

BEFORE THE BOARD OF TAX APPEALS.
STATE OF WASHINGTON.

DEACONESS MEDICAL CENTER,
et al.,

Appellants,

v.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,

Respondent.

Docket No. 85-186
Deaconess Medical Center

Docket No. 86-29
All Hospitals

Re: Excise Tax Appeal

FINAL DECISION

The Board of Tax Appeals (Board) heard this matter on March 16 and 17, 1987. The appellants, Deaconess Medical Center (Deaconess) and 38 hospitals, were represented by Randall L. Stamper and Raymond G. Dodge, Jr., Steer and Taylor, P.S. The respondent, State of Washington, Department of Revenue (Department), was represented by Assistant Attorneys General John M. Gray and Mary E. Fairhurst. (The Swedish Hospital appeal [BTA 86-28], originally scheduled for the same docket as the 38 hospitals and Deaconess appeals, was continued by agreement of the parties to a later and separate hearing date.)

The Board received evidence at the hearing. The following witnesses were sworn and gave testimony for the 38 hospitals and Deaconess: Michael W. Bonthuis, Craig Ross, John Robinson, Dr. W. B. Hamlin, Dr. Robert Nielsen, and Dr. Margaret Allen. Les Jaster testified on behalf of the Department. Exhibits were admitted. The appellants offered ten exhibits that were entered without objection. The appellants' exhibits are designated A-1 through A-10. The respondent offered no exhibits. Appellants and respondent filed trial briefs. The parties settled the kidney dialysis machine issue.

After consideration of all the evidence and the briefs, together with the oral arguments of counsel, and after full consideration of the entire record in this case, the Board makes the following:

FINDINGS OF FACT.

1. All 38 hospital appellants are qualified, nonprofit hospitals located throughout the state of Washington.

2. Respondent, Department of Revenue, audited some of appellants' business records for the period including tax years 1980 through the present, depending upon the individual hospital and the issue in question.

3. The hospital appellants were assessed or have paid sales and/or use taxes on irrigation solutions, intravenous sets, laboratory reagents, and nutrition products.

4. The appellants have sought either refunds or abatement of assessments for sales tax or use tax.

5. This action was brought before this Board pursuant to the Department's Final Determination No. 86-199 issued on June 30, 1986. In that determination the Department concluded the following:

PRESCRIPTION DRUGS.

Irrigation solutions purchased and used in the manner explained by the taxpayers are subject to retail sales tax or use tax liability by the hospitals so employing them. If any portion of such solutions are sold, outright to patients or administered to patients, by prescription, hospitals need not collect sales tax upon the identifiable charges to patients for such things and may receive a refund of any sales or use tax paid by the hospitals on such items.

Substances referred to as laboratory reagents and used in conducting laboratory tests are not sold to patients for the diagnosis, treatment, or prevention of disease or ailment in humans. Purchases and laboratory uses of such substances by hospitals are not tax exempt under RCW 82.08.0281 and RCW 82.12.0275. If such substances are sold outright to patients or administered to patients by injection, infusion, or other direct application to the human body for an identifiable charge, such sales are exempt of retail sales tax under RCW 82.08.0281.

Nutrition products purchased and used in the manner explained by the taxpayers are subject to retail sales tax or use tax liability by the hospitals so employing them. If any portion of such products are sold outright to patients or administered to patients, by prescription, hospitals need not collect sales tax upon the identifiable charges to patients for such things and may receive a refund of any sales or use tax paid by the hospitals on such items.

IV sets and similar medical delivery systems are not entitled to the exemptions of RCW 82.08.0281 and RCW 82.12.0275 when purchased by hospitals and used by them to administer drugs or similar solutions. If such items are sold outright to patients for an identifiable charge, such sales are exempt of retail sales tax under RCW 82.08.0281.

PROSTHETIC DEVICES.

Heart, lung, kidney dialysis machines are not exempt of retail sales tax or use tax when purchased and used by any consumer, including hospitals.

Infusion pumps purchased and used by any consumer, hospitals and patients alike, are not exempt of sales tax under RCW 82.08.0283 and RCW 82.12.0277.

Before July 1, 1986 hearing aids did not constitute tax exempt "prosthetic devices." Sales of hearing aids to any consumer were properly subject to sales tax and sellers who failed to collect such tax were properly subject to deferred sales tax (assessed as use tax).

The exemption of the kidney dialysis machine has been settled by the Department and is no longer an issue before this Board. In their Hearing Memorandum at page 24-25, the Department gives the history of their treatment of the kidney dialysis machine and pacemakers, as follows:

The Department, in 1975, treated kidney dialysis machines as "prosthetic devices." In 1979, the Department accorded pacemakers the same prosthetic device treatment. Under the Department's analysis of prosthetic devices, one notes that the machines effectively replace the entire kidney, and that because the kidney is an internal organ, it is silly to require that it be physically missing. Similarly one may defend the decision on pacemakers by noting that pacemakers were permanently implanted and replaced destroyed nerves in the heart. In conclusion, the Department makes these observations:

1. The decisions--for whatever reason-- probably exceed the legislative intent of "prosthetic device;" and

2. Since 1979, the Department has resolutely resisted pleas to ignore the definition and to expand the treatment of prosthetic devices to other medical instruments; and

3. Whatever the reasons were for giving prosthetic device treatment to kidney dialysis machines and pacemakers, that is no reason to throw open the door and

allow other devices to enter the sanctum of tax exemption, regardless of whether or not they are deserved. The Department respectfully asks the BTA to deny the hospitals' appeal to designate hearing aids as "prosthetic devices" for all periods before July 1, 1986.

6. The Department has agreed to allow the consolidation of the 38 hospitals' appeal with the Deaconess appeal to consider the application of the sales and use tax exemptions in the hospital setting.

I. Prescription Drugs.

7. Prescription drugs are dispensed to patients in hospitals from two types of locations. They can be dispensed to the patient from the hospital pharmacy. These are identified on the patient's bill by a specific "line item" charge. The hospitals also maintain a locked medicine cabinet of prescription drugs (floor supplies) on each floor for convenience in case of emergencies. The charge to the patient for prescription drugs dispensed as "floor supplies" is included in "floor charges" and is not specifically line itemed on the patient's bill.

8. A "floor charge" is an average, pre-set charge to patients that includes prescription drugs taken from a hospital's "floor supplies." The "floor charge" is commonly a component of or an addition to the patient's daily room charge.

9. "Floor charges" may include charges for other items in addition to prescription drugs.

10. The lump sum charge to a hospital patient for ancillary hospital services may also include the charges for prescription drugs, medical services and medical supplies.

11. RCW 82.08.0281 and 82.12.0275 (hereinafter, the "prescription drugs exemption statutes") provide an exemption from sales and use tax for prescription drugs. RCW 82.08.0281 specifically exempts sales of drugs to the state, political subdivisions or municipal corporations dispensed to patients by prescription without charge from the retail sales tax.

12. To substantiate a claim for prescription drug exemption, the Department requires proof that a sale has occurred and in the course of an audit, it seeks billings to the patient that would include a "line item" for the sale of a prescription drug under the provisions of WAC 458-20-18801.

13. A "line item" indicating a sale of a prescription drug means that (a) the name of the drug is identified, (b) the price of the drug is identified, and (c) the name of the patient to whom the prescription drug was resold is identified.

14. If a hospital produces (a) a written prescription and (b) a separate billing to a patient for a prescription drug, the Department will treat the sale of the prescription drug between the supply house and the hospital as tax exempt from the sales tax and the use tax, and the resale between the hospital and the patient as tax exempt from the sales tax and the use tax.

15. The 38 hospital appellants have maintained adequate records to verify the use for floor charges by way of the physicians' prescriptions or orders which are made a part of patients' medical charts and records.

16. Medicines, drugs, prescription lenses, and other substances were and are only dispensed, in a hospital setting, upon the written order (prescription) of a physician.

17. The prescription drugs exemption statutes define "prescription drugs" as

any medicine, drug, prescription lens, or other substance other than food for use in the diagnosis, cure, mitigation, treatment or prevention of disease or other ailment in humans ordered by (1) the written prescription . . . by a practitioner authorized by law of this state . . . or (2) upon an oral prescription of such practitioner . . . reduced promptly to writing

18. At the time the drug is bought from the supply house, no prescription has been issued.

19. The Department has already issued a tax refund for sales/use tax paid by an appellant hospital for purchases of IV sets and irrigation solutions where a "line item" charge appeared on the patient's bill.

20. WAC 458-20-18801 requires that sales claimed as deductible under the prescription drugs exemption statutes must be separately accounted for, as follows:

A deduction is allowed from gross retail sales for sales to patients of drugs, medicines, prescription lenses, or other substances, but only when

- (a) Dispensed by a licensed dispensary
- (b) Pursuant to a written prescription

(c) Issued by a medical practitioner

(d) For diagnosis, cure, mitigation, treatment, or prevention of disease or other ailment in humans.

This deduction does not apply to sales of food. Thus, dietary supplements or dietary adjuncts do not qualify for the deduction even though prescribed by a physician.

Sales claimed deductible under this rule must be separately accounted for. As proof of entitlement to the deduction, sellers must retain in their files the written prescription bearing the signature of the medical practitioner who issued the prescription and the name of the patient for whom prescribed. See also WAC 458-20-150 Optometrists, ophthalmologists, and oculists; 458-20-151 Dentists, dental laboratories and physicians; and 458-20-168 Hospitals.

(Emphasis added.)

21. The purpose of requiring that a prescription drug be separately billed to the patient is to show that the prescription drug was resold from the hospital to that patient.

22. The Department does not exempt prescription drugs from sales tax and use tax, unless the Department is furnished with a billing indicating by a separate "line item" entry that the prescription drug was resold to the patient.

23. The Department asserts that unless specifically resold by "line item," prescription drugs are consumed by the hospital in its providing of services.

24. By express provision RCW 82.04.190, the term "consumer" includes any person engaged in any business activity taxable under RCW 82.04.290 (tax on business and service activities). This classification includes hospitals.

25. WAC 458-20-168 is the regulation concerning hospitals. This rule explains that consumable sold to the service providers are subject to sales tax.

26. Appellants appeal the requirement that there be the need for record keeping a "line item" for proof of prescription drug sales to their patients.

27. Appellants maintain that a sale to patients does occur in floor charge items and that a "resale" is not required.

28. The appellants sought tax exempt status for irrigation solutions, intravenous sets and solutions, reagents

and nutrition products which are charged to hospital patients in a lump sum by a "floor charge" or ancillary hospital services.

29. Irrigation solutions, laboratory reagents, and nutrition products may be administered to a patient only upon the written prescription of a physician, or upon an oral prescription that is subsequently reduced to writing.

30. The irrigation solutions for which exempt status is sought are saline solution, sterile water, lactated ringers, balanced salt solution, and glycine.

31. Irrigation solutions are not usually separately billed by a line item entry to a patient.

32. Irrigation solutions are used by the hospital in its performance of medical services to a patient.

33. Laboratory reagents are chemical compounds used to promote reactions in the laboratory to aid in determining disease pathology.

34. Laboratory reagents are used only in the laboratory and are not administered directly to the patient.

35. Reagents are not billed by a line item but are included in a test charge which also includes labor, supplies, and indirect expenses.

36. An intravenous set is a stand and a series of tubing that delivers the intravenous solution into the patient's body.

37. An intravenous set is a medical apparatus that is conceptually and physically distinct from the intravenous solution that it delivers.

38. No testimony was submitted concerning nutrition products, although several containers of nutrition products were received as appellants' exhibits.

II. Prosthetic Devices.

39. The appellants also sought tax-exempt status for heart-lung machines, infusion pumps, and hearing aids.

40. RCW 82.08.0283 and RCW 82.12.0277 (hereinafter, the "prosthetic devices exemption statutes") provide an exemption from sales and use tax for prosthetic devices.

41. The Department defines "prosthetic devices" in WAC 458-20-18801 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, and materials which become ingredients or components of prostheses."

42. Dorland's Illustrated Medical Dictionary (26th ed.) defines prosthetic and prosthesis, as follows:

Prosthetic - serving as a substitute; pertaining to the use or application of prosthesis.

Prosthesis - an artificial substitute for a missing body part, such as an arm or leg, eye or tooth, used for functional or cosmetic reasons, or both.

43. The heart-lung machine is used for open-heart or heart transplant surgery.

44. The heart-lung machine is a device that temporarily supplies blood and oxygen to the patient.

45. The heart-lung machine is employed during open-heart surgery and transplant surgery to function in place of the malfunctioning or nonfunctioning heart, and in the case of transplant surgery, the completely missing heart, and the lungs.

46. The heart-lung machine and related supplies take over the vital pumping function of the heart to maintain the blood and oxygen flow and take over the vital function of the lungs in the carbon dioxide-oxygen exchange process.

47. The heart-lung machine is used only in the operating room and does not permanently replace the heart or the lungs.

48. The heart-lung machine and related supplies are only utilized upon the written order of a physician which appears in the medical charts of the patient.

49. The Department has treated kidney dialysis machines and related supplies as prosthetic devices.

50. An infusion pump is a motor driven syringe which delivers insulin at measured amounts in measured intervals to diabetic patients.

51. Use of infusion pumps is restricted mainly to Type I diabetics whose islet of langerhans beta cells, which are located in the pancreas and produce insulin, are missing.

52. Type I diabetics would die without insulin.

53. The pancreas is an internal organ of the human body.

54. Even if the beta cells cease to make insulin, the pancreas continues to produce a hormone named glucagon and to produce digestive enzymes.

55. The infusion pump assists but does not replace the pancreas.

56. Infusion pumps are only utilized under the orders of a physician.

57. Pacemakers provide electrical stimulus to the heart so that it beats.

58. The Department has treated pacemakers as tax-exempt prosthetic devices.

59. A hearing aid replaces the audio sensory function of the inner ear.

60. The inner ear is an internal organ of the human body.

61. Any Conclusion of Law which should be deemed a Finding of Fact is hereby adopted as such.

From the foregoing Findings of Fact, the Board now makes the following:

CONCLUSIONS OF LAW.

1. The Board of Tax Appeals has jurisdiction over the parties and the subject matter of this litigation.

2. Each of the 38 hospitals and Deaconess are "hospitals" as defined in RCW 70.41.020.

3. The Department of Revenue is an agency of the State of Washington that administers the sales and use tax laws contained in Chapters 82.08 and 82.12 RCW.

4. Sales and use tax applies to transactions in Washington unless the legislature has provided an express exemption. RCW 82.08.020 and RCW 82.12.020.

5. This Board holds that statutes that provide for exemption from taxation must be strictly construed.

[I] It is well established in this state that "an exemption in a statute imposing a tax must be strictly construed in favor of the application of the tax and against the person claiming the exemption . . ." In re All-State Constr. Co., 70 Wn.2d 657, 665, 425 P.2d 16 (1967). Further, "the burden of showing qualification for the tax benefit afforded . . . rests with the taxpayer. And, statutes which provide for [exemption] are, in case of doubt or ambiguity, to be construed strictly, though fairly and in keeping with the ordinary meaning of their language, against the taxpayer." Group Health Cooperative v. State Tax Comm'n, 72 Wn.2d 422, 429, 433 P.2d 201 (1967).

(Emphasis added.) Catholic Archbishop v. Johnston, 89 Wn.2d 505, 507, 573 P.2d 793 (1978).

6. Intravenous sets are not entitled to the prescription drug exemption because they are not prescription drugs as defined in the prescription drugs exemption statutes. They are conceptually and physically distinct and separate from the intravenous solution, a prescription drug, they deliver. The intravenous sets are distinct, consumable medical apparatus used by the hospitals in the delivery of medical services and are not prescription drugs resold to the patients.

7. RCW 70.41.020 defines a hospital, in pertinent part, as follows:

Unless the context clearly indicates otherwise, the following terms, whenever used in this chapter, shall be deemed to have the following meanings:

. . . .
(2) "Hospital" means any institution, place, building, or agency, which provides accommodations, facilities and services over a continuous period of twenty-four hours or more for observation, diagnosis, or care, of two or more individuals not related to the operator who are suffering from illness, injury, deformity, or abnormality, or from any other condition for which obstetrical, medical, or surgical services would be appropriate for care or diagnosis.

(Emphasis added.)

8. This Board concludes that hospitals do not resell a prescription drug unless the resale is evidenced on the

patient's billing by means of a specific "line item" entry identifying the name of the drug, the price of the drug, and the name of the patient.

9. This Board holds that the statutory law pertinent here exempts only sales of drugs which have been prescribed at the time of sale and does not exempt sales of drugs based on the intent to dispense a drug pursuant to a prescription. If the legislature intended to exempt all sales of drugs for eventual sale to patients under prescription, the provision of RCW 82.08.0281 pertaining to sales of drugs to the state, political subdivisions, and municipal corporations for dispensation free of charge would have been unnecessary.

10. This Board concludes that a hospital is a service provider and that prescription drugs that are not clearly billed to patients by means of a "line item" entry have been consumed by the hospital in delivering medical, surgical or obstetrical services to that patient.

11. This Board concludes that unless a hospital bills a patient with a clear "line item" entry for the sale of a prescription drug, the sale of the prescription drug between the supply house and the hospital is a taxable transaction.

12. Irrigation solutions, laboratory reagents and nutrition products which are prescription drugs do not qualify for the prescription drug exemption unless there is a specific separate entry to document the transaction, because they have been consumed by the hospital in the delivery of their medical services.

13. The legislature did not define "prosthetic devices" in RCW 82.08.0283 and RCW 82.12.0277. The Department is empowered to promulgate rules and regulations pursuant to the authority of RCW 82.32.300.

There is a presumption that WAC 458-20-18801 is valid:

In determining the validity of WAC 173-24, we first note that where the legislature specifically delegates to an administrative agency the power to make rules, there is a presumption such rules are valid. . . . Thus, this court's review of such rules should normally go no further than to ascertain whether the rule is reasonably consistent with the statute it purports to implement The court should not invalidate a legislative rule merely because it believes the rule is unwise. . . .

Furthermore, this court has consistently given weight to an interpretation of an ambiguous statute by the agency charged with its administration:

When a statute is ambiguous, the construction placed upon it by the officer or department charged with its administration, while not binding on the courts, is entitled to considerable weight in determining the intention of the legislature.

(Citations omitted.) *Weyerhaeuser v. Department of Ecology*, 86 Wn.2d 310, 314-15 545 P.2d 5 (1976).

14. The Department did not exceed its authority in defining "prosthetic devices" in WAC 458-20-18801.

15. The Department's definition of "prosthetic devices" in WAC 458-20-18801 is consistent with the recognized definition of prosthetic devices and reasonably implements the statute.

16. This Board perceives that the clear legislative intent is to interpret the exemption laws narrowly and does not feel it could broaden the definition of prosthetic devices to include temporary replacements of missing parts of the human body.

17. Heart-lung machines are not "prosthetic devices" as that term is used in the prosthetic devices exemption statutes and rules because they only temporarily replace the heart and lung.

18. Infusion pumps are not "prosthetic devices" as that term is used in the prosthetic devices exemption statutes and rules because they do not replace a missing part of the human body.

19. Hearing aids were legislatively determined to be a prosthetic device when the legislature expressly exempted hearing aids from sales and use tax under the provisions of RCW 82.08.0283 and RCW 82.12.0277 effective July 1, 1986. This action would not have been necessary if the hearing aids were already exempt from sales and use tax under the provisions of RCW 82.08.0283 and RCW 82.12.0277.

20. This Board Concludes that the Department exceeded the intent of the legislature and their rule WAC 458-20-18801 when they accorded the kidney dialysis machine and the Pacemaker treatment as Prosthetic devices. See Bearing Memorandum of Respondent Department of Revenue at 24-25.

21. This Board believes that the legislature is the proper forum to determine whether to provide sPecific exemption for the heart-lung machine and the infusion Pump, which are not prosthetic devices, from the sales and use tax as they have done for the hearing aid.

22. Any Finding of Fact which should be deemed a Conclusion of Law is hereby adopted as such.

From these Conclusions of Law, the Board enters this

DECISION.

The Board sustains the determination of the Department of Revenue.

DATED this 24 day of September, 1987.

BOARD OF TAX APPEAL

* * * * *.

WAC 456-08-540. Petition for Rehearing. (I) Any party may after a final decision of the board file a petition for rehearing. A petition for rehearing must be filed within fifteen days of service of notice of final decision in the hearing. The petition for rehearing, and an answer, if called for, must be served on the other parties in the hearing, and three copies filed with the board.

(2) The filing of a petition for rehearing shall suspend the final decision of the board until it is denied by the board or a modified decision is entered by the board.

(3) In response to a petition for rehearing, the board may (a) deny, (b) call for an answer, (c) modify its decision, or (d) permit a rehearing.