

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

425.0775

In the Matter of the Petition for
Redetermination of State and
Local Sales and Use Taxes

DECISION AND RECOMMENDATION
OF HEARING OFFICER

X-----

Petitioner

The above-entitled matter came on regularly for hearing on February 28, 1979, in Sacramento, California.

Appearing for Petitioner:

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Assistant Controller

Appearing for the Board:

Mr. Jack Warner, Principal Auditor
Out-of-State District

PROTEST

Petitioner protests the assertion of tax on sales of medical supplies. Tax was asserted on the basis of an audit covering the period from April 1, 1972 through December 31, 1976, and pursuant to a determination dated March 8, 1978. The amount upon which the protested tax is based is \$652,914 for state, local and county tax purposes and \$104,470 for transit district tax purposes.

CONTENTION

Petitioner contends that the sales upon which tax is asserted were exempt sales of prescription medicines.

SUMMARY

1. Petitioner is a corporation engaged in the manufacture and sale of industrial chemicals, pharmaceuticals, and medical diagnostic products.
2. Sales by petitioner's Nuclear Division for the month of June 1976 were reviewed by the auditor. Sales to hospitals of products which were not regarded by the auditor to meet the exemption requirements for prescription medicines were found to have been claimed by petitioner as exempt. Petitioner had not charged tax reimbursement on these sales nor reported or paid tax. The auditor calculated an error factor and used this factor to calculate a tax deficiency for the entire audit period. The products in question are Res-

O-Mat Kits, Ria-Mat Kits, Plasma Volume Kits, Sodium Chromate Kits, Isojex syringes, evacuated vials, reference standards and Technescan Kits. In a letter dated July 23, 1976, petitioner requested an opinion from the Board's legal staff as to the application of tax to Ria-Mat Kits, Res-a-Mat Kits and Plasma Volume Kits. In a letter dated August 17, 1976, Mr. Gary J. Jugum of the Board's legal staff informed petitioner that all three of these items would be regarded as exempt from tax as prescription medicines. In a letter dated January 17, 1977, Mr. Jugum informed petitioner that the previous advice with regard to Ria-Mat and Res-a-Mat Kits was based on an incorrect understanding of their use, and that the sale of the kits is taxable. It should be noted that the Ria-Mat and Res-a-Mat Kits account for the bulk of the disputed sales. Petitioner did not specifically object to the tax asserted on the sales of the other items.

3. Petitioner describes the Ria-Mat Kit as a system to diagnose plasma renin activity in the blood by means of radioimmunoassay. The diagnosis is performed in the laboratory on samples of a patient's blood. Petitioner describes the Res-a-Mat Kit as a system to diagnose hypo-thyroid, euthyroid, or hyper thyroid conditions in human beings by means of radioimmunoassay. This diagnosis is also performed in the laboratory on samples of a patient's blood. Both products are used under a physician's direction, and both are regulated by the Federal Food and Drug Administration. Petitioner points out that Business Taxes Law Guide, Annotation 425.0900, December 6, 1963, states that sale of Uroscreen, a product used for urinalysis, is not subject to tax and argues that the use of its product is similar and should also be exempt from tax.

4. Petitioner's principal argument is that it was the intent of the Legislature to exempt all medicines and drugs from tax when it enacted Section 6369 of the Revenue and Taxation Code. Petitioner argues that when that section was originally enacted in 1961, it was intended that all prescription drugs as defined in Section 4031 of the Business and Professions Code be exempted from tax. That section defines drug independently of the method of use. In 1963 Section 6369 was revised to eliminate reference to Section 4031. Medicine was defined as any substances intended for use by internal or external application to the human body in the diagnosis, cure, mitigation, treatment or prevention of disease. Petitioner points out that Section 6369 has been repeatedly liberalized indicating that it was not the intent of the Legislature that the 1963 revision be more restrictive than the original enactment. There is nothing in the legislative history to indicate the reason for the change in the definition of medicine.

5. Petitioner argues that even if the sale of its products is subject to tax, it would be inequitable to assert tax other than after January 17, 1977. Petitioner stated it was not previously informed that the sale of the products was subject to tax, and that between August 17, 1976, and January 17, 1977, it was certainly entitled to rely on the legal opinion that it had obtained from the Board. Further it had received many letters earlier from physicians claiming that the products were exempt from tax. It is also inequitable to assert the tax because petitioner cannot at this time bill its customers for reimbursement. The auditor stated that tax was asserted on sales of Res-a-Mat Kits in the prior audit, putting petitioner on notice that tax applies to sales of this type of product. Petitioner

states that the amount was small in the last audit, and the implications may have been misunderstood by its accounting department at that time.

ANALYSIS AND CONCLUSIONS

1. Section 6369 in its present form provides an exemption from tax for certain sales of prescription medicines “intended for use by external or internal application to the human body in the diagnosis, cure, mitigation, treatment or prevention of disease”. Petitioner's products in question, except for plasma volume kits, are clearly used in the laboratory and not by external application to the human body. The exemption does not apply to the sale of the products in the express words of the statute. Petitioner's reliance on B.T.L.G. Annotation 425.0900 is misplaced. That opinion provides that Uroscreen is exempt provided it is used for internal or external application to the human body (emphasis added). The opinion is misleading, in that Uroscreen cannot be so used, and the annotation should be deleted. Moreover, BTLG Annotation 425.0540, November 16, 1965, specifically states that sale of a substance used exclusively for in vitro testing is not exempt under Section 6369.

2. Petitioner's principal argument rests on its interpretation of legislative intent with respect to Section 6269. It is possible that sales of petitioner's products would have been exempt under the original version of the statute, and it is true that the Legislature has widened the exemption over the course of time. Nevertheless, I am bound by the words of the statute where no ambiguity exists. In this case the words are clear; there is no exemption for medicines used solely in the laboratory. Statutes granting exemption from taxation are to be strictly construed. See Good Humor Co. v. State Board of Equalization, 152 Cal.App.2d 873 .

3. With regard to petitioner's arguments on equity, neither the Board nor its employees can through erroneous advice create an exemption not authorized by law. See Market Street Railway Co. v. State Board of Equalization, 137 Cal.App.2d 87. Furthermore tax was asserted against petitioner in the prior audit on sales of one of the products. Petitioner was on notice that sales of medicines used solely in the laboratory were not exempt from tax. We have in the past in some instances permitted-prospective application of tax where a formal opinion was modified or reversed. In this case the only formal opinion upon which petitioner could have relied was the opinion of August 17, 1976, which was reversed as to Ria-Mat and Res-a-Mat Kits on January 17, 1977. Tax should not be applied to sales of those kits during that interval.

RECOMMENDATION

Adjust error factor to delete sales of Plasma Volume Kits. Delete estimates of sales of Ria-Mat and Res-O-Mat Kits for the period from August 17, 1976 through December 31, 1976, from the measure of tax. Redetermine without other adjustment. Out-of-State District to make adjustments.

H. L. Cohen, Hearing Officer

March 2, 1979