

Cite as Det. No. 15-0333, 35 WTD 361 (2016)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of) D E T E R M I N A T I O N
Assessment of)
) No. 15-0333
)
...) Registration No. . . .
)

[1] RULE 168; RCW 82.04.620: B&O TAX – EXEMPTIONS – CERTAIN PRESCRIPTION DRUGS. The “federal rate” means the rate at which the federal government or its agents will reimburse providers for prescription drugs. Because the taxpayer was completely reimbursed by the federal government for the drugs it prescribed at the amounts billed on its invoices, the taxpayer is entitled to deduct charges for drugs where the Medical Payment Allowance Limit was rounded up to the nearest cent on taxpayer’s billing invoices.

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.

Weaver, A.L.J. – Taxpayer petitioned for the correction of an assessment, claiming it was entitled to a larger business and occupation (B&O) tax credit, because certain deductions for prescription drugs were improperly disallowed by the Audit Division of the Department of Revenue (Department). Taxpayer’s petition is granted.¹

ISSUE

Whether, under RCW 82.04.620, a taxpayer that rounds Medicare prescription drug prices set by the federal government up to the nearest cent is entitled to a deduction for prescription drugs.

FINDINGS OF FACT

[Taxpayer] operates a group of medical clinics comprised of multi-specialty physicians. Taxpayer has multiple locations in Washington. Taxpayer was audited for the period of January 1, 2009 through December 31, 2012, by the Department of Revenue’s Audit Division. During the audit, the Audit Division examined amounts deducted by Taxpayer from its business and occupation (B&O) tax for drugs for infusion or injection. The Audit Division disallowed all of Taxpayer’s deductions that exceeded Medicare Payment Allowance Limits for Medicare Part B Drugs. The deductions disallowed by the Audit Division technically exceeded the Payment

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

Allowance Limits, because the Taxpayer rounded the amounts it was billing for drugs for infusion or injection to the nearest full cent.

The Payment Allowance Limits for Medicare Part B Drugs are disseminated by the Centers for Medicare & Medicaid Services (CMS). As an illustration, we list the Payment Allowance Limits² for three selected drugs here:

<u>Short Description</u>	<u>Payment Limit</u>
Rabies vaccine (im) (HCPCS Code 90675)	\$. . . (for 1ML)
Pneumococcal vaccine (HCPCS Code 90732)	. . . (for .5 ML)
Flu Vaccine (6-35 mo, im) (HCPCS Code 90657)	. . . (for 0.25 ML)

As evidenced by these examples, the Payment Allowance Limits are set to three places after the decimal point. Taxpayer used the Payment Allowance Limits to set its pricing for the drugs it sold to patients for infusion or injection.

Because Taxpayer does not bill to the thousandth of a dollar, Taxpayer, on its billing invoices, rounded the amounts set in the Payment Allowance Limits to the nearest cent. This practice is what caused the Audit Division to disallow certain of Taxpayer's deductions. Where the Payment Allowance Limit ended in a number in the final decimal place of 4 or less, Taxpayer rounded down to the nearest cent. Where the Payment Allowance Limit ended in a number in the final decimal place of 5 or more, Taxpayer rounded up to the nearest cent. When Taxpayer rounded down, the Audit Division allowed the deduction. When Taxpayer rounded up, the Audit Division did not.

The CMS prepared a Medicare Claims Processing Manual to assist medical clinics on how to process claims. Paragraph 20.1 of that Manual reads, in relevant part, as follows:

**20.1 – MMA Drug Pricing – Average Sales Price
(Rev. 1513; Issued: 05-23-08; Effective/Implementation Date: 06-23-08)**

...
The ASP³ pricing file shall contain 3 places after the decimal point in the currency field for the ASP file and contractors shall load the ASP file including 3 places after the decimal point. Contractors shall carry 3 places after the decimal point for the calculation of the amount due for a line item for each covered drug, then follow standard rounding procedures in determining the final allowance for that line item. The final allowed amounts will continue to carry 2 places after the decimal point.

Medicare Claims Processing Manual, U.S. Centers for Medicare & Medicaid Services, Rev. 3085 (Oct. 3, 2014), Chapter 17, ¶ 20.1. Taxpayer states that it followed these procedures in its billing practices.

² These amounts come from the Payment Allowance Limits for Medicare Part B Drugs, effective July 1, 2015 through September 30, 2015.

³ Average Sales Price

Moreover, Taxpayer sought reimbursement from Medicare or the Washington Basic Health Plan for all of the invoiced drugs. Taxpayer received reimbursement for all of the drugs at issue in the appeal. In other words, Medicare reimbursed Taxpayer at the amounts it billed on its invoices in full, even when Taxpayer rounded up to the nearest cent.

On September 5, 2013, the Audit Division issued Assessment No. . . . , in the amount of \$. . . , which included \$. . . in use tax/deferred sales tax, a credit of \$. . . in service and other activities B&O tax, and \$. . . in interest. Taxpayer appealed this assessment arguing that its credit for service and other activities B&O tax was incorrectly reduced as a result of the Audit Division's disallowances.

ANALYSIS

RCW 82.04.220 imposes the business and occupation ("B&O") tax "for the act or privilege of engaging in business activities." Persons, such as Taxpayers, who are engaged in a service business or business that is not specifically taxed under another B&O tax classification, are generally required to pay B&O tax under RCW 82.04.290(2), measured by the "gross income of the business."

RCW 82.04.620 provides a prescription drug deduction, and reads as follows:

Exemptions — Certain prescription drugs.

In computing tax there may be deducted from the measure of tax imposed by RCW 82.04.290(2) amounts received by physicians or clinics for drugs for infusion or injection by licensed physicians or their agents for human use pursuant to a prescription, but only if the amounts: (1) Are separately stated on invoices or other billing statements; (2) do not exceed the then current federal rate; and (3) are covered or required under a health care service program subsidized by the federal or state government. The federal rate means the rate at or below which the federal government or its agents reimburse providers for prescription drugs administered to patients as provided for in the medicare, part B, drugs average sales price information resource as published by the United States department of health and human services, or any successor index thereto.

RCW 82.04.620. In this case, there is no dispute that prongs (1) and (3) of the statute are met. The only issue is whether the amounts stated on Taxpayer's invoices or billing statements that were disallowed as deductions by the Audit Division exceeded the "then current federal rate."

WAC 458-20-168 (Rule 168) is an administrative rule promulgated for guidance in interpreting RCW 82.04.620. It reads, in relevant part, as follows:

(j) **Prescription drugs administered by the medical service provider.** RCW 82.04.620 allows a deduction from the measure of tax for reporting under the service and other activities classification of the B&O tax (RCW 82.04.290) for amounts earned by physicians or clinics for drugs for infusion or injection by licensed physicians or their

agents for human use pursuant to a prescription. This deduction only applies to amounts that:

- (i) Are separately stated on invoices or other billing statements;
- (ii) Do not exceed the then current federal rate; and
- (iii) Are covered or required under a health care service program subsidized by the federal or state government.

For the purpose of this deduction only, amounts that “are covered or required under a health care service program subsidized by the federal or state government” include any required drug copayments made directly from the patient to the physician or clinic.

(A) “Federal rate” means the rate at or below which the federal government or its agents reimburse providers for prescription drugs administered to patients as provided for in the medicare, Part B, drugs average sales price information resource as published by the United States Department of Health and Human Services, or any index that succeeds it.

(B) The deduction is available on an “all or nothing” basis against the total amount earned for a specific drug charge. If the total amount earned by the physician or clinic for a specific drug exceeds the federal reimbursement rate, none of the total amount earned qualifies for the deduction (including any required copayment received directly from the patient). In other words, a physician or clinic may not simply take an “automatic” deduction equal to the federal reimbursement rate for each drug

Rule 168(9)(j) (emphasis added). . . .

“Federal rate” is defined in Rule 168 as “the rate at or below which the federal government or its agents reimburse providers for prescription drugs administered to patients as provided for in the medicare, Part B, drugs average sales price information resource.” Rule 168(9)(j). In this case, there is no dispute that the amounts Taxpayer invoiced were reimbursed by the federal government. Indeed, the evidence tends to show that Taxpayer rounded its billings to the nearest cent in the manner instructed by CMS. [See *Medicare Claims Processing Manual*, U.S. Centers for Medicare & Medicare Services, Rev. 3085 (Oct. 3, 2014), Chapter 17, ¶ 20.1.] Therefore, we hold that all of Taxpayer’s billings, whether rounded up or down to the nearest cent, meet the definition of the “federal rate,” and are therefore, all eligible for the deduction under RCW 82.04.620.

Moreover, in interpreting statutes, courts are to avoid constructions that yield unlikely, absurd, or strained consequences. See *Killian v. Atkinson*, 147 Wn.2d 16, 21, 50 P.3d 638 (2002). “Departure from the literal construction of a statute is justified when such a construction would produce an absurd and unjust result and would clearly be inconsistent with the purposes and policies of the act in question.” *State v. McDougal*, 120 Wn.2d 334, 351, 841 P.2d 1232 (1992) (quoting 2A N. Singer, *Statutory Construction*, § 45.12 (4th ed. 1984)). In the context of this case, where the Taxpayer is rounding its drug prescription billings to the nearest cent in the manner prescribed by CMS, we find the Audit Division’s denial of the deduction for Taxpayer’s drug billings that were rounded up to be contrary to the purposes and policies of the statutory prescription drug deduction.

In this case, Taxpayer followed CMS rounding procedure in its billing practices and Taxpayer was actually reimbursed in full by the federal government for the drugs it sold. Indeed, Rule 168(9)(j) states that the “federal rate” means the rate at which the federal government or its agents will reimburse providers for prescription drugs.⁴ There is no dispute that Taxpayer was completely reimbursed for the prescribed drugs at the amounts it billed on its invoices. For these reasons, we hold that the Audit Division improperly disallowed Taxpayer’s deductions for drugs where the Medicare Payment Allowance Limit was rounded up to the nearest cent on Taxpayer’s billing invoices.

DECISION AND DISPOSITION

Taxpayer’s petition is granted.

Dated this 1st day of December, 2015.

⁴ This portion of the rule is in accord with the Final Bill Report in the legislative history for the prescription drug deduction statute, which states: “To qualify for the deduction, the drugs must not be sold for an amount that exceeds the rate at which the federal government reimburses under Medicare Part B.” Final Bill Report, Senate Bill 1891, Chapter 447, Laws of 2007.