

Excise Tax Advisory

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ETA 3218.2020

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Collection Agents: Requirements to exclude certain amounts from gross income

Purpose

This Excise Tax Advisory (“ETA”) provides guidance on when a person providing billing and collection agent services can exclude amounts collected from the service provider’s customers from its taxable gross income.

For information about a person acting as an agent on behalf of a client or customer in procuring goods or services from a provider, refer to WAC 458-20-111 (Rule 111) titled, *Advances and reimbursements*. As a general matter collection agent services and Rule 111 activities are similar. The first two requirements are generally the same in both circumstances. However, when looking at requirement three, a collection agent is acting as an agent of the Provider. Alternatively, when procuring goods or services under Rule 111, the taxpayer is acting as an agent of the Customer.

What is a collection agent?

A “collection agent” is a person who bills and collects amounts owed by a third-party debtor to a seller of goods or services.¹

For the purposes of this ETA:

- The “Taxpayer” refers to the collection agent;
- The “Provider” refers to the seller of goods or services; and
- The “Customer” refers to the person who owes the funds to the Provider.

¹ In contrast, a debt collection agent typically refers to a person who is in the business of collecting debts on behalf of creditors by contracting with other businesses to collect amounts due to those creditors once the debtor has become delinquent. Debt collection agents typically are permitted to retain some portion of the amounts they collect from the debtor. This ETA does not address the tax treatment of these debt collection agents.

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Amounts excluded from gross income

A Taxpayer acting as a collection agent may exclude from its gross income amounts collected from Customers on behalf of a Provider and remitted to the Provider, but only when all three of the following requirements are met:

1. The Taxpayer is collecting money owed by the Customer to the Provider;
2. The Taxpayer does not sell the goods or services and has no liability for the quality of the goods or services provided; and
3. The Taxpayer is acting as a bona fide agent of the Provider and has no liability for the payment except as an agent.

If any one of these requirements is not met, the Taxpayer must include the amounts collected from the Customer in its gross income.² Each of these three requirements is explained below.

**Requirement 1:
The Taxpayer is collecting money owed to the Provider**

The first requirement a collection agent must meet to exclude amounts from gross income is that it must be collecting money owed by the Customer to the Provider. To meet this requirement, the Taxpayer must be collecting amounts from the Customer to pay the Customer's obligation to the Provider. This means that the Customer must have an obligation to pay the Provider.

Example 1:

- **Facts:** Medical Office Services Group (Taxpayer) contracts with Dr. Jennings (Provider) to bill and collect amounts due from her patients (Customers). Each patient has an agreement with Dr. Jennings for the medical services that Dr. Jennings will render. Medical Office Services Group is not a party to the patient agreements. Each patient knows that Dr. Jennings will render the medical services and Dr. Jennings can seek payment directly from her patients if the bill for services is not paid.
- **Result:** Medical Office Services Group meets Requirement 1 because it is collecting money owed by patients to Dr. Jennings.

Example 2:

- **Facts:** Construction Incorporated Services (Taxpayer) contracts with multiple construction industry professionals (Providers) to bill and collect money from clients (Customers) who hire construction industry professionals for performing plumbing, electrical, and carpentry work on their residential homes and commercial businesses. Each client enters into an agreement with the construction industry professional for the work to be performed, and Construction Incorporated Services is not a party to those agreements. Each client knows that the construction industry professional will render the services and the construction industry

² *Washington Imaging Services, LLC v. Dep't of Revenue*, 171 Wn.2d 548 (2011) is the Supreme Court's most recent decision discussing the tax implications of being a "collection agent" and reaffirming the application of Rule 111 and RCW 82.04.080(1).

professional will seek payment directly from the client if the bill for services is not paid.

- **Result:** Construction Incorporated Services meets Requirement 1 because it is collecting money owed by the clients to the construction industry professionals.

Example 3:

- **Facts:** Health Services Organization (Taxpayer) provides health services to patients (Customers). However, Health Services Organization has contracts with local doctors (Providers) who read and analyze reports generated for patients. Health Services Organization bills the patients and collects money that it then pays to the doctors for the report-related services. Patients are not aware of the contract between Health Services Organization and the local doctors or that Health Services Organization makes payments to the doctors. The patients have no separate agreement with the doctors.
- **Result:** Health Services Organization does not meet Requirement 1 because the money it is collecting from patients is owed by the patients to Health Services Organization.

**Requirement 2:
The Taxpayer does
not sell the goods or
services provided**

The second requirement is that a collection agent does not sell the goods or services provided. If the Taxpayer sells the types of goods or services that a Provider sells, the presumption is that the Taxpayer is rendering the goods or services.

To meet this requirement, the Taxpayer cannot sell the goods or services, and cannot be obligated to sell, directly or indirectly³, the goods or services provided to the Customer. In addition, the Taxpayer cannot be obligated to the Customer for the quality of the goods or services rendered by the Provider. As a way to rebut the presumption, an agreement between the Provider and Customer may support that the Provider, and not the Taxpayer, has the obligation to render the goods and services if the agreement clearly makes the Provider solely responsible for providing the goods or services at issue.

Example 4:

- **Facts:** Medical Office Services Group (Taxpayer) provides billing and collecting services to Dr. Jennings (Provider). Patients (Customers) know they are receiving medical services from Dr. Jennings and not Medical Office Services Group. Medical Office Services Group is not obligated to perform the medical services and is not responsible for the performance or quality of the services provided by Dr. Jennings. Moreover, the Medical Office Services Group does not in fact perform the medical services.
- **Result:** Medical Office Services Group meets Requirement 2 because it does not render the medical services provided by Dr. Jennings.

³ A business may be obligated to perform services even if it does not itself render the services. When a business hires independent contractors to fulfill its obligations, it is considered to be rendering services.

Example 5:

- **Facts:** Construction industry professionals (Providers) contract with Construction Incorporated Services (Taxpayer) to bill and collect money from clients (Customers) of the construction industry professionals. The clients hire construction industry professionals to perform plumbing, electrical, and carpentry work on their residential homes and commercial businesses. Each client enters into an agreement with the construction industry professional for the work to be performed. Construction Incorporated Services is not a party to the agreements and is not responsible for performing the work, nor is it responsible to the clients for the quality of the work performed. Each client knows that the construction industry professional will render the construction services and is responsible for the quality of the work performed. Moreover, Construction Incorporated Services does not in fact perform the services.
- **Result:** Construction Incorporated Services meets Requirement 2 because it does not render the services sold by the construction industry professionals.

Example 6:

- **Facts:** Health Services Organization (Taxpayer) operates a medical clinic. The patients (Customers) of the clinic are billed by Health Services Organization. Health Services Organization contracts with local doctors (Providers) to render the medical services provided at the clinic. The patients have no separate agreement with the doctors. Although the doctors physically perform the medical services, Health Services Organization is responsible to the patients for supplying the services and for the quality of the services rendered.
- **Result:** Health Services Organization does not meet Requirement 2 because it renders the services at issue by contracting with local doctors.

**Requirement 3:
The Taxpayer is
acting as agent of
the Provider**

The third requirement a collection agent must meet is that it must be acting as agent of the Provider and have no liability other than as an agent. The Department will recognize a bona fide agency relationship between the Taxpayer and Provider when all of the following are true:

- The Taxpayer and Provider have mutually agreed that the Taxpayer is acting on behalf of the Provider and the Taxpayer acts, in some material degree, under the direction and control of the Provider, i.e., as principal and agent.
 - The Taxpayer has no obligation to the Customer. If the Customer pays the Taxpayer but the Provider does not perform the services purchased by the Customer, the Customer would have no recourse against the Taxpayer. The Customer could seek recourse from the Provider.
 - The Taxpayer has agency liability to the Provider. Thus, Provider can seek recourse against the Taxpayer for breach of agency duties Taxpayer owes
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Provider – e.g., to be paid the funds that Taxpayer collected on the Provider’s behalf as agent.

Example 7:

- **Facts:** Medical Office Services Group (Taxpayer) provides billing and collecting services for Dr. Jennings (Provider). The written agreement between Dr. Jennings and Medical Office Services Group clearly indicates that Medical Office Services Group acts as agent, at the direction and under the control of Dr. Jennings, and that Medical Office Services Group must remit and is liable to Dr. Jennings for all amounts collected on behalf of Dr. Jennings from Dr. Jennings’ patients for services rendered. The parties conduct their activities consistent with the obligations above. Medical Office Services Group has no other contractual or actual obligations to Dr. Jennings with regard to the payments.
- **Result:** Dr. Jennings is a disclosed principal, and Medical Office Services Group is acting as her agent. Medical Office Services Group has no other obligation or liability to Dr. Jennings. Medical Office Services Group meets Requirement 3 because it is acting as agent of Dr. Jennings.

Example 8:

- **Facts:** Construction Incorporated Services (Taxpayer) contracts with multiple construction industry professionals (Providers) to bill and collect money from their clients (Customers), who hire the construction industry professionals to perform plumbing, electrical, and carpentry work on their residential homes and commercial businesses. According to the contract, Construction Incorporated Services acts under the direction and control of the construction industry professionals, and must remit and is liable for remitting all amounts collected on behalf of the construction industry professionals from clients for services rendered by the professionals within 15 days of receiving payment from the client. The parties conduct their activities consistent with these obligations. Construction Incorporated Services has no other contractual or actual obligations to the construction industry professionals with regard to the payments.
- **Result:** The construction industry professionals are disclosed principals, and Construction Incorporated Services is acting as their agent. Construction Incorporated Services meets Requirement 3 because it is acting as agent of the construction industry professionals.

Example 9:

- **Facts:** Health Services Organization (Taxpayer) contracts with local doctors (Providers) in order to fulfill its obligation to provide health services to patients (Customers). Nothing in the contract states or suggests that Health Services Organization works at the direction or control of the doctors. Health Services Organization’s contracts with the doctors obligates it to pay the doctors for services the doctors render to patients.

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- **Result:** Health Services Organization is not an agent of the doctors and the doctors are not disclosed principals. Additionally, Health Services Organization has liability to pay the doctors, other than as agent. Requirement 3 is not met.
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