

Washington Health Law Manual — Third Edition
Washington State Society of Healthcare Attorneys (WSSHA)

Chapter 23:

State Taxes and

Exemptions

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Reference Date: The authors prepared this chapter from reference materials that were available as of January 31, 2009.

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Acknowledgments

The authors thank Jill Allyn and Paula Yurko of Garvey Schubert Barer for their assistance with this chapter.

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23.1 Chapter Summary

The goal of this chapter is to provide a practical guide to those Washington state taxes which generally apply to health care providers, including hospitals, boarding homes, nursing homes, physicians, clinics, and other licensed health care practitioners. Because the law in this area is constantly changing, this chapter should be used in conjunction with, but not in lieu of, competent legal advice in the area of state taxation.

This chapter focuses primarily on exemptions, deductions and exclusions from state taxes. The application of federal income taxes to health care providers is a subject that is dealt with comprehensively in many other sources, and it is not addressed here.

23.2 Overview of Washington Taxes

Taxes in Washington State can be divided into two general categories: ad valorem property taxes (taxing value) and excise taxes (taxing a privilege or “incident”). Property taxes are imposed on the value of the property owned by a taxpayer. Excise taxes are triggered by an activity and can be assessed at both the state and local levels. Excise taxes include revenue taxes such as the premium and health care prepayment tax (RCW Chapter 48.14), and the business and occupation tax (RCW Chapter 82.04) (“B&O” tax), as well as taxes on transfers, such as the retail sales tax (RCW Chapter 82.08), the use tax (RCW Chapter 82.12) and the real estate sales excise tax (RCW Chapter 82.45). We introduce these taxes below.

23.2.1 The Premium Tax

The premium tax, imposed under RCW Chapter 48.14, requires HMOs (as defined by RCW 48.46.020), health care service contractors (as defined by RCW 48.44.010), and self-funded multiple employer welfare arrangements (as defined by RCW 48.135.010) to pay a tax on premiums and prepayments received for health care services. As discussed below, for purposes of the premium tax, “health care services” likely include medical, surgical, dental, chiropractic, hospital, optometric, podiatric, pharmaceutical, ambulance, custodial, mental health and other therapeutic services. *See* RCW 48.125.010 and RCW 48.44.010.

23.2.2 The B&O Tax

The B&O tax is levied on the act or privilege of engaging in business activities in Washington. (*See* RCW 82.04.220.) “Business” activities are broadly defined to include “all activities engaged in with the object of gain, benefit or advantage to the taxpayer or to another person or class, directly or indirectly.”¹ “Unlike most state and the federal tax systems, Washington’s tax system, specifically its B&O tax, applies to nonprofit organizations. Washington’s B&O tax is imposed upon all entities that generate gross receipts or proceeds, unless there is a specific statutory exemption or deduction.” *See* WAC 458-20-169.² There is an exemption for the state itself, and for its departments and institutions, as distinct from its corporate agencies or instrumentalities, because the state is not defined as a “person” for B&O tax purposes. *See* RCW 82.04.030 and WAC 458-20-189.

The rate of tax depends on the nature of the business activity which is subject to tax. Taxable business activities are classified into a number of specific classifications (e.g., retailing, operation of a hospital, manufacturing and services) each of which has a separate tax rate and tax base. Many non-hospital health care providers are often

¹ RCW 82.04.140.

² *See also* *YMCA v. State*, 62 Wn.2d 504, 383 P.2d 497 (1963) and *Seattle v. State*, 59 Wn.2d 150, 367 P.2d 123 (1961).

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taxed under the catchall “other business or service activities” category, which is imposed on all activities other than those specifically enumerated in the statute.

The B&O tax rate is stated as a percentage which is then multiplied by the applicable tax base. The tax base may be any of the following: “gross proceeds of sales,” “gross income of the business,” or “the value of products,” depending on the type of business activity.³ Thus, the taxpayer must compute the tax by multiplying the revenue by the B&O tax rate applicable to that activity. A taxpayer who engages in more than one taxable activity may be subject to taxation under more than one classification; however, where a revenue stream represents income from multiple integrated activities, the Department of Revenue has typically classified the revenue by the predominate activity.

23.2.3 The Sales and Use Tax

The retail sales and use taxes are structured to ensure that the acquisition of all tangible personal property and certain specified services purchased by consumers in the state has been subject to an excise tax. The retail sales tax applies to the sale of an item within the state. The use tax applies to the use of items for which no sales tax has been paid. The use tax, in particular, is intended to tax items of personal property used in this state but bought in another state.

23.2.4 The Real Estate Excise Tax

The real estate excise tax applies to each sale of real property⁴ and is expressed as a percentage of the selling price of the property.⁵ “Sale” is defined in RCW 82.45.010 as having its ordinary meaning and includes, among other things, conveyances, grants, assignments, quitclaims or transfer of ownership or title to real property. “The term ‘sale’ also includes the transfer or acquisition within any twelve-month period of a controlling interest in any entity with an interest in real property located in this state for a valuable consideration.” *Id.*

23.3 Principals Applicable to Washington Taxes

23.3.1 Burden of Proof

When structuring transactions and evaluating tax questions, practitioners should consider the burden of proof which will apply in the event of tax litigation. The burden of proof in a tax dispute concerning a tax exemption, deduction, or credit rests with the taxpayer, while the burden relative to a dispute as to the application of a tax statute arguably rests with the Department.

- “Tax exemptions must be construed narrowly, and the burden of establishing the exemption falls on the taxpayer.” *Deaconess Medical Center v. Dep’t of Revenue*, 58 Wn. App. 783, 788 (1990).
- *See also Group Health Coop. of Puget Sound, Inc. v. Tax Comm’n*, 72 Wn.2d 422 (1967). “In connection with each [i.e., a deduction or an exemption], the burden of showing qualification for the tax benefit afforded likewise rests with the taxpayer. And statutes which provide for either are, in case of doubt or ambiguity, to be construed strictly, though fairly and in keeping with the ordinary meaning of their language, against the taxpayer.” *Id.* at 429.

³ RCW 82.04.220.

⁴ “Real property” is defined in RCW 82.45.032(1) to mean “any interest, estate, or beneficial interest in land or anything affixed to land, including the ownership interest or beneficial interest in any entity which itself owns land or anything affixed to land. The term includes used mobile homes, used park model trailers, used floating homes, and improvements constructed upon leased land.”

⁵ RCW 82.45.060.

- This court strictly construed tax statutes conferring credits, refunds, or deductions. The policy reason for construing a tax statute narrowly is “to protect the State from unanticipated losses.” *Lacey Nursing Ctr., Inc. v. Dep’t of Revenue*, 128 Wn.2d 40, 49-50 (1995) (internal citations omitted).

23.3.2 Overview of Washington’s Rules of Statutory Construction

The goal of Washington courts is to determine the meaning of a statute by ascertaining the Legislative intent behind its adoption. However, Washington’s rules of statutory construction may heavily influence the outcome of a tax dispute. These rules can be broadly stated as follows:

1. First Look to the Language of the Statute

When interpreting statutory language, the goal of the court is to carry out the intent of the Legislature. In ascertaining this intent, the court will review the language at issue and will evaluate that language in the context of the entire statute. Courts will avoid interpretations that are strained, unlikely, or unrealistic. *See Simpson Inv. Co. v. Dep’t of Revenue*, 141 Wn.2d 139 (2000).

- “When a statute fails to define a term, we look to the regular dictionary definition when a term has a well-accepted, ordinary meaning.” *City of Spokane v. Dep’t of Revenue*, 145 Wn.2d 445, 454 (2002).
- When an otherwise common word is given a distinct meaning in a technical dictionary or other technical reference and has a well-accepted meaning within the industry, courts turn to the technical, rather than general purpose, dictionary to resolve the word’s definition. *City of Spokane v. Dep’t of Revenue*, 145 Wn.2d 445, 452 (2002).
- If neither the dictionary nor other statutory definitions define a key term in a tax statute, the Court may look to other sources. (Because the dictionary and other statutory definitions do not provide a definitive answer as to whether CHAMPUS is an “employee benefit program” under RCW 82.04.4297, we next turn to the CHAMPUS program itself.” *Whidbey General Hosp. v. State*, 143 Wn. App. 620, 631 (2008).)

2. When a Statute is Ambiguous Look to Other Sources to Ascertain Legislative Intent

Where a statute is unambiguous, the Court will determine legislative intent from the statutory language alone. *See Waste Mgmt. v. Wash. Util. & Transp. Comm’n*, 123 Wn.2d 621 (1994).

A statute is ambiguous if it is susceptible to more than one *reasonable* interpretation. *See W. Telepage, Inc. v. City of Tacoma*, 140 Wn.2d 599, 608 (2000).

Only when the statutory language is ambiguous will a court go beyond the statutory language to attempt to understand the Legislature’s intent, by reviewing sources, such as legislative history. *See Senate Republican Campaign Comm. v. Public Disclosure Comm’n*, 133 Wn.2d 229 (1997).

3. Apply the Correct “Benefit of the Doubt” Rule

Washington courts strictly interpret ambiguities in statutes imposing taxes in favor of the taxpayer. However, as stated above, a tax exemption, deduction, or credit statute that creates ‘doubt or ambiguity’ must “be construed strictly, though fairly and in keeping with the ordinary meaning of [its] language, against the taxpayer.” *Sacred Heart Med. Ctr. v. Dep’t of Revenue*, 88 Wn. App. 632, 637 (1997).

23.4 Exemptions from State Property Taxes: RCW 84.36

Article VII of the Washington State Constitution provides that all property that is subject to ownership, whether tangible or intangible, is taxable unless specifically excluded. Absent a statutory exception, the state of Washington therefore imposes a property tax on all property within the state⁶ based on its assessed value.⁷ The rate of taxation

⁶ RCW 84.36.005.

⁷ RCW 84.52.010.

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is determined by the county assessor in the county where the property is located, subject to maximum rates established by state law. A further explanation of the property tax system, including the current property tax rate for a particular area, may be obtained from the county tax assessor in the county where the property is located.⁸

Some health care providers may avoid the property tax because of the property tax exemption for public property⁹ and some property owned or used by nonprofit organizations¹⁰ is exempt from the property tax. Property owners seeking an exemption must file an application with the state Department of Revenue.¹¹ The exemption must be renewed annually.¹² In some instances an exemption is available only if the property is owned by a particular type of entity; in other instances the exemption is available if the property is used by a qualified party, provided the exemption inures to the benefit of a qualified user. In addition, in some instances exempt property may be rented or loaned by an exempt owner, without jeopardizing the exemption, provided the requirements relating to such an arrangement, found in WAC 458-16-165 and RCW 84.36.805, are satisfied.

Specific exemptions that may be available to a health care provider are described below. Each of these exemptions includes detailed requirements. In addition, in order to qualify for many of the specific exemptions afforded nonprofit organizations, the nonprofit organization must also meet the requirements of RCW 84.36.805.

RCW 84.36.805 limits the exemption for loaned/rental property to situations where the rent or donations received for the use of the property are reasonable and do not exceed maintenance and operating expenses of the property rented, and in certain instances the property would qualify for exemption if owned by the tenant/user.

RCW 84.36.805 does not apply to any exemptions granted under RCW 84.36.020 (the exemption for cemeteries, churches, parsonages, convents, and grounds), RCW 84.36.032 (the exemption for administrative officers of nonprofit religious organizations), RCW 84.36.250 (the exemption for water distribution property), and RCW 84.36.260 (the exemption for conservation, open spaces, parks, etc.).

23.4.1 General Conditions for Obtaining Exemption by Nonprofits – RCW 84.36.805

RCW 84.36.805 set out conditions which apply to many of the property tax exemptions available in Washington. Thus, before discussing the specific exemptions, we first review the requirements of RCW 84.36.805.

Where applicable, the statute provides that the exempt property must be used exclusively for the actual operation of the activity for which exemption is granted, unless otherwise provided.¹³ Further, the exempt facilities must be available to all regardless of race, color, national origin or ancestry, and if the nonprofit is required to be licensed or certified by state law or regulation, it must be so licensed/certified. Finally, with

⁸ RCW 84.08.115.

⁹ RCW 84.36.010 provides that “all property belonging exclusively to the United States, the state, or any county or municipal corporation; all property belonging exclusively to any federally recognized Indian tribe located in the state, if that property is used exclusively for essential government services; . . . is exempt from taxation.” For a more comprehensive discussion, consult the *Public Hospital District Legal Manual*, published by the Association of Public Hospital Districts (AWPHD), Chapter 4.

¹⁰ For definition of “nonprofit organization,” see RCW 84.36.800(4).

¹¹ RCW 84.36.815, RCW 84.36.825.

¹² RCW 84.36.820, RCW 84.36.825.

¹³ RCW 84.36.805(2).

certain exceptions, RCW 84.36.805 disqualifies from property tax exemption property held subject to a taxable seller's repurchase rights.

The statute provides that exempt property may also be used for fundraising if the fundraising activities are consistent with the purposes for which the exemption is granted,¹⁴ and provided the fundraising activities do not exceed five days in length and that at least 51% of profits realized by the activity are disbursed to the exempt nonprofit entity holding the fund raising event.¹⁵

23.4.2 Exemption for Property Used for Character Building, Benevolent, Protective or Rehabilitative Social Services

Real and personal property owned by nonsectarian nonprofit organizations is exempt from property tax if the property is used by the organization for character-building, benevolent, protective or rehabilitative social services directed at persons of all ages.¹⁶ Detailed requirements regarding this exemption are set forth at WAC 458-16-210 (in addition to WAC 458-16-165 and RCW 84.36.805, which also apply to this exemption).

23.4.3 Exemption for Administrative Offices Used by Nonprofit Religious Organization

Property used by a nonprofit religious organization as administrative offices is exempt to the extent the property is used to administer religious programs or such other programs as would be exempt under RCW 84.36.020 (cemeteries, churches, parsonages, and convents) or RCW 84.36.030 (character building, benevolent or rehabilitative social services).¹⁷ This exception is available with respect to property rented to the nonprofit religious organization. RCW 84.36.805 does not apply to this exemption.

23.4.4 Exemption for Nonprofit Blood, Bone or Tissue Bank

The real and personal property owned or leased by a nonprofit organization, if used exclusively in the business of a blood bank, tissue bank or blood and tissue bank (or administration of such business) is exempt from property tax.¹⁸ If the property is leased, the benefit of the exemption must inure to the nonprofit organization.¹⁹

Thus, in drafting lease agreements for facilities used for these purposes, the practitioner should assure that the lease allocates the benefit of the exemption to the nonprofit organization. To qualify for this exemption, a blood, tissue or blood and tissue bank must meet the additional requirements set out in RCW 82.04.324 which apply to entities seeking B&O tax exemption as blood, tissue or blood and tissue banks. These requirements, discussed below in Section 2, relate to operations (i.e., primary business purpose) and organization (qualification under IRC § 501(c)(3) and federal registration as a blood, tissue or blood and tissue bank.)²⁰ RCW 84.36.805 applies to this exemption.

¹⁴ RCW 84.36.805(2)(b).

¹⁵ WAC 458-16-165(4)(b).

¹⁶ RCW 84.36.030(1).

¹⁷ RCW 84.36.032.

¹⁸ RCW 84.36.035.

¹⁹ *Id.*

²⁰ RCW 84.36.035, RCW 82.04.324.

23.4.5 Exemption for Hospitals for the Sick or Infirm and Outpatient Dialysis Facilities

Real and personal property used by nonprofit hospitals, public hospital districts, homes for the sick or infirm or outpatient dialysis facilities is exempt from property tax, if the benefit of the exemption inures to the user.²¹ If the property is leased to the hospital, the lease should allocate the benefit of the exemption to the nonprofit organization. The statute further provides that “to be exempt under this section, the property must be used exclusively²² for the purposes for which exemption is granted, except as provided in RCW 84.36.805.” Detailed requirements regarding the exemption are set forth at WAC 458-16-260. RCW 84.36.805 applies to this exemption.

The business of a “hospital” is defined as the activity of providing “medical, surgical, nursing or related health care services for the prevention, diagnosis or treatment of human disease, pain, injury, disability, deformity, mental illness, or retardation as well the equipment and facilities used . . . to deliver such services to inpatients.”²³ A hospital unit includes all “buildings or properties that are part of an integrated, interrelated, homogeneous unit exclusively used for exempt hospital purposes.”²⁴ For hospitals, the exemption extends to the entire hospital building, including other buildings used in connection with the hospital, such as employee residences.²⁵ The exemption does not extend, however, to clinics or physicians’ offices which are not integrated components of the hospital.²⁶

23.4.6 Exemption for Nonprofit Homes for the Aging and Disabled

Property used by a nonprofit home for the aging and disabled is totally or partially exempt²⁷ from property taxes. If the facility is leased, the benefit of the exemption must inure to the home. The breadth of the exemption depends on factors set out in the regulations (WAC 458-16A-010). Full tax exemption is available if the home is subsidized by a HUD program, fifty percent or more of the units are occupied by “eligible residents” (as defined by the regulations with respect to age and income), or the facility was constructed, rehabilitated, acquired, or refinanced under a program using bonds exempt from federal income tax for at least

²¹ RCW 84.36.040.

²² The Board of Tax Appeals has refused to narrowly define a hospital for property tax purposes. As the Board stated in *Providence Hosp. v. Dep’t of Revenue*, BTA No. 11240:

While the rule of strict construction should and does apply to exemptions from taxation under RCW 84.36.040, the activities and the use of the premises by the hospital in the operation of this particular gift shop is so related to the health care services, so closely managed and operated as a portion of the hospital unit that mere isolated instances of purchases by members of the staff or visitors for their personal use or consumption should not disqualify the appellant for an exemption of the gift shop area in question. The accepted rule of strict construction does not require that the narrowest possible meaning be given to the words “exclusively used” to qualify for exemption; a fair and reasonable interpretation must be made of RCW 84.36.040 with due regard for the ordinary and reasonable acceptance of the language therein contained and the object sought to be accomplished thereby.

²³ WAC 458-16-260.

²⁴ WAC 458-16-260. Also see *Legacy Salmon Creek Hosp. v. Dep’t of Revenue*, BTA No. 06-062 (2007), holding the “hospital licensure and qualification of services for Medicare reimbursement as a provider based hospital provides a rational and consistent method for determining that a facility qualifies for the hospital exemption due to the integration of clinical services requirement.” See also *Franciscan Health System West v. Dep’t of Revenue*, BTA No. 06-118 (2008).

²⁵ WAC 458-16-260(2)(d)(i).

²⁶ See WAC 458-16-260(2)(d)(ii)(B).

²⁷ RCW 84.36.041, WAC 458-16A-010.

seventy-five percent of the total amount financed and the financing program required the home to reserve or set aside a percentage of all dwelling units so financed for low-income residents.²⁸

If the home does not qualify for a total exemption, it may receive a partial exemption, determined on a unit by unit basis depending on the occupant (i.e., residents requiring significant assistance with activities of daily living, occupancy by “eligible residents” (as defined by the regulation), and common and share use areas.) The home may qualify for a total exemption for its personal property. RCW 84.36.805 applies to this exemption.

23.4.7 Exemption for Nonprofit Organization Property Available Without Charge for Medical Research or Training of Medical Personnel

Property owned or used by a nonprofit organization is exempt from property tax if it is made available, without charge for research by, or for the training of, medical personnel,²⁹ or for medical research, the results of which are made available to the public without charge.³⁰ If the property is leased to the nonprofit organization, the benefit of the exemption must inure to the nonprofit entity. RCW 84.36.805 applies to this exemption.

23.4.8 Nonprofit Cancer Clinic or Center

All of the real and personal property owned or used by a nonprofit entity in connection with a nonprofit cancer clinic or center is exempt from property tax,³¹ provided the cancer center is comprised of or formed by an organization qualified for exemption under IRC § 501(c)(3), by a municipal hospital corporation, or both. The operator of the clinic/center must be qualified for federal tax exemption under IRC § 501(c)(3). The property must generally be used primarily (i.e., 51% of patients are seen at the clinic/center because they have cancer) in connection with the prevention, detection and treatment of cancer. If the property is leased to the center/clinic, the benefit of the exemption must inure to the clinic/center. RCW 84.36.805 applies to this exemption.

23.5 Exemptions, Deductions and Exclusions from State Excise Taxes: Taxes on Revenue

23.5.1 Premium and Prepayment Tax – RCW 48.14.0201

Certain health care providers must pay a 2% tax on premiums and prepayments received for health care services.³² This tax is imposed on HMOs,³³ health care service contractors (HCSCs)³⁴ and self-funded multiple employer welfare arrangements³⁵ (to the extent not preempted by ERISA).³⁶ Although the term “health care services” is not defined in RCW 48.14.0201, practitioners may wish to review the definitions used in the HCSC’s act and the law which applies to self-funded multiple employer welfare arrangements.

²⁸ See RCW 84.36.041 and WAC 458-16A-010.

²⁹ Medical personnel includes (but is not limited to) doctors, nurses, laboratory technicians, hospital administrators and staff. RCW 84.36.045.

³⁰ *Id.*

³¹ RCW 84.36.046.

³² RCW 48.14.0201.

³³ The term “health maintenance organization” is defined in RCW 48.46.020.

³⁴ The term “health care service contractor” is defined in RCW 48.44.010 as “any corporation, cooperative group, or association, which is sponsored by or otherwise intimately connected with a provider or group of providers, who or which not otherwise being engaged in the insurance business, accepts prepayment for health care services from or for the benefit of persons or groups of persons as consideration for providing such persons with any health care services.”

³⁵ “Self-funded multiple employer welfare arrangement” is defined by RCW 48.125.010 as “a multiple employer welfare arrangement that does not provide for payment of benefits under the arrangement solely through a policy or policies of insurance issued by one or more insurance companies licensed under this title.”

³⁶ RCW 48.14.0201(8).

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RCW 48.44.010 defines health care services with respect to HCSCs as “medical, surgical, dental, chiropractic, hospital, optometric, podiatric, pharmaceutical, ambulance, custodial, mental health and other therapeutic services.” RCW 48.125.010 defines the term with respect to self-funded multiple employment welfare arrangements as “the service offered or provided by health care facilities and health care providers relating to the prevention, cure, or treatment of illness, injury or disease.”

The premium and prepayment tax for each calendar year is due on or before March 1 of the following year and is paid to the state treasurer through the Office of the Insurance Commissioner (“OIC”).³⁷ However, the approximate tax obligation must be prepaid periodically during the calendar year.³⁸ Exemptions and other opportunities to avoid application of the premium tax are discussed below. Taxes collected are deposited into a health services account maintained under RCW 43.72.900.

23.5.1.1 Exemption for Medicare Prepayments

Amounts received by any taxpayer as prepayments for health care services received from the United States or any instrumentality thereof as prepayments for services provided under Medicare are exempt from the premium and prepayment tax.³⁹

23.5.1.2 Exemption for Certain State Funded Health Care Programs

Amounts received from the state of Washington as prepayments under the various state health programs, including the medical care services program (under RCW 74.09.035), the Washington Basic Health Plan for subsidized enrollees (under RCW Chapter 70.47), and the Medicaid Program for services rendered to elderly or disabled clients if received prior to July 1, 2009 under a voluntary demonstration or pilot project, are exempt from tax.⁴⁰

23.5.1.3 Exemption for Prepayments for Dentistry Services

Amounts received by HCSCs as prepayments for dentistry services are exempt from the premium and prepayment tax.⁴¹ The scope of dentistry services covered by this exemption is limited by reference to RCW 18.32.020, which defines the practice of dentistry.

23.5.1.4 Deduction for Assessments Under the Health Insurance Coverage Access Act

The premium and prepayment tax does not apply to policies of insurance issued under the Health Insurance Coverage Access Act (RCW 48.41.010 through 48.41.210). The law provides that the amount of any assessment under RCW 48.41.010 through 48.41.210 may be deducted from taxable premiums and

³⁷ RCW 48.14.0201(2).

³⁸ *Id.* at § 48.14.0201(3). The calculations are as follows: (a) on or before June 15, forty-five percent; (b) on or before September 15, twenty-five percent; and (c) on or before December 15, twenty-five percent.

³⁹ RCW 48.14.0201(6)(a).

⁴⁰ RCW 48.14.0201(6).

⁴¹ RCW 48.14.0201(6)(c).

prepayments.⁴² After the taxable premiums and payments have been reduced to zero, any excess deduction allowance may be carried forward and deducted in successive years until the deduction is exhausted.⁴³

23.5.1.5 Basic Health Plan Payments Exemption

With some limitations, the activities and operations of the Washington Basic Health Plan are exempt from the provisions and requirements of RCW Chapter 48 (the state Insurance Code), which includes the requirements relating to the premium and prepayment tax.⁴⁴ This exemption extends to the activities and operations of managed health care systems, to the extent of their participation in the Basic Health Plan,⁴⁵ except (subject to RCW 48.14.201) with respect to health care services for non-subsidized enrollers in the basic health plan. “Managed health care system” is defined in RCW 70.47.020(3) to include, among others, HMOs and HCSCs – the two “taxpayers” subject to the premium and prepayment tax of RCW 48.14.0201. RCW 70.47.130(2) provides that “premiums paid on behalf of nonsubsidized enrollees in the basic health plan are subject to the premium and prepayment tax.”

23.5.2 Business and Occupation Tax: RCW 82.04

RCW 82.04.220 imposes a gross receipts tax on every person or company⁴⁶ for the privilege of engaging in business⁴⁷ activities within the state. Many health care providers are subject to taxation on their core activities under the general “service and other activities” B&O tax classification.⁴⁸ The service and other activities B&O tax classification is subject to a number of exceptions and certain providers will be subject to taxation in other classifications. Nonprofit hospitals and hospitals operated by the state or any of its political subdivisions, for example, are subject to B&O tax under a specially created statutory classification with respect to income from hospital operations.⁴⁹ Certain sales by providers of medical products and certain leasing arrangements involving tangible personal property would be subject to B&O tax under the retailing B&O classification.⁵⁰

Taxpayers engaged in activities which are subject to the provisions of multiple sections of the B&O tax statutes are taxable under each paragraph applicable to the activities engaged in.⁵¹ Exemptions and deductions from, and potentially applicable credits to, B&O taxes may be available to health care providers. In addition, there are special (i.e., favorable) tax rates applicable with respect to certain health activities.

⁴² RCW 48.14.022(2).

⁴³ *Id.*

⁴⁴ RCW 70.47.130.

⁴⁵ *Id.*

⁴⁶ “Person” and “company” are used interchangeably with regard to B&O tax and are defined in RCW 82.04.030.

⁴⁷ “Business” is defined in RCW 82.04.140. “Engaging in business” is defined in RCW 82.04.150.

⁴⁸ RCW 82.04; WAC 458-20-224(2).

⁴⁹ RCW 82.04.260(10). See discussion at Section 2(d), below.

⁵⁰ WAC 458-20-168(3). See generally RCW 82.04.050, RCW 82.04.250.

⁵¹ RCW 82.04.440(1). Specifically, persons engaged in activities which are within the purview of RCW 82.04.230 to 82.04.290, inclusive, are taxable under each paragraph applicable to the activities engaged in. Another example: the gross income of a nonprofit corporation or association which is derived from research and development activities within the state is subject to a B&O tax rate of .0484% and is not subject to taxation in the service and other activities classification. RCW 82.04.260(3).

23.5.2.1 Deduction Under RCW 82.04.4297 for Amounts Received from Public Entities for Health or Social Welfare Services

Income received by a health or social welfare organization from public entities⁵² as compensation for, or to support, health or social welfare services may be deducted from gross income before computing the amount of B&O tax due.⁵³ In order to qualify for the deduction under RCW 82.04.4297, the entity must satisfy a number of statutory conditions (municipal corporations or political subdivisions automatically qualify).

Specifically, the statute defines a “health or social welfare organization” as an organization, including any community action council, that (1) renders health or social welfare services, (2) is either a not-for-profit corporation under RCW Chapter 24.03 that is managed by a governing board of not less than eight individuals none of whom is a paid employee of the organization, or which is a corporation solely under RCW Chapter 24.12.⁵⁴ “Health or social welfare services” include, among other things, health care services.⁵⁵ Also included are services such as: mental health, drug or alcoholism counseling or treatment; family counseling; therapeutic, diagnostic, rehabilitative or restorative services for the care of the sick, aged or physically, developmentally or emotionally-disabled individuals; and temporary medical housing if certain conditions are met.⁵⁶

The term “health or social welfare organization” does not include a corporation providing professional services as authorized under RCW Chapter 18.100.⁵⁷ The statute contains numerous other eligibility requirements for the health and social welfare deduction.⁵⁸ If a health care provider can satisfy these

⁵² “Public entities” as used in this section refers to “the United States or any instrumentality thereof or from the state of Washington or any municipal corporation or political subdivision thereof.” RCW 82.04.4297.

⁵³ *Id.*

⁵⁴ The Washington State Department of Revenue has held that, where directors of a hospital were paid employees of the organization’s parent company and those directors helped manage the hospital pursuant to a contract between the hospital and the parent, the hospital did not qualify as a health or social welfare organization for purposes of the B&O tax deduction under RCW 82.04.4297. Determination No. 91-187 (1992).

⁵⁵ RCW 82.04.431(2).

⁵⁶ *Id.*

⁵⁷ RCW 82.04.431(1).

⁵⁸ Additional eligibility requirements set forth in RCW 82.04.431 (1) are as follows:

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

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

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

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

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

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

detailed requirements or is a municipal corporation such as a public hospital district, provider revenues attributable to government sources such as the Medicare, Medicaid and CHAMPUS⁵⁹ programs may be deductible from the B&O tax base.

23.5.2.2 Deduction for Compensation Received Under the Medicare Program by Certain Hospitals or Health Centers

In order to assure that amounts received by qualified health care providers from managed care organizations qualified for a tax deduction, the Washington State Legislature adopted RCW 82.04.4311 in 2002. The Legislature provided a mechanism for a retroactive refund of taxes paid between January 1, 1998 and April 2, 2002.

RCW 82.04.4311 provides that (1) public hospitals owned by municipal corporations, (2) nonprofit hospitals, (3) community health centers and (4) networks of nonprofit community health centers, that qualify as health and social welfare organizations (as defined by RCW 82.04.431) may, beginning April 2, 2002, deduct from taxable income, “amounts received as compensation for health care services covered under” the Medicare program, the Children’s Health or other programs under RCW 74.09, and the Washington Basic Health Plan under RCW 70.47. This deduction does not “apply to amounts received from patient copayments and deductibles.”⁶⁰

23.5.2.3 Special B&O Tax Rate for Nonprofit and Public Hospitals

Certain hospital activity is taxed at a special (1.5%) B&O tax rate with respect to services rendered in the business of a hospital.⁶¹ The rule interpreting the application of this tax rate is WAC 458-20-168.

WAC 458-20-168 provides that “gross income of public or nonprofit hospitals derived from providing personal or professional services to inpatients, is subject to B&O tax under the public or nonprofit hospitals classification.” The rule continues, stating that “[g]ross income of public or nonprofit hospitals derived from providing personal or professional services for persons other than inpatients is generally subject to B&O tax under the service and other activities classification.” *Id.*

Finally, the regulation provides that gross income derived from medical clinics and departments providing services to both inpatients and outpatients and operated by a public or nonprofit hospital is subject to B&O tax under the public or nonprofit hospitals classification where the clinic or department is an integral, interrelated, and essential part of the hospital. Otherwise, the gross income derived from medical clinics

(g) The director of revenue shall have access to its books in order to determine whether the corporation is exempt from taxes within the intent of RCW 82.04.4297 and this section.

⁵⁹ See *Whidbey General Hosp. v. State*, 143 Wn. App. 620, 631 (2008).

⁶⁰ RCW 82.04.4311.

⁶¹ RCW 82.04.260(10) provides as follows:

Upon every person engaging within this state in business as a hospital, as defined in chapter 70.41 RCW, that is operated as a nonprofit corporation or by the state or any of its political subdivisions, as to such persons, the amount of tax with respect to such activities shall be equal to the gross income of the business multiplied by the rate of 0.75 percent through June 30, 1995, and 1.5 percent thereafter. The moneys collected under this subsection shall be deposited in the health services account created under RCW 43.72.900.

and departments providing services to both inpatients and outpatients and operated by a public or nonprofit hospital is subject to B&O tax under the service and other activities classification.” *Id.*

Hospitals have disputed the Department of Revenue’s rules, which limit the rate to only those hospital departments that care for both inpatients and outpatients, because the statute defines the business as a hospital with reference to RCW 70.41. RCW 70.41 provides the statutory framework for the licensing of hospitals in the state of Washington. RCW 70.41.020(4) defines a hospital as “any institution, place, building, or agency which provides accommodations, facilities and services over a continuous period of twenty-four hours or more, for observation, diagnosis, or care, of two or more individuals not related to the operator who are suffering from illness, injury, deformity, or abnormality, or from any other condition for which obstetrical, medical, or surgical services would be appropriate for care or diagnosis.”

In *Legacy Salmon Creek Hosp. v. Dep’t of Revenue*, BTA No. 06-062 (2007),⁶² the Board of Tax Appeals held that the “hospital licensure and qualification of services for Medicare reimbursement as a provider-based hospital provides a rational and consistent method for determining that a facility qualifies for the hospital exemption due to the integration of clinical services requirement.” Although a discussion of Medicare’s provider-based rules (*see* 42 CFR § 413.65) is beyond the scope of this paragraph, practitioners may want to acquaint themselves with those rules.

23.5.2.4 Special Tax Rate for Research and Development Performed by Nonprofit Corporations and Associations

There is a separate (and favorable) B&O tax rate that applies to nonprofit corporations and nonprofit associations for income received in performing research and development within this state, including medical research. *See* RCW 82.04.260(3). The rate is .484%.

23.5.2.5 Exemption for Income of Boarding Homes

The B&O tax does not apply to amounts received by a nonprofit boarding home licensed under RCW Chapter 18.20 for providing room and domiciliary care to residents of the home.⁶³ A nonprofit boarding home is defined as a home operated by a religious or charitable organization exempt from federal income tax under IRC § 501(c)(3), incorporated under chapter 24.03 RCW, and is either operated as part of a nonprofit hospital or part of a public hospital district.

23.5.2.6 Exemption for Comprehensive Cancer Care Centers

B&O tax does not apply to amounts received by a comprehensive cancer care center to the extent that the amounts are exempt from federal income tax. A comprehensive cancer care center is defined as a cancer center that has been recognized by the National Cancer Institute as a comprehensive cancer care center and that qualifies as tax exempt under IRC 501(c)(3).⁶⁴

⁶² *See also Franciscan Health System West v. Dep’t of Revenue*, BTA No. 06-118 (2008).

⁶³ RCW 82.04.4264.

⁶⁴ RCW 82.04.4265.

23.5.2.7 Exemption for Blood Banks, Tissue Banks, and Blood and Tissue Banks

The B&O tax does not apply to amounts received by blood banks, tissue banks, and blood and tissue banks, to the extent the amounts are exempt from federal income tax and the “bank” qualifies for exemption under Section 501(c)(3) of the IRC, and is registered pursuant to Federal Regulation 21 C.F.R. part 607 (in the case of a blood bank), 21 C.F.R. part 1271 (in the case of a tissue bank) or 21 C.F.R. parts 607 and 1271 in the case of a blood and tissue bank.⁶⁵

For purposes of this exemption, the organization’s primary purposes must be: (1) the collection, preparation, and processing of blood – in the case of a blood bank, (2) the recovery, processing, storage, labeling, packaging, or distribution of human bone tissue, ligament tissue and similar musculoskeletal tissues, skin tissue, heart valve tissue, or human eye tissue – in the case of a tissue bank, or (3) the collection, preparation, and processing of blood and the recovery, processing, storage, labeling, packaging, or distribution of human bone tissue, ligament tissue and similar musculoskeletal tissues, skin tissue, heart valve tissue – in the case of a blood and tissue bank.⁶⁶ This exemption is not available to comprehensive cancer centers recognized as such by the National Cancer Institute; these organizations enjoy their own exemption, discussed above.

23.5.2.8 Exemption for Licensed Adult Family Home

RCW 82.04.327 provides that the B&O tax does not apply to income earned by a licensed adult family home or an adult family home exempt from licensing under the rules promulgated by the Department of Social and Health Services.

23.5.2.9 Exemption from B&O Taxation on Payments Received in an Agency Capacity

Because the B&O tax is structured to apply to revenues as they pass through the hands of successive entities (e.g., manufacturer, wholesaler, retailer), particular care must be taken in structuring payments among separate but related entities to avoid an undesirable “pyramiding” of B&O tax liability. This situation frequently arises in the context of provider networks where one entity (e.g., a physician hospital organization (“PHO”)) may contract with providers to deliver their services to a health plan and to collect payments from the health plan and distribute those payments, under some agreed upon mechanism, to the providers. Legal authority exists in Washington for the proposition that if one entity is acting as an agent for taxpayers in collecting revenues on its behalf, the agent will not be subject to B&O tax on the contract payments that pass through the agent’s hands.⁶⁷

PHOs have received letter rulings from the Washington State Department of Revenue indicating that they are not subject to B&O tax on capitation or fee-for-service payments that they receive from payors in compensation for health care services rendered by providers in the PHO networks. Such rulings are

⁶⁵ RCW 82.04.324.

⁶⁶ *Id.*

⁶⁷ See generally WAC 458-20-111 and *Rho Company, Inc. v. Dep’t of Revenue*, 113 Wn.2d 561 (1989). The nature of an agency relationship for B&O tax purposes was addressed by the Washington State Supreme Court in *Rho Co. v. Dep’t of Revenue* (holding clarified by the decision in *City of Tacoma v. The William Rogers Co., Inc.*, 148 Wn.2d 169 (2002) (amended by order of the Court on January 8, 2003)).

premised on the provider and payor agreements entered into by the PHOs containing language acknowledging the agency status of the PHO.

Participating providers who are members of the PHO are subject to B&O taxation with respect to compensation received from payors. Any amounts charged by the PHO for administrative services would also be subject to B&O taxation.

23.5.2.10 Exemption for Certain Prescription Drugs

RCW 82.04.620 (although labeled as an exemption statute) provides a deduction for taxes levied under RCW 82.04.290(2) (i.e., the B&O tax on other businesses) on amounts received by licensed physicians or clinics, for drugs for infusion or injection by licensed physicians or their agents for human use pursuant to a prescription. In addition, the amount to be exempted must (1) be separately stated on invoices or billing statements; (2) not exceed the federal rate reimbursed Medicare Part B providers; and (3) be covered or required by a health care service program subsidized by the federal or state government.

23.5.2.11 Exemption for Income Subject to Premium and Prepayment Tax Under RCW 48.14.0201

Income of an HMO, HCSC, or certified health plan, which is subject to premium and prepayment tax under RCW 48.14.0201, is exempt from all B&O tax.⁶⁸

23.5.2.12 Exemption for Amounts Received by Nonprofit Organizations From Fund-Raising Activities

RCW 82.04.3651 provides that income received by certain nonprofit organizations⁶⁹ from fundraising is exempt from the B&O tax. Fundraising is defined by the statute as “soliciting or accepting contributions of money or other property or activities involving the anticipated exchange of goods or services for money between the soliciting organization and the organization or person solicited.”⁷⁰ Fundraising does not include the operation of a regular place of business in which sales are made during regular hours such as a bookstore, thrift shop, restraint or similar business. Nor does it include the operation of a regular place of business from which services are provided or performed during regular hours, such as the provision of retail, personal, or professional services. The rules regarding this exemption are found at WAC 458-20-169.

⁶⁸ RCW 82.04.322. *See also* RCW 82.04.320 which provides a blanket exemption from the B&O tax for revenues attributable to insurance business upon which premium tax is paid.

⁶⁹ Qualified nonprofit organizations include (1) entities exempt from federal income tax under IRC § 501(c)(3) (educational and charitable organizations), IRC § 501(c)(4) (social welfare organizations), or IRC § 501(c)(10) (fraternal societies operating as lodges); (2) a nonprofit entity which would qualify under the foregoing IRC provisions except that it is not organized as a nonprofit corporation; and (3) nonprofit organizations that meet the following organizational requirements: its members, stockholders, officer, directors or trustees do not receive any part of the gross organization’s income (except as payment for services), compensation received from any person for services rendered is reasonable under the circumstances, and the activities of the organization do not include a substantial amount of political activity.

⁷⁰ *Id.*

23.5.2.13 Exemption for Income From Patient Services or Sales of Prescription Drugs by Certain Kidney Dialysis Facilities, Hospices, Nursing Homes and Homes for Unwed Mothers

Regulation WAC 458-20-18801 provides that “the business and occupation tax applies to the gross proceeds from sales of drugs, medicines, prescription lenses, or other substances used for diagnosis, cure, mitigation, treatment, or prevention of disease or other ailments in humans. Sales of these items to persons for resale are taxable under the wholesaling classification. Sales to consumers are taxable under the retailing classification. Persons who provide medical services to patients are taxable under the service and other business activities classification on the gross charge to the patient, notwithstanding that some prescription drugs may be separately charged to the patient.”

The B&O tax does not apply to income received as compensation for services rendered to patients or from sales of prescription drugs furnished as an integral part of services to patients by: (1) a kidney dialysis facility operated as a nonprofit corporation, (2) a nonprofit hospice licensed under RCW 70.127, (3) nursing homes and homes for unwed mothers operated as religious or charitable organizations.⁷¹ In order to qualify for this exemption, no part of the net earnings of the institution may inure, directly or indirectly, to any person other than the eligible facility.⁷² The deduction for income from operation of kidney dialysis facilities is available to nonprofit hospitals if the hospital accurately identifies and accounts for the income from this activity.⁷³ Rules regarding this exemption are set forth at WAC 458-20-168 and 458-20-18801.

WAC 458-20-18801 defines prescription drugs as “medicines, drugs, prescription lenses, or other substances, other than food for use in the diagnosis, cure, mitigation, treatment, or prevention of disease or other ailment in humans ordered by (i) the written prescription to a pharmacist by a practitioner authorized by the laws of this state or laws of another jurisdiction to issue prescriptions, or (ii) an oral prescription of such practitioner which is reduced promptly to writing and filled by a duly licensed pharmacist, or (iii) by refilling any such written or oral prescription if such refilling is authorized by the prescriber either in the original prescription or by oral order which is promptly reduced to writing and filled by the pharmacist, or (iv) physicians or optometrists by way of written directions and specifications for the preparation, grinding, and fabrication of lenses intended to aid or correct visual defects or anomalies of humans.” WAC 458-20-18801.

23.5.2.14 Deduction for Boarding Homes Under RCW 82.04.4337

Boarding homes licensed under RCW 18.20 are entitled to a B&O tax deduction for amounts received as compensation for providing adult residential care, enhanced adult residential care, or assisted living services (as such terms are defined by RCW 74.39A.009) under contract with the Department of Social and Health Services authorized by Chapter 74.39A RCW to residents who are Medicaid recipients.

⁷¹ RCW 82.04.4289.

⁷² *Id.*

⁷³ WAC 458-20-168(3)(d).

23.5.2.15 Deduction for Amounts Derived from Investments

Amounts derived from some investments may be deducted from taxable income, except for taxpayers engaged in banking, lending or security businesses.⁷⁴ The deduction included is also available for interest received by a parent entity, or between subsidiaries of a common parent, if the total investment and loan income is less than 5% of the business gross receipts.⁷⁵

23.5.2.16 Deduction for Bona Fide Initiation Fees, Dues, Contributions, Donations and Endowment Funds

Amounts received from bona fide initiation fees, dues, contributions, donations, endowment funds and other miscellaneous sources may be deducted from gross income before computing the amount of B&O tax due.⁷⁶ This deduction cannot be construed to exempt amounts derived from the sale of tangible personal property or from the provision of facilities or services, for which a special charge is made to members.⁷⁷ If dues are in exchange for any significant amount of goods or services or if dues are assessed on a graduated scale based on the amount of goods or services rendered, the value of such goods or services may not be deducted from gross income subject to B&O tax.⁷⁸

23.5.2.17 Deduction for Reimbursement of Co-Employment Costs

RCW 82.04.540 provides that a professional services organization is taxed under RCW 82.04.290(2), but is allowed a deduction from revenue equal to the portion of the “fee charged to a client that represents the actual cost of wages, salaries, benefits, worker’s compensation, payroll taxes, withholding, or other assessments paid to or on behalf of a covered employee by the professional employer organization pursuant to a professional employer agreement.” In order to qualify for the deduction, the following criteria must be met:

1. The professional services organization and the client must share a common employee through a coemployment relationship. A “coemployment relationship means a relationship which is intended to be an ongoing relationship rather than a temporary or project-specific one, wherein the rights, duties, and obligations of an employer which arise out of an employment relationship have been allocated between coemployers pursuant to a professional employer agreement and applicable state law.” RCW 82.04.540(3)(c).
2. The employee must be a covered employee. A covered employee is an individual having a coemployment relationship with a professional employer organization and a client, if the following criteria are met:
 - a. The individual employee has received written notice of coemployment; and
 - b. The individual’s coemployment relationship is pursuant to a professional employer agreement. RCW 82.04.540(3)(d).

⁷⁴ RCW 82.04.4281.

⁷⁵ *Id.*

⁷⁶ RCW 82.04.4282.

⁷⁷ *Id.*

⁷⁸ *Id.*

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3. The parties must enter into a written coemployment agreement which provides: (i) for the coemployment of covered employees; and (ii) for the allocation of employer rights and obligations between the client and the professional employer organization. RCW 82.04.540(3)(e).

In addition, the professional employer organization must be engaged in the business of providing professional employer services. Note: the statute does not require that the professional employer organization be engaged exclusively in the business of providing professional services; however, the term “professional employer services” is defined as “the service of entering into a coemployment relationship with a client in **which all or a majority of the employees** providing services to a client or to a division or work unit of a client are covered employees.” RCW 82.04.540(3)(e).

Further, the deduction allowed by RCW 82.04.540 is **not** available in the context of **commonly owned companies** (within the meaning of IRC Section 414(b) or (c)), unless the employer’s principal business activity is (1) entering into professional employer arrangements and (2) the employer holds itself out as a professional employer organization. (See RCW 82.04.540(3)(f)(1)⁷⁹.)

23.5.2.18 Credit for Research and Development Activities

Any “person” with research and development (“R&D”) expenditures may be entitled to a tax credit. The first step in determining the amount of the credit is to calculate the greater of (1) the amount of qualified R&D expenditures, or (2) 80% of amounts received by any person (other than a public educational or research institution) as compensation for conducting R&D. Second, subtract .92% of taxable income from the amount determined in step one.⁸⁰

This resulting amount is multiplied by the appropriate R&D credit rate.⁸¹ The credit rate is the greater of the taxpayer’s average tax rate for the year or 1% in calendar year ending December 31, 2008, 1.25% in calendar year ending December 31, 2009, and 1.5% in calendar year ending December 31, 2010 and thereafter.

Any person who is eligible for R&D credit must take that credit against B&O tax (or assign it to the person contracting for the R&D) for the year in which the credit was earned.⁸² The maximum allowable credit for each person is limited to the lesser of two million dollars or the total amount of B&O tax which that person would otherwise owe.⁸³ A taxpayer claiming the credit is required to file a survey with the Department of Revenue by March 31 of the year following any year in which a credit is claimed.

⁷⁹ The exact language of RCW 82.04.540(3)(f)(1) is as follows: The “following shall not be deemed to be professional employer organizations or the providing of professional employer services for purposes of this section: (i) Arrangements wherein a person, whose principal business activity is not entering into professional employer arrangements and which does not hold itself out as a professional employer organization, shares employees with a commonly owned company within the meaning of section 414(b) and (c) of the Internal Revenue Code of 1986, as amended”.

⁸⁰ RCW 82.04.4452(2)(b).

⁸¹ RCW 82.04.4452(2)(c)(ii).

⁸² RCW 82.04.4452(4).

⁸³ *Id.*

23.5.2.19 Credit for Ride-Sharing Incentive Payments Under RCW 82.70.020

Employers may claim a credit under RCW 82.04 and RCW 82.16 equal to the amount paid to or on behalf of each employee in the form of financial incentives to their own or other employees for ride sharing, for using public transportation, for using car sharing, or for using nonmotorized commuting before July 1, 2013, multiplied by 50%, not to exceed sixty dollars per employee per fiscal year. No refunds may be granted for these credits.

23.5.2.20 Credit for Mechanical Lifting Devices

Effective June 7, 2006 through December 30, 2010,⁸⁴ the state has authorized ten million dollars (statewide) in aggregate for the costs of hospitals purchasing mechanical lifting devices and other equipment primarily used to minimize patient handling by health care providers, consistent with a safe patient handling program developed and implemented by the hospital in compliance with RCW 70.41.390. The credit applies on a first come, first served basis, is limited to the cost of the equipment purchased between the dates set out above, but the credit for any one hospital may not exceed \$1,000 per acute inpatient bed. A hospital is defined by the state hospital licensing statute, RCW 70.41.020.

23.5.2.21 Credit for Energy Efficient Commercial Equipment

Effective July 1, 2008 through December 30, 2010,⁸⁵ the state has authorized seven hundred and fifty thousand dollars (statewide) annually in the aggregate with respect to the purchase of certain qualified energy efficient equipment. The credit is calculated as 8.8% of the purchase price of qualified commercial freezers, high efficiency commercial clothes dryers, commercial ice makers, commercial full-sized convection ovens, commercial deep fat fryers, and commercial hot food handling cabinets, and commercial electric and gas steam cookers. The credit is available only to taxpayers whose gross income for the business in the prior year did not exceed \$750,000 per year. The credit may be carried over if not fully used in the year earned, but may not be offset against taxes for a prior year. No refund can be granted for this credit.

23.5.2.22 Adjustments to Revenues

A hospital, in reporting income, must initially include the total charges billed to the patient as gross income unless the hospital's records clearly indicate the amount of income to which it will be entitled under its contracts with insurance carriers.⁸⁶ However, where tax returns are initially filed based on gross charges, an adjustment may be taken at the time of filing future tax returns (after the hospital has adjusted its records to reflect the actual amounts collected).⁸⁷ In this way the hospital can make adjustments due to write-offs relating to charity care or billings which must be reduced to rates established by contract with Medicare, Medicaid or private insurers.⁸⁸

⁸⁴ RCW 82.04.4485.

⁸⁵ RCW 82.04.4493.

⁸⁶ WAC 458-20-168(2)(f).

⁸⁷ *Id.*

⁸⁸ *Id.*

23.6 Exemptions, Deductions and Exclusions from State Excise Taxes: Tax on Transfers

In Washington there are three types of taxes on transfers which might be applicable to a health care provider. They are the retail sales tax, the use tax and the real estate excise tax.

23.6.1 Retail Sales Tax

In Washington a specified tax is assessed on each retail sale⁸⁹ in the state, including successive retail sales of the same property.⁹⁰ The sales tax principally applies to sales of tangible personal property and certain specified services. Medical and health care services are not among those listed as subject to the sales tax.⁹¹

Sales tax is paid by the buyer to the seller who collects and holds the tax in trust until paid to the Washington State Department of Revenue.⁹² The seller is liable to the state for the amount of the tax, whether or not collected from the buyer, unless the seller has taken from the buyer in good faith a proper resale certificate under RCW 82.04.4 70.⁹³

Exemptions from and credits to the retail sales tax, which might be applicable to health care providers, are described below.

23.6.1.1 Exemption for Personal Property Used in Providing Medical Care

The sales tax does not apply to charges to a patient for tangible personal property used in providing medical services to a patient, even if separately billed. This is because the property used is not deemed to have been sold separately from the medical services simply because those items are separately invoiced.⁹⁴

23.6.1.2 Exemption for Medical Supplies, Chemicals, or Materials Sold to a Comprehensive Cancer Center

Effective July 1, 2006, sales of medical supplies, chemicals, or materials to a comprehensive cancer center are exempt from retail sales and use tax. The rules discussing this exemption are discussed in WAC 458-20-168(4)(c).

23.6.1.3 Exemption for Sales of Prescription Drugs, Prescribed Family Planning Drugs and Devices and Family Planning Devices Supplied by Certain Family Planning Clinics

Drugs for human consumption⁹⁵ dispensed pursuant to a prescription are exempt from the state retail sales tax.⁹⁶ Drugs are defined as compounds, substances, preparations, and components of the same, which are (1) recognized by the United States pharmacopoeia, official homeopathic pharmacopoeia, or official

⁸⁹ “Retail sale” is defined by reference to RCW 82.04.050. RCW 82.08.010(4).

⁹⁰ RCW 82.08.020.

⁹¹ RCW 82.04.050; RCW 82.08.010(4).

⁹² RCW 82.08.050.

⁹³ *Id.*

⁹⁴ *See* WAC 458-20-168(4)(a).

⁹⁵ RCW 82.08.0281.

⁹⁶ *Id.*

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national formulary, (2) otherwise intended for use in diagnosis, cure, mitigation, treatment or prevention of disease, (3) or intended to affect the structure or any function of the body. We emphasize that the definition would include items beyond those traditionally categorized as drugs as that term is commonly used. The term “drug” does not include food items, dietary supplements, or alcoholic beverages.

The regulations define “other substances” as “products such as catalytics, hormones, vitamins, and steroids, but the term generally does not include devices, instruments, equipment, and similar articles. However, ‘other substances’ does include the needles, tubing, and the bag which are part of an intravenous set for delivery of prescription drugs. It also includes infusion pumps and catheters when used to deliver prescription drugs to a specific patient. These items are not conceptually distinct from the prescription drug solution. This same rationale applies to tubing and needles which are used in placing prescribed nutritional products in the patient’s system. The stand which holds the intravenous set is not included nor are plain glass slides, plain specimen collection devices, and similar items which are used in the laboratory. This term does include diagnostic substances and reagents, including prepared slides, tubes and collection specimen devices which contain diagnostic substances and reagents at the time of purchase by a laboratory.”⁹⁷

Also exempted under RCW 82.08.0281 are sales of drugs or devices prescribed for family planning purposes, including the prevention of conception. Finally, drugs and devices supplied by a family planning clinic under contract with the Washington State Department of Health (without regard to whether the drugs or devices are prescribed by someone having prescriptive authority) are also exempt from sales tax.

Whether particular items fall within the scope of an exemption for drugs has been the subject of a number of Department of Revenue rulings; however, the practitioner should be aware that RCW 82.08.0281 was amended in 2003 and that RCW 82.08.0283 was added at that time.

The practitioner is directed to WAC 458-20-18801 which was enacted prior to the substantial revisions to RCW 82.08.0281 in 2003 and which regulation continues to define a “prescription” as “written directions and specifications by physicians or optometrists for the preparation, grinding, and fabrication of lenses intended to aid or correct visual defects or anomalies of humans.”

23.6.1.4 Exemption for Over-the-Counter Drugs for Human Use

The sales tax does not apply to sales of over-the-counter drugs for human use dispensed or to be dispensed to patients, pursuant to a prescription.⁹⁸ “Over-the-counter drug” is defined in RCW 82.08.0281 as “a drug that contains a label that identifies the product as a drug required by 21 C.F.R. Sec. 201.66, as amended or renumbered on January 1, 2003 to have a label which includes: (1) a ‘drug facts’ panel, or (2) a statement of the ‘active ingredients’ with a list of those ingredients contained in the compound, substance or preparation.”

⁹⁷ WAC 458-20-18801(1)(c).

⁹⁸ RCW 82.08.940.

23.6.1.5 Exemption for Sales of Prosthetic Devices, Prescription Drugs and Oxygen

The Sales tax does not apply to sales of prosthetic devices, fitted, or furnished for an individual by a person licensed under Washington law to prescribe, fit, or furnish such devices or components of the same.⁹⁹

Medicines of mineral, animal and botanical origin are also exempt from sales tax, if drugs are prescribed, administered, dispensed or used in the treatment of an individual by a naturopath licensed under RCW Chapter 18.36A.¹⁰⁰ As discussed below, there is a separate exemption for the sale of drugs dispensed pursuant to a prescription and an exemption for the sale of drugs and devices for family planning purposes, if certain conditions are met.

In addition, medically prescribed oxygen, oxygen concentrator systems, oxygen enricher systems, liquid oxygen systems and gaseous, bottled oxygen systems, prescribed for an individual by a physicians licensed under RCW Chapter 18.71 are exempt from sales tax.¹⁰¹

Further, the sales tax does not apply to charges for labor or services rendered with respect to repairing, cleaning, altering, or improving prosthetic devices or oxygen systems.

The sales tax exemption allowed by RCW 82.08.0283 does not otherwise apply to durable medical equipment or mobility enhancement equipment.

23.6.1.6 Exemption for Dietary Supplements

The sales tax does not apply to sales of dietary supplements for humans dispensed or to be dispensed to patients pursuant to a prescription.¹⁰² The term “dietary supplement” is defined by RCW 82.08.0293 as a non-tobacco product to supplement the diet that contains one or more of the following: a vitamin, a mineral, an herb or other botanical, an amino acid, a dietary supplement to increase total dietary intake, or a concentrate, metabolite, constituent extract, or a combination of these items. In addition, the supplement cannot be represented as either conventional food or as a sole meal/diet and the item must be labeled as “dietary supplement” on the box as required by 21 C.F.R. Sec. 101.36, as amended and renumbered as of January 1, 2003.¹⁰³

23.6.1.7 Exemption for Disposable Devices Used to Deliver Prescription Drugs

The sales tax does not apply to sales of disposable devices used or to be used to deliver drugs for human use, pursuant to a prescription. This exemption applies to single use items such as syringes, tubing, or catheters.¹⁰⁴

⁹⁹ RCW 82.08.230.

¹⁰⁰ RCW 82.08.0283.

¹⁰¹ *Id.*

¹⁰² RCW 82.08.925.

¹⁰³ RCW 82.08.0293.

¹⁰⁴ RCW 82.08.935.

23.6.1.8 Exemption for Fundraising Sales by a Nonprofit Organization

The sales tax does not apply to “a sale by a nonprofit organization if the gross income from the sale is exempt” from B&O tax under RCW 82.04.3651, which exempts certain amounts received by nonprofit organizations for fundraising activities from the B&O tax.¹⁰⁵

While the sale by a nonprofit organization may be exempt from the sales tax, the buyer may still be responsible for paying a use tax. This is because there is no comparable use tax exemption provided to the buyer/user of property purchased at these fundraising sales. Thus, the nonprofit organization “is encouraged to inform the buyer of the buyer’s possible use tax obligation.”¹⁰⁶

23.6.1.9 Exemption for Sales to Federal Corporations Providing Aid and Relief

Sales to certain federal aid and relief organizations, such as the American Red Cross and the USO, are exempt from the retail sales tax.¹⁰⁷

23.6.1.10 Exemption for Sales of Necessary Items to Free Hospitals

Retail sales tax does not apply to sales to free hospitals of “items reasonably necessary for the operation of and provision of health care by, free hospitals.”¹⁰⁸ “A free hospital” is defined in RCW 82.08.02795(2) as a hospital that does not charge patients for health care provided by the hospital.

23.6.1.11 Exemption for Sales to Blood, Bone or Tissue Bank

Retail sales tax does not apply to the sale of medical supplies, chemicals or materials to a qualifying blood bank, a qualifying tissue bank, or a qualifying bone and tissue bank.¹⁰⁹ The definitions set out in RCW 82.04.324 apply to this exemption. This exemption does not apply to the sale of construction materials, office equipment, building equipment, administrative supplies or vehicles.

23.6.1.12 Exemption for Sales of Food for Human Consumption

Sales of food products which are subject to, or exempt from, the retail sales tax are carefully delineated in RCW 82.08.0293(2)-(4) and WAC 458-20-119. Typically, meals served to hospital patients are not subject to retail sales tax, while meals served in the hospital cafeteria are subject to retail sales tax.

Additionally, sales under a state administered nutrition program for the aged are exempt.¹¹⁰ Also exempt are sales to senior citizens, disabled persons or low-income persons, by a duly organized nonprofit

¹⁰⁵ RCW 82.08.02573.

¹⁰⁶ WAC 458-20-169(4)(c)(ii).

¹⁰⁷ RCW 82.08.0258.

¹⁰⁸ RCW 82.08.02795(1).

¹⁰⁹ RCW 82.08.02805.

¹¹⁰ RCW 82.08.0293(3)(a).

organization.¹¹¹ However, this exemption is not available if the meals are provided by a nonprofit (such as a hospital) as part of the services rendered to such patients.¹¹²

23.6.2 Use Tax

The Washington State use tax is designed to collect tax on articles of tangible personal property and specified services used in the state which would be subject to retail sales tax if purchased or sold in Washington.¹¹³ The use tax is also imposed on certain services, if those services are included in the definition of retailing. Use tax is imposed in the same amount as the retail sales tax.¹¹⁴ Exemptions from the use tax which are relevant to health care providers are described in the discussion of sales taxes.

23.6.3 Streamlined Sale and Use Tax Agreement

Washington joined as a member state in the streamlined sales and use tax agreement (the “SSUTA”).¹¹⁵ “The SSUTA is a cooperative effort of 44 states, the District of Columbia, local governments and the business community to simplify and make more uniform sales and use tax collection and administration by retailers and states. It is intended to reduce the cost and administrative burdens on retailers that collect the sales tax, particularly retailers operating in multiple states. It would encourage ‘remote sellers’ selling over the Internet and by mail order to collect tax on sales to Washington customers. It seeks to make local ‘brick-and-mortar’ stores and remote sellers all operate by the same rules and in the same competitive environment.”¹¹⁶

The SSUTA “provides for a simpler and more uniform sales and use tax structure among the states that have sales and use taxes.”¹¹⁷ RCW 82.02.210 provides that it is the intent of the Washington State Legislature that the provisions of Title 82.02 be “interpreted and applied consistently with the SSUTA.”¹¹⁸

Prior to July 1, 2008, Washington retailers were required to collect the local sales tax based on where the delivery was made. Starting July 1, 2008, with respect to shipments and deliveries to locations within Washington State, retailers generally are required to collect the local sales and use tax based on the destination of the shipment or delivery – the “destination” of the sale. (*See* RCW 82.32.730.)

The Streamlined Sales Tax Governing Board has released several white papers which provide guidance on a variety of topics implicated by the SSUTA. Included in these white papers is the Medical Equipment Issue Paper, http://www.streamlinedsalestax.org/issue_papers.html. That issue paper addresses and defines the terms “prosthetic device,” “durable medical equipment” and “mobility enhancing equipment” for purposes of the SSUTA. Washington has adopted these definitions.

In accord with RCW 82.32.740, the Department has developed a taxability matrix which is available in downloadable format from the Department’s web site.¹¹⁹

¹¹¹ *Id.*; WAC 458-20-169(4).

¹¹² WAC 458-20-119(3)(b).

¹¹³ RCW 82.12.020.

¹¹⁴ RCW 82.12.020(4).

¹¹⁵ RCW 82.02.210.

¹¹⁶ <http://dor.wa.gov/Content/FindTaxesAndRates/RetailSalesTax/DestinationBased/ImplementationFAQ.aspx> (accessed Jan 5, 2009).

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ <http://dor.wa.gov/docs/pubs/misc/streamline/2008wataxabilitymatrix.pdf> (last accessed on Jan. 5, 2009).

23.6.4 Real Estate Excise Tax

Each sale¹²⁰ of real property¹²¹ is subject to a specified tax, expressed as a percentage of the selling price.¹²² The tax is collected by the treasurer for the county where the property which was sold is located and no evidence of sale may be filed or recorded by the county auditor until the tax is paid.¹²³ A lien, enforceable in the manner prescribed for mortgage foreclosure, attaches to each piece of real property upon sale and remains in force until the tax is paid.¹²⁴

Of interest to health care providers is the scope of what constitutes a sale for purposes of the real estate excise tax. Specifically, a “sale” subject to the tax does not include a transfer by “gift, devise or inheritance.”¹²⁵ Thus, charitable gifts or bequests to health care providers could be outside the scope of the statute. Additionally, the tax does not apply to the distribution of real property to the beneficiaries of an irrevocable trust when no valuable consideration is given and the distribution is made according to the trust instruments.¹²⁶ Transfers by government entities such as state or county owned hospitals and public hospital districts may also be exempt.¹²⁷ However, property purchase transactions (not including condemnation proceedings) by governmental entities are generally taxable.¹²⁸ Rules regarding the real estate excise tax are set forth at WAC 458-61A.

23.7 B&O Taxes Levied By Washington’s Cities

Except for taxes imposed on utilities, RCW 35.102.040 requires cities which impose a business and occupation tax conform to a “uniform system of city business and occupation taxes that eliminates multiple taxation, allowing for some continued local control and flexibility to cities.” The Core Model Ordinance was developed by the Association of Washington Cities.

For a comparison, city by city, of the B&O Tax Code Deviations from the Core Model Ordinance Provisions, *see* the Municipal Research and Services Center of Washington’s¹²⁹ website: <http://www.mrsc.org/Subjects/Finance/B-Otax.aspx> (last accessed January 5, 2009). Posted on this web site is a comparison table of city B&O tax rates. The following are required areas of conformity among the various city B&O taxes:

- (a) A system of credits that meets the requirements of RCW 35.102.060 and a form for such use;

¹²⁰ “Sale” is defined in RCW 82.45.010, as having its ordinary meaning and includes, among other things, conveyances, grants, assignments, quitclaims or transfer of ownership or title to real property.

¹²¹ “Real property” is defined in RCW 82.45.032(1) to mean “any interest, estate or beneficial interest in land or anything affixed to land, including the ownership interest or beneficial interest in any entity which itself owns land or anything affixed to land.” The term also includes used mobile homes, used floating homes and improvements constructed on leased land.

¹²² RCW 82.45.060(1).

¹²³ RCW 82.45.090(1).

¹²⁴ RCW 82.45.070.

¹²⁵ RCW 82.45.010(3)(a); WAC 458-61A-102(15)(d)(i).

¹²⁶ WAC 458-61-411(2).

¹²⁷ RCW 82.45.010(3)(m).

¹²⁸ WAC 458-61A-205.

¹²⁹ “The Municipal Research and Services Center (MRSC) is a nonprofit, independent organization created in 1969 to continue programs established in 1934 under the Bureau of Governmental Research at the University of Washington.” <http://www.mrsc.org/center.aspx>. Last accessed Jan. 5, 2009.

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(prepared from reference materials available as of January 31, 2009)

- (b) A uniform, minimum small business tax threshold of at least the equivalent of twenty thousand dollars in gross income annually;
- (c) Tax reporting frequencies that meet the requirements of RCW 35.102.070;
- (d) Penalty and interest provisions that meet the requirements of RCW 35.102.080 and 35.102.090;
- (e) Claim periods that meet the requirements of RCW 35.102.100;
- (f) Refund provisions that meet the requirements of RCW 35.102.110; and
- (g) Definitions, which at a minimum, must include the definitions enumerated in RCW 35.102.030 and 35.102.120. The definitions in Chapter 82.04 RCW (the Washington B&O Tax statute) were used as the baseline for all definitions in the model ordinance.

In addition, the model ordinance imposes a system for allocating income among the various cities. With respect to services and other income, income is allocated using two factor apportionment. Income is apportioned to a city by multiplying service income by a payroll factor (based on the payroll within the jurisdiction), plus the service-income factor (based on the income producing activity attributable for tax purposes within the jurisdiction), divided by two.

Although Washington cities have latitude to develop a tax system that includes non-mandatory provision of the model ordinance with respect to tax exemptions, credits, and deductions, cities that do so must make a description of the differences available to the public.¹³⁰ Charts comparing the B&O Tax Code Deviations from Core Model Ordinance Provisions for the following cities are located on the MRSC website:

- Bellevue
- Bellingham
- Burien
- Kelso
- Longview
- Olympia
- Seattle
- Shelton
- Tacoma

23.7.1 Preemption of State and Local Taxes

Beginning on January 1, 2000, the state preempted county, city, town and other municipal subdivisions from imposing any excise or privilege tax on premiums and payments for health benefits offered by employment welfare arrangements, HCSCs, HMOs and self-funded multiple employer welfare arrangements.¹³¹

¹³⁰ RCW 35.102.040.

¹³¹ RCW 48.14.0210(7). *See also Group Health Cooperative v. City of Seattle*, 146 Wash. App. 80 (2008).