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NO. 51436-2-II

**COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON**

PEACEHEALTH ST. JOSEPH MEDICAL CENTER, et al.,

Appellants,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

**OPENING BRIEF OF RESPONDENT
DEPARTMENT OF REVENUE**

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I. INTRODUCTION

This appeal presents a dispute over the scope of a tax deduction statute. RCW 82.04.4311 allows a public or nonprofit hospital to deduct from the measure of Washington's business and occupation (B&O) tax amounts received for providing health care services covered under certain government-funded programs. The Board of Tax Appeals (BTA) misinterpreted the statute as applying to health care services covered under any state's Medicaid or Children's Health Insurance (CHIP) program.

The plain language of RCW 82.04.4311 limits the scope of the deduction to the Medicaid and CHIP programs authorized "under chapter 74.09 RCW." The BTA erred by reading the limiting language out of the statute. Consequently, the BTA's decision creates a tax deduction broader than statutorily authorized.

The Legislature clearly and deliberately limited the scope of the deduction to medical services covered under the programs established, administered, and funded by Washington State. It had good reason to do so. Further, RCW 82.04.4311 need not be liberally construed to avoid running afoul of the dormant commerce clause. Providing a tax deduction for publicly funded services the State makes available to its citizens does not raise dormant commerce clause concerns.

The superior court correctly reversed the BTA's decision based on the deduction statute's plain language and this Court should affirm.

II. ASSIGNMENT OF ERROR

1. The Board of Tax Appeals erred in ruling that the tax deduction in RCW 82.04.4311(1) applies to amounts received for providing medical services covered under any state's medical assistance or children's health program, rather than just those established "under chapter 74.09 RCW."

III. ISSUE PRESENTED

RCW 82.04.4311 authorizes a B&O tax deduction for amounts a public or nonprofit hospital receives for providing medical services covered under the "medical assistance, children's health, or other program under chapter 74.09 RCW." RCW 74.09 establishes Washington's Medicaid and CHIP programs, which provide state-subsidized medical services to eligible Washington residents. Did the BTA misinterpret and misapply RCW 82.04.4311 in concluding the deduction applies to a nonprofit hospital's revenues from providing medical services covered under any state's Medicaid or CHIP program?

IV. STATEMENT OF THE CASE

A. The Taxpayers in this Case

Appellants St. Joseph Medical Center and St. John Medical Center (collectively, “Peacehealth”) are nonprofit hospitals located in Bellingham and Longview, Washington, respectively. AR 255. They are part of a regional network of hospitals and clinics. *Id.* Both hospitals provided services to patients enrolled in Washington’s Medicaid program and also served patients covered under Medicaid programs established by other states. AR 256. Peacehealth’s Medicaid receipts constitute approximately 15 percent of its net patient service revenue. *Id.* One percent of St. Joseph’s Medicaid revenues are from states other than Washington. *Id.* St. John Medical Center, which is near the Oregon border, receives approximately 8.5 percent of its Medicaid revenues from other states, primarily Oregon. *Id.*

B. Statutory Background

The State levies and collects “from every person a tax for the act or privilege of engaging in business activities.” RCW 82.04.220. Nonprofit corporations engaging in business as a hospital in Washington are taxed at the rate of 1.5 percent. RCW 82.04.260(10). However, various deductions are available for certain categories of hospital revenues.

RCW 82.04.4311 provides a deduction for amounts a qualified public or nonprofit hospital receives as compensation for providing health care services covered under the federal Medicare program, Washington's Basic Health Plan, and the "medical assistance, children's health, or other program under chapter 74.09 RCW." Chapter 74.09 establishes Washington's Medicaid program, CHIP, and other state-funded medical services programs for eligible Washington residents.

C. Washington's Medical Assistance, Children's Health, and Other Programs under Chapter 74.09 RCW

Unlike Medicare, which is a national health insurance program administered by the federal government, the federal Medicaid program consists of 56 distinct state-level Medicaid plans, each designed, administered, and funded by state government.¹ AR 150.

Medicaid is "designed to advance cooperative federalism." *Wisconsin Dep't of Health & Family Servs. v. Blumer*, 534 U.S. 473, 495, 122 S. Ct. 962, 151 L. Ed. 2d 935 (2002). States are the "first-line administrators" of the program and may "select dramatically different levels of funding and coverage, alter and experiment with different financing and delivery modes, and opt to cover (or not to cover) a range of particular procedures and therapies." *Nat'l Fed'n of Indep. Bus. v.*

¹ There is a state-level Medicaid program for each state, the District of Columbia, and each U.S. Territory. AR 150.

Sebelius, 567 U.S. 519, 629, 132 S. Ct. 2566, 183 L. Ed. 2d 450 (2012) (Ginsburg, J., concurring in part) (quoting Ruger, *Of Icebergs and Glaciers*, 75 L. & Contemp. Probs. 215, 233 (2012)). So long as a state operates its program within federal guidelines, the federal government reimburses the state for a portion of the costs of providing medical assistance to low-income individuals. AR 147. 42 U.S.C. § 1396(a)-(e).

A state participates in the Medicaid program by submitting and obtaining federal approval of a State Plan. 42 U.S.C. § 1396a(a); 42 C.F.R. § 430.10. AR 150. States have a great deal of leeway in designing and administering their Medicaid programs, including in determining eligibility requirements, the scope of coverage, cost-sharing requirements, provider reimbursement rates, contracting practices, fraud and waste prevention programs, management structures, and funding mechanisms. AR 150.

Congress enacted the CHIP program in 1997 to enable the states to provide coverage for children in low-income families that earn too much to qualify for Medicaid. 42 U.S.C. § 1397aa. Each state designs, administers, and finances its own CHIP program, and is eligible to receive federal funding in exchange for complying with pertinent federal

regulations. 42 U.S.C. § 1397ee. As a practical matter, CHIP operates as an extension of the State's Medicaid program.² WAC 182-500-0120.

In addition to the Medicaid and CHIP programs, the Legislature has established state-only funded programs to provide services for which no matching federal funds are available. For example, federal law generally bars the states from using federal funds to cover certain categories of individuals, such as undocumented immigrants, and certain types of services, including most elective abortions. *See Korab v. Fink*, 797 F.3d 572 (9th Cir. 2014) (federal law permissibly limits eligibility for Medicaid benefits to citizens and lawfully present aliens); *Harris v. McRae*, 448 U.S. 297, 100 S. Ct. 2671, 65 L. Ed.2d 784 (1980) (affirming constitutionality of the Hyde Amendment banning funding of abortions).

Washington's Alien Emergency Medical Program covers emergency care, cancer treatment, and long-term nursing services for undocumented immigrants. *See* WAC 182-507 (Medical Assistance Programs for Noncitizens). The Maternity Care Access Program authorizes state-funding for abortion services for low-income women.³ *See* RCW 74.09.800(2) (directing HCA to develop a maternity care access

² *See* <https://www.hca.wa.gov/about-hca/apple-health-medicaid>.

³ Washington is one of just 17 states to provide state-funded abortion services. *See* <https://www.kff.org/womens-health-policy/issue-brief/coverage-for-abortion-services-in-medicaid-marketplace-plans-and-private-plans/>.

program, which provides services not covered under the federal Medicaid program); WAC 182-532-123(10) (listing covered reproductive services for women). The Medical Care Services program offers limited services for the aged, disabled, and blind who are not otherwise eligible for Medicaid. WAC 182-508-0005.

“Washington Apple Health” is the umbrella term or “brand name” for all Washington State medical assistance programs, including Medicaid, CHIP, and state-only funded programs. WAC 182-500-0120. AR 92. The Washington State Health Care Authority (HCA) administers most Washington Apple Health programs.⁴ RCW 74.09.530. The Medicaid program is consistently the State’s second greatest expenditure each year, after basic education.⁵ Historically, Medicaid spending accounts for approximately 20 percent of Washington’s total budget. AR 118.

D. The Administrative Review and Appeal Proceedings

Peacehealth filed a refund request with the respondent Department of Revenue to recover the B&O taxes it had paid on its gross receipts from

⁴ Washington’s Medicaid program formerly was called “Healthy Options.” *St. John Med. Center v. Dep’t of Soc. & Health Servs.*, 110 Wn. App. 51, 56, 38 P.3d 383 (2002). In 2011, the Legislature renamed the program “Apple Health” as part of a reorganization of the State’s public health insurance program. The Legislature created a new state agency, the Health Care Authority, to assume responsibility for administering the State’s Medicaid and CHIP programs. RCW 74.04.050; Laws of 2011, ch. 15, § 64.

⁵ See <https://www.nasbo.org/reports-data/state-expenditure-report/state-expenditure-archives> (annual reports by the National Association of State Budget Officers, summarizing each state’s annual expenditures on major budget items).

services covered under Oregon's Medicaid and CHIP programs. AR 297. The Department denied the request on the ground that RCW 82.04.4311 applies only to the medical assistance (Medicaid), children's health (CHIP), and other state-funded health services programs established "under chapter 74.09 RCW." AR 300.

Peacehealth filed a timely appeal with the BTA. AR 289. Following a hearing, the BTA granted summary judgment to Peacehealth. AR 10-17. The BTA concluded RCW 82.04.4311 clearly and unambiguously allows a deduction for receipts from any state's Medicaid or CHIP program. The BTA reasoned that the last antecedent rule supports reading "under chapter 74.09 RCW" as modifying only "other program" and not "medical assistance" or "children's health." AR 16. The BTA stated its interpretation best fulfills the legislative purpose of the statute, which the BTA viewed as helping nonprofit hospitals to "close the gap" between their costs of providing medical services and Medicaid reimbursement rates. AR 16.

The Department timely petitioned for judicial review under RCW 34.05.510. The superior court granted the Department's petition and reversed the BTA's final decision. In its oral ruling, the superior court stated "it's clear that under chapter 74.0[9] refers to medical assistance,

children’s health or other program” and “the last-antecedent rule does not govern.” Verbatim Report of Proceeding (VRP) (1/19/2018), at 49. AR 3.

Peacehealth timely appealed the superior court’s order reversing the BTA’s final decision. As the party challenging the underlying agency action (i.e. the BTA’s summary judgment order granting Peacehealth’s tax appeal), the Department is responsible for filing the opening brief in this Court. General Order 2010-1.

V. ARGUMENT

A. This Court Reviews the BTA’s Summary Judgment Order De Novo

The Administrative Procedure Act (APA), RCW 34.05, governs judicial review of a final order entered by the BTA. RCW 82.03.180. Under the APA, the burden of demonstrating the invalidity of agency action is on the party asserting that the agency erred. RCW 34.05.570(1). In an appeal of a superior court order granting a petition for judicial review, the burden remains with the party challenging the underlying agency action. General Order 2010-1. Thus, the Department must demonstrate the BTA’s decision is erroneous.

In reviewing a summary judgment order issued by an administrative agency, the court applies the standard of review ordinarily applicable to a summary judgment. *Verizon Nw., Inc. v. Employ. Sec.*

Dep't, 164 Wn.2d 909, 915, 194 P.3d 255 (2008). Thus, the court reviews the facts in the record in the light most favorable to the non-moving party and the law in light of the “error of law” standard. *Id.* at 916.

Under the error of law standard, the reviewing court may substitute its own interpretation of the statute for the agency’s interpretation.

Verizon, 164 Wn.2d at 915. A court, however, accords “considerable deference” to the interpretation made by the agency charged with enforcing a statute or implementing its own rules. *Dep’t of Revenue v. Nord Nw. Corp.*, 164 Wn. App. 215, 229-30, 264 P.3d 259 (2011). Here, the Department, not the BTA, is entitled to such deference because the Department is the agency charged with assessing and collecting “all taxes” and administering “all programs relating to taxes” enacted by the Legislature. RCW 82.01.060(1). *See Port of Seattle v. Pollution Control Hearings Bd.*, 151 Wn.2d 568, 593-94, 90 P.3d 659 (2004) (holding that the court defers to the agency charged with administering a particular statute rather than a quasi-judicial body’s interpretation of the statute).

When possible, “the court derives legislative intent solely from the plain language enacted by the Legislature, considering the text of the provision in question, the context of the statute in which the provision is found, related provisions, amendments to the provision, and the statutory scheme as a whole.” *Cashmere Valley Bank v. Dep’t of Revenue*, 181

Wn.2d 622, 631, 334 P.3d 1100 (2014). “Taxation is the rule and exemption is the exception.” *TracFone Wireless, Inc. v. Dep’t of Revenue*, 170 Wn.2d 273, 296-97, 242 P.3d 810 (2010). Thus, a taxpayer who claims an exemption carries the burden of proving it qualifies. *Activate, Inc. v. Dep’t of Revenue*, 150 Wn. App. 807, 813, 209 P.3d 524 (2009).

A tax deduction statute may not be extended by implication. *TracFone*, 170 Wn.2d at 296-97 (citing *Belas v. Kiga*, 135 Wn.2d 913, 934, 959 P.2d 1037 (1998)). The legislative intent to authorize a deduction must be expressed in unambiguous terms. *Id.* Thus, in any case where a statutory deduction is susceptible to more than one reasonable interpretation, the statute must be construed “strictly, though fairly and in keeping with the ordinary meaning of [the statute’s] language, against the taxpayer.” *Group Health Co-op. of Puget Sound, Inc. v. Wash. State Tax Comm’n*, 72 Wn.2d 422, 429, 433 P.2d 201 (1967). The policy reasons for narrowly construing tax deductions include avoiding revenue losses that were not clearly within the contemplation of the Legislature and respecting the Legislature’s plenary authority over the State’s tax policy. *Lacey Nursing Center, Inc. v. Dep’t of Revenue*, 128 Wn.2d 40, 49-50, 905 P.2d 338 (1995).

B. RCW 82.04.4311 Applies Only to the Medicaid and CHIP Programs Established “under Chapter 74.09 RCW”

Washington imposes a B&O tax on every person for the act or privilege of engaging in business activities in the state. RCW 82.04.220.

The tax is assessed on the gross receipts of the business, without deduction for any of the costs of doing business and without regard to profit or loss.

Budget Rent-A-Car of Wash.-Ore., Inc. v. Dep’t of Revenue, 81 Wn.2d 171, 173-74, 500 P.2d 764 (1972). The B&O tax applies to virtually all business activities in the state, including providing healthcare services.

Group Health, 72 Wn.2d at 431.

The Legislature has enacted several exemptions and deductions from the B&O tax for revenues that health care providers receive for certain types of medical services. At issue in this case is RCW 82.04.4311, which allows a qualified public or nonprofit hospital to deduct:

amounts received as compensation for health care services covered under the federal medicare program authorized under Title XVIII of the federal social security act; *medical assistance, children's health, or other program under chapter 74.09 RCW*; or for the state of Washington basic health plan under chapter 70.47 RCW. The deduction authorized by this section does not apply to amounts received from patient copayments or patient deductibles.

(Emphasis added).

It is undisputed that Peacehealth is a nonprofit hospital entitled to take the deduction authorized by RCW 82.04.4311.⁶ In dispute is whether the deduction is limited to amounts received for providing services covered under a medical assistance, children's health, or other program authorized "under chapter 74.09 RCW." It plainly is. The BTA erred by reading "medical assistance" and "children's health" as standalone provisions unrestricted by the phrase "under chapter 74.09 RCW." As a consequence, the BTA erroneously concluded the deduction extends to revenues a nonprofit hospital receives for providing services covered under any state's medical assistance or children's health program.

The BTA's decision is contrary to the plain language of the statute and results in an overly-broad application of RCW 82.04.4311. The superior court correctly reversed the BTA's decision, and this Court should affirm.

1. The structure and text of the statute show the deduction is limited to programs authorized under state law

The structure and text of RCW 82.04.4311 lead to only one reasonable conclusion. The Legislature clearly and unambiguously provided a B&O tax deduction for a nonprofit hospital's receipts from

⁶ To claim the deduction, a health care provider must qualify as a "health or social welfare organization" as defined in RCW 82.04.431, which requires, among other things, that the amounts deducted by the organization are used for engaging in the exempt activities. RCW 82.04.431(1)(e).

services covered under the medical assistance, children's health, and other health services programs authorized "under chapter 74.09 RCW."

First, the structure of the deduction, with parallel statutory references in each of the three categories of eligible payments, indicates the deduction applies only to the medical assistance and children's health programs established "under chapter 74.09 RCW." The statutory references in RCW 82.04.4311 are to the laws establishing the federal Medicare program ("Title XVIII of the federal social security act") and the health services programs established, administered, and funded by this State. RCW 70.47 authorized Washington's Basic Health Plan to provide state-subsidized health insurance for low-income families and childless adults who do not qualify for Medicaid.⁷

RCW 74.09 establishes Washington's Medicaid program, CHIP, and other state-funded health services programs. *See* RCW 74.09.500 ("There is hereby established a new program of federal-aid assistance to be known as medical assistance to be administered by the [HCA]."); RCW 74.09.470(1) (directing the HCA to provide health care coverage to

⁷ The Legislature consolidated the Basic Health Plan with the State's Medicaid program after Congress enacted the Patient Protection and Affordable Care Act of 2010 (ACA), Pub. L. No. 111-148, 124 Stat. 119 (2010). *See* Laws of 2011, ch. 284, § (2)(6) (directing HCA to transition enrollees from the Basic Health Plan into the newly expanded Medicaid and CHIP "programs administered under chapter 74.09 RCW"); § (2)(11) (directing HCA to treat applications for enrollment in the Basic Health Plan as "an application for medical assistance under chapter 74.09 RCW").

children “who reside in Washington state,” consistent with federal law requirements for receiving matching funds under Title XIX (Medicaid) and Title XXI (CHIP)); RCW 74.09.510 (authorizing coverage for various categories of needy persons in Washington); RCW 74.09.520 (defining “medical assistance” as including certain types of services and excluding others); RCW 74.09.522 (directing HCA to contract with managed care organizations to provide coverage for medical assistance enrollees).

The phrase, “medical assistance, children’s health, or other program under chapter 74.09 RCW” refers to the medical assistance, children’s health, and other health services programs established under Washington law. RCW 82.04.4311. The use of semicolons to separate the phrase “medical assistance, children’s health, or other program” from the federal Medicare program and Washington’s Basic Health Plan indicates these three terms are to be read together as forming a distinct category.

Cf. Olympic Tug & Barge, Inc. v. Dep’t of Revenue, 188 Wn. App. 949, 957, 355 P.3d 1199 (2015) (reading words bracketed by semicolons as a single category of deductible activities). Sidney Greenbaum, *The Oxford English Grammar* 513 (1996) (“[S]emicolons are used ... to separate phrases when internal commas obscure the major units.”). *See also Code Reviser Bill Drafting Guide 2017, instructions on style, part IV (1)(b)* (“A

semicolon is not used where a comma will suffice but is to be used to separate phrases already containing commas.”).⁸

The semicolons in RCW 82.04.4311 divide the statute into three categories of qualifying government programs: (1) the federal Medicare program “under Title XVIII” of the social security act; (2) medical assistance, children’s health, or other program “under chapter 74.09 RCW”; and (3) the State of Washington’s Basic Health Plan “under chapter 70.47 RCW.” The legal subject of the middle clause of RCW 82.04.4311 is the “medical assistance,” “children’s health,” or “other” health services program *established under RCW 74.09*.

The BTA erred in reading “medical assistance” and “children’s health” as standalone provisions. In doing so, the BTA ignored both the methodical way the statute is punctuated and the clear parallelism created by the phrases, “program under Title XVIII,” “program under chapter 74.09 RCW,” and “plan under chapter 70.47 RCW.” The punctuation and parallelism provide unmistakable textual evidence that the Legislature intended “medical assistance, children’s health, or other program” to form a unified category modified by the phrase “under chapter 74.09 RCW.”

⁸ Available at:
http://leg.wa.gov/CodeReviser/Pages/bill_drafting_guide.aspx#Semicolons.

Collectively, these are the programs that make up Washington's Apple Health Program. In fact, the Legislature defined the scope of the deduction in language that essentially mirrors the administrative regulations defining Washington's Apple Health Program. *See* WAC 182-500-0120 ("Washington apple health is the name used in Washington state for medicaid, the children's health insurance program (CHIP), and state-only funded health care programs."); WAC 182-500-0010 (defining "apple health for kids program" as the umbrella term for various programs funded jointly by the state and federal governments through the Medicaid and CHIP programs, or solely through state funds); WAC 182-503-0510 (summarizing the subcategories of Washington's apple health program).

2. The BTA misapplied the last antecedent rule

The BTA erroneously invoked the last antecedent rule to justify its strained reading of the statute. In the BTA's view, the lack of a comma before "under chapter 74.09 RCW" means that phrase modifies only its immediately preceding antecedent, "other program." AR 16-17.

The last antecedent rule provides that qualifying or modifying words and phrases refer only to the immediately preceding antecedent. *State v. Bunker*, 169 Wn.2d 571, 578, 238 P.3d 487 (2010). But the presence of a comma before the modifying phrase is evidence the modifier is intended to apply to all antecedents, not just the immediately preceding

one. *Id.* The last antecedent rule is “not inflexible or uniformly binding.” *In re Smith*, 139 Wn.2d 199, 205, 986 P.2d 131 (1999). It does not apply “if other factors, such as context and language in related statutes, indicate contrary intent or if applying the rule would result in an absurd or nonsensical interpretation.” *Bunker*, 169 Wn.2d at 578.

The “series-qualifier principle,” for example, addresses a common indicia of contrary intent. Under the series-qualifier principle, when there is a list of all nouns or verbs in a series, a modifier at the end of the list normally applies to the entire series when doing so yields a sensible construction of the statute.⁹ *Lockhart v. United States*, 136 S. Ct. 958, 965, 194 L. Ed. 2d 48 (2016) (citing *Paroline v. United States*, 134 S. Ct. 1710, 1721, 188 L. Ed. 2d 714 (2014)); *In re Estate of Pawlik*, 845 N.W.2d 249, 252 (Minn. 2014).

The series-qualifier principle reflects the ordinary, intuitive way people make sense of language. *See Lockhart*, 136 S. Ct. at 969-70 (Kagan, dissenting) (illustrating the point with multiple examples drawn from casual speech and case law). As Justice Kagan aptly observed, for example, if a real estate agent agreed to find you “a house, condo, or

⁹ Justice Antonin Scalia, in collaboration with Bryan Garner, coined the term “series-qualifier principle.” *See* A. Scalia & B. Garner, *READING LAW: THE INTERPRETATION OF LEGAL TEXTS* 147 (2012) (“When there is a straightforward, parallel construction that involves all nouns or verbs in a series, a modifier [at the beginning or end of the list] normally applies to the entire series.”).

apartment in New York,” you would be annoyed if she sent you information about condos in Maryland. *Id.*

Here, the phrase at issue, “medical assistance, children’s health, or other program under chapter 74.09 RCW” is written in straightforward, parallel construction. Moreover, the qualifier sensibly applies to all listed nouns in the series. The statute is naturally read as referring to the medical assistance *program*, the children’s health *program*, or other *program*. The terms “medical assistance” and “children’s health” are being used as noun adjectives, just like “other,” each of which modifies “program.” It then follows that “under chapter 74.09 RCW” modifies each of the three types of programs described in the statute’s middle clause.

The use of a catchall provision to end the series “medical assistance, children’s health, or other program” is further syntactical evidence contrary to the last antecedent rule. A catchall provision at the end of a list of specific items indicates all preceding antecedents are modified by the entirety of the catchall provision notwithstanding the lack of a final comma. *See, e.g., Paroline*, 134 S. Ct. at 1721 (treating the entirety of the phrase “any other losses suffered by the victim as a proximate result of the offense” as “a summary” of all the preceding types of losses covered). This is because a catchall provision naturally

encompasses the specific antecedents while bringing into the statute similar items. *Id.*

Here, the catchall provision brings into the statute any “other” program under chapter 74.09 RCW *in addition to* the medical assistance program under chapter 74.09 RCW and the children’s health program under chapter 74.09 RCW.

In contrast to this straightforward reading of the statute, the BTA’s interpretation makes the statute ungrammatical and nonsensical. Under the BTA’s reading, the statute applies to health care services covered under “medical assistance” or “children’s health.” There are no health care services covered under “medical assistance” or “children’s health.” These terms have no discernible meaning standing alone. They only make sense when read together with the phrase “program under chapter 74.09 RCW.”

The BTA was wrong to suppose a comma was necessary to associate the phrase “under chapter 74.09 RCW” with “medical assistance” and “children’s health.” Indeed, it would be odd if the statute read “medical assistance, children’s health, or other program, under chapter 74.09 RCW.” The BTA’s mistake was in failing to recognize that each of the items in the list “medical assistance, children’s health, and other” modify “program under chapter 74.09 RCW.” The statute describes the three different types of programs “under chapter 74.09 RCW” that

make up Washington's Apple Health Program. *See* WAC 182-500-0120 ("Apple Health" is the umbrella term for Washington's Medicaid, CHIP, and "state-only funded health care programs").

The series-qualifier principle together with other indicia of contrary intent override the last antecedent rule in this case. The grammatical structure of the statute and the comprehensive applicability of the qualifying phrase compel the conclusion that "program under chapter 74.09 RCW" modifies all of the preceding noun adjectives in the series, not just "other."

Peacehealth argued to the BTA that the reference to "the state of Washington" in the third clause of RCW 82.04.4311 ("or for the state of Washington basic health plan under chapter 74.09 RCW") shows the Legislature "clearly knew how to refer to Washington-specific programs" but it chose instead to use "generic references" in the second clause. AR 201. But the Legislature naturally referred to the State of Washington in describing the Basic Health Plan because that program was created exclusively under Washington law. In contrast, Washington's Medicaid and CHIP programs are federal-state partnerships authorized by a combination of federal and state law. *See* RCW 74.09.500 (establishing "a new program of federal-aid assistance to be known as medical assistance")

and authorizing the HCA to comply with federal law requirements “to secure federal matching funds for such program”).

Moreover, the Legislature did not, in fact, refer generically to medical assistance and children’s health. It referred to the *state law* establishing Washington’s Medicaid and CHIP programs. If the Legislature had intended to expansively apply the deduction to *any* state’s Medicaid or CHIP program, it easily could have done so by referring to the pertinent federal laws (Titles XIX and XXI of the federal social security act), just as it did when authorizing a deduction for the federal Medicare program in the immediately preceding clause. *See United Parcel Service, Inc. v. Dep’t of Revenue*, 102 Wn.2d 355, 362, 687 P.2d 186 (1984) (where the Legislature uses certain statutory language in one instance, and different language in another, there is a difference in legislative intent). Instead, it provided a deduction for the medical assistance or children’s health programs “under chapter 74.09 RCW.”

3. The BTA erred in relying on legislative findings to justify its overly broad interpretation

The BTA also erred by relying on the legislative findings in the 2002 enactment of RCW 82.04.4311 to expand the deduction beyond the programs specified in the statute. The Legislature found that providing publicly financed health care services for elderly, disabled, and low-

income persons is a “vital governmental function” and that it would be inconsistent with that function to tax a public or nonprofit hospital on amounts covered “under a health services program subsidized by federal or state government.” H.B. 2732, 57th Leg., Reg. Sess. (Wash. 2002). AR 248. The BTA viewed the legislative findings as support for reading “medical assistance” and “children’s health” as standalone provisions, unrestricted by the phrase “under chapter 74.09 RCW.” The BTA read too much into the legislative findings.

An enacted statement of legislative intent is properly considered in determining the intended effect of a statute, but it cannot trump the operative statutory provisions or create ambiguity where none exists. *State v. Reis*, 183 Wn.2d 197, 212, 351 P.3d 127 (2015) (express statement of legislative intent to decriminalize use of medical marijuana did not bar criminal prosecution absent an express operative provision). This is true even when the statement of intent “speaks directly to the enacted statute.” *Kilian v. Atkinson*, 147 Wn.2d 16, 23-24, 50 P.3d 638 (2002) (declining to infer a cause of action for age discrimination under WLAD even though the codified legislative findings expressly include age among the types of discrimination harmful to society).

The legislative findings in section one of House Bill 2732 do not broaden the scope of the B&O tax deduction, which is authorized in

sections two and three of the session law. Although the Legislature referred generally to “state government” in the intent section, it specifically described the health services programs established under Washington law when defining the actual scope of the deduction.

If the Legislature had intended to create a deduction for services covered under any state’s Medicaid or CHIP program, it would have referred generally to “a government-funded program” as it did when authorizing B&O tax deductions for amounts received for providing child welfare, mental health, and chemical dependency services. *See* RCW 82.04.4275 (deduction for “providing child welfare services under a government-funded program”); RCW 82.04.4277 (deduction for “providing mental health services or chemical dependency services under a government-funded program). But it did not do so.

Moreover, the legislative findings are entirely consistent with the limitation created by “under chapter 74.09 RCW” when the Legislature’s reference to “state government” is properly understood as referring to the *Washington* state government. Whether the Legislature was purporting to speak on behalf of any other governing body in declaring the state’s public policy is ambiguous at best.

The Legislature is well aware the federal Medicaid program leaves the states free to implement their own health care policies. *See, e.g.,* Laws

of 2011, 1st Spec. Sess., ch 1, § 1 (finding that mounting budget pressures and regulatory constraints have caused many states to consider withdrawing from Medicaid altogether). Each state government must decide for itself whether to provide publicly funded health care to its residents, the extent of such coverage, and how to pay for it.

Other state governments may conclude that taxing a public or nonprofit hospital's Medicaid receipts is entirely consistent with performing the state's vital governmental function of providing health care services for the needy. *See* AR 113 (discussing the "significant variation" in state funding sources, including reliance on "provider taxes" to finance the state share of Medicaid); AR 157 (B. Blasé, "*Medicaid Provider Taxes: The Gimmick That Exposes Flaws With Medicaid's Financing*").

The State of Oregon, for example, funds the bulk of its Medicaid program through a 4.3 percent hospital tax, which it then uses to secure federal matching funds for covered services. AR 153-54 ("Smooth Passage Expected for Four-Year, \$1.4 Billion Hospital Tax"). In fact, the Washington Legislature subsequently enacted similar legislation. *See* Laws of 2010, 1st Spec. Sess., ch. 30 (imposing a new 1% "assessment" on all non-public hospitals, including nonprofit hospitals, "to generate additional state and federal funding for the medicaid program" and increase reimbursement rates), codified as RCW 74.69. AR 108.

The BTA erred by inferring that general references to “state government” in the legislative findings of the 2002 session law showed the intent to provide a tax deduction for health care costs incurred by *other* state governments.

C. Legislative History Confirms the Legislature Intended to Provide a Deduction for the Medical Services Programs Established under Washington Law

Although unnecessary because the plain language of RCW 82.04.4311 limits its scope, a brief review of the history of the statute confirms the Legislature did not intend the deduction to extend to services covered under another state’s Medicaid or CHIP program.

In 1980, the Legislature enacted RCW 82.04.4297 to authorize a deduction for “*amounts received from the United States or any instrumentality thereof or from the state of Washington or any municipal corporation or political subdivision thereof as compensation for, or to support, health or social welfare services rendered by a health or social welfare organization[.]*” Laws of 1980, ch. 37, § 17 (emphasis added). RCW 82.04.4297 allows nonprofit hospitals to deduct the payments it receives from the federal government or from the state of Washington for providing covered services. But the continuing availability of the deduction was cast into doubt when Congress and the Legislature adopted a private managed care model of healthcare delivery. *See* AR 73 (H.B.

Rep. 1624, 57th Leg., 2d Spec. Sess. (Wash. 2001)); AR 87 (H.B. Rep. 2732, 57th Leg., Reg. Sess. (Wash. 2002)).

Under managed care, the government arranges for private managed care organizations to contract directly with the healthcare providers that provide services covered under a health services program. *See St. John Med. Center v. Dep't of Soc. & Health Servs.*, 110 Wn. App. 51, 56, 38 P.3d 383 (2002) (holding that DSHS was not liable for unpaid fees owed to providers contracted by managed care organizations). As a result, health care providers do not receive payment directly from the government; rather, they receive payment from managed care organizations, many of which are for-profit organizations. AR 92, 96.

In the mid-1990s, the Department notified nonprofit hospitals that RCW 82.04.4297 does not apply to amounts received from private managed health care providers. AR 87. This spurred the Washington State Hospital Association to lobby for the passage of a bill redefining "amounts received from the United States . . . or from the state of Washington" to include amounts received from "a managed care organization or other entity that is under contract to manage healthcare benefits" for the federal Medicare program, the State's Basic Health Plan, or "a medical assistance, children's health, or other program authorized under chapter 74.09 RCW."

Laws of 2001, ch. 23, § 2. *See* S.H.B. Rep. on S.H.B. 1624, 57th Leg., 2d Spec. Sess. (2001), at 2-3. AR 73.

In explaining the amendment, the Legislature stated the B&O tax deduction was “intended to provide government with greater purchasing power” when providing publicly funded health care services and that objective would be “thwarted” if the deduction were lost solely because Congress and the Legislature had opted to provide health care services through contractual managed care programs. Laws of 2001, ch. 23, § 1.

Following the passage of House Bill 1624 in 2001, the Department advised the Legislature the statute would be difficult to administer because the amounts hospitals receive from managed care organizations are not necessarily limited to the state-funded share of covered services. AR 229. During the next legislative session, the Legislature enacted House Bill 2732 to address the Department’s concerns.

Whereas the 2001 legislation had referred to “amounts *received from* a managed care organization,” HB 2732 described the subject of the deduction as “amounts *received for* healthcare services” covered under the same government health services programs but excluding patient copayments and deductibles. *Compare* S.H.B. 1624 (Laws of 2001, 2d Spec. Sess., ch. 23, § 2) (emphasis added), *with* H.B. 2732 (Laws of 2002, ch. 314, § 2). AR 71-74; AR 76-79.

The Legislature made no material change in describing the qualifying government programs: the 2001 and 2002 bills both referred to the federal Medicare program, “medical assistance, children’s health, or other program under chapter 74.09 RCW,” and Washington’s Basic Health Plan. Laws of 2002, ch. 314, § 2.

The clear legislative purpose for the 2001 amendment of RCW 82.04.4297 and the 2002 enactment of RCW 82.04.4311 was to preserve the original deduction for amounts “received from the United States . . . or from the State of Washington” for services covered under a government-funded health services program. RCW 82.04.4297.

Nothing in the legislative history indicates the Legislature intended to expand the deduction to services covered under another state’s Medicaid or CHIP program. To the contrary, the Legislature described the subject of the deduction as the federal Medicare program and the state-funded health services programs authorized under Washington law.

D. The Legislature Reasonably Limited the Deduction to Washington’s Medicaid and CHIP Programs

Peacehealth argued to the BTA that it would make “no sense” for the Legislature to limit the statutory deduction to services covered under Washington’s Medicaid program because Medicaid is a “national program, not a state program” that gives the states “very little flexibility”

in how they administer their programs. AR 212, 214. Peacehealth is incorrect. In view of the federal statutory design of Medicaid, it makes perfect sense for the Legislature to limit the deduction to services covered under Washington's Apple Health program.

1. Washington has no authority or control over any other state's Medicaid or CHIP program

Congress deliberately designed Medicaid to give the states a great deal of flexibility and discretion to establish programs consistent with their own needs, policies, and resources. "[S]tate level policy discretion and experimentation" is "Medicaid's hallmark." *Nat'l Fed'n of Indep. Bus.*, 567 U.S. at 630 (Ginsburg, J., concurring in part and dissenting in part).

Medicaid is "a cooperative federal-state program through which the Federal Government provides financial assistance to States so that they may furnish medical care to needy individuals." *Wilder v. Virginia Hosp. Ass'n*, 496 U.S. 498, 502, 110 S. Ct. 2510, 110 L. Ed. 2d 455 (1990).

Although the federal government has regulatory oversight over state Medicaid programs, each state establishes, administers, and funds its own program.¹⁰ *Nat'l Fed'n of Indep. Bus.*, 567 U.S. at 629-30 (Ginsburg, J., concurring in part and dissenting in part).

¹⁰ In its landmark decision addressing the constitutionality of the Affordable Care Act, the Supreme Court invalidated the provisions mandating the expansion of state Medicaid programs as a violation of the sovereign powers reserved to the states under our federalist system of government. *Nat'l Fed. of Indep. Bus.*, 567 U.S. at 519. The decision

Each state has “broad discretion to define the package of benefits it will finance.” *Pharm. Research & Mfrs. of Am. v. Walsh*, 538 U.S. 644, 666, 123 S. Ct. 1855, 155 L. Ed. 2d 889 (2003). For example, each state is responsible for setting its own reimbursement policies, financing methods, contracting procedures, auditing procedures, and cost-sharing policies.

Washington has no control over the amount paid or the services covered by another state; no means to detect or deter fraud, waste or abuse;¹¹ no ability to control, supervise, or even monitor the contracting practices or auditing procedures of other states; and, perhaps most importantly, no right to recoup the State’s expenditures from legally liable third parties or the beneficiary’s estate.¹² *See Bircumshaw v. State*, 194

effectively makes Medicaid expansion voluntary. As a result, the variation among the states has increased dramatically. AR 126.

¹¹ State processes for developing rates may vary in a number of ways. The states have a great deal of discretion in negotiating rates with health plans. *See Medicaid Managed Care: CMS’s Oversight of States’ Rate Setting Needs Improvement*. (Washington, DC: U.S. Government Accountability Office), August 2010), <http://www.gao.gov/products/GAO-10-810>, at 5. Each state is responsible for ensuring that its rates are “actuarially sound.” *Id.* In a 2010 report, the GAO reported that Washington was the only state in which the auditor’s office had evaluated the soundness of the State’s rate-setting methodology. *Id.* at 4.

¹² The States are required to recover amounts paid for services covered under its Medicaid program from any responsible third parties and from the estate of a deceased beneficiary. 42 U.S.C. § 1392(a)(25); 42 U.S.C. § 1396p. Upon enrolling a person in a Medicaid program, a State acquires by assignment the right to third party payment for covered expenses. 42 U.S.C. § 1396k. Each state has the duty to recover its Medicaid expenditures to the extent possible. *West Virginia v. Dep’t of Health & Human Servs.*, 289 F.3d 281 (4th Cir. 2002). But Washington has no claim on amounts paid under another State’s Medicaid program and, thus, no possibility of recouping any revenues that would be lost if the State authorized a tax deduction for another state’s Medicaid program.

Wn. App. 176, 380 P.3d 524, 531 (2016) (discussing HCA's authority to recoup Medicaid payments for improperly documented medical services); RCW 74.09.200 (authorizing DSHS "to inspect and audit all records" relating to services covered by the State). Moreover, Washington has no right to reciprocal tax relief for amounts paid for health care services Washington residents receive while traveling out of state.

Given that Washington has no regulatory or administrative control over any other state's Medicaid program, the Legislature reasonably limited the deduction to services covered under Washington's Medicaid program. There is no reason to believe the Legislature intended to subsidize any other state's costs for a healthcare program designed to benefit its own residents and over which the State has no regulatory or administrative authority, let alone financial responsibility.

Peacehealth or a competitor may well persuade the Legislature to broaden the scope of the deduction in view of policy arguments they may advance, but until then neither the Department nor the Board is at liberty to interpret the statute more broadly than its plain language.

2. Washington has no obligation to subsidize the health care costs incurred by other state governments

The federal Medicaid program requires the states to balance the competing interests in maximizing the quantity and quality of service

available to eligible state residents while minimizing the burdens imposed on the state's taxpayers who ultimately foot the bill. *See* 42 U.S.C. § 1396a(a)(3)(A) (requiring states “to assure that payments are consistent with efficiency, economy, and quality of care and are sufficient to enlist enough providers”). The perennial challenge for state government is to set rates as low as the market will bear consistent with quality and quantity of service. *See Methodist Hospitals, Inc. v. Sullivan*, 91 F.3d 1026, 1030 (7th Cir. 1996) (states “may behave like other buyers of goods and services in the marketplace: they may say what they are willing to pay and see whether this brings forth an adequate supply. If not, the state [must] raise the price until the market clears”).

One of the tools available to states is to provide a tax deduction to providers in lieu of a direct expenditure of state funds. Financing government services through a tax expenditure is a common and legitimate way for government to provide access to affordable health care. *See, e.g.,* Sean Lowry, *Health-Related Tax Expenditures: Overview and Analysis*, Congressional Research Service, January 8, 2016 (analyzing effects of health-related tax expenditures authorized by the Internal Revenue Code to subsidize the costs of public and private health insurance

programs).¹³ “Both tax exemptions and tax-deductibility are a form of subsidy that is administered through the tax system. A tax exemption has much the same effect as a cash grant to the organization of the amount of tax it would have to pay on its income.” *Regan v. Taxation with Representation of Wash.*, 461 U.S. 540, 544, 103 S. Ct. 1997, 76 L. Ed. 2d 129 (1983).

By providing a tax deduction for Medicaid receipts, the Legislature can alter the tipping point at which a provider might withdraw from participation in the State’s Medicaid program due to the gap between the costs of providing care and Medicaid reimbursement rates. A B&O tax deduction by definition lowers the provider’s costs by 1.5 percent. This makes up for a significant portion of the gap between the costs of providing services and Washington’s Medicaid reimbursement rates. *See* AR 111 (HCA report to the Legislature projecting a 4 percent aggregate gap between the estimated costs of providing inpatient hospital services and Washington’s Medicaid reimbursement payments for 2013). But the deduction applies only to public and nonprofit hospitals (for profit

¹³ For example, since 1918, the federal government has been subsidizing health care costs through a tax deduction for employer-sponsored health insurance. *See* Lowry, *Health-Related Tax Expenditures: Overview and Analysis*, at 5. The report is available at <https://fas.org/sgp/crs/misc/R44333.pdf>.

hospitals and clinics do not qualify), and it does not apply to patient copayments or deductibles.

Giving a tax deduction to nonprofit hospitals extends the purchasing power of the limited dollars available for appropriation from the State's general fund by reducing the gap between hospital costs and the Medicaid reimbursement rates established by the HCA and, thus, in theory, incentivizes more providers to participate in Washington's Apple Health Program.¹⁴ Washington obtains no such benefit by allowing deductions for other states' Medicaid and CHIP programs.

In support of its summary judgment motion, Peacehealth presented declaration testimony by a lobbyist for the Washington State Hospital Association who asserted a tax deduction should be available for any state's Medicaid program because health care markets "do not stop at state lines." AR 252 (Declaration of Carrie Sauer, at ¶ 7). But the State's sovereign power to tax or regulate health care providers *does* end at the state line. Washington's taxing jurisdiction does not extend to the out-of-state hospitals that provide services to Washington residents. Thus, the Legislature cannot offer a tax deduction to an out-of-state hospital as an

¹⁴ Of course, there is no guarantee that the State will recoup the tax revenues it foregoes in the form of reduced healthcare expenditures or increased participation in the State's Medicaid program. As with every tax expenditure, the Legislature is gambling that the net benefits of the tax expenditure will outweigh the costs.

incentive to provide services at a reduced rate. And it cannot collect taxes from an out-of-state hospital to help fund Washington's Medicaid program.

When dealing with out-of-state hospitals, Washington stands in the same position as a private party. *See Asante v. Calif. Dep't of Health Care Servs.*, 886 F.3d 795, 800-01 (9th Cir. 2018) (a state's Medicaid administrator acts "much like that of a private insurer participating in the market" when contracting with out-of-state hospitals for health care services). Like a private party, Washington is subject to the tax burdens other state governments impose on the medical services out-of-state hospitals provide to individuals covered under Washington's Apple Health Program. *See Dep't of Revenue of Kentucky v. Davis*, 553 U.S. 328, 342-43, 128 S. Ct. 1801, 170 L. Ed. 2d 685 (2008) (discussing *Bonaparte v. Tax Court of Baltimore*, 104 U.S. 592, 26 L. Ed. 845 (1881) (each state is subject to the taxes imposed by other states when it engages in out-of-state activities)). Given that reality, it is not surprising the Legislature would confine the scope of the B&O tax deduction to health care services provided to the beneficiaries of Washington's health services programs.

Absent an interstate agreement on reciprocal tax relief, extending the tax deduction to medical services provided to non-residents would

effectively subsidize another state's health services program with no corresponding benefit for Washington taxpayers.

There is no reason to believe the Legislature intended to broadly apply the B&O tax deduction to health care expenditures made by other states. When the Legislature enacted RCW 82.04.4311, it took care to specify the Washington state-funded health insurance programs that qualify for the deduction. The availability of the deduction is a quid pro quo for providing healthcare services covered under Washington's Apple Health Program.

E. Limiting the Scope Of The Deduction Was Permissible Under The Dormant Commerce Clause

The Department anticipates that Peacehealth may argue RCW 82.04.4311 should be interpreted broadly to avoid imposing an undue burden on interstate commerce in violation of the dormant commerce clause. AR 214. The superior court correctly rejected Peacehealth's argument. Limiting the deduction to services covered under Washington's Medicaid program does not raise dormant commerce clause concerns.

The dormant commerce clause prevents the states from using their taxing power or regulatory authority to favor instate *private* interests at the expense of out-of-state *private* interests. But it does not prevent a State from enacting a tax preference that favors the State itself over everyone

else, including other state governments, in performing its traditional governmental function of providing for the public health, safety, or welfare. The controlling authority on this issue is *Davis*, 553 U.S. 328.

In *Davis*, the Supreme Court affirmed Kentucky's right to provide a tax credit for interest paid on bonds issued by local governments while taxing the interest paid by out-of-state municipal bond issuers. The municipal bonds financed various public works projects. The Court dismissed the notion that such preferential tax treatment raised dormant commerce clause concerns.

Considering that the issuance of debt securities to finance public works is "a quintessentially public function," the Supreme Court held that Kentucky was free to provide a tax deduction to help lower its own costs of borrowing money, while denying such a deduction for interest paid by out-of-state bond issuers. *Davis*, 553 U.S. at 341. The Court reasoned that a state's preference for its own citizens in providing public goods or services is exempt from dormant commerce clause scrutiny "owing to its likely motivation by legitimate objectives distinct from the simple economic protectionism the [Commerce Clause] abhors." *Id.* Our federalist system protects the sovereign authority of the states to carry out their traditional government functions as they see fit. *Id.*

Providing publicly-financed health services to the needy is as much a “quintessentially public function” as borrowing money to finance public projects, with roots running just as deep. *See, e.g., St. Luke’s Hosp. v. Stevens County*, 181 Wash. 360, 362-63, 42 P.2d 1109 (1935) (each county has a duty to cover emergency medical expenses for indigent persons who fall sick in the county) (citing Rem. Rev. Stat. section 9986).

Following *Davis*, the Legislature was free to provide a tax deduction for amounts Washington hospitals receive for providing services authorized and financed by the State itself. The Legislature was not required to forego tax revenues on amounts Peacehealth earned from providing services paid for by any other state government.

Washington is free to decide to spend more on its healthcare programs than Oregon does, and to limit its benefits to Washington residents. *Cf. Asante*, 886 F.3d at 800-01 (holding that California’s purportedly disparate treatment of out-of-state hospitals in setting Medicaid reimbursement rates is exempt from dormant commerce clause restrictions).

It is well-established that state-provided benefits may be limited to bona fide residents. “Neither the overnight visitor, the unfriendly agent of a hostile foreign power, the resident diplomat, nor the illegal entrant, can advance even a colorable constitutional claim to a share in the bounty that

a conscientious sovereign makes available to its own citizens.” *Matthews v. Diaz*, 426 U.S. 67, 78, 96 S. Ct. 1883, 48 L. Ed. 2d 478 (1976). The Legislature was no more required to authorize a tax deduction for services covered under Oregon’s Medicaid or CHIP programs than to grant Oregon residents benefits under Washington’s Apple Health Program.

VI. CONCLUSION

A tax deduction is a matter of legislative grace. Whether RCW 82.04.4311 should be extended to medical services covered under another state’s Medicaid or CHIP program is a policy question for the Legislature. This is a textbook case for why tax deduction statutes are narrowly construed. Medicaid is Washington’s second greatest expenditure, after basic education. Each year the Legislature strains to extend the purchasing power of the limited taxpayer dollars available for appropriation to the State’s Medicaid and CHIP programs. RCW 82.04.4311 provides a limited deduction to public and nonprofit hospitals in Washington for amounts received for providing services covered only under the array of health services programs comprising Washington’s Apple Health Program.

RCW 82.04.4311, construed “strictly, though fairly,” applies only to amounts covered under the medical assistance, children’s health, and other medical services programs authorized “under chapter 74.09 RCW.” The statute does not extend to amounts Peacehealth received for providing

services covered under another state's Medicaid or CHIP program. Thus, this Court should affirm the superior court's order reversing the BTA's summary judgment order.

RESPECTFULLY SUBMITTED this 21st day of May, 2018.

ROBERT W. FERGUSON
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I certify under penalty of perjury under the laws of the State of
Washington that the foregoing is true and correct.

DATED this 21st day of May, 2018, at Tumwater, WA.


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ATTORNEY GENERAL'S OFFICE - REVENUE & FINANCE DIVISION

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