stated:

The final requirement of Rule 111 exclusion is also satisfied because the taxpayer is not liable for paying the associate firms except as the *agent* of the client. An attorney is not liable for charges incurred by the attorney on behalf of his client unless the attorney assumes such liability. Annot., 15 A.L.R.3d 531, 536 (1967). This includes charges owed agents hired by the attorney to provide services. *Sansom Reporting, Inc. v. Feine, Klaris & Curtis*, 69 Misc. 2d 215, 329 N.Y.S.2d 984 (1981). . . .

Here, both parties have stipulated that the associate firms understand that they are working for the named clients with respect to the work performed. Consequently, the taxpayer is not legally liable to pay the associate firms.

Christensen, 97 Wn.2d at 770.

Here, the parties' stipulation was quite different than the one in *Christensen*. It did not provide that the physicians understood that they were working for MCN's clients. To the contrary, it simply provided that "if MCN is unable to collect the fee from a client for consultation services provided by [the physician], MCN is not obligated to pay [the physician] for his or her services." As explained earlier, the only reasonable inference from this stipulation is that *MCN's liability* to the physicians was dependent upon a condition precedent. Otherwise, the parties would not have further stipulated that "L&I has not and would not pay a bill to an individual physician working for the Panel." CP 222.

In sum, the decision of the Court of Appeals is contrary to this Court's decisions in *Rho*, *Walthew*, and *Christensen*.

3. Public policy considerations strongly support granting review of the decision of the Court of Appeals.

Review also should be granted on the basis that this petition raises an issue of substantial public interest that should be determined by this Court. The Court of Appeals' flawed decision represents a radical departure from the usual analysis that is required to establish an agency

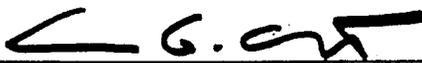
relationship. *See Rho*, 113 Wn.2d at 573 ("the standard definition of agency should be used in analyzing Rule 111"). Consequently, it will encourage taxpayers similarly situated to MCN to structure their contracts with third-parties so as to avoid paying taxes simply by exalting form over substance. That is, taxpayers will be able to avoid paying B&O taxes merely by asserting into their contracts with third-parties a condition that will never occur. *See CP 222* ("MCN has never encountered a client which did not pay for an IME"). Avoidance of a properly imposed tax should not be achieved by the insertion of a condition which will not affect the contracting parties.

F. CONCLUSION

This Court should grant review of the Court of Appeals' decision and reverse the trial court's order requiring the Department to refund to MCN certain business and occupation taxes it paid in 1991 and 1994.

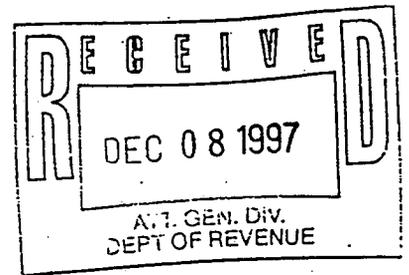
DATED this 13th day of February, 1998.

CHRISTINE O. GREGOIRE
Attorney General
State of Washington


CAMERON G. COMFORT
WSBA #15188
Assistant Attorney General
Attorneys for Washington State
Department of Revenue

APPENDIX

- A-1 Court of Appeals' decision
- A-12 Order Denying Motion to Reconsider
- A-13 RCW 82.04.080
- A-14 RCW 82.32.180
- A-15 WAC 458-20-111 ("Rule 111")
- A-16 RESTATEMENT (SECOND) OF AGENCY, § 220 (1958)



IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

MEDICAL CONSULTANTS NORTHWEST,
INC.,

Respondent/Cross-Appellant,

v.

STATE OF WASHINGTON,

Appellant/Cross-Respondent.

No. 20489-4-II

Consolidated with
No. 20544-1-II

PUBLISHED OPINION

Filed: DEC 05 1997

HUNT, J. – The State of Washington appeals the trial court’s order to refund to Medical Consultants NW, Inc. (“MCN”) excess business and occupation taxes collected, plus interest. The trial court ruled that payments received by MCN were not taxable as gross income because they were not compensation for services provided by MCN. We affirm.

FACTS

A. Procedure

MCN filed a lawsuit to recover taxes paid under protest to the State Department of Revenue (“the Department”) in 1991 and 1994. MCN alleged that the Department erroneously assessed a business and occupation tax against certain payments MCN received from its clients. MCN alleged that these payments were not taxable as gross income subject to Washington’s business and occupation (B&O) tax because the payments were not compensation for services provided by MCN. Rather, the payments represented advances from clients to MCN to pay independent physicians who provided services to MCN’s clients.

A-1

At trial, MCN and the Department submitted an agreed statement of stipulated facts. Based on these stipulated facts, the trial court concluded that the payments should have been excluded from MCN's gross income and ordered the Department to refund MCN's excess tax payments, with interest calculated pursuant to RCW 82.32.060(5).

On appeal, the Department contends that the trial court misinterpreted the stipulated facts and erroneously concluded that the payments should have been excluded from MCN's gross income. On cross appeal, MCN argues that the trial court erred in concluding that RCW 82.32.060(5), rather than RCW 4.56.110, applied to the calculation of postjudgment interest. We affirm.

B. Substantive Facts

1. Medical Exams

The following facts are gleaned from the stipulation. MCN is in the business of providing objective medical opinions in the form of written reports. MCN's opinions are based on medical exams performed by independent physicians.

MCN is not licensed to practice medicine. MCN contracts with individual physicians to conduct independent medical examinations ("IMEs") on behalf of MCN's clients. The IMEs are generally performed by a variety of specialists, who see patients either individually or as part of a panel of several examining physicians. The owner of MCN is a licensed physician, qualified to conduct exams in his specialty; he also serves as MCN's president and medical director.

The physicians perform as independent contractors, not employees of MCN. The physicians maintain their own staffs and practices, independent of MCN, and have absolute

independence in their medical opinions. MCN publishes and distributes to the physicians, documents and a manual ("MCN's Manual"), which sets forth the respective obligations of MCN and the physician. MCN enters into a written agreement with each physician that provides, "MCN will act on [p]hysician's behalf to facilitate [p]hysician serving as a [c]onsultant in medical matters."

MCN generally schedules IMEs on behalf of its clients. Most of the IMEs are conducted on MCN's premises, although some take place in the physicians' independent offices.

MCN's staff converts the results of a physician's completed examination into a final report to be sent to the client. But first MCN resubmits the report to the examining physician for signature. If this examining physician is not available to sign the final report, MCN's medical director can sign (and on rare occasion has signed) the final report on the examining physician's behalf.

2. Billing of MCN's Clients

MCN bills its clients for services provided both by MCN and by the independent physicians. The client pays the total fees for services in one check. Then, MCN forwards the allocable portion to the physician for services rendered. MCN's clients are aware that a portion of the MCN bill represents the fee due the independent physicians who performed the medical examination.

MCN's Manual states: "The physician is paid on a per-patient basis, with payment made at the end of the month during which payment is received from the client. . . . Patient no-shows

are not an uncommon occurrence. When this occurs, you will be reimbursed from the client as a no-show fee."

Prior to 1995, MCN's administrative staff orally informed the physicians that if a client did not pay MCN for an examination performed, MCN would not be obligated to pay the physicians. MCN's current agreement with the physicians, effective in 1995, states in pertinent part that:

(8) MCN will make every reasonable effort to collect fees for any consultation services provided by [the physician]. However, if MCN is unable to collect the fee from a client for consultation services provided by Consultant, MCN is not obligated to pay [the physician] for his services.

MCN has never encountered a client who has failed to pay its bill. If a physician is later called upon to testify on behalf of a client, the client arranges and pays for that service directly.

ANALYSIS

A. Standard of Review

Generally, findings of fact that are supported by substantial evidence will not be disturbed on appeal. *Bering v. Share*, 106 Wn.2d 212, 220, 721 P.2d 918 (1986). But exceptions to this rule have been made in cases where the court's findings are not based on oral testimony. *In re Riley's Estate*, 78 Wn.2d 623, 479 P.2d 1, 48 A.L.R. 3d 902 (1970)¹; *But see In re Marriage of Stern*, 68 Wn. App. 922, 928, 846 P.2d 1387 (1993).²

¹(Where deposition testimony is before an appellate court and the witness in question did not testify orally, the appellate court will determine from the deposition what finding should have been made.)

²The proper standard of review of findings based on a trial by affidavit is whether the findings are supported by substantial evidence and whether the trial court has made an error of law.

B. Trial on Stipulated Facts

On appeal, the Department asserts that it stipulated only that MCN made *representations* to the physicians disclaiming liability, both orally and in written agreements. The Department contends that these representations do not support the trial court's findings. The Department assigns error to the trial court's findings that: (1) "only the [plaintiff's] client has liability for paying the physician and if the client does not pay the physician then the physician understands that [the plaintiff] has no liability either primarily or secondarily for payment,"³ and (2) MCN has no liability for paying the physicians, except as an agent for its client.

Factual stipulations are generally binding on the parties and the court. *Ross v. State Farm Mu. Auto. Ins. Co.*, 132 Wn.2d 507, 940 P.2d 252 (1997). "When a case is submitted to the trial court upon stipulated facts, neither party will be heard to suggest on appeal that the facts were other than as stipulated. Relief from a stipulation may be had only in the trial court." *State ex rel. Carroll v. Gatter*, 43 Wn.2d 153, 155, 260 P.2d 360 (1953). "The power of the court to act upon facts conceded by counsel is as plain as its power to act upon evidence produced." *Best v. District of Columbia*, 291 U.S. 411, 415, 54 S. Ct. 487, 489, 78 L. Ed. 882 (1934) (citing *Oscanyan v. Arms Co.*, 103 U.S. 261, 263, 13 Otto 261, 26 L. Ed. 539 (U.S.N.Y. 1880)).

Here, the finding that MCN's clients assumed sole liability for paying the physicians is clearly supported by the stipulated facts. The trial court buttressed its findings with the following explanation:

The Department stipulates to the fact that if MCN is unable to collect the fee from the client for the medical examination then MCN is not obligated to pay the physician for their services. That is, they admit as fact, that only the client has liability for paying the physician and if the client does not pay the physician then the physician understands that MCN has no liability either primarily or secondarily for that payment. To the extent they do have liability, i.e. when the client does pay, it is liability to forward the payment to the physician. At the time of the initial audit this *modus operandi* was pursuant to a verbal understanding between MCN and the examining physicians. Since 1995 it has been reduced to writing. There is no evidence that the current writing changed how things have always been done and the Department conceded as much during oral argument. The Department simply says in footnote 4 on page 12 of their trial brief that even though they stipulate as fact that MCN does not pay or have to pay the physician if the client does not pay they "question whether this is true." This is confusing. They stipulate that it is true in the Stipulation of Facts, page 6, lines 2-10, which is corroborated by Exhibit K On these facts the court must find that the Department has stipulated that only the client and not MCN is liable for the payment to the physicians. . . .

(Footnotes omitted).

Even if the Department stipulated that MCN made only certain *representations* regarding liability, the sole reasonable inference is that MCN is not obligated to pay the physicians unless MCN is first paid by the client. Absolutely no evidence was offered by the Department to suggest otherwise. Accordingly, the trial court properly relied on the stipulated facts and all reasonable inferences drawn therefrom.

C. Exclusions From Washington's Business and Occupation Tax

Washington levies a business and occupation tax on a business's gross income, including compensation for "rendition of services." RCW 82.04.080. Gross income is broadly defined.

³This finding was part of the trial court's written decision. The written decision was incorporated into the written findings of fact and conclusions of law to the extent necessary to clarify the court's conclusions of law.

with no deductions allowed for expenses involved in conducting the business. RCW 82.04.080, *Rho Co. v. Department of Revenue*, 113 Wn.2d 561, 782 P.2d 986 (1989).

Although business expenses are not deductible, the Department has adopted WAC 458-20-111 ("Rule 111"), an administrative rule that excludes from the definition of gross income certain "pass through" expenses, as follows:

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.

WAC 458-20-111.

The Washington Supreme Court has analyzed Rule 111 in three reported cases. In *Christensen, O'Connor, Garrison & Havelka v. Department of Revenue*, 97 Wn. 2d 764, 769, 649 P.2d 839 (1982), the court held that Rule 111 excludes from gross income "pass through" payments when the following three conditions are met: (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*, 97 Wn.2d at 768-69.

In *Walthew, Warner, Keefe, Arron, Costello and Thompson v. State Dep't of Revenue*, 103 Wn.2d 183, 691 P.2d 559 (1984), the court interpreted Rule 111 in conjunction with RCW 82.04.080, the statute authorizing a business and occupation tax on services. In *Walthew*, a taxpayer law firm sought to exclude from its gross income, client reimbursements for court reporters, physicians, and process servers. The court found that these expenses were the obligation of the client and that the law firm, at most, assumed liability for these payments only as agent for the clients. The court held that "pass-through" payments of this type were not intended by the Legislature to be included in gross income and therefore were not subject to the state's business and occupation tax.

In *Rho*, the taxpayer was in the business of supplying temporary workers to engineering firms. The court focused on the third condition of the *Christensen* test and excluded from Rho's gross income, certain wages paid by Rho's engineering firm clients and passed on to the temporary workers. These wages were excludable only if Rho's obligation to pay the temporary workers resulted solely from its capacity as an agent for the clients. The court ruled that determination of an agency relationship should not be restricted to an analysis of the contract between the parties, but should also take into consideration the parties' actions. The court remanded the case to the Board of Tax Appeals to determine whether Rho acted as the clients'

agent in paying the temporary workers, and if so, whether Rho's liability to the temporary workers was solely that of an agent. *Rho*, 113 Wn.2d 561, 566-71.

Here, the first prong of the *Christensen* test is not in dispute. The second prong of the test is supported by the undisputed fact that MCN does not have a medical license and therefore *cannot* perform the medical examinations. The monies MCN collects for medical exams are not for MCN's "rendition of services," but rather are passed through to the actual renderers of the medical examination services, i.e., the physicians. Finally, the third prong of the *Christensen* test is satisfied because MCN is not obligated to pay an independent physician unless MCN is first paid by its client. If MCN is paid by its client, MCN's obligation to the physician is solely as an agent of its client. Accordingly, the trial court properly concluded that payments MCN receives for the purpose of paying independent physician bills are not subject to Washington's business and occupation tax.

D. Postjudgment Interest

MCN argues that the trial court erroneously calculated postjudgment interest pursuant to RCW 82.32.060(5), which governs interest on tax refunds. MCN concedes that RCW 82.32.060(5) was properly used to calculate prejudgment interest, but contends that RCW 4.56.110(3), which governs interest on judgments *generally* and provides a higher interest rate, should have been used to calculate postjudgment interest in this case.

In *Columbia Steel Co. v. State*, 34 Wn.2d 700, 209 P.2d 482 (1949), the court held that principles of sovereign immunity govern whether the State is required to pay interest on a judgment.

The right to sue the state, when accorded by statute, extends no farther than to grant the plaintiff the right to bring his action and . . . to recover against the state a judgment for the amount due, not including interest unless the payment of interest by the state is also authorized by statute.

Columbia, 34 Wn.2d at 712; see also *Our Lady of Lourdes Hosp. v. Franklin County*, 120 Wn.2d 439, 842 P.2d 956 (1993).

The Legislature has since enacted a statute that waives this immunity and specifically authorizes interest to be paid on tax refunds. RCW 82.32.060 reads in pertinent part:

(5) Any judgment for which a recovery is granted by any court of competent jurisdiction, not appealed from, for tax, penalties, and interest which were paid by the taxpayer, and costs, in a suit by any taxpayer shall be paid in the same manner, as provided in subsection (4) of this section, upon the filing with the department of a certified copy of the order or judgment of the court. Except as to the credits in computing tax authorized by RCW 82.04.435, interest at the rate of three percent per annum shall be allowed by the department and by any court on the amount of any refund, credit, or other recovery allowed to a taxpayer for taxes, penalties, or interest paid by the taxpayer before January 1, 1992. For refunds or credits of amounts paid or other recovery allowed to a taxpayer after December 31, 1991, the rate of interest shall be the rate as computed for assessments under RCW 82.32.050(2), less one percentage point.

MCN argues that the above-quoted statute applies only when the State voluntarily refunds excess tax payments, not when judgment is entered against the State. MCN argues that when judgment is entered against the State for a tax refund, the State must pay interest in accordance with RCW 4.56.110.

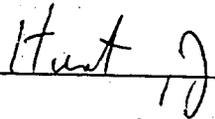
RCW 4.56.110 provides in pertinent part:

interest on judgments shall accrue as follows:

(3) Except as provided under subsections (1) and (2) of this section, judgments shall bear interest from the date of entry at the maximum rate permitted under RCW 19.52.020 on the date of entry thereof

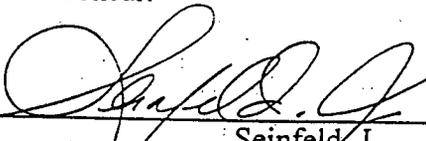
RCW 82.32.060 specifically addresses interest to be paid on tax refunds, including court-ordered judgments for refunds, whereas RCW 4.56.110 speaks to judgments generally. It is a well-settled rule of statutory construction that the specific prevails over the general. *S. Martinelli & Co. v. Washington State Dep't of Revenue*, 80 Wn. App. 930, 940, 912 P.2d 521, review denied, 130 Wn.2d 1004 (1996); see also *Muije v. Department of Social & Health Servs.*, 97 Wn.2d 451, 645 P.2d 1086 (1982).

We hold that RCW 82.32.060(5) controls the rate of interest here and that the trial court properly calculated interest under this statute. We therefore affirm.

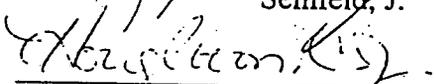


Hunt, J.

We concur:



Seinfeld, J.



Houghton, C.J.

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

MEDICAL CONSULTANTS,
NORTHWEST, INC.,

Respondent/ Cross -Appellant,

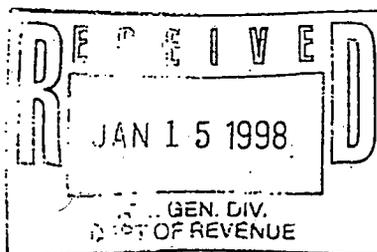
v.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,

Appellant/ Cross-Respondent.

No. 20489-4-II

ORDER DENYING MOTION TO
RECONSIDER



FILED
COURT OF APPEALS
98 JAN 14 PM 1:20
STATE OF WASHINGTON
BY *[Signature]*

APPELLANT moves for reconsideration of the court's decision terminating review, filed December 5, 1997. Upon consideration, the Court denies the motion. Accordingly, it is

SO ORDERED.

DATED this 14th day of January, 1998.

FOR THE COURT:

[Signature]
CHIEF JUDGE

Heather Francks
Suite # 4000
800 5th Avenue
Seattle, WA 98104

Cameron G. Comfort
Assistant Attorney General
400 General Admin. Bldg.
P.O.Box 40123
Olympia, WA 98504-0123

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.

RCW 82.32.180 Court appeal--Procedure.

Any person, except one who has failed to keep and preserve books, records, and invoices as required in this chapter and chapter 82.24 RCW, having paid any tax as required and feeling aggrieved by the amount of the tax may appeal to the superior court of Thurston county, within the time limitation for a refund provided in chapter 82.32 RCW or, if an application for refund has been made to the department within that time limitation, then within thirty days after rejection of the application, whichever time limitation is later. In the appeal the taxpayer shall set forth the amount of the tax imposed upon the taxpayer which the taxpayer concedes to be the correct tax and the reason why the tax should be reduced or abated. The appeal shall be perfected by serving a copy of the notice of appeal upon the department within the time herein specified and by filing the original thereof with proof of service with the clerk of the superior court of Thurston county.

The trial in the superior court on appeal shall be de novo and without the necessity of any pleadings other than the notice of appeal. At trial, the burden shall rest upon the taxpayer to prove that the tax as paid by the taxpayer is incorrect, either in whole or in part, and to establish the correct amount of the tax. In such proceeding the taxpayer shall be deemed the plaintiff, and the state, the defendant; and both parties shall be entitled to subpoena the attendance of witnesses as in other civil actions and to produce evidence that is competent, relevant, and material to determine the correct amount of the tax that should be paid by the taxpayer. Either party may seek appellate review in the same manner as other civil actions are appealed to the appellate courts.

It shall not be necessary for the taxpayer to protest against the payment of any tax or to make any demand to have the same refunded or to petition the director for a hearing in order to appeal to the superior court, but no court action or proceeding of any kind shall be maintained by the taxpayer to recover any tax paid, or any part thereof, except as herein provided.

The provisions of this section shall not apply to any tax payment which has been the subject of an appeal to the board of tax appeals with respect to which appeal a formal hearing has been elected.

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.

A-15

RESTATEMENT OF THE LAW
Second

AGENCY 2d

Volume 1

§§ 1-283

As Adopted and Promulgated

BY THE

AMERICAN LAW INSTITUTE

AT WASHINGTON, D. C.

May 23, 1957

ST. PAUL, MINN.

AMERICAN LAW INSTITUTE PUBLISHERS

1958

A-16

WHO IS A SERVANT

§ 220. Definition of Servant

(1) A servant is a person employed to perform services in the affairs of another and who with respect to the physical conduct in the performance of the services is subject to the other's control or right to control.

(2) In determining whether one acting for another is a servant or an independent contractor, the following matters of fact, among others, are considered:

(a) the extent of control which, by the agreement, the master may exercise over the details of the work;

(b) whether or not the one employed is engaged in a distinct occupation or business;

(c) the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision;

(d) the skill required in the particular occupation;

(e) whether the employer or the workman supplies the instrumentalities, tools, and the place of work for the person doing the work;

(f) the length of time for which the person is employed;

See Appendix for Reporter's Notes, Court Citations, and Cross References

(g) the method of payment, whether by the time or by the job;

(h) whether or not the work is a part of the regular business of the employer;

(i) whether or not the parties believe they are creating the relation of master and servant; and

(j) whether the principal is or is not in business.

Comment on Subsection (1):

a. Servants not performing manual labor. The word "servant" does not exclusively connote a person rendering manual labor, but one who performs continuous service for another and who, as to his physical movements, is subject to the control or to the right to control of the other as to the manner of performing the service. The word indicates the closeness of the relation between the one giving and the one receiving the service rather than the nature of the service or the importance of the one giving it. Thus, ship captains and managers of great corporations are normally superior servants, differing only in the dignity and importance of their positions from those working under them. The rules for determining the liability of the employer for the conduct of both superior servants and the humblest employees are the same; the application differs with the extent and nature of their duties.

b. Non-contractual employment. The word "employed" as used in this Section is not intended to connote a contractual or business relation between the parties. In fact, as pointed out in Section 225, the relation may rest upon the most informal basis, as where the owner of a car invites a guest to drive the car temporarily in his presence or to assist him in making minor repairs.

c. Generality of definition. The relation of master and servant is one not capable of exact definition. It is an important relation in that upon it depends the liability of the master to third persons and to his employees under the provisions of various statutes as well as under the common law; the relation may prevent liability, as in the case of the fellow servant rule. It cannot, however, be defined in general terms with substantial accuracy. The factors stated in Subsection (2) are all considered in determining the question, and it is for the triers of fact to determine

whether or not there is a sufficient group of favorable factors to establish the relation. See Comment *g*. If the inference is clear that there is, or is not, a master and servant relation, it is made by the court; otherwise the jury determines the question after instruction by the court as to the matters of fact to be considered.

d. Control or right to control. Although control or right to control the physical conduct of the person giving service is important and in many situations is determinative, the control or right to control needed to establish the relation of master and servant may be very attenuated. In some types of cases which involve persons customarily considered as servants, there may even be an understanding that the employer shall not exercise control. Thus, the full-time cook is regarded as a servant although it is understood that the employer will exercise no control over the cooking. In other types of situations where an emergency creates peril to human lives, as in the case of a ship in a storm, a servant—in this case the captain—might properly refuse to be controlled by the ship owner and still cause his master to be liable for his negligence or other faulty conduct.

When two persons are engaged in a common undertaking, it may be understood that there is to be joint control, as where two men hire an automobile for a vacation trip, alternating in driving. On the other hand, two servants, directed to drive on their master's business and alternating in driving, do not agree to joint control, and one of them would not be liable to a person hurt by the negligent driving of the other.

Where the owner of a vehicle driven by a guest is in the vehicle, there is ordinarily an inference that he is in control, rebuttable only if he agrees with the guest to surrender complete control to him.

e. Independent contractors. It is important to distinguish between a servant and an agent who is not a servant, since ordinarily a principal is not liable for the incidental physical acts of negligence in the performance of duties committed by an agent who is not a servant. See § 250. One who is employed to make contracts may, however, be a servant. Thus, a shop girl is, and a traveling salesman may be, a servant and cause the employer to be liable for negligent injuries to a customer or for negligent driving while traveling to visit prospective customers. The important distinction is between service in which the actor's physical activities and his time are surrendered to the control of the

See Appendix for Reporter's Notes, Court Citations, and Cross References

master, and service under an agreement to accomplish results or to use care and skill in accomplishing results. Those rendering service but retaining control over the manner of doing it are not servants. They may be agents, agreeing to use care and skill to accomplish a result and subject to the fiduciary duties of loyalty and obedience to the wishes of the principal; or they may be persons employed to accomplish or to use care to accomplish physical results, without fiduciary obligations, as where a contractor is paid to build a house. An agent who is not subject to control as to the manner in which he performs the acts that constitute the execution of his agency is in a similar relation to the principal as to such conduct as one who agrees only to accomplish mere physical results. For the purpose of determining liability, they are both "independent contractors" and do not cause the person for whom the enterprise is undertaken to be responsible, under the rule stated in Section 219.

Illustrations:

1. P employs A as a broker to sell Blackacre. A, while driving T, a prospective customer, to inspect the premises, negligently injures him. P is not liable to T.

2. The salesman of a real estate broker, while driving T, a prospective customer, to view a house, negligently injures him. The broker, but not the broker's principal, is subject to liability to T.

f. Subservants. A subservant is a servant of the servant who employed him and also of the master for the conduct of whose affairs he was employed. See § 5(2).

Comment on Subsection (1), continued:

g. Statutory interpretation. The word servant has retained its early significance in cases involving the liability of the master to third persons and the common law liability of master and servant. However, in statutes dealing with various aspects of the relation between the two parties, the word "employee" has largely displaced "servant". In general, this word is synonymous with servant. Under the usual Employers' Liability Acts and the Workmen's Compensation Acts the tests given in this Section for the existence of the relation of master and servant are valid. Beyond this there is little uniformity of decision. Under the existing regulations and decisions involving the Federal Labor

See Appendix for Reporter's Notes, Court Citations, and Cross References

Relations Act, there is little, if any, distinction between employee and servant as here used. Under the federal and state wages and hours acts, the purpose of which is to raise wages and working conditions, persons working at home at piece rates and choosing their own time for work have been held to be employees, although clearly not servants as the word is herein used.

Comment on Subsection (2):

h. Factors indicating the relation of master and servant.

The relation of master and servant is indicated by the following factors: an agreement for close supervision or *de facto* close supervision of the servant's work; work which does not require the services of one highly educated or skilled; the supplying of tools by the employer; payment by hour or month; employment over a considerable period of time with regular hours; full time employment by one employer; employment in a specific area or over a fixed route; the fact that the work is part of the regular business of the employer; the fact that the community regards those doing such work as servants; the belief by the parties that there is a master and servant relation; an agreement that the work cannot be delegated.

i. Effect of custom. The custom of the community as to the control ordinarily exercised in a particular occupation is of importance. This, together with the skill which is required in the occupation, is often of almost conclusive weight. Unskilled labor is usually performed by those customarily regarded as servants, and a laborer is almost always a servant in spite of the fact that he may nominally contract to do a specified job for a specified price. If, however, one furnishes unskilled workmen to do work for another, it is not abnormal to find that the workmen remain the servants of the one supplying them. See § 227. Even where skill is required, if the occupation is one which ordinarily is considered as a function of the regular members of the household staff or an incident of the business establishment of the employer, there is an inference that the actor is a servant. Thus, highly skilled cooks or gardeners, who resent and even contract against interference, are normally servants if regularly employed. So too, the skilled artisans employed by a manufacturing establishment, many of whom are specialists, with whose method of accomplishing results the employer has neither the knowledge nor the desire to interfere, are servants. On the other hand, the

See Appendix for Reporter's Notes, Court Citations, and Cross References

question of the degree of skill requisite for the job is often determinative where the actor is employed temporarily to enter the household or establishment and render incidental assistance. Thus, one employing a laborer for a specific job is normally, as stated above, his master; whereas one engaging a plumber to repair a boiler is not, in the absence of a special arrangement for supervision. The fact that the state regulates the conduct of an employee through the operation of statutes requiring licenses or specific acts to be done or not to be done does not prevent the employer from having such control over the employee as to constitute him a servant.

Illustrations:

3. P, who knows little of social affairs, employs A as a social secretary to instruct P in her own deportment and the conduct of all social events, it being agreed that A is to live at P's home and to have complete management within her sphere. P is subject to liability for A's conduct within the scope of employment.

4. P employs a woman to open his summer house. It is agreed that she is to come just before his arrival to clean it and put it in order. For this she is to receive thirty dollars. During her presence in the house, she is P's servant.

Comment on Subsection (2), continued:

j. Period of employment and method of payment. The time of employment and the method of payment are important. If the time of employment is short, the worker is less apt to subject himself to control as to details and the job is more likely to be considered his job than the job of the one employing him. This is especially true if payment is to be made by the job and not by the hour. If, however, the work is not skilled, or if the employer supplies the instrumentalities, the workman may be found to be a servant.

k. Ownership of instrumentalities. The ownership of the instrumentalities and tools used in the work is of importance. The fact that a worker supplies his own tools is some evidence that he is not a servant. On the other hand, if the worker is using his employer's tools or instrumentalities, especially if they are of substantial value, it is normally understood that he will follow the directions of the owner in their use, and this indicates

See Appendix for Reporter's Notes, Court Citations, and Cross References

that the owner is a master. This fact is, however, only of evidential value.

Illustrations:

5. P employs A to drive him around town in A's automobile at \$4.00 per hour. The inference is that A is not P's servant. If P supplies the automobile, the inference is that A is P's servant for whose conduct within the scope of employment P is responsible.

6. P employs a salesman who agrees to give substantially his full time to the employment and who is furnished a car by the employer. On these facts it is inferred that he is a servant.

7. P employs a salesman who agrees to give full time to the work but furnishes his own car, is paid by commission and can call on those whom he pleases. It is inferred that the salesman is not P's servant.

Comment on Subsection (2), continued:

1. *Control of the premises.* If the work is done upon the premises of the employer with his machinery by workmen who agree to obey general rules for the regulation of the conduct of employees, the inference is strong that such workmen are the servants of the owner, and this inference is not necessarily rebutted by the fact that the workmen are paid by the amount of work performed or by the fact that they supply in part their own tools or even their assistants. If, however, the rules are made only for the general policing of the premises, as where a number of separate groups of workmen are employed in erecting a building, mere conformity to such regulations does not indicate that the workmen are servants of the person making the rules.

Illustrations:

8. P conducts a manufacturing establishment for the manufacture of woolen goods. Certain factory employees normally arrive at eight in the morning and leave at five in the afternoon, but are not required to work a fixed number of hours or during specified periods, provided they accomplish a specified amount of work during the week, for each unit of which they receive compensation. Such employees are servants.

9. P is the owner of a coal mine employing miners. He provides them with the larger units of machinery and the means of ingress and egress. The miners supply their own implements, the powder necessary, and their own helpers, being paid for each ton mined and brought to the surface. The miners, including the assistants, are the servants of the mine owner. The assistants are servants of the miners and subservants of the owner.

Comment on Subsection (2), continued:

m. Belief as to existence of relation. It is not determinative that the parties believe or disbelieve that the relation of master and servant exists, except insofar as such belief indicates an assumption of control by the one and submission to control by the other. However, community custom in thinking that a kind of service, such as household service, is rendered by servants, is of importance.

Illustrations:

10. A, employed by a taxi company, is sent by P, his employer, to drive B from X to Y, and it is agreed between A, P, and B that for the purposes of the trip A is to be B's servant, although B is to exercise no more control over A's conduct than is normal in the ordinary case of passengers in taxicabs. A is not B's servant.

11. A is employed by P as resident cook for his household under an agreement in which P promises that he will in no way interfere with A's conduct in preparing the food. A is P's servant.

NO. 20489-4-II

Consolidated with
No. 20544-1-II

COURT OF APPEALS
STATE OF WASHINGTON
DIVISION II

MEDICAL CONSULTANTS, NORTHWEST, INC.,

Respondent,

-vs-

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,

Petitioner.

PETITION TO WASHINGTON SUPREME COURT
FOR REVIEW OF COURT OF APPEALS DECISION

CHRISTINE O. GREGOIRE
Attorney General
State of Washington

CAMERON G. COMFORT
WSBA #15188
Assistant Attorney General
Attorneys for Appellant

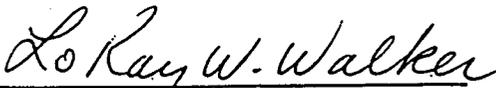
400 General Admin. Bldg.
P. O. Box 40123
Olympia WA 98504-0123
(360) 753-5528

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

MEDICAL CONSULTANTS,)	NO. 20489-4-II
NORTHWEST, INC.,)	
)	Consolidated with
Respondent/Cross-Appellant,)	No. 20544-1-II
)	
v.)	
)	CERTIFICATE OF
STATE OF WASHINGTON,)	SERVICE
DEPARTMENT OF REVENUE,)	
)	
Appellant/Cross-Respondent.)	

I certify that on the 13th day of February, 1998, I caused to be served the Department of Revenue's PETITION TO WASHINGTON SUPREME COURT FOR REVIEW OF COURT OF APPEALS DECISION by depositing a copy in the U. S. mail, first-class postage prepaid, addressed as follows:

Heather Francks
Suite 4000
800 5th Avenue
Seattle WA 98104
Attorney for Respondent/Cross-Appellant


LORAY W. WALKER