

State and Local Tax Implications for Healthcare Organizations

HFMA Washington-Alaska Chapter

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Topics Covered

- Washington Tax Considerations
 - Overview of various Washington taxes
 - B&O tax exclusions, exemption & deductions
 - Common B&O tax reporting issues
- Multistate Tax Considerations
 - When is your organization subject to another state's tax?
 - Types of taxes imposed
 - Assessing the risk, the cost of compliance and mitigation strategies

Washington Tax Considerations

Washington Tax Overview

- Unlike the Federal Government, Washington State has no general tax exemptions for nonprofits
- Major taxes –
 - Business and occupation (B&O) tax
 - Retail sales / use taxes
 - Real and personal property taxes
 - City taxes

Business & Occupation Tax

The basics

- Tax imposed on the privilege of engaging in business
- Common classifications
 - Retailing
 - Gross proceeds of sale / .471%
 - Wholesaling
 - Gross proceeds of sale / .484%
 - Manufacturing
 - Value of products manufactured in Washington / .484%
 - Service & Other
 - Gross income of the business / 1.5%
 - Public & Nonprofit Hospitals
 - Gross Income of the business / 1.5%

Common B&O tax misconceptions and traps

- Double taxation
 - Tax applies to transactions at multiple levels (i.e., tax pyramids)
 - Tax applies to all transactions between “persons” (no intercompany exemption / elimination)
- Broad definition of engaging in business
- Form of transaction controls (rather than substance)
- Advances and reimbursements
- Transactions between related parties (or intercompany transactions)

The basics

- Tax on privilege of purchasing taxable goods and services at retail
- Applies to tangible personal property, digital products and specific services
- Imposed on the consumer (end user)
- Collected by the seller who is liable if fails to collect
- State and local components administered by Department of Revenue
- Purchases for resale – reseller permits

Common exemptions

- Sale for resale
- Certain items dispensed/administered pursuant to a prescription
 - Medicines and other substances for use in the diagnosis, cure, mitigation, treatment or prevention of disease in humans
 - Lenses and eyeglass frames
 - Orthotic devices
 - Medical oxygen
- Prosthetic devices
- Hearing aids
- Ostomic items
- Laboratory reagents and other diagnostic substances used in a test prescribed to diagnose disease in humans

Transactions often overlooked

- Digital Products
 - Definitions
 - Software v. digital products
 - Digital goods
 - Digital automated services
 - Remote access software
 - Exemptions
 - Business use
 - Exclusions from definition of digital automated service
 - Multiple points of use

The basics

- Companion to sales tax – same tax rate
- Everyone owes use tax on taxable property, digital goods or services purchased for use in the state when no sales tax is collected by the seller
- Accrued and self-reported
- Use tax is not due on donated items
 - Donor also exempt

Real & Personal Property Taxes

The basics

- Based on assessed value
- Levy rate determined based on tax districts and “equalization” process
- All property is assumed to be taxable unless a specific exemption exists
- Exemptions are construed narrowly in favor of taxation
- The Department of Revenue is charged with administering exemptions including approving/disapproving exemption applications for taxpayers and auditing for compliance

Real & Personal Property Taxes

Exemptions

- The real and personal property used by, and exclusively for the purposes of, non-profit hospitals for the sick is exempt from property taxation
 - Leased property is eligible
 - Eligibility requirements have expanded in recent years to include fully integrated outpatient treatment facilities that are included in an acute care hospital license issued by Department of Health
- General conditions for exemption from property tax:
 - Exclusive use for the exempt purpose required
 - Strict limits on the loan or rental of exempt property
 - Irrevocable dedication to the exempt purpose required (exception for leased property)
 - No discrimination is allowed for services provided
 - Must comply with licensing and inspection requirements

Exemption application process

1. Taxpayer files application for exemption
2. Department of Revenue evaluates qualification
3. Department schedules a field visit
4. Determination letter is issued and forwarded to the county to update the tax rolls
5. Exemption generally becomes effective for taxes due in the year following application

City Taxes

Overview

- B&O tax – Imposed by over 40 Washington cities and towns
- Admissions tax – Imposed by Seattle (and perhaps others). There are exemptions for nonprofits under certain circumstances. An exemption certificate is required, which should be obtained in advance of the event.
- Commercial parking tax – Imposed by Seattle at a very high rate (12.5%). Tax is imputed if purchased and provided at a discount (e.g. parking provided to employees)
- Repeal of the Seattle square footage tax effective January 1, 2016
- Nonprofit exemptions (501(c)(3), H&SW, life sciences)
- Business license requirement
- Other local taxes

B&O Tax Exclusions, Exemptions & Deductions

B&O Tax Exclusions, Exemptions & Deductions

Available to all taxpayers

- Wages
- Investment income
- Income from real estate
- Donations, contributions and endowments
- Fundraising
- Bad debts
- Discounts
- Advances and reimbursements

B&O Tax Exclusions, Exemption & Deductions

Available in healthcare context

- Health or social welfare services deduction
 - Applies to public and nonprofit hospitals
 - A nonprofit hospital must be a “health or social welfare organization” (HSWO)
 - Must meet certain organizational requirements (Chap 24.03 RCW nonprofit corporation or corporation sole)
 - Governing board of at least 8 members
 - No member may be a paid employee of the organization
 - Applies to payments received directly from federal, state or local governmental entities to provide health or social welfare services
 - Deduction includes
 - Medicare, Medicaid, Basic Health and similar programs
 - Champus / Tricare
 - Indian Health
 - Department of Corrections / Bureau of Prisons
 - Does not include amounts received under an employee benefit plan

Available in healthcare context (continued)

- Federal Medicare, Medicaid and similar programs administered by the State
 - Applies to public / nonprofit hospitals and nonprofit community health centers
 - Nonprofit organization must qualify as a HSWO
 - Payments may be received from an intermediary
 - Deduction doesn't apply to patient copays or patient deductibles
- Nonprofit organizations operating kidney dialysis facilities
 - Fees for kidney dialysis service
 - Sales of prescription drugs dispensed as an integral part of dialysis service
 - Applies to dialysis services provided by nonprofit hospitals if separately accounted for

B&O Tax Exclusions, Exemptions & Deductions

Available in healthcare context (continued)

- Amounts received by blood, tissue, or blood and tissue banks
 - IRC 501(c)(3) organization
 - Primary purpose requirement
 - Registered under 12 CFR, parts 607 and/or 1271
- Qualified organ procurement organization
 - Defined in 42 USC Sec 273(b)
 - Exempts all amounts received that are exempt from federal income tax.
- Charges for certain prescription drugs
 - Infusion or injection by licensed physician or agent
 - Separately stated charge on billing statement
 - Doesn't exceed federal reimbursement rate
 - Covered under a plan subsidized by federal or state government

Common B&O Tax Reporting Issues

Common B&O Tax Reporting Issues

- Contractual adjustments
 - Contractual adjustments are a necessary adjustment to gross patient revenue
 - Difficulties with the adjustment:
 - Accounting for subsequent adjustments to revenue that are presented in gross
 - Timing issues caused by reimbursements received in subsequent periods
 - Accounting for changes in reimbursement rates or differences in actual reimbursement
- Proper classification
 - Public or nonprofit hospitals
 - Currently not an issue, but may become an issue if legislature enacts change in service rate
 - Rate applies only to providing personal or professional services to inpatients
 - Clinics and departments providing outpatient and inpatient services are eligible only when the clinic or department is an “integral, interrelated, and essential part of the hospital.”
 - Factors include location of the clinic or department and whether it furnishes services of a type normally provided by hospitals (24 hour intake and emergency services)

Common B&O Tax Reporting Issues

- Proper classification (continued)
 - Service classification
 - Transcription fees
 - Income from licenses to use real property
 - Other miscellaneous income not classified elsewhere
 - Retailing
 - Sales of tangible personal property
 - Intercompany sales of digital products
 - Sales of meals (except to patients)
 - Manufacturing
 - Internal printing of invoices, letterhead, envelopes, etc.
- Fundraising
 - Distinguished from soliciting donations
 - No regular place of business
 - Non IRC § 501(c)(3), (4) or (10) organizations and political activity

Common B&O Tax Reporting Issues

- Grants
 - No explicit deduction available (donation or contribution)
 - To be deductible, must not be in exchange for significant goods or services
 - Acknowledgement and reporting findings generally allowed, but no transfer of proprietary rights to intellectual property created
 - Form of document may be relevant
 - Meaningful use payments
- Interest on loans
 - Investment income is deductible
 - Intercompany loans
 - Deduction does not extend to lending activity (finance charges)
- Advances / Reimbursements
 - Common payroll
 - Common purchasing
 - Joint billing
- Management fees / cost allocations

Common B&O Tax Reporting Issues

Current Healthcare B&O Tax Issues

- Medicaid reimbursements paid by other states
 - Health or social welfare deduction applies to “amounts received from . . . The state of Washington or any municipal corporation or political subdivision thereof”
 - Nonprofit hospital deduction applies to “amounts received for healthcare services covered under [Medicare]; medical assistance, children’s health, or other program under chapter 74.09 RCW”
 - Department of Revenue ruled that out-of-state Medicaid reimbursements are not deductible
- Amounts reimbursed and paid under self-insured employee health plan for services rendered by the plan sponsor
 - Board of Tax Appeals ruled that amounts recognized for healthcare services provided by plan sponsor and paid through TPA were subject to B&O tax
- Medicare Advantage Reimbursements

Common B&O Tax Reporting Issues

Rules of thumb

- Assume all activities are taxable;
- Determine the characteristics of receipts (i.e., retailing, wholesaling, or services);
- Determine whether a specific exemption, exclusion or deduction applies to an activity; and
- Collect or give any documentation required to establish an exemption.

Multistate Tax Considerations

Multistate Tax Considerations

When are you taxable in another state?

- “Nexus” – a jurisdictional concept
- Physical presence
 - Employees and/or property
 - Representatives
 - Affiliates
- Economic presence
 - Exploiting in-state market
 - “Bright-line” or “factor presence” nexus

Multistate Considerations

Tax types

- Income/franchise taxes
 - Tax exempt status
 - UBIT
 - Non-income taxes
- Sales and use taxes
 - Collection obligation
 - Payment on purchases
 - Self-assess
- Employment related obligations
 - Social insurance: unemployment and worker's compensation
 - Payroll withholding
- Property Taxes

Multistate Considerations

Practical considerations

- Assessing the risk
 - Transitory v. established presence
 - Nature of activity
 - What organizations are you engaging with inside the state?
- Cost of compliance
- Mitigation strategies
 - Voluntary disclosure programs
 - Income tax withholding policy for mobile employees

Questions?

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