

Cite as Det. No. 98-210, 19 WTD 109 (2000)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition	)	<u>D E T E R M I N A T I O N</u>
For Correction of Assessment of	)	
	)	No. 98-210
...	)	
	)	Registration No. . . .
	)	FY. . . /Audit No. . . .
	)	

RULES 233, 151, 168, 18801; B&O TAX – DRUGS – SALE OF – ADMINISTRATION. Only those drugs sold and physically administered by the seller are taxable under the services and other activities classifications of the B&O tax. Drugs sold to patients or their caregivers for either patient self –administration or administration by a caregiver other than the seller are taxable under the retailing classification of the B&O tax.

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.

NATURE OF ACTION:

Taxpayer protests the reclassification of its sale of drugs from the retailing to the service and other activities classification of the business and occupation (B&O) tax.<sup>1</sup>

FACTS:

Bauer, A.L.J. – The books and records of Taxpayer<sup>2</sup> were reviewed by the Audit Division (Audit) of the Department of Revenue (Department) for the period January 1, 1992 to September 30, 1995. As a result of this review, the above-referenced tax assessment was issued on November 20, 1996 in the amount of \$. . . , interest in the amount of \$. . . , for a total due of \$. . . This assessment has not been paid, but was timely appealed.

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<sup>1</sup>Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

<sup>2</sup> Taxpayer is a wholly-owned corporation of . . . , Inc., which purchased Taxpayer in 1993.

Taxpayer began business in 1976 by providing pharmacy services to nursing homes. In the early 1980's, Taxpayer expanded into durable medical equipment and other home-based health care services. Taxpayer then introduced home infusion therapy to its business in the late 1980's and, in the early 1990's, initiated home respiratory therapy.

Today, Taxpayer offers a comprehensive "menu" of home health care services to clients. These include durable medical equipment, home health care, including skilled nursing, physical, occupational, respiratory and speech therapy, women's health services, home infusion therapy, pharmacy, and rehabilitative equipment services.

During the audit period, Taxpayer reported only the nursing charges to patients under the Service and Other Activities classification of the B&O tax, and reported its sales of drugs and durable medical goods under the Retailing classification. Audit reasoned that all such charges -- nursing and the sale of drugs and supplies -- should have been reported under the service and other activities classification.

Audit summarized WAC 458-20-168 (Rule 168), WAC 458-20-151 (Rule 151), and WAC 458-20-233 (Rule 233) as follows:

The gross income derived from medical care activities is properly subject to the service and other activities classification of the business and occupation tax. The retailing business and occupation tax applies to sales by such persons of tangible personal property sold and billed separately from services rendered. However, this does not include charges to patients for tangible personal property which is used in providing medical services to a patient, even if separately billed. The retailing classification applies only when the medical staff does not administer the drug or other medicine to the patient. (Emphasis added.)

Audit further reasoned, however, that Taxpayer's diversified services "seem to cross over tax applications." Recognizing that the mere sale of tangible personal property is subject to the retailing classification of the B&O tax, Audit nevertheless found that Taxpayer's services in regard to home infusion therapy, respiratory therapy, and home health care "would seem to be for providing medical care," and that the only difference between the care supplied by Taxpayer in the patient's home, and the care supplied by a hospital or other care facility, was the location of where the care takes place.

Audit further commented that, while the actual administration of the therapy is by either the patient, nurse, technician, or relative of the patient, the same type of activity takes place in a care facility, and if oral drugs are given they are always taken by the patient. If infusion is necessary, a nurse or doctor normally does it, but sometimes the patient could do this. The audit report commented:

We have looked at 65 patients (Home Infusion therapy) bills for a one month billing cycle for a test period. . . . It would appear that medical care would be the taking on the

responsibility and a watchful attention of the patient. Care then may be whatever it takes to ensure successful therapy.

(Schedule 2, Reconciliation of Income dated October 16, 1996.)

#### TAXPAYER'S EXCEPTIONS:

Taxpayer characterizes the auditor's finding to be that Taxpayer was primarily furnishing medical services to its clients. Taxpayer strongly disputes this characterization of its business. Taxpayer claims its pharmaceutical sales were in fact retail sales to clients, and thus taxable as retail sales.

Taxpayer concedes it did perform various medical services for its clients. When such services were performed, Taxpayer states it generally reported the resulting income under the service and other activities classification of the B&O tax. However, all drug sales were reported under the retailing classification. During the audit period, Taxpayer states that it did not report any nursing services attendant to the training of individuals to self-administer drugs or medication or any other related services because these services were de minimus in relation to the total amount of drug sales. Moreover, in many instances, these services were unbilled.

Taxpayer reports that it performed a test sampling during the audit (agreed to by the Department's auditor), and was able to demonstrate that less than seven percent of the drugs sold were either administered to clients by Taxpayer's personnel, or were administered in conjunction with the provision of other nursing services provided by Taxpayer (many of the latter being primarily for teaching and training purposes). Nevertheless, the auditor assessed service B&O tax on nearly all of Taxpayer's pharmacy supplies.

Taxpayer argues it reported all of its pharmacy sales during the audit period under the retailing B&O tax classification. Arguably, concedes Taxpayer, when Taxpayer administered the drugs to clients or performed some other incidental service, the income could be reported under the service and other activities B&O tax classification. However, this would represent only a very small percentage of Taxpayer's pharmacy sales. Most of the sales involved Taxpayer merely selling drugs to clients which drugs were not administered by Taxpayer.

Taxpayer argues that all of the rules and regulations relating to this issue are consistent in that they require the sales of drugs to be taxable under the service and other activities classification when they are administered by the seller, but under the retailing classification when they are not. Taxpayer therefore argues that Audit's reclassification of all of its drug sales to the service and other activities classification of the B&O tax was error because no more than seven percent of the drug sales involved Taxpayer's administering of drugs or providing any other related services to clients. Taxpayer's records indicate that more than 93 percent of its drug sales were outright sales of pharmaceuticals with no medical services provided by Taxpayer.

Taxpayer points out that Schedule 2A of the Audit report -- which lists a sampling of 65 clients who purchased drugs from taxpayer -- demonstrates the errors that have been made by the auditor. Sales

of drugs to these 65 clients totaled \$. . . , of which sales in the amount of \$. . . were reclassified as taxable under the service and other activities classification of the B&O tax. Taxpayer also lists the number of visits with these clients by Taxpayer's nurses. The auditor failed to take into consideration the fact that Taxpayer generally charged the person for the nursing visits and paid service and other activities B&O tax on such income. More importantly, however, is the fact that the great majority of these pharmacy sales were simply sales of drugs with no attendant services.<sup>3</sup>

Taxpayer argues that Determination No. 90-35A, 9 WTD 289 (1990) restates the Department's position that permits taxpayers to qualify their drug sales for the retailing classification by distinguishing -- in their patient billings and in their own records -- between drugs which are self-administered by patients off-premises from drugs which are administered by physicians or staff.

#### ISSUE:

Whether Taxpayer's sales of drugs provided to home health care patients are properly taxable under Service and other activities classification of the B&O tax when they were not administered by Taxpayer's personnel.

#### DISCUSSION:

Rules interpreting the Revenue Act concerning this matter provide as follows:

All medical service bureaus, medical service corporations, hospital service associations and similar health care organizations engaging in business within this state are subject to the provisions of the business and occupation tax and are taxable under the service and other business activities classification upon their gross income.

Rule 233.

(a) SERVICE AND OTHER BUSINESS ACTIVITIES. [Dentists, dental laboratories and physicians] are taxable under the service and other business activities classification on the gross income from charges for performing professional services.

(i) This includes any separate charge to the patient for drugs, medicines, and other substances used by a dentist, or physician, or administered to a patient as part of the dental or medical services to the patient. . . .

(b) RETAILING. A physician or a medical clinic may occasionally make sales of drugs as a convenience to a customer with the sale not being part of the medical services to the patient. These sales are taxable under the retailing classification. The retailing

<sup>3</sup> Taxpayer particularly points out "George B." (drug sales in the amount of \$. . . ) who was cared for by a visiting nurse hospice; "Jane C.," whom Taxpayer visited eight times, but Taxpayer administered none of her medication; and "Katherine S." who resided in and was cared for solely by a nursing home whose payments to Taxpayer for drugs alone (\$. . . ) were taxed under service and other activities and not retailing. In addition, individuals listed as numbers 9, 12, 24, 30, 32, 33, 37, 38, 40, 47, 48, 49, 50, and 51 received no nursing visits at all, and yet the auditor reclassified all of the pharmacy sales to them to the service and other activities classification.

classification applies only when the physician or medical staff does not administer the drug or other medicine to the patient. Adequate records must be kept by the business to distinguish drugs which are administered as part of a medical service from those which are sold outright.

#### Rule 151.

(3) **Business and occupation tax.** The sale of tangible personal property which is not part of the medical service being provided to a patient is taxable under the retailing B&O tax classification. . . .

(c) Retailing. The retailing business and occupation tax applies to sales by such persons of tangible personal property sold and billed separately from services rendered. However, this does not include charges to patients for tangible personal property which is used in providing medical services to a patient, even if separately billed. Tangible personal property which is used in providing medical services is not considered to have been sold separately from the medical services simply because those items are separately invoiced. These charges, even if separately itemized, are for providing medical services and are taxable under either the "public or nonprofit hospital" classification or the "service and other business activities" classification, depending on the type of organization making the sale. . . .

(7) **Retail sales and use tax exemptions.** The following exemptions from the retail sales and use tax apply:

. . . (b) Sales of drugs, medicines, prescription lenses, orthotic devices, medical oxygen, or other substances, prescribed by medical practitioners are exempt of retail sales tax where the written prescription bearing the signature of the issuing medical practitioner and the name of the patient for whom prescribed is retained. Sales of prosthetic devices, hearing aids as defined in RCW 18.35.010(3), and ostomic items whether or not prescribed are also exempt of sales tax. See WAC 458-20-18801.

#### Rule 168.

(2) Business and occupation tax. The business and occupation tax applies to the gross proceeds from sales of drugs, medicines, prescription lenses, or other substances used for diagnosis, cure, mitigation, treatment, or prevention of disease or other ailments in humans. Sales of these items to persons for resale are taxable under the wholesaling classification. Sales to consumers are taxable under the retailing classification. Persons who provide medical services to patients are taxable under the service and other business activities classification on the gross charge to the patient, notwithstanding that some prescription drugs may be separately charged to the patient.

WAC 458-20-18801(2), (Rule 18801). (Emphasis added.)

Determination No. 90-35A, 9 WTD 289 (1990), in light of the above guidance, specifically sets forth the Department's position on the taxability of the sale of drugs:

The way taxpayer bills its patients for the drugs administered by the doctors or staff does not control whether its income is subject to the retailing or service and other rate. The transaction or service must be examined as a whole to determine the proper classification. Like Deaconess, the contractual relationship between taxpayer and its patients is not one of sale, but one of service, even though such transfer or administration of drugs may result in separate charges.

[2] Although the Department does not favor bifurcation of income into separate classifications, taxpayer's argument for the [WAC 458-20-168(2)] retailing category would apply if it merely sold drugs to the patients and its doctors and staff did not administer them. For example, taxpayer could classify income from such sales as retailing if the patients took the drugs home to administer them. By comparison to doctors or staff administering drugs, such sales do not involve medical services rendered to patients. The sales of drugs by physicians would be similar to sales of prescription drugs by a pharmacy.

To qualify for the retailing classification, taxpayer's records and patients' bills must distinguish between drugs, which are self-administered by patients off-premises from drugs which are administered by the physicians or staff. Taxpayer did not bill the patients during the audit period in such a manner. Therefore, the retailing classification does not apply even to the patient-administered drugs. However, for the subject audit period, taxpayer is not precluded from attempting to show the Department's auditors that it can separate income from drugs administered by the clinic from those administered by the patients. Of course, any claim is subject to taxpayer's existing records and the limitations of RCW 82.32.060.

(Determination No. 90-35A, 9 WTD at 291-192 (emphasis included in original, bracketed material added)).

[1] Thus, only those drugs sold and physically administered by the seller are taxable under the services and other activities classification of the B&O tax. Drugs sold to patients or their caregivers for either patient self-administration or administration by a caregiver other than the seller are taxable under the retailing classification of the B&O tax.

In this case, Taxpayer claims its records and its patients' billings do distinguish between drugs which Taxpayer administered to patients and those drugs which were merely sold for administration by patients themselves, or by caretakers other than Taxpayer. Therefore, this matter will be remanded to Audit so that Taxpayer, in accordance with Det. No. 90-35A, supra, may demonstrate which drugs are properly taxable under the retailing classification.

#### DECISION AND DISPOSITION:

Taxpayer's petition is granted.

DATED this 28th day of December 1998.