

STATE OF NEW YORK

STATE TAX COMMISSION

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| In the Matter of the Petition                 | : |          |
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| of  | : |          |
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| ROCHESTER AREA HEALTH                         | : |          |
| MAINTENANCE ORGANIZATION                      | : | DECISION |
| for Revision of a Determination or for Refund | : |          |
| of Sales and Use Taxes under Articles 28 and  | : |          |
| 29 of the Tax Law for the Sales Tax Quarterly | : |          |
| Periods ended November 30, 1978 through       | : |          |
| May 31, 1980                                  | : |          |

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Petitioner, Rochester Area Health Maintenance Organization, 220 Alexander Street, Rochester, New York, 14607, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the sales tax quarterly periods ended November 30, 1978 through May 31, 1980 (File No. 37508).

A small claims hearing was held before Dennis M. Galliher, Hearing Officer, at the offices of the State Tax Commission, 259 Monroe Avenue, Rochester, New York, on December 7, 1984 at 9:00 A.M., with all briefs to be submitted by February 15, 1985. Petitioner appeared by Chamberlain, D'Amara, Oppenheimer & Greenfield, Esqs. (Michael T. Harren, Esq. of counsel). The Audit Division appeared by John P. Dugan, Esq. (Thomas C. Sacca, Esq., of counsel).

ISSUES

I. Whether petitioner is entitled to exemption from sales and use taxes pursuant to either Tax Law section 1116(a)(2) or 1116(a)(4).

II. Whether, if petitioner is not entitled to exemption as above-noted, such denial of exemption constitutes a discriminatory application of the Tax Law and a denial to petitioner of equal protection.

FINDINGS OF FACT

1. On February 26, 1982, following an audit, the Audit Division issued to petitioner, Rochester Area Health Maintenance Organization, a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the sales tax quarterly periods ended November 30, 1978 through May 31, 1980 in the amount of \$16,362.52, plus minimum statutory interest.

2. Petitioner operates as a medical care insurer of the health maintenance organization type, more specifically operating as an Independent Practitioner Association ("I.P.A.") health maintenance organization.

3. Petitioner was organized in 1977 as a not-for-profit corporation, and is classified as a type "B" corporation under Section 201 of the Not-for-Profit Corporation Law.<sup>1</sup>

4. During the period commencing with the start of the audit period and continuing until October 31, 1979, petitioner was involved in its initial development as a federally-qualified and state-certified health maintenance organization. During this period of time, petitioner's total income consisted of an Initial Development Grant provided by the United States Department of Health, Education and Welfare ("H.E.W.").

5. Effective November 1, 1979, petitioner was qualified to operate as a health maintenance organization by H.E.W. and received a certificate of authority

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1 The Not-for-Profit Corporation Law defines a Type "B" Corporation as follows:

"Type B - A not-for-profit corporation of this type may be formed for any one or more of the following non-business purposes: Charitable, educational, religious, scientific, literary, cultural or for the prevention of cruelty to children or animals."

to operate a health maintenance organization from the New York State Commissioner of Health. During the balance of the audit period, i.e. November 1, 1979 through May 31, 1980, petitioner operated as a health maintenance organization pursuant to the applicable provisions of federal law and regulations and Article 44 of the New York Public Health Law.

6. The major source of petitioner's funds during the audit period subsequent to November 1, 1979 consisted of the proceeds from an operating cost assistance agreement provided to petitioner by H.E.W. The balance of income during this period of time was premium income from subscribers. Premium income was budgeted only to cover the expenses of delivery of medical benefits, and did not provide any additional money for the administration of the plan or for purchases which would be subject to sales or use taxes.

7. The only way to join petitioner is to be employed by an employer participating in petitioner's plan and to subscribe under the group policy offered through that employer. For each subscriber under a group plan, the employer pays to petitioner an amount equal to the employer's payment to its basic health plan, while the subscriber pays the difference between such employer contribution and the premium cost charged by petitioner. An individual cannot contract directly with the petitioner to become a subscriber and obtain its services. Petitioner will not reimburse physicians for care provided to non-subscribers.

8. Petitioner, as an I.P.A. health maintenance organization, does not employ physicians or provide medical services itself, but rather contracts with third-party physicians who become (after a credentialing process) members of petitioner to whom petitioner's subscribers go for medical services. Petitioner's,

subscribers pay a modest co-payment fee (\$3.00) to the physician, with the balance of the physician's fee paid by petitioner.

9. Prior to 1976, organizations operating as health maintenance organizations on a not-for-profit basis (i.e. not-for-profit medical expense and hospital indemnity programs such as Blue Cross, Blue Shield, and certain other similar health maintenance organizations) were organized under Insurance Law Article 9C, and were exempt from sales and use taxes.<sup>2</sup> In 1976, the Legislature specifically authorized health maintenance organizations to exist as such by the adoption of Article 44 of the Public Health Law. Article 44 of the Public Health Law specifically provided that organizations previously licensed under Insurance Law Article 9C could operate under Article 44 without a change in corporate structure. In effect, Article 9C health maintenance organizations were "grandfathered" into Article 44.

10. The Insurance Department, which shares responsibility with the Department of Health in the supervision of Article 44 health maintenance organizations, treated health maintenance organizations in all respects as though they were Article 9C corporations. With respect to financial review, rate setting, approval of contracts and provision of benefits, the Insurance Department took the administrative position that Article 44 health maintenance organizations were the equivalent of Article 9C corporations. It has been the consistent position of the Insurance Department that any legislation which provides that an Article 9C corporation must provide a minimum health benefit is equally applicable to Article 44 health maintenance organizations.

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<sup>2</sup> Insurance Law Section 251(3).

11. In May, 1979, petitioner received Federal income tax exempt status pursuant to Internal Revenue Code Section 501(c)(4) and, on May 5, 1981, was granted sales and use tax exemption by the Audit Division pursuant to Tax Law Section 1116(a)(7), retroactive to April 1, 1980.

12. Petitioner asserts that through educating both patients and physicians as to the importance of proper utilization of medical services, it is able to make available to its subscribers high quality medical care while at the same time controlling the costs thereof. Petitioner notes that its effectiveness in this regard has reduced hospital utilization by its subscribers, thereby benefiting the general community by reducing the overall need for construction of additional hospital facilities. Finally, petitioner maintains that, given its size when initially opened, had it offered open enrollment to the public and too many individuals requiring extensive or highly-specialized medical treatments had joined (known as "adverse selection"), the cost of petitioner's plan would have spiralled and become prohibitively expensive. Accordingly, petitioner's plan has been limited to employer groups, as noted, rather than offered through open public enrollment.

13. Petitioner does not contest the taxability of the types of items held taxable on audit or the dollar amount of tax as computed thereon, but asserts that it is not an entity properly subject to sales and use tax.

#### CONCLUSIONS OF LAW

A. That Tax Law Section 1116(a)(7), added by the Laws of 1980, Chapter 903, provides for exemption from sales and use taxes for "[a] not-for-profit corporation operating as a health maintenance organization subject to the provisions of article forty-four of the public health law". Section 2 of L.1980, C.903, provided:

"[T]his act [enacting par.(7) of subd. (a) of (Section 1116)] shall take effect immediately (December 17, 1980) and shall apply to transactions occurring on and after April first, nineteen hundred eighty."

B. That then - Governor Carey's memorandum of approval with regard to Tax Law Section 1116(a)(7) provided as follows:

"[o]ver the years, health maintenance organizations have proven their ability to provide quality medical care at reasonable cost. In my annual State of the Health Messages, I have repeatedly expressed my strong commitment to the development of new health maintenance organizations and I have sought during my administration to eliminate legal and other impediments to their development. This bill will remove one such barrier by including health maintenance organizations subject to Article 44 of the Public Health Law among those organizations which are exempt from sale and use taxation. While most health maintenance organizations are presently exempt from sales and use taxes, those few which are not are placed at substantial disadvantage. By making all health maintenance organizations exempt from sales and use taxes, all health maintenance organizations will be placed on an equal footing."

C. That Tax Law Section 1116(a)(4) is modeled after section 501(c)(3) of the Internal Revenue Code ("I.R.C."), and thus Federal law may be looked to for guidance and interpretation (see Yellin v. New York State Tax Commission, 81 A.D.2d 196).

D. That petitioner's services, most specifically that of making available quality medical care at modest cost, are available only to the class of individuals constituting its membership. While laudable benefits flow from petitioner's operation, notably health care cost containment, such benefits run primarily to petitioner's subscribers. In Sound Health Association v. Commissioner, 71 T.C. 158 (1978), the petitioner, a health maintenance organization, was granted exemption pursuant to I.R.C. section 501(c)(3). However petitioner, in Sound Health, unlike petitioner herein, was itself the health care service provider, had an enrollment open to all individuals, had an emergency room open to anyone

needing emergency care, (regardless of whether or not the person was a member of Sound Health and regardless of ability to pay for services), and established a fund for contributions to be used to subsidize costs for persons unable to afford full payments for membership. Whereas in Sound Health the class eligible for membership and receipt of benefits was essentially unlimited, petitioner herein confers primary and direct benefit on only a limited class (i.e. its members).

E. That the Legislature did act, in 1980, to confer exemption from sales and use taxes upon entities such as the petitioner, and specifically made such exempt status retroactive to April 1, 1980. It is presumed that the Legislature acts with a purpose, and that here that purpose was to confer tax exempt status upon health maintenance organizations such as petitioner which were not exempt under existing law, specifically Tax Law Section 1116(a)(4). Finally, the Legislature clearly specified a retroactive effective date for the exemption granted, which date may not be altered by act of the State Tax Commission. Accordingly, based on the foregoing, petitioner was not entitled to exemption pursuant to Tax Law section 1116(a)(4).

F. That the receipt of grant monies from H.E.W., as described, does not make petitioner an instrumentality of the United States nor does it confer upon petitioner immunity from taxation pursuant to Tax Law section 1116(a)(2).

G. That the State Tax Commission is without authority to pass upon the constitutional issue raised by petitioner.

H. That the petition of Rochester Area Health Maintenance Organization is hereby denied and the Notice and Demand dated February 26, 1982 is sustained.

Dated: Albany, New York

JUL 16 1985

STATE TAX COMMISSION

Roderick W. Allen  
PRESIDENT

Francis R. Koenig  
COMMISSIONER

Mark J. Jones  
COMMISSIONER