

NO. 36120-5-II

COURT OF APPEALS
FOR THE STATE OF WASHINGTON
DIVISION TWO

WHIDBEY GENERAL HOSPITAL,

Appellant

vs.

STATE OF WASHINGTON
DEPARTMENT OF REVENUE,

Respondent

An Appeal from the Thurston County
Superior Court, Case No. 05-2-02517-1

APPELLANT'S BRIEF

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I. INTRODUCTION

Whidbey General Hospital (“Whidbey”), appellant and plaintiff in this tax refund case, raises two tax issues of first impression in seeking reversal of the trial court’s order granting the Department of Revenue’s (“Department”) motion for summary judgment and denying Whidbey’s cross motion for summary judgment.

The first issue is whether a hospital may deduct federal money it receives under The Civilian Health and Medical Program of the Uniformed Services (“CHAMPUS”) from gross income subject to Washington’s business and occupation (“B&O”) tax. RCW 82.04.4297 allows a hospital to deduct money it receives from the federal government as compensation for providing health services, *except* “for amounts that are received under an employee benefit plan.” Because CHAMPUS is not an “employee benefit plan,” the exception to RCW 82.04.4297 is inapplicable and Whidbey is entitled to the tax refund it seeks.

The second issue is whether Congress and the Department of Defense (“DOD”) have preempted the B&O tax to the extent that it reaches CHAMPUS payments from the federal government. Pursuant to expressly delegated powers from Congress, the DOD has declared that any state law relating to health care delivery or financing methods is preempted and does not apply in connection with CHAMPUS. Because

Washington's B&O tax on hospitals relates to health care delivery and financing, Congress has preempted the tax to the extent that it reaches CHAMPUS payments.

In deciding the parties' cross motions for summary judgment, the trial court ruled that CHAMPUS is an employee benefit plan under RCW 82.04.4297 and that the DOD did not preempt the B&O tax on CHAMPUS income. Whidbey requests that the Court reverse the trial court's grant of summary judgment for the Department on these two issues and enter summary judgment for Whidbey. Whidbey further requests that upon granting Whidbey's motion, the Court remand for entry of judgment in Whidbey's favor for the \$102,723 refund it seeks plus pre-judgment interest, court costs, and any applicable attorney's fees. Finally, Whidbey asks for an award of any applicable appellate costs and attorney's fees under RAP 14.3 and RAP 18.1

II. ASSIGNMENTS OF ERROR

- 1) The trial court erred in granting the Department's motion for summary judgment and denying Whidbey's motion for summary judgment by holding that Whidbey was not entitled to deduct federal CHAMPUS payments from gross income subject to the B&O tax under RCW 82.04.4297.
- 2) The trial court erred in granting the Department's motion for summary judgment and denying Whidbey's motion for summary judgment by holding that federal law does not preempt imposition of the B&O tax on CHAMPUS payments received by a hospital.

III. ISSUES ON APPEAL

1) RCW 82.04.4297 allows a tax deduction for amounts received from the federal government for providing health services, unless the money is received under an employee benefit plan. CHAMPUS is not an employee benefit plan under Black's Law Dictionary, ERISA, Chapter RCW 82, or the Department's definition of the term. Did the trial court err in holding that Whidbey was not entitled to deduct federal CHAMPUS payments from gross income subject to the B&O tax under RCW 82.04.4297?

2) Congress and the Department of Defense have provided that state laws relating to health care financing or delivery are preempted to the extent they impact CHAMPUS. Washington's B&O tax on hospitals is used to fund health care in this state, and it is therefore a state law relating to health care financing and delivery. Did the trial court err in holding that federal law does not preempt imposition of the B&O tax on CHAMPUS payments received by a hospital?

IV. STATEMENT OF CASE

On December 23, 2005, Whidbey filed a notice of appeal for refund of taxes in Thurston County Superior Court. CP 4-7. Whidbey had paid \$102,723 in B&O taxes on January 16, 2001 pursuant to an audit that the Department conducted. CP 5. Whidbey had paid the taxes on

payments it received from the federal government for medical services it had provided under CHAMPUS. CP 5. Whidbey claimed (1) that it was entitled to the tax deduction in RCW 82.04.4297 and (2) that Congress had preempted the B&O tax to the extent that it reached CHAMPUS revenues. CP 5-6.

On February 2, 2007, Whidbey and the Department filed cross motions for summary judgment. CP 8-30, 252-266. Both parties conceded that there were no disputed questions of fact presented by the cross motions for summary judgment. CP 9, 253. In resolving the cross motions for summary judgment, then, the trial decided purely legal questions, meaning that either Whidbey or the Department was entitled to summary judgment.

In an order issued on March 2, 2007, the trial court denied Whidbey's motion for summary judgment and granted the Department's motion for summary judgment. CP 487-489. The trial court found that RCW 82.04.4297 was unambiguous and that CHAMPUS was an "employee benefit plan" under the common and ordinary meaning of the word as defined by the Department. CP 488. Therefore, the trial court concluded:

For purposes of the exception to the tax deduction provided in RCW 82.04.4297, income Whidbey General Hospital receives under the federal Civilian Health and

Medical Program of the Uniformed Services (“CHAMPUS”) is income “received under an employee benefit plan.” Hence, Whidbey General is not entitled to a deduction for such income in calculating its state business and occupation taxes.

CP 488. The trial court also held that “[f]ederal law does not preempt imposition of the State of Washington’s business and occupation taxes on CHAMPUS income received by a hospital.” CP 488.

On March 29, 2007, Whidbey timely and otherwise properly filed a notice of appeal with this Court. CP 490-96. Whidbey requests that the Court reverse the trial court’s grant of summary judgment for the Department and enter summary judgment for Whidbey. Whidbey further requests that upon granting Whidbey’s motion for summary judgment, the Court remand for entry of judgment in Whidbey’s favor for the \$102,723 refund it seeks plus pre-judgment interest and court costs.

V. **ARGUMENT**

A. **Because CHAMPUS is not an Employee Benefit Plan under RCW 82.04.4297, Whidbey is Entitled to Deduct CHAMPUS Payments from Gross Income Subject to the B&O Tax.**

Washington allows a deduction from gross income subject to the B&O tax for amounts received from the federal government as compensation for providing health services, *unless* that money is received under an employee benefit plan:

In computing tax there may be deducted from the measure of tax amounts received from the United States ... as compensation for, or to support, health or social welfare services rendered by a health or social welfare organization ... except deductions are not allowed under this section for amounts that are received under an employee benefit plan.

RCW 82.04.4297.

There is no dispute that Whidbey is a “health or social welfare organization” or that it received amounts from the United States as compensation for providing “health or social welfare services.” CP 256. The only question is whether CHAMPUS is “an employee benefit plan.”

1. CHAMPUS is not an “Employee Benefit Plan” as Defined in Black’s Law Dictionary, so RCW 82.04.4297’s Deduction Applies.

Like any other instance of statutory interpretation, the goal in analyzing whether CHAMPUS is an “employee benefit plan” is to determine and carry out the Legislature’s intent. Sacred Heart Med. Ctr. v. Dep’t of Revenue, 88 Wn. App. 632, 636, 946 P.2d 409 (1997). Because this is a question of law that the trial court decided on summary judgment, the conclusion that CHAMPUS is an “employee benefit plan” is subject to de novo review. W. Telepage, Inc. v. City of Tacoma, 140 Wn.2d 599, 607, 998 P.2d 884 (2000). When engaging in de novo review, the court of appeals undertakes the same inquiry as the trial court. Enterprise Leasing, Inc. v. City of Tacoma, 139 Wn.2d 546, 551, 988 P.2d 961, 964 (1999).

To ascertain the Legislature's intent in creating a statute, courts first look to the statute's language. State v. Watson, 146 Wn.2d 947, 51 P.3d 66 (2002). When that language is unambiguous, it is the sole means of determining the Legislature's intent:

Courts should assume the Legislature means exactly what it says. Plain words do not require construction. The courts do not engage in statutory interpretation of a statute that is not ambiguous. If a statute is plain and unambiguous, its meaning must be derived from the wording of the statute itself.

State v. Keller, 143 Wn.2d 267, 276, 51 P.3d 66 (2002).

A statute is ambiguous only if it is susceptible to more than one *reasonable* interpretation. W. Telepage, Inc., 140 Wn.2d at 608. A statute "is not ambiguous simply because different interpretations are conceivable," Keller, 143 Wn.2d at 276, and a court is not "obliged to discern any ambiguity by imagining a variety of alternative interpretations." W. Telepage, Inc., 140 Wn.2d at 608.

In this case, the term "employee benefit plan" is unambiguous. The Legislature did not specifically define the term for purposes of RCW 82.04.4297. An undefined statutory term is given its common and ordinary meaning as found in a regular dictionary, *unless* the term has an applicable technical meaning. City of Spokane v. Dep't of Revenue, 145 Wn.2d 445, 452-454, 38 P.3d 1010 (2002) (adopting a technical definition over that found in a general purpose dictionary and setting forth other

cases that have done the same).

As the Supreme Court has held, even when a regular dictionary defines a technical term, the term's technical meaning still controls for purposes of interpreting a statute

[W]here an otherwise common word is given a distinct meaning in a technical dictionary ... courts should turn to a technical rather than a general purpose dictionary to resolve ambiguities in its definition.

Id. at 454.

Here, the case for application of a technical meaning is even stronger, because no regular dictionary defines "employee benefit plan." Black's Law Dictionary is the *only* dictionary that defines the term, so there is no ambiguity in how to define it.

Black's defines "employee benefit plan" as coterminous with the definition set forth by The Employee Retirement Income Security Act of 1974 ("ERISA"):

Employee benefit plan. A written stock-purchase, savings, option, bonus, stock-appreciation, profit-sharing, thrift, incentive, pension, or similar plan solely for employees, officers, and advisers of a company. **The term includes an employee-welfare benefit plan, an employee-pension benefit plan, or a combination of those two. See 29 USCA § 1002(3).** But the term excludes any plan, fund, or program (other than an apprenticeship or training program) in which no employees are participants.

Black's Law Dictionary 564 (8th Ed. 2004) (emphasis added).

The highlighted portion of the definition comes from ERISA, which states that “[t]he term ‘employee benefit plan’ ... means an employee welfare benefit plan¹ or an employee pension benefit plan or a plan which is both an employee welfare benefit plan and an employee pension benefit plan.” 29 U.S.C. § 1002(3). According to Black's, then, the technical meaning of “employee benefit plan” is derived from ERISA.²

ERISA's definition of “employee benefit plan” *excludes* governmental programs such as CHAMPUS. 29 U.S.C. § 1003(b)(1). A “governmental plan” is “a plan established or maintained for its employees by the Government of the United States....” 29 U.S.C. § 1002(32). CHAMPUS is a federally-funded health care program that “provides free medical or dental care to active members of the military, military retirees, and their dependents.” McGee v. Funderberg, 17 F.3d 1122, 1125 (8th Cir. 1994) (citing 10 U.S.C. § 1074). Thus, “CHAMPUS, as a governmental program, is excluded from ERISA.” Id.

Because the technical meaning of “employee benefit plan”

¹ A welfare benefit plan, according to ERISA and Black's Law Dictionary, provides employees with, among other things, health care benefits. 29 U.S.C. § 1002(1); Black's Law Dictionary 565 (defining “welfare plan” exactly as ERISA does).

² Arguably, Black's is using a technical definition from ERISA to set forth a common and ordinary definition of the term “employee benefit plan.” Whether this definition is called technical or common and ordinary is immaterial, because under either label, Black's definition, excludes CHAMPUS, still applies.

excludes CHAMPUS, CHAMPUS is not an “employee benefit plan” under RCW 82.04.4297. By extension, CHAMPUS payments cannot be “amounts that are received under an employee benefit plan.” Therefore, RCW 82.04.4297’s deduction applies, CHAMPUS payments are not subject to the B&O tax, and Whidbey is entitled to the refund it seeks.

2. CHAMPUS is not an “Employee Benefit Plan” as Defined in the B&O Tax Chapter, so RCW 82.04.4297’s Deduction Applies.

Although Black’s establishes that ERISA’s definition of “employee benefit plan” applies to this case, adopting that definition makes sense for other reasons. For one, the term also is defined in RCW Chapter 82.04 as coextensive with ERISA’s definition:

An “employee benefit plan,” which includes any plan, trust, commingled employee benefit trust, or custodial arrangement that is subject to the employee retirement income security act of 1974, as amended, 29 U.S.C. Sec. 1001 et seq., or that is described in sections 125, 401, 403, 408, 457, and 501(c)(9) and (17) through (23) of the internal revenue code of 1986, as amended, or a similar plan maintained by a state or local government, or a plan, trust, or custodial arrangement established to self-insure benefits required by federal, state, or local law.

RCW 82.04.293.

This definition is set forth in the context of international investment management services for purposes of the B&O tax on such services under 82.04.290. Id. It is located in the same chapter as both the B&O tax on the gross income of hospitals under RCW 82.04.260(10), and

the deduction at issue in this case under RCW 82.04.4297.

“It is well settled that when the same words are used in different parts of a statute ... the meaning is presumed to be the same throughout.” Simpson Investment Co. v. Dep’t of Revenue, 141 Wn.2d 139, 160, 3 P.3d 741 (2000); see also De Grief v. City of Seattle, 50 Wn.2d 1, 297 P.2d 940 (1956) (“Since ‘state census’ is defined in § 10 of the act, as hereinbefore stated, we must hold that the definition therein provided by the legislature applies equally to § 1. Only by so interpreting these two sections can the act be purposeful and not meaningless.”).

The Legislature’s use of “employee benefit plan” in different parts of the same statute creates a presumption that the definition in RCW 82.04.293 applies to RCW 82.04.4297. The presumption is bolstered by the Department’s adoption of RCW 82.04.293’s definition of “employee benefit plan” for purposes of analyzing whether CHAMPUS payments were deductible under RCW 82.04.4297 in a memorandum it issued on January 14, 2000. CP 298.³

Even if the Court finds that the Department has overcome the presumption that RCW 82.04.293’s definition applies, that definition is

³ In the memorandum, the Department wrote that “RCW 82.04.293 ... relevantly provides a definition of ‘employee benefit plan’ ...” CP 298. Despite adopting this position for purposes of its memorandum, the Department still concluded that CHAMPUS is an employee benefit plan. CP 297-299.

still analogous authority for the proposition that ERISA’s technical definition of “employee benefit plan” applies here. The mere incorporation of ERISA’s definition in RCW 82.04.293 indicates that ERISA is where the Legislature looks when defining “employee benefit plan.”

Other Washington statutes also have recognized ERISA’s authoritativeness in matters concerning employee benefit plans by incorporating its definition of the term or adopting its position that government plans do not fit within it. One such statute is related to enforcement of judgments, which, like ERISA, excludes governmental plans such as CHAMPUS from the definition of employee benefit plan:

The term “employee benefit plan” shall not include any employee benefit plan that is established or maintained for its employees by the government of the United States, by the state of Washington under chapter 2.10, 2.12, 41.26, 41.32, 41.34, 41.35, 41.40 or 43.43 RCW or RCW 41.50.770, or by any agency or instrumentality of the government of the United States.

RCW 6.15.020(4).

Similarly, Washington’s Family Medical Leave Act, in its definition of “employment benefits,” refers and cites directly to ERISA in stating that the term includes “all benefits provided or made available to employees ... through an employee benefit plan as defined in 29 U.S.C. Sec. 1002(3) [ERISA].” RCW 49.78.020(6).

The use of ERISA’s definition in these statutes shows that its definition is authoritative. This makes sense. ERISA is a federal system “designed to promote the interests of employees and their beneficiaries in *employee benefit plans*.” Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 90 (1983) (emphasis added). ERISA broadly preempts any state law “relating to” it. 29 U.S.C. § 1144(a); Puget Sound Elec. Workers Health & Welfare Trust Fund v. Merit Co., 123 Wn.2d 565, 569, 870 P.2d 960 (1994) (“ERISA’s [preemption] provision, however, is virtually unique and is conspicuous for its breadth.”) (quotations and citations omitted). Because ERISA is so comprehensive and ubiquitous in matters related to employee benefit plans, its definition of the term should apply in this case, even if the Court does not adopt Black’s definition of “employee benefit plan” or the definition set forth in RCW 82.04.293.

3. Even under the Department’s Definition, CHAMPUS is not an “Employee Benefit Plan” so RCW 82.04.4297’s Deduction Applies.

The Department argues that the definition of “employee benefit plan” found in Black’s Law Dictionary, ERISA, RCW 82.04.293, and its own memorandum should not apply. Instead, the Department claims that the Court should refer to a regular dictionary and assign the term its common and ordinary meaning. CP 258-262. Even if such a regular dictionary definition existed – and it does not – the Supreme Court still

requires that the term be given its technical meaning. City of Spokane 145 Wn.2d at 452-454.

However, the Court need not even apply this rule, because rather than supply a regular dictionary definition of “employee benefit plan,” the Department combines a dictionary definition of “employee” with its own self-serving definition of “benefit plan” to create what it argues is the term’s common and ordinary meaning.

The Department defines “employee” as one who works for an employer in exchange for financial compensation. CP 258-59 (quoting Webster’s II New Riverside University Dictionary at 429 (1988)).

Without citing to authority, the Department then claims that “[t]he ordinary understanding of ‘benefit plan’ in turn is a plan that provides medical (or other) benefits to a defined class of individuals.” CP 259.

It strains credulity to argue that a particular dictionary definition should provide a term’s common and ordinary meaning when that dictionary does not define the term. If the dictionary it relies on does not define “benefit plan,” the Department cannot supply its own meaning. Indeed, the absence of a source for the Department’s definition suggests that the term has no dictionary definition *outside* of Black’s. Therefore, the definition set forth therein applies.

In the event that the Court applies the Department’s unattributed

definition of “employee benefit plan,” Whidbey is still entitled to RCW 82.04.4297’s deduction. Under the Department’s definition, CHAMPUS is still not an employee benefit plan, because (1) CHAMPUS covers military personnel and their families, not employees, and (2) CHAMPUS is a government plan, not a benefit plan.

- a. *Military personnel are not employees, so CHAMPUS cannot be an employee benefit plan.*

Because CHAMPUS only covers military personnel and their dependents, the Department’s definition of “employee” is only valid if it includes military personnel. But military personnel are not employees in any common and ordinary sense of the word. See CP 298 (Department noting that “some may still question whether uniformed military are employees in the traditional sense); see also CP 304 (Department admitting that “members of the military are not called ‘employees’...”).

First, military personnel, unlike civilian employees, have a legal entitlement to health care. See Barnett v. Weinberger, 818 F.2d 953, 958 (D.C. Cir. 1987) (noting that “access to statutorily-authorized military-dependent medical care is a legal entitlement” under CHAMPUS).

However, under ERISA, there is no requirement that an employer provide an employee with a health care plan. Shaw, 463 U.S. at 91 (1983) (noting that “ERISA does not mandate that employers provide any particular

benefits”).

Second, employees have a host of rights that do not extend to military personnel. For example, employees may sue employers under Title VII for discrimination, but military personnel may not. Mier v. Owens, 57 F.3d 747, 749 (9th Cir. 1995) (“Title VII does not protect military personnel.”). The unique nature of military service precludes military personnel from sharing the same rights that civilian employees do. See id. (“Courts have declined to review a variety of employment actions involving military personnel because, in the military, overriding demands of discipline and duty prevail, demands which do not have a counterpart in civilian life.”) (quotation and citation omitted); see also Chappell v. Wallace, 462 U.S. 296, 305 (1983) (“enlisted military personnel may not maintain a suit to recover damages from a superior officer for alleged constitutional violations”).

Third, the employer-employee relationship is one of contract, and contract principles apply to that relationship. As Black’s defines it, an “employee” is “[a] person who works in the service of another person (the employer) *under an express or implied contract of hire ...*” Black’s Law Dictionary 564 (emphasis added). But many of a military service member’s rights, such as entitlement to pay, are not determined by contract law principles. See Bell v. United States, 366 U.S. 393, 401

(1961) ("[I]t is to be observed that common-law rules governing private contracts have no place in the area of military pay.").

Finally, an employee is traditionally at-will and may leave or be terminated from his job at any time. Hubbard v. Spokane County, 146 Wn.2d 699, 707, 50 P.3d 602 (2002). No such right exists for enlisted military personnel, who must serve for a predetermined length of time or face military court martial for refusing to complete their service to the government. 10 U.S.C. § 651, § 886.

These four key differences, as well as the Department's own admissions, show that military personnel are not employees in any common and ordinary sense of the word. If military personnel are not employees, then CHAMPUS, because it covers military personnel and their dependents, cannot be an employee benefit plan as the Department defines it.

- b. *CHAMPUS is not a benefit plan, so it cannot be an employee benefit plan.*

The Department claims a benefit plan is one "that provides medical (or other) benefits to a defined class of individuals." CP 259. They argue that CHAMPUS "is similar to private insurance programs, and is designed to provide financial assistance to beneficiaries for certain prescribed medical care obtained from civilian sources." *Id.* (quoting 32 C.F.R. § 199.4(a)). Consequently, they claim, because CHAMPUS is analogous to

the private health insurance that employers provide to private employees, CHAMPUS is an employee benefit plan. CP 259.

Congress, though, has already defined CHAMPUS as a government health plan, which precludes the Department from ascribing to CHAMPUS its own definition of a benefit plan. CHAMPUS is one of several health plans established and funded by the federal government. 42 U.S.C. § 1320d(5). The term “health plan” includes Medicare, Medicaid, and CHAMPUS. *Id.* at § 1320d(5)(D)-(F), (I), & (K). Because CHAMPUS is already defined as a “health plan” by Congress, who also explicitly chose to exclude it as an “employee benefit plan” under ERISA, CHAMPUS cannot be a benefit plan as defined by the Department.

Moreover, the Department’s attempt to analogize CHAMPUS to private insurance provided by employers is strained at best. Although CHAMPUS resembles insurance in some respects, CHAMPUS “is not an insurance program in that it does not involve a contract guaranteeing the indemnification of an insured party against a specified loss in return for a premium paid.” 32 C.F.R. § 199.1(d) (1994);

Other differences between CHAMPUS and private insurance establish that any analogy between the two is a tenuous one. For example, unlike retired military members who receive care under CHAMPUS until they qualify for Medicare, *see* 10 U.S.C. § 1086(d)(1) & 32 C.F.R. §

199.3(e)(3)(vi), a retired employee does not continue to receive private insurance from his employer.

Also unlike private insurance, “[c]overage under CHAMPUS does not involve the payment of a premium.” McGee v. Funderberg, 17 F.3d 1122, 1125 (8th Cir. 1994) (“The members of the “group”– its beneficiaries – do not contribute to the fund; the fund is supplied by the taxpayers as a benefit of and reward for military service.”); see also Smith v. Office of Civilian Health & Medical Program of the Uniformed Services, 97 F.3d 950, 952 (7th Cir. 1996) (“CHAMPUS beneficiaries pay no premiums. Rather, CHAMPUS is funded by annual Congressional appropriations.”).

Another difference is that coverage under CHAMPUS is not primary as it is with private health insurance. Wilson v. Office of Civilian Health & Medical Programs of the Uniformed Services, 65 F.3d 361, 363 (4th Cir. 1995) (noting that the CHAMPUS “program supplements the military’s system of direct care for members of the armed services”); 32 C.F.R. 199.3(a) (stating that “the use of CHAMPUS may be denied if a Uniformed Service medical treatment facility capable of providing the needed care is available”); McGee, 17 F.3d at 1125 (“CHAMPUS does not provide benefits like private health insurance, it requires that a base hospital be used if one is nearby and its coverage is secondary.”).

Finally, unlike an employee with private insurance, a CHAMPUS beneficiary does not know beforehand whether medical services will be covered:

Another unique feature of CHAMPUS is that it is an “at risk” program, meaning that unlike traditional health insurance programs, where beneficiaries usually know whether a treatment is covered beforehand, CHAMPUS beneficiaries typically receive medical care first and then submit a claim to CHAMPUS officials for an after-the-fact ruling on coverage. The beneficiary is "at risk" in the sense that the medical services received may not qualify for payment under CHAMPUS.

Smith, 97 F.3d at 952 (emphasis added).

In these respects, CHAMPUS is different from the typical private health insurance provided by employers for their employees. Consequently, the Department’s attempts to analogize CHAMPUS to a benefit plan that non-military employees receive from their employers is limited. Thus, CHAMPUS does not qualify as a benefit plan as defined by the Department, and it cannot be an employee benefit plan for purposes of RCW 82.04.4297.

4. Even if the Term “Employee Benefit Plan” is Ambiguous, the Legislative History Indicates that RCW 82.04.4297’s Deduction Applies to CHAMPUS.

As stated earlier, a statute is ambiguous if it is susceptible to more than one reasonable interpretation. W. Telepage, Inc. v. City of Tacoma, 140 Wn.2d 599, 608, 998 P.2d 884 (2000). When presented with an

ambiguous statute, the court must look beyond the text to interpret it.

State v. Bash, 130 Wn.2d 594, 601, 925 P.2d 978 (1996).

In the context of tax deduction statutes, ambiguity, if any, is “construed strictly, though fairly ... against the taxpayer.” Group Health Coop. of Puget Sound, Inc. v. Tax Comm’n, 72 Wn.2d 422, 429, 433 P.2d 201 (1967)). But because the question in this case is whether an *exception* to an otherwise applicable tax deduction exists, “it is important to bear in mind that ... exceptions to statutory provisions are narrowly construed in order to give effect to legislative intent underlying the general provisions.” R.D. Merrill Co. v. Pollution Control Hearings Bd., 137 Wn.2d 118, 140, 969 P.2d 458 (1999).

Going beyond the plain language of RCW 82.04.4297 in the event that the Court determines the term “employee benefit plan” is ambiguous, the Legislative findings of RCW 82.04.4297 clarify that there is no intent to except CHAMPUS payments from that statute’s deduction:

The legislature finds that the deduction under the business and occupation tax statutes for compensation from public entities for health or social welfare services was intended to provide government with greater purchasing power when government provides financial support for the provision of health or social welfare services to benefited classes of persons ... [and] that this objective would be thwarted to a significant degree if the business and occupation tax deduction were lost by health or social welfare organizations solely on account of their participation in managed care for government-funded health programs. In keeping with the original purpose of the health or social

welfare deduction, it is desirable to ensure that compensation received from government sources through contractual managed care programs also be deductible.

Legislative Findings 82.04.4297.

The Legislative intent behind RCW 82.04.4297's deduction is clear. The goal is to give the government more purchasing power when it pays for the health care of designated beneficiaries. CHAMPUS is the exact type of "government-funded health program" the Legislature had in mind when enacting the deduction. CHAMPUS is a health plan under 42 U.S.C. § 1320d(5). It is designed to pay for health care for designated beneficiaries, in this case, active and retired military members and their dependents. 10 U.S.C. § 1074; 10 U.S.C. § 1071(a). Thus, CHAMPUS payments clearly fall within the class of those whom the deduction in RCW 82.04.4297 is designed to benefit.

Applying the exception to the deduction in RCW 82.04.4297 would thwart the Legislature's intent to provide the government with more purchasing power for programs like CHAMPUS. If the money that the federal government pays to providers for health care is subject to the B&O tax, then that health care will increase in cost. Providers will pass off the B&O tax costs to the government in the form of higher prices for health care services. The increased cost of health care will reduce the federal government's purchasing power, when the Legislature actually intended to

increase it.

Further, the Legislature has stated that its goal in enacting the exception to the deduction in RCW 82.04.4297 was to preclude a deduction “for amounts received from the federal, state, and local governments for *health insurance*.” CP 236-239, 245, 284. This was in response to a 1986 Washington Supreme Court decision that allowed HMOs to apply the deduction in RCW 82.04.4297 to *health insurance* payments from federal, state, and local governments. Id.

Thus, the Legislature was attempting to disallow a deduction for monies received for insurance payments from the government, not for monies received as payment for health care services under programs like Medicare, Medicaid, and CHAMPUS. As established earlier, CHAMPUS is not health insurance. See infra, § 5, Para. A(3)(b). To be consistent with the Legislature’s intent, the Court should find that CHAMPUS payments are deductible under RCW 82.04.4297.

B. Even if the CHAMPUS is an Employee Benefit Plan, the Federal Government has Pre-empted RCW 82.04.4297.

Pursuant to the Supremacy Clause, U.S. CONST., Art. VI, cl. 2, Congress may pre-empt state law. Ting v. AT&T, 319 F.3d 1126 (9th Cir. 2003). The intent to pre-empt may be express or implied. Morales v. TWA, 504 U.S. 374, 383 (1992). Such an intent exists “whether Congress’ command is explicitly stated in the statute’s language or

implicitly contained in its structure and purpose.” Id. (quoting FMC Corp. v. Holliday, 498 U.S. 52, 56-57 (1990)). To determine whether state law is pre-empted, the court must examine the statute’s plain language, and “assum[e] that the ordinary meaning of the language accurately expresses the legislative purpose.” Id.

1. Because the B&O tax is one relating to health care delivery or financing methods and because the DOD has declared its intent to pre-empt, the B&O tax has been pre-empted by federal law.

In this case, Congress has expressly delegated to the Secretary of Defense the power to pre-empt state laws that impact CHAMPUS:

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

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

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

10 U.S.C. § 1103 (a)(1)-(2) (emphasis added).

According to 10 U.S.C. § 1103, then, pre-emption occurs when (1)

there is a state law relating to health insurance, prepaid health plans, health care delivery, or health care financing methods, *and* (2) the Secretary of Defense determines that (a) the state law is inconsistent with a CHAMPUS contract *or* (b) preemption is necessary to implement or administer a CHAMPUS contract *or* (c) preemption is necessary to achieve an important federal interest.

Both of these two prongs are present here. First, the tax and deduction at issue here are state laws “relating to ... health care delivery or financing methods” under 10 U.S.C. § 1103. The crucial phrase is “relating to.” As the Supreme Court has held, this phrase is capacious, expansive, and nearly all-encompassing:

For purposes of the present case, the key phrase, obviously, is “relating to.” The ordinary meaning of these words is a broad one – to stand in some relation; to have bearing or concern; to pertain; refer; to bring into association with or connection with – and the words thus express a broad pre-emptive purpose. We have repeatedly recognized that in addressing the similarly worded pre-emption provision of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U. S. C. § 1144(a), which pre-empts all state laws “insofar as they . . . relate to any employee benefit plan.” We have said, for example, that the breadth of that provision’s pre-emptive reach is apparent from its language, that it has a broad scope, and an expansive sweep; and that it is broadly worded, deliberately expansive, and conspicuous for its breadth.

Morales, 504 U.S. at 383 (internal quotation marks and citations omitted); see also State v. Lounsbury, 74 Wn.2d 659, 664, 445 P.2d 1017 (1968) (finding the phrase “relating to” in a statute to be a broad one); Howell v. Alaska Airlines Inc., 99 Wn. App. 646, 649, 994 P.2d 901 (2000) (noting that the words “relating to” express a broad preemptive purpose).

Applied to this case, it is clear that the B&O tax from which Whidbey seeks a deduction is one relating to health care delivery and financing methods.

- a. *The B&O tax is one relating to health care financing methods.*

The B&O tax is a statute relating to health care financing methods, because the revenues collected from hospitals for the B&O tax are “deposited in the health services account created under RCW 43.72.900.” RCW 82.04.260(10). The B&O tax revenues that flow into that account are used “for maintaining and expanding health services access for low-income residents, maintaining and expanding the public health system, maintaining and improving the capacity of the health care system, containing health care costs, and the regulation, planning, and administering of the health care system.” RCW 43.72.900.

In other words, these revenues finance health care provided throughout Washington. Because these revenues help pay for various forms of health care throughout the state, they concern health care

financing. Thus, the B&O tax, as applied to hospitals, is a statute relating to health care financing.

- b. *The B&O tax is one relating to health care delivery.*

The B&O tax reaches amounts that civilian health care providers receive for treating CHAMPUS beneficiaries. This makes it more expensive for the federal government to purchase health care for its CHAMPUS beneficiaries, thereby affecting the health care that civilian health care providers deliver to military personnel and their families. To the extent that the tax reaches CHAMPUS payments, it relates to health care delivery; that is, the tax stands in some relation to, bears on, concerns, pertains, refers, or is associated or connected with health care delivery.

- c. *The DOD has expressly preempted the Washington's B&O tax to the extent it impacts CHAMPUS.*

The second prong of 10 U.S.C. § 1103 is also satisfied. The Department of Defense ("DOD") has expressly declared, pursuant to 10 U.S.C. § 1103 (a)(2), that preemption of state laws "relating to ... health care delivery or financing methods is necessary to achieve important Federal interests." 32 C.F.R. 199.17(a)(7)(i). Declaring in 32 C.F.R. 199.17(a)(7)(i) that important federal interests require preemption, the DOD proceeded to specify the type of state laws related to CHAMPUS that it was preempting:

Based on the determination set forth in paragraph (a)(7)(i) of this section, **any State or local law relating to health insurance, prepaid health plans, or other health care delivery or financing methods is preempted and does not apply in connection with TRICARE regional contracts.**⁴ Any such law, or regulation pursuant to such law, is without any force or effect, and State or local governments have no legal authority to enforce them in relation to the TRICARE regional contracts...

32 C.F.R. 199.17(a)(7)(ii) (emphasis added).

The scope of preemption set forth by the DOD in 32 C.F.R. 199.17(a)(7)(ii) is broad – as broad as Congress allowed for in 10 U.S.C. § 1103(a). The Regulation specifies that any state law relating to health care delivery or financing methods is preempted and does not apply in connection with CHAMPUS. The language in 32 C.F.R. 199.17(a)(7)(ii) is identical to 10 U.S.C. § 1103 (a). For the reasons just set forth above, the B&O tax, to the extent that it reaches CHAMPUS payments from the federal government, is a statute relating to health care delivery and financing methods. Therefore, the DOD, via 32 C.F.R. 199.17(a)(7)(ii), has expressly preempted RCW 82.04.4297.

2. Because the B&O Tax is Not a Tax on Net Income and Does Not Apply to a Broad Range of Business Activity, the Exception to Preemption Does Not Apply.

In 32 C.F.R. 199.17(a)(7)(iii), the DOD set forth an exception to

⁴ CHAMPUS has been renamed TRICARE. 32 C.F.R. 199.17(a)(6)(C).

the broad preemption of 32 C.F.R. 199.17(a)(7)(ii), stating that taxes on net income that apply to a broad range of business activity are not exempt:

The preemption of State and local laws set forth in paragraph (a)(7)(ii) of this section includes State and local laws imposing premium taxes on health or dental insurance carriers or underwriters or other plan managers, or similar taxes on such entities. Such laws are laws relating to health insurance, prepaid health plans, or other health care delivery or financing methods, within the meaning of the statutes identified in paragraph (a)(7)(i) of this section.

Preemption, however, does not apply to taxes, fees, or other payments on net income or profit realized by such entities in the conduct of business relating to DOD health services contracts, if those taxes, fees or other payments are applicable to a broad range of business activity. For purposes of assessing the effect of Federal preemption of State and local taxes and fees in connection with DOD health and dental services contracts, interpretations shall be consistent with those applicable to the Federal Employees Health Benefits Program under 5 U.S.C. 8909(f).

32 C.F.R. 199.17(a)(7)(iii) (emphasis added).

- a. *The B&O tax does not apply to net income, so the exception set forth in 32 C.F.R. 199.17(a)(7)(iii) is inapplicable.*

Like the interpretation of the other statutes and regulations at play here, if the wording of 32 C.F.R. 199.17(a)(7)(iii) is plain and unambiguous, that wording must be given effect. Applied to this case, there is nothing ambiguous about the exception to preemption set forth in 32 C.F.R. 199.17(a)(7)(iii). The regulation expressly states that preemption does not apply to broad business taxes on “net income or

profit.”

Because Washington’s B&O tax is on *gross income*, the exception to preemption for taxes on *net income* or *profit* is inapplicable. RCW 82.04.220 could not be clearer in providing that Washington’s B&O tax “shall be measured by the application of rates against value of ... *gross income of the business...*” (emphasis added).

The Legislature defines “gross income” as follows:

“Gross income of the business” means the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, *all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.*

RCW 82.04.080 (emphasis added). In other words, gross income is the opposite of net income and profit, which are defined as “sales revenue less the cost of the goods sold and all additional expenses.” Black’s Law Dictionary at 1247.

Gross income, on one hand, and net income and profit, on the other, have clearly defined and distinct meanings. Had the DOD intended the exception in 32 C.F.R. 199.17(a)(7)(iii) to apply to taxes on gross income, as well as to those on net income, it would have said so. The

DOD did not say so, and it should be taken at its word, because its word is clear. The plain language of 32 C.F.R. 199.17(a)(7)(iii) indicates that the exception to pre-emption for wide-ranging business taxes on net income does not apply. Because it does not apply, the general rule of pre-emption set forth in 32 C.F.R. 199.17(a)(7)(ii) governs.

A finding of preemption of state laws taxing gross income and an exception to preemption for state laws taxing net income makes sense in light of the declared purpose behind preemption. The federal interest supporting the DOD's declaration of preemption is "the assurance of uniform national health programs for military families *and the operation of such programs at the lowest possible cost to the DOD*, that have a direct and substantial effect on the conduct of military affairs and national security policy of the United States.." 32 C.F.R. 199.17(a)(7)(i).

If taxes on gross income are permitted, then providers cannot be sure that it is economically feasible to contract with the government to provide services to CHAMPUS beneficiaries, and, at a minimum, providers will pass the cost on to the government, thus raising the cost to the DOD. On the other hand, when taxes on net income are at issue, such taxes will only be reaching profit, and providers can be sure that it is profitable to provide service to CHAMPUS beneficiaries without having to pass on the cost to the government.

Applying the exception to the deduction in RCW 82.04.4297 would thwart the Legislature's intent to provide the government with more purchasing power for programs like CHAMPUS. If the money that the federal government pays to providers for health care is subject to the B&O tax, then that health care will increase in cost. Providers will pass off the B&O tax costs to the government in the form of higher prices for health care services. The increased cost of health care will reduce the federal government's purchasing power, when the Legislature actually intended to increase it.

- b. *The B&O tax does not apply to a broad range of business activity as cases under the FEHBP have interpreted that phrase, so the exception set forth in 32 C.F.R. 199.17(a)(7)(iii) is inapplicable.*

Further evidence that the B&O tax is preempted is found in cases dealing with the Federal Employees Health Benefits Program ("FEHBP") under 5 U.S.C. § 8909(f).⁵ Similar to 32 C.F.R. 199.17(a)(7), 5 U.S.C. § 8909(f)(1) prohibits a state from imposing any "tax ..., directly or indirectly, on a carrier or an underwriting or plan administration subcontractor" of the FEHBP with respect to payments made from the Employees Health Benefits Fund.

⁵ The "FEHBA provides health benefits for federal employees, their families, and federal retirees." Health Maintenance Organization of New Jersey, Inc. v. Whitman, 72 F.3d

The FEHBP statute also similarly provides:

Paragraph (1) shall not be construed to exempt any carrier or underwriting or plan administration subcontractor ... from the imposition ... of a tax, fee, or other monetary payment on the net income or profit accruing to or realized by such carrier or underwriting or plan administration subcontractor ... if that tax, fee, or payment is applicable to a broad range of business activity.

5 U.S.C. § 8909(f)(2) (emphasis added).

Because 5 U.S.C. § 8909(f)(2) contains a similar exception to preemption as 32 C.F.R. 199.17(a)(7)(iii), the DOD noted that “interpretations [of 32 C.F.R. 199.17(a)(7)(iii)] shall be consistent with those applicable to the Federal Employees Health Benefits Program under 5 U.S.C. 8909(f).” 32 C.F.R. 199.17(a)(7)(iii). The existing interpretations of 5 U.S.C. § 8909(f)(2) indicate that the exception to preemption does not apply in this case, because special purpose gross receipts taxes, like the B&O tax used to fund health care in Washington, are *not* taxes that apply to a broad range of business activity.

For example, in Connecticut v. United States, 1 F. Supp.2d 147 (D. Conn. 1998), the court addressed whether the FEHBP preempted certain taxes used to fund healthcare for the underinsured and uninsured. Connecticut had initially imposed a direct tax on patients with private

1123, 1126 (3rd Cir. 1995)

health insurance that was used to “subsidize the cost of hospital care for underinsured and uninsured patients.” Id. at 150. The court found that such a tax was preempted by the FEHBP. Id. at 151-152.

The state amended the tax in favor of a six percent sales tax on all hospital bills. Id. at 152. The state argued that the sales tax was “saved” from preemption, because it was just like the six percent sales tax that applied to every other business in the state. Therefore, the state claimed, “it applied to a broad range of business activity.” Id. In opposition, the defendants argued “that, unlike the vast majority of the proceeds from Connecticut's 6% sales tax, the sales tax of the 1993 Amendments was specifically earmarked to fund the UCP [Uncompensated Care Pool].” Id.

The court agreed with the defendants that the sales tax did not apply to a broad range of business activity, even though it was a state-wide tax. The fact that the tax *as applied* to defendants was a special purpose tax made it a tax that *did not* apply to a broad range of business activity:

Pursuant to the FEHBA, an assessment that would otherwise be preempted is saved from preemption if it applies to a broad range of business activity. Accordingly, if the sales tax as set forth in the 1993 Amendments can be said to have applied to a broad range of business activity, then the FEHBA does not preempt it.

The court finds that the sales tax of the 1993 Amendments was not akin to Connecticut’s overall 6% sales tax, which is applied to a multitude of industries and, in the majority of instances, is remitted to the State’s general fund. Rather, the sales tax of the 1993 Amendments was specifically

levied on hospital industry services for the narrow purpose of funding the UCP. Accordingly, the court concludes that the sales tax of the 1993 Amendments did not fall within the exception to the FEHBA preemption provision because it did not apply to a broad range of business activity.

Id.

Like the sales tax in Connecticut v. US, the B&O tax is a statewide tax, but as levied on hospitals – and only on hospitals – it is for the specific purpose of “maintaining and expanding health services access for low-income residents” and improving other areas of the health care system. RCW 82.04.260(10); RCW 43.72.900. The tax in this case, also like the one in that case, is not remitted to the state’s general fund, but is instead “deposited in the health services account created under RCW 43.72.900.” RCW 82.04.260(10).

If the sales tax in Connecticut v. U.S. did not apply to a broad range of business activity, then the B&O tax in this case, as levied against hospitals, does not apply to a broad range of business activity. See also Health Maintenance Organization of New Jersey, Inc. v. Whitman, 72 F.3d 1123, 1132 (3rd Cir. 1995) (“Given Congress’ objective, a tax applicable to only a single industry like insurance, banking, or real estate, cannot be treated as applying to a broad range of business activity. At the very least, the tax must apply to more than a single industry or business activity.”). Thus, the exception to preemption set forth in 32 C.F.R.

199.17(a)(7)(iii) does not apply, and the B&O tax is not “saved” from preemption

VI. CONCLUSION

RCW 82.04.4297 allows a hospital to deduct federal money it receives in return for providing health services, unless the money is “received under an employee benefit plan.” Black’s Law Dictionary, ERISA, Chapter RCW 82.04, and other Washington statutes exclude CHAMPUS from their definition of “employee benefit plan.” Even under the Department’s definition, CHAMPUS is not an “employee benefit plan,” because military personnel are not employees and because CHAMPUS is not like insurance that employees receive from their employees. Because CHAMPUS is not an “employee benefit plan” under any meaning of the term, Whidbey may deduct the CHAMPUS payments it received from the federal government.

The DOD has expressly declared that any state law relating to health care delivery or financing methods is preempted and does not apply in connection with CHAMPUS. The B&O tax is a statute relating to health care financing methods, because the B&O tax revenues collected from hospitals for the B&O tax are used to pay for various forms of health care throughout the state and therefore finance Washington’s health care system. The tax is a statute relating to health care delivery to the extent

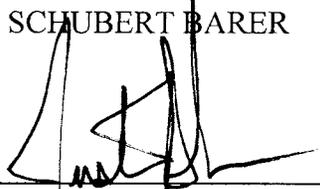
that it reaches amounts that hospitals receive for treating CHAMPUS beneficiaries. Because the B&O tax is one relating to health care financing methods and health care health care delivery, it is preempted to the extent that it reaches CHAMPUS income.

These two reasons, set forth in detail in the body of the argument, establish that RCW 82.04.4297's deduction applies to this case and that the B&O tax as applied to Whidbey's CHAMPUS revenues has been preempted. Accordingly, Whidbey respectfully requests the Court to reverse summary judgment in favor of the Department and enter summary judgment for Whidbey and to remand for entry of judgment in Whidbey's favor for the \$102,723 refund it seeks plus pre-judgment interest, court costs, and applicable attorney's fees, if any. Whidbey also asks for an award of any applicable appellate costs and attorney's fees under RAP 14.3 and RAP 18.1

DATED this 25th day of July, 2007.

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CERTIFICATE OF SERVICE

I, Fred Schmidt, certify under penalty of perjury under the laws of the State of Washington, that on July 25, 2007, I caused a copy of the foregoing document to be served on the person(s) listed below via legal messenger.

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Dated at Seattle, Washington, this 25th day of July, 2007.


Fred Schmidt

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