SUPREME COURT NO. 101845-2
COURT OF APPEALS NO. 83563-7-I

SUPREME COURT OF THE STATE OF WASHINGTON

ENVOLVE PHARMACY SOLUTIONS, INC.,

Respondent,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Petitioner.

DEPARTMENT OF REVENUE'S PETITION FOR REVIEW

ROBERT W. FERGUSON
Attorney General

CHARLES ZALESKY, WSBA 37777
Assistant Attorney General
PO Box 40123
Olympia WA 98504-0123
(360) 753-5515
OID No. 91027

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Rules

Other Authorities

I. INTRODUCTION

Since its enactment in 1935, the business and occupation (B&O) tax has included an exemption for insurance businesses that pay gross premiums tax under the insurance code. The Legislature expressed its intent that payment of premiums tax is "in lieu of" other state taxes. RCW 48.14.080. To accomplish that intent, the Legislature exempted from B&O tax "[a]ny person in respect to insurance business upon which a tax based on gross premiums is paid to the State of Washington." Laws of 1935, ch. 180, § 11(c) (codified in RCW 82.04.320(1)). This Court addressed the exemption in *Armstrong v. State*, 61 Wn.2d 116, 377 P.2d 409 (1962), emphasizing the "in lieu of" nature of the premiums tax and the legislative purpose of preventing imposition of both the B&O tax and insurance premium tax on the same premium income.

Respondent Envolve Pharmacy Solutions, Inc. (Envolve) is not an insurance business and pays no premiums tax to the state. Nevertheless, it claims entitlement to the insurance

business exemption by virtue of the fact that it provides pharmacy benefit management services to an affiliated health maintenance organization (HMO) that pays a gross premiums tax to the state. Envolve argues, and the Court of Appeals below agreed, that the insurance business exemption is broad enough to allow a non-insurer to escape B&O tax if it provides services to an insurance business (or, in this case, an HMO) so long as those services are "required to be performed under the insurance contract." Slip op. at 13. The result is that Envolve pays no state business activity tax at all: no gross premiums tax *and* no B&O tax.

The Court of Appeals badly misconstrued the statute, ignoring its actual language and sidestepping controlling authority from this Court addressing the exemption's purpose and "in lieu of" nature. Importantly, the phrase "required to be performed under the insurance contract" is found nowhere in the statute's language, and the Court's decision to add that phrase to the statue creates a means for non-insurers like

Envolve to escape all state taxation of its business activity. This is so even though this Court explained in *Armstrong* that the Legislature did not intend to create the "unique" circumstance where a business can "pay[] no state tax[] whatever, while everyone else engaged in business would be paying" either the premiums tax or the B&O tax. 61 Wn.2d at 122. The decision below is contrary to *Armstrong* and merits review.

Moreover, the Court casually brushed aside decades of settled law holding that affiliated businesses are separate entities for tax purposes by opening the exemption to both affiliated *and unaffiliated* businesses that contracts with insurers. And its "double taxation" policy argument conflicts with a 1934 decision that rejected the very same argument. These inconsistencies and conflicts also merits review.

Finally, the decision below will have far-reaching effects beyond merely granting Envolve a tax refund. Applied literally, the Court of Appeals has sanctioned a B&O tax exemption for any business that provides services to an insurance company or

HMO when those services are contractually "required" to be performed. Due to that massive change in the state's tax policy—without any input from the Legislature—the issue presented is one of substantial public interest meriting review.

II. IDENTITY OF PETITIONER AND COURT OF APPEALS DECISION

The Department of Revenue seeks review of the Court of Appeals' published decision, *Envolve Pharmacy Solutions, Inc. v. Department of Revenue*, No. 83563-7-I, ___ Wn. App. 2d ___, 524 P.3d 1066 (Feb. 27, 2023). A copy of the decision is attached as Appendix A.

III. ISSUE PRESENTED FOR REVIEW

RCW 82.04.320 provides a B&O tax exemption for insurance business upon which a tax based on gross premiums is paid to the state. Does that exemption also apply to Envolve, which is not an insurance business and paid no premiums tax in lieu of B&O tax, merely because Envolve provided services required under a contract with an HMO that paid a premiums tax to the state?

IV. STATEMENT OF THE CASE

A. The Board of Tax Appeals Rejects Envolve's Effort to Exempt All of its Gross Income from B&O Tax

Envolve is a pharmacy benefit management company that manages its clients' prescription drug benefit programs. CP 22 (Board Finding of Fact # 1). During the 2012 through 2015 periods at issue, Envolve received most of its gross income from providing pharmacy benefit management services to Coordinated Care Corporation (Coordinated Care), which is an HMO that managed Washington's "Basic Health" and "Healthy Options" Medicaid programs. CP 22-23 (Finding of Fact # 2, 3, & 4). As an HMO, Coordinated Care paid "premiums and prepayments tax" on its health care premium income. *See* RCW 48.14.0201 (imposing premiums and prepayment tax on certain health care service providers, including HMOs).[1]

[1] The premiums and prepayments tax is separate from the insurance premiums tax imposed by RCW 48.14.020. *See infra* at pages 14 and 15 (contrasting insurance premiums tax with the premiums and prepayments tax). Taxpayers that pay the premiums and prepayments tax are exempt from B&O tax under RCW 82.04.322.

Envolve is not an insurance business or HMO, and pays no gross premiums tax to the state. Instead, in 2012, it began paying B&O tax under the "service and other" reporting category. CP 23 (Finding of Fact # 5). However, rather than reporting the actual gross income it received from its in-state business activity, Envolve reported only the net amount it earned after taking an unauthorized deduction equal to the amounts it paid to participating pharmacies for the cost of dispensed drugs. *See generally* CP 1029 (memo from Envolve's accountants explaining that the company paid B&O tax only on the "delta" between what it received for its services and "the costs paid to the pharmacies").

The Department uncovered and denied Envolve's unauthorized deduction, CP 1050, resulting in an assessment of underreported B&O tax for the January 2012 through June 2015 tax reporting periods. CP 1043; CP 1058.

Envolve did not challenge the denial of its unauthorized deduction. Instead, the company filed an administrative appeal

and related refund claim with the Department, arguing that it was entitled to exclude all of its gross income from B&O tax under the insurance business exemption. Although none of Envolve's gross income had been subject to premiums tax, the company asserted that it qualified for the exemption under the terms of a letter ruling that the Department issued to Envolve's parent company. In that letter ruling (the "Centene letter ruling"), the Department suggested that a business paying no premiums tax could claim the insurance business exemption on income the company received for providing administrative services to an affiliated insurance business. CP 1018.

The Department gave Envolve the benefit of the Centene letter ruling, lowering the tax assessment for amounts Envolve could tie to administrative fees it received from Coordinated Care. CP 1073-77. Envolve, however, was dissatisfied with the revised audit results, contending that all of its gross income should be exempt. The Department's Administrative Review and Hearings Division (ARHD) rejected the claim, explaining

that the Department had previously allowed affiliates of an insurance business to claim the insurance business exemption only with respect to income from providing "[g]eneral administrative services such as accounting, personnel and data processing …." CP 1088 (quoting Determination No. 88-311A, 9 WTD 293, 297 (1990)). By contrast, the Department had not allowed affiliates of insurance businesses to exclude amounts derived from non-administrative services such as providing health care services or "maintaining a network of pharmacies." *Id*. at 1090. ARHD then concluded that Envolve had offered no valid reason for the Department to depart from its prior practice, and that the Department's auditor had properly applied the Centene letter ruling. CP 1091-92.

Still dissatisfied, Envolve filed an appeal with the Board of Tax Appeals, again asserting that all of its service income should be exempt from B&O tax. Once discovery was complete, Envolve and the Department filed cross-motions for summary judgment. The Board granted the Department's

motion and denied Envolve's motion, concluding that Envolve had failed to establish that it was entitled to avoid B&O tax on all its service income. CP 27 (Conclusion of Law # 9).

B. The Board's Decision is Reversed on Appeal

Envolve appealed the Board's decision under the Administrative Procedure Act, claiming that the Board erred in granting summary judgment to the Department. CP 1. The trial court reversed the Board's decision, concluding that all of Envolve's service income was exempt from B&O tax under the insurance business exemption. The trial court did not address the holding or analysis in *Armstrong*, concluding instead that a published Department tax determination, Determination No. 88-311A, "is a reasonable interpretation of RCW 82.04.320." CP 1439 (Superior Court Conclusion of Law # 7). The Court of Appeals affirmed. Slip Op. at 16.

V. ARGUMENT

The Court of Appeals' decision affirming the trial court conflicts with this Court's decision in *Armstrong*, which

addressed the language and purpose of the insurance business exemption. It also expands the exemption in a manner that effectively avoids an unbroken line of cases like *Rena-Ware Distributors, Inc. v. State*, 77 Wn.2d 514, 463 P.2d 622 (1970), holding that affiliated entities are treated as separate persons under the B&O tax code and cannot claim a tax benefit based on their relationship to another taxpayer. Additionally, the decision conflicts with this Court's decision in *Supply Laundry Co. v. Jenner*, 178 Wash. 72, 34 P.2d 363 (1934), which rejected the very same "double taxation" argument the Court of Appeals relied on below.

Moreover, and perhaps more importantly, the Court of Appeals fundamentally changed how the insurance business exemption works. In practical effect, the Court rewrote the statute to permit the payment of a gross premiums tax by an insurer or HMO to exempt not only the insurer or HMO from B&O tax on their premium income, but all businesses that

provide "contractually required" services to the insurer or HMO.

Review under RAP 13.4(b)(1) and (4) is warranted to bring the B&O tax exemption back in line with its actual language and with this Court's prior decisions.

A. History and Application of the Insurance Business Exemption

Washington imposes a B&O tax upon every person "for the act or privilege of engaging in business activities" in the state, RCW 82.04.220, with "business" broadly defined to include "all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly." RCW 82.04.140. Emphasizing the broad reach of the B&O tax, this Court has explained that the tax applies unless an express deduction or exemption exists. *Dot Foods, Inc. v. Dep't of Revenue*, 185 Wn.2d 239, 245, 372 P.3d 747 (2016). One such exemption is the insurance business exemption. RCW 82.04.320. Like all tax exemptions, the insurance business exemption is construed narrowly to avoid

revenue losses that the Legislature did not anticipate or approve. *Lacey Nursing Ctr., Inc. v. Dep't of Revenue*, 128 Wn.2d 40, 49-50, 905 P.2d 338 (1995).

As originally enacted, the exemption provided in relevant part that B&O tax "shall not apply to … [a]ny person in respect to insurance business upon which a tax based on gross premiums is paid to the State …." Laws of 1935, ch. 180, § 11(c). The statute has been amended on occasion, but its core language has remained unchanged. *See* RCW 82.04.320(1).

The Legislature did not define the term "insurance business." The term, however, was generally understood to mean a business "subject to control under the insurance statutes" that writes insurance contracts specifying "an 'insurer,' an 'insured,' a 'premium,' and a 'beneficiary." *State v. Globe Casket & Undertaking Co.*, 82 Wash. 124, 129, 128, 143 P. 878 (1914); *see also State v. Universal Serv. Agency*, 87 Wash. 413, 423-24, 151 P. 768 (1915) (an insurance contract requires "(1) An insurer; (2) a consideration; (3) a person

insured or his beneficiary; (4) a hazard or peril insured against whereby the insured or his beneficiary may suffer loss or injury").[2]

A company meeting the understood meaning of an "insurance business" was subject to insurance premiums tax on "the gross premiums received from business in Washington." *Armstrong*, 61 Wn.2d at 120. That tax, codified at RCW 48.14.020, applies to "each authorized insurer except title insurers and registered eligible captive insurers" at the rate of two percent of all premiums collected or received during the prior calendar year. RCW 48.14.080(1). As noted in *Armstrong*, the tax is "in lieu of" other state taxes. 61 Wn.2d at 120 (quoting RCW 48.14.080). The insurance business exemption

[2] The term "insurance business" has a similar meaning under current law. *See* RCW 48.01.050 (defining "insurer" to "include[] every person engaged in the business of making contracts of insurance, other than a fraternal benefit society"); RCW 48.01.040 (defining "insurance" as "a contract whereby one undertakes to indemnify another or pay a specified amount upon determinable contingencies").

in the B&O tax code prevents the imposition of both taxes on an insurer's premium income.

The meaning of "insurance business" in 1935 did not include what we today would call health care benefit plans or HMOs; *i.e.*, businesses that contract for healthcare services on behalf of their members. *Universal Serv. Agency*, 87 Wash. at 424. These types of healthcare service businesses did not become subject to regulation under the state insurance code until 1975, and were not subject to a gross premiums tax until 1993. *See* Laws of 1975, 1st Ex. Sess., ch. 290 (enacting the Washington Health Maintenance Organization Act, codified as RCW 48.46); Laws of 1993, ch. 492, § 301(2) (enacting the "premiums and prepayments tax" on health care premiums, codified in RCW 48.14.0201(2)).[3] Thus, HMOs are not

[3] Although HMOs were regulated under the insurance code starting in 1975, the Legislature was careful to distinguish HMOs from insurance businesses. *See, e.g.,* Laws of 1975, 1st Ex. Sess., ch. 290, § 12(1) ("No health maintenance organization may refer to itself in its name or advertising with any of the words: 'insurance', 'casualty', 'surety', 'mutual', or

insurance businesses, do not owe the insurance premiums tax, and cannot claim the insurance business exemption. Instead, the Legislature in 1993 enacted a different B&O tax exemption for HMOs that pay the premiums and prepayment tax. *See* RCW 82.04.322 ("This chapter does not apply to any health maintenance organization … in respect to premiums or prepayments that are taxable under RCW 48.14.0201.").

The Department of Revenue administers the B&O tax, but not the insurance premiums tax or the premiums and prepayments tax, which are administered by the Insurance Commissioner. In any event, even though the premiums tax on insurance business is imposed only on "premiums … collected or received by the insurer," RCW 48.14.020(1), the Department of Revenue issued a published tax determination in 1990 allowing an insurer that paid insurance premiums tax to exclude from B&O tax not only its premium income, but also other

---

any other words descriptive of the insurance, casualty, or surety business") (codified in RCW 48.46.110(1)).

gross income earned from incidental services provided to an affiliated insurance business. That tax determination, Determination No. 88-311A, 9 WTD 293 (1990) (copy attached as Appendix B), is central to Envolve's legal arguments and the Court of Appeals analysis, forming the basis for the Court's understanding of the "plain language" of the insurance business exemption. Slip Op. at 12.

The Department withdrew Determination No. 88-311A from publication in 2019 because it improperly expanded the insurance business exemption to untaxed "functionally related" services performed by an insurer. Excise Tax Advisory 3133.2022 at 2.[4] The Determination was also being misapplied as authority allowing non-insurers paying no premiums tax to claim that their gross income from service performed for affiliated insurance businesses was exempt.

[4] Available on-line at https://taxpedia.dor.wa.gov/documents/current%20eta/3133.2022.pdf.

B. The Court of Appeals' Interpretation of the Insurance Business Exemption Conflicts with *Armstrong*

The Court of Appeal construed the insurance business exemption as permitting a non-insurer (Envolve) to avoid B&O tax on its in-state service activity so long as the service was "required to be performed under [an] insurance" contract with an entity that pays a gross premiums tax to the state. Slip Op. at 13. That holding finds no support in the actual words of the exemption, and conflicts with this Court's statutory analysis in *Armstrong*.

The plain meaning of a statute "'is to be discerned from the ordinary meaning of the language at issue, the context of the statute in which that provision is found, related provisions, and the statutory scheme as a whole.'" *Lake v. Woodcreek Homeowners Ass'n*, 169 Wn.2d 516, 526, 243 P.3d 1283 (2010) (quoting *State v. Engel*, 166 Wn.2d 572, 578, 210 P.3d 1007 (2009)). Moreover, it is fundamental error to add words to a statute in the guise of ascertaining its plain meaning. *Id*.

In *Armstrong*, this Court read the insurance business exemption in light of two related statutes, RCW 48.14.020 (imposing the insurance premiums tax) and RCW 48.14.080 (making the premiums tax "in lieu of" other state taxes). *Armstrong*, 61 Wn.2d at 120. Although the issue in *Armstrong* involved a constitutional challenge to the B&O tax exemption, which did not apply to independent agents or representatives of insurance companies, this Court grounded its analysis in the language and purpose of the statute. Construed as a whole and in light of the related statutes, the Court concluded that the Legislature acted rationally when it tied the exemption to the payment of a gross premiums tax to the state. "The legislative decision to consider the gross premium tax as the exclusive tax on insurance company operations … does not mean that it is necessary for the legislature to grant an exemption to general agents who are in business for themselves." *Id*. at 121-22.

The Court of Appeals rejected this Court's analysis, asserting that *Armstrong* is inapt. Slip Op. at 15. Instead, it held

(contrary to *Armstrong*) that the statute's plain language does not require the person claiming the exemption to pay a state tax on its gross premiums. *Id*. at 11. The Legislature in 1935 wrote the insurance business exemption in passive voice, which the Court of Appeals could have cited as supporting a finding that the statute is ambiguous. But in light of the holding and statutory analysis in *Armstrong*, which upheld the Legislature's rational decision to tie the exemption to payment of an "in lieu of" gross premiums tax to the state, the Court of Appeals' assertion that the statute "plainly" does not require the taxpayer to pay a premiums tax in lieu of B&O tax is untenable.

The Court of Appeals also erred when it looked to the Department's 1990 tax determination as support for its plain language analysis. Where a statute is plain on its face, courts glean legislative intent from the "words of the statute itself, regardless of contrary interpretation by an administrative agency." *Tesoro Refin. & Mktg. Co. v. Dep't of Revenue*, 173

Wn.2d 551, 556, 269 P.3d 1013 (2012); *accord Bostain v. Food Express, Inc.*, 159 Wn.2d 700, 715-16, 153 P.3d 846 (2007).

Additionally, and more importantly, even if a Department tax determination issued in 1990 could possibly help ascertain the plain meaning of an exemption enacted in 1935, the Court of Appeals misread that tax determination. When read correctly, the determination does not remotely support the Court's interpretation that the insurance business exemption applies to gross income from services "required to be performed under the insurance contract."

The Department's holding in Determination No. 88-311A was quite narrow. It held that an insurance company *that paid insurance premium tax* could exclude from B&O tax amounts received for providing incidental services to affiliated insurance businesses. CP 350 (Appendix B. at p. 6). The taxpayer was not seeking to avoid paying both premiums tax and B&O tax on all of its gross income, as is the case with Envolve.

Rather, as described in the Determination, the taxpayer was an insurance business and earned premium income subject to the insurance premiums tax. CP 346. It also earned service income from providing general administrative services to its subsidiaries, which were also insurance businesses. CP 347-48. The issue before the Department was whether the taxpayer's payment of insurance premiums tax on its premium income meant that it owed no B&O tax on its administrative services income. It was in that context that the Department ruled that the insurance business exemption "includes not only those activities specifically regulated under Title 48 RCW, but those which are functionally related as well." CP 350. The Department was analyzing the breadth of the exemption as applied to an insurer that paid premium tax. The Department did not rule that a person that pays no premium tax could exclude "functionally related" income from the B&O tax.

The decision below greatly expands the Department's prior practice. Determination No. 88-311A only marginally

expanded the insurance business exemption, permitting insurance companies subject to the insurance premium tax to exclude income from performing administrative services like accounting, payroll, and data processing. The Department never considered non-administrative services, including healthcare services provided by or to an HMO, to be "functionally related" to the business of insurance.

A fair reading of Determination No. 88-311A does not support the holding below that the insurance business exemption applies to non-insurers that perform services "required" under an insurance contract. The Department did not come up with the "required to be performed under the insurance contract" language the Court of Appeals added to the statute, and actively argued against that unprincipled expansion of the exemption in this appeal. Thus, even if the statute's plain meaning could be guided by a tax determination issued in 1990, there is no legal or logical reason to expand the exemption in the manner the Court of Appeals has done here.

RCW 82.04.320 states that the exemption applies only to insurance business upon which a gross premiums tax has been paid to the state, and *Armstrong* supports that statutory language by emphasizing the legislative intent. This Court should review the Court of Appeals' choice to reject *Armstrong* and, instead, rely on a 1990 Department tax determination addressing a different issue. RAP 13.4(b)(1).

C. The New "Required by the Contract" Standard Will Allow Non-Insurers to Sidestep Controlling Authority

The decision below also creates an avenue for non-insurers like Envolve to sidestep a long line of cases holding that affiliated businesses are treated as separate persons for tax purposes. *See, e.g.*, *Wash. Sav-Mor Oil Co. v. Tax Comm'n*, 58 Wn.2d 518, 521, 364 P.2d 440 (1961); *Rena-Ware*, 77 Wn.2d at 517-18; *Impecoven v. Dep't of Revenue*, 120 Wn.2d 357, 364, 841 P.2d 752 (1992).

Envolve argued below that its affiliation with its sister corporation, Coordinated Care, was an important fact supporting its effort to avoid B&O tax. CP 66, 274-77, 664-66,

1418-19. For example, in its motion for summary judgment to the Board, Envolve argued that for "almost 30 years" the insurance business exemption has been applied to "affiliates that perform activities functionally related to the 'business of insurance.'" CP 665-66. But on appeal to the Court of Appeals, Envolve could not logically support that argument in light of this Court's long-standing precedent—which the Court of Appeals had recognized and followed in prior cases. *See, e.g.*, *Dep't of Revenue v. Nord NW. Corp.*, 164 Wn. App. 215, 230, 264 P.3d 259 (2011) ("Washington law … treats an owner of a business entity as a separate person from the entity itself.") (Citing *Wash. Sav-Mor Oil*, 58 Wn.2d at 520-23).

Unfortunately, the Court of Appeals effectively sidestepped *Washington Sav-Mor Oil*, *Rena-Ware*, and this Court's other precedent by holding that affiliation with an insurance company or HMO does not matter. Slip Op. at 14. In other words, had Envolve performed the same services for an unaffiliated HMO, it could still exclude its service income from

B&O tax so long as those services were "required to be performed" under the HMO contract and the unaffiliated HMO paid gross premiums tax on its premium income.

The Court's expansive reading of the insurance business exemption opens the door for any non-insurer to get around the B&O tax through contract negotiation with an insurance business that pays the insurance premiums tax or (as here) an HMO that pays the premiums and prepayment tax. In addition, the Court's decision is inconsistent with the *underlying principle* of *Washington Sav-Mor Oil*, *Rena-Ware*, etc. Those cases stand for the principle that separate businesses are treated as separate entities for tax purposes *even if* they are affiliated. It defies logic to hold that this Court's authority is inapt if a tax exemption is expanded to include business activity performed by, or taxes paid by, an unrelated business. Simply put, the payment of a gross premiums tax to the state by an unrelated insurer or HMO should have absolutely no bearing on whether a person contracting with that insurer (or HMO) can avoid

B&O tax. The decision below implants that illogical result into the exemption.

This Court should review the Court of Appeals' choice to brush aside settled law by enlarging the insurance business exemption. RAP 13.4(b)(1), (4).

D. The Court of Appeals' "Double Taxation" Policy Argument Conflicts with *Supply Laundry*

The Court of Appeals also erred when it based its decision in part on what it perceived as an unjust result in imposing tax on Envolve's service income. "Requiring Envolve to pay a B&O tax for performing services required under the HCA contract, where Coordinated Care already paid a premium tax, would result in double taxation …." Slip Op. at 13. But that was the same argument this Court expressly rejected in *Supply Laundry Co. v. Jenner*.

Supply Laundry involved the "occupation tax" of 1933, which was the forerunner to the B&O tax. *Supply Laundry*, 178 Wash. at 73. The occupation tax applied to insurance agents, but exempted insurance companies that paid the insurance

premiums tax. Laws of 1933, ch. 191, § 4(2). In upholding the constitutionality of the tax, this Court concluded that imposing occupation tax on agents that were paid a "commission in the form of a percentage of the premiums" received by the insurer did not constitute "double taxation." *Supply Laundry*, 178 Wash. at 79. Similar to the "relation existing between wholesaler and retailer," taxing "gross receipts of each may in the final analysis result from the sale of the same merchandise, yet this would furnish no logical ground for contending that there was double taxation." *Id*.

The Legislature is the proper body to consider policy arguments like a perceived "double taxation" of HMOs and their affiliates. The Court of Appeals should not step into that role. And its decision to do so conflicts with *Supply Laundry*, warranting review under RAP 13.4(b)(1).

E. The Court of Appeals Decision Effectively Creates a New Exemption for Non-Insurers, Meriting This Court's Review

Washington Sav-Mor Oil and *Rena-Ware* are important because each was a unanimous decision explaining that affiliated businesses remain separate entities for tax purposes. *E.g.*, *Rena-Ware*, 77 Wn.2d at 518. And *Armstrong* is important because it emphasized that the legislative purpose underlying the insurance business exemption is to prevent insurers from paying both insurance premiums tax and B&O tax. *Armstrong*, 61 Wn.2d at 122. The exemption was not designed so that non-insurers "who are in business for themselves" can avoid the B&O tax. *Id*. The central holdings of these cases establish that there is no recognized legal or policy reason to expand the insurance business exemption to non-insurers like Envolve that pay no premiums tax to the state in lieu of the B&O tax.

The Court of Appeals expansion of the insurance business exemption to allow Envolve and others to avoid *both* B&O tax and premiums tax, without any input from the

Legislature or even a cursory analysis of legislative intent, raises an issue of substantial public interest meriting this Court's review. RAP 13.4(b)(4). It should be the prerogative of the Legislature, if it sees fit, to create an avenue for businesses to pay no tax whatever on their in-state business activity.

VI. CONCLUSION

For the foregoing reasons, the Department respectfully requests that this Court grant review.

This document contains 4,677 words, excluding the parts of the document exempted from the word count by RAP 18.17.

RESPECTFULLY SUBMITTED this 28th day of March, 2023.

ROBERT W. FERGUSON
Attorney General

CHARLES ZALESKY, WSBA 37777
Assistant Attorney General
Attorney for Petitioner Department of Revenue, OID No. 91027

PROOF OF SERVICE

I certify that I electronically filed this document with the Clerk of the Court using the Washington State Appellate Courts' e-file portal and thus served the following:

Brett Durbin
Daniel Kittle
Callie Castillo
Lane Powell PC
durbinb@lanepowell.com
kittled@lanepowell.com
castilloc@lanepowell.com
flabela@lanepowell.com
craiga@lanepowell.com
docketing@lanepowell.com

Counsel for Respondent Envolve

Dirk Giseburst
Heather Coldwell
Davis Wright Tremaine LLP
dirkgiseburt@dwt.com
heathercoldwell@dwt.com

Counsel for Amicus Curiae Association of Washington Healthcare Plans

Signature on following page.

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

DATED this 28th day of March, 2023, at Tumwater, WA.

Dani McFadden, Legal Assistant

APPENDIX A

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

ENVOLVE PHARMACY SOLUTIONS, INC.,	No. 83563-7-I
Respondent,	DIVISION ONE
v.	PUBLISHED OPINION
STATE OF WASHINGTON, DEPARTMENT OF REVENUE,	
Appellant.	

MANN, J. — This case is about the insurance business exemption to Washington State's Business and Occupation (B&O) tax, RCW 82.04.320 (2020). During the 2012 to 2015 tax period at issues in this appeal, the insurance business exemption provided, in relevant part:

> Exemptions—Insurance business. This chapter shall not apply to any person in respect to insurance business upon which a tax based on gross premiums is paid to the state: PROVIDED, [t]hat the provisions of this section shall not exempt any person engaging in the business of representing any insurance company, whether as a general or local agent, or acting as broker for such companies.

RCW 82.04.320 (2020).[1]

[1] RCW 82.04.320 was amended in 2021. The amendment does not impact the issues raised on appeal.

After an audit, the Department of Revenue (Department) assessed Envolve Pharmacy Solutions, Inc. (Envolve) with unpaid B&O taxes and penalties. The Department's assessment was affirmed by the Board of Tax Appeals (Board). Envolve petitioned the King County Superior Court for review of the Board's decision arguing that its activities were "functionally related" to insurance business and therefore exempt from B&O tax. The superior court agreed and reversed the Board's decision. The Department appeals. We agree with the trial court and conclude that Envolve's activities were at least functionally related to insurance business on which a premiums tax had been paid. We affirm.

I.

A.

Envolve[2] is a subsidiary of Centene Corporation, a publicly traded multi-line healthcare enterprise. Centene operates two lines of business: managed care and specialty services. The managed care segment provides health plan coverage to individuals through government subsidized programs, including Medicaid, CHIP,[3] and other publicly funded health programs.

In 2012, Coordinated Care Corporation (Coordinated Care), another subsidiary of Centene, contracted with the Washington State Health Care Authority (HCA) to provide services for the Basic Health and Healthy Options programs. Coordinated Care is licensed with the Washington Office of the Insurance Commissioner as a Health Maintenance Organization, and files and pays Washington's "premiums and

[2] Envolve was originally known as U.S. Scripts, Inc. It changed its name to Envolve Pharmacy Solutions, Inc. in 2016.

[3] Washington Children's Health Insurance Program.

prepayments" tax imposed under RCW 48.14.0201. Coordinated Care pays a premiums tax on the monthly premiums paid by enrollees.

Under the HCA contract, Coordinated Care must maintain a network of pharmacies to provide pharmacy services and pharmacy benefits (PBM) services to enrollees. PBM services include, but are not limited to, processing and paying claims to pharmacies for drugs dispensed to enrollees, maintaining a list of prescription drugs covered under the pharmacy benefit, and conducting drug utilization reviews. Coordinated Care contracted with Envolve to fulfill its PBM services required by the HCA contract. Envolve's PBM agreement with Coordinated Care requires Envolve to manage the availability and payment of enrollees' pharmacy benefits on behalf of Coordinated Care. Coordinated Care relied on Envolve to provide the pharmacy benefits to Coordinated Care's enrollees. The PBM services performed for Coordinated Care were Envolve's only relevant business activity in Washington during the tax periods at issue.

All of the PBM services provided by Envolve under the PBM agreement were required under the HCA contract between Coordinated Care and the HCA. The PBM services Envolve must provide on behalf of Coordinated Care include:

- Administering and determining the eligibility of persons enrolled in Coordinated Care's health plan ("enrollees");
- Coordination of benefits; verification of coverage; and record keeping;
- Maintaining a network of pharmacies ("Network Pharmacies") that agree to provide pharmacy services to enrollees under the terms of Envolve's claims process;
- Auditing and credentialing Network Pharmacies to ensure compliance with the HCA Contract and federal, state, and local laws;
- Selecting Network Pharmacies at locations and in sufficient number to ensure reasonable access for enrollees;

- Processing claims from Network Pharmacies, which includes applying Envolve's concurrent drug utilization review services;
- Managing a prescription drug formulary (list of preferred prescription drugs) and collecting rebates from pharmaceutical supplies on behalf of Coordinated Care; and
- Providing a 24-hour a day, 7 day a week toll-free telephone line for inquiries regarding the PBM Services provided by Envolve.

Envolve is not a licensed pharmacy in Washington. Envolve does not provide pharmacy services or mail-order pharmacy services to Coordinated Care. HCA enrollees fulfill prescription drug orders at network pharmacies, not through Envolve. The network pharmacies then compound or purchase prescription drugs and deliver the prescription drugs directly to enrollees. Envolve does not purchase prescription drugs from network pharmacies or deliver prescription drugs to enrollees. The network pharmacies file a claim for services and prescription drugs provided to enrollees, which Envolve then processes and arranges for payment on Coordinated Care's behalf. Envolve's payment structure is in the PBM agreement and is based on a percentage of collected amounts or set fees.

B.

Envolve filed Washington excise tax returns beginning with the 3rd quarter 2012 reporting period. Envolve reported and paid B&O tax under the "service and other" reporting category.

In December 2012, a tax representative for Centene submitted a letter ruling request to the Department. The request asked whether Medicaid receipts received by Coordinated Care and passed on to its affiliates, including Envolve, were subject to B&O tax, or exempt from tax under RCW 82.04.320—the insurance business exemption.

In October 2013, the Department issued a letter ruling explaining that the affiliates could qualify for the B&O exemption only if they were providing services that were "functionally related" to Coordinated Care's insurance business. The letter explained:

> Because the affiliates do not pay a premiums tax, they can qualify for the B&O exemption only if they are providing services that are functionally related to Coordinated Care's insurance business. Functionally related services are those activities incidental to accomplishing the insurance function. Services performed are considered functionally related if they relate exclusively to the insurance business that pays the premium taxes.
>
> Thus, if an affiliate is providing administrative, legal, or other services functionally related to Coordinated Care's insurance business, the amounts the affiliate receives from Coordinated Care for those services will be exempt from B&O tax to the extent that Coordinated Care paid the premiums tax to Washington State.

After receiving the letter ruling, Envolve filed amended B&O tax returns, requesting a refund of $73,263 for July 1, 2012, through September 30, 2013. Envolve claimed that all the services provided to Coordinated Care were functionally related to Coordinated Care's insurance business. Envolve requested a refund of all B&O taxes paid because Coordinated Care had paid the premiums tax on those receipts.

The Department denied the requested refund. Expanding on its October 2013 letter ruling, the Department explained that some services provided by Envolve were functionally related to Coordinated Care's insurance function, and some services which were not.

> Functionally related services are those activities incidental to accomplishing the insurance function. Services performed are considered functionally related if they relate exclusively to the insurance business that pays the premium taxes.

> Administrative services are generally considered functionally related. Thus, an affiliate doing administrative services (i.e., HR, claims processing and adjusting) will be exempt from paying B&O taxes on the amounts that it receives from [Coordinated Care], to the extent that [Coordinated Care] paid premiums tax to Washington.
>
> The function of insurance is to help pay for and cover the costs of health care services. Thus, the provision of health care services is not incidental to accomplishing this function. Providing health care services is independent from providing health insurance.
>
> [Envolve] provides some administrative services (claims processing, adjudicating, etc.) to [Coordinated Care] as a pharmacy benefit manager. Any amounts received for these services are exempt from B&O tax. These services include: claims processing, determining eligibility of recipients, coverage verification, prior authorization, maintaining the list of covered drugs, providing a customer service phone line to answer questions about the foregoing services and other similar services. However, to the extent [Envolve] provides additional services (such as maintaining a network of pharmacies, providing mail order pharmacy services, selecting network pharmacies, etc.) the amount it receives for these services must be included in gross income.

(Emphasis added.) The refund request denial did not explain how or why the Department considered some of Envolve's activities functionally equivalent and some not.

Following the denial of Envolve's refund request, the Department audited Envolve for the period January 2010 through June 2015. The audits led to two assessments totaling over $3.5 million. The audits asserted tax on amounts Envolve had received from Coordinated Care and paid to third-party pharmacies. The audits noted that Envolve might be able to exclude some of the payments it received under the "functionally related" criteria, but needed to prove which funds were for which purposes:

> Therefore, [Envolve] may be able to exclude some amounts it retains as an administrative services fee for the administrative services it performs. To the extent that [Coordinated Care] is paying the fee for services that are functionally related to its insurance business, [Envolve] can exclude

> the amounts under the B&O exemption for premiums so long as [Coordinated Care] pays premiums tax to Washington State for those amounts. However, it is the burden of [Envolve] to show which amounts are received for providing functionally related services and which are received for other services. Additionally, [Envolve] may not exclude any of the fees it receives or retains from providing pharmacy benefit management services to unrelated third parties.

Envolve responded by providing documentation related to administrative services it provided to Coordinated Care. The Department then revised the assessments, explaining:

> [Envolve] was able to provide documentation and information relating to employees that provide administrative services (claims processing, adjudicating, etc.) to Coordinated Care as a pharmacy benefit manager. The amounts received for those services are exempt from B&O tax. Pursuant to the audit, [Envolve] provided documentation to substantiate employee counts in the administrative services function as well as total employee counts. A ratio was then calculated (administrative employees divided by total employees) and applied against the total administrative services fee to compute the amount subject to Service and Other B&O tax. However, the payments to the pharmacies (for ingredient costs and dispensing fees) are not excludable from B&O tax under WAC 458-20-111 as discussed above and those amounts which were erroneously deducted to arrive at the tax base on the excise tax returns have been assessed in full.

After the revision, the audits assessed $3,203,762 in unpaid B&O tax, plus interest, and 5 percent assessment penalty.

Envolve sought administrative review of the denial of its refund claim and the assessments of underreported B&O tax with the Department's Administrative Review and Hearings Division (ARHD). The ARHD upheld the assessments. ARHD agreed with the Department that Envolve was engaged in some activities that were functionally related to insurance and some that were not:

> [I]t appears that [Envolve] is engaged in certain "general administrative services" like "accounting personnel and data processing" that are

> functionally related to Affiliate MCO's insurance business. . . . In particular, Taxpayer's administration of eligibility management services, claim processing, claims adjudication, benefit coordination, coverage verification, and recordkeeping services are all "general administrative services" that are similar to the "functionally related" services in Det. 88-311A, 2 WTD 293.
>
> However, [Envolve] is also engaged in a number of activities that do not appear to be "functionally related" to Affiliate MCO's "insurance business," in that they are not "activities incidental to accomplishing the insurance function." The activities that are not "functionally related" include: maintaining a network of pharmacy contacts; credentialing of network pharmacies; selecting network pharmacies; drug utilization review services; quality improvement; managing the prescription drug formulary; collecting rebates from pharmaceutical manufacturers; and maintaining information data systems.

Envolve appealed the ARHD decision to the Board. Envolve argued that the amounts it received were functionally related to Coordinated Care's insurance business under both the 2013 Letter Ruling and the Department's published Revenue Determination 88-311A, 9 Wash. Tax. Dec. 293 (1990).[4]

After cross motions for summary judgment, the Board agreed with the Department and concluded that Envolve failed to establish that it was entitled to avoid B&O tax on all its PBM services income. The Board found that Envolve was entitled to rely on the Department's precedent and that any activities that were "functionally related" to insurance qualified as "insurance business" activities exempt from B&O tax

---

[4] RCW 82.32.170 allows taxpayers to petition for determining whether a refund request was properly denied. WAC 458.20.100 sets out the Department's rules for informal administrative reviews, including determinations. Under the rule, "[t]he department will make such determination and resolve matters as may appear to the department to be just and lawful under its statutory authority." WAC 458-20-100. The Department may publish a determination when: (1) the decision is a well-reasoned application of the law to a specific set of facts, (2) the decision addresses only the law and facts necessary to resolve the case, (3) the decision is needed to provide guidance on a previously unaddressed area of the law, articulate the Department's current policy, apply the law to a significantly different set of facts, overrule a published determination, or provide a better or more current articulation on how the law should be interpreted, and (4) the decision can be effectively sanitized, or the taxpayer will grant a waiver of the secrecy clause.

under RCW 82.04.320. But the Board found that Envolve provides "pharmacy services," which the Board asserted are "healthcare services" outside the definition of insurance and not covered by the functionally related test. Envolve unsuccessfully moved for reconsideration.

Envolve petitioned for judicial review of the Board's final order with the King County Superior Court. The superior court reversed the Board's order, holding that the Department's prior administration of the statute was consistent with the statutory language, and that Envolve's activities were insurance business activities exempt under RCW 82.04.320. The court also held that Envolve was entitled to rely on the Department's letter ruling under RCW 82.32A.020. The trial court's order required the Department to refund the B&O tax Envolve paid on its PBM services income.

The Department appeals.

II.

A.

The Administrative Procedure Act (APA), ch. 34.05 RCW, governs judicial review of the Board's decision. RCW 82.03.180; RCW 34.05.510. PeaceHealth St. Joseph Med. Ctr. v. Dep't of Revenue, 9 Wn. App. 2d 775, 779, 449 P.3d 676 (2019), aff'd, 196 Wn.2d 1, 468 P.3d 1056 (2020). This court sits in the same position as the superior court, directly reviewing the Board's decision. Dep't of Revenue v. Bi-Mor, Inc., 171 Wn. App. 197, 202, 286 P.3d 417 (2012). The burden of demonstrating the invalidity of agency action is on the party challenging the agency order—in this case Envolve. RCW 34.05.570(1)(a).

We may reverse the Board's decision if, among other reasons, the agency erroneously interpreted or applied the law, the agency's order is not supported by substantial evidence, the order is outside the agency's statutory authority, or the order is arbitrary and capricious. RCW 34.05.570(3). We review issues of law de novo under the APA error of law standard which allows us to substitute our view of the law for that of the Board. Bi-Mor, 171 Wn. App. at 202.

The meaning of a statute is a question of law that we review de novo. Durant v. State Farm Mut. Auto. Ins. Co., 191 Wn.2d 1, 8, 419 P.3d 400 (2018). Our "fundamental objective in determining what a statute means is to ascertain and carry out the legislature's intent." Durant, 191 Wn.2d at 8. "If the statute's meaning is plain on its face, then courts must give effect to its plain meaning as an expression of what the legislature intended." Durant, 191 Wn.2d at 8. To discern a statute's plain meaning, we consider the text of the provision in question, considering the statutory scheme as a whole. Dep't of Ecology v. Campbell & Gwinn, L.L.C., 146 Wn.2d 1, 11, 43 P.3d 4 (2002). "We may use a dictionary to discern the plain meaning of an undefined statutory term." Nissen v. Pierce County, 183 Wn.2d 863, 881, 357 P.3d 45 (2015).

B.

Envolve argues that the Board erred by concluding that it did not qualify for an exemption from B&O tax under the insurance business exemption, RCW 82.04.320.[5] We agree.

---

[5] The Department appears to argue on appeal that because Coordinated Care is an HMO it does not pay a "premiums" tax under RCW 48.14.020, but pays a premiums and prepayment tax under RCW 48.14.0201. While the Department is technically correct that Coordinated Care is an HMO and pays a premiums and prepayment tax under RCW 48.14.0201, it is a distinction without importance. RCW 82.04.320 creates an exemption from B&O tax where a tax based on gross premiums has been paid.

The B&O tax is imposed "for the act or privilege of engaging in business activities" and is measured by the "value of products, gross proceeds of sales, or gross income of the business, as the case may be." RCW 82.04.220(1). The tax is intended to reach "virtually all business activities carried on within the state" and "applies unless a specific exemption exists." Avnet, Inc. v. Dep't of Revenue, 187 Wn.2d 44, 66, 384 P.3d 571 (2016); Dot Foods, Inc. v. Dep't of Revenue, 185 Wn.2d 239, 245, 372 P.3d 747 (2016). One such exemption is the "insurance business" exemption in RCW 82.04.320. The exemption provides that "any person in respect to insurance business upon which a tax based on gross premiums is paid to the state" is exempt from paying the B&O tax.

The Department first argues that RCW 82.04.320 does not apply as a matter of law because Envolve itself did not pay the premiums tax. This view, however, contradicts the plain language of the statute. The exemption in RCW 82.04.320 applies to "any person in respect to insurance business upon which a tax based on gross premiums is paid to the state." (Emphasis added.) The statute does not require that the entity claiming the exemption must be the same entity that paid the premiums tax. Instead, the question is whether Envolve was performing "insurance business" on which a premiums tax was paid.

The term "insurance business" is not defined in the state tax code. See ch. 48.01 RCW; ch. 48.05 RCW. The Department argues, and the Board appeared to agree, that Envolve provided "heathcare services" and not insurance benefits. This is based on the

---

The Department does not contest that Coordinated Care paid such a premium tax. The argument also appears new on appeal. The Department's audits, the ARHD determination, and the Board's decision, all addressed RCW 82.04.320 and RCW 48.14.020.

Department's contention that insurance business is limited to only administrative duties such as issuing contracts and collecting premiums. Envolve, on the other hand, argues that insurance business should be read broadly enough to include the business of carrying out the PBM services required under the HCA contract.[6] We agree with Envolve.

A fair reading of "insurance business" in RCW 82.04.320 includes more than the administrative tasks of issuing contracts and collecting premiums. It includes the activities necessary or incidental to fulfilling the requirements of the insurance contract. Indeed, since at least 1990, the Department has applied a "functionally related" test to interpret the extent of "insurance business":

> For purposes of RCW 82.04.320, the insurance business includes not only those activities specifically regulated under Title 48 RCW, but those which are functionally related as well. . . . Revenue generating activities which are considered functionally related to a taxpayer's insurance business are those activities incidental to accomplishing the insurance function.

Revenue Determination No. 88-311A, 9 Wash. Tax. Dec. 293, 297-98 (1990). The Department's 2013 letter ruling to Centene was consistent with Revenue Determination No. 88-311A.

We agree with the trial court that the "functionally related" test adopted in Revenue Determination No. 88-311A is a reasonable interpretation of the term "insurance business" within RCW 82.04.320, and consistent with the plain language of

---

[6] The Department also argues that Envolve is not an "authorized insurer," under RCW 48.05.030(1) and if it were, it would have to pay a premiums tax under RCW 48.15.020. The Department's argument misses the point—while Envolve may not be an "insurer," Coordinated Care is, and Coordinated Care pays a premium tax based on fulling the duties under the HCA contract, including PBM services. Envolve, by contract, is carrying out Coordinated Care's obligations under the HCA contract.

the statute.[7] Consistent with Revenue Determination No. 88-311A, we hold that where activities are required to be performed under the insurance contract in exchange for premium payments, and a tax is paid on those premium payments, the activities are at least functionally related to "insurance business" under RCW 82.04.320.[8]

There is no dispute that under the HCA contract, Coordinated Care must maintain a network of pharmacies to provide PBM services and benefits to enrollees. There is also no dispute that if Coordinated Care performed the PBM services required under the HCA contract, it would be exempt from B&O tax under RCW 82.04.320. And finally, there is no dispute that Coordinated Care contracted with Envolve to fulfill the PBM services required by the HCA contract. Requiring Envolve to pay a B&O tax for performing services required under the HCA contract, where Coordinated Care already paid a premium tax, would result double taxation—contrary to the intent of the exemption. Grp. Health Coop. v. Dep't of Revenue, 8 Wn. App. 2d 210, 214-19, 438 P.3d 158 (2019).

Envolve performs PBM services—services required under the Coordinated Care's HCA contract. Envolve was required to maintain a network of pharmacies,

---

[7] The Department withdrew Revenue Determination No. 88-311A in 2019 stating it was wrongly decided. The Department now takes the position that, to be eligible for the exemption, the taxpayer itself must be subject to the insurance premiums tax. But neither party is arguing that the functionally related test in Revenue Determination No. 88-311A does not apply here. And the Board concluded that Envolve had the right to have its tax liability determined using that standard for the tax periods at issue. Washington's Taxpayer Bill of Rights grants taxpayers the "right to rely on specific, official written advice and written tax reporting instructions from the department of revenue to that taxpayer, and to have interest, penalties, and in some instances, tax deficiency assessments waived where the taxpayer has so relied to their proven detriment." RCW 82.32A.020(2). The Board correctly held that Envolve was entitled to rely on the letter ruling. The only question is thus whether the Board properly applied the functionally related test to those tax periods at issue.

[8] See also RCW 48.01.060 (3)-(4) (defining "insurance transaction" to include the "execution of an insurance contract" and "[t]ransaction of matters subsequent to execution of the contract and arising out of it."

process claims from network pharmacies, audit pharmacies to ensure compliance with the HCA contract, and administer and determine eligibility of persons enrolled in Coordinated Care's health plan. Because these activities are required under the HCA contract and, if performed by Coordinated Care, would be considered insurance business activities, it is unreasonable to claim these actions are not at least functionally related to the insurance business.

C.

The Department relies on Rena-Ware Distribs., Inc. v. State, 77 Wn.2d 514, 518, 463 P.2d 622 (1970), Armstrong v. State, 61 Wn.2d 116, 377 P.2d 409 (1962), and Express Scripts, Inc. v. Dep't of Revenue, 8 Wn. App.2d 167, 437 P.3d 747 (2019), in support of its argument. Each case is either not applicable or distinguishable.

The Department relies on Rena-Ware, for the proposition that affiliated businesses, although owned by a common parent, remain separate entities for tax purposes. 77 Wn.2d at 518. Thus, the Department contends, Envolve cannot justify claiming an exemption because one of its sister companies can rightfully claim an exemption. But contrary to the Department's representation, Envolve is not claiming the insurance business exemption because its corporate affiliate is exempt. Instead, Envolve claims that it is exempt under RCW 82.04.320 because its activities providing PBM services to Coordinated Care are at least functionally related to "insurance business upon which a tax based on gross premiums." Envolve's contract with Coordinated Care is not dependent on its corporate affiliation with Coordinated Care.

The Department relies on Armstrong, for the proposition that the purpose of the insurance business exemption in RCW 82.04.320 is to prevent imposing a premium tax

and B&O tax on the same premium income, not to permit a person that pays no premium tax to avoid the B&O tax. Armstrong addressed the proviso in RCW 82.04.320 excepting those representing insurance companies, including agents and brokers, from the insurance business exception. The appellant challenged the proviso arguing that allowing the exemption for insurance company branch offices, but not independent agents or brokers violated equal protection.[9] Armstrong, 61 Wn.2d at 117-18. As the court explained, its duty was to "sustain the classification adopted by the Legislature if there are substantial differences between the occupations separately classified." Armstrong, 61 Wn.2d at 120. The court concluded that because independent agents were sufficiently different from insurance companies, the differential tax treatment was justified.

This case does not concern the proviso—it concerns the exemption. The Armstrong court did not address, or hold, that applying the insurance business exemption to amounts received by a contractor performing activities required under the terms of the insurance contract would conflict with the intent of the exemption. Armstrong does not apply.

The Department relies on Express Scripts to argue that because Envolve is a PBM manager, it is subject to the B&O tax on its in-state service activities. Express Scripts concerned an out-of-state PBM manager (ESI) that had a variety of clients

---

[9] In 1962, RCW 82.04.320 provided:
Exemptions—Insurance business. This chapter shall not apply to any person in respect to insurance business upon which a tax based on gross premiums is paid to the state: Provided, That the provisions of this section shall not exempt any person engaging in the business of representing any insurance company, whether as general or local agent, or acting as a broker for such companies.

Armstrong, 61 Wn.2d at 117, n.2.

including HMOs, health insurers, third-party administrators, employers, and government health care plans. At issue was whether ESI was subject to B&O tax for payments it received from clients for the value of prescription drugs. ESI argued that the payments from clients for the value of the prescription drugs or ingredients were "pass-through" funds moving from its clients, through ESI, to the pharmacies. Express Scripts, 8 Wn. App. 2d at 171-172. Division Two of this court disagreed, concluding that "ESI does not act as a mere 'pass-through' agent for its clients. Rather, the compensation ESI receives from its clients for the value of the prescription drugs is an integral part of ESI's business model for its PBM services." Express Scripts, 8 Wn. App. 2d at 174. While the court concluded that ESI owed B&O taxes for its PBM services, the court did not address, or discuss, the insurance business exemption in RCW 82.04.320. Express Scripts does not support the Department's position.

Envolve's PBM activities under its contract with Coordinated Care are at least functionally related to "insurance business upon which a tax based on gross premiums [was] paid to the state." RCW 82.04.320. We affirm the superior court's order reversing the Board's decision.

Affirmed.

Mann, J.

WE CONCUR:

Smith, A.C.J.

Andrus, C.J.

APPENDIX B

THIS DETERMINATION HAS BEEN WITHDRAWN EFFECTIVE OCTOBER 2, 2019, AND IS NO LONGER IN EFFECT. SEE ETA 3133.2019.

Cite as 9 WTD 293 (1990)

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of	FINAL DETERMINATION
	No. 88-311A
. . .	Registration No. . . .
	. . . /Audit No. . . .

[1] RULE 163: RCW 82.04.320 AND RCW 48.14.080 -- B&O TAX -- EXEMPTION -- INSURANCE BUSINESS. The gross premiums tax established by Title 48 RCW is in lieu of all other taxes on the insurance business, but not in lieu of B&O tax on income from business activities which are not functionally related to the insurance business.

[2] RULE 102 AND RULE 178: RCW 82.12.010(2) -- SALES TAX -- RESALE CERTIFICATE -- PURCHASES FOR A DUAL PURPOSE. A Taxpayer who purchases items for both resale and consumption and gave a resale certificate for all purchases is liable for deferred sales tax on items that were not resold, but delivered to taxpayer in Washington.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

TAXPAYER REPRESENTED BY: . . .
. . .

DEPARTMENT REPRESENTED BY: Garry G. Fujita, Former Assistant Director
Edward L. Faker, Former Sr. A.L.J.

DATE OF TELECONFERENCE: November 30, 1988

NATURE OF ACTION:

Faker, A.D.[1] -- The taxpayer appeals to the Director of the Department of Revenue ("Department") from the findings and conclusions of Determination No, 88-311, issued August 5, 1988. The operative facts, pertinent to the issues on appeal, are fully set forth in the original determination and will not be restated here.

ISSUES:

The issues presented on appeal are stated as follows:

1. Does RCW 48.14.080 preclude the assessment of business and occupation tax upon the gross receipts of an insurance company derived from services performed for affiliates?

2. Does the retail sales tax properly apply to purchases of tangible personal property in this state for incorporation into products for use outside the state?

TAXPAYER'S EXCEPTIONS:

As to the first issue, the taxpayer asserts its original position that the language of RCW 48.14.080 is plenary and preemptive in establishing that "as to insurers" the insurance premiums tax of Chapter 48.14 RCW is in lieu of all other taxes, with specific exclusions not relevant here. Thus, the taxpayer argues that the B&O tax may not be assessed upon any of its income even if the portions sought to be taxed are not subject to the insurance premiums tax. The taxpayer is aware of the express provisions of RCW 82.04.320 that the B&O tax does not apply in respect to insurance business upon which a tax based on gross premiums is paid. However, the taxpayer insists that the Insurance Code provision of RCW 48.14.080 addresses specific persons, i.e., "insurers;" and as to these persons it imposes the premiums tax "in lieu of all other taxes." According to the taxpayer, the "in lieu" provision is plenary in nature and it proscribes any other taxes upon insurance businesses. The taxpayer emphasizes that the "in lieu" provision is not an

[1] Administrative Law Judge, Robert Heller, also participated in the production of this Final Determination.

exemption or deduction provision covering only that portion of an insurer's business upon which the premium tax is actually due and paid. Instead, the taxpayer asserts it is a preemptive provision.

The taxpayer submitted a pamphlet which it produced which stresses that the gross premiums tax of Chapter 48.14 RCW is literally an "in lieu" tax which is intended to replace all other kinds of taxation (except property tax and some transaction taxes expressly excluded.) The taxpayer notes that of the 2.1% gross premiums tax, 2% goes to the general fund of this state and the remaining .1% funds the State Insurance Commissioner's Office as a dedicated fund.

Furthermore, the taxpayer reminds us that the Department of Revenue has ruled that income from the investment of premium dollars and the receipt of interest from investments, including interest received from loans against life insurance policies is excluded from B&O tax liability. This ruling presumably recognizes that the gross premiums tax is not imposed only upon certain portions of income (premiums), but has a broader scope. Thus, it argues the position taken by the Department in a subsequent Determination 88-186, 5 WTD 319 (1988) that the gross premiums tax is imposed upon "income", not "persons" (meaning insurers) is incorrect. Rather, RCW 48.14.020(4) clearly expresses the legislative characterization of the gross premiums tax as an "excise" on persons doing business as insurers. If not, then it must be an excise tax on gross premiums which would constitute an unconstitutional income tax.

The taxpayer asserts that its foregoing arguments demonstrate the need for an administrative policy ruling upon the issues in controversy. The taxpayer's activities subjected to the B&O tax in this case were simply related insurance activities of an insurer in an attempt to provide its insurance at the most efficient rates. The Department should not bifurcate these activities and isolate every insurance function which generates revenue in an attempt to distinguish that activity from the insurance business in order to subject that isolated activity to the B&O tax.

Finally on this issue, the taxpayer asserts that the Service B&O tax assessed upon income from affiliate companies for data processing, accounting, legal services, personnel, education and administration expenses allocated to such affiliates results

in taxing income which has already been subject to the gross premiums tax. It asserts that of the $396,200 assessed for Service B&O tax, $273,000 has been subjected to the gross premiums tax.

As to the second issue, the taxpayer argues that deferred sales/use tax was improperly assessed on materials (paper and ink) purchased in connection with printing insurance forms for use out of state.
The taxpayer asserts that it should not pay Washington use/deferred sales tax on the forms it ships out of state for its own use because it pays use tax in the destination state. The taxpayer asserts that tax may only be assessed in the state of first use.

DISCUSSION:

[1] B&O Tax on Expenses Allocated to Affiliates. All insurance companies doing business in Washington State are subject to a tax equal to 2.1% of their gross premium income. RCW 48.14.020. This "gross premiums" tax is collected and administered by the office of the Insurance Commissioner. According to RCW 48.14.080:

> As to insurers other than title insurers, the taxes imposed by this title shall be in lieu of all other taxes, except taxes on real and tangible personal property and excise taxes on the sale, purchase or use of such property.

The taxpayer argues that, as to insurers, this provision preempts all forms of taxation other than the gross premium tax and those imposed on the sale, purchase or use of property. As an insurer, the taxpayer asserts that no other tax is payable by it on any other business activity it conducts.

Chapter 82.04 RCW contains a separate statute that addresses the taxation of insurance business. RCW 82.04.320 provides as follows:

> This chapter shall not apply to any person in respect to insurance business upon which a tax based on gross premiums is paid to the state . . . . (Emphasis supplied.)

Since the gross premium tax only applies to insurers, it is clear that insurers are the only taxpayers entitled to the

benefit of this exemption. Although RCW 82.04.320 and RCW 48.14.080 both address the issue of taxing insurers, the revenue code provision differs in its reference to a particular type of business activity exempt from tax. The words "in respect to insurance business" refer to a specific business activity undertaken by insurers. The taxpayer's argument that RCW 82.04.320 exempts insurers from the B&O tax on all business activities ignores the legislature's specific reference to a person's "insurance business." If the legislature intended to extend the exemption beyond insurance business, it could have done so.

If, as the taxpayer suggests, RCW 48.14.080 completely preempts other forms of taxation on all activities of insurance companies, the "in respect to insurance business" language of RCW 82.04.320 would be rendered meaningless. Statutes "in pari materia" are those which relate to the same person or thing and must be construed together. State v. Houck, 32 Wn.2d 681 (1949). The rules of statutory construction require that statutes concerning the same subject matter be interpreted to give meaning and effect to each. Henderson V. McCullough, 59 Wn.2d 601 (1962). In light of the language contained in RCW 82.04.320, we find it unreasonable to conclude that the legislature intended to allow an insurance company to escape taxation on business which is unrelated to its insurance business.

Moreover, substantial weight is to be accorded to an agency's interpretation of a statute over which it has administrative authority. Cosro, Inc. v. Liquor Control Board, 107 Wn.2d 754 (1987). WAC 458-20-163 ("Rule 163") is the administrative regulation which governs the taxation of insurers. In enacting Rule 163, the Department has taken the position that the exemption contained in RCW 82.04.320 "does not apply to any business engaged in by an insurance company other than its insurance business." As Rule 163 has been duly adopted by the Department, is consistent with the statute, and has not been declared invalid by a court of record, it has the same force and effect as the law itself. See RCW 82.32.300.

In our opinion, Determination 88-311 correctly sets out the position of the Department as required by all relevant statutes and regulations insofar as it concludes that RCW 82.04.320 does not apply to any business of the taxpayer other than its insurance business. However, we believe that Determination 88-

311 unduly restricts the term "insurance business" and that further guidance is warranted.

For purposes of RCW 82.04.320, the insurance business includes not only those activities specifically regulated under Title 48 RCW, but those which are functionally related as well. Revenue generating activities which are functionally related to the taxpayer's conduct of its insurance business are not subject to the excise tax (except for the sale, purchase or use of property). Revenue generating activities which are considered functionally related to a taxpayer's insurance business are those activities incidental to accomplishing the insurance function.

Whether a particular revenue generating activity is functionally related to the insurance business is a question of fact to be resolved on a case by case basis. In the case of the performance of services, the relationship of the taxpayer to the recipient of the services is relevant. Services provided by a corporation to an affiliate may be considered functionally related to the insurance business while the same services provided to an unrelated entity may not. Where the taxpayer performs services for an unrelated entity and receives payment, other than premiums paid under a contract of insurance, the activity will not be considered functionally related to the insurance business.

Services performed for an affiliate will be considered functionally related, provided they are rendered in the regular course of the taxpayer's insurance business and relate exclusively to the affiliate's insurance business.[2] General administrative services such as accounting, personnel and data processing are considered functionally related when performed for an affiliate's insurance business. Legal services provided to an affiliate that relate to its insurance business are also considered functionally related.
If the affiliate is engaged in one or more business activities not related to the insurance business, services rendered to the affiliate are taxable to the extent they relate to other business activities. For example, accounting and data processing services provided to an affiliate whose sole activity

[2] For this purpose affiliates are members of a group of companies majority owned or controlled by the same parent or owner.

is providing financial counseling to individuals would not be considered functionally related to the insurance business.

Independent entrepreneurial activities which involve the active and direct conduct of a trade or business and result in sales of services to unrelated parties are not functionally related. This includes services rendered to employees. For instance, the operation of a company sponsored cafeteria where meals are purchased by employees is an activity not functionally related to the insurance business. Charges for legal services provided to employees of either the taxpayer or an affiliate for advice on matters of a personal nature are also not functionally related to the insurance business. Whether an activity is operated at a profit is irrelevant.

The assessment in question involves expense allocations to affiliates for services performed by the taxpayer's home and divisional offices. These services include data processing, accounting, legal, personnel, education and administration rendered to the taxpayer's affiliates in the course of its insurance business. Each of the taxpayer's affiliates is engaged in the insurance business to which these services are functionally related. Because we find the services at issue to be functionally related to the taxpayer's insurance business, we do not reach the taxpayer's other arguments on this issue. The assessment of B&O tax on expense allocations to affiliates is reversed.

[2] Printshop/Deferred Sales Tax. According to the express provisions of RCW 48.14.080, excise taxes may be imposed upon the sale, purchase or use of tangible personal property by insurers. Here, the Department has assessed deferred sales/use tax on the taxpayer's purchases of printing materials.

The sales tax applies to each retail sale within this state. RCW 82.08.020. A "retail sale" is defined in RCW 82.04.050 as:

> . . . every sale of tangible personal property (including articles produced, fabricated, or imprinted) to all persons irrespective of the nature of their business and including, among others, without limiting the scope hereof, persons who install, repair, clean, alter, improve, construct, or decorate real or personal property of or for consumers other than a sale to a person who . . . purchases for the purpose of consuming the property purchased

in producing for sale a new article of tangible personal property or substance . . ..

WAC 458-20-103 ("Rule 103") is the administrative regulation governing where a sale takes place. Rule 103 provides in pertinent part as follows:

> For the purpose of determining tax liability of persons selling tangible personal property, a sale takes place in this state when the goods sold are delivered to the buyer in this state, irrespective of whether title to the goods passes to the buyer at a point within or without this state.

WAC 459-20-193A ("Rule 193A") governs sales of goods where delivery is made in Washington. According to Rule 193A, the retail sales tax applies to sales of goods delivered in Washington "irrespective of the fact that the purchaser may use the property elsewhere."

WAC 458-20-102 ("Rule 102") is the administrative regulation governing the issuance of resale certificates. This rule states in part:

> PURCHASES FOR DUAL PURPOSE. It may happen that a buyer normally is engaged in both consuming and reselling certain types of articles of tangible personal property and is not able to determine at the time of purchase whether the particular property acquired will be consumed or resold. In such cases, the buyer should purchase according to the general nature of his business; that is, if principally, he consumes the articles in question, he should not give a resale certificate for any portion thereof, but if, on the other hand, he principally resells such articles, he may sign a resale certificate for the whole amount of his purchases.
>
> If the buyer gives a resale certificate for all purchases and thereafter consumes some of the articles purchased, he must set up in his books of account the value thereof and remit to the department of revenue the deferred sales tax payable thereon. (Emphasis supplied.)

Rule 102 sets forth a method whereby persons, such as the taxpayer, may purchase items without paying sales tax on the initial transaction because they are not sure whether the item will be resold or used. Referring to the tax assessed as

"deferred sales tax," simply means the payment of the sales tax is "deferred" until it can be determined whether the property is resold. The sales tax is a transaction tax and does not depend on use in Washington. If delivery takes place in Washington and the items are not purchased for resale, or are otherwise exempt from sales tax, the retail sales tax is due.

Here, the materials purchased by the taxpayer are used in printing insurance forms for its own use and for sale to its affiliates. The taxpayer furnishes a resale certificate to the seller of the materials and does not pay retail sales tax on the materials purchased. At the time the materials are purchased, it does not know how much of the materials will be used to produce forms for sale to its affiliates and how much will be used for its own forms. Later, when the taxpayer ships forms out of state for its use there the amount of materials subject to the retail sales tax has been determined.

Accordingly, sales tax was not due at the time the printing materials were purchased by the taxpayer and used in the printing of insurance forms. Sales tax is due, however, on the materials which were not resold. To the extent that the taxpayer pays a use tax on the forms which it uses out of state, it should be entitled to a credit for the Washington sales tax paid on the materials used to print those forms. The taxpayer's appeal on this issue is denied.

DECISION AND DISPOSITION:

The taxpayer's appeal is granted as to the assessment of the B&O tax on services rendered to affiliates (Audit Schedules V and VI). The appeal is denied as to the assessment of deferred sales/use tax on printing materials. The file is to be remanded to the Audit Section for adjustments consistent with this determination. Because the delay in issuing this Determination was at the sole convenience of the Department, interest will not be assessed after September 6, 1988, a date six months after the filing of the taxpayer's original petition.

DATED this 30th day of May, 1990.

ATTORNEY GENERAL'S OFFICE - REVENUE & FINANCE DIVISION

March 28, 2023 - 2:56 PM

Filing Petition for Review

Transmittal Information

Filed with Court:	Supreme Court
Appellate Court Case Number:	Case Initiation
Appellate Court Case Title:	Envolve Pharmacy Solutions, Inc., Respondent v. State of WA, Dept of Revenue, Appellant (835637)

The following documents have been uploaded:

- PRV_Petition_for_Review_20230328145418SC519779_7207.pdf
  This File Contains:
  Petition for Review
  The Original File Name was DeptPetRev.pdf

A copy of the uploaded files will be sent to:

- Carrie.Parker@atg.wa.gov
- HeatherColdwell@dwt.com
- Kyleen.Inman@atg.wa.gov
- castilloc@lanepowell.com
- craiga@lanepowell.com
- danikelli@comcast.net
- dirkgiseburt@dwt.com
- durbinb@lanepowell.com
- kittled@lanepowell.com
- wendy.hail-lombardi@atg.wa.gov

Comments:

Sender Name: Dani McFadden - Email: Dani.McFadden@atg.wa.gov
Filing on Behalf of: Charles E Zalesky - Email: Chuck.Zalesky@atg.wa.gov (Alternate Email: revolyef@atg.wa.gov)

Address:
PO Box 40123
Olympia, WA, 98504-0123
Phone: (360) 753-5515

Note: The Filing Id is 20230328145418SC519779