

No. 34710

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

CHARLESTON

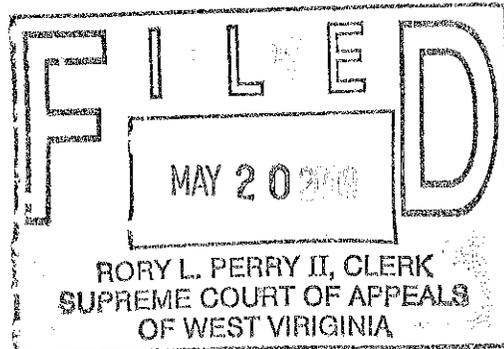
CHARLESTON AREA MEDICAL CENTER, INC.
Appellant,

v.

STATE TAX DEPARTMENT OF WEST VIRGINIA
Appellee.

**REPLY BRIEF
OF CHARLESTON AREA MEDICAL CENTER, INC., APPELLANT**

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TABLE OF CONTENTS

INTRODUCTION1

1. The accounting entries CAMC used to track utilization of the optional self-insurance fringe benefit are not an amount received by or an account receivable of CAMC.....1

2. Employee fringe benefits do not constitute an in-kind service to an employer from employees for provider tax purposes.....2

3. The State Tax Department’s Brief fails to address applicable provisions in the provider tax statute.....4

3. Decisional delays is an appropriate ground for reversal of the circuit court’s order.....5

CONCLUSION.....6

TABLE OF AUTHORITIES

CASE

Concept Mining, Inc. v. Helton, 217 W.Va. 298, 617 S.E.2d 845 (2005).....2

STATUTES/RULES

W.Va. Code § 11-1-2.....4

W.Va. Code § 11-10A-1 *et sq*.....2

W.Va. Code § 11-15-2(s).....3

W.Va. Code § 11-27-33

W.Va. Code § 11-27-22.....4, 5

IRC § 61; P.L. 98-369, div A., title V, Sec. 531(c), 98 Stat. 884.....4

IRC § 274.....4

U.S. Tsy. Reg. § 1.61-21.....4

OTHER AUTHORITIES

W.Va. State Tax Department Administrative Decision 96-155 ME5

W.Va. State Tax Department Administrative Notice 97-205

INTRODUCTION

Despite citing more than sixty cases¹ and wide-ranging secondary sources, the State Tax Department's Brief cannot identify any external authority supporting the State Tax Department's substantive tax position: *When an employer provides an optional fringe benefit to an employee, the employer derives gross receipts from the employee.*

- 1. The accounting entries CAMC used to track utilization of the optional self-insurance fringe benefit are not an amount received by or an account receivable of CAMC.**

As is typical of state tax administrative dispute matters like this, the State Tax Department issued an assessment against CAMC and was not prepared to offer any evidence other than the assessment itself to support the assessment at the administrative hearing. Accordingly, the hearing was an entirely one-sided affair: CAMC offered (1) a fact witness to explain the optional self-insurance benefit and how utilization was accounted for and (2) an expert witness in health care accounting to provide guidance and an opinion as concerning the assessment finding (which erroneously characterized accounting entries tracking utilization of the self-insurance benefit as an account receivable of CAMC). The State Tax Department failed to even make the auditor available to support the meager "audit findings" that made no reference whatsoever to "in-kind" employee services.

The State Tax Department never attempted to offer any evidence that the accounting entry used by CAMC to track utilization of the optional self-insurance fringe benefit provided to a participating employee reflected the value of services rendered by that employee to CAMC over and above wages and other compensation. The hearing examiner, appointed by the State

¹ This Reply Brief does not purport to address each of the cases and law review articles cited. By our count, just four of the cases cited are West Virginia tax cases and *none* of those cases support the State Tax Department's substantive position taken for the first time in this case.

Tax Commissioner,² made express findings of fact in the administrative decision and the hearing examiner never found that the accounting entries constitute accounts receivable of CAMC (as this would have been contrary to the rest of the record). Instead, the State Tax Department found as a fact: “CAMC did not bill to or receive *any payments* from its patients/employees or third-parties in connection with these accounting entries.”

2. Employee fringe benefits do not constitute an in-kind service to an employer from employees for provider tax purposes.

The State Tax Department contends that a health care provider’s taxable *gross receipts* must include a measure of services by a provider’s employees in exchange for health care services offered to employees, qualified retirees and their families in connection with the employment arrangement. As mentioned above, the State Tax Department fails to provide case law authority or scholarly arguments supporting this point despite extensive research efforts. Moreover, as discussed below, the State Tax Department’s Brief fails to address direct arguments in CAMC’s Brief.

First, the State Tax Department’s Brief fails to address the nature of the in-kind exchange at issue as described in CAMC’s Brief: “If anything, these indirect, non-incremental employee-services are ‘exchanged’ for *coverage*, not for taxable health care services.” There is no service-for-service “in-kind” exchange; if anything, there is a service-for-health-care-coverage exchange under the State Tax Department’s theory.³ The health care provider tax simply does not apply to

² The hearing predated the effective date of W.Va. Code §§ 11-10A-1 *et seq.* which established the office of tax appeals. By now relying on a significantly different factual finding (by the circuit court) than its own factual finding in the administrative decision, the State Tax Department is appealing (or at least amending) its own administrative order, something that the State Tax Department cannot do. *Concept Mining, Inc. v. Helton*, 217 W.Va. 298, 617 S.E.2d 845 (2005).

³ Coverage may be satisfied as necessary by health care services rendered by providers other than CAMC.

a provider's receipt of services in exchange for the promise of health care coverage, self-insured or otherwise. The health care provider tax is **not** an insurance, or self-insurance, tax.

Second, the State Tax Department fails to address the established and proper tax treatment of economic exchanges among employers and employees. The provider tax statute itself specifically addresses employer-employee exchanges in W.Va. Code § 11-27-3, wherein the law generally merges the business of the employer and employee, so there is not separable exchange or business between the employee and the employer.⁴ Indeed, tax laws regularly treat employee services to an employer as not being subject to a transaction tax or gross receipts tax, even where the tax otherwise generally applies to in-kind exchange transactions. *See, e.g.*, W.Va. Code § 11-15-2(s) ("service... shall not include... the services rendered by an employee to his or her employer..."). Perhaps most tellingly, the State Tax Department's Brief ignores the State Tax Department's own experience with other broad based gross receipts based taxes⁵ imposed in West Virginia, including the State business and occupation tax, addressed in CAMC's Brief. Theoretical in-kind employee-services receipts by an employer have never been deemed to be gross receipts of an employer for West Virginia tax purposes, despite the State Tax Department's long history with gross receipts taxes.

⁴ The State Tax Department's Brief claims that "CAMC's reliance on West Virginia Code § 11-27-3 is waived...." First, CAMC has never waived any rights and protections provided under law in this case; the statute applies on its face. Second, CAMC cited and relied on W.Va. Code § 11-27-3 both in a post-administrative hearing brief and in a circuit court brief. CAMC expressly argued to the circuit court that W.Va. Code § 11-27-3 restricts taxation respecting theoretical "exchanges" among an employer and an employee. The circuit court chose not to address W.Va. Code § 11-27-3 and other issues raised by CAMC, but the circuit court's error does not somehow constitute a waiver or abandonment by CAMC.

⁵ The health care provider tax is indeed a *gross receipts based tax* and not a tax on the "value" or "volume" of health care services rendered. The value or volume of health care services provided for charitable care, write-offs, contractual allowances, etc. are not included in the provider tax base. (One could argue that a health care provider receives various economic benefits in connection with some of these not-taxed arrangements, including charity care (federal income tax exemption) and negotiated contractual allowances (voluntary participant coverage arrangements in part to assure a certain volume of business), but the State Tax Department is not seeking to tax values or volumes in these arrangements.)

Third, while the taxation of fringe benefits has been a hot topic in federal income tax circles for at least a quarter-century,⁶ research does not disclose any taxing authority taking the unprecedented position set forth by the State Tax Department increasing an *employer's* gross receipts when an employer provides an optional benefit to an employee, including self-insurance, employee discounts and below or no-cost services. The national tax focus on fringe benefits generated significant further legislative and administrative attention on the taxation of fringe benefits.⁷ Despite intense scrutiny of employee fringe benefits by taxing authorities and commentators, research reveals that Internal Revenue Service has *not* sought to increase an **employer's** gross income where the employer offers or provides fringe benefits to its employees. The State Tax Department in this case seeks to administratively⁸ extend the base of the health care provider tax beyond normal tax boundaries.

3. The State Tax Department's Brief fails to address applicable provisions in the provider tax statute.

The State Tax Department's Brief also ignores W.Va. Code § 11-27-22(c), addressed in CAMC's Brief. This statute mandates that a provider's method of accounting for health care provider tax purposes be consistent with its accounting method for federal income tax reporting purposes. The State Tax Department has ruled that this includes the taxpayer's method of

⁶ In 1984, the United States Congress amended the law to expressly include "fringe benefits" as constituting gross income of a U.S. taxpayer. P.L. 98-369, div. A, title V, Sec. 531(c), 98 Stat. 884, amending what is now § 61(a) of the Internal Revenue Code of 1986, as amended (the "IRC").

⁷ See, e.g., U.S. Tsy. Reg. § 1.61-21; IRC § 274.

⁸ Perhaps erroneously, the State Tax Department's Brief, at page 9, states: "CAMC parades the horrors about how far the *legislature* will go in imposing taxes on fringe benefits." (emphasis supplied). If the Legislature had expressly imposed provider tax on an employer for offering the fringe benefit at issue, we would not be here. The Legislature did no such thing. The State Tax Department is formulating this policy by administrative fiat, not even bothering with the rulemaking process which provides significant legislative involvement and an opportunity for affected taxpayers to be heard regarding formulation of policies like the one at issue. Insofar as W.Va. Code § 11-1-2 commands faithful and equal and uniform enforcement of tax laws, the State Tax Department is bound to eventually extend this new rule to all health care providers and municipal gross receipts tax administrators will naturally apply this administrative employer-gross-receipts-from-fringe-benefits theory as a source of new municipal revenue.

including or excluding non-cash items as gross receipts. In this case, the State Tax Department is mandating CAMC to deviate from its accepted federal income tax filing practices. The State Tax Department is not authorized to ignore this unambiguous statute.⁹

4. Decisional delay is an appropriate ground for reversal of the circuit court's order.

The State Tax Department's Brief essentially argues that the statute then in place, requiring that an administrative decision be rendered in a reasonable time, provides taxpayers' a right without a remedy.¹⁰ The Brief provides little historical and practical context.

At the time the State Tax Department took the actions under review, timing of the assessment, hearing and decision were all solely in the State Tax Department's control. The State Tax Department chose not to pursue initiating a rulemaking procedure despite the importance of the tax and the unprecedented nature of this issue. Instead, the State Tax Department chose to issue an assessment. After a hearing (at which the State Tax Department offered *no witnesses*) and briefs, it took the State Tax Department over 15 months to determine whether or not its action (the assessment) was correct. All the while, tax periods are rolling along and a taxpayer must determine without reliable guidance how to report this tax. This choice of a delayed administrative lawmaking method puts all taxpayers, who are required to comply in good faith without delay, at peril.

⁹ The State Tax Department's Brief (at n. 4, page 8) appears to rely on lower court decisions in Maine, Michigan and New Jersey as authority for the State Tax Department to deviate from the federal income tax consistency. However, the State Tax Department ignores (1) the express West Virginia statute (W.Va. Code § 11-27-22), (2) the uncontroverted testimony at hearing about how CAMC's federal form 990 income tax filings are correct and consistent with CAMC's position in this case (accepted as true by the administrative law judge), and (3) the State Tax Department's own administrative rulings to this effect (Administrative Notice 97-20 and Administrative Decision 96-155 ME, cited in CAMC's Brief at n. 6, page 8). The State Tax Department further fails to address the burden its policy places on taxpayers; yet another set of books is now required of taxpayers, despite the express legislative mandate for consistency and simplicity.

¹⁰ New administrative tax hearing procedures adopted in W.Va. Code § 11-10A-1 *et seq.* (effective January 1, 2003) supplant the former system. Accordingly, a narrow ruling by this Court on this decisional delay issue would likely have limited affect on other tax cases prospectively.

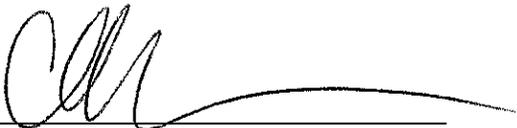
That's why the Legislature required the State Tax Department to issue a decision in a reasonable time. If the State Tax Department chooses to pursue the audit-assessment-hearing-decision procedure to make policy, it ought to announce its policy findings in a reasonable time. If the State Tax Department could not comply, it could have chosen a more appropriate method of policymaking.

CONCLUSION

The circuit court's order is incorrect and should be reversed for the reasons stated in CAMC's Brief and this Reply Brief.

Respectfully Submitted,

CHARLESTON AREA MEDICAL CENTER, INC.
By Counsel

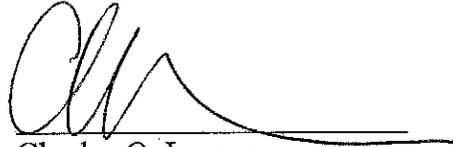


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CERTIFICATE OF SERVICE

I, Charles O. Lorensen, do hereby certify that service of the attached REPLY BRIEF was made upon the parties by mailing a true and exact copy thereof in the United States mail, postage prepaid, on this 20th day of May, 2009 to the individual named below:

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