

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION

425.0175.575

APPEALS SECTION

In the Matter of the Petitions for Redetermination Under the Sales and Use Tax Law of:	)	DECISION AND RECOMMENDATION
H--- L--- - B---	)	Nos. SR --- XX-XXXXXX-010
A---	)	
H--- L---, INC.	)	SS --- XX-XXXXXX-010
<u>Petitioners</u>	)	

The Appeals conference in the above-referenced matters was held by Supervising Senior Staff Counsel Susan Wengel on May 24, 1995, in Sacramento, California. This matter was reassigned to Staff Counsel Carl J. Bessent to prepare when Ms. Wengel was named Assistant Chief Counsel.

Appearing for Petitioners: Ms. A--- B---  
Accounting Manager

Appearing for the Sales and Use Tax Department: Mr. Jack Warner  
District Principal Auditor

Type of Business: Manufacturer of industrial cleaners,  
germicides, surgical scrubs, antiseptic soaps  
and body care products.

Protested Items

The protested tax liabilities for the accounts are measured by:

<u>Item</u>	<u>State, Local and County</u>
SR --- XX-XXXXXX-010 (1/1/91 - 12/31/93)	

Claimed exempt sales disallowed based on  
a test of sales transactions for the months

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of June 1991, August 1992, and April 1993,  
which resulted in a 21.74 percent of error

\$211,984<sup>1</sup>

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Claimed exempt sales disallowed based on  
a test of sales transactions for the months  
of June 1991, August 1992, and April 1993,  
which resulted in a 20.28 percent of error

\$800,801<sup>2</sup>

#### Petitioner's Contentions

1. The products qualify as exempt medicines based on the Purdue-Frederick case.
2. Petitioners relied upon written advice from the Board's legal staff.

#### Summary

Petitioners manufacture and retail industrial cleaners, germicides, surgical scrubs, antiseptic soaps, and body care products. Petitioners' manufacturing plant is located in Indiana.

The products in dispute are primarily hand soaps, lotions, and cleansers that are sold to hospitals and medical facilities. Initially, there were 21 products in dispute. Copies of the labels were provided and are included in the petition file. The Sales and Use Tax Department (Department) treated six products as "surgical scrubs" and thus exempt medicines. The Department treated the remaining 15 products as "medicines" when applied to the body of a patient. What remains in dispute is the proper tax treatment when the 15 products are used by medical personnel.

The remaining 15 products are divided into two categories: "antimicrobial" and "non-antimicrobial". The antimicrobial products in question are Accent Plus Skin Cleanser, Accent Plus Perineal Cleanser, Accent Plus 1 Skin Lotion, Accent Plus 2 Body Massage, Bacti-Stat, Cida Rinse, Medi-Scrub and Accent Plus 3 Skin Creme.

The non-antimicrobial products are Accent plus Total Body Shampoo, Baby San, Serma San, Derma Soft, Epi-Fresh, Germa-Care Liqua San T and Wash.

Petitioners state that the antimicrobial products are used by hospital personnel prior to any patient contact through the duration of the patient's stay. The products are used both for minor

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<sup>1</sup>Petitioner is in disagreement with \$142,411 out of the total because this amount represents the projection of the errors under protest.

<sup>2</sup>Petitioner is in disagreement with \$553,594 out of the total because this amount represents the projection of the errors under protest.

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surgical procedures and by hospital personnel and patients from dispensers mounted in hospital rooms. Petitioners state that they have communicated to hospitals that any other use (i.e., by janitors) does not qualify for exemption.

In regards to the products that are not antimicrobial, petitioners state that these products are used by hospital personnel and patients in the same manner as the antimicrobial products. Petitioner contends that these products play a significant role in the mitigation and prevention of disease.

Petitioners contend that the disputed products should be treated as tax-exempt medicines based on Purdue Frederick Co. v. State Bd. of Equalization (1990) 218 Cal.App.3d 1021.

The Department denied exempt medicine status for the products used by medical personnel because, in its opinion, there was no direct connection between these products and the treatment of the patient.

Petitioners provided a copy of a letter dated October 17, 1990 from then-Senior Tax Counsel Mary C. Armstrong to Mr. R--- J. F---. Petitioners assert that the opinion expressed by Ms. Armstrong supports their contentions. The court case referred to is Purdue Frederick. Petitioners quoted the following sentences from Ms. Armstrong's opinion:

“The court disagreed and found that the Board's definition of the words ‘treatment of patients’ was too narrow. It concluded that when a substance such as Betadine is applied by hospital personnel to their own bodies it is undeniable that its germicidal effects benefit the patient and constitutes a critical component of the patient's treatment.”

The Department's position as to Ms. Armstrong's quoted passage is that it refers to “a substance such as Betadine”. Betadine is a surgical scrub. The Department allowed as exempt petitioners' sales of surgical scrubs. Thus, the quotation is not in conflict with the Department's position.

Petitioners' second contention is that they relied upon the written response by Mr. John Waid of the Board's Legal Division dated November 9, 1992. Specifically, the letter stated:

“Annotation 425.0880 has already been amended to incorporate the rule of the Purdue Frederick case.... That holding will be applied to like products which would be considered medicines if applied directly to patients and which are used by physicians to sterilize their hands in the same manner as the products before the court in Purdue Frederick.”

The Department stated that if an incorrect ruling was issued and the taxpayer relied upon it, then the taxpayer may be relieved of the liability to the extent of the erroneous advice. However, if the taxpayer misinterpreted the advice, the taxpayer may still be liable.

#### Analysis and Conclusions

Revenue and Taxation Code Section 6369(a)(4) provides for the exemption from taxation of receipts from the sale in California of “medicines” “[s]old to a...health facility for the treatment of a human being”. Section 6369(b) defines “medicines” to mean:

“...any substance or preparation intended for use by external or internal application to the human body in the diagnosis, cure, mitigation, treatment or prevention of disease and which is commonly recognized as a substance or preparation intended for that use.”

The Purdue Frederick case involved a determination by the Board that an antiseptic sudsing skin scrub (Betadine) purchased by hospitals for preoperative use on patients, preoperative scrubbing by surgical teams, and hand cleansing by other hospital personnel was not a medicine for purposes of exemption from taxation under Section 6369, except to the extent it was applied to patients. The trial court found that the scrub was a “medicine” exempt from taxation.

The Court of Appeal held that Section 6369(a)(4) (exemption from sales tax for medicines sold to a health facility “for the treatment of a human being”), applied to the scrub when used on hospital personnel, since hand washing by hospital personnel to mitigate and to prevent disease is beneficial to patients. The court stated that in recent hospital trials, infection rates were reduced by approximately half when staff used antiseptic, germicidal handwashing products, as compared with plain soap.

“Detergent (plain soap) with water can physically remove microbes (germs), but antiseptic agents are necessary to kill them.... The primary action of antimicrobial cleansers includes both mechanical removal and chemical killing or inhibition of both organism and colonizing flora.” (Purdue Frederick Co., supra, 218 Cal.App.3d 1021, 1025.)

The court stated that a second characteristic that set certain antiseptics apart from plain soap is an ability to continue a persistent chemical activity on skin.

In Purdue Frederick, the court concluded that the facts establish that the scrub was used, among other purposes, for hand washing by hospital personnel caring for and treating patients. Due to the antiseptic germ-killing properties, the scrub was intended for use in both mitigation and prevention of disease. The scrub was “commonly recognized as a substance or preparation intended for that use.” It was stipulated that the scrub was a “medical necessity and a required procedure commonly recognized and required by hospitals of their surgical personnel.” (Purdue Frederick, supra, at 1027.)

As to the specific products that remain in dispute, we will discuss each product. Accent Plus Skin Cleanser is often found at the sink in the patient’s room. The product actually kills the bacteria. It leaves a residue on the hands that kills bacteria on future contact. It has antiseptic (germ-killing) properties and is intended for use in both “mitigation” and “prevention” of disease. We find that Accent Plus Skin Cleanser is commonly recognized as a preparation intended for “mitigation” and “prevention” of disease. It is recognized that infection rates were cut in half when medical staff used antiseptic handwashing products as compared to plain soap. The use of this product for

handwashing is not specifically required by hospitals but it certainly must be highly encouraged. Accent Plus Skin Cleaner is to be treated as an exempt medicine.

Accent Plus Perineal Cleanser is a product similar to the product to clean human feces, found in Annotation 425.0248 (August 26, 1991). In the annotation, the products were considered exempt medicines. It is our understanding that Accent Plus Perineal Cleanser is only used by medical staff when treating a patient. The product must be diluted by medical staff. The use by the medical staff is probably only incidental use. The product is commonly used to clean a patient, directly. Thus, the sales of Accent Plus Perineal Cleanser are exempt from tax.

Accent Plus 1 Skin Lotion is exempt when used on a patient. This product is not for handwashing. When the product is used by the medical staff, it is not commonly recognized for the "mitigation" and "prevention" of disease. Medical personnel use this product for the lotion. Killing germs is incidental to use. Thus, the sales of Accent Plus 1 Skin Lotion are not exempt from tax when used by the medical staff.

Accent Plus 2 Body Massage is a product designed for use on the patient. It is ideal for daily patient massage. The overall purpose is for use on the patient. We assume the use is for the patients' benefit. Thus, the sales of Accent Plus 2 Body Massage are exempt from tax. This is based on the assumption that the product is not used at places such as nurses' stations.

Accent Plus 3 Skin Creme is similar to Accent Plus 1. It is not used for handwashing. It is not commonly recognized for "mitigation" and "prevention" of disease. This product is used as a lotion. Killing germs is incidental to use. Thus, the sales of Accent Plus 3 Skin Creme are taxable when used by medical personnel.

Bacti-Stat is an antibacterial handwash. It provides excellent antimicrobial activity. Its use is for medical personnel between patient contact to reduce incidence of nosocomial (hospital-acquired) infection. This product may be in the patient's room and is fairly expensive. We find that this product is commonly recognized as a preparation intended for "mitigation" and "prevention" of disease. Thus, the sales of Bacti-Stat are exempt from tax.

Cida-Rinse is an antiseptic handrinse to control the spread of nosocomial infections when the situation prevents handwashing. This product is used in places such as ambulances to obtain the benefit of handwashing without a sink. We find that this product is commonly recognized as a preparation intended for "mitigation" and "prevention" of disease. Thus, the sales of Cida-Rinse are exempt from tax.

Medi-Scrub is an antibacterial liquid handwash to be used by medical personnel in between patient contact to reduce the incidence of nosocomial infection. We find that this product is commonly recognized as a preparation intended for "mitigation" and "prevention" of disease. Thus, the sales of Medi-Scrub are exempt from tax.

Derma San Intact Skin Care appears to be similar to plain soap. This is not sufficient for the use by medical personnel to be exempt.

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Accent Plus Total Body Shampoo leaves the skin and hair feeling soft and smooth. We do not see any causal connection between the use of this product by medical personnel and the treatment of the patient. The use of this product by medical personnel is not to be considered an exempt medicine.

Baby-San is a liquid castile baby soap for newborns. This product appears to be used on babies. In line with Annotation 425.0180 (June 10, 1965), we conclude that the sales of Baby-San are exempt from tax because the use is on babies as patients.

The remaining non-antimicrobial products are Derma San, Derma Soft, Epi-Fresh, Germa-Care, Liqua San T and Wash. These products do not appear to be commonly recognized as substances intended for use by external or internal application to the medical staff personnel in the diagnosis, cure, mitigation, treatment or prevention of disease. Additionally, these products are not antimicrobial such as in Purdue Frederick. These products do not describe on their labels an ability to continue a persistent chemical activity on the skin. Thus, these products are not to be treated as exempt when used by medical personnel.

Revenue and Taxation Code Section 6596 provides in relevant part that if the Board finds that a person's failure to pay the correct amount of tax was due to that person's reasonable reliance on written advice from the Board, the person may be relieved of any sales or use taxes imposed.

We reviewed the letter by Ms. Armstrong and agree with the Department that the letter referred to a substance such as Betadine. The Department already allowed as exempt petitioners' surgical scrubs which are similar to Betadine.

As to Mr. Waid's letter dated November 9, 1992, he indicated that the Purdue Frederick case would be applied to like products. The interpretation would apply to surgical scrubs. With the changes that we are recommending, "like products" includes products other than surgical scrubs. Thus, we feel that this decision expands upon the intent of Mr. Waid's letter. We believe that to the extent petitioners relied upon Mr. Waid's letter to expand the exempt medicines for medical personnel beyond surgical scrubs, petitioners erroneously and unreasonably misinterpreted Mr. Waid's letter of November 9, 1992.

#### Recommendation

Conduct a reaudit to allow as exempt medicines the following products: Accent Plus Skin Cleanser, Accent Plus Perineal Cleanser, Accent Plus 2 Body Massage, Bacti-Stat, Cida-Rinse, Medi-Scrub, and Baby-San.

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Carl J. Bessent, Staff Counsel

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Date