Cite as Det. No. 18-0307, 40 WTD 077 (2021)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Refund of Assessment of	)	D E T E R M I N A T I O N
	)	No. 18-0307
. . .	)	Registration No. . . .

RCW 82.04.4282: B&O TAX – DEDUCTION – DONATIONS – CONTRIBUTIONS – FEDERAL INCENTIVE PAYMENTS. Federal incentive program payments to move medical records from paper to digital format do not qualify for the donations or contributions deduction from B&O tax because they were not given for a gratuitous purpose.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Sattelberg, T.R.O. (successor to Valentine, T.R.O.) – A medical services provider protests the Department's assessment of service and other activities business and occupation ("B&O") tax on federal incentive payments. Taxpayer argues the incentive payments are deductible from B&O tax as deductions or contributions. We deny the petition.[1]

ISSUE

Whether federal incentive payments received by a medical services provider are deductible from B&O tax as [donations] or contributions under RCW 82.04.4282 when the payments were for the upgrade of physical medical records to electronic medical records as part of a government plan, enacted by federal statute.

FINDINGS OF FACT

. . . ("Taxpayer") is a medical services provider specializing in . . . medicine in Washington. Taxpayer operates multiple health clinics and surgery centers in Washington and has numerous medical professionals on staff. Taxpayer applied for and received federal incentive payments to upgrade its physical medical records to electronic medical records.

The federal incentive payments were broadly authorized under the American Recovery and Reinvestment Act ("Stimulus Act").[2] The incentive payments are found in the Stimulus Act's

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
[2] Pub. L. 111-5, 123 Stat. 115 (Feb. 17, 2009).

Health Information Technology for Economic and Clinical Health Act ("HITECH Act") section.[3] The HITECH Act sought to create a nationwide network of electronic health records users to develop a nationwide health information technology infrastructure.[4] The Act established Medicare and Medicaid incentive payments for "eligible professionals" that adopted and "meaningfully used" "certified electronic health record technology."[5]

The Centers for Medicare & Medicaid Services ("CMS"), a part of the United States Department of Health and Human Services, was the federal authority responsible for implementing this federal incentive program under the HITECH Act. According to CMS, "eligible professionals" had to attest to their "meaningful use" through CMS's online Attestation module in order to receive any incentive payments.[6] CMS defined which types of medical professionals were eligible for the incentive payments, and published schedules establishing maximum incentive payment amounts.[7] CMS defined "meaningful use" through regulation:[8]

> The Stage 1 meaningful use criteria, consistent with other provisions of Medicare and Medicaid law, focuses on electronically capturing health information in a structured format; using that information to track key clinical conditions and communicating that information for care coordination purposes (whether that information is structured or unstructured, but in structured format whenever feasible); implementing clinical decision support tools to facilitate disease and medication management; using [electronic health records] to engage patients and families and reporting clinical quality measures and public health information. Stage 1 focuses heavily on establishing the functionalities in certified [electronic health records] technology that will allow for continuous quality improvement and ease of information exchange. By having these functionalities in certified [electronic health records] technology at the onset of the program and requiring that the [eligible professional], eligible hospital or [critical access hospital] become familiar with them through the varying levels of engagement required by Stage 1, we believe we will create a strong foundation to build on in later years. Though some functionalities are optional in Stage 1, as outlined in discussions later in this rule, all of the functionalities are considered crucial to maximize the value to the health care system provided by certified [electronic health record] technology. We encourage all [eligible professionals], eligible hospitals and [critical access hospitals] to be proactive in implementing all of the functionalities of Stage 1 in order to prepare for later stages of meaningful use, particularly functionalities that

---

[3] Pub. L. No. 111-5, Division A, Title XIII, 123 Stat. 226

[4] *See* http://www.personalpphysicianmd.com/2012/11/15/meaningful-use-part-one.

[5] Title IX of Division B, § 4101, 123 Stat. 647. On July 28, 2010, CMS published a regulation regarding the Electronic Health Records program, which would later be codified, in pertinent part, into 42 C.F.R. § 495. 42 C.F.R. § 495.4 defines "eligible professionals," certified electronic health record technology," and "meaningful EHR (electronic health record) user."

[6] https://www.cms.gov/Regulations-and-Guidance/Legislation/EHRIncentivePrograms/Downloads/EP_Attestation_User_Guide_2013.pdf (last visited March 29, 2018)

[7] In 2012, for example, the maximum payment for an eligible professional that had not claimed a payment in 2011 was $18,000. https://www.cms.gov/Regulations-and-Guidance/Legislation/EHRIncentivePrograms/Downloads/MLN_MedicareEHRProgram_TipSheet_EP.pdf (last visited March 29, 2018)

[8] In CMS's first version of its regulation regarding the incentive payments, published in the Federal Register at 75 FR 44313, CMS defined "meaningful use" differently depending on the different stage of the incentive program.

> improve patient care, the efficiency of the health care system and public and population health. The specific criteria for Stage 1 of meaningful use are discussed at section II.2.c of this final rule.

Notably, the program encouraged voluntary participation through compensation in the form of the incentive payments, but also encouraged participation through a penalty for not voluntarily complying. For "eligible professionals" that did not convert to electronic medical records by specific time frames, the Stimulus Act imposed an increasing reduction in Medicare or Medicaid reimbursement rates.[9]

In 2014, the Department's Audit Division ("Audit") reviewed Taxpayer's business records for the time period of January 1, 2010, through June 30, 2014 (the "Audit Period"). Audit discovered that, during the Audit Period, Taxpayer had received a total of $ . . . in federal incentive payments to convert its medical records from physical records to electronic records.[10] Taxpayer had not reported these incentive payments as taxable income. Audit determined that these federal incentive payments were taxable because, Audit concluded, the federal government received business benefits in return for providing the payments. On July 21, 2015, Audit assessed Taxpayer a total of $ . . . , $ . . . of which was service and other activities B&O tax on the federal incentive payments.[11]

Taxpayer timely sought review of only the B&O tax on the federal incentive payments, arguing they are deductible from B&O tax as deductions or contributions. On review, Taxpayer provided numerous news updates from CMS discussing eligibility for, upcoming deadlines of, and other aspects of the incentive program.

ANALYSIS

Washington's B&O tax is imposed for the privilege of engaging in business in Washington. RCW 82.04.220. The term "business" includes "all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or another person or class, directly or indirectly." RCW 82.04.140. The measure of the tax is the gross proceeds of sales, value proceeding or accruing, or gross income of the business. RCW 82.04.220.

However, RCW 82.04.4282 provides that bona fide contributions and [donations] are not subject to B&O tax. It reads as follows: "In computing tax there may be deducted from the measure of tax amounts derived from bona fide . . . (3) contributions, (4) donations . . . ." RCW 82.04.4282; *see also* WAC 458-20-168(3)(b).[12] Exemptions from a taxing statute must be narrowly construed.

---

[9] *See* https://www.cms.gov/Regulations-and-Guidance/Legislation/EHRIncentivePrograms/Basics.html.

[10] Taxpayer received $ . . . in incentive payments in 2012, and the remaining $ . . . in 2013.

[11] The assessment included $ . . . in use tax, $ . . . in service & other activities B&O tax, and $ . . . in interest. Audit also found Taxpayer had underreported its use tax obligation as well as its income from providing medical services. Taxpayer paid the portion of the assessment pertaining to these items and does not dispute those amounts due.

[12] WAC 458-20-168 is the Department's regulation for medical facilities. It provides the following regarding contributions and donations:

> **Contributions, donations, and endowment funds.** RCW 82.04.4282 provides a B&O tax deduction for amounts received as contributions, donations, and endowment funds, including grants,

Budget Rent-A-Car, Inc. v. Dep't. of Revenue, 81 Wn.2d 171, 174, 500 P.2d 764 (1972); *Evergreen-Washelli Memorial Park Co. v. Dep't. of Revenue*, 89 Wn.2d 660, 663, 574 P.2d 735 (1978). Taxation is the rule; exemption is the exception. *Spokane County v. City of Spokane*, 169 Wash. 355, 358, 13 P.2d 1084 (1932).

The Washington Court of Appeals examined whether amounts received from the federal government could be deducted as "contributions" or "donations" under RCW 82.04.4282 in *Analytical Methods, Inc. v. Dep't of Revenue*, 84 Wn. App. 236, 928 P.2d 1123 (1996). In that case, federal funds were dispensed to small businesses pursuant to contracts with federal agencies. *Id*. The small businesses contracted to conduct research as part of the federal Small Business Innovative Research Program ("Program").[13] *Id*. at 239. In return for the federal funding, the federal government (1) chose the research topic, (2) required periodic progress reporting, and (3) received certain intellectual property rights in return for the funds. *Id*. at 243. The Court concluded that the federal funds were not deductible from the measure of B&O tax as contributions or donations under RCW 82.04.4282, holding:

> "Contribution" means "a sum or thing voluntarily contributed." Webster's Third New International Dictionary 496 (1966). "Contribute" means "to give or grant in common with others (as to a common fund or for a common purpose)." Webster's Third New International Dictionary 496 (1966). "Contribute" also means "to give . . . to a common supply, fund, etc., as for charitable purposes." Random House Dictionary of the English Language (2d ed. 1987). "Donation" means "the action of making a gratuitous gift or free contribution." Webster's Third New International Dictionary 672 (1966). *These definitions require a gratuitous purpose that is missing from the [Program] . . . .*

Id. (emphasis added).

Here, the purpose of the incentive payments is not exactly like the purpose of the Program in *Analytical Methods*, which was "to use small business to meet federal research and development needs," a purpose the Court of Appeals found to not be gratuitous. *Id*. at 243. The federal government was not using the incentive payments to contract out work it would otherwise be required to perform as part of its governmental mandate, as in *Analytical Methods*. However, the federal government did place restrictions on granting the incentive payments in the form of the "meaningful use" requirement.

Most importantly, in *Analytical Methods,* the Court of Appeals went on to consider [that] the dictionary definitions of both "donation" and "contribution" required a "gratuitous purpose," [a requirement which] was missing from the Program. *Id*. "Gratuitous" is defined as "1.a. given freely or without recompense, b. costing the recipient or participant nothing, free." Webster's Third New

---

> which are not in exchange for goods, services, or business benefits. For example, a B&O tax deduction is allowed for donations received by a public hospital, as long as the donors do not receive any goods, services, or any business benefits in return. On the other hand, a public hospital may not take a B&O tax deduction on amounts earned from a state university for work-study programs or training seminars, because the university receives business benefits in return, as students receive education and training while enrolled in the university's degree programs.

[13] The Program was created by the Small Business Innovation Development Act of 1982 (codified at 15 U.S.C. § 638).

International Dictionary 992 (3rd ed. 1993). The recipients of the incentive payments here were not freely given money from the federal government, but instead were incentivized to apply for the program through the promise of compensation, had to attest to their "meaningful use" of electronic health records in order to receive compensation through the incentive payments, and, if they did not participate, they risked losing money in the form of reduced Medicare or Medicaid reimbursement rates.

As we must "narrowly construe" exemption statutes, we hold that the incentive payments here lack the "gratuitous purpose" discussed in *Analytical Methods*. The incentive payments were not "given freely," but instead were given with strict compliance requirements and in lieu of a punitive measure for noncompliance. Further, the electronic health records program was designed to move medical providers from using paper medical records to using digital medical records. The purpose of the program was to modernize American medical records, as envisioned by the federal government. Pub. L. No. 111-5, 123 Stat. 230. We hold that the incentive payments here were not given gratuitously, but were given expressly to further the purpose of the electronic health records program.

We have previously analyzed whether amounts other taxpayers received qualified for deduction as donations or contributions under *Analytical Methods*. In Det. No. 13-0156R, 33 WTD 199 (2014), the taxpayer operated a primary care medical facility. 33 WTD at 200. The taxpayer received substantial financial support from a local nonprofit foundation under the terms of an agreement between the two parties. *Id*. The Department taxed the amounts the taxpayer received from the foundation, and the taxpayer protested, arguing it was eligible to deduct these amounts as donations or contributions. *Id*. at 201. We held the amounts the taxpayer received from the foundation were not deductible, reasoning that they were given under a contract to provide services. *Id*. at 203. As the amounts were in exchange for operating the clinic, we held they were not given for a "gratuitous purpose," as *Analytical Methods* requires. *Id*.

In Det. No. 14-0286, 34 WTD 563 (2015), the taxpayer operated a private tennis club. 34 WTD at 564. The taxpayer issued its members capital assessments that its bylaws authorized, in order to pay for capital improvements to the facility. *Id*. The taxpayer requested a ruling regarding the taxability of the capital assessments, and the Department ruled that the capital assessments were not deductible as donations or contributions. *Id*. at 566. The taxpayer protested the ruling. *Id*. We held the amounts the taxpayer received as capital assessments were not deductible, reasoning they were mandatory assessments and thus not given gratuitously, as *Analytical Methods* requires. *Id*. at 569.

We conclude the federal incentive payments here were not given for a "gratuitous purpose." While the incentive payments at hand were not amounts given in exchange for contractually required services like in 33 WTD 199, their purpose was to move medical providers to using electronic health records, which is quite different than a freely given contribution of money. Similarly, the incentive payments were also not amounts assessed to members for a specific capital purpose as in 34 WTD 563, but the purpose here is nonetheless not gratuitous, like the purpose in 34 WTD 563. Accordingly, we deny Taxpayer's petition.

DECISION AND DISPOSITION

We deny Taxpayer's petition for refund.

Dated this 21st day of November 2018.