

Cite as Det. No. 15-0343, 36 WTD 547 (2017)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition for Refund	)	<u>D E T E R M I N A T I O N</u>
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	)	No. 15-0343
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...	)	Registration No. . . .
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[1] RCW 82.04.290(2): SERVICE B&O TAX - FEDERAL PREEMPTION - FEDERAL EMPLOYEES HEALTH BENEFITS ACT (FEHBA) - 5 USC § 8909(f)(1) - HEALTH CARE PROVIDER’S RECEIPTS FROM FEHBA INSURANCE CARRIERS. The preemption provision in, 5 USC § 8909(f)(1), forbids states from imposing a direct or indirect tax on insurance carriers with respect to payments made to them from the FEHB fund. Service B&O tax imposed on a grocery stores receipts from sales made by their in-store pharmacies is not preempted by this provision as it is not a direct or indirect tax imposed on a FEHBA.

[2] RCW 82.04.290(2): SERVICE B&O TAX - FEDERAL PREEMPTION - 42 CFR § 422.404 - HEALTH CARE PROVIDER’S RECEIPTS FROM MEDICARE ADVANTAGE (MA) PLANS. Under 42 CFR § 422.404, states are prohibited from taxing payments that the Centers for Medicare & Medicaid Services (CMS) makes to MA Plans on behalf of MA enrollees. Service B&O tax imposed on tax imposed on a grocery stores receipts from sales made by their in-store pharmacies is not prohibited by this provision because it is not a tax imposed on payments CMS makes on behalf of MA enrollees to MA Plans.

[3] RCW 82.04.290(2): SERVICE B&O TAX - FEDERAL PREEMPTION - 10 USC § 1103(a) - 32 CFR § 199.17(a)(7) - HEALTH CARE PROVIDER’S RECEIPTS FROM TRICARE INSURANCE CARRIERS. 10 USC § 1103(a) and 32 CFR § 199.17(a)(7) preempt state and local laws relating to TRICARE regional contracts, and premium taxes imposed on TRICARE insurance carrier contractors. Service B&O tax imposed on grocery stores receipts from sales made by their in-store pharmacies are not preempted by this provision because it is not a tax imposed on the premiums or other payments that TRICARE insurance carriers receive from the TRICARE program.

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 grocery store with pharmacies in a number of its retail stores, that made sales of prescription drugs, seeks a refund of retailing business and occupation (B&O) tax paid on these sales asserting that this tax is a prohibited indirect tax on the insurance carriers participating in the Federal Employees Health Benefits Act (FEHBA), Medicare Advantage, and TRICARE, federal health insurance programs, from whom it received payment. We conclude that the B&O tax is not preempted and affirm the denial of the request for refund.<sup>1</sup>

### ISSUES

1. Whether the imposition of B&O tax on a grocery store pharmacy's receipts from insurance carriers who participate in the . . . FEHB program is preempted by 5 USC § 8909(f).
2. Whether the imposition of B&O tax on a grocery store pharmacy's receipts from insurance carriers who participate in the Medicare Advantage program is preempted by 42 CFR § 422.404.
3. Whether the imposition of B&O tax on a grocery store pharmacy's receipts from insurance carriers who participate in the TRICARE program is preempted by 32 CFR § 199.17(a)(7).

### FINDINGS OF FACT

[Taxpayer] is a corporation engaged in the business of operating multiple grocery stores in Washington. From January 1, 2008, through December 31, 2009, the Taxpayer reported income under the Uniform Business Identifier (UBI) number . . . . The account was closed on December 31, 2009. Beginning in January of 2010, the Taxpayer reported under the UBI . . . . The Taxpayer submitted a consolidated refund request in the amount of \$ . . . , dated July 25, 2014, that was received by the Department of Revenue (Department) on August 25, 2014. The Department separated out the refund request and reviewed the amounts for the two time periods when the Taxpayer was reporting under the applicable UBI number.<sup>2</sup>

In a number of its grocery stores, the Taxpayer has a pharmacy section and in some instances a walk up clinic offering limited services, such as flu shots and basic physicals for school sports programs. The Taxpayer sought the refund of retailing B&O tax paid on amounts received from insurance carriers for items sold to customers who were covered by federally funded healthcare plans. The specific federal healthcare plans at issue are addressed below.

The Taxpayer asserts that federal preemption precludes the imposition of the B&O tax on the receipts it received from insurance carriers who received funds from federally funded healthcare plans. The Audit Division reviewed the refund requests and denied the refund claims concluding that [the] federal preemption doctrine did not apply to payments received by the Taxpayer. The refund for \$ . . . in taxes paid in 2008 and 2009, under UBI . . . , was denied by Document No. . . . . The refund for \$ . . . in taxes paid in 2010 and 2011 was denied by Document No. . . . . The

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<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

<sup>2</sup> The refund requests were submitted in conjunction with an audit of the Taxpayer's business activities for July 1, 2008, through December 31, 2009. This audit resulted in the issuance of an assessment for additional tax due, which is not at issue in these appeals, and which was paid in full by the Taxpayer.

Taxpayer timely filed two appeal petitions contesting the denial of the refund requests. As both appeals raised the same issues, the petitions were consolidated by the Appeals Division and this Determination addresses both appeals.

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 States Treasury, entitled the Federal Employees Health Benefits Fund (the FEHB Fund). 5 USC §§ 8906, 8909. Insurance carriers pay Taxpayer by drawing against the FEHB Fund to pay for covered health care benefits. *Id.*; *see also* 48 CFR § 1632.170(b). Taxpayer does not provide group insurance policies or similar arrangements in consideration of premiums or other periodic charges.

Medicare Advantage (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 & Medicaid Services (CMS), a federal agency, to provide Medicare benefits. *See* 42 CFR § 422.2. Taxpayer does not receive any payments from CMS or other Medicare funds; rather, Taxpayer receives payments from MA plans for health services provided to its patients who are MA enrollees. MA plans provide Part A (hospital insurance) and Part B (medical insurance) Medicare coverage to eligible patients. MA plans are also referred to as Medicare Part C. MA plans can also offer prescription drug coverage, Medicare Part D, as well as vision, hearing, dental and other health and wellness programs.

TRICARE provides a comprehensive managed health care program for active and retired military personnel and their dependents. The United States Department of Defense administers the TRICARE program. 32 CFR § 199.17(a).

The Taxpayer received payments from insurance carriers providing coverage to eligible patients, who were the Taxpayer's customers and purchased items covered under the programs detailed above during the refund period. In addition to receipts for prescription drugs, the Taxpayer's appeal petitions also noted amounts paid for injections for immunizations. However, upon subsequent review it was confirmed that the original refund claims did not detail these amounts, and that the Taxpayer would be filing a separate refund claim for any injections. Accordingly this issue will not be addressed here.

#### ANALYSIS

RCW 82.04.220 imposes the business and occupation ("B&O") tax "for the act or privilege of engaging in business activities." . . .

RCW 82.04.4286 provides a B&O tax deduction for amounts derived from business, which the state is prohibited from taxing under the Constitution or laws of the United States.

The Supremacy Clause of the United States Constitution provides that the Constitution and federal laws are the supreme law of the land. 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 mandate 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.

When interpreting a statute, it must be presumed “that a legislature says in a statute what it means and means in a statute what it says.” *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 252, 112 S.Ct. 1146 (1992). The preemption provisions for the three federal programs are each provided below.

### 1. FEHB Program

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 Seattle*, 146 Wn. App. 80, 189 P.3d 216 (2008). The court set forth the established requirements to invoke the preemption doctrine:

Under 5 USC § 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.J., Inc. v. Whitman*, 72 F.3d 1123, 1128 (3rd Cir. 1995).

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

In that case, Group Health Cooperative, a health maintenance organization, 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 were covered by the FEHB 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 circumstances in the present appeal are entirely different from those in *Group Health*. Here, the Taxpayer is not a “carrier” under 5 USC § 8909 because the Taxpayer does not provide group insurance policies or similar arrangements in exchange for premiums or other periodic dues. Rather, the Taxpayer is selling prescription items to its customers who are patients insured by carriers. Additionally, the Taxpayer did not receive payments from the FEHB Fund; therefore, the FEHBA preemption provision does not apply to them under the plan language of 5 USC § 8909(f)(1).

On appeal, the Taxpayer provided a number of letters from the United States Office of Personnel Management (OPM) to several states addressing taxes imposed on pharmacy sales, which state that OPM has concluded that FEHBA preempts the imposition of a variety of taxes on pharmacy sales as an indirect tax on FEHB carriers.<sup>3</sup> OPM is the administrator of the FEHB program and provides information for and accepts applications for carriers who are seeking approval for participation in the FEHB program. A number of these letters cite the preemption provisions addressed above and detail that the carriers will deduct the assessment of the specific tax at issue

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<sup>3</sup> The following letters were provided:

FEHBA Carrier Letter 1998-54 - Kentucky Provider Taxes

June 4, 2001 KY Revenue Cabinet Letter agreeing to preemption under FEHBA

OPM Cover letter and FEHBA Carrier Letter 2003-01 – Massachusetts Assessment on Pharmacies

HealthPartners, Inc. v. Minnesota Commissioner of Revenue (1999)

FEHBA Carrier Letter 2000-39 Minnesota Care Tax

FEHBA Carrier Letter 2003-17 Missouri Pharmacy Assessment

FEHBA Carrier Letter 2003-16 Surcharge and Assessments under New York Health Care Reform Act

2005 Email from OPM stating its position regarding preemption in Circuits outside the 4th Circuit

when calculating their payments to the pharmacies in the jurisdiction at issue. We note initially that OPM directs and provides information to carriers. As detailed in the discussion of the *Group Health* case above, this directly impacts the applicability of the preemption provisions. The Taxpayer is not a carrier. Furthermore, while these letters convey OPM's opinion on the scope of what OPM categorizes as an indirect tax, they are not binding authority for Washington taxation. Finally, the taxes at issue in these letters appear to be predominantly taxes specifically targeted at health care providers or pharmacies, rather than a general gross receipts tax such as the B&O tax at issue here, further limiting the applicability or persuasiveness of the analysis presented. Accordingly, we do not consider these carrier letters persuasive authority in applying the preemption provisions at issue to the Washington retailing B&O tax.

On appeal the Taxpayer asserts that the B&O tax issue is preempted because the tax may be passed on as a cost to the insurance carriers, and therefore should be classified as a preempted indirect tax. However, this sort of economic pass-through theory has been rejected by the courts. 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), and more recently by a medical products retailer in *Mobility Medical, Inc. v. Mississippi Dep't of Revenue*, 119 So. 3d 1002 ([Miss.] 2013). 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. 3d at 1005.

In *West Virginia*, the Fourth Circuit held that even though health care providers *could* pass the economic costs of a gross receipts tax to an insurance carrier, that potential choice by the providers did not constitute a prohibited imposition of an indirect tax on the insurance carrier. *West Virginia*, 339 F.3d at 218-219. The court stated that the legal incidents of the state gross receipts tax fell on the providers alone, and a possible economic pass-through of costs to FEHBA carriers does not equate to the indirect imposition of a tax.<sup>4</sup> *Id.* In further support of its holding, the court relied on the Supreme Court's rejection of economic pass-through theories in determining what constitutes indirect taxation in the analogous constitutional field of preemption of state taxation of the federal government. *Id.* at 216 (*citing United States v. Fresno*, 429 U.S. 452, 459, 97 S.Ct. 699 (1977) (state taxation of federal employees' housing benefit, though passing an economic burden through to the federal government by lowering the effective pay rate of its employees, was not a prohibited tax on the federal government because the tax equally applied to other similarly situated constituents of the state)). The *West Virginia* court determined that the rule espoused by the *Fresno* Court should also apply to the FEHBA preemption provision because of the similarities between the prohibitions:

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<sup>4</sup>The Fourth Circuit did not find helpful the federal government's citation to Office of Personnel Management regulation 48 CFR § 1631.205-41, which provides, in part: "5 USC § 8909(f)(1) prohibits the imposition of taxes . . ., directly or indirectly, on FEHB premiums . . . and it applies to all forms of direct and indirect measurements of FEHBP premiums . . . regardless of how they may be titled, to whom they must be paid, or the purpose for which they are collected . . ." *West Virginia*, 339 F.3d at 214, fn 1. The court stated, "[t]his regulatory instruction, saying nothing about from whom the tax is collected, sheds no light on what constitutes indirectness, as such relates to the relationship between a tax and its payer." *Id.*

*Fresno's* holding therefore results in the rule that an economic pass-through of a generally applicable tax does not constitute a tax, direct or indirect, of the recipient of the pass-through. . . .

*Fresno's* rule should apply here by analogy because of the many similarities between section 8909(f)'s preemption and the Constitution's preemption of state taxation of the federal government. Section 8909(f) precludes states from taxing the Carriers directly or indirectly. The Constitution precludes states from taxing the federal government directly or indirectly. Both ensure that state tax laws do not thwart the will of the federal government. Both face the economic reality that the states' tax regimes would be seriously hampered were all state taxes of non-protected taxpayers that create pass-through economic burdens on protected taxpayers treated as indirect taxes of those protected taxpayers.

*West Virginia*, 339 F.3d at 216-217.

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 ([Miss.] 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.* This analysis supports the conclusion that the B&O tax is a cost that the Taxpayer could pass on to the carriers who are remitting payment for covered expenses [and] does not render the tax a preempted indirect tax on a carrier.

As recognized by the authority detailed above, 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 Department has confirmed the limits of preemption consistent with this authority in Det. No. 13-0241, 33 WTD 354 (2014). The Taxpayer has not established that Washington's B&O tax on its gross revenues is a direct or indirect tax imposed on a FEHBA carrier that is preempted by 5 USC § 8909(f)(1), and therefore, has not established a valid basis for refund of the taxes at issue.

## 2. MA Program

Taxpayer asserts that Washington's B&O tax on its gross revenues received from insurance carriers who receive payments from MA plans 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 provision discussed above, 42 CFR 422.404 also only limits taxing payments made by CMS from the federal fund. The Taxpayer is not a MA plan or MA organization because it is not a risk-bearing entity and does not receive any payments from CMS or the Medicare fund. Instead, the Taxpayer is receiving payments from MA plans for the sale of covered items to customers/patients who are MA enrollees. Washington’s B&O tax on Taxpayer’s gross receipts from these sales 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 therefore is not prohibited by 42 CFR 422.404(a). Taxpayer’s economic pass-through argument that its tax costs may be passed along to MA plans does not amount to a prohibited tax or assessment under the same analysis of *Fresno*, *West Virginia*, and *Medical Mobility* discussed above in regards to preemption under FEHBA.

### 3. TRICARE Program

The Taxpayer asserts that Washington’s B&O tax on its gross revenues from carriers who receive payments from the TRICARE program is preempted by 32 CFR § 199.17(a)(7), which provides:

(ii) . . . any State or local law relating to health insurance, prepaid health plans, or other health care delivery or financing methods is preempted and does not apply in connection with TRICARE regional contracts. Any such law, or regulation pursuant to such law, is without any force or effect, and State or local governments have no legal authority to enforce them in relation to the TRICARE regional contracts. . . .

(iii) The preemption of State and local laws set forth in paragraph (a)(7)(ii) of this section includes State and local laws imposing premium taxes on health or dental insurance carriers or underwriters or other plan managers, or similar taxes on such entities. . . . For purposes of assessing the effect of Federal preemption of State and local taxes and fees in connection with DoD health and dental services contracts, interpretations shall be consistent with those applicable to the Federal Employees Health Benefits Program under 5 USC § 8909(f).

(Emphasis added.) See 10 USC § 1103(a).<sup>5</sup>

Preemption is limited to state and local laws relating to TRICARE regional contracts and premium taxes imposed on the insurance carrier contractors. Washington's B&O tax is imposed on Taxpayer's receipts from *insurance carriers*, not on the premiums or other payments the insurance carriers may receive from the TRICARE program. Again, the Taxpayer has not established that Washington's B&O tax on its receipts from TRICARE contractors is preempted pursuant to 32 CFR § 199.17(a)(7). [Taxpayer's] economic pass-through theory of preemption fails under the same analysis applied to the FEHBA preemption provision above.

We sustain the Audit Divisions denial of the Taxpayer's refund requests as the Taxpayer has not established that it is entitled to a refund of the taxes paid.

#### DECISION AND DISPOSITION

The Taxpayer's petitions are denied.

Dated this 14th day of December 2015.

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<sup>5</sup> The statutory preemption provision in 10 USC § 1103(a) provides:

(a) Occurrence of preemption. A law or regulation of a State or local government relating to health insurance, prepaid health plans, or other health care delivery or financing methods shall not apply to any contract entered into pursuant to this chapter by the Secretary of Defense or the administering Secretaries to the extent that the Secretary of Defense or the administering Secretaries determine that:

(1) the State or local law or regulation is inconsistent with a specific provision of the contract or a regulation promulgated by the Secretary of Defense or the administering Secretaries pursuant to this chapter; or

(2) the preemption of the State or local law or regulation is necessary to implement or administer the provisions of the contract or to achieve any other important Federal interest.