

OHIO BOARD OF TAX APPEALS

TOTAL RENAL CARE, INC., (et. al.),)
Appellant(s),) CASE NO(S). 2019-848
vs.)
(COMMERCIAL ACTIVITY TAX)
PATRICIA HARRIS, TAX)
COMMISSIONER OF OHIO, (et. al.),) DECISION AND ORDER
Appellee(s).)

APPEARANCES:

For the Appellant(s) - TOTAL RENAL CARE, INC.
Represented by:
PAUL E. MELNICZAK
REED SMITH LLP
THREE LOGAN SQUARE, SUITE 3100
1717 ARCH STREET
PHILADELPHIA, PA 19103

For the Appellee(s) - PATRICIA HARRIS, TAX COMMISSIONER OF OHIO
Represented by:
RAINA M. NAHRA BOULOS
ASSISTANT ATTORNEY GENERAL
OHIO ATTORNEY GENERAL
30 EAST BROAD STREET, 25TH FLOOR
COLUMBUS, OH 43215

Entered Monday, July 24, 2023

Mr. Harbarger, Ms. Clements, and Ms. Allison concur.

Total Renal Care, Inc. (“TRC”) appeals from a final determination of the Tax Commissioner denying an application for refund of commercial activity tax (“CAT”). The Commissioner found that TRC failed to show that the CAT reported and remitted was erroneously paid. TRC asks us to overturn that decision and argues that we should conclude that some of TRC’s gross receipts should be situated outside of Ohio. We disagree. For the reasons that follow, we affirm the Commissioner’s decision.

BACKGROUND

TRC is a healthcare organization that provides dialysis and kidney care education to chronic kidney failure and end-stage renal disease patients. TRC’s primary service is dialysis

treatment and education. To receive dialysis, a patient usually goes to a dialysis center to be attached to a dialysis machine, which removes, cleans, and places blood back into their systems. Hearing Record (“H.R.”) at 44.

TRC initially paid the CAT for April 1, 2012, through December 31, 2014. Later, TRC filed two refund claims, one requesting a refund for April 1, 2012, through June 30, 2012, for \$28,011, and another requesting a refund for July 1, 2012, through December 31, 2014, for \$365,660. TRC asserted that laboratory testing services and healthcare provider services were performed out of state, so those services should be situated outside of Ohio. The Department denied the refund requests, stating that the purchasers (patients) received the benefit of kidney dialysis in Ohio, and therefore the gross receipts were correctly situated to Ohio. TRC appealed the decision. The Commissioner issued Final Determinations denying the requests. The Commissioner found that the patients were the ultimate beneficiaries of the services, and the business records submitted did not show what exact amounts of its gross receipts were generated based on services performed outside of Ohio. From these determinations, TRC filed appeals, and the appeals have been consolidated.

At the hearing before this Board, TRC presented testimony from Sarah Beidelschies, Division Vice President of DaVita, TRC’s parent company. Ms. Beidelschies described the treatment that TRC provided to patients and testified that 90% of the treatment volume occurred in outpatient clinics. She testified that lab testing was performed in Florida. Ms. Beidelschies asserted that activities essential to TRC’s healthcare services, such as accounting, personnel services, and IT services, were performed by DaVita employees outside Ohio. Jeannie Oh, Vice President of Tax at DaVita, also testified at the hearing. She explained that the Centers for Medicare and Medicaid Services (“CMS”) reimburses TRC for costs and explained how to read medical claims sent to Medicare. Ms. Oh testified that CMS requires providers to submit cost reports and explained how to read cost reports.

In post-hearing briefs, the Commissioner asserts that an application of R.C. 5751.033(I) resolves this case. The Commissioner asserts that the dialysis treatment that TRC sells is received by patients in Ohio, and therefore the treatment is correctly situated in Ohio. The Commissioner argues that TRC's reading of the code sections is incorrect. The Commissioner claims that administrative functions are not "services," as found in the relevant Ohio Revised Code and Administrative Code Sections, but rather are overhead costs. The Commissioner argues that situsing TRC's receipts to where the costs were incurred (as TRC argued is appropriate) is consistent with a cost-of-performance net income tax system, but not Ohio's current market-based situsing scheme. The Commissioner also posits that since, according to TRC, almost any expense TRC or DaVita could incur is essential to the health services provided, overhead costs would not be limited, and results would be absurd.

TRC argues that lab testing occurs at laboratories in Florida and that DaVita performed administrative tasks in states outside of Ohio to support TRC's operation. Therefore, TRC contends that the gross receipts associated with these services should be situated outside Ohio. TRC argues that the administrative support services are integral to the healthcare service provided and are all considered part of the healthcare service.

ANALYSIS

Standard of Review

In an appeal of the Commissioner's final determination, the Ohio Supreme Court has held that the Commissioner's factual findings are presumptively valid. *Alcan Aluminum Corp. v. Limbach*, 42 Ohio St.3d 121, 537 N.E.2d 1302 (1989). A taxpayer challenging such findings must rebut the presumption by establishing a clear right to the requested relief. *Belgrade Gardens, Inc. v. Kosydar*, 38 Ohio St.2d 135, 311 N.E.2d 1 (1974). A taxpayer must present credible evidence establishing in what manner and to what extent the Commissioner's determination is in error. *Federated Dept. Stores, Inc. v. Lindley*, 5 Ohio St.3d 213, 450 N.E.2d 687 (1983).

Commercial Activity Tax (CAT)

The General Assembly enacted the CAT in 2005. Am.Sub.H.B. No. 66, 151 Ohio Laws, Part II, 2868. “The idea was to make Ohio a more attractive place to do business by replacing the existing business-tax regime.” *NASCAR Holdings, Inc. v. McClain*, 2022-Ohio-4131, ¶ 4. The Court explained that:

The CAT is imposed on “taxable gross receipts for the privilege of doing business in this state.” R.C. 5751.02(A). “Gross receipts” are “the total amount realized, * * * without deduction for cost of goods sold or expenses incurred, that contributes to the production of gross income.” R.C. 5751.01(F). In other words, instead of being imposed on a net income, the CAT is applied to all funds received from business transactions. See R.C. 5751.03.

The CAT law defines as “taxable gross receipts” only those receipts that are “gross receipts *sitused* to this state.” (Emphasis supplied.) R.C. 5751.01(G). The amount of “gross receipts sitused to this state” is important for two reasons. First, gross receipts are used to determine whether a business is subject to the CAT; those subject to the CAT include businesses with a “substantial nexus” to Ohio. R.C. 5751.02. Among the ways a business can have a substantial nexus to Ohio is to have \$500,000 of annual taxable gross receipts. R.C. 5751.01(H)(3) and (I)(3); *see Crutchfield Corp. v. Testa*, 151 Ohio St. 3d 278, 2016-Ohio-7760, 88 N.E.3d 900, ¶ 5, 21. Second, gross receipts are used to determine *how much* tax is owed; liability is calculated by applying the base tax rate to “taxable gross receipts.” R.C. 5751.02.

Id. at ¶¶ 5-6.

The dispute before us concerns whether certain receipts were properly sitused to Ohio. Receipts are sitused to Ohio according to taxable categories, as listed in R.C. 5751.033. The situsing law provides that gross receipts from “the sale of all other services, and all other gross

receipts not otherwise situated under this section, shall be situated to this state in the proportion that the purchaser's benefit in this state with respect to what was purchased bears to the purchaser's benefit everywhere with respect to what was purchased." R.C. 5751.033(I). This code section is relevant to the case at issue today.

In addition, the Ohio Administrative Code provides guidance on how to source various services and what siting method should be used for CAT purposes. Ohio Adm.Code 5703-29-17(C)(28) specifically mentions healthcare services, stating:

If healthcare services are performed in Ohio, one hundred per cent of the gross receipts are situated to Ohio. If a healthcare service is provided partly in this state and outside this state, a reasonable allocation for the services performed in Ohio must be made.

For example, a German resident comes to have a surgery performed at a hospital in Ohio. One hundred per cent of that gross receipt is an Ohio taxable gross receipt.

Total Renal Care's requests are inconsistent with the purpose of the CAT

We agree with the Commissioner that TRC essentially argues that overhead costs should be deductible. Furthermore, we agree with the Commissioner that this is inconsistent with Ohio's gross receipts tax. As described above, the CAT is imposed on taxable gross receipts. Gross receipts are the "total amount realized by a person, without deduction for the cost of goods sold or other expenses incurred * * *." R.C. 5751.01(F). TRC's request to deduct administrative functions, such as capital improvement planning, human resource functions, billing patients, etc., amounts to a request for deduction of overhead costs, not services. Requesting the deduction of administrative functions, as Total Renal Care does, is not appropriate for a CAT.

R.C. 5751.033(I) establishes situs where the benefit is received

In this case, there are three services to consider. TRC's primary service is dialysis and

kidney care education. This service is performed in Ohio. TRC does not dispute that CAT was properly charged for this service, so we can continue with the other two services.

The benefit of laboratory work is received in Ohio

Second, TRC argues that since laboratory work is provided outside Ohio, it should be allocated outside Ohio under Ohio Adm.Code 5703-29-17(C)(28). The Commissioner argues that interpretation creates a clear conflict with R.C. 5751.033(I), and the lab work and support work are not “healthcare services” at all. “Testing laboratories” are mentioned in Ohio Adm.Code 5703-29-17(C)(49), as noted on TRC’s notice of appeal.

We find that the Commissioner’s reading is correct. In the recent case *Defender Security Co. v. McClain*, the Ohio Supreme Court held that under R.C. 5751.033(I), the “paramount” consideration when determining what proportion of the benefit is attributed to Ohio is the physical location where the purchaser actually used and received the benefit of what was purchased. 162 Ohio St.3d 473, 2020-Ohio-4594, 165 N.E.3d 1236. That holding is directly applicable to this case. The laboratory work was explained in detail during the hearing before this Board. Ms. Beidelschies explained that lab samples are sent to Florida for lab testing. H.R. at 20. Ms. Oh explained that TRC’s kidney dialysis patients were required to get their lab testing done at least once a month. H.R. 61-62. Ms. Beidelschies testified that the lab testing helped to monitor the patient’s treatment and showed whether the patient’s dialysis treatments were working, if changes needed to be made to prescriptions, etc. H.R. 20. Ms. Beidelschies also testified that only dialysis patients received lab testing. H.R. 21. In other words, patients received the benefit of the services in Ohio.

Similarly, the lab testing falls under Ohio Adm.Code 5703-29-17(C)(28) since it is a healthcare service. By looking at Ohio Adm.Code 5703-29-17(C)(28), the question is whether the benefit is received in Ohio. The testing is done in Florida, but the benefit of the testing is received in Ohio. The patients are located in Ohio. Moreover, the testing is done to support the dialysis

treatment, which is located in Ohio. No one receives the testing unless they receive dialysis treatment from TRC. Therefore, the lab testing is properly situated in Ohio.

The benefit of the administrative functions is received in Ohio

TRC also alleges that the administrative functions that Davita performs to support TRC should be situated outside of Ohio. Included among the administrative functions are “storing medical records, drafting and implementing record retention policies, billing patients and other providers, hiring non-medical staff, and providing accounting and regulatory services.” TRC Merit Brief at 1. TRC alleges that since the Davita employees who perform these functions are located outside of Ohio, these functions should be situated outside of Ohio. However, these administrative functions are what underpin TRC and allow it to operate. These administrative functions would be necessary for any similar health organization to operate. Because of these services, TRC can deliver dialysis and kidney care education. The administrative functions fall under Ohio Adm.Code 5703-29-17(C)(28), since they are healthcare services. Again, the question is whether the benefit is received in Ohio. Ohio Adm.Code 5703-29-17(C)(28). Further, the example provided in the Administrative Code section is of an individual traveling to Ohio for surgery. Similarly, an individual could travel to Ohio for dialysis and kidney care education from TRC. The dialysis and education are received by the patient in Ohio; therefore, the entire benefit is situated there. When someone receives dialysis and kidney care education, they are not receiving, for example, the accounting services supporting the healthcare company. As the Commissioner argued, this would yield absurd results. What matters is where the benefit (dialysis and kidney care education) is received, and it was received in Ohio.

TRC’s proposed methods of allocation are not supported by evidence

Even if we found that the laboratory testing and administrative services could be situated outside of Ohio, TRC has failed to support their proposed allocation with sufficient documentation. TRC argues that there are two methods for calculating what portion of the services

should be allocated to Ohio. The first method was found by taking CMS' proposed rules covering payment process. A table with numbers is located in the rules, which is CMS' best estimate of how the costs break down into different categories. TRC argues that per the chart, 1.53% of costs were attributable to the cost of providing lab services and 17.42% of costs were attributable to the cost of providing administrative and general services. TRC adds those two numbers together and argues that 18.96% of TRC's gross receipts are situated outside of Ohio.

TRC has not provided enough evidence to show why the number from a proposed rule from CMS should show us what percentage of the gross receipts should be situated in Ohio. A national number does not mean that TRC actually followed these guidelines. TRC has made a giant leap here and has not supported it with business records, testimony, or other documents.

TRC proposes a second approach to show what portion of services should be allocated outside of Ohio. This method relies on perusing DaVita's internal work papers, as explained somewhat by TRC's witness, Ms. Oh, at the hearing before this Board. However, the CAT is imposed on gross receipts, which are not found on the cost reports. TRC states that \$9,345,134.00 in laboratory costs were incurred outside Ohio at DaVita's Florida-based laboratory, and that number can be found on the cost report on page 22 of Exhibit 33. TRC also alleges that \$26 million of TRC's costs incurred in 2014 were a result of general and administrative services performed outside Ohio, accounting for 10.2% of the total costs, and this number can be found on the cost report account detail, Exhibit 33, on the first tabbed page marked 2014. However, these cost reports do not show gross receipts, which is what is actually at issue here.

With respect to the siting of receipts from services for CAT, the importance of submitting supporting documentation is identified clearly in both the relevant statute (R.C. 5751.033(I)) and the relevant administrative rule (Ohio Adm.Code 5703-29-17(A)). Both provisions recognize that a taxpayer's method for siting services must be supported by the taxpayer's business records as they existed at the time of the performance of the service. TRC has

also provided with its brief a chart explaining its reasoning. However, this is not a business record and is a chart supplied after the fact. TRC has not proven the allocation that it is requesting. As noted above, TRC bears the obligation to explain precisely how the Commissioner committed an error with probative and credible evidence. TRC has not done so in this case. Therefore, we find that TRC failed to provide probative and credible evidence that the Commissioner erred in her determination regarding its CAT liability.

CONCLUSION

For the foregoing reasons, this Board finds that the appellant has failed to overcome the presumption in favor of the Commissioner’s determination. Accordingly, the Commissioner’s decision must be and, hereby is, affirmed.

BOARD OF TAX APPEALS		
RESULT OF VOTE	YES	NO
Mr. Harbarger		
Ms. Clements		
Ms. Allison		

I hereby certify the foregoing to be a true and complete copy of the action taken by the Board of Tax Appeals of the State of Ohio and entered upon its journal this day, with respect to the captioned matter.



Kathleen M. Crowley, Board Secretary