Cite as Det. No. 15-0285, 36 WTD 095 (2017)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

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| In the Matter of the Petition for Refund | ) | D E T E R M I N A T I O N |
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| | ) | No. 15-0285 |
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| . . . | ) | Registration No. . . . |
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[1] RCW 82.04.290(2); RCW 82.04.4286: SERVICE B&O TAX - FEDERAL PREEMPTION - FEDERAL EMPLOYEES HEALTH BENEFITS ACT - 5 USC § 8909(f)(1) - HEALTH CARE PROVIDER'S RECEIPTS FROM FEHBA INSURANCE CARRIERS. Service B&O tax imposed on a physician group's receipts from insurance carriers who participate in the FEHB program is not a direct or indirect tax imposed on a FEHBA carrier with respect to payments made from the FEHB fund and, therefore, is not preempted by 5 USC § 8909(f)(1).

[2] RCW 82.04.290(2); RCW 82.04.4286: SERVICE B&O TAX - FEDERAL PREEMPTION - 42 CFR § 422.404 - HEALTH CARE PROVIDER'S RECEIPTS FROM MEDICARE ADVANTAGE PLANS. Service B&O tax imposed on a physician group's receipts from MA Plans is not a tax imposed on payments Centers for Medicare and Medicaid Services makes on behalf of MA enrollees to MA Plans and, therefore, is not preempted by 42 CFR § 422.404.

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.

Kreger, A.L.J. – A physician group protests the denial of its request for refund of service and other activities business and occupation (B&O) tax paid on receipts from the Federal Employee Health Benefits [(FEHBA)] and Medicare Advantage [(MA)], federal insurance programs, which it asserts are preempted from taxation by federal law. We conclude that the Taxpayer has not established that Washington tax is preempted and deny the Taxpayer's petition.[1]

## ISSUES

1. Whether the imposition of B&O tax on a [physician group's] receipts from insurance carriers who participate in the [FEHBA] program is preempted by 5 USC § 8909(f).

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

2. Whether the imposition of B&O tax on a [physician group's] receipts from insurance carriers who participate in the [MA] program is preempted by 42 CFR § 422.404.

## FINDINGS OF FACT

[Taxpayer] is a Washington corporation engaged in the business of providing outpatient primary and specialty healthcare services to patients in . . . Washington. The Taxpayer serves patients carrying health insurance through a variety of insurance companies, including patients who are covered by the [FEHBA] program or one of the [MA] programs. For the period at issue, the Taxpayer remitted service and other activities (Service) B&O tax on these receipts.

The Taxpayer submitted a refund request seeking a refund of the Service B&O tax paid on receipts from patients covered by FEHBA and MA insurance for the period of December 1, 2008, through December 31, 2011 (Refund Period), in the amount of $ . . . . The basis for Taxpayer's claims is that the Taxpayer is not subject to Washington's B&O taxes under the federal preemption doctrine on payments it receives from these federally-funded healthcare plans. The Audit Division of the Department of Revenue (Department) denied the refund request because the Taxpayer failed to [establish] that [it] was a qualifying insurance carrier or received payments directly from the federal insurance programs. The Taxpayer timely appealed the denial of the refund request.

The [FEHBA]establishes a comprehensive program of health insurance for civilian employees of the federal government, their dependents, and federal retirees. 5 USC § 8901, *et seq*. FEHBA authorizes the Office of Personnel Management to contract with private insurance carriers to offer federal employees an array of health care plans. 5 USC § 8902(a). To purchase insurance under a FEHBA plan, enrollees make payments, matched by contributions from the federal government, into a specifically designated account in the United State Treasury, entitled the Federal Employees Health Benefits Fund (the FEHB Fund). 5 USC §§ 8906, 8909. The selected insurance carriers then pay the Taxpayer by drawing against the FEHB Fund to pay for covered health care benefits. *Id.*; *see also* 48 CFR § 1632.170(b). The Taxpayer does not provide group insurance policies or similar arrangements, but rather is compensated for services to insured patients by the insurance carrier providing the FEHBA coverage.

[MA] is a type of Medicare health plan under which the federal government pays a private insurance company to take over coverage for a Medicare eligible individual. The private insurance company contracts with the Centers for Medicare and Medicaid Services (CMS), a federal agency, to provide Medicare benefits. *See* 42 CFR § 422.2. The Taxpayer does not receive any payments from CMS or other Medicare funds; rather, the Taxpayer receives payments from participating MA plan insurance companies for health services provided to patients who are enrollees in the applicable MA plan.

Taxpayer received payments from insurance carriers under these federal programs above during the Refund Period. The Taxpayer asserts that the Service B&O tax is a prohibited indirect tax of payments made from the FEHB fund and is also a prohibited "other similar assessment" under 42 CFR § 422.404 for the MA payments.

## ANALYSIS

RCW 82.04.220 imposes the B&O tax "for the act or privilege of engaging in business activities." Persons, such as the taxpayer, who are engaged in a service business or business that is not specifically taxed under another B&O tax classification are generally required to pay B&O tax under RCW 82.04.290(2) measured by the "gross income of the business."

Pursuant to the Supremacy Clause, U.S. CONST., ART. VI., cl.2, federal law can preempt state law through: (1) express preemption; (2) field preemption (sometimes referred to as complete preemption); and (3) conflict preemption. *Int'l Paper Co. v. Ouellette*, 479 U.S. 481, 491, 107 S.Ct. 805 (1987). Express preemption exists where Congress enacts an explicit statutory command that state law be displaced. *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 382, 112 S.Ct. 2031 (1992). Absent explicit preemptive text, preemption may be inferred based on field or conflict preemption, both of which require us to [infer] Congress' intent from the statute's structure and purpose. *FMC Corp. v. Holliday*, 498 U.S. 52, 56-57, 111 S.Ct. 403 (1990).

When considering preemption, no matter which type, "[t]he purpose of Congress is the ultimate touchstone." *Cipollene v. Liggett Group, Inc.*, 505 U.S. 504, 516, 112 S.Ct. 2608 (1992); *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 655, 115 S.Ct. 1671 (1995). In order to avoid an unintended encroachment on state authority, the Supreme Court has made clear that when interpreting a federal statute, courts should be reluctant to find preemption. *CSX Transportation v. Easterwood*, 507 U.S. 658, 662-64, 113 S.Ct. 1671 (1995); *Travelers*, 514 U.S. at 654. Evidence of pre-emptive purpose is sought in the text and structure of the statute at issue. *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 95, 103 S.Ct. 2890 (1983). "If the statute contains an express pre-emption clause, the task of statutory construction must in the first instance focus on the plain wording of the clause, which necessarily contains the best evidence of Congress' pre-emptive intent." *CSX*, 507 U.S. at 664.

. . . The preemption provisions for the applicable federal programs are addressed below.

1. FEHBA Coverage:

FEHBA contains the following preemption provision forbidding states from taxing health insurance carriers with respect to payments made to them from the FEHB Fund:

> No tax, fee, or other monetary payment may be imposed, directly or indirectly, on a carrier or an underwriting or plan administration subcontractor of an approved health benefits plan by any State, . . . with respect to any payment made from the [FEHB] Fund.

5 USC § 8909(f)(1)(emphasis added). FEHBA defines a "carrier" as:

> [A] voluntary association, corporation, partnership, or other nongovernmental organization which is lawfully engaged in providing, paying for, or reimbursing the cost of, health services under group insurance policies or contracts, medical or hospital service agreements, membership or subscription contracts, or similar group arrangements, in consideration of premiums or other periodic charges payable to the carrier, including a

> health benefits plan duly sponsored or underwritten by an employee organization and an association of organizations or other entities described in this paragraph sponsoring a health benefits plan.

5 USC § 8901(7) (emphasis added).

The Washington Court of Appeals reviewed the FEHBA preemption provision cited above in relation to Seattle's B&O tax in *Group Health Cooperative v. City of Seattle*, 146 Wn. App. 80, 189 P.3d 216 (2008). The court set forth the established requirements to invoke [FEHBA] preemption:

> [Thus, "under section] 8909(f)(1), state regulation is preempted if it is (1) a state or local tax, fee, or other monetary payment; (2) imposed directly or indirectly on a carrier; and (3) with respect to payments made from the [FEHB Fund]." *Health Maint. Org. of N.N., Inc. v. Whitman*, 72 F.3d 1123, 1128 (3d Cir. 1995).

*Group Health*, 146 Wn. App. at 94 (bracketed term ours).

In that case, Group Health Cooperative, a health maintenance organization (HMO), received premium payments from its patient members in exchange for health services, and received premium payments made by the federal government from the FEHB Fund for those patients that are covered by the FEHBA program. *Id.* at 83-84. The court held that Group Health was a *carrier*, as defined by the FEHBA, that contracted with the federal government to provide health care coverage in exchange for payments from the FEHB Fund; therefore, the court concluded that 5 USC § 8909(f)(1) preempted the city's imposition of B&O tax on Group Health's receipts from the FEHB Fund. *Group Health*, 146 Wn. App. at 95-96.

The Taxpayer here is not [a] carrier, but rather argues that imposing the B&O tax on the amounts it receives for patients with FEHBA coverage is an indirect tax on payments made from the FEHB Fund to the carriers who pay the Taxpayer and thus should be preempted. However, as we noted in Det. No. 13-0241, 33 WTD 354 (2014), [courts have rejected that argument]:

> Arguments based on similar economic pass-through theories were made by the federal government in *United States v. West Virginia*, 339 F.3d 212 (4th Cir. 1995) [(*West Virginia*)], and more recently by a medical products retailer in *Mobility Medical, Inc. v. Mississippi Dep't of Revenue*, No. 2011-CA-01780-SCT, 2013 WL 246684 (Miss. Sup. Ct., June 6, 2013) [119 So.2d 1002 (Miss. 2013)] [(*Mobility Medical*)]. The courts in both cases held that taxing the gross income of a business that receives payments from a FEHBA carrier was not an indirect imposition of a tax on a FEHBA carrier with respect to payments from the FEHB Fund. *West Virginia*, 339 F.3d at 218-219; *Mobility Medical*, [119 So.2d at 1002] 2013 WL 246684, at *2.

33 WTD 354 continues on to discuss the *West Virginia* case in greater detail, noting that the [Fourth] Circuit stated that even though the health care providers could pass the economic cost of the tax to the insurance carriers, this did not constitute a prohibited indirect imposition of tax on the insurance carriers, because the incidence of the state gross receipts tax fell on the providers

alone. *West Virginia*, 339 F.3d at 218-219. The Taxpayer asserts that this line of reasoning should not apply to the Washington B&O tax because the B&O tax is intended to be part of the taxpayer business overhead, citing RCW 82.04.500. That is, because the B&O tax is incorporated into the amounts that the Taxpayer charges its patients, which is paid by the insurance companies paying for the patient's treatment using FEHB Fund receipts, the cost of these taxes [is] included in the service charges and represents an indirect imposition of state tax on the FEHBA plans.

We disagree . . . . The discussion of *West Virginia* in 33 WTD 354 notes that the possibility that gross receipts tax could be included in charges to the FEHBA carrier is not the same as an indirect imposition of a tax. This supports the pertinent holding from the *West Virginia* case that taxing the gross income of a business that receives payments from a FEHBA carrier is not an indirect imposition of tax on the FEHBA carrier.

33 WTD 354 then goes on to discuss *Mobility Medical* in greater detail, noting that:

> The Mississippi Supreme Court also refused to equate a potential economic pass-through of costs to an indirect tax on FEHBA carriers in *Mobility Medical, Inc. v. Mississippi Dep't of Revenue*, 119 So. 2d 1002 (2013). Mobility Medical, a medical products retailer, asserted that FEHBA preempted Mississippi's gross receipts tax on its revenues from FEHBA carriers because any state tax that *might* result in an increase in costs for the FEHB Fund is an indirect tax. *Mobility Medical*, 119 So. 2d, at 1004-1005. The court held that nothing in the Mississippi tax law requires the retailer to pass on the tax (or any of its costs) to its customers, or that the retailer be reimbursed its costs by the FEHB Fund; therefore, there was no preemption because there was no indirect tax on the carrier, or conflict between the state and federal laws. *Id.* The court noted that if an economic cost "trickle-down effect" amounted to an indirect tax, then preemption would equally apply to all state and local taxes born by any retailer, including inventory tax, unemployment tax, property taxes, franchise tax, license fees, and the numerous taxes or fees that a retailer might "indirectly" pass along to its customers, and that there was no evidence of such expansive Congressional intent in the FEHBA. *Id.*

[33 WTD at 359.]

In this case, the Taxpayer is receiving payments from a FEHBA carrier for services to covered patients. The imposition of tax is not on a carrier, and under the authority detailed above, does not constitute an indirect imposition of tax on the carrier. As recognized by the above authorities, 5 USC § 8909(f)(1) limits preemption to taxes "imposed, directly or indirectly, on a carrier" and this limitation is clearly expressed in the plain language of that preemption provision. The Taxpayer has not established that Washington's B&O tax on [its] gross revenues as a health service provider is a direct or indirect tax imposed on a FEHBA carrier that is preempted by 5 USC § 8909(f)(1). *See also* 33 WTD 354.

The Audit Division requested that the Taxpayer substantiate that it actually received payments from the FEHBA Fund or verification that the Taxpayer was a carrier, which the Taxpayer was not able to provide. . . . Accordingly, the Audit Division . . . properly denied the refund claim for

tax paid on the charges for patients covered by FEHBA plans. We sustain the Audit Division and deny the Taxpayer's petition on this issue.

2. MA Coverage:

Taxpayer asserts that Washington's B&O tax on [its] gross revenues received from insurance carriers who receive payments from the Medicare program is preempted by 42 CFR § 422.404, which provides:

> § 422.404 State premium taxes prohibited.
>
> (a) Basic rule. No premium tax, fee, or other similar assessment may be imposed by any State, . . . with respect to any payment CMS makes on behalf of MA enrollees under subpart G of this part, or with respect to any payment made to MA plans by beneficiaries, or payment to MA plans by a third party on a beneficiary's behalf.
>
> (b) Construction. Nothing in this section shall be construed to exempt any MA organization from taxes, fees, or other monetary assessments related to the net income or profit that accrues to, or is realized by, the organization from business conducted under this part, if that tax, fee, or payment is applicable to a broad range of business activity.

(Emphasis added.) The terms "MA organization" and "MA plan" are defined in 42 CFR 422.2 as follows:

> MA organization means a public or private entity organized and licensed by a State as a risk-bearing entity (with the exception of provider-sponsored organizations receiving waivers) that is certified by [Center for Medicare & Medicaid Services ("CMS")] as meeting the MA contract requirements.
>
> MA plan means health benefits coverage offered under a policy or contract by an MA organization that includes a specific set of health benefits offered at a uniform premium and uniform level cost-sharing to all Medicare beneficiaries residing in the service area of the MA plan . . . .

(Emphasis added.) Similar to the FEHBA preemption provisions addressed above, 42 CFR 422.404 is limited to . . . payments made by CMS from the federal fund. Here, the Taxpayer is not a MA plan or a MA organization because it is not a risk-bearing entity and does not receive payments directly from CMS or the Medicare fund. The Taxpayer receives payments from private insurers participating in MA plans for health services provided to their patients who are MA enrollees. Washington's B&O tax on Taxpayer's gross receipts from health services is not a tax or other assessment imposed "with respect to any payment CMS makes on behalf of MA enrollees . . . or any payment made to MA plans . . . ;" and accordingly, is not prohibited by 42 CFR 422.404(a).

The Taxpayer asserts that the payments it receives should be considered as an "other similar assessment" made on behalf of MA enrollees. However, the Taxpayer has not established that it

is either a MA organization or a MA plan. Thus, similar to the FEHBA preemption provisions discussed previously, the Taxpayer has failed to establish that it is an entity to whom the preemption provisions apply. Instead, the Taxpayer is receiving payment from insurance companies participating in MA plans and, as such, there is no applicable provision preempting the imposition of tax.

The Taxpayer also asserts that the insurance companies offering the MA plan coverage are acting as agents of the Taxpayer and, therefore, the Taxpayer should be considered to be receiving funds directly from the CMS as they are a "similar health care organization" under WAC 458-20-233 (Rule 233).

All medical service bureaus, medical service corporations, hospital service associations, and similar health care organizations engaging in business within this state are subject to the provisions of the B&O tax and are taxable under the service and other business activities classification upon their gross income. WAC 458-20-233 (Rule 233). Insofar as tax liability is concerned, it is immaterial that such organizations may be incorporated as charitable or nonprofit corporations. *Id*. The rule also addresses the possible deduction of amounts received as an agent and provides:

> Certain of these organizations operate under contracts by the terms of which the bureau or association acts solely as the agent of a physician, hospital, or ambulance company in offering to its members or subscribers medical and surgical services, hospitalization, nursing, and ambulance services. In computing tax liability such bureaus and associations, therefore, will be entitled to deduct from their gross income the amounts paid to member physicians, hospitals and ambulance companies. No deduction will be allowed with respect to amounts retained as surplus or reserve accounts or to amounts expended for the purchase of supplies or for any other expense of the bureau or association other than as provided herein.

Rule 233.

We have previously addressed the three essential requirements of a similar health care organization, for purposes of Rule 233: 1) that it has a membership or group of subscribers, 2) that in return for a fee or premium, it provides to its members or subscribers a range of medical and/or surgical services, and 3) that, by contract, its relationship to the physicians who provide services is that of agent to principal. Det. No. 89-512, 8 WTD 373 (1989); Det. No. 87-332, 4 WTD 205 (1987). The Taxpayer has not detailed that it meets any of these essential requirements, nor has it provided any contractual evidence or documentation that indicates that it is acting solely as an agent. Accordingly, we find no basis to apply the provisions of Rule 233 to the Taxpayer.

The Taxpayer cites a Board of Tax Appeals Decision, *Group Health Northwest v. Dep't. of Revenue*, BTA Docket No. 91-11 (1992) (*Group Health Northwest)* and asserts that its relationship with the MA plans is functionally the same as that of the health care organizations such as Group Health, an HMO covered by Rule 233. We note initially that the BTA itself subsequently limited application of its *Group Health Northwest* decision to HMOs, and the Taxpayer is not an HMO. *Charles A. Pilcher, M.D. v. Dep't of Revenue*, BTA Docket No. 46920 (1996), *affirmed*, *Pilcher v. Dep't. of Revenue*, 112 Wn. App. 428, 49 P.3d 947 (2002). Additionally, we find no authority that supports

an alleged functional equivalence as sufficient to establish payment or receipt solely as an agent. Accordingly, we disagree that this functional equivalency argument is sufficient to establish a basis for preemption here.

We conclude that the B&O tax at issue is not a prohibited tax or assessment under 42 CFR § 422.404(a) and, accordingly, that the Audit Division properly denied the Taxpayer's refund request for the B&O tax paid on these funds and deny the Taxpayer's petition on this issue.

## DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 26th day of November, 2015.