

## Washington High Court: Insurance Affiliate Qualifies for Exemption

by Andrea Muse

A pharmacy benefit manager affiliated with an insurance business is exempt from Washington's business and occupation (B&O) tax, the state supreme court has held.

In a 5–4 decision, the Washington Supreme Court ruled December 12 in *Envolve Pharmacy Solutions Inc. v. Department of Revenue* that the pharmacy benefit manager met all the requirements of the state's insurance business exemption set out in Wash. Rev. Code section 82.04.320, under the plain language of the statute.

Michelle DeLappe of Fox Rothschild LLP told *Tax Notes* December 12 that the court has been divided in its last two tax decisions, noting that the other decision — *Antio LLC v. Department of Revenue* — is pending reconsideration.

DeLappe noted that the author of the dissent in *Antio*, in which the majority ruled that investment fund limited liability companies were not entitled to a deduction for investment income, penned the majority opinion in this case.

"One of the frustrating aspects of the Department of Revenue's position in this case, which the majority captured very effectively, is the reversal of its historic position in interpreting the governing tax laws," DeLappe added. "This type of conduct from the Department keeps arising in case after case — *Antio* being another recent example."

She added that "it is heartening to see a well-reasoned decision where the focus is on doing what is fair and sensible, not simply what collects the most tax revenue for the state."

### Background

Envolve Pharmacy Solutions Inc. and Coordinated Care, which administer health insurance benefits, are both subsidiaries of Centene Corp.

Coordinated Care contracts with Washington and collects premium payments from consumers. It pays the state's gross premiums tax and is therefore exempt from the B&O tax under section 82.04.320.

Starting in 2012, Coordinated Care contracted with Envolve to administer the health insurance benefits, including pharmacy benefit management (PBM) services, forwarding a percentage of the premiums it collects to Envolve as payment.

Envolve initially paid B&O tax, but Centene sought a DOR letter ruling on whether the subsidiaries affiliated with Coordinated Care also qualify for section 82.04.320's B&O tax exemption.

In a 2013 response, the DOR said that any activity by a Coordinated Care affiliate that was functionally related to Coordinated Care's insurance business isn't subject to the premiums tax or the B&O tax as long as Coordinated Care had paid its premiums tax.

Envolve then sought a refund of roughly \$75,000 in B&O tax. The DOR denied the refund claim and assessed more than \$3 million in taxes for the period from January 2010 and June 2015.

In denying the refund, the DOR concluded that Envolve's administrative services were functionally related to Coordinated Care's insurance business but that its PBM services (selecting and maintaining a network of pharmacies and providing mail-order pharmacy services) were not.

The DOR determined that the amounts Envolve received from Coordinated Care and paid to third-party pharmacies were payments for providing health care services and were subject to tax because they weren't incidental to accomplishing Coordinated Care's insurance business.

A trial court found that Envolve was entitled to a refund of the B&O tax and the Washington Court of Appeals affirmed in a February 2023 decision, finding that Envolve's activities were functionally related to the insurance business.

The appellate court concluded that the PBM services were required to be performed under the managed care contract with the Washington State Health Care Authority and would be considered exempt insurance business activities if performed by Coordinated Care.

The DOR appealed to the Washington Supreme Court.

### Plain Language

The supreme court found that the exemption is available for “any person” under the plain language of the statute, concluding that Envolve met the broad definition of the term for purposes of the exemption.

The court also determined that Envolve’s activities were related to the insurance business based on the managed care contract with the state.

The court said that almost all the services in the managed care contract between the state and Coordinated Care and its contract with Envolve were “activities that the State requires state health insurers to perform,” disagreeing with the DOR’s argument that Envolve’s activities were health care services and not insurance work.

Holding that Envolve was entitled to the exemption even though Coordinated Care paid the premiums tax and Envolve did not, the court noted that the statute does not describe who must pay the tax but instead uses the passive voice to require that the premiums tax be paid.

The court added that the history of the exemption supports its conclusion, noting that the exemption was initially only for insurance companies but was amended to the current, broader language in 1935 when the State Legislature replaced the occupation tax with the B&O tax.

The court also noted that the DOR had interpreted the statute in a 1990 determination to allow the exemption in cases in which a company’s insurance business had been contracted out to an affiliate owned or controlled by the same entity if the activities performed by the affiliate were functionally related to the insurance business. But the DOR withdrew the 1990 determination and the functionally related test in 2019.

### Narrow Tax Exceptions

In a dissenting opinion joined by Justices Mary I. Yu and Raquel Montoya-Lewis and Justice Pro Tempore Stanley J. Rumbaugh, Chief Justice Steven C. González argued that Envolve was entitled to the exemption for only some of its work on behalf of an insurance company.

Stating that the tax exceptions are generally construed narrowly, González said the exemption

was intended to prevent insurance businesses that pay the premiums tax from being taxed twice on the same income.

González argued that there was nothing to indicate that the Legislature intended the exemption to apply to taxpayers who do business with insurance companies but do not pay the premiums tax.

Neither the DOR nor the lawyers for Envolve replied to requests for comments by press time.

### A Pleasant Surprise for Taxpayers

Gregg Barton of Perkins Coie LLP told *Tax Notes* in a December 12 email that the decision, though 5 to 4, is a pleasant surprise for taxpayers. He added that it was not a good omen that the court chose to take this case since the taxpayer prevailed at the court of appeals and the oral argument seemed to sway in favor of the DOR, which may be reflected in the close decision.

“The majority’s holding, in which it concluded that the taxpayer itself need not have paid the premiums tax, and that the scope of the exemption is broader than what the Department would grant, should be valuable to similarly situated taxpayers,” Barton added.

Barton said the majority’s discussion concerning the 1990 determination was also important, adding that published guidance, like the guidance in this case, is statutorily precedential.

In this case, Barton added, the DOR argued that the determination was relevant only if the court concluded that the statute was ambiguous, but the court’s analysis didn’t appear to have been so limited.

“The court’s task was easier since it found the plain language and determination to be consistent, but one can only hope that the court would uphold the taxpayer’s reliance on the determination even if it found the language of the statute ambiguous,” Barton stated.

The taxpayer in *Envolve Pharmacy Solutions Inc. v. Department of Revenue* (No. 101845-2) is represented by Brett Durbin, Daniel A. Kittle, and Callie A. Castillo of Lane Powell PC. ■