CALIFORNIA HOSPITAL ASSOCIATION

Providing Leadership in Health Policy and Advocacy

January 16, 2019

Ms. Trista Gonzalez
California Department of Tax and Fee Administration
450 N Street
PO Box 942879
Sacramento, CA 94279-0092

Via email: Trista.Gonzalez@cdtfa.ca.gov

Re: Comments to Second Discussion Paper on Proposed Amendments to Regulation 1503

Dear Ms. Gonzalez:

Thank you for the opportunity to provide comments on the California Department of Tax and Fee Administration's (CDTFA) second discussion paper and proposed amendments to Regulation 1503, released on December 10, 2018. We also appreciate having had the opportunity to discuss the proposed changes during the meeting held on December 17, 2018, and CDTFA's acknowledgement that all hospital claims for services rendered prior to January 1, 2019, will not be impacted by changes made through this rulemaking process.

The California Hospital Association (CHA), representing more than 400 hospitals and health systems, remains opposed to the proposed amendments and requests that CDTFA convene a small workgroup of experts (including hospitals, taxpayers, representatives and CDTFA staff) to seriously consider the future ramifications of the proposed rule. We believe in CDTFA's commitment to building the nation's most effective 21st Century revenue department and adapting to the challenges of the modern marketplace. CDTFA's decision to release a second discussion paper on the proposed amendments signals its dedication to transparency and efforts to implement regulatory changes that are clear for taxpayers, able to be administered and adaptable to future advancements in the health care industry. However, if the proposed rule is finalized as currently written, CHA believes it will hamper the department's effectiveness and restrict its ability to adapt to future advancements. This runs contrary to the department's goals and will require future rulemaking or legislative changes to remedy. **CHA urges CDTFA to convene a small workgroup and consider the full ramifications of the proposed amendments.** Our detailed comments are provided below.

California's Board of Equalization (BOE) decided to treat hospitals as retailers under Regulation 1503(b)(2) in 2001, and should not change the policy now.

Current Regulation 1503 provides guidance to hospitals on the application of sales and use tax to their operations; one section addresses the exemption for sales of tangible personal property to the United States government. Regulation 1503 — in conjunction with Regulation 1591 — recognizes that hospitals sell tangible personal property to the United States government when treating patients covered by

Medicare. Thus, transfers of tangible personal property to Medicare patients are exempt from sales use tax. Under Regulation 1503(b)(2), hospitals are treated as retailers; this policy was formalized in 2001. At that time, the issue was contemplated in-depth by hospital associations, taxpayers, representatives and staff. In the formal issue paper 00-026, BOE staff specifically stated that "facilities will still have the option to be a retailer under the proposed regulation." Clearly, the impact of this decision was fully considered at the time, and the BOE chose not to make substantive changes to the sales and use tax rules. This has remained the case even as the rule has been reviewed numerous times over the years by BOE and California courts.

CDTFA should avoid the use of confidential patient medical records to determine taxability.

The proposed amendments to Regulation 1503 will implicate the administrative/non-administrative regulatory system that existed prior to the 2001 revisions. Reverting to a system that existed prior to 2001 will not only result in a significant amount of administrative work for hospitals, whose small administrative departments are already stressed with compliance in a rapidly changing health care environment, but also runs contrary to CDTFA's goal of simplifying compliance and the verification upon audit. The fact is, to determine the "economic reality" of a transaction, CDTFA auditors will need to review confidential, patient-level medical records; have a detailed understanding of medical procedures and the associated medical products and supplies; and comply with the requirements of the Health Insurance Portability and Accountability Act (HIPAA) of 1996. The BOE chose not to enact regulatory processes that required its auditors to review an individual patient's medical records for multiple reasons — it did not want its auditors reviewing confidential, HIPAA-protected Medicare records, and state tax auditors and administrators do not have the requisite training or medical knowledge to perform such a review.

CDTFA should replace the effective date of January 1, 2019, with a prospective date so that hospitals can prepare for the finalized changes.

January 2019 is well underway, and the actual regulatory process with the Office of Administrative Law can take many months to complete. Assuming no significant issues arise — and assuming these changes do not exceed the $50 million threshold that would require the agency to complete an economic impact assessment— hospitals will be forced to retroactively retract resale certificates, update reporting procedures and establish new compliance processes. This is a significant burden on hospitals and CHA urges CDTFA to consider the ramifications of assuming a January 1, 2019, effective date.

Thank you for your review and consideration of our comments. Please do not hesitate to contact me at rwitz@calhospital.org or Barbara Glaser, CHA senior legislative advocate, at bglaser@calhospital.org with any questions you may have.

Sincerely,

/s/

Ryan Witz
Vice President, Health Care Finance Initiatives
California Hospital Association