

**PROVIDER REIMBURSEMENT REVIEW BOARD  
HEARING DECISION**

ON-THE-RECORD  
98-D92

**PROVIDER** -Las Encinas Hospital  
Pasadena, CA

**DATE OF HEARING-**  
August 10, 1998

Provider No. 05-4078

Cost Reporting Period Ended -  
July 31, 1992

**vs.**

**INTERMEDIARY** -  
Blue Cross and Blue Shield Association/  
Blue Cross of California

**CASE NO.** 95-0303

**INDEX**

	Page No.
<b>Issue</b> .....	2
<b>Statement of the Case and Procedural History</b> .....	2
<b>Provider's Contentions</b> .....	2
<b>Intermediary's Contentions</b> .....	4
<b>Citation of Law, Regulations &amp; Program Instructions</b> .....	4
<b>Findings of Fact, Conclusions of Law and Discussion</b> .....	5
<b>Decision and Order</b> .....	5

ISSUE:

Was the Intermediary's adjustment to the property tax expense proper?

STATEMENT OF CASE AND PROCEDURAL HISTORY:

Las Encinas Hospital ("Provider) is a 143-bed general hospital located in Pasadena, California. During fiscal year 1992, the year under appeal, the Provider was a proprietary, psychiatric hospital. On May 31, 1994, Blue Cross of California ("Intermediary") issued the Provider's Notice of Program Reimbursement in which it disallowed an increase of \$117,994 in the Provider's property taxes.<sup>1</sup>

On March 16, 1989, the management of Hospital Corporation of America ("HCA"), the Provider's parent corporation, bought 100 percent of the company's stock in order to restructure HCA as a closely held entity. The transaction was considered to be a leveraged buy-out ("LBO"). In the Provider's trial balance, all expenses related to the LBO were separately identified and excluded from the cost report. As a result of the LBO, the County Tax Assessor of Los Angeles conducted an appraisal of the Provider's property. The appraisal resulted in the property tax increase, which was claimed by the Provider but subsequently disallowed by the Intermediary.<sup>2</sup>

On November 16, 1994, the Provider filed an appeal with the Provider Reimbursement Review Board ("Board") and has met the jurisdictional requirements of 42 C.F.R. §§ 405.1805-.1841. The Medicare reimbursement effect of the Intermediary's adjustment is approximately \$20,560.

The Provider was represented by Douglas S. Cumming, Esquire, and the Intermediary, by Bernard M. Talbert, Esquire, of the Blue Cross and Blue Shield Association.

PROVIDER'S CONTENTIONS:

The Provider states that California law requires a reassessment of property at the current value whenever new construction or a change of ownership occurs. Under the state constitution, as amended by Proposition 13, a change of ownership occurs when there is a purchase or transfer of stock of the corporation that owns the real property.<sup>3</sup> The LBO meets this criteria although, admittedly, it is not considered a change of ownership for Medicare purposes. The Provider notes, however, that the Provider Reimbursement Manual, Part I ("HCFA Pub. 15-

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<sup>1</sup> Intermediary's Position Paper, Exhibit I-3.

<sup>2</sup> Provider's Position Paper at 5/Intermediary's Supplemental Position Paper at 2.

<sup>3</sup> Provider's Position Paper, Exhibit 4.

1”) § 2122.1, states that “[t]axes assessed against the provider, in accordance with the levying enactments of the several States and lower levels of the government and for which the provider is liable for payment are allowable cost. Tax expense should not include fines and penalties.” *Id.* Since these property taxes are not fines or penalties but are actual costs incurred based on state law, they should be allowed.

The Provider also points out that most jurisdictions periodically assess and increase taxes as property values increase. Medicare reimburses providers for these increased costs. However, in California, due to Proposition 13, property taxes are only increased when property changes hands. The Provider concludes that California law is actually saving the Medicare program money compared to what occurs in other jurisdictions.

The Provider refutes the Intermediary’s rationale for the adjustment as reflected in a position paper filed by the Intermediary in the Provider’s appeal for the following fiscal year. In that case, the Intermediary noted that the Provider had disallowed other capital-related expenditures such as depreciation related to the LBO. The Intermediary concluded that if depreciation was not allowed, then a related increase in property taxes was also not allowable.<sup>4</sup> The Provider states that just because Medicare does not recognize depreciation and other capital costs related to the LBO does not mean the related increase in property taxes should also be disallowed.

The Provider also argues that the Intermediary incorrectly uses HCFA Pub. 15-1 § 2122.2 as the basis for its position that a transfer of stock had occurred and, therefore, the taxes were unallowable. Under this subsection, the following categories of taxes are not recognized:

[t]axes in connection with financing, refinancing, or refunding operations, such as taxes on the issuance of bonds, property transfers, issuance or transfer of stocks,  
etc. . . . Generally, these costs are either amortized over the life of the securities or depreciated over the life of the asset. They are not, however, recognized as tax expense.

HCFA Pub. 15-1 § 2122.2.

The Provider maintains that the Intermediary has selected one isolated part of this subsection, i.e., ‘transfer of stocks,’ for the basis of its adjustment rather than analyzing the provision as a whole. When viewed in its entirety, the subsection’s meaning is that taxes assessed by a local jurisdiction are unallowable only if they are incurred as part of a financing, refinancing, or refunding operation. In the instant case, a change of ownership occurred under California law in connection with the LBO. The LBO is not a financing, refinancing, or refunding operation.

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<sup>4</sup> Provider’s Supplemental Position Paper at 2/Intermediary’s Position Paper for PRRB Case No. 96-0558.

In fact, this subsection is intended to disallow taxes directly incurred in connection with the described transactions, rather than with changes of ownership.

INTERMEDIARY’S CONTENTIONS:

The Intermediary argues that under the LBO, the Provider’s corporate structure was unchanged. Stock ownership by HCA was transferred to the new, closely held entity, which triggered no issues pertaining to change of ownership under 42 C.F.R. § 489.18. The Medicare provider agreement was not affected because the corporate structure remained intact.<sup>5</sup>

The Intermediary contends that under 42 C.F.R. § 413.9, all payments to providers must be based on the reasonable cost of services covered by Medicare and related to the care of program beneficiaries. Reasonable cost includes all necessary and proper costs incurred in furnishing these services. Further, necessary and reasonable costs are “[c]osts that are appropriate and helpful in developing and maintaining the operation of patient care facilities and activities. They are usually costs that are common and accepted occurrences in the field of the provider’s activities.” See 42 C.F.R. § 413.9(c)(2). The LBO was not connected to the development or maintenance of patient care activities but was consummated to foster larger strategic interests related to corporate structure. The benefits of the LBO were not related to patient care.

The Intermediary also maintains that two previous Board decisions, Florida Medical Center, Inc. v. Blue Cross and Blue Shield Association/Blue Cross and Blue Shield of Florida, PRRB Decision No. 93-D19, Medicare & Medicaid Guide (“CCH”) ¶ 41,305 (February 19, 1993); PRRB Decision No. 93-D48, Medicare & Medicaid Guide (“CCH”) ¶ 41,573 (June 23, 1993) support its position. In these instances, the provider unsuccessfully sought reimbursement for legal fees it incurred over an ownership dispute. Further, the court in Florida Medical Center, Inc. v. Shalala, No. 94-7026-CIV-KLR (S.D. FL 1996) (unpublished), Medicare and Medicaid Guide (“CCH”)

¶ 44,690, upheld the disallowance of legal fees and interest expense incurred over ownership issues because they were not related to patient care. Although the expenses in these cases resulted from a hostile dispute while those for the Provider arose from a voluntary restructuring, the principle is the same. Costs associated with ownership issues are not ‘necessary and proper.’

CITATION OF LAWS, REGULATIONS AND PROGRAM INSTRUCTIONS:

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

§§ 405.1835 -.1841

- Board Jurisdiction

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<sup>5</sup> Intermediary’s Supplemental Position Paper at 3.

- § 413.9 - Cost Related to Patient Care
  - § 413.9(c)(2) - Cost Related to Patient Care, Necessary and Proper Cost
  - § 489.18 - Change of Ownership or Leasing
2. Program Instructions - Provider Reimbursement Manual Part I (HCFA Pub. 15-1):
- § 2122.1 - Taxes, General Rule
  - § 2122.2 - Taxes Not Allowable as Costs
3. Cases:

Florida Medical Center, Inc. v. Blue Cross and Blue Shield Association/Blue Cross and Blue Shield of Florida, PRRB Decision No. 93-D19, Medicare & Medicaid Guide (“CCH”) ¶ 41,305 (February 19, 1993); PRRB Decision No. 93-D48, Medicare & Medicaid Guide (“CCH”) ¶ 41,573 (June 23, 1993).

Florida Medical Center, Inc. v. Shalala, No. 94-7026-CIV-KLR (S.D. FL 1996) (unpublished), Medicare & Medicaid Guide (“CCH”) ¶ 44,690.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board, after consideration of the facts, parties’ contentions, and evidence presented, finds and concludes that the Intermediary’s disallowance of the increased property tax was improper.

The Board finds that the Provider was subject to California Proposition 13 which held down property assessment values. The Provider’s property had not been assessed since 1975/76. Additionally, the Board finds that the property tax is based on the assessed value of the property and not the value of the financial transaction such as the LBO. The Board further finds that both parties agreed that there was no change of ownership for Medicare purposes. The Board also finds that the evidence supports the states right to reassess the property when there is a LBO.

The Board concludes that HCFA Pub. 15-1 § 2122.1 applies to this case. Pursuant to § 2122.1, the property taxes are allowable. The LBO was not unique in that several other financial transactions could have triggered a reassessment by the state of California.

With respect to the Intermediary arguments, the Board finds that nothing in HCFA Pub. 15-1 § 2102.2 applies in this case. The Board also finds that the prior Board decisions in Florida Medical Center are not on point. In particular, the Board concludes that in these two cases the provider initiated the expenses whereas in this case the State caused the expense increase.

DECISION AND ORDER:

The Intermediary improperly disallowed the property tax increase claimed by the Provider. The Intermediary's determination is reversed.

Board Members Participating:

Irvin W. Kues  
James G. Sleep  
Henry C. Wessman, Esquire  
Martin W. Hoover, Jr. Esquire  
Charles R. Barker

**Date of Decision:** September 11, 1998

FOR THE BOARD:

Irvin W. Kues  
Chairman