No. 97247-8

SUPREME COURT
OF THE STATE OF WASHINGTON

EXPRESS SCRIPTS, INC.,

Petitioner,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

ANSWER OF PETITIONER EXPRESS SCRIPTS, INC. TO MEMORANDUM OF AMICUS CURIAE COUNCIL ON STATE TAXATION IN SUPPORT OF PETITION FOR REVIEW

George C. Mastrodonato WSBA #7483
Michael B. King, WSBA #14405
CARNEY BADLEY SPELLMAN, P.S.
701 Fifth Avenue, Suite 3600
Seattle, Washington 98104-7010
Telephone: (206) 622-8020
Facsimile: (206) 467-8215
Attorneys for Petitioner Express Scripts, Inc.

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I. INTRODUCTION

Amicus Curiae Council on State Taxation (COST) argues that the Court of Appeals failed to apply the requirements of the Taxpayer Bill of Rights, set forth in RCW 82.32A.020(2), to Express Scripts. COST Memo at 2. COST points out that other of its members in Washington State have also experienced the Department's failure to honor its own "specific, official written advice" when determining a taxpayer's liability.

COST also argues that the Court of Appeals' decision in this appeal (reported at *Express Scripts, Inc. v. Dep't of Revenue,* 8 Wn. App. 167, 437 P.3d 747 (2019)) "exacerbates the impact of the tax pyramiding that occurs when multiple businesses are engaged in facilitating the same or related transactions." COST Memo at 1. COST believes that the negative impact of "pyramiding" Washington's business and occupation (B&O) tax "can be minimized by a proper interpretation of 'gross income of the business'" (RCW 82.04.080) and by recognizing "the economic realities of a transaction when certain funds are passed through (or paid) to clients." *Id.*

COST's analysis cogently underscores the reasons why this Court should grant review.

II. ARGUMENT

A. COST's Members' Adverse Experiences Dealing With the Department Underscores Why This Court Should Grant Review of the Taxpayer Bill of Rights Issue.

COST correctly states that the audit instructions issued to Express Scripts by the Department in 2007 satisfied RCW 82.32A.020(2)'s statutory right of a taxpayer "to rely on specific, official written advice" of the

Department. COST Memo at 10. COST highlights the absurdity of the Court of Appeals' decision, in which it stated that Express Scripts "offered no evidence that it actually relied on the audit's instruction" (Slip Opinion at 16). (The Court of Appeals' Slip Opinion is cited in this instance because the quotation above is part of the unpublished portion of the decision.) The court's statement is nonsense. It is *self-evident* that Express Scripts relied on the audit's instructions since it reported its taxes for the 2007-2010 period consistent with the instructions.

Importantly, COST stated that several of its members "have informed COST of audit techniques utilized by the Department that fail to rely on its own 'specific, official written advice'" and "COST has approached the Department regarding these issues." COST Memo at 2. This is direct confirmation that Express Scripts is not the only taxpayer being denied rights taxpayers are afforded by the legislature in Chapter 82.32A RCW. The right granted in RCW 82.32A.020(2) – "to rely on specific, official written advice and written tax reporting instructions from the department of revenue to that taxpayer, and to have interest, penalties, and in some instances, tax deficiency assessments waived where the taxpayer has so relied to their proven detriment" – is one of the most important, if not *the* most important, rights of taxpayers. Both COST and Express Scripts highlight the Department's complete refusal to recognize those rights. The Department will continue to disregard taxpayer rights until the courts require the Department to do so, and in this case the Court of Appeals has failed to do its job.

This Court has reported only one decision (*see TracFone Wireless, Inc. v. Dep't of Revenue*, 170 Wn.2d 273, 242 P.3d 810 (2010)) on the Taxpayer Bill of Rights, and the Court of Appeals has reported none. The only discussion in *TracFone* was a statement that the Department had provided clear reporting instructions under RCW 82.32A.020(5). In the nearly 30 years since the Act was enacted, no court has addressed a case under RCW 82.32A.020(2), involving when the Department has failed to comply with the Act. In light of the Department's egregious conduct in this case and others as noted by COST, the taxpayers of this State deserve a decision from this Court requiring the Department to live up to the standards set forth in the Taxpayer Bill of Rights.

B. COST Appropriately Identifies the Problems with B&O Tax "Pyramiding" in This Case.

COST described pyramiding in general terms and did not fully explain its practical application to the Washington B&O tax. Pyramiding is a concept in which every participant in a vertical chain of production and sale of goods or services – the extractor, the manufacturer, the wholesaler and the retailer – pays a B&O tax (unless exempt) on their gross receipts. *See First American Title Ins. Co. v. Dep't of Revenue*, 144 Wn.2d 300, 305 n.3, 27 P.3d 604 (2001) (a tax pyramids when it applies to "a sequential set of transactions"). It is also the way the B&O tax applies to prescription drugs as they are produced and sold by manufacturers to wholesale suppliers, from the wholesalers to the retailers (the pharmacies) and, ultimately by the pharmacies who sell the drugs to consumers. In each case,

the sale of the product is taxed multiple times. This is the way B&O tax pyramiding, for all its faults, is intended to operate.

However, the pharmacy benefit management transaction is not part of the vertical chain of production, and consequently, pyramiding is not applicable in this instance. The Court of Appeals' decision deviated from pyramiding in the classic sense in two key ways: (1) the decision imposes B&O tax on the cost of the prescription drugs in the hands of the pharmacy benefit manager, who never possesses or sells the drugs and who is outside the actual distribution of those drugs, and (2) the rate of the B&O tax paid by the pharmacy benefit manager on the value of the drugs – 1.5% under the service category – makes no sense, because the PBM is performing a service, not selling tangible personal property (the prescription drugs), which are ordinarily taxed at a much lower rate.

COST correctly states that the PBM is subject to "excessive and unfair double taxation" (COST Memo at 5) because both the pharmacy and PBM are taxable on the same cost of the prescription drug, yet the latter is outside the distribution of the tangible personal property and taxed at a much higher B&O rate.

COST recognizes that while pyramiding of the B&O tax is a necessary result of Washington's tax scheme it "should be kept to a minimum" because it creates a disincentive to specialize. COST Memo at 4 (citing John L. Mikesell, *Gross Receipts Taxes in State Government Finances: A Review of Their History and Performance*, January 2007). Pyramiding can be kept to a minimum "by properly interpreting the

meaning of 'gross income of the business.'" COST Memo at 4. A proper interpretation would make "the tax more economically neutral by not penalizing businesses that elect not to self-administer pharmacy programs and instead use a business, such as [Express Scripts], that is specialized in administering those programs." COST Memo at 5.

The Court of Appeals' misapplication of the tax pyramid scheme in this case could result in both the reduction of the use of PBM services in Washington and increasing costs to the extent any PBM service providers can afford to continue to do business here. In both cases, the cost of prescription drugs will increase. A week does not go by where the high cost of prescription drugs is not in the news, and this tax will do nothing but exacerbate the problem in Washington. Throughout this appeal the Department regularly points to Pharmacy Benefits Program Contract #323555 between King County and Express Scripts. *See* CP 1221-1270. King County and its employees will face further increases in their contractual payments for the cost of prescription drugs if the Court of Appeals' decision is allowed to stand.

Finally, COST points out that the Court of Appeals' erroneously stated that "the only way funds qualify for 'pass-through' treatment is under WAC 458-20-111 (Rule 111)." COST Memo at 6 (quoting *Express Scripts*, 8 Wn. App at 172). COST notes that foreign currency exchanges and the holding of this Court in *First American,* 144 Wn.2d 300, are two examples when "[not] all receipts are 'gross income of the business' if they do not satisfy Rule 111." COST Memo 7. This Court's decision in *Weyerhaeuser*

Co. v. Dep't of Revenue, 106 Wn.2d 557, 723 P.2d 1141 (1986), as well as the credit card transaction raised by Express Scripts and addressed in the Court of Appeals decision (8 Wn. App. at 174-75), are two additional situations where either the courts or the Department itself have determined that certain pass-through receipts are not "gross income of the business" and are outside the scope of Rule 111. Thus, there are *at least four situations*, including two decisions of this Court *(First American* and *Weyerhaeuser)*, that conflict with the holding of the Court of Appeals. These conflicts merit review by this Court.

III. CONCLUSION

COST provides this Court with several additional reasons why Express Scripts' petition should be granted. The Court should grant review.

Respectfully submitted this 14th day of August, 2019.

CARNEY BADLEY SPELLMAN, P.S.

By _____

George C. Mastrodonato WSBA #7483
Michael B. King, WSBA #14405
Attorneys for Petitioner Express Scripts, Inc.

CERTIFICATE OF SERVICE

The undersigned certifies under penalty of perjury under the laws of the State of Washington that I am an employee at Carney Badley Spellman, P.S., over the age of 18 years, not a party to nor interested in the above-entitled action, and competent to be a witness herein. On the date stated below, I caused to be served a true and correct copy of the foregoing document on the below-listed parties of record by the methods noted:

Via Appellate Portal:

Charles Zalesky, Assistant Attorney General
chuckz@atg.wa.gov

Rosann Fitzpatrick, Assistant Attorney General
RosannF@ATG.WA.GOV

Andrew Krawczyk, Assistant Attorney General
andrewsk1@atg.wa.gov

Julie Johnson, Legal Assistant
juliej@atg.wa.gov

Candy Zilinskas, Legal Assistant
candyz@atg.wa.gov

REVOlyEF@atg.wa.gov

Gregg D. Barton
GBarton@perkinscoie.com

Robert A. Mahon
RMahon@perkinscoie.com

DATED this 14th day of August, 2019.

Anne Gutches, Legal Assistant

CARNEY BADLEY SPELLMAN

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Address:
701 5th Ave, Suite 3600
Seattle, WA, 98104
Phone: (206) 622-8020 EXT 149

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