Cite as Det. No. 21-0153, 42 WTD 074 (2023)

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

In the Matter of the Petition for Correction of Assessment of . . .	)	D E T E R M I N A T I O N No. 21-0153 Registration No. . . .

[1] WAC 458-20-111; RCW 82.04.080; EXCISE TAXES – BUSINESS AND OCCUPATION TAX – GROSS INCOME OF THE BUSINESS – EXCLUSIONS – ADVANCES AND REIMBURSEMENTS. When a pharmacy benefit manager's services included paying pharmacies for drugs dispensed to healthcare plan members, for which it received payments from its customers as compensation under the service agreements, the payments received from customers were compensation for services rendered and were not excludable advancements and/or reimbursements and were properly included as part of its gross income.

[2] WAC 458-20-108; RCW 82.04.080; EXCISE TAXES – BUSINESS AND OCCUPATION TAX – GROSS INCOME OF THE BUSINESS – SELLING PRICE – DISCOUNTS. When a pharmacy benefit manager received rebates under agreements with pharmaceutical manufacturers, which rebates were contingent upon the manger's submission of claims data, and entered into separate agreements with customers under which it paid a portion of the rebates, the rebate amounts it received from the manufacturers and subsequently paid to customers were not bona fide discounts and were properly included as part of the selling price.

[3] WAC 458-20-228; RCW 82.32.105; TAXES – PENALTIES – WAIVER OR CANCELLATION OF PENALTIES. When a taxpayer misunderstood its reporting obligations and did not apportion its income to Washington or file annual reconciliations of its income during the review period, its misunderstanding does not relieve it of its reporting obligations, and it is not eligible for any waiver or cancellation of penalties.

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.

McCormick, T.R.O. – A company that acts as a pharmacy benefit manager disputes the inclusion of certain items in gross income of the business and the resulting assessment of service and other activities business and occupation ("B&O") tax, along with the assessment of annual reconciliation penalties. The company asserts that payments received from customers—intended to cover certain payments the company made to pharmacies on behalf of the customers—are either not included in

gross income of the business or excluded from gross income of the business as an advance or reimbursement. The company also asserts that certain rebates from pharmaceutical manufacturers constitute bona fide discounts that reduce the company's gross income of the business, and that an annual reconciliation penalty was erroneously assessed because the company did not apportion its gross income during the period at issue. We deny the petition.[1]

ISSUES

1. Whether under RCW 82.04.080 payments that a pharmacy benefit manager receives from its customers to compensate for payments to associated pharmacies are properly included as part of the pharmacy benefit manager's gross income.

    a. [In the alternative], whether under . . . WAC 458-20-111 a pharmacy benefit manager may exclude them from its gross income, as amounts received from its customers as an advance or reimbursement for payments to associated pharmacies.

2. Whether under RCW 82.04.080 and WAC 458-20-108, rebates paid by pharmaceutical manufacturers to a pharmacy benefit manager qualify as bona fide discounts and may be deducted from the pharmacy benefit manager's gross income.

3. Whether under RCW 82.32.105 and WAC 458-20-228, a pharmacy benefit manager qualifies for a waiver of delinquent penalties imposed on its failure to timely file annual reconciliations of its apportionable income because it . . . did not apportion its income during the review period and [asserts that it] was not obligated to submit annual reconciliations.

FINDINGS OF FACT

[Taxpayer] provides pharmacy benefit management services to its customers, including health insurers, employers, union-sponsored benefit plans, workers' compensation plans, government health programs, and tribal plans (Customers). Customers provide healthcare insurance coverage to their respective healthcare plan members (Members).

The healthcare insurance coverage provided by Customers to Members includes a prescription drug benefit plan. Taxpayer manages these prescription drug benefit plans on Customers' behalf.

During 2019 and 2020, the Department's Audit Division (Audit) investigated Taxpayer's business activities in Washington for the period of January 1, 2015, through December 31, 2019. Audit reviewed Taxpayer's books and records to verify whether Taxpayer correctly reported its tax liabilities during the covered period.

Audit determined that Taxpayer failed to report the following as gross income of the business: (1) payments Taxpayer received from Customers to compensate Taxpayer for payments to pharmacies; and (2) rebates from pharmaceutical manufacturers. On May 14, 2020, the Department issued Letter ID . . . , a notice of balance due (Assessment) in the amount of $. . . ,

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

comprised of $. . . in service and other activities B&O tax[2], $. . . in use tax, a five percent penalty of $. . . for substantial underpayment, $. . . in delinquent penalties[3], and $. . . in interest. Payment of the Assessment was due June 15, 2020. On June 16, 2020, the Department extended the Assessment due date to September 14, 2020. The Assessment remains unpaid.

Throughout the review period, Taxpayer did not . . . file any annual reconciliations of apportionable income. The delinquent penalties included in the Assessment include the following penalties for Taxpayer's failure to submit annual reconciliations of apportionable income: a 29 percent penalty of $. . . for 2015; a 29 percent penalty of $. . . for 2016; a 29 percent penalty of $. . . for 2017; and a 29 percent penalty of $. . . for 2018.

The Assessment is based on the following: Taxpayer enters into a pharmacy services agreement (Services Agreement) with each of its Customers, which establishes the specific services Taxpayer is required to provide for that Customer. Generally, as part of its services, Taxpayer performs the following functions:

- Evaluates drugs for price, value, and efficacy, in order to assist clients in selecting a cost-effective formulary
- Leverages purchasing volume to deliver discounts to health benefit providers
- Promotes the use of generics and low-cost brands
- Offers cost-effective home delivery pharmacy and specialty services which result in drug cost savings for plan sponsors and co-payment savings for Members.

Taxpayer works with associated pharmacies, Customers, and Members to:

- Help reduce costs
- Improve quality and increase efficiency in the drug distribution chain
- Manage costs in the pharmacy benefit
- Improve Members' health outcomes and satisfaction.

Taxpayer's services involve the management of outpatient prescription drug utilization to foster high quality, cost-effective pharmaceutical care. Taxpayer helps Customers turn data into information they can use. The data management system can integrate pharmacy and medical data, allowing Customers maximum flexibility for data input/output identifying quality and cost savings opportunities.

By providing timely, customized information, Customers can implement clinical, drug utilization review, and disease management initiatives based on current best practices and evidence-based medicine. Evidence-based formulary, a list of medications, is designed to provide the lowest pharmacy cost per Member per month and to provide high-quality prescription drug therapy while reducing costs. Formulary decisions are Customer- and Member-focused. Coverage of any product is subject to a plan's benefit design.

[2] . . .
[3] . . .

Taxpayer consults with Customers to assist them in selecting plan design features that balance Customers' requirements for cost control with Member choices and convenience.

Taxpayer did not provide a copy of the Services Agreement between Taxpayer and Customers. However, according to Taxpayer, the Services Agreement "provides that [Taxpayer] is administering a pharmacy drug program through member pharmacies pursuant to payor's [Customer] pharmacy plan for reimbursement." Petition at 7. Taxpayer states the Services Agreement provides in relevant part:

> . . .

Petition at 7 (emphasis added) (quoting Services Agreement . . .).[4] Thus, Taxpayer is responsible for administering Customer's pharmacy benefit plan, including outlining the details of Customers' pharmacy plan. Taxpayer is responsible for ensuring member pharmacies provide the agreed pharmacy plan benefits to Members; Customers are obligated to pay Taxpayer for its pharmacy services.

In connection with Services Agreements, Taxpayer enters into separately negotiated pharmacy provider agreements (Pharmacy Agreements) with retail pharmacies in its pharmacy network (Pharmacies) to provide prescription drugs to Members under their respective pharmacy benefit plans. Members receive quality service from Pharmacies, which includes over 850 retail pharmacies located in Washington, in addition to a national network of pharmacies if patients live in or are visiting other states. Taxpayer offers:

- State-of-the-art claims adjudication technology providing immediate and accurate claims processing;
- Surety that each prescription is paid at the current price and in compliance with the benefit design; and,
- A system that allows for extensive messaging to pharmacists regarding eligibility, formulary issues, and clinical information.

All Pharmacies communicate with Taxpayer online and in real-time to process prescription drug claims. Taxpayer's claims management adjudication system helps clients:

- Increase generic drug utilization;
- Improve formulary compliance; and
- Foster appropriate use of medications.

Under the Pharmacy Agreements, when Members go to Pharmacies for a prescription, Pharmacies communicate directly with Taxpayer online to confirm Members' insurance coverage. Taxpayer's online claims system alerts Pharmacies of any issues with the drug, confirms that Taxpayer will issue payment to Pharmacies for dispensed drugs, and notifies Pharmacies of the co-payment that must be collected from Members.

[4] Taxpayer's petition allegedly refers to sections of the Services Agreement; however, Taxpayer did not provide a copy of the Services Agreement as part of either Audit's initial review or our review here.

The Pharmacy Agreement provides in relevant part:

. . .

Pharmacy Agreement at 1-2.

Thus, the Pharmacy Agreements provide that Taxpayer will pay Pharmacies[’] established amounts for drugs dispensed to Members, while the Services Agreements provide that Customers will pay Taxpayer corresponding amounts as compensation for the amounts Taxpayer pays to Pharmacies. In addition to these payments, Taxpayer receives management fees for its services.

During the review period, Taxpayer received payments from Customers under the Services Agreements to compensate for amounts paid to Pharmacies under the Pharmacy Agreements, but did not report these amounts to the Department. In conducting its review, Audit noted that Taxpayer’s records recognized these payments as income. Taxpayer’s QuickBooks Profit & Loss statement for the review period list as “Income” the payments identified as “. . . Claims Billed Client-RX Only”[5] in the amount of $. . . .[6] Audit also noted that “[t]ypically, funds held in trust as an agent would be found on the Balance Sheet as a Liability, not included in the company’s revenue accounts.” Division Response at 2.

Audit determined that these amounts were part of Taxpayer’s gross income and were subject to service and other activities B&O tax. Audit also determined that Taxpayer was not entitled to exclude any of its gross income under WAC 458-20-111 because Taxpayer was primarily liable for payment to Pharmacies and its liability was not solely as Customers’ agent.

During the review period, Taxpayer also received rebate payments from pharmaceutical manufacturers, but did not report these amounts to the Department. According to information Audit received from its discussions with Taxpayer, in order to receive the rebates, Taxpayer was required to submit claims data to the pharmaceutical manufacturers. When Taxpayer’s claims amounts exceeded the threshold established by agreement between Taxpayer and pharmaceutical manufacturers, the manufacturers issued Taxpayer rebates, paid on a quarterly basis.

Under separate agreements with Pharmacies, Taxpayer agreed to share a certain portion of the rebates it received with Pharmacies.[7] Manufacturers paid rebates directly to Taxpayer and were not informed as to the rebate sharing agreements between Taxpayer and Pharmacies. Taxpayer subsequently paid Pharmacies the portion of the rebates that they were due. Audit determined that Taxpayer was not acting as Pharmacies’ agent when it received the payments directly from pharmaceutical manufacturers. Audit determined that the rebate amounts Taxpayer received from pharmaceutical manufacturers were part of Taxpayer’s gross income and were subject to service and other activities B&O tax.

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[5] The reimbursement payments received for 2015 and 2016, identified as “Claims,” are also recognized as income and listed as “Revenue” on . . . Taxpayer’s Financial Report for 2016 and 2015, that was included with its petition for administrative review.

[6] Audit’s QuickBooks backup only went through March 31, 2019; therefore, this amount is less than the total for the full review period through December 31, 2019.

[7] The Pharmacy Agreement makes no mention of rebates or Taxpayer’s obligation to receive and remit rebate payments on Pharmacies’ behalf.

On September 14, 2020, Taxpayer timely petitioned for administrative review of the Assessment. As part of this review, Taxpayer provided the following:

- A copy of the Audit Report;
- A sample Pharmacy Agreement form;
- Taxpayer's Financial Report for 2016 and 2015;
- A copy of Audit's June 16, 2020, letter which extended the Assessment due date; and,
- A sample Member ID card.

Taxpayer asserts that Audit incorrectly determined that payments Taxpayer received from Customers as compensation for amounts Taxpayer paid to pharmacies were part of its gross income. Taxpayer asserts that because it did not receive the subject payments as consideration for rendition of its services and they were "funds that merely pass through [Taxpayer] on their way to the pharmacies, [they] are not [Taxpayer's] taxable revenues," and are not part of its gross income. Petition at 11.

Taxpayer cited to the Washington Supreme Court decision in *Weyerhaeuser Co. v. Dep't of Revenue,* 106 Wn.2d 557, 723 P.2d 1141 (1986), in support of its assertion. That case considered the Department's imposition of interest on a taxpayer where the contract at issue did not specifically provide for interest. . . .

. . .

. . . Taxpayer argues that "if [Taxpayer] never 'receives' the pharmacy reimbursement, then it is not subject to B&O tax regarding the reimbursement." Petition at 11.

Taxpayer further asserts that the subject payment amounts should also be excluded from inclusion in its gross income as reimbursements under WAC 458-20-111 because Taxpayer maintains that it is acting only as Customers' agent in paying Pharmacies and that its liability to Pharmacies is limited to that of an agent. Taxpayer argues that the terms of the Services Agreements and Pharmacy Agreements grant Taxpayer "solely agent authority to reimburse pharmacies pursuant to the pricing [Customers] ha[ve] provided and agreed to reimburse." Petition at 15.

. . .

Taxpayer asserts that Audit also incorrectly determined that amounts Taxpayer received from pharmaceutical manufacturers as rebates were part of its gross income. Taxpayer asserts that the rebate amounts Taxpayer received are bona fide discounts on the selling price of the dispensed drugs under WAC 458-20-108. . . .

Taxpayer asserts that the Department incorrectly assessed delinquent penalties for failing to file annual reconciliations of apportionable income. Taxpayer does not dispute that it had apportionable income during the review period and that the apportionable income is properly subject to service and other activities B&O tax. However, Taxpayer maintains that throughout the review period, it did not apportion its receipts to Washington and, thus, "had no reason to file an annual reconciliation and should not be subject to penalties" for failing to timely file annual

reconciliations of apportionable income. Petition at 2. Taxpayer asserts that information included in the Department's website and in WAC 458-20-19402 do not clearly establish its obligation to file the reconciliations or that a failure to do so will be subject to delinquent penalties. Taxpayer asserts that this "misinformation caused the delinquency." Petition at 21. Taxpayer requests the Department cancel the Assessment, including the subject delinquent penalties.

The Notes to Financial Statements included in Taxpayer's Financial Report for 2016 and 2015 relevantly provides:

> [Revenues related to the distribution of prescription drugs by retail pharmacies are recognized when the claim is processed. Taxpayer pays its network pharmacy for the benefits provided to the members. Taxpayer acts as a principal in the arrangement and includes the prescription price as revenues. Taxpayer receives rebates from drug manufacturers which are shared with a majority of clients. Rebates paid to clients are treated as a reduction of revenues.]
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> . . .

Petition at 63 (underlined in original, bold ours).

Previously, Taxpayer's November 2013 combined excise tax return, due December 26, 2013, was paid late on December 30, 2013, for which Taxpayer paid a delinquent penalty.

ANALYSIS

1. The subject payments Taxpayer received from Customers were for Taxpayer's rendition of pharmacy benefit management services and are part of its gross income subject to B&O tax.

Washington's B&O tax is imposed on every person "for the act or privilege of engaging in business activities" and applies to the gross income of the business. RCW 82.04.220. "Business" for B&O tax purposes includes "all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly." RCW 82.04.140. "Gross income of the business" is broadly defined and means:

> [T]he value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

RCW 82.04.080. The phrase "value proceeding or accruing" is defined as "the consideration, whether money, credits, rights, or other property expressed in terms of money, actually received or accrued." RCW 82.04.090. Under this broad definition, a service provider may not deduct any

of its costs of doing business from its gross income. *See Pilcher v. Dep't of Revenue*, 112 Wn. App. 428, 49 P.3d 947 (2002) (citing *Rho Co. Inc. v. Dep't of Revenue,* 113 Wn.2d 561, 570, 782 P.2d 986 (1989)). Thus, unless a specific exemption, deduction, or exclusion applies, all of Taxpayer's gross income is subject to B&O tax without any deduction for overhead or other expenses. The Legislature "intended to impose the business and occupation tax upon virtually all business activities carried on within the state." *Simpson Inv. Co. v. Dep't of Revenue*, 141 Wn.2d 139, 149, 3 P.3d 741 (2000) (quoting *Time Oil Co. v. State*, 79 Wn.2d 143, 146, 483 P.2d 628 (1971)).

Here, Taxpayer paid Pharmacies, as contractually obligated under the Pharmacy Agreements, established prices for drugs dispensed to Members. Subsequently, Customers paid Taxpayer corresponding amounts to compensate for these payments to pharmacies, as contractually obligated under the Services Agreements. Taxpayer actually received the payments from Customers, as evidenced by Taxpayer's QuickBooks Profit & Loss statement for the review period identifying the subject payments as "Income" and Taxpayer's Financial Report for 2016 and 2015, which states Taxpayer recognizes the revenue when it processes Members' claims submitted by Pharmacies. Petition at 63.

According to Taxpayer's recitation of the Services Agreements, Customer was obligated to pay Taxpayer "for pharmacy services performed by [Taxpayer]." Petition at 7. Taxpayer's administering Customers' pharmacy benefit plan, contracting with Pharmacies and ensuring they provide pharmacy plan benefits to Members, and paying Pharmacies for drugs dispensed to Members, were all part of Taxpayer's pharmacy services. Thus, Taxpayer received the subject payments from Customers as compensation for its pharmacy benefit management services[,] and the subject payments were consideration actually received or accrued by reason of the transaction of the business engaged in and were part of Taxpayer's gross income subject to service and other activities B&O tax. *See* RCW 82.04.080; RCW 82.04.090.

Taxpayer asserts that because it passed the payments on to Pharmacies, it never actually received them. Taxpayer cites *Weyerhaeuser* in support of its assertion that because it did not "receive" the subject payments, the payments are not subject to B&O tax. That case considered the Department's assessment of B&O tax on imputed interest under WAC 458-20-109. In that matter, the subject contracts did not provide for interest, while the taxpayer's records included interest computations. The Department imputed interest to the taxpayer based upon the interest computations in the taxpayer's records and assessed B&O tax on the imputed interest. The Court found that the interest computations were solely an internal bookkeeping mechanism, and that the taxpayer did not actually receive any interest, as required by WAC 458-20-109. The Court specifically held that the Department may not impute interest without statutory or regulatory authority when a contract fails to specifically provide for interest. *Weyerhaeuser*, 106 Wn.2d at 566.

Here, we do not consider whether the Department properly imputed any interest amounts to Taxpayer but must consider whether the Department properly included amounts Taxpayer received from Customers under the Services Agreements as part of Taxpayer's gross income. Unlike *Weyerhaeuser*, the payments at issue were booked as revenue in Taxpayer's records and paid [to Taxpayer] pursuant to the Services Agreements.

We conclude that Taxpayer's pharmacy benefit management services include issuing payments to Pharmacies for the cost of the drugs dispensed to Members and that the subject payments Taxpayer received from Customers were compensation for the rendition of its services. Thus, the Department correctly determined that the subject payments Taxpayer received from Customers were properly included as part of Taxpayer's gross income. We deny the petition as to this issue.

a. Taxpayer's liability to Pharmacies was not solely as an agent, and Taxpayer may not exclude from its gross income amounts received from Customers as reimbursement for payments to Pharmacies under WAC 458-20-111.

Taxpayer asserts that subject payments it received from Customers were reimbursements for payments to Pharmacies and are excludable from its gross income under WAC 458-20-111, which permits a taxpayer to exclude from its gross income certain advances and reimbursements that a taxpayer receives solely in its capacity as an agent. WAC 458-20-111 provides, in relevant part:

> The words "advance" and "reimbursement" apply only *when the customer or client alone is liable for the payment of the fees* or costs and when the *taxpayer making the payment has no personal liability therefor*, either primarily or secondarily, *other than as agent* for the customer or client.
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> . . .
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> The foregoing is limited to cases wherein the taxpayer, as an incident to the business, undertakes, on behalf of the customer, guest or client, the payment of money, either upon an obligation owing by the customer, guest or client to a third person, or in procuring a service for the customer, guest or client which the taxpayer does not or cannot render and for which no liability attaches to the taxpayer. It does not apply to cases where the customer, guest or client makes advances to the taxpayer upon services to be rendered by the taxpayer or upon goods to be purchased by the taxpayer in carrying on the business in which the taxpayer engages.

WAC 458-20-111 (emphasis added).

WAC 458-20-111 requires the existence of a true agency relationship between the client and the taxpayer. *Washington Imaging Services, LLC v. Dep't of Revenue,* 171 Wn.2d 548, 562, 252 P.2d 885 (2011). Agency requires a factual determination that both parties consented to the agency relationship and that the principal exercised control over the agent. *Id.; see also Nordstrom Credit, Inc. v. Dep't of Revenue,* 120 Wn.2d 935, 941, 835 P.2d 1331 (1993); Det. No. 05-0206E, 25 WTD 72 (2006); Det. No. 03-0128, 24 WTD 168 (2005); Restatement (Third) of Agency § 1.01 (2006). The *Washington Imaging* court emphasized that "[t]he proper focus is on the facts and whether they show a true agency relationship that requires payment to a third party on behalf of the recipient (e.g., client or patient) paying for the goods or services." *Washington Imaging*, 171 Wn.2d at 565, 252 P.3d 885.

An agency relationship can exist "even if the parties execute contracts expressly disavowing the creation of an agency relationship." *Rho Co.*, 113 Wn.2d at 570, 782 P.2d at 991. However, the contractual labeling of the parties' relationship remains a factor in making the determination if an agency relationship exists. *Id*.

The burden of establishing an agency relationship is on the party asserting its existence. *Hewson Const., Inc. v. Reintree Corp.*, 101 Wn.2d 819, 823, 685 P.2d 1062 (1984). An agency relationship is not presumed. *Blodgett v. Olympic Savings & Loan Assn,* 32 Wn. App. 116, 128, 646 P.2d 139 (1982). Nor does it come into existence out of thin air. Rather, facts or circumstances must "establish that one person is acting at the instance of and in some material degree under the direction and control of the other." *Washington Imaging,* 171 Wn.2d at 562 (quoting *Matsumura v. Eilert,* 74 Wn.2d 362, 368-69, 444 P.2d 806 (1968)).

Once an agency relationship has been established, an inquiry must be made into whether the taxpayer's liability to pay constituted "solely agent liability." *City of Tacoma v. William Rogers Co.*, 148 Wn.2d 169, 178, 60 P.3d 79, 83 (2002). The *William Rogers* court explained that if a taxpayer assumes any liability beyond that of an agent, payments made pursuant to such liability are not excludable under WAC 458-20-111. *Id.* Therefore, for WAC 458-20-111 to apply in this case, Taxpayer must establish that it had an agency relationship with Customers and that its liability to pay Pharmacies was solely in its capacity as Customers' agent.

Here, Taxpayer has not met its burden of establishing the existence of an agency relationship with Customers. The sections of the Services Agreement Taxpayer cited in its petition state that Taxpayer is responsible for administering Customers' pharmacy drug program through Pharmacies and provide that Pharmacies "will collect the lower of full contracted price or usual and customary price or co-payment amount at the time of dispensing," presumably from Members. Petition at 7. Under the Services Agreement, Customers pay Taxpayer "for pharmacy services performed by [Taxpayer.]" *Id.*

Taxpayer asserts that "the [Services Agreement] makes clear that this reimbursement is paid through [Taxpayer] to the [P]harmacies." Petition at 13. We disagree. Under the Services Agreement, Customers pay Taxpayer for pharmacy [benefit management services] performed. Nothing in the Services Agreement, as cited by Taxpayer, establishes [Customers'] obligation to pay Pharmacies for the cost of drugs dispensed to Members or Customers' obligation to reimburse Taxpayer for the cost of drugs dispensed to Members. Other than administering Customers' pharmacy drug program, the Services Agreement cited by Taxpayer does not expressly provide any authority for Taxpayer to act on Customers' behalf as agent. While this is not completely dispositive of an agency relationship, it is indicative that an agency relationship did not exist. *Rho Co*., 113 Wn.2d at 570.

Under the terms of the Pharmacy Agreement, Pharmacies agree to provide pharmacy prescription services to Members[,] and "[Taxpayer] shall be responsible to reimburse Pharmac[ies] for rendered services within 20 days of the end of each month . . . [according to] the agreed upon third party payor reimbursement level less any applicable copay amount." Petition at 53. While, under the Pharmacy Agreement, Taxpayer is solely responsible for contracting with Customers and requiring Pharmacies to provide pharmacy prescription services according to Customers' plan and

established reimbursement levels, nothing in the agreement presumes that Taxpayer is acting as anything other than a principal and is solely liable to Pharmacies.

Even if Taxpayer were able to establish the existence of an agency relationship with Customers, despite the express terms of the Services Agreement and Pharmacy Agreement, Taxpayer must then establish that its liability to pay Pharmacies was solely in its capacity as Customers' agent, in order to qualify for the exclusion under WAC 458-20-111. Here, Taxpayer entered into Pharmacy Agreements with Pharmacies on its own behalf, and was solely liable to Pharmacies for payment under the agreements. This is confirmed by Taxpayer's Financial Report for 2016 and 2017, which recognizes Taxpayer's "contractual obligation to pay [Pharmacies] for benefits provided to [Members] . . . [and that] the Company acts as a principal in the arrangement . . . ." Petition at 63.

Taxpayer asserts that under the Pharmacy Agreements, "[P]harmacies are notified that [Taxpayer] has no liability to them other than as an agent of [Customers], who are required to reimburse [Taxpayer] for reimbursing the [P]harmacies. In other words, [Taxpayer] is not primarily liable to the [P]harmacies." Petition at 16. We disagree. As explained above, the express terms of the Pharmacy Agreement place sole liability on Taxpayer for payment of Pharmacies' pharmacy prescription services. Thus, Taxpayer is primarily liable to Pharmacies.

Taxpayer has not established the existence of an agency relationship with Customers and that its liability to pay Pharmacies was solely in its capacity as Customers' agent. We deny the petition as to this issue.

2. Rebates Taxpayer received from pharmaceutical manufacturers were not bona fide discounts and may not be deducted from Taxpayer's gross income.

RCW 82.04.4283 states that, "[i]n computing tax there may be deducted from the measure of tax the amount of cash discount actually taken by the purchaser." RCW 82.04.160 defines "cash discount" as "a deduction from the invoice price of goods or charge for services which is allowed if the bill is paid on or before a specified date." WAC 458-20-108 (Rule 108) further explains the deduction for cash discounts [and other trade discounts]:

> (7) **Bona fide discounts.** When a sale is made subject to cash or trade discount, the gross proceeds actually derived from the selling price are determined by the transaction as finally completed. A sale is made subject to a discount when the sales price is reduced under terms known to the buyer and seller at the time of the sale, and the price reduction occurs at the time of the sale or within a time agreed and understood by the parties at the time of the sale.
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> The selling price or sales price of a service or article of tangible personal property does not include bona fide discounts actually taken by the buyer. The amount of bona fide discounts may be deducted only if the amount has been included in the gross amount reported.

Thus, a purchaser may deduct a bona fide cash discount that it actually takes on a particular sale from its gross income. RCW 82.04.4283; WAC 458-20-108. The Department has previously elaborated:

> Rule 108(7) clarifies that a "bona fide discount" is one whose terms are contemplated at the time of sale, and applies at time of sale or within a time as determined by both parties. Therefore, under Rule 108, in order to be a bona fide discount not included in taxpayer's gross income, *the discount must be part of a single transaction*.

Det. No. 19-0005, 40 WTD 100 (2021) (emphasis added).

Additionally, the Department has long recognized that discounts are "bona fide" when they are "reduced prices[,]" and the buyer is not required to do anything in return for that reduced price. *See* Det. No. 14-0159, 34 WTD 257 (2015); Det. No. 05-0142, 26 WTD 256 (2007); Det. No. 83-180, 11 WTD 5 (1983).

We note that, in general, "[t]axation is the rule and exemption is the exception." *Budget Rent–A–Car,* 81 Wn.2d 171, 174, 500 P.2d 764 (1972). "The taxpayer has the burden of establishing eligibility for an exemption." *Stroh Brewing Co. v. Dep't of Revenue*, 104 Wn. App. 235, 240, 15 P.3d 692 (2001).

Here, in order to receive the rebates from pharmaceutical manufacturers, Taxpayer was required to submit claims data to the manufacturers to confirm that it exceeded the established thresholds. After reviewing Taxpayer's claims data, pharmaceutical manufacturers issued rebate payments to Taxpayer. Pharmaceutical manufacturers issued Taxpayer rebate payments on a quarterly basis. Under separate agreements, Taxpayer paid Pharmacies the portion of the rebate payments which they were due. Because pharmaceutical manufacturers pay rebate payments directly to Taxpayer and Taxpayer enters into separate agreements with Pharmacies under which it agrees to share a portion of the rebate payments with Pharmacies, Audit determined that the rebate payments that Taxpayer received from pharmaceutical manufacturers were properly included as part of Taxpayer's gross income.

Taxpayer does not dispute that the rebate payments it received from pharmaceutical manufacturers and did not pay to Pharmacies are properly included as part of its gross income. However, Taxpayer asserts that the rebate payments it received from pharmaceutical manufacturers and passed on to Pharmacies should be excluded from its gross income as pass-through income under WAC 458-20-111. As explained above, in order to qualify for the exclusion, Taxpayer must first establish the existence of an agency relationship with Pharmacies in negotiating and receiving the rebate payments. Taxpayer has neither asserted nor provided any evidence that such a relationship existed. . . . Thus, the rebate payments may not be excluded from its gross income under WAC 458-20-111.

Taxpayer also asserts that the subject rebate payments may be deducted from its gross income as bona fide discounts under WAC 458-20-108. In order to be a bona fide discount, the discount must apply at the time of sale and be part of a single transaction. *See* Det. No. 19-0005, 40 WTD 100

(2021). However, because the pharmaceutical manufacturers' issuance of rebate payments was contingent upon Taxpayer's claims data exceeding the established thresholds, the rebate payments were not discounts associated with any particular [payment for pharmacy services]. Thus, the terms of the applicable rebate payment agreements could not apply at the time of [payment for pharmacy services], but only after Taxpayer provided evidence that it exceeded the thresholds, as evidenced by the pharmaceutical manufacturers' quarterly issuance of rebate payments to Taxpayer. Both Taxpayer's [payments for pharmacy services] and receipt of rebate payments were separate transactions and were not bona fide discounts. We deny the petition as to this issue.

3. Taxpayer has not established that its failure to apportion its receipts to Washington during the review period and timely file annual reconciliations of its apportionable income were due to any circumstances that were beyond its control, and therefore is not eligible for a waiver of delinquent penalties.

Taxpayers are responsible to know their tax reporting obligations, and when they are uncertain about their obligations, seek instructions from the Department. RCW 82.32A.030(2); *see also* Det. No. 01-165R, 22 WTD 11, 15-16 (2003). Because of the nature of Washington's tax system, the burden of becoming informed about tax liability falls upon the taxpayer, and it is the taxpayer who bears the consequences of a failure to be correctly informed. RCW 82.32A.030(2); 22 WTD at 15.

RCW 82.04.460 establishes that:

> [A]ny person earning apportionable income taxable under this chapter and also taxable in another state must, for the purpose of computing tax liability under this chapter, apportion to this state, in accordance with RCW 82.04.462, that portion of the person's apportionable income derived from business activities performed within this state.

RCW 82.04.462 requires that "a taxpayer must correct the reporting for the current tax year when complete information is available to calculate the receipts factor for that year, *but not later than October 31st of the following tax year*." (Emphasis added.)

Taxpayers "must file a reconciliation [of their apportionable income] and either obtain a refund or pay any additional tax due. . . . If the reconciliation is completed prior to October 31st of the following year, no penalties will apply to any additional tax that may be due." WAC 458-20-19402(602).

Here, Taxpayer asserts that information included in the Department's website and WAC 458-20-19402 do not clearly establish its obligation to file annual reconciliations of apportionable income. Taxpayer has not provided the specifics of such information on the Department's website or citations to WAC 458-20-19402 that allegedly caused Taxpayer to fail to file. Taxpayer also asserts that because it did not apportion its income during the review period, it was not required to file annual reconciliations of apportionable income.

Taxpayer had the burden of becoming informed of its tax liability and must bear the consequences of any resulting failure to be correctly informed. *See* RCW 82.32A.030(2). RCW 82.04.460 and

RCW 82.04.462 establish Taxpayer's obligation to apportion its income to Washington and file annual reconciliations of apportionable income. Taxpayer does not dispute that it had apportionable income during the review period, only that it was unclear of its obligation to file annual reconciliations. The Department correctly determined that Taxpayer was statutorily required to apportion its income to Washington and timely file annual reconciliations of its apportionable income for the covered periods included in the review period, but failed to do so, and was properly subject to the delinquent penalty.

The Department operates under a progressive delinquent penalty scheme, outlined in RCW 82.32.090(1):

> If payment of any tax due on a return to be filed by a taxpayer is not received by the department of revenue by the due date, there is assessed a penalty of nine percent of the amount of the tax; and if the tax is not received on or before the last day of the month following the due date, there is assessed a total penalty of nineteen percent of the amount of the tax under this subsection; and if the tax is not received on or before the last day of the second month following the due date, there is assessed a total penalty of twenty-nine percent of the amount of the tax under this subsection.

Assessment of the delinquent payment penalty is mandatory. Det. No. 01-193, 21 WTD 264 (2002); Det. No. 99-279, 20 WTD 149 (2001); Det. No. 87-235, 3 WTD 363 (1987). When the Department did not receive Taxpayer's annual reconciliations of apportionable income for 2015, 2016, 2017, and 2018, by the last day of the second month following their respective due dates, it was required to impose a 29 percent delinquent penalty on the assessed tax amount for each period.

Having determined that the Department properly imposed the assessed delinquent penalties, we now turn to whether the Department can waive them.

The Department has authority to waive or cancel delinquent penalties only in limited situations. RCW 82.32.105. One such situation is when the Department finds that the penalties incurred were the result of "circumstances beyond the control of the taxpayer." RCW 82.32.105(1).

WAC 458-20-228 (Rule 228) explains that "[c]ircumstances beyond the control of the taxpayer are generally those which are immediate, unexpected, or in the nature of an emergency. Such circumstances result in the taxpayer not having reasonable time or opportunity to obtain an extension of the due date or otherwise timely file and pay." Rule 228(9)(a)(ii). The circumstances must directly cause the late payment. Rule 228(9)(a)(i).

Rule 228(9)(a)(ii) lists examples of circumstances that are generally considered beyond a taxpayer's control sufficient to cancel penalties:

- Erroneous written information from the Department;
- An act of fraud or conversion by the taxpayer's employee or contract helper which the taxpayer could not immediately detect or prevent;

- Emergency circumstances around the time of the due date, such as the death or serious illness of the taxpayer or a family member or accountant; or
- Destruction of the business or records by fire or other casualty.

Rule 228(9)(a)(iii) also lists examples of situations that are generally considered *not* beyond the control of a taxpayer:

- Financial hardship;
- A misunderstanding or lack of knowledge of a tax liability; or
- Mistakes or misconduct on the part of employees or other persons contracted with the taxpayer.

Here, Taxpayer asserts that misinformation included in the Department's website and WAC 458-20-19402, caused it to incur the subject delinquent penalties. However, Taxpayer has not specified any erroneous information included in either the website or rule which caused its failure to timely file the annual reconciliations of apportionable income. Instead, Taxpayer contends that the Department's website and WAC 458-20-19042 do not clearly state any specific due date or that delinquent penalties will apply. This assertion ignores the plain language of RCW 82.04.462, which requires an annual reconciliation of apportionable income to be filed by October 31st of the following year.

Taxpayer has the responsibility to know its tax reporting obligations. *See* RCW 82.32A.030(2). Taxpayer was responsible to know that it was required to apportion its income to Washington throughout the review period and report its additional tax liabilities by timely filing and paying annual reconciliations of apportionable income by October 31st of the following year. RCW 82.04.462. Taxpayer's failure to realize its responsibility to apportion its income and file annual reconciliations prior to the Assessment amounts to a lack of knowledge of a tax liability. In Det. No. 01-165, 22 WTD 5 (2003), we reiterated that lack of knowledge of a tax liability was not a circumstance that was beyond the taxpayer's control and was not a basis for waiving the penalties in that case. Similarly, Taxpayer's lack of knowledge is not a basis for waiving the penalties at issue.

Taxpayer asserts that because it did not apportion its income to Washington during the review period, it was not required to file annual reconciliations of its apportionable income. As explained above, Taxpayer was statutorily required to both apportion its income during the review period and file annual reconciliations of its apportionable income by October 31st of the following year. Taxpayer's misunderstanding of its reporting requirements does not relieve it of its obligation to timely pay the taxes that were due. Taxpayer has failed to demonstrate that there were any circumstances that were beyond its control that caused it to incur the subject delinquent penalties.

The other situation in which the Department may waive the delinquent penalty is when a taxpayer has a good payment history. Rule 228 establishes when a taxpayer can qualify for waiver of the delinquent penalty for having a good payment history under RCW 82.32.105(2). The rule explains that a taxpayer is eligible for this provision when it requests a penalty waiver and "has timely filed and paid all tax returns due for that specific tax program for a period of twenty-four months

immediately preceding the period covered by the return for which the waiver is being requested." Rule 228(9)(b)(i)(B).

Here, Taxpayer paid its November 2013 tax return after it was due. In Det. No. 18-0116, 38 WTD 197 (2018), the Department reiterated that in order for a taxpayer to be eligible for the 24-month penalty waiver, it must have a clean reporting history for its excise tax returns—in addition to its annual reconciliation returns—because the two comprise the same tax program. Thus, because Taxpayer failed to timely pay its November 2013 return, it is not eligible for any waiver of delinquent penalties under Rule 228(9)(b)(i)(B). We deny the petition as to this issue.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 16th day of September 2021.