

Cite as 2 WTD 459 (1987)

BEFORE THE INTERPRETATION AND APPEALS SECTION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u> <u>N</u>
For Refund of)	
)	No. 87-106
)	
)	Registration No. . . .
. . .)	
)	

[1] **RULE 18801, RCW 82.08.0283 AND RCW 82.12.0277:**
PROSTHETIC DEVICE -- DIALYSIS MACHINE. Dialysis
machine is treated as a prosthetic device for
purposes of sales and use tax exemption even though
it does not physically replace the disfunctioning
kidneys.

[2] **RULE 18801, RCW 82.08.0283 AND RCW 82.12.0277:**
PROSTHETIC DEVICE -- INGREDIENTS OR COMPONENTS --
DIALYSIS MACHINE. Reusable dialyzer (artificial
kidney) and various single-use, disposable items,
such as needles, tubing, filters, etc., are exempt
from sales and use tax as "ingredients or components
of prostheses," because they are functionally
inseparable from the process of dialysis and are
functionally integral with the tax exempt machine.

Headnotes are provided as a convenience for the reader and are
not in any way a part of the decision or in any way to be used
in construing or interpreting this Determination.

TAXPAYER REPRESENTED BY: . . .
 . . .
 . . .

DATE OF HEARING: December 16, 1986

NATURE OF ACTION:

Nonprofit kidney dialysis facility petitions for a refund of sales and use taxes paid on kidney dialysis machines and related equipment and supplies.

FACTS AND ISSUES:

Rosenbloom, A.L.J.--The taxpayer, a nonprofit corporation, provides dialysis services to patients suffering from chronic kidney failure. Some of these patients have End-Stage Renal Disease (ESRD), a term used to describe permanent and irreversible kidney disease. Others have lost their kidney function as a result of injury or trauma. In either case, the taxpayer's patients no longer have healthy, properly functioning kidneys to remove waste products and excess fluids from their blood. They must receive regular dialysis in order to survive. The only alternative to dialysis is a kidney transplant.

There are two kinds of dialysis: hemodialysis and peritoneal dialysis. In hemodialysis, the more common of the two, the patient's blood is removed from the body via a tube, circulated through an artificial kidney or dialyzer, and then returned to the body via a second tube. The dialyzer is a cylindrical device containing thousands of tiny hollow fibers. Surrounding these fibers is a completely enclosed chamber through which dialysate is pumped. Dialysate is a solution of highly purified water and a variety of chemicals, such as potassium, sodium, glucose, etc. The exact concentration of chemicals in the dialysate is prescribed by the patient's physician. Blood passes through the fibers while dialysate washes around the fibers. Waste products and excess fluid pass from the blood through the semi permeable fiber walls and into the dialysate by the processes of diffusion and osmosis. The blood is maintained at a higher pressure than the dialysate so that, in case of leakage, blood will pass into the dialysate instead of vice versa.

The piece of hardware used to accomplish all of this is the dialysis machine. The machine pumps the blood, mixes and pumps the dialysate, and performs a variety of monitoring functions (e.g. the machine can detect the presence of blood in the dialysate, which would indicate leakage in the dialyzer). The dialysis machine is a durable good with a useful life of many years.

The dialyzer, on the other hand, can only be used ten to fifteen times (always by the same patient). The dialyzer must be cleaned and tested between each use. The taxpayer used to

send the dialyzers out to a third party contractor for manual cleaning and testing; however, the taxpayer has since purchased a "re-use" machine. The re-use machine is a sophisticated device that automatically cleans and tests the dialyzer, and issues a computer printout advising whether it is safe for re-use.

In addition to the dialysis machine and dialyzer, dialysis requires the use of various disposable, single-use items such as tubing, filters, needles, etc. The dialysate is also used but once and then discarded.

The less common method of kidney dialysis is peritoneal dialysis. In this method, the patient's peritoneal cavity is filled with dialysate through a surgically implanted catheter. The dialysate remains in the patient's body for a specified period of time. Waste products and excess fluid pass from the blood through the patient's peritoneal membrane and then into the dialysate. the dialysate is removed and the process is repeated with fresh dialysate. The taxpayer currently has only one peritoneal dialysis patient.

In December of 1985, the taxpayer received a tax assessment from the Department of Revenue. The assessment included use tax on the value of the re-use machine, several dialysis machines, and related equipment and supplies. The taxpayer paid the assessment without protest.

Later, while discussing the audit with the operator of another kidney dialysis center, the taxpayer learned that the Department had previously issued a letter advising that artificial kidney machines qualify for sales and use tax exemption as prosthetic devices. The taxpayer then petitioned for a refund of taxes paid under the tax assessment, and a refund of sales and use tax paid in error.

DISCUSSION:

RCW 82.08.0283 provides a retail sales tax exemption for prescribed prosthetic devices. The complementary use tax exemption is supplied by RCW 82.12.0277. These exemptions became effective July 2, 1975. On July 8, 1975, the Department issued Excise Tax Bulletin (ETB) 498.08.151, which defined the term "prosthetic device" as

. . . artificial substitutes which replace missing parts of the human body, such as a limb, bone, joint, eye, tooth, or other organ or part thereof.

WAC 458-20-18801, prior to its most recent revision, included the same definition with the addition of the words

. . . and materials which become ingredients or components of prosthesis.

In a 1975 letter to another dialysis facility the Department ruled that artificial kidney (i.e. dialysis) machines used at the facility qualified for tax treatment as prosthetic devices. The Department agreed that the machines "replace missing parts of the human body."

Effective March 20, 1987, the language of WAC 458-20-18801 has been amended so that the definition of prosthetic devices refers to "artificial substitutes which physically replace missing parts of the human body." (Emphasis ours.) Strictly speaking, dialysis machines do not physically replace missing kidneys. However, this recent amendment of the rule was not intended to, nor should it, alter the Department's longstanding position that dialysis machines qualify for tax exempt treatment like prosthetic devices.

The dialysis machine must be used regularly in order to sustain the life of a patient suffering from chronic kidney failure. Dialysis provides all, or substantially all, of the function normally provided by healthy kidneys. Further, dialysis must continue for the remainder of the patient's life, unless the patient receives a successful kidney transplant. If the transplanted kidney also fails, the patient must again receive regular dialysis.

[1] The dialysis machine does not physically replace the dysfunctioning kidneys only because current medical technology does not allow this. If the technology existed to produce self-contained dialysis machines small enough to fit within the space occupied by the useless kidneys, then the machines would very likely be surgically implanted in the patient's body just as pacemakers are. (The Department recognizes that pacemakers also qualify for tax exempt treatment.) We conclude that the dialysis machines in question qualify for the sales and use tax exemption like prosthetic devices.

[2] The dialysis machines does not act alone, however. Dialysis requires the use of various other items, notably the reusable dialyzer or artificial kidney. this is where the waste products and excess fluid are removed from the blood. Dialysis cannot occur without this very important component.

In addition, many single-use, disposable items are used in the procedure. These include needles, tubing, filters, etc., as well as the chemical ingredients of the dialysate, all of which are integral parts in the sense that they are functionally inseparable from the process of dialysis. We conclude that these items also qualify for sales and use tax exemption as "materials which become ingredients or components of prostheses." WAC 458-20-18801.

The re-use machine, however, does not qualify for exemption. It is used to clean and test the dialyzers. Dialyzers are reused a number of times and must be cleaned and tested between each use. But we do not believe that the re-use machine which accomplishes this is an integral part in the sense that it is functionally inseparable of the entire process of dialysis. The re-use machine is not essential to the procedure. The dialyzers can be cleaned and tested manually. In fact, that is what was done before the re-use machine was acquired.

DECISION AND DISPOSITION:

The taxpayer's petition for refund is granted in part and denied in part. The Audit Section will verify the amount claimed and advise the taxpayer of the amount of credit or refund.

DATED this 8th day of April 1987.