425.0030

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
(916) 324-3828

October 22, 1991

Mr. REDACTED TEXT
President, REDACTED TEXT

RE: SR REDACTED TEXT

Dear Mr. REDACTED TEXT:

I am writing this in response to your letter to me of August 27, 1991. You have requested advice on the application of the Sales and Use Tax Law to various transactions into which your company, REDACTED TEXT enters.

OPINION

I shall organize my opinion around your specific questions.

A. Medicare Capped Rentals

You describe your problem as follows:

> "Often when dealing with insurances, such as Medicare, Medi/Cal and some private insurances, suppliers are not reimbursed for as long as 6 months after the item is sold or rented.… Do durable medical equipment companies pay taxes on moneys not yet received? Do durable medical equipment companies pay taxes on gross taxable receipts?
>
> "Medicare has instituted a program called the 6 Point Plan…. Under this program durable medical equipment cannot be purchased because the need/and length of time for such equipment is unknown. At the end of 10 months, if the patient still needs the equipment, an option to buy, or rent, is offered if he wishes to do so. The patient is not obligated to buy and suppliers often recommend he doesn't because he becomes responsible for maintaining the equipment. Where he does opt to buy or continue the lease, after 15 months no other monies are received from Medicare. If the patient accepts the option to lease, every 6 months Medicare will pay for a maintenance fee equal to one month rent on the specific equipment.

"Under these conditions does this constitute a sale or a lease?"

Leases of durable medical equipment (DME) are governed by the rules normally applicable to any other kind of lease. The lease (or rental) of tangible personal property in California is generally a sale unless (among other exceptions) that property is leased in substantially the same form as acquired by the lessor and the lessor has paid sales tax reimbursement or use tax measured by the purchase price of the property. (Rev. & Tax. Code § 6006(g)(5), Reg. 1660. All further statutory references are, unless otherwise stated, to the Revenue and Taxation Code.) If the lease is a sale under this definition, that lease is subject to use tax measured by rentals payable unless it is specifically exempted by statute. The taxable rental payments include all payments required by the lease. (Reg. 1660(c)(1). Sales and Use Tax Regulations are Board promulgations which have the force and effect of law.) Required maintenance payments are thus subject to tax. (II Bus. Tax. L. Guide, Annot. 330.3440. Annotations are excerpts from previous Board staff opinion letters and serve as a guide to staff positions.)

Your question indicates that the leases in question are continuing sales and purchases under the above authority and that PMS is collecting from its lessees use tax measured by the rental payments. PMS must collect the tax at the time of each payment and give its lessees receipts of a kind called for by Regulation 1686. Tax is thus not due until the payment is made, whether it is made by the patient or directly by medical insurance. Your letter indicates that the maintenance charges are required by the lease. If so, tax must be reported on them in the quarters in which they are received.

A lease with an option to purchase remains a lease until the option is exercised. (Reg. 1660(c)(7).) All charges paid by the lessee at the time the option is exercised are included in the measure of tax arising out of the sale. (Annot. 330.3500.)

B. Urinary Catheters

You ask if urinary catheters are considered to be "medicines". You list several situations in which urinary catheters are necessary to aid the patient to drain the bladder. You also discuss the various medical problems that can result from improper drainage.

Prior to October 1, 1977 only those catheters which were permanently (i.e., for at least six months) "implanted in the human body to assist the functioning of any natural organ, artery, vein or limb and which remained permanently or dissolved in the body" were considered exempt medicines. (§6369(c)(2); Regulation 1591(b)(2).)

Effective October 1, 1977, Revenue and Taxation Code section 6369 was amended to add:

> "Mammary prostheses, and any appliances and related supplies necessary as a result of any surgical procedure by which an artificial opening is created in the human body for the elimination of natural waste." (Section 6369(g).)
>
> "Prosthetic devices, and replacement parts for such devices, designed to be worn on or in the person of the user to replace or

assist the functioning of a natural part of the human body." (Section 6369(c)(4).)

As a result of the 1977 amendments, certain drainage catheters were considered exempt medicines under section 6369(g) because they were utilized as a result of a surgical procedure by which "an artificial opening is created in the human body for the elimination of natural waste." Certain other drainage catheters were still considered taxable because they were utilized through a "natural opening." Since 1977 several types of drainage catheters have been classified as exempt medicines even though they were utilized through a natural opening. The main requirement was that the catheters had to be worn on the person of the user or be permanently implanted. The interpretation to allow drainage catheters used as a result of a natural opening was an extension of the exemption provided to catheters in section 6369(g). As a consequence, the requirement for post-surgical use was maintained. Certain other catheters which are used for diagnostic purposes, irrigation, feeding and administration were not considered exempt under any part of section 6369 and tax applies to their sale.

In summary, sales of catheters are generally taxable with three major exceptions: (1) catheters which are permanently implanted are exempted under section 6369(c)(2); (2) catheters which are used for drainage purposes through artificial openings are non-taxable under section 6369(g) dealing with ostomy materials (this exemption includes supplies); and (3) catheters or other types of drainage devices used for drainage through natural openings are non-taxable as prosthetic devices under section 6369(c)(4). Catheters may also be exempted if they are an integral and necessary part of another exempt item.

We have previously determined that urinary catheters and related supplies qualify as medicines either as prosthetic devices inserted through a natural opening in the body under Regulation 1591(b)(4) or as drainage devices inserted through an artificial opening in the body under Regulation 1591(j). Sales of urinary catheters are thus exempt from tax when made under the conditions set forth in Regulation 1591(a).

C. Medical Facilities

You indicate that most DME companies are under contract to nursing homes, long care facilities, and intermediate care institutions, and we assume that PMS is too. You ask whether PMS should charge tax on its sales to these facilities of items which are listed as exempt in Pamphlet No. 45. You also ask if the above facilities need tax exempt numbers.

Please note that under the California scheme, the retailer – not the purchaser – pays sales tax. (§6051.) The retailer may collect sales tax reimbursement from the purchaser pursuant to agreement. (Civ. Code § 1651.1.) Thus, when you say PMS "charges" tax, you mean that it pays tax and collects reimbursement from the purchaser.

Health facilities may purchase medicines free of tax by giving their suppliers exemption certificates in a form substantially conforming to the requirements of Regulation 1667. (Reg. 1591(p)(3).) Some buyers purchase intending to either re-sell the items purchased or use them in purveying their services and be unable at the time of purchase to determine which items will be re-sold and which will be used. In that case, they may purchase all of the items free of tax by

giving their suppliers resale certificates substantially conforming to the requirements of Regulation 1668. The purchasers must then report and pay use tax on the taxable items which they withdraw from inventory for their own use. (Reg. 1668(a)(2).)

As long as your customers are facilities organized, maintained, and operated for the diagnosis, care, treatment, and prevention of human illness, including convalescence and rehabilitation, and admit patients for periods of 24 hours or longer, they qualify as "health facilities" under Regulation 1591(g). PMS may sell to them free of tax by accepting either resale or exemption certificates. Even though a particular facility might not qualify as a "health facility" because it does not admit patients for twenty-four hours or longer, under the facts of a particular purchase the exemption may still be available if the purchase complies with the other terms of Regulation 1591(a).

D. Traction Devices

You indicate that sales of pelvic and cervical traction devices are exempt from tax and you attached to your letter illustrations of the types of traction devices that you believe qualify as medicines. You also attached illustrations of other traction devices and request advice on those.

The criteria to be applied in this area are of long standing. For a device, appliance, etc., to be considered an orthosis, Regulation 1591(b)(4) requires that it be designed to be worn on the person of the user. We have previously determined that such devices must be fully worn on the body of the patient. If any portion of the device is stationary, it does not qualify.

Those pelvic and cervical traction devices which qualify as medicines are devices such as cervical collars which are fully worn on the body of the patient. The devices your exhibits depict show that the patient is strapped to the device rather than the other way around. These devices are attached to the patient's bed. We have previously determined that such devices – e.g., the Bucks Traction Device – do not qualify under the regulation as orthotic devices. Therefore, their sales are subject to tax.

You apparently already have a copy of Pamphlet No. 45, which includes copies of Regulations 1591 and 1668. I hope the above discussion has answered your question. If you need anything further, please do not hesitate to write again.

Sincerely,

John L. Waid
Tax Counsel

JLW:es

Encs.: Regs 1667 and 1686