



City Council Agenda Bill

20279

Bill Number

Subject: ORDINANCE REPEALING THE B&O TAX EXEMPTION FOR NONPROFIT RELIGIOUS HEALTHCARE PROVIDERS AND ADOPTING HEALTHCARE-SPECIFIC DEDUCTIONS AND EXEMPTIONS CONTAINED IN THE WASHINGTON STATE B&O TAX CODE.

Summary Statement: On November 4, 2013, Council directed staff to prepare an ordinance that eliminates the current exemption for healthcare providers and adopts healthcare specific deductions and exemptions contained in the Washington State B&O tax code. The attached ordinance will implement the requested changes to the BMC and is being presented for council consideration. The next step would be to schedule a public hearing on the proposed changes to the Bellingham Municipal Code.

The attached memorandum provides information on a payment-in-lieu-of-taxes (PILOT) alternative that has subsequently been proposed.

Previous Council Action: July 15th, August 12, and November 4, 2013 committee work sessions.

Fiscal Impact: Repealing the B&O tax exemption will result in an increase in General Fund revenue. Depending upon the option chosen, General Fund revenue may increase up to \$1.2 million (see memo).

Funding Source: N/A

Attachments: Ordinance
Referenced RCWs
January 27, 2014 Finance & Legal staff update memorandum
October 23, 2013 Background & discussion memorandum

Meeting Activity	Meeting Date	Staff Recommendation	Presented By	Time
Committee Briefing Council Direction Requested	27-Jan-2014	Provide Direction to Staff	Brian Henshaw	10

Council Committee:

Finance and Personnel
Michael Lilliquist, Chair
Gene Knutson; Terry Bornemann

Committee Actions:

Council Action:

Agenda Bill Contact:

Brian Henshaw

Reviewed By
Brian Henshaw, Finance
Matt Stamps, Legal

Initials	Date
BH	1/21/14
MS	1/21/14

Legal
Mayor

MTS KL	1/21/14 1-21-14
-----------	--------------------

ORDINANCE NO. _____

AN ORDINANCE OF THE CITY OF BELLINGHAM, WASHINGTON REPEALING THE BUSINESS AND OCCUPATIONS TAX EXEMPTION FOR NONPROFIT RELIGIOUS HEALTHCARE PROVIDERS AND ADOPTING CERTAIN HEALTHCARE-SPECIFIC DEDUCTIONS AND EXEMPTIONS CONTAINED IN THE WASHINGTON STATE BUSINESS AND OCCUPATIONS TAX CODE.

WHEREAS, Washington state law authorizes Washington cities to register businesses and to collect fees and taxes, including a gross receipts business and occupation tax ("B&O tax"); and

WHEREAS, the City of Bellingham (the "City") imposes B&O tax upon every person engaging in business activities within the City, subject to certain specific exemptions and deductions, in accordance with Bellingham Municipal Code ("BMC") Chapters 6.04 and 6.05; and

WHEREAS, the City's B&O tax code currently exempts from B&O tax the gross income of nonprofit religious healthcare providers; and

WHEREAS, the City desires to amend its B&O tax code to repeal the B&O tax exemption for nonprofit religious healthcare providers; and

WHEREAS, the City desires to further amend its B&O tax code to adopt certain provisions of the Revised Code of Washington that provide persons operating medical or other healthcare facilities with certain deductions and exemptions from Washington state B&O tax so that these same deductions and exemptions may be claimed against City B&O tax; and

WHEREAS, the City believes that repealing the B&O tax exemption for nonprofit religious healthcare providers and replacing it with certain healthcare-specific deductions and exemptions available under the Washington state B&O tax code will promote fairness and equity among medical and other healthcare facilities engaging in business activities within the City; and

WHEREAS, the City further believes that aligning the healthcare-specific deductions and exemptions available under the City's B&O tax code with those that are available under the Washington state B&O tax code will provide administrative efficiencies in reporting and auditing B&O tax.

NOW, THEREFORE, THE CITY COUNCIL OF THE CITY OF BELLINGHAM DOES HEREBY ORDAIN THAT:

Section 1. BMC 6.04.090 is amended as follows:

BMC 6.04.090 - Exemptions

The provisions of this chapter shall not apply to the following:

- A. [UNCHANGED]
- B. [UNCHANGED]
- C. [UNCHANGED]
- D. [UNCHANGED]
- E. [UNCHANGED]
- F. [UNCHANGED]
- G. Health Maintenance Organization, Health Care Service Contractor, Certified Health Plan.

1. This chapter does not apply to any health maintenance organization, health care service contractor, or certified health plan in respect to premiums or prepayments that are taxable under RCW 48.14.0201. However, per RCW 48.14.0201(7), this exemption is not intended to, and shall not, impair the city's ability to impose a tax hereunder upon the health care services directly delivered by the employees of a health maintenance organization under Chapter 48.46 RCW.

2. ~~The gross income received by any religious society, religious association or religious corporation, through the operation of any hospital, clinic, resort or other institution devoted exclusively to the care of healing of human beings; provided, that no exemption is granted where the income therefor inures to the benefit of any physician, surgeon, stockholder, or individual by the virtue of ownership or control of such hospital, clinic, resort, or other institution.~~

- H. [UNCHANGED]
- I. [UNCHANGED]
- J. [UNCHANGED]
- K. [UNCHANGED]
- L. [UNCHANGED]
- M. [UNCHANGED]
- N. [UNCHANGED]

O. [UNCHANGED]

P. [UNCHANGED]

Q. [UNCHANGED]

R. [UNCHANGED]

S. [UNCHANGED]

T. [UNCHANGED]

U. [UNCHANGED]

V. [UNCHANGED]

W. [UNCHANGED]

X. Medical or Other Health Care Facilities. The following provisions of the Revised Code of Washington as presently constituted or hereinafter amended are adopted by reference:

RCW

82.04.324 Exemptions - Qualifying blood, tissue, or blood and tissue banks.

82.04.326 Exemptions - Qualified organ procurement organizations.

82.04.4265 Exemptions - Comprehensive cancer centers.

82.04.4289 Exemptions - Compensation for patient services or attendant sales of drugs dispensed pursuant to prescription by certain nonprofit organizations.

82.04.620 Exemptions - Certain prescription drugs.

Whenever the term "chapter" is used in the above provisions of the Revised Code of Washington, it shall be considered to mean Chapter 6.04 of the Bellingham Municipal Code. Whenever the term "tax" is used in the above provisions of the Revised Code of Washington, it shall be considered to mean the B&O tax imposed by Chapter 6.04 of the Bellingham Municipal Code.

Section 2. BMC 6.04.100 is amended as follows:

BMC 6.04.100 - Deductions

In computing the license fee or tax, there may be deducted from the measure of tax the following items:

A. [UNCHANGED]

B. [UNCHANGED]

- C. [UNCHANGED]
- D. [UNCHANGED]
- E. [UNCHANGED]
- F. [UNCHANGED]
- G. [UNCHANGED]
- H. [UNCHANGED]
- I. [UNCHANGED]
- J. [UNCHANGED]
- K. [UNCHANGED]
- L. [UNCHANGED]
- M. [UNCHANGED]
- N. [UNCHANGED]
- O. [UNCHANGED]

P. Medical or Other Health Care Facilities. The following provisions of the Revised Code of Washington as presently constituted or hereinafter amended are adopted by reference:

RCW

82.04.4297 Deductions - Compensation from public entities for health or social welfare services - Exception.

82.04.4311 Deductions - Compensation received under the federal medicare program by certain hospitals or health centers.

82.04.4337 Deductions - Certain amounts received by assisted living facilities.

Whenever the term "tax" is used in the above provisions of the Revised Code of Washington, it shall be considered to mean the B&O tax imposed by Chapter 6.04 of the Bellingham Municipal Code.

Section 3.

This ordinance shall take effect [REDACTED].

PASSED by the Council this _____ day of _____, 2014.

Council President

APPROVED by me this ____ day of _____, 2014.

Mayor

ATTEST:

Finance Director

APPROVED AS TO FORM:

Office of the City Attorney

Published:

RCW 82.04.324**Exemptions — Qualifying blood, tissue, or blood and tissue banks.
(Effective until July 1, 2016.)**

(1) Except as otherwise provided in subsection (3) of this section, this chapter does not apply to amounts received by a qualifying blood bank, a qualifying tissue bank, or a qualifying blood and tissue bank to the extent the amounts are exempt from federal income tax.

(2) For the purposes of this section:

(a) "Qualifying blood bank" means an exempt organization under 26 U.S.C. 501(c)(3) as existing on June 10, 2004, that is registered pursuant to 21 C.F.R., part 607 as existing on June 10, 2004, and whose primary business purpose is the collection, preparation, testing or processing of blood, on behalf of itself or other qualifying blood bank or qualifying blood and tissue bank. "Qualifying blood bank" does not include a comprehensive cancer center that is recognized as such by the national cancer institute.

(b) "Qualifying tissue bank" means a tissue bank that qualifies as an exempt organization under 26 U.S.C. 501(c)(3) as existing on June 10, 2004, is registered pursuant to 21 C.F.R., part 1271 as existing on June 10, 2004, and whose primary business purpose is the recovery, processing, storage, labeling, packaging, or distribution of human bone tissue, ligament tissue and similar musculoskeletal tissues, skin tissue, heart valve tissue, or human eye tissue. "Qualifying tissue bank" does not include a comprehensive cancer center that is recognized as such by the national cancer institute.

(c) "Qualifying blood and tissue bank" means an exempt organization under 26 U.S.C. 501(c)(3) as existing on June 10, 2004, that is registered pursuant to 21 C.F.R., part 607 and part 1271 as existing on June 10, 2004, and whose primary business purpose is the collection, preparation, testing, or processing of blood, on behalf of itself or other qualifying blood bank or qualifying blood and tissue bank, and the recovery, processing, storage, labeling, packaging, or distribution of human bone tissue, ligament tissue and similar musculoskeletal tissues, skin tissue, and heart valve tissue. "Qualifying blood and tissue bank" does not include a comprehensive cancer center that is recognized as such by the national cancer institute.

(3) A person claiming the exemption under this section must report amounts exempt under this section to the department. Except for persons whose primary business purpose is the collection, preparation, and processing of blood, a person may not claim an exemption under this section for more than one hundred fifty thousand dollars in tax per calendar year.

[2013 2nd sp.s. c 13 § 1202; 2004 c 82 § 1; 1995 2nd sp.s. c 9 § 3.]

Notes:

Intent — 2013 2nd sp.s. c 13: "Part XII of this act is intended to allow flexibility for nonprofit organizations where qualifying activities will be provided by more than one organization. It is not the legislature's intent to expand the lines of nontaxable activity. Therefore, the legislature further intends to reassess the changes made in part XII of this act to ensure the actual fiscal impact reasonably conforms with the fiscal estimate provided in the fiscal note for the legislation." [2013 2nd sp.s. c 13 § 1201.]

Effective date -- 2013 2nd sp.s. c 13: See note following RCW 82.04.43393.

Effective date -- 1995 2nd sp.s. c 9: See note following RCW 84.36.035.

RCW 82.04.324

Exemptions — Qualifying blood, tissue, or blood and tissue banks. (Effective July 1, 2016.)

(1) This chapter does not apply to amounts received by a qualifying blood bank, a qualifying tissue bank, or a qualifying blood and tissue bank to the extent the amounts are exempt from federal income tax.

(2) For the purposes of this section:

(a) "Qualifying blood bank" means a blood bank that qualifies as an exempt organization under 26 U.S.C. 501(c)(3) as existing on June 10, 2004, is registered pursuant to 21 C.F.R., part 607 as existing on June 10, 2004, and whose primary business purpose is the collection, preparation, and processing of blood. "Qualifying blood bank" does not include a comprehensive cancer center that is recognized as such by the national cancer institute.

(b) "Qualifying tissue bank" means a tissue bank that qualifies as an exempt organization under 26 U.S.C. 501(c)(3) as existing on June 10, 2004, is registered pursuant to 21 C.F.R., part 1271 as existing on June 10, 2004, and whose primary business purpose is the recovery, processing, storage, labeling, packaging, or distribution of human bone tissue, ligament tissue and similar musculoskeletal tissues, skin tissue, heart valve tissue, or human eye tissue. "Qualifying tissue bank" does not include a comprehensive cancer center that is recognized as such by the national cancer institute.

(c) "Qualifying blood and tissue bank" is a bank that qualifies as an exempt organization under 26 U.S.C. 501(c)(3) as existing on June 10, 2004, is registered pursuant to 21 C.F.R., part 607 and part 1271 as existing on June 10, 2004, and whose primary business purpose is the collection, preparation, and processing of blood, and the recovery, processing, storage, labeling, packaging, or distribution of human bone tissue, ligament tissue and similar musculoskeletal tissues, skin tissue, and heart valve tissue. "Qualifying blood and tissue bank" does not include a comprehensive cancer center that is recognized as such by the national cancer institute.

[2004 c 82 § 1; 1995 2nd sp.s. c 9 § 3.]

Notes:

Effective date -- 1995 2nd sp.s. c 9: See note following RCW 84.36.035.

RCW 82.04.326**Exemptions — Qualified organ procurement organizations.**

This chapter does not apply to amounts received by a qualified organ procurement organization under 42 U.S.C. Sec. 273(b) in effect as of January 1, 2001, to the extent that the amounts are exempt from federal income tax.

[2002 c 113 § 1.]

Notes:

Effective date -- 2002 c 113: "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and takes effect immediately [March 22, 2002]." [2002 c 113 § 4.]

RCW 82.04.4265**Exemptions — Comprehensive cancer centers.**

(1) This chapter does not apply to amounts received by a comprehensive cancer center to the extent the amounts are exempt from federal income tax.

(2) For the purposes of this section, "comprehensive cancer center" means a cancer center that has written confirmation that it is recognized by the national cancer institute as a comprehensive cancer center and that qualifies as an exempt organization under 26 U.S.C. Sec. 501(c)(3) as existing on July 1, 2006.

[2005 c 514 § 401.]

Notes:

Effective date -- 2005 c 514 §§ 401-403: "Sections 401 through 403 of this act take effect July 1, 2006." [2005 c 514 § 1304.]

Part headings not law -- Severability -- 2005 c 514: See notes following RCW 82.12.808.

RCW 82.04.4289

Exemption — Compensation for patient services or attendant sales of drugs dispensed pursuant to prescription by certain nonprofit organizations.

This chapter does not apply to amounts derived as compensation for services rendered to patients or from sales of drugs for human use pursuant to a prescription furnished as an integral part of services rendered to patients by a kidney dialysis facility operated as a nonprofit corporation, a nonprofit hospice agency licensed under chapter 70.127 RCW, and nursing homes and homes for unwed mothers operated as religious or charitable organizations, but only if no part of the net earnings received by such an institution inures directly or indirectly, to any person other than the institution entitled to deduction hereunder. "Prescription" and "drug" have the same meaning as in RCW 82.08.0281.

[2003 c 168 § 402; 1998 c 325 § 1; 1993 c 492 § 305; 1981 c 178 § 2; 1980 c 37 § 10. Formerly RCW 82.04.430(9).]

Notes:

Effective dates — Part headings not law — 2003 c 168: See notes following RCW 82.08.010.

Findings — Intent — 1993 c 492: See notes following RCW 43.20.050.

Short title -- Severability -- Savings -- Captions not law -- Reservation of legislative power -- Effective dates -- 1993 c 492: See RCW 43.72.910 through 43.72.915.

Intent — 1980 c 37: See note following RCW 82.04.4281.

RCW 82.04.620**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.

[2007 c 447 § 1.]

Notes:

Effective date — 2007 c 447: "This act takes effect October 1, 2007." [2007 c 447 § 2.]

RCW 82.04.4297**Deductions — Compensation from public entities for health or social welfare services — Exception.**

In computing tax there may be deducted from the measure of tax amounts received from the United States or any instrumentality thereof or from the state of Washington or any municipal corporation or political subdivision thereof as compensation for, or to support, health or social welfare services rendered by a health or social welfare organization, as defined in RCW 82.04.431, or by a municipal corporation or political subdivision, except deductions are not allowed under this section for amounts that are received under an employee benefit plan.

[2011 1st sp.s. c 19 § 2; 2002 c 314 § 3; 2001 2nd sp.s. c 23 § 2; 1988 c 67 § 1; 1980 c 37 § 17. Formerly RCW 82.04.430(16).]

Notes:

Application -- 2011 1st sp.s. c 19: See note following RCW 82.04.4277.

Findings – Refund of taxes -- Effective date – 2002 c 314: See notes following RCW 82.04.4311.

Findings – 2001 2nd sp.s. c 23: "The legislature finds that the deduction under the business and occupation tax statutes for compensation from public entities for health or social welfare services was intended to provide government with greater purchasing power when government provides financial support for the provision of health or social welfare services to benefited classes of persons. The legislature also finds that both the legislature and the United States congress have in recent years modified government-funded health care programs to encourage participation by beneficiaries in highly regulated managed care programs operated by persons who act as intermediaries between government entities and health or social welfare organizations. The legislature further finds that the objective of these changes is again to extend the purchasing power of scarce government health care resources, but that this objective would be thwarted to a significant degree if the business and occupation tax deduction were lost by health or social welfare organizations solely on account of their participation in managed care for government-funded health programs. In keeping with the original purpose of the health or social welfare deduction, it is desirable to ensure that compensation received from government sources through contractual managed care programs also be deductible." [2001 2nd sp.s. c 23 § 1.]

Effective date – 2001 2nd sp.s. c 23: "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and takes effect immediately [July 13, 2001]." [2001 2nd sp.s. c 23 § 4.]

Intent -- 1980 c 37: See note following RCW 82.04.4281.

"Health or social welfare organization" defined – Conditions for exemption – "Health or social welfare services" defined: RCW 82.04.431.

RCW 82.04.4311**Deductions — Compensation received under the federal medicare program by certain hospitals or health centers.**

(1) A public hospital that is owned by a municipal corporation or political subdivision, or a nonprofit hospital, or a nonprofit community health center, or a network of nonprofit community health centers, that qualifies as a health and social welfare organization as defined in RCW 82.04.431, may deduct from the measure of tax amounts received as compensation for health care services covered under the federal medicare program authorized under Title XVIII of the federal social security act; medical assistance, children's health, or other program under chapter 74.09 RCW; or for the state of Washington basic health plan under chapter 70.47 RCW. The deduction authorized by this section does not apply to amounts received from patient copayments or patient deductibles.

(2) As used in this section, "community health center" means a federally qualified health center as defined in 42 U.S.C. 1396d as existing on August 1, 2005.

[2005 c 86 § 1; 2002 c 314 § 2.]

Notes:

Effective date – 2005 c 86: "This act takes effect August 1, 2005." [2005 c 86 § 2.]

Findings – 2002 c 314: "The legislature finds that the provision of health services to those people who receive federal or state subsidized health care benefits by reason of age, disability, or lack of income is a recognized, necessary, and vital governmental function. As a result, the legislature finds that it would be inconsistent with that governmental function to tax amounts received by a public hospital or nonprofit hospital qualifying as a health and social welfare organization, when the amounts are paid under a health service program subsidized by federal or state government. Further, the tax status of these amounts should not depend on whether the amounts are received directly from the qualifying program or through a managed health care organization under contract to manage benefits for a qualifying program. Therefore, the legislature adopts this act to provide a clear and understandable deduction for these amounts, and to provide refunds for taxes paid as specified in section 4 of this act." [2002 c 314 § 1.]

Refund of taxes -- 2002 c 314: "A public hospital owned by a municipal corporation or political subdivision, or a nonprofit hospital that qualifies as a health and social welfare organization under RCW 82.04.431, is entitled to:

(1) A refund of business and occupation tax paid between January 1, 1998, and April 2, 2002, on amounts that would be deductible under section 2 of this act; and

(2) A waiver of tax liability for accrued, but unpaid taxes that would be deductible under section 2 of this act." [2002 c 314 § 4.]

Effective date -- 2002 c 314: "This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and takes effect immediately [April 2, 2002]." [2002 c 314 § 5.]

RCW 82.04.4337**Deductions — Certain amounts received by assisted living facilities.**

(1) An assisted living facility licensed under chapter 18.20 RCW may deduct from the measure of tax amounts received as compensation for providing adult residential care, enhanced adult residential care, or assisted living services under contract with the department of social and health services authorized by chapter 74.39A RCW to residents who are medicaid recipients.

(2) For purposes of this section, "adult residential care," "enhanced adult residential care," and "assisted living services" have the same meaning as in RCW 74.39A.009.

[2012 c 10 § 72; 2004 c 174 § 7.]

Notes:

Application -- 2012 c 10: See note following RCW 18.20.010.

Effective date -- 2004 c 174: See note following RCW 82.04.2908.



City of Bellingham

City Hall, 210 Lottie Street

Bellingham, Washington 98225

Telephone: (360) 778-8010 Fax: (360) 778-8001

DATE: JANUARY 27, 2014
TO: CITY COUNCIL & MAYOR LINVILLE
SUBJECT: UPDATE TO DISCUSSION OF B&O TAX EXEMPTION FOR RELIGIOUS HEALTHCARE PROVIDERS

This memorandum provides an update to the October 23, 2013 memorandum discussing various options regarding the cities current B&O tax exemption for religious healthcare providers. A copy of the October 23, 2013 memorandum is included in the packet without attachments.

I. PREVIOUS COUNCIL DIRECTION

At the November 4, 2013 work session, Council directed staff to prepare an ordinance repealing the religious Business & Occupation Tax exemption for nonprofit religious healthcare providers and adopting healthcare-specific deductions and exemptions contained in the Washington State Business & Occupation Tax Code.

The ordinance presented today provides equity among all healthcare providers in Bellingham by uniformly applying the existing services rate of .44% to all healthcare providers. Adopting the existing Washington State healthcare-specific deductions and exemption lessens the impact of repealing the tax exemption and provides some efficiency for tax reporting. Tax filers will be able to utilize the same financial information and apply the same deductions and exemptions when reporting their gross revenue to the city and state.

II. SUBSEQUENT PROPOSAL

The economic impact of repealing the current exemption will provide additional revenue to the city's General Fund. The total increase in revenue is not known at this time because PeaceHealth is not currently required to report to the city. However, in an August 28, 2013 letter, PeaceHealth estimated that their tax liability would be \$1.2 million. Subsequently, PeaceHealth is now proposing to make annual payments-in-lieu-of-taxes (PILOT) to the city for lost B&O tax revenue. This payment would be to compensate the city for lost B&O tax revenue associated with PeaceHealth acquisitions of medical providers.

The chart below is an estimate of the lost city revenue from two acquisitions by PeaceHealth. It is based on the last full year of taxes received by two businesses that were acquired by PeaceHealth. The current impact and accumulated lost revenue was then calculated by multiplying the annual taxes in 2007 and 2010 by the Consumer Price Index: Medical Care (past five years 3.2%). The estimate is provided for information purposes only. Any payment-in-lieu-of-taxes agreement would need to be negotiated and approved by City Council.

Estimated Lost Revenue								
	2007	2008	2009	2010	2011	2012	2013	Total
Acquisition #1	215,294	222,183	229,293	236,631	244,203	252,017	260,082	1,659,703
Acquisition #2				64,676	66,746	68,881	71,086	271,389
	215,294	222,183	229,293	301,307	310,948	320,899	331,168	1,931,092

III. DIRECTION REQUESTED

Staff is requesting council direction to either move forward with a public hearing on the ordinance presented or to move forward with negotiating an alternative payment-in-lieu-of-taxes agreement.



City of Bellingham

City Hall, 210 Lottie Street

Bellingham, Washington 98225

Telephone: (360) 778-8010 Fax: (360) 778-8001

DATE: OCTOBER 23, 2013
TO: CITY COUNCIL & MAYOR LINVILLE
SUBJECT: B&O TAX EXEMPTION FOR RELIGIOUS HEALTH CARE PROVIDERS

I. INTRODUCTION

At its August 12, 2013 meeting, City Council discussed various options for addressing the exemption from business and occupation ("B&O") tax currently provided to religious health care providers under the Bellingham Municipal Code ("BMC"). This memorandum addresses several questions posed by City Council and refines and expands upon the options discussed.

II. EXECUTIVE SUMMARY

The policy objective supporting the religious provider exemption is unclear. This memorandum explores the potential for repealing the religious provider exemption and replacing it with a tax preference for specific healthcare services that further an identifiable public-policy objective.

One option is to repeal the religious provider exemption and replace it with an exemption for healthcare providers who are required by law to provide charity care. Charity care laws require hospitals and federally-qualified health centers to provide healthcare services for free or at a reduced rate to individuals with a family income at or below 200% of the federal poverty level. Uncompensated charity care generates no revenue and, therefore, no B&O tax. Consequently, the real impact of option 1 is that it would allow charity-care providers to avoid B&O tax on income derived from services for which payment is expected and received. For reporting purposes, charity care providers report charity care as income that is then written off. In 2010, PeaceHealth St. Joseph Medical Center reported charity care charges to the Department of Health amounting to 2.21% of the hospital's total revenue and 5.89% of its adjusted revenue (excluding Medicare and Medicaid). This statistic provides cause to consider whether an exemption of *all* revenues earned by charity-care providers is disproportionate to the community benefit derived from charity care.

A second option is to adopt some or all of the healthcare-specific tax preferences available under the state B&O tax code. A significant preference offered by the state is a deduction for nonprofit "health and social welfare organizations" as defined in state law under RCW 82.04.431 (including qualifying non-profit hospitals and community health centers) for amounts received under health service programs

paid for by the federal or state government. The deduction includes amounts received for services covered by Medicare, Medicaid, and other state health care programs under RCW 74.09 (Children's Health and other programs) and RCW 70.47 (Washington State Basic Health Plan). The Legislature stated the public policy objective for this deduction was to not tax amounts paid to public or nonprofit hospitals under a government-subsidized health care program for the care of the elderly, low income, or disabled people, as providing health care for such persons is a recognized, necessary, and vital government function.

If neither of the preceding options strike the right balance, a third option is to adopt a separate set of deductions that allow certain similarly-situated healthcare providers (e.g., non-profits) to avoid B&O tax on all but a select set of services for which B&O tax is deemed appropriate. The financial impacts of this option may be further fine-tuned by adopting a higher or lower B&O tax rate for the services selected for taxation. This option provides additional flexibility but would be more challenging to establish and administer. In essence, this third option is a place holder for an alternative healthcare tax preference that would need to be further developed and refined based upon additional policy direction from Council.

III. BACKGROUND

A. B&O Tax Overview

Percentage Tax on Gross Receipts. B&O taxes are levied at a percentage rate on the gross receipts of the business. Businesses are put in different classes such as extracting, manufacturing, wholesaling, retailing, and services. Within each class the rate must be the same but it may differ among classes.

Imposed by City and State. The City imposes its B&O tax through BMC 6.04. This tax is in addition to B&O tax imposed by the state through Revised Code of Washington ("RCW") 82.04. The City's B&O tax code is relatively simple compared to the State's. The City has only five classifications and two rates: extracting, manufacturing, wholesaling, and retailing are taxed at the rate of .17%; services and other activities are taxed at the rate of .44%. The state has many more classifications and rates.

Deductions and Exemptions. Both the city and the state provide numerous deductions and exemptions within their B&O tax codes. Deductions and exemptions reduce a business's taxable income, as opposed to a tax credit which reduces its tax bill. Neither the city nor the state provide a general tax exemption to non-profit entities.

B. B&O Tax & Health Care

City B&O Tax. Health care providers are subject to City B&O tax at the "services and other activities" rate of .44%, with one notable exception—non-profit health care providers *with a religious affiliation* are altogether exempt from paying City B&O tax. BMC 6.04.090(G)(2) exempts:

The gross income received by any religious society, religious association or religious corporation, through the operation of any hospital, clinic, resort or other institution devoted exclusively to the care of healing of human beings; provided, that no exemption is granted where the income therefor inures to the benefit of any physician, surgeon,

stockholder, or individual by the virtue of ownership or control of such hospital, clinic, resort, or other institution.

The religious provider exemption was included in the original B&O tax code adopted by the City in 1955. The adopting ordinance and meeting minutes provide no insight into the original intent of the exemption.

State B&O Tax. Unlike the City, the state does not exempt religious health care providers from B&O tax. Religious providers are taxed along with other health care providers at the rate of 1.5%. The state does, however, allow numerous deductions, credits and exemptions specific to medical and other health care facilities, including a deduction for Medicare and Medicaid reimbursements.

Jurisdictional Comparison.

	State	Bellingham
Non-Profit Health Care Providers	1.5%	.44%
Non-Profit Health Care Providers with a Religious Affiliation	1.5%	Exempt

C. Charity Care

Charity care was a significant topic of discussion at the August 12, 2013 City Council meeting. Strictly speaking, "charity care" is a creature of state law applicable only to hospitals. However, analogous requirements are imposed by federal law on federally-qualified health centers. Charity care and its interplay with B&O tax is discussed below.

Washington Hospitals. The 1989 Legislature enacted RCW 70.170, which requires Washington hospitals to provide "charity care." Charity care is defined as "necessary hospital health care rendered to indigent persons, to the extent that the persons are unable to pay for the care or to pay deductibles or co-insurance amounts required by a third-party payer." RCW 70.170.020(4). "Indigent persons" means those patients who have exhausted any third-party coverage, including Medicare and Medicaid, and whose family income is at or below 200% of the federal poverty level. WAC 246-453-040. "Hospital" is defined in RCW 70.41.020(4) and is limited to institutions that provide 24-hour medical care.

There are two main components to charity care: *First*, Washington hospitals are prohibited from:

- Denying access to emergency care based on ability to pay. RCW 70.170.060(2).
- Adopting or maintaining admission policies which result in a significant reduction in the proportion of patients who are unable to pay for hospital services. RCW 70.170.060(1).

Second, hospitals are required to subsidize charity care at the following levels:

- Persons with a family income at or below 100% of the poverty level qualify for a full discount of all hospital charges. WAC 246-453-040(1).
- Persons with a family income between 100% and 200% of the federal poverty level qualify for partial discounts from charges in accordance with a sliding fee schedule promulgated by the hospital and approved by the Washington State Department of Health ("DOH"). WAC 246-453-040(2).

Hospitals report charity care as billed charges that are then written off. DOH reports that statewide hospital charity care charges for fiscal year 2010 amounted to 2.62% of total revenue and 5.45% of

adjusted revenue (Medicare and Medicaid taken out). According to the same report, PeaceHealth St. Joseph Medical Center reported charity care charges amounting to 2.21% of total revenue and 5.89% of adjusted revenue (Medicare and Medicaid taken out).

Federally-Qualified Health Centers. Under federal law, entities known as "federally qualified health centers" are subject to similar requirements to care for the indigent, although the term "charity care" is not used. Federally-qualified health centers are defined as non-profit, private or public entities that serve medically underserved areas or populations, including migratory and seasonal agricultural workers, the homeless, and residents of public housing. Public Health Service Act, 42 USC § 254b(a). There are currently two federally qualified health centers in Bellingham: Interfaith Community Health Center ("Interfaith") and SeaMar Community Health Clinics ("SeaMar").

Under federal law, federally-qualified health centers must:

- Assure that no patient will be denied health care services due to an individual's inability to pay for such services, and assure that any fees or payments required for such services will be reduced or waived as necessary to fulfill this assurance. 42 USC § 254b(k)(3)(G).
- Adopt a fee schedule that provides a full discount to individuals and families at or below 100% of the federal poverty level. For those with incomes between 100% and 200% of the federal poverty level, fees must be charged in accordance with a sliding discount policy based on family size and income. 42 CFR Part 51c.303(f).

For ease of reference, the legal requirements applicable to Washington hospitals and federally-qualified health centers with regard to the provision of health care services to patients regardless of their ability to pay (as outlined above) may be referred to collectively hereinafter as "charity care."

Uncompensated Charity Care Generates No Income and, therefore, No B&O Tax. Charity care requirements result in the provision of medical services for free or at reduced fees based on the financial need of the patient. The discounted portion of the service generates no income and, therefore, no B&O tax. The same is true of other forms of uncompensated care, including unreimbursed Medicaid and bad debt. The term "unreimbursed Medicaid" refers to the difference between the rates that the service would normally be billed out at versus the approved Medicaid reimbursement level. B&O tax does not apply to uncompensated Medicaid because, as with charity care, payment is neither expected nor received. (Medicaid prohibits health care providers from "balance billing" patients for the difference between billed charges and Medicaid reimbursement levels.) "Bad debt" refers to uncollectable amounts resulting from patients' or third-party payers' unexcused failure to pay for services rendered. The tax treatment of bad debt is more complicated, but ultimately results in no income and, therefore, no B&O tax.¹ In sum, uncompensated care generates no income and, therefore, no B&O tax.

¹ The treatment of bad debt depends on whether the business keeps its books on a cash basis or an accrual basis. If a business keeps its books on a cash basis, no B&O tax is paid on bad debt because no cash is received. If a business keeps its books on an accrual basis (where income is recognized at the time service is rendered), then bad debt may be subtracted from taxable income during the reporting period in which the bad debt is written off. In this way, no B&O tax is ultimately paid on bad debt.

IV. DISCUSSION

This section discusses three policy options for repealing the B&O tax exemption for religious healthcare providers and replacing it with an exemption or set of deductions tied to specific health care services.

OPTION 1. Repeal the Religious Provider Exemption and Replace it with an Exemption for Entities who are Required by Law to Provide Charity Care

Under this option, government mandated charity-care providers (i.e., hospitals and federally-qualified health centers) would be exempt from B&O tax. As discussed above, charity-care providers already pay no B&O tax on uncompensated charity care because, by definition, uncompensated charity-care generates no revenue against which the tax could apply. Consequently, the real impact of option 1 is that it would allow charity-care providers to avoid B&O tax on income derived from services for which payment is expected and received.

Impacts:

- Equity among charity-care providers.
- Inequity with other healthcare providers (competitive disadvantage).
- Likely reduction in B&O tax revenue.

Policy considerations:

- Whether the exemption is disproportionate to the community benefit derived from charity care.
- Whether the exemption should be expanded to all non-profit health and social welfare organizations as defined in state law under RCW 82.04.431, attached hereto as *Appendix A*.

OPTION 2. Repeal the Religious Provider Exemption and Adopt Deductions Specific to Medical and Other Health Care Facilities under the State B&O Tax Code

Under this option, the City would incorporate by reference all state B&O tax deductions, credits and exemptions specific to medical and other health care facilities under state law. Deductions, credits and exemptions specific to medical and other health care facilities under state law are compiled in WAC 458-20-168(3), a copy of which is attached hereto as Appendix B. The City's B&O tax rate of .44% (rather than the State's rate) would apply to any taxable revenue.

As noted above, a significant tax preference offered by the state is a deduction for nonprofit health and social welfare organizations as defined in state law under RCW 82.04.431 (including non-profit hospitals and federally-qualified community health centers) for amounts received under health service programs paid for by the federal or state government. This deduction is codified in RCW 82.04.4297 and 82.04.4311 and includes amounts received by health and social welfare organizations for services covered by Medicare, Medicaid, and other state health care programs under RCW 74.09 (Children's Health and other programs) and RCW 70.47 (Washington State Basic Health Plan). *See also* WAC 458-20-168(3)(e), (f). The Legislature stated the public policy objective for this deduction as follows:

The legislature finds that the provision of health services to those people who receive federal or state subsidized health care benefits by reason of age, disability, or lack of

income is a **recognized, necessary, and vital governmental function. As a result, the legislature finds that it would be inconsistent with that governmental function to tax amounts received by a public hospital or nonprofit hospital qualifying as a health and social welfare organization, when the amounts are paid under a health service program subsidized by federal or state government.** Further, the tax status of these amounts should not depend on whether the amounts are received directly from the qualifying program or through a managed health care organization under contract to manage benefits for a qualifying program. Therefore, the legislature adopts this act to provide a clear and understandable deduction for these amounts, and to provide refunds for taxes paid as specified in section 4 of this act."

Additional health-care specific deductions available under the State B&O tax code are summarized below:

- Amounts received by organ procurement organizations and blood and tissue banks are exempt to the extent that the amounts are exempt from federal income tax. WAC 458-20-168(3)(a), (g).
- Adult family homes licensed by DSHS, or exempted from licensing requirements by DSHS, are exempt from B&O tax. WAC 458-20-168(3)(c).
- Boarding homes may deduct amounts received as compensation for providing adult residential care, enhanced adult residential care, or assisted living services under contract with DSHS. In addition, non-profit boarding homes may deduct amounts received for providing room and domiciliary care. WAC 458-20-168(3)(h).
- Amounts received from comprehensive cancer centers are exempt to the extent that the amounts are also exempt from federal income tax. WAC 458-20-168(3)(i).
- Hospitals may credit against B&O tax the cost of purchasing mechanical lifting devices and other equipment used to minimize patient handling. WAC 458-20-168(3)(j).

State law contains no exemption for charity care.

Impacts:

- Provides equity among health care providers by applying a uniform rate and neutral tax-preference criteria.
- Provides targeted tax breaks for certain services selected by the state for preferential treatment based upon identifiable policy objectives.
- Likely increase in B&O tax revenue.
- Administrative efficiency.

OPTION 3. Repeal Religious Provider Exemption and Replace with New Set of Deductions and/or New Tax Rate

If neither of the preceding options strike the right balance, a third option is to adopt a separate set of deductions that allow certain similarly-situated health care providers (e.g., non-profits) to avoid B&O tax on all but a select set of services for which B&O tax is deemed appropriate. The financial impacts of this option may be further fine-tuned by adopting a higher or lower B&O tax rate for the services selected for taxation. This option provides additional flexibility but would be more difficult to establish

and administer. In essence, this third option is a place holder for an alternative healthcare tax preference that would need to be further developed and refined based upon additional policy direction from Council.

Policy considerations:

- Difficult to establish, involves high level of subjectivity.
- Difficult to administer, both for the City and its tax payers.
- Impact on B&O tax revenue and equity among providers depends upon the services selected for taxation and the tax rates imposed upon those services.