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**SUPREME COURT OF THE STATE OF WASHINGTON**

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PEACEHEALTH ST. JOSEPH MEDICAL CENTER AND  
PEACEHEALTH ST. JOHN MEDICAL CENTER,

*Petitioners,*

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

*Respondent.*

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**STATE OF WASHINGTON, DEPARTMENT OF REVENUE'S  
SUPPLEMENTAL BRIEF**

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## I. INTRODUCTION

For forty years, Washington has provided public and nonprofit hospitals a Business and Occupation tax deduction on reimbursements for healthcare and social services subsidized by the State of Washington and the federal government. While the deduction has evolved slightly to account for industry-wide changes in administering subsidized healthcare, the plain text and structure of the authorizing statute, its legislative history, and relevant case law all support the Court of Appeals' conclusion that the deduction applies only to compensation for Washington's Medicaid and Children's Health Insurance Programs.

Moreover, this Court does not need to construe the deduction broadly to avoid a violation of the dormant Commerce Clause. The deduction here falls within two separate exceptions to the dormant Commerce Clause: the traditional government function exception and the market participant exception. By granting the deduction, the Legislature simply chooses not to tax its own money provided in the form of healthcare subsidies. The deduction thus fulfills the same purpose as the subsidies themselves—to support the State's core civic responsibility to protect the health, safety, and welfare of its residents and to stretch the State's own dollars in purchasing healthcare for its residents. In fulfilling these purposes, the deduction also complies with the design of the federal Medicaid program, which grants states flexibility in choosing the amount and types of benefits to offer its residents, while asking states only to

shoulder the costs of their own residents' care. The deduction does not violate the dormant Commerce Clause.

This Court should affirm.

## **II. STATEMENT OF ISSUES**

1. Is the Business & Occupation tax deduction under RCW 82.04.4311 limited to reimbursements for services covered under Washington's Medicaid, CHIP, and other Washington State-subsidized health services programs?

2. Does limiting a tax deduction to reimbursements for Washington's Medicaid and CHIP programs violate the dormant Commerce Clause?

## **III. STATEMENT OF THE CASE**

### **A. History of the Business and Occupation Tax Deduction**

The Business & Occupation (B&O) tax deduction originated in a statute, RCW 82.04.4297, passed forty years ago.<sup>1</sup> In its original form, the deduction covered amounts received "from" the federal government or Washington "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 (former RCW 82.04.4297). By its plain terms, the deduction did not apply to reimbursements received from other states.

In 2001, the Legislature amended the statute to address a reimbursement gap created by the "managed care revolution" of the mid to

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<sup>1</sup> Absent a statutory exception, public and nonprofit hospitals with business activities in the State pay B&O taxes of 1.5% of gross receipts. RCW 82.04.260(10).

late 1990s. See Carlos Zarabozo, *Milestones in Medicare Managed Care*, 22 Health Care Financing Rev. 65 (Fall 2000).<sup>2</sup> With managed-care organizations increasingly serving as intermediaries for delivery and compensation of subsidized care, reimbursement for such care was no longer directly received “from” the federal government or Washington State, jeopardizing the ability of public and non-profit hospitals to claim a deduction under RCW 82.04.4297.

The Legislature enacted SHB 1624<sup>3</sup> in 2001 to address this specific issue. SHB 1624 amended RCW 82.04.4297 by extending the deduction to “amounts received from” “a managed care organization or other entity that is under contract to manage health care benefits for the federal Medicare program authorized under Title XVIII of the federal social security act; for a medical assistance, children’s health, or other program authorized under chapter 74.09 RCW; or for the state of Washington basic health plan authorized under chapter 70.47 RCW . . . .” SHB 1624, § 2 (App. A at 3). The amendment’s stated objective was to provide the government with “greater purchasing power” in providing subsidized care to “benefited classes of persons” by extending the deduction to “compensation received from government sources through contractual managed care programs.” SHB 1624, § 1.

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<sup>2</sup> [https://pdfs.semanticscholar.org/6e1f/1f02af96ac055baa28ec797473c6ec478053.pdf?\\_ga=2.131956747.560007565.1583779065-334744982.1583779065](https://pdfs.semanticscholar.org/6e1f/1f02af96ac055baa28ec797473c6ec478053.pdf?_ga=2.131956747.560007565.1583779065-334744982.1583779065).

<sup>3</sup> Substitute H.B. 1624 (SHB 1624), § 2, 57th Leg., 2d Sp. Sess. (Wash. 2001) (attached as App. A) (Laws of 2001, 2d Spec. Sess., ch. 23, § 2).

In 2002, the Legislature again addressed the B&O tax deduction to address a concern raised by the Department of Revenue about the administrative burdens of SHB 1624, requiring taxpayers and the Department to “trace” dollars back through a managed care organization’s records to differentiate taxable from deductible receipts. AR 229-30. The Department proposed a revision eliminating the need for such tracing by exempting amounts received “*for*” healthcare services under the specified programs, instead of amounts received “*from*” managed care organizations under the same programs. *Compare* HB 2732<sup>4</sup> § 2 (emphasis added) (App. B at 3), *with* SHB 1624 § 2 (emphasis added) (App. A at 3).

The Department stated that the “fiscal impact of this proposal should be minimal.” AR 238-39. In adopting the Department’s proposed fix, the Legislature moved the language originating in SHB 1624 into a new, separate statute, RCW 82.04.4311. RCW 82.04.4311 now allows a public or nonprofit hospital in Washington 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.

(Emphasis added.) The deduction excludes “amounts received from patient copayments or patient deductibles.” RCW 82.04.4311.

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<sup>4</sup> H.B. 2732 (HB 2732), 57th Leg., Reg. Sess. (Wash. 2002) (attached as App. B) (Laws of 2002, ch. 314, § 2).

## **B. Federal and State Structure of Medicaid and CHIP**

The federal Medicaid program consists of 56 distinct state-level Medicaid plans, each designed, administered, and funded by state government. AR 150. Medicaid is “designed to advance cooperative federalism.” *Wis. Dep’t of Health & Family Servs. v. Blumer*, 534 U.S. 473, 495, 122 S. Ct. 962, 151 L. Ed. 2d 935 (2002). Within this framework, 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).

State Medicaid programs thus vary widely. AR 150. States 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. Sebelius*, 567 U.S. 519, 629, 132 S. Ct. 2566, 183 L. Ed. 2d 450 (2012) (Ginsburg, J., concurring in part); see Brietta R. Clark, *Medicaid Access & State Flexibility: Negotiating Federalism*, 17 *Hous. J. Health L. & Pol’y* 241 (2017). The Affordable Care Act in 2010 further broadened state-level policy discretion.<sup>5</sup> As long as states operate within federal guidelines, the federal government reimburses a portion of each state’s Medicaid expenses. AR 147; 42 U.S.C. § 1396(a)-(e).

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<sup>5</sup> See Samantha Artiga et al., *Current Flexibility in Medicaid: An Overview of Federal Standards and State Options* 3-11 (Kaiser Family Found. Jan. 2017), <http://files.kff.org/attachment/Issue-Brief-Current-Flexibility-in-Medicaid-An-Overview-of-Federal-Standards-and-State-Options>.

Congress enacted the CHIP program in 1997 to enable states to provide coverage for children in low-income families that earn too much to qualify for Medicaid. 42 U.S.C. § 1397aa. As with Medicaid, each state designs, administers, and finances its own CHIP program within federal guidelines and is eligible to receive federal funding. 42 U.S.C. § 1397ee. As a practical matter, CHIP operates as an extension of a state’s Medicaid program. WAC 182-500-0120.

**C. Procedural History and the Court of Appeals’ Opinion**

Petitioners PeaceHealth St. Joseph Medical Center and PeaceHealth St. John Medical Center (together PeaceHealth) applied for a refund of B&O taxes paid between December 1 to 31, 2008, on Medicaid and CHIP reimbursements received from other states. *PeaceHealth St. Joseph Med. Ctr. v. Dep’t of Revenue*, 9 Wn. App. 2d 775, 449 P.3d 676 (2019), review granted, 194 Wn.2d 1016 (2020). The Department denied the request. *Id.* The Board of Tax Appeals reversed, granting the refund. *Id.* The Department appealed, and the superior court reversed. *Id.*

PeaceHealth appealed, and the Court of Appeals affirmed. *Id.* at 777. The Court of Appeals held that the operative statutory language—“medical assistance, children’s health, or other program under chapter 74.09 RCW”—applied solely to Washington’s Medicaid, CHIP, and other state-funded public health services programs covered “under chapter 74.09 RCW.” *Id.* at 780-83 (quoting RCW 82.04.[4311]). The Court of Appeals also held that the statutory deduction did not raise dormant Commerce Clause concerns because, under *Department of Revenue of Kentucky*

*v. Davis*, 553 U.S. 328, 128 S. Ct. 1801, 170 L. Ed. 2d 685 (2008), the deduction supported Washington’s efforts to provide healthcare to indigent state residents. *Id.* at 783-84.

#### IV. ARGUMENT

##### A. **The B&O Tax Deduction Does Not Apply to Other States’ Reimbursement of Care For Out-of-State Residents**

RCW 82.04.4311’s plain language is unambiguous. The plain language and statutory scheme support the Court of Appeals’ conclusion that the B&O tax deduction does not apply to amounts that other states pay hospitals to treat out-of-state residents under Medicaid or CHIP. The statute’s legislative history, if considered, supports this conclusion.

PeaceHealth bears the burden of establishing the tax deduction. *Group Health Coop. of Puget Sound, Inc. v. Wash. State Tax Comm’n*, 72 Wn.2d 422, 429, 433 P.2d 201 (1967). Any deduction must be construed “strictly,” though fairly against the taxpayer to avoid unanticipated revenue losses. *Lacey Nursing Center, Inc. v. Dep’t of Revenue*, 128 Wn.2d 40, 49-50, 905 P.2d 338 (1995). Courts grant “great weight” to an agency’s interpretation of an ambiguous statute within its expertise. *First Student, Inc. v. Dep’t of Revenue*, 194 Wn.2d 707, 717, 451 P.3d 1094 (2019) (deference granted to agency, not quasi-judicial body). Courts discern plain meaning from the ordinary meaning of the language, the context of the statute, related provisions, and the statutory scheme. *Id.* at 710-11.

Here, the parties’ dispute focuses on the second clause of RCW 82.04.4311, which provides a deduction for amounts received for

services “covered under” “medical assistance, children’s health, or other program under chapter 74.09 RCW.” The Court of Appeals correctly applied the “series qualifier”<sup>6</sup> rule over the “last antecedent rule” advocated by PeaceHealth. *PeaceHealth*, 9 Wn. App. 2d at 780-83.

PeaceHealth never disputed that the two textual signals for the “series-qualifier” rule apply here. The modifier—“program under chapter 74.09 RCW”—makes sense as applied to each item in the series and also appears “at the end of a single, integrated list.” *Id.* at 781 (citing *Lockhart v. United States*, 136 S. Ct. 958, 965, 194 L. Ed. 2d 48 (2016)). Each item in the series here—“medical assistance, children’s health, or other”—refers to different types of “program[s] 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”). “Medical assistance program” refers to Washington’s Medicaid program. *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 [Health Care] authority”). “Children’s health program” refers to the CHIP program authorized under RCW 74.09.470(1) (directing the Health Care Authority to take actions to secure federal funding for “the state children’s health insurance program”). And RCW 74.09 authorizes a number of “other programs” for which federal

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<sup>6</sup>Under the series-qualifier rule, “there is a presumption that ‘when there is a straightforward, parallel construction that involves all nouns or verbs in a series, a prepositive or postpositive modifier normally applies to the entire series.’” *PeaceHealth*, 9 Wn. App. 2d at 781 (quoting *Black’s Law Dictionary* (10th ed. 2014)).

matching funds are not available. *See e.g.*, RCW 74.09.035 (medical care services for the aged, blind, or disabled, and lawful immigrants ineligible for Medicaid); RCW 74.09.800 (maternity care access).

Combining these different programs authorized under the same chapter “in the same clause in a straightforward and parallel construction,” makes perfect grammatical and syntactical sense. *PeaceHealth*, 9 Wn. App. 2d at 782; *see also Paroline v. United States*, 572 U.S. 434, 447, 134 S. Ct. 1710, 188 L. Ed. 2d 714 (2014) (“When several words are followed by a clause which is applicable as much to the first and other words as to the last, the natural construction of the language demands that the clause be read as applicable to all.” (quoting *Porto Rico Ry., Light & Power Co. v. Mor*, 253 U.S. 345, 348, 40 S. Ct. 516, 64 L. Ed. 944 (1920))). This construction is also consistent with the use of “other program” as a catchall phrase that “bring[s together] within a statute categories similar in type to those specifically enumerated.” *Id.* at 447 (quoting *Fed. Maritime Comm’n v. Seatrain Lines, Inc.*, 411 U.S. 726, 734, 93 S. Ct. 1773, 36 L. Ed. 2d 620 (1973)). As the Court of Appeals explained, the statutory language is most naturally read as “medical assistance [program under chapter 74.09 RCW], children’s health [program under chapter 74.09 RCW], or other program under chapter 74.09 RCW[.]” *PeaceHealth*, 9 Wn. App. 2d at 782 (quoting RCW 82.04.[4311]).

Applying the series-qualifier rule also comports with the internal logic and structure of the statute as a whole, which identifies each category of deductible reimbursements by reference to the law authorizing the

qualifying program. Consistent with this structure, the deduction applies to two additional categories of reimbursements for services “covered under” (1) the “federal medicare program authorized under Title XVIII of the federal social security act” and (2) the “state of Washington basic health plan under chapter 70.47 RCW.” *See* RCW 82.04.4311. The Legislature’s use of semicolons to create three parallel categories of deductible receipts, each identified by reference to the laws authorizing the qualifying programs, further supports applying the series-qualifier rule here. *PeaceHealth*, 9 Wn. App. 2d at 783.<sup>7</sup>

If considered, the legislative history further reinforces the Court of Appeal’s conclusion. The operative language here originated in SHB 1624, which the Legislature passed with the express purpose of stretching the State’s “purchasing power,” “in keeping with the original purpose of the deduction,” to account for the rising use of managed-care organizations as fiscal intermediaries in reimbursing subsidized care. SHB 1624, § 1 (App. A at 2). SHB 1624 achieved this goal by amending RCW 82.04.4297 to allow deductions not only for reimbursements received “from” Washington and the federal government, but also “from” managed-care organizations for the same subsidy programs. *PeaceHealth* did not argue below that SHB 1624 expanded the deduction to include reimbursements for other states’

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<sup>7</sup> While *PeaceHealth* argues that the definition of “medical assistance” in RCW 74.09.010(14) refers to the federal Medicaid program, other states’ residents are not “covered under” the operative provisions of RCW 74.09 and its implementing regulations. *See, e.g.*, RCW 74.09.510 (directing Washington health care authority to establish eligibility requirements); WAC 182-503-0520 (defining Washington residency requirement for Apple Health programs).

Medicaid and CHIP programs. *See* Resp. Br. of Appellant PeaceHealth at 12-13, 16-18.

PeaceHealth instead argued that the Legislature expanded the deduction in 2002 when it adopted the Department's suggested legislative fix for the "tracing" difficulties created by SHB 1624. Resp. Br. of Appellant PeaceHealth at 12-13, 16-18. But the operative language in the 2002 bill identifying the programs qualifying for the deduction remained substantively identical to the operative language in SHB 1624. *Compare* HB 2732, § 2 (App. B at 3), *with* SHB 1624, § 2 (App. A at 3). When the Legislature adopted the Department's proposed fix in 2002, it never indicated an intent to forego an untold amount of additional tax revenue to expand the deduction to cover reimbursements from other states. To the contrary, the Department made clear that the "fiscal impact" of its own proposed changes "should be minimal." AR 239.

Construing the deduction to apply to reimbursements from other states also makes little sense within the overall statutory scheme. The original deduction in RCW 82.04.4297 continues to be limited to reimbursements received "from" the federal government or Washington State and their instrumentalities/subsidiaries. Consistent with this scheme, RCW 82.04.4311 should be construed as a way to maintain the intended scope of the original exemption, whether paid by the government or an intermediary, while also relieving taxpayers and the Department of the burden of "tracing" dollars to determine taxable versus deductible receipts.

PeaceHealth reads too much into the legislative finding that providing healthcare to needy residents is “a recognized, necessary, and vital governmental function” and that it would be “inconsistent” with this function to tax amounts subsidized by “federal or state government.” HB 2732, § 2 (App. B at 3). A statute’s statement of intent must be read in the context of statute’s operative provisions, which controls the analysis. *State v. Reis*, 183 Wn.2d 197, 212, 351 P.3d 127 (2015). The reference to “state government” here is most reasonably understood to refer to Washington State government, the only governmental functions and duties the Legislature controls. This interpretation is also consistent with Medicaid’s overall structure, which only requires states generally to cover the costs of their own residents’ care. *See generally infra* note 5.

The requirement that deductions be narrowly construed also weighs heavily here. *Lacey Nursing Center*, 128 Wn.2d at 49-50. The deduction’s basic scope here has remained relatively constant for 40 years. The fact that the Legislature has never explicitly indicated an intent to forego substantial tax revenues in connection with the 2002 changes to the B&O tax deduction is all the more reason it should be construed narrowly.

PeaceHealth’s proposed interpretation of RCW 82.04.4311 conflicts with the statute’s plain language and structure, its legislative history, and the statutory scheme as a whole. This Court should affirm the Court of Appeals’ determination that the deduction in RCW 82.04.4311 does not apply to Medicaid and CHIP reimbursements from other states.

**B. The B&O Tax Deduction Does Not Violate the Dormant Commerce Clause**

**1. Washington Does Not Discriminate Against Interstate Commerce in Exercising an Essential Governmental Function of Providing Healthcare to Its Own Residents**

The B&O tax deduction here supports Washington’s exercise of its essential governmental function of providing healthcare to its most vulnerable residents. A state’s exercise of its traditional government functions to protect the welfare of its citizens does not discriminate against interstate commerce under the dormant Commerce Clause.

The Commerce Clause empowers Congress to “regulate Commerce . . . among the several States.” U.S. Const. art. I, § 8, cl. 3. While the Constitution does not expressly prohibit state regulation of interstate commerce, the U.S. Supreme Court has long recognized such an implied restraint under the dormant Commerce Clause. The dormant Commerce Clause prohibits “economic protectionism,” which the Supreme Court defines as “regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.” *Dep’t of Revenue of Kentucky v. Davis*, 553 U.S. 328, 338, 128 S. Ct. 1801, 170 L. Ed. 2d 685 (2008) (quoting *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 273-74, 108 S. Ct. 1803, 100 L. Ed. 2d 302 (1988)).

The dormant Commerce Clause does not, however, prevent a state from favoring its *own* interests in performing its traditional government functions. *Id.* States are not “substantially similar entities” as private economic actors for purposes of the dormant Commerce Clause

analysis. *United Haulers Ass’n, Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 342, 127 S. Ct. 1786, 167 L. Ed. 2d 655 (2007) (“any notion of discrimination assumes a comparison of substantially similar entities” (quoting *General Motors Corp. v. Tracy*, 519 U.S. 278, 298, 117 S. Ct. 811, 136 L. Ed. 2d 761 (1997))). States are “vested with the responsibility of protecting the health, safety, and welfare of [their] citizens.” *Id.* at 342 (alteration in original). Laws favoring states in the performance of such duties thus generally have “legitimate objectives distinct from the simple economic protectionism the Clause abhors.” *Davis*, 553 U.S. at 341. In light of states’ civic responsibilities, it does not make sense to view “laws favoring local government and laws favoring private industry with equal skepticism.” *United Haulers*, 550 U.S. at 343. When a state exercises a “quintessentially public function” (*Davis*, 553 U.S. at 342), it is not required to “treat itself as being ‘substantially similar’” to private actors (*id.* at 343). This exception is “independent[] of the market participation” exception. *Id.* at 339.

Applying the traditional government function exception, the U.S. Supreme Court has upheld regulations favoring a state’s fulfillment of its core civic responsibilities. In *Davis*, for example, the Court upheld a Kentucky tax deduction that applied only to interest earned on in-state municipal bonds. The Court approved the deduction because it favored the state’s interests in incentivizing the purchase of the bonds, and bond proceeds, in turn, helped the state shoulder its “cardinal civic responsibilities” to protect the health, safety and welfare of its

residents. *Id.* at 342. Similarly, in *United Haulers*, the Court upheld a “flow control ordinance” requiring private waste haulers to process waste at a state-operated facility because the regulation supported the government’s exercise of its traditional public function in managing waste. *United Haulers*, 550 U.S. at 342-45. In both cases, the Court determined that the laws supported the local governments, rather than protecting in-state private economic interests at the expense of out-of-state private economic interests, and thus did not violate the dormant Commerce Clause.

The reasoning of *Davis* and *United Haulers* applies squarely here. The B&O tax deduction here supports a quintessentially public function of providing healthcare to Washington’s most vulnerable residents. *See Davis*, 553 U.S. at 342-43; *see also St. Luke’s Hosp. v. Stevens County*, 181 Wash. 360, 42 P.2d 1109 (1935) (each county has a duty to cover emergency medical services for the indigent who fall ill within the county). Medicaid is Washington’s second greatest expenditure, after basic education. AR 124. The Legislature itself recognized that providing healthcare to vulnerable residents is “a recognized, necessary, and vital governmental function.” HB 2732, § 1 (App. B at 2). The Legislature also identified the B&O deduction as a way to stretch the State’s “purchasing power” in fulfilling this core civic duty. SHB 1624, § 1 (App. A at 2). By exempting public and nonprofit hospitals from paying B&O tax when they treat Washington patients under Washington’s Medicaid and CHIP programs, the Legislature simply chooses not tax its own subsidies. In economic terms, providing a deduction thus operates much the same way as subsidizing the care. *Regan v. Taxation*

*with Representation of Wash.*, 461 U.S. 540, 544, 103 S. Ct. 1997, 76 L. Ed. 2d 129 (1983) (“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.”).

*Davis*’s traditional government function analysis applies here, not the analysis that PeaceHealth relies on from *Camps Newfound/Owatonna, Inc. v. Town of Harrison, Me.*, 520 U.S. 564, 575-76, 117 S. Ct. 1590, 137 L. Ed. 2d 852 (1997). There, the Court struck down a state tax law that offered a less generous property tax exemption to charities that primarily served out-of-state residents than to charities that primarily served in-state residents. *Id.* at 568. But the state in *Camps NewFound* did not exercise a “traditional government function” in providing summer camp services to its residents: it provided no services at all. *Camps NewFound* underscores the lack of economic protectionism here, where the deduction serves a core public function of mitigating the cost of healthcare of Washington’s residents directly subsidized by the State.<sup>8</sup>

This Court should also reject PeaceHealth’s argument that the deduction does not directly impact Washington’s Medicaid outlays and thus cannot fall within the “traditional government function” exception. PeaceHealth applies the wrong test. The Court in *Davis* focused solely on the “public character” of the activity supported by the deduction, not the

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<sup>8</sup> The out-of-pocket costs of all Medicaid and CHIP patients are determined by their respective states’ laws and plans, and federal law. *See* 42 U.S.C. § 1396o; 42 C.F.R. §§ 447.50-.57.

dollar-for-dollar benefit obtained by the state. *Davis*, 553 U.S. at 342. This makes perfect sense because a state’s efforts to protect the health, safety, and welfare of its citizens will often result in financial costs to a state in exchange for benefits to its citizens. The touchstone of the government function analysis is not whether a state directly benefits from a deduction, but whether the deduction supports the state’s core civic responsibilities to its citizens. *Id.*<sup>9</sup> The deduction here unquestionably serves this public purpose and, as such, does not discriminate against interstate commerce.

**2. The Dormant Commerce Clause Does Not Apply to Washington’s Participation in the Market for Subsidized Healthcare**

The tax deduction here also falls within the broader rubric of the market participant exception, an independent basis for concluding there is no dormant Commerce Clause violation. *See Davis*, 553 U.S. at 342.

The U.S. Supreme Court has made clear that the dormant Commerce clause restrains state action solely as a market regulator, not as market participant. *White v. Mass. Council of Constr. Emp’rs, Inc.*, 460 U.S. 204, 206, 103 S. Ct. 1042, 75 L. Ed. 2d 1 (1983). The key distinction between a state’s role as market regulator versus market participant is whether the challenged action “reach[es] beyond the immediate parties with which the

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<sup>9</sup> The Court in *Davis* left open the question of whether the balancing test under *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142, 90 S. Ct. 844, 25 L. Ed. 2d 174 (1970) applies when the state exercises its essential government functions. Even assuming the test applied, the Court held that it was not in the best position to weigh the relative costs and benefits of the tax deduction on interstate commerce given the complexity of the issue. *Davis*, 553 U.S. at 354-56. Here, to the extent the *Pike* balancing test applies, PeaceHealth has not shown any burden to interstate commerce, much less that the burdens of the deduction “clearly outweigh the benefits.” *Id.*

government transacts business.” *Asante v. Cal. Dep’t of Health Care Servs.*, 886 F.3d 795, 801 (9th Cir. 2018) (quoting *Big Country Foods, Inc. v. Bd. of Educ. of Anchorage Sch. Dist.*, 952 F.2d 1173, 1178 (9th Cir. 1992)). An effort to impact downstream commerce indicates a state’s effort to regulate, not just participate in the relevant market. *White*, 460 U.S. at 204. When a state participates directly in a given market, it is free to use its own resources in favor of its own citizens. *Id.* at 206.

Here, the state is a direct participant in the market for healthcare services when it provides subsidies to hospitals and fiscal intermediaries to reimburse the care of Washington residents participating in Washington’s Medicaid and CHIP programs. Purchasing these services, as the state does, is participating in, not regulating, the market. As the Ninth Circuit recently recognized in *Asante*, 886 F.3d at 801, the state’s role in the healthcare market is analogous to that of a private insurer. Just as with private insurance plans, hospitals choose whether to participate in each state’s Medicaid plan: no hospital is forced to participate. *Id.*; *St. John Med. Ctr. v. Dep’t of Soc. & Health Servs.*, 110 Wn. App. 51, 38 P.3d 383 (2002) (hospitals have no legal duty to participate in State’s Medicaid program).

While this case is different from *Asante* because it involves a tax deduction, the plurality decision in *Davis* recognized that the market participation exception nevertheless applies when a state employs regulatory tools, like a tax deduction, to support its participation in a market. As explained in *Davis*, “[i]t simply blinks this reality to disaggregate the Commonwealth’s two roles and pretend that in exempting the income from

its securities, Kentucky is independently regulating or regulating in the garden variety way that has made a State vulnerable to the dormant Commerce Clause.” *Davis*, 553 U.S. at 345. The plurality cited two seminal market participation cases, *White*, and *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 796, 96 S. Ct. 2488, 49 L. Ed. 2d 220 (1976), each of which upheld local governments’ use of “tools of regulation to invigorate its participation” in the markets at issue. *Davis*, 553 U.S. at 346. In neither case did the Court dissect the government’s separate roles; it instead treated the regulatory activity as part of the market participation. *Id.*

This same analysis is persuasive here. *Thalheimer v. City of San Diego*, 645 F.3d 1109, 1127 n.5 (9th Cir. 2011) (Supreme Court plurality opinion treated as persuasive authority). As in *White* and *Davis*, the specific B&O deduction at issue here applies to subsidies that are provided by the State as a participant in the healthcare market. By granting the deduction, the Legislature chooses not to tax the dollars the Legislature itself provides to hospitals and their fiscal intermediaries. The deduction thus operates economically much the same way as the subsidy itself, while providing the Legislature with flexibility of mitigating the healthcare costs of its residents through a tax deduction, rather than through expenditures from the general fund. Under dormant Commerce Clause principles, the deduction should not be considered separately from the economic reality of Washington’s direct participation in the market through the State’s subsidization of the programs supported by the deduction.

The fact that the subsidies are partly funded by the federal government does not take the deduction outside the market participation exception. *Asante*, 886 F.3d at 801-02; *White*, 460 U.S. at 212-13. The deduction here, as in *White*, is “harmonious” with the overall design of Medicaid, in which each state shoulders the burden of care only for their own residents. It does not violate the dormant Commerce Clause.

## V. CONCLUSION

The States respectfully requests that the Court affirm the Court of Appeals decision.

RESPECTFULLY SUBMITTED this 9th day of March 2020.

ROBERT W. FERGUSON

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**PROOF OF SERVICE**

I certify that on this date, I electronically filed this document with the Clerk of the Court using the Washington State Appellate Courts' e-file portal, which will send notification of such filing to all counsel of record at the following:

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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 9th day of March 2020, at Olympia, Washington.

*s/ Wendy R. Otto*  
Wendy R. Otto  
Legal Assistant

# **Appendix A**

CERTIFICATION OF ENROLLMENT

**SUBSTITUTE HOUSE BILL 1624**

57th Legislature  
2001 Second Special Legislative Session

Passed by the House June 4, 2001  
Yeas 87 Nays 0

\_\_\_\_\_  
**Speaker of the House of Representatives**

\_\_\_\_\_  
**Speaker of the House of Representatives**

Passed by the Senate June 14, 2001  
Yeas 48 Nays 0

\_\_\_\_\_  
**President of the Senate**

Approved

\_\_\_\_\_  
Governor of the State of Washington

CERTIFICATE

We, Timothy A. Martin and Cynthia Zehnder, Co-Chief Clerks of the House of Representatives of the State of Washington, do hereby certify that the attached is **SUBSTITUTE HOUSE BILL 1624** as passed by the House of Representatives and the Senate on the dates hereon set forth.

\_\_\_\_\_  
**Chief Clerk**

\_\_\_\_\_  
**Chief Clerk**

FILED

Secretary of State  
State of Washington

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**SUBSTITUTE HOUSE BILL 1624**

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Passed Legislature - 2001<sup>m</sup> Special Session

**State of Washington**

**57th Legislature**

**2001 Regular Session**

**By** House Committee on Finance (originally sponsored by Representatives Morris, Cairnes, Reardon, Conway, Dunshee, Ogden, Pennington, Van Luven, Doumit, Voloria, Dickerson, Fromhold, Anderson and Edwards)

Read first time . Referred to Committee on .

1 AN ACT Relating to the business and occupation tax deduction for  
2 health or social welfare services as applied to government-funded  
3 health benefits paid through managed care organizations; amending RCW  
4 82.04.4297; creating new sections; and declaring an emergency.

5 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

6 NEW SECTION. **Sec. 1.** The legislature finds that the deduction  
7 under the business and occupation tax statutes for compensation from  
8 public entities for health or social welfare services was intended to  
9 provide government with greater purchasing power when government  
10 provides financial support for the provision of health or social  
11 welfare services to benefited classes of persons. The legislature also  
12 finds that both the legislature and the United States congress have in  
13 recent years modified government-funded health care programs to  
14 encourage participation by beneficiaries in highly regulated managed  
15 care programs operated by persons who act as intermediaries between  
16 government entities and health or social welfare organizations. The  
17 legislature further finds that the objective of these changes is again  
18 to extend the purchasing power of scarce government health care  
19 resources, but that this objective would be thwarted to a significant

1 degree if the business and occupation tax deduction were lost by health  
2 or social welfare organizations solely on account of their  
3 participation in managed care for government-funded health programs.  
4 In keeping with the original purpose of the health or social welfare  
5 deduction, it is desirable to ensure that compensation received from  
6 government sources through contractual managed care programs also be  
7 deductible.

8 **Sec. 2.** RCW 82.04.4297 and 1988 c 67 s 1 are each amended to read  
9 as follows:

10 In computing tax there may be deducted from the measure of tax  
11 amounts received from the United States or any instrumentality thereof  
12 or from the state of Washington or any municipal corporation or  
13 political subdivision thereof as compensation for, or to support,  
14 health or social welfare services rendered by a health or social  
15 welfare organization or by a municipal corporation or political  
16 subdivision, except deductions are not allowed under this section for  
17 amounts that are received under an employee benefit plan. For purposes  
18 of this section, "amounts received from" includes amounts received by  
19 a health or social welfare organization that is a nonprofit hospital or  
20 public hospital from a managed care organization or other entity that  
21 is under contract to manage health care benefits for the federal  
22 medicare program authorized under Title XVIII of the federal social  
23 security act; for a medical assistance, children's health, or other  
24 program authorized under chapter 74.09 RCW; or for the state of  
25 Washington basic health plan authorized under chapter 70.47 RCW, to the  
26 extent that these amounts are received as compensation for health care  
27 services within the scope of benefits covered by the pertinent  
28 government health care program.

29 NEW SECTION. **Sec. 3.** This act applies to taxes collected after  
30 the effective date of this act, including taxes collected on reporting  
31 periods prior to the effective date of this act.

32 NEW SECTION. **Sec. 4.** This act is necessary for the immediate  
33 preservation of the public peace, health, or safety, or support of the

1 state government and its existing public institutions, and takes effect  
2 immediately.

--- END ---

# **Appendix B**

CERTIFICATION OF ENROLLMENT

**HOUSE BILL 2732**

57th Legislature  
2002 Regular Session

Passed by the House February 18, 2002  
Yeas 97 Nays 1

\_\_\_\_\_  
**Speaker of the House of Representatives**

Passed by the Senate March 12, 2002  
Yeas 48 Nays 0

\_\_\_\_\_  
**President of the Senate**

Approved

\_\_\_\_\_  
**Governor of the State of Washington**

CERTIFICATE

I, Cynthia Zehnder, Chief Clerk of the House of Representatives of the State of Washington, do hereby certify that the attached is **HOUSE BILL 2732** as passed by the House of Representatives and the Senate on the dates hereon set forth.

\_\_\_\_\_  
**Chief Clerk**

FILED

**Secretary of State  
State of Washington**

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HOUSE BILL 2732

---

Passed Legislature - 2002 Regular Session

State of Washington

57th Legislature

2002 Regular Session

By Representatives Gombosky, Cairnes, Berkey, Nixon, Morris, Armstrong, Esser, Fromhold, Ogden, Conway, Hunt, Van Luven, Voloria, Romero, Reardon, Edwards, Chase, Morell, Santos, Kenney and Wood

Read first time 01/25/2002. Referred to Committee on Finance.

1 AN ACT Relating to the tax treatment of revenue from federal or  
2 state subsidized health care; amending RCW 82.04.4297; adding a new  
3 section to chapter 82.04 RCW; creating new sections; and declaring an  
4 emergency.

5 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

6 NEW SECTION. **Sec. 1.** The legislature finds that the provision of  
7 health services to those people who receive federal or state subsidized  
8 health care benefits by reason of age, disability, or lack of income is  
9 a recognized, necessary, and vital governmental function. As a result,  
10 the legislature finds that it would be inconsistent with that  
11 governmental function to tax amounts received by a public hospital or  
12 nonprofit hospital qualifying as a health and social welfare  
13 organization, when the amounts are paid under a health service program  
14 subsidized by federal or state government. Further, the tax status of  
15 these amounts should not depend on whether the amounts are received  
16 directly from the qualifying program or through a managed health care  
17 organization under contract to manage benefits for a qualifying  
18 program. Therefore, the legislature adopts this act to provide a clear

1 and understandable deduction for these amounts, and to provide refunds  
2 for taxes paid as specified in section 4 of this act.

3 NEW SECTION. **Sec. 2.** A new section is added to chapter 82.04 RCW  
4 to read as follows:

5 A public hospital that is owned by a municipal corporation or  
6 political subdivision, or a nonprofit hospital that qualifies as a  
7 health and social welfare organization as defined in RCW 82.04.431, may  
8 deduct from the measure of tax amounts received as compensation for  
9 health care services covered under the federal medicare program  
10 authorized under Title XVIII of the federal social security act;  
11 medical assistance, children's health, or other program under chapter  
12 74.09 RCW; or for the state of Washington basic health plan under  
13 chapter 70.47 RCW. The deduction authorized by this section does not  
14 apply to amounts received from patient copayments or patient  
15 deductibles.

16 **Sec. 3.** RCW 82.04.4297 and 2001 2nd sp.s. c 23 s 2 are each  
17 amended to read as follows:

18 In computing tax there may be deducted from the measure of tax  
19 amounts received from the United States or any instrumentality thereof  
20 or from the state of Washington or any municipal corporation or  
21 political subdivision thereof as compensation for, or to support,  
22 health or social welfare services rendered by a health or social  
23 welfare organization or by a municipal corporation or political  
24 subdivision, except deductions are not allowed under this section for  
25 amounts that are received under an employee benefit plan. ((For  
26 purposes of this section, "amounts received from" includes amounts  
27 received by a health or social welfare organization that is a nonprofit  
28 hospital or public hospital from a managed care organization or other  
29 entity that is under contract to manage health care benefits for the  
30 federal medicare program authorized under Title XVIII of the federal  
31 social security act; for a medical assistance, children's health, or  
32 other program authorized under chapter 74.09 RCW; or for the state of  
33 Washington basic health plan authorized under chapter 70.47 RCW, to the  
34 extent that these amounts are received as compensation for health care  
35 services within the scope of benefits covered by the pertinent  
36 government health care program.))

1        NEW SECTION.    **Sec. 4.**    A public hospital owned by a municipal  
2 corporation or political subdivision, or a nonprofit hospital that  
3 qualifies as a health and social welfare organization under RCW  
4 82.04.431, is entitled to:

5            (1) A refund of business and occupation tax paid between January 1,  
6 1998, and the effective date of this act on amounts that would be  
7 deductible under section 2 of this act; and

8            (2) A waiver of tax liability for accrued, but unpaid taxes that  
9 would be deductible under section 2 of this act.

10        NEW SECTION.    **Sec. 5.**    This act is necessary for the immediate  
11 preservation of the public peace, health, or safety, or support of the  
12 state government and its existing public institutions, and takes effect  
13 immediately.

--- END ---

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