

PRIVATE TAXPAYER RULING LR02-013

August 9, 2002

The following private taxpayer ruling is in response to your letter dated May 24, 2002. You have requested a ruling regarding the transaction privilege tax implications associated with renting and selling specific medical supplies and devices. As was stated in the interim letter, this private taxpayer ruling is limited to a determination of whether enteral nutrition supplies, tracheotomy care supplies, ostomy/urological supplies, mastectomy supplies, and the related products listed in your letter constitute prosthetic appliances exempt from transaction privilege tax under the retail classification.

Statement of Facts:

The following is a restatement of the facts presented in your letter dated May 24, 2002. . . . ("Taxpayer") is in the business of selling and renting durable medical equipment and related supplies to patients for use primarily in their homes. Payment for products sold and rented is received from Medicare, Medicaid, private insurance companies and patients.

The products requiring clarification are as follows:

1. enteral nutrition supplies
2. tracheotomy care supplies
3. ostomy/urological supplies
4. mastectomy supplies.

Enteral nutrition therapy is prescribed for patients who cannot ingest food orally. Enteral therapy may be administered into the body through nasogastric, jejunostomy or gastrostomy tubes or button catheters. Patients receive enteral nutrition through electric infusion pumps, specifically designed for enteral feeding or gravity feeding bags. Related supplies sold to patients pursuant to a physician's prescription include feeding bags, tubing, tape, dressings, and feeding tubes. Typically, the supplies are disposed of after one use.

In particular, tracheotomy care and cleaning supplies are disposable single use supplies prescribed by a physician for use by patients who have undergone tracheotomies. The supplies are used to care and clean a tracheotomy tube. Tracheotomy tubes are small tubes inserted into a surgical opening in the neck to provide a pathway for air or oxygen to enter the trachea. The tracheotomy tube is an artificial device that replaces the mouth and throat as a means to introduce air or oxygen into a patient's trachea, which carries life-sustaining oxygen

into the lungs.

Ostomy and urological supplies and appliances are prescribed for patients who have a surgically created opening, which is used to divert urine, feces, or ileal (intestinal) contents outside the body. Ostomy/urological supplies include skin barriers, belts, lubricants, closed and drainable pouches, external urinary collection devices (cups and pouches), drainage tubing, tape, adhesives, adhesive removers, filters, ostomy deodorant, urological catheters, irrigation trays, and irrigation and cleaning supplies. The supplies are single use items, which are medically necessary for patients who have undergone ostomy procedures and have implanted ostomy catheters to expel waste from the body.

Mastectomy supplies such as specialized mastectomy bras, forms and adhesives are prescribed for patients who have undergone a mastectomy due to breast cancer or other illness. The specialized bras are designed to hold a form or breast prosthesis in place. The adhesives are used to attach the form to the skin to minimize unwanted shifting and movement. The mastectomy supplies are prescribed to patients who have undergone surgical removal of the breast. The supplies are part of a comprehensive system designed to replace a patient's breast removed due to illness, disease or injury. Patients who have not undergone or completed reconstruction of the removed tissue use the bras and forms.

Issues:

Whether the following products constitute prosthetic appliances for purposes of an exclusion from transaction privilege tax under the retail classification.

1. Enteral nutrition supplies

- a. feeding bags
- b. tubing
- c. tape
- d. dressings
- e. feeding tubes

2. Tracheotomy care supplies

- a. tracheotomy care and cleaning kits

3. Ostomy/urological supplies

- a. skin barriers

- b. belts
- c. rings
- d. lubricants
- e. closed and drainable pouches
- f. external urinary collection devices (cups and pouches)
- g. drainage tubing
- h. tape
- i. adhesives
- j. adhesive removers
- k. filters
- l. ostomy deodorant
- m. urological catheters
- n. irrigation trays
- o. irrigation and cleaning supplies

4. Mastectomy supplies

- a. specialized mastectomy bras
- b. forms
- c. adhesives

Your Position:

It is your position that enteral nutrition supplies, tracheotomy care supplies, and ostomy/urological supplies are intrinsic and essential to the functioning of prosthetic appliances and are therefore included in Arizona's prosthetic appliance exemption from transaction privilege tax. In addition, it is your position that the specialized mastectomy bras, forms, and adhesives are exempt as prosthetic appliances because these supplies are part of a comprehensive system designed to replace a missing body part, the patient's breast.

Applicable Law:

Arizona Revised Statutes ("A.R.S.") § 42-5023 states that it is "presumed that all gross proceeds of sales and gross income derived by a person from business activity classified under a taxable business classification comprise the tax base for the business until the contrary can be established."

A.R.S. § 42-5061(A) states, "[t]he retail classification is comprised of the business of selling

tangible personal property at retail. The tax base for the retail classification is the gross proceeds of sales or gross income derived from the business."

A.R.S. § 42-5061(A)(9) provides that the tax imposed on the retail classification does not apply to the gross proceeds of sales or gross income from "[p]rosthetic appliances as defined in § 23-501 prescribed or recommended by a health professional licensed pursuant to title 32, chapter 7, 8, 11, 13, 14, 15, 16, 17 or 29." These chapters refer to podiatrists, doctors of chiropractic, dentists, physicians and surgeons, naturopathic physicians, nurses, osteopathic physicians and surgeons, and homeopathic physicians.

A.R.S. § 23-501 defines "prosthetic appliance" as "an artificial device necessary to support or take the place of a part of the body, or to increase the acuity of a sense organ."

A.R.S. § 42-5061(A)(25) provides that the tax imposed on the retail classification does not apply to tangible personal property sold to:

- (a) A qualifying hospital as defined in § 42-5001.
- (b) A qualifying health care organization as defined in § 42-5001 if the tangible personal property is used by the organization solely to provide health and medical related educational and charitable services.
- (c) A qualifying health care organization as defined in § 42-5001 if the organization is dedicated to providing educational, therapeutic, rehabilitative and family medical education training for the blind, visually impaired and multi-handicapped children from the time of birth to age twenty-one.
- (d) A qualifying community health center as defined in § 42-5001.
- (e) A nonprofit charitable organization that has qualified under § 501 (c)(3) of the internal revenue code and that regularly serves meals to the needy and indigent on a continuing basis at no cost.

Arizona Administrative Code ("A.A.C.") R15-5-156(A)(7) defines "prosthetic appliance" as "an artificial device which fully or partially replaces a part or function of the human body or increases the acuity of a sense organ."

A.A.C. R15-5-156(C) provides that the sale of component or replacement parts for an exempt prosthetic appliance is also exempt.

A.A.C. R15-5-156(E) states that gross receipts from the sale of medical supplies to doctors are taxable unless otherwise exempt.

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Discussion:

Arizona's transaction privilege tax is a tax on the privilege of conducting business in the state of Arizona. The seller may pass the burden of the tax on to the purchaser; however, the seller is ultimately liable to Arizona for the tax.

The transaction privilege tax is imposed on the business of selling tangible personal property at retail in accordance with A.R.S. § 42-5061. The tax base is the gross proceeds of sales or gross income derived from the business. All sales of tangible personal property are subject to tax unless specifically exempt by statute.

The retail classification does not contain any specific exemptions for the items specified in your request. Generally, medical supplies are subject to transaction privilege tax because they do not meet the requirements for prosthetic appliances or durable medical equipment. Under A.R.S. § 42-5061(A)(9), an exclusion from the transaction privilege tax on retail sales is provided for the sale of prosthetic appliances that are prescribed or recommended by a physician or surgeon. In order to qualify for the exclusion the item sold must be a "prosthetic appliance" as defined by statute. "Prosthetic appliance" is defined as an artificial device necessary to support or take the place of a part of the body or to increase the acuity of a sense organ. Further A.A.C. R15-5-156 defines a "prosthetic appliance" as "an artificial device which fully or partially replaces a part or function of the human body or increases the acuity of a sense organ."

Under A.R.S. § 42-5061(A)(13), durable medical equipment is equipment which has a Centers for Medicare and Medicaid Services common procedure code, is designated reimbursable by Medicare, is prescribed by a person who is licensed under Title 32, Chapter 7, 8, 13, 14, 15, 17, or 29, can withstand repeated use, is primarily and customarily used to serve a medical purpose, is generally not useful to a person in the absence of illness or injury and is appropriate for use in the home.

Appliances and related supplies, which do not meet the requirements of a prosthetic appliance or durable medical equipment are subject to transaction privilege or use tax unless a specific exemption applies. Two exemptions which may apply when selling medical supplies are: (1) sale for resale, or (2) sales to qualifying hospitals or health care organizations as provided under A.R.S. § 42-5061(A)(25); however, gross receipts from the sale of medical supplies to doctors are taxable unless otherwise exempt. As a result, supplies including therapeutic appliances and expendable medical supplies are subject to the transaction privilege tax unless sold for resale or to a qualifying hospital or health care organization.

Based on the information provided, it appears that the items listed in your request meet at least one of the requirements for prosthetic appliances because they support or take the place of a part or function of the body.

Enteral Nutrition Supplies

Nutritional feeding is a process that replaces the function of an esophagus for patients who have lost the capability to swallow food. Enteral pumps are used to introduce nutritional products directly into the stomach or intestines bypassing the mouth and esophagus and are determined to be a prosthetic appliance. Supplies such as enteral feeding tubes, tubing, and feeding bags are used in conjunction with the enteral pumps and allow nutrition to reach the digestive tract. As a whole, the pump and supplies constitute an integrated process which replaces the function of the mouth and esophagus, by introducing nutrients directly into the stomach, and often replace the function of the stomach by introducing nutrients directly into the intestines.

In many cases the patient's mouth, esophagus and stomach remain in the body. However, replacement of a part of the human body is not the determining factor in determining whether an item is a prosthetic appliance. A.A.C. R15-5-156(A)(7) defines a prosthetic appliance as "an artificial device which fully or partially replaces a part or function of the human body" Collectively, the enteral pump, feeding tubes, tubing, feeding bags, tape, and dressings perform a process which fully replaces the function of the mouth, esophagus, and in some cases the stomach, and therefore meet the requirements of a prosthetic appliance. At the very least the supplies constitute components of the enteral pump and are exempt. A.A.C. R15-5-156(C).

Tracheotomy Supplies

A tracheotomy is defined in Dorland's Illustrated Medical Dictionary, 24th edition, as a "surgical creation of an opening into the trachea through the neck, for insertion of a tube to facilitate the passage of air to the lungs, or the evacuation of secretions." The trachea tube is inserted into the body by means of an incision in the trachea. It is used to facilitate the function of the trachea for purposes of respiration and removing metabolic waste. As a result, the trachea tube constitutes a prosthetic appliance.

Here the question is whether the trachea care and cleaning kits are exempt from transaction privilege tax. Taxpayer suggests the trachea care and cleaning kits should be exempt because they are intrinsic and essential to the proper functioning of the tracheotomy tubes. Chandler Community Dialysis Center, Ltd. v. Arizona Dep't of Rev., No. 865-91-U (B.T.A., Div. II, Feb. 8, 1994). The department agrees.

In 1997, the Arizona Department of Revenue appealed from the judgment of the Arizona Tax

Court in RenalWest v. Arizona Department of Revenue, 943 P.2d 769 (Ariz. App. Div. 1, 1997). In Renalwest, the court addressed whether kidney dialysis machines, solutions, testing equipment and supplies constitute an exempt prosthetic appliance. The court determined that the definition of "device" includes a process. Dialysis is a "complicated, integrated process requiring solutions, testing equipment and supplies." The court determined that these items used in dialysis constitute devices necessary to substitute for failed kidneys. The items taken in their entirety constitute a prosthetic appliance. In other words, the entire kidney dialysis process is a prosthetic appliance because, when taken together, the items used in the process constitute a device that replaces the function or process of the kidney.

Similarly, the trachea care and cleaning kits are essential and integral to the proper functioning of the tracheotomy tubes. Without daily care and cleaning of the tubes, patients may risk blocked airways that could result in further injury or death. The trachea care and cleaning kits enable the trachea tube to function properly and therefore, directly contribute to the process of respiration and removing metabolic waste. See RenalWest, 943 P.2d 769. As a result, the trachea care and cleaning kits also qualify as a prosthetic appliance and are exempt from the transaction privilege tax.

Ostomy/Urological Supplies

Ostomy and urological supplies include skin barriers, belts, rings, lubricants, closed and drainable pouches, external urinary collection devices (cups and pouches), drainage tubing, tape, adhesives, adhesive removers, filters, ostomy deodorant, urological catheters, irrigation trays, and irrigation and cleaning supplies.

Pouches, collection cups, and drainage tubing used by patients with urinary/ostomy incontinence constitute prosthetic appliances because such supplies support and replace the function of the bladder and colon. In addition, supplies such as skin barriers, belts, rings, lubricants, tape, adhesives, adhesive removers, filters, ostomy deodorant, catheters, irrigation trays, and irrigation and cleaning supplies used in the management of incontinence are an intrinsic and necessary to the entire process. Therefore, they too constitute a prosthetic device and are exempt from transaction privilege tax. See RenalWest, 943 P.2d 769.

Mastectomy Supplies

Mastectomy supplies such as specialized mastectomy bras, forms, and adhesives are prescribed for patients who have undergone a mastectomy due to breast cancer or other illness. A doctor prescribes a breast for patients to replace a missing breast. As a result, a mastectomy or breast prosthesis constitutes a prosthetic appliance because it replaces a part of the body.

Further, a specialized mastectomy bra, which includes a mastectomy form, also meets the

definition of a prosthetic appliance; however, specialized mastectomy bras without a form are subject to tax. The specialized mastectomy bra without a mastectomy form is merely an item of clothing and doesn't constitute a prosthetic appliance. Thus, it is subject to tax. In addition, the adhesives used to attach the breast form constitute a prosthetic because they partially or fully replace the breast tissue.

As a general rule, all of Taxpayer's sales are taxable until the contrary is established. Taxpayer must separately state exempt supplies and taxable items in its books and records. Otherwise, the entire sale price is subject to transaction privilege tax under the retail classification.

Conclusion and Ruling:

The following ruling is given based on the facts presented in your request.

The department rules that the enteral nutrition supplies, ostomy/urological supplies, and trachea care and cleaning kit constitute a prosthetic appliance and are exempt from tax.

In addition, the department rules that the breast forms, specialized mastectomy bras that include breast forms, and adhesives are exempt from tax. However, specialized mastectomy bras without a form are subject to tax.

The conclusions in this private taxpayer ruling do not extend beyond the facts presented in your letter dated May 24, 2002.

This response is a private taxpayer ruling and the determination herein is based solely on the facts provided in your request. The determination in this taxpayer ruling is the present position of the department and is valid for a period of four years from the date of issuance except as set out herein. This determination is subject to change should the facts prove to be different on audit. If it is determined that undisclosed facts were substantial or material to the department's making of an accurate determination, this taxpayer ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law or notification of a different department position.

The determinations in this private taxpayer ruling are only applicable to the taxpayer requesting the ruling and may not be relied upon, cited nor introduced into evidence in any proceeding by a taxpayer other than the taxpayer who has received the private taxpayer ruling.