PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION

99-D30

PROVIDER -

Columbia/HCA HealthCare Corporation
90 Franchise Tax - Louisiana, Highland Hospital, North Monroe Hospital & Lake Area Medical Center

Provider Nos. 19-0112
19-0197
19-0201

vs.

INTERMEDIARY -
Blue Cross and Blue Shield Association/
Trispan Health Services

DATE OF HEARING-
June 25, 1998

Cost Reporting Period Ended -
Various

CASE NO. 93-1376G

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ISSUE:

Was the Intermediary's classification of the Louisiana franchise tax as an operating cost rather than a capital cost proper?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Columbia/HCA Healthcare Corporation owns the three different providers participating in this group appeal: Highland Hospital, North Monroe Hospital, and Lake Area Medical Center ("Providers"). Each of the Providers paid franchise taxes for doing business in Louisiana. The Providers seek to have the franchise tax classified as a capital cost as opposed to an operating cost. Trispan Health Services ("Intermediary") has treated these costs as operating costs for the fiscal years at issue. The Providers have filed timely appeals from their Notices of Program Reimbursement ("NPRs"). The Providers filings have met the jurisdictional requirements of 42 C.F.R. §§ 405.1835-.1841. The Medicare reimbursement in dispute is approximately $95,000.

The Providers paid franchise taxes for doing business in Louisiana. The franchise tax "base" in Louisiana is the greater of: 1) the assessed value of real and personal property in Louisiana, or 2) capital stock, surplus, undivided profits, and borrowed capital. See La. Rev. Stat. §§47:601.A and 47:606.C.[1] For each of the Providers in the group, capital stock, surplus, undivided profits and borrowed capital was a higher figure than the assessed value of real and personal property in Louisiana. Thus, each of the Providers incurred franchise tax expense based upon their capital stock, surplus, undivided profits and borrowed capital. A substantial portion of the franchise tax base for the Providers was borrowed capital, which is by definition long term debt.

Jurisdictional Issues

The Intermediary raised two jurisdictional objections. With respect to one Provider, Highland Hospital for fiscal year ended ("FYE") May 31, 1988, the Intermediary asserts that the appeal was dismissed prior to the addition of the franchise tax issue. The Intermediary also claims that the Board does not have jurisdiction in instances where the Providers claimed the franchise taxes as operating expenses instead of as capital costs on their cost reports and only later tried to add the issue to their appeals. The Intermediary points out that in these cases there was no Intermediary adjustment in dispute.

With respect to the closed case issue, the Board notes that Highland Hospital had its appeal closed by the Board on June 2, 1992. The Providers claim that the Highland Hospital appeal

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[1] Providers Exhibit D.

was closed erroneously,[2] and therefore that its subsequent request, dated December 8, 1992, to add the franchise tax issue to the appeal should be honored. The Board finds that the case was properly closed by the Board on June 2, 1992. Although the Providers may have been entitled to reopen the case because it never received an Intermediary hearing, the case was not open when the request was made to add the franchise tax issue to the appeal and transferred it to the group appeal. The Board therefore finds that the Highland Hospital for FYE 1988 is excluded from this appeal.

With respect to the lack of an audit adjustment for some of the Providers, the Board notes that all Providers in this group filed timely appeals from their NPRs. One Provider, North Monroe Hospital, on its FYE December 31, 1990 cost report, claimed the franchise tax cost as capital related, and the Intermediary, through an audit adjustment, reclassified those costs as operating. The other Providers, citing compliance with two intermediary manual provisions, HCFA Pub. 13-4 § 4199 and HCFA Pub. 13-2 § 2048, claimed the costs as operating costs. The Board notes that the franchise costs were claimed on the cost report and that the Board has jurisdiction over the entire cost report. See 42 U.S.C. § 1395oo(d). The Board accepts jurisdiction over the remaining Providers in the group.

The Providers were represented by Laurence D. Getzoff, Esquire, and Jon P. Neustadter, Esquire, of Hooper, Lundy & Bookman, Inc. The Intermediary was represented by Bernard M. Talbert, Esquire, of Blue Cross and Blue Shield Association.

PROVIDERS' CONTENTIONS:

The Providers contend that the portion of the Louisiana franchise tax levied upon a valuation of the Providers' fixed assets is a capital related cost under the relevant regulations and manuals. The Providers contend that much of their borrowed capital is "some valuation" of land or depreciable assets, because the debt and intercompany accounts that make up the borrowed capital were used to acquire land or depreciable assets. Thus, a tax calculated on such long term debt and intercompany accounts, the Providers contend, is a tax based upon a valuation of land or depreciable assets, and is therefore a capital related cost.

The Providers assert that a substantial portion of the Louisiana franchise tax base consists of the Providers, "borrowed capital." See La. Rev. Stat. § 47:606.C. By definition, borrowed capital consists of certain long term debt obligations, including intercompany transfers, such as loans from a parent corporation to one of its subsidiaries. See La. Rev. Stat. § 47:603 (defining "borrowed capital" as all indebtedness of more than one year and including amounts owed to an affiliated corporation). The Providers contend that their long term debt and the debt in the intercompany accounts, used in calculating the Providers' Louisiana franchise tax assessment, were incurred in order to acquire land and depreciable assets. As such, the Providers contend that the long term debt and intercompany accounts included in the

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[2] See June 10, 1998 letter.

Louisiana franchise tax base represent a valuation of land and depreciable assets.

The Providers also contend that since the Health Care Financing Administration's (“HCFA’s”) own regulations and manual provisions provide that taxes assessed against the value of a provider's depreciable assets or land are treated as capital related costs, the taxes assessed against the Providers’ long term debt and intercompany accounts in this case are likewise a capital related cost. See 42 C.F.R. § 413.130 and HCFA Pub. 15-1 § 2806.1 and § 2806.2.

The Providers contend that the regulatory and manual provisions support the Providers’ key point in this case: a tax on borrowing associated with the purchase of land and real property is indeed a
tax based on a valuation of land or depreciable assets. The pertinent provisions do not require any particular form of valuation and certainly do not limit capital related taxes to taxes labeled as "property" taxes.

The Providers further contend that their balance sheets clearly show an equivalency between long term debt and intercompany accounts on the one hand and fixed assets on the other hand. The Providers contend that because the franchise tax base is equivalent to the Providers’ assets, the portion of the franchise tax base associated with fixed assets is determinable. The portion of the franchise tax base, the Providers contend, that is associated with the value of fixed assets is the portion of the franchise tax expense that is capital related.

The Providers contend that they have appropriately calculated the portion of the franchise tax expense that is capital related. The Providers presented a detailed calculation of that portion of the franchise tax which is capital related.[3] The calculations utilize a formula that is fully consistent with the concept that the Providers' fixed assets are a mirror reflection of the Providers’ long term debt and intercompany accounts.' This makes sense because the Providers’ fixed assets were acquired by way of long term debt and the borrowed capital represented by their intercompany accounts.

Using the Providers’ franchise tax returns, the following formula was used to establish that portion of the Providers' Louisiana franchise tax expense that is capital related: current assets (CA) + fixed assets (FA) + other assets (OA) - current liabilities (CL) = other liabilities (OL) + intercompany accounts (I/C) + long term liabilities (LTD) + capital stock (E) (“the formula”). The right side of this formula is the Louisiana franchise tax base. The Providers contend that the formula, therefore, establishes that the Providers’ long term debt and intercompany accounts are directly linked to the acquisition and valuation of fixed assets, such as land and depreciable assets.

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[3] Providers Exhibit 17.

The Providers also presented testimony with respect to a hypothetical situation in which a hospital is bought and then assessed the franchise tax on that very same day.[4] The Providers contend that this hypothetical demonstrated again that the formula accurately reflects that the franchise tax is assessed on the value of fixed assets. Before the hospital begins operations, all that the books of the hospital show is the value of the fixed asset (the hospital) on one side of the formula and the same amount as a liability (through an intercompany loan) on the other side of the formula. Although the franchise tax is assessed against the liability side of the formula, i.e., the intercompany account, the tax is a tax on the value of the fixed assets.[5]

After establishing the equivalency (using the figures on the franchise tax returns at issue) between the franchise tax base, on the one hand, and current, fixed, and other assets (less current liabilities), on the other hand, the Providers then established a ratio of fixed assets to total assets.[6] Using this methodology, the Providers contend, makes certain that the Providers only claim as capital related that portion of the franchise tax base associated with acquiring fixed assets, such as land and depreciable assets. The Providers presented calculations of the franchise tax expense for each of the Providers' fiscal years.[7]

The Providers contend that basic canons of statutory construction require that taxes assessed against the Providers' borrowed capital be treated as capital related costs. The Providers contend that the use of the term "related" in the statute is significant and must allow for the exclusion from the Prospective payment system ("PPS") of more than just direct capital costs. The plain language of the term "related" allows for the treatment of a portion of the franchise tax expense at issue in this case as capital related.

Finally, the Providers contend that University Medical Center v. Blue Cross & Blue Shield Association/Blue Cross and Blue Shield of Tennessee, PRRB Decision No. 92-D59, September 4, 1992, Medicare & Medicaid Guide (CCH) ¶ 40,740, declined rev. HCFA Administrator, October 14, 1992 ("University") is not inconsistent with ruling in the Providers' favor in this case. This is because the University decision did not involve a franchise tax based upon borrowed capital.

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4 Tr. at 105-108.

5 See Providers Exhibit 20.

6 See Providers Exhibit 14.

7 See Providers Exhibit 18.

<u>INTERMEDIARY'S CONTENTIONS</u>:

The Intermediary contends that only one Provider claimed the costs as capital related and Board jurisdiction does not exist for the other Providers in the case. The Intermediary asserts that under the Louisiana Statutes, the franchise tax is levied by the state in order to carry on or do business in the state in a corporate form and therefore, the franchise tax is not a capital-related cost as defined under 42 C.F.R. § 413.130. The Intermediary contends that the nature of the tax, a cost of doing business, should not be equated to how it is determined. It is not a tax on land or depreciable assets, that is, a property tax, which would be capital-related. The Intermediary contends that the basis of the tax, what factors the tax uses in the computation, does not change the nature of the expense.

The Intermediary points out that only one Provider in the group, North Monroe Hospital, for FYE 1990, claimed the Louisiana franchise taxes on its as-filed cost reports as a capital related cost. The other Providers reported it as an operating cost and consequently, there are no Intermediary adjustments. The Intermediary maintains that a provider does not have a right to a hearing unless “[a]n intermediary determination has been made with respect to the provider.” 42 C.F.R. §405.1835(a)(1). Since no intermediary determination was made with respect to the Providers that claimed the franchise tax as an operating cost, they have no right to a hearing. Instead the Providers should have sought a reopening pursuant to 42 C.F.R. § 405.1885.

The Intermediary notes that pursuant to the franchise tax "base" in Louisiana is the greater of: the assessed value of real and personal property in Louisiana, or capital stock, surplus, undivided profits and borrowed capital. For each of the providers in the group, the franchise tax was based on that providers' capital stock, surplus, undivided profits and borrowed capital. The Providers contend that the portion of the franchise tax based on its borrowed capital should be considered a capital related cost.

The Intermediary states that the Louisiana statutes, the franchise tax is levied by the state of Louisiana in order to carry on or do business in the state in a corporate form. The tax is required to do business in the state, a cost of doing business. The statute states that the tax is levied for any one of the following:

1. The qualification to carry on or do business in this state or the actual doing of business within this state in a corporate form . . .

2. The exercising of a corporation's charter or the continuance of its charter within the state.

3. The owning or using any part or all of its capital, plant, or other property in this state in a corporate capacity.

Therefore, the Intermediary contends that the franchise tax is not a capital-related cost as defined in the regulation, which states in part:

> (a) General rule. Capital-related costs and an allowance for return on equity are limited to the following:...
>
> (2) Taxes on land or depreciable assets used for patient care.

42 C.F.R. § 413.130.

The Louisiana Corporation Franchise Tax, assessed against corporations as a right to operate in the state of Louisiana, is based, for these providers, on stock, surplus, undivided profits and borrowed capital. The Providers argue that the tax on the portion of borrowed capital, as it relates to land and depreciable assets, should be considered as a capital related cost. The Intermediary contends that the nature of the tax, a cost of doing business, should not be equated to how it is determined. It is not a tax on land or depreciable assets, that is, a property tax, which would be capital-related. It is a tax to operate in the state.

The Providers cite the manual provisions on capital related costs as follows:

> [t]his section sets forth some of the costs that are excluded from capital-related costs. To the extent that these costs may be allowable, they may be included in determining each provider's operating costs. Exclusions from capital-related costs include:
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> . . .
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> e. taxes other than those assessed on the basis of **some valuation** of land or depreciable assets used for patient care ...

HCFA Pub. 15-1 § 2806.2 (emphasis added).

The Provider argues that the portion of the tax based on borrowed capital, used to finance capital-related assets used for patient care, is "some valuation" of land or depreciable assets and should also be considered a capital-related tax. The Intermediary contends that the basis of the tax, what factors the tax uses in the computation, does not change the nature of the expense. The tax expense is a cost of operating a corporate business in the state, not a tax on its capital assets, as defined by the Medicare Program. Therefore, the tax should not be construed as being capital-related by how it is based, but viewed as what it is, an operating cost.

In University, supra, the Board ruled that "the franchise tax is allowable as a capital-related cost to the extent it is based on the value of land and depreciable property." Medicare and Medicaid Guide (CCH) ¶40,740, at 32,491. The Intermediary respectfully disagrees with this conclusion.

There is no question that the franchise tax expense is an allowable cost. The court cases cited in PRRB decision affirm the allowability of the franchise tax but the Intermediary asserts that this not in the question here.

The Intermediary also contends that the capital related provisions should not be construed as broadly as the Provider contends. Taxes on land or depreciable assets are capital related. Franchise taxes, according to the generally accepted accounting principles (“GAAP”), are operating expenses. Hypothetically speaking, if a lawn maintenance contract calls for payment based on the square footage of the property, the Medicare Program would not consider this cost as a capital-related cost because it is based on the area of the land. The basis of the expense does not change the nature of the cost. If an administrator’s salary is somehow tied into the value of the building, this cost would not be capital-related because it is linked to the value of the building. It would still remain an operating cost. Likewise, a franchise tax tied into the value of the land should remain an operating cost, not be somehow connected to depreciable assets to change its classification to a capital-related cost.

The Intermediary notes that the Providers are trying to link the franchise tax to “borrowed capital” that is used to acquire land and depreciable assets. This is also contrary to the regulation which states that taxes on land and depreciable assets used for patient care may be considered capital related costs. The link between the borrowed capital and the depreciable assets is not in question. It is whether the Medicare program intended capital related costs to be determined based on borrowed capital. The regulation does not support this approach.

In summary, the Intermediary contends that franchise taxes are not taxes on land or depreciable assets used for patient care, as stated in 42 CFR § 413.130. The franchise tax is a cost of doing business. The franchise tax should not be construed as a capital-related cost, but remain an operating cost. The Intermediary's adjustment for the one Provider with an adjustment should be affirmed. And if the Board grants jurisdiction to the other Providers, their franchise taxes costs should not be reclassified as capital related costs, but remain as operating costs.

CITATIONS OF LAWS, REGULATIONS AND PROGRAM INSTRUCTIONS:

1. Laws -42 U.S.C.:

§ 1395x(v)(1)(A) - Reasonable Cost

§ 1395oo(d) - Provider Reimbursement Review Board

2. Regulations - 42 C.F.R.:

§ 405.1835 - Right to a Board Hearing; Criteria

§ 405.1885 - Reopening a Determination or Decision

§ 413.9 - Cost Related to Patient Care

§ 413.130 et seq. - Capital-related Costs

3. Program Instructions - Provider Reimbursement Manual, Part I (HCFA Pub. 15-1):

§ 2806.1 - Costs Included in Capital-related Costs

§ 2806.2 - Costs Excluded From Capital-related Costs

4. Cases:

Gurnsey v. Shalala, 115 S. Ct. 1232 (1995).

University Medical Center v. Blue Cross & Blue Shield Association/Blue Cross and Blue Shield of Tennessee, PRRB Decision No. 92-D59, September 4, 1992, Medicare & Medicaid Guide (CCH) ¶ 40,740, declined rev. HCFA Administrator, October 14, 1992

5. Other:

La. Rev. Stat. §§47:601 et seq. - Louisiana Corporate Franchise Tax

HCFA Pub. 13-2 § 2048 - Grouping Sheet for Hospital Data Profile

HCFA Pub. 13-4 § 4199 - Administrative and General Expenses

GAAP Guide § 33.01 - Real and Personal Property Taxes

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board, after consideration of the facts, parties' contentions, evidence presented, testimony elicited at the hearing, and post hearing brief, finds and concludes as follows:

The Board majority finds that the Louisiana Franchise tax is a cost of doing business and, thus, is an operating cost. The Board majority also finds that the Medicare rules provide that franchise taxes be treated as operating costs and that the method of determining the franchise tax does not change it into a property tax allowable under capital related costs. The Board majority further finds that the a franchise tax based on borrowed capital does not meet the property tax requirements of 42 C.F.R. § 413.130 and HCFA Pub. 15-1 § 2806.1 and § 2806.2.

The Board majority points out the language of the Louisiana Corporate Franchise Tax statute states that the tax is levied in order "to carry on or do business in the state or the actual doing of business with this state in a corporate form." See La. Rev. Stat. § 47:601.A.1. The Board majority finds the franchise tax to be a cost of doing business as opposed to a property tax. The Board majority agrees with the Intermediary that the method by which the franchise tax is determined should not change the nature of the tax from an operating expense to a property tax.

The Board majority notes that property taxes in general are considered a cost of doing business and are treated as operating costs under GAAP. See GAAP Guide § 33.01 The Board points out that except where the manual provisions provide otherwise, costs are to be in accordance with GAAP. See Gurnsey v. Shalala, 115 S. Ct. 1232 (1995). The Board majority notes that the regulation, at 42 C.F.R. § 413.130, allows the inclusion of "taxes on land and depreciable assets used for patient care" in capital related costs. The Board majority also notes that the language of HCFA Pub. 15-1 §2806.2 allows the inclusion of taxes that are based on "some valuation of property or depreciable assets used for patient care." The Board majority further notes that a previous Board decision held that a franchise tax could be included as a capital cost if it were based on some valuation of property or depreciable assets. See University, supra. The Board majority finds, however, that the franchise tax is not a tax on land or other depreciable assets under the regulation and that other provisions of the manual specifically provide that franchise taxes are to be administrative and general versus capital related costs.[8] Thus, the Board majority finds that franchise taxes were not meant to be included under HCFA Pub. 15-1 § 2806.2.

[8] See Providers' Jurisdiction brief at 3 and HCFA Intermediary Manual, Part II § 2048 and Intermediary Manual, Part IV § 4199 in Appendix C.

Even if the Board majority agreed with the decision in University, supra, it does not agree with the Providers' assertion that the tax based on borrowed capital should be allowed because it was used to finance capital related assets used for patient care. The Board majority finds that the tax on borrowed capital in this case is not directly related to land or depreciable assets.

Finally, the Board majority further notes that franchise taxes, as operating costs, were probably included in the development of the PPS rates and should not be reclassified and reimbursed separately as a capital related cost, under HCFA Pub. 15-1 § 2806.2.

In summary, the Board majority finds that the Louisiana franchise taxes is a cost of doing business and should be treated as a operating expenses as opposed to a capital related costs. In the opinion of the Board's majority, there is no need to go further.

DECISION AND ORDER:

The Intermediary's determination to classify franchise taxes as operating costs instead of capital related costs was correct. The Intermediary's determinations are affirmed.

Board Members Participating:
Irvin W. Kues (concurring)
James G. Sleep
Henry C. Wessman, Esquire
Martin W. Hoover, Jr., Esquire
Charles R. Barker (concurring)

Date of Decision: March 22, 1999

FOR THE BOARD:

Irvin W. Kues
Chairman

CAL/HCA 90 FRANCHISE TAX CONCURRENCE

We concur with the decision reached by the majority of The Board, but base our concurrence on a different analysis of the case.

The Board majority primarily based its decision on two understandings:

1. The plan meaning of a franchise tax and the fact that a franchise tax is a fee for doing business in the state.

2. Guidance from two sections from Intermediary operating manuals; namely; Intermediary Manual 13-4 section 4199 and 13-2 section 2048. These Manuals deal with Intermediary audit emphasis and the Hospital Data Profile, respectively.

Our analysis of this case and our concurrence is based on the following three conclusions:

1. Capital related costs include taxes on land and depreciable assets used for patient care.

2. A tax, such as that imposed in this case by the State of Louisiana, if related directly to land and depreciable capital can be a capital related cost.

3. The tax at issue in this case is a tax based primarily on borrowed capital which we find not directly related to land or depreciable capital assets.

Our conclusions are similar to the conclusions reached in a previous Board decision namely University, PRRB Decision No. 92-D59, September 4, 1992, Medicare and Medicaid guide (CCH) ¶40,740 declined review by HCFA Administrator. We note that in that decision the Board concluded that the portion of the Provider's franchise tax that was based on depreciable real and personal property and land is allowed as capital -related cost.

In reaching our conclusions in this case, we relied on the capital related cost regulation and the associated manual interpretation of the regulation. More specifically, we take note of the regulation at §413.130 (a) (2) which states:

(a) General Rule. Capital related costs-----are limited to the following:

(2) Taxes on land or depreciable assets used for patient care.

This is further clarified by the regulation at §413.130 (i) which discusses. "Cost Excluded From Capital - Related Costs." Specifically, section (5) states that, "taxes other than those assessed on the basis of some valuation of land or depreciable assets used for patient care." Id. (emphasis added).

Additionally we take note of HCFA - Pub. 15-1 Section 2806.2 which also deals with Costs Excluded From Capital Related Costs and states:

> This interpretative section sets forth some of the costs that are excluded from capital-related costs. To the extent that these costs may be allowable, they may be included in determining each Provider's operating costs. Exclusions from capital-related costs include:
>
> . . .
>
> e. Taxes other than those assessed on the basis of some valuation of land or depreciable assets used for patient care.

Id. (emphasis added).

The regulation and Manual sections clearly indicate that a tax such as we have in this case can be capital related. We, however, find that a substantial portion of the specific tax in this case is based on borrowed capital which we find not directly related to land or depreciable capital assets.

With due respect to the Board majority in this case we make the following additional observation taken from the Count of Appeals in the Ninth Circuit.[9] This observation deals with the weight given to HCFA - PRM Part I manual sections, as related to the weight given Part II of the manual.

> However, a former Medicare reimbursement policy-maker who testified before the PRRB testified that part II of the Manual was never intended to establish Medicare policy. New policies were properly promulgated through regulations, and occasionally through part I of the Manual. Part II is only an instruction form to help intermediaries fill out Medicare reimbursement forms. The Secretary does not contest this characterization, which is consistent with this court's past descriptions of the Manual.

National Medical Enterprises, 851 F. 2d 291 (9th Cir 1988).

In our judgment Intermediary manuals 13-2 & 13-4 are more instructional and are not directly on point as their purpose is not to interpret the nature of taxes which are allowable as capital costs as HCFA-Pub. 15-1 section 2806.2 does and, therefore, they were never intended to establish Medicare Policy.

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[9] National Medical Enterprises v. Bowen, 851 F. 2d 291 (9th Cir. 1988).

In Summary, we affirm the adjustment of the Intermediary in this case. The Provider failed to prove that the tax at issue in this case was directly related to land and depreciable asset. That is to say that a clear Provider specific connection between borrowed capital and the intercompany accounts payable was not made to the capital assets by the Provider.

Irvin W. Kues

Charles R. Barker