STATE OF CALIFORNIA

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

January 8, 1993

REDACTED TEXT

Re: HMO Reimbursement of Expenses
Cervical Diaphragms
Hearing Aids

Dear REDACTED TEXT:

I am responding to your letter to the Legal Division dated November 16, 1992. You indicate that one of your clients is an HMO and has inquired about a number of issues regarding the role of an HMO in determining the tax consequences of the sale of medicines and medical equipment. Since you did not identify the taxpayer, this letter does not constitute specific written advice to the taxpayer under Revenue and Taxation Code Section 6596. Rather, it constitutes general comments regarding the applicability of California Sales and Use Tax Law to a set of hypothetical facts.

You indicate that the structure of the HMO is such that three separate entities combine to provide the services covered by the members' health plans. You further describe its operation generally as follows:

> "Specifically, the 'health plan' entity of the HMO operates as an insurance company (though is not so licensed with the Department of Insurance), covering services provided under the plan either through contracting with doctor entity, the hospital entity, pharmacists, or other medical practitioners. When within the service area, the coverage may include all aspects of health care including prescription (scripts), durable medical equipment (DME), extended health care, in-home nursing, hospice care, eye, etc. When the member is outside of his/her service area, the HMO reimburses the costs of emergency service or service in another affiliated region in full based on the agreement or plan."

OPINION

A. What Is the Role of an Insurer under Regulation 1591(n) and (o)?

For this issue, you quote the applicable sub-sections of Regulation 1591. Paraphrased, Sub-section (n) provides that the normal rules regarding exemption of sales of medicines apply regardless of whether the person to whom the medicine is furnished is paid, wholly or in part, by

a medical insurer, even though the retailer may make a joint billing. Likewise, Sub-section (o) says the fact that certain employers have contracted with their employees to provide the latter with medical, surgical, and hospital benefits in a hospital operated by or under contract with the employer for a fixed charge, usually a payroll deduction, in no way affects the exemption of sales of medicines. Simply put, these sub-divisions provide that a sale is determined to be taxable or exempt according to the normal rules just as if a self - or employer-provided health plan was not providing the payment. While the insurer might, under the proper set of facts, be the retailer or consumer of the item sold it is not made so merely by providing medical insurance coverage.

You posit three scenarios and several questions with each scenario. I will organize my answers around your hypothetical situations. For convenience, we will refer to the health plan entity as "the HMO."

> 1. "The plan states that the patient pays no co-payment or fee for the prescribed medicines. The patient may take the script to the pharmacy which will dispense the medicines or be reimbursed for said purchases from another pharmacy."
>
> If the pharmacy supplying the medicines is owned by the HMO, the HMO is the retailer of the medicines, containers and labels. It may buy those items ex-tax for resale. The subsequent sales of medicines to consumers will be exempt if they qualify under Regulation 1591(a). The subsequent sales of the containers and labels containing the medicines will be exempt if they qualify under Regulation 1589(b). If the HMO does not own the pharmacy, the latter is the retailer with the same results. It matters not if the patient must make a co-payment.
>
> 2. "The plan states that it will provide DME to patients including wheelchairs, crutches, walkers, etc. ... The health plan entity plans to purchase these items and provide them to their members when so ordered by physicians. However, the entity will retain title to such capital DME products even though the products will almost never return to the health plan, nor will the plan charge the patient for them."

As you note, Regulation 1591(k) provides an exemption for the sale, rental, or lease of such items "when sold to an individual for the personal use of that individual as directed by a licensed physician." Here the HMO, and not the patient, is the consumer of the items. When transferring items at no cost to the patient, if the HMO does not expect to get them back, it makes a gift of its property; otherwise it is a bailment. Either way the item is sold to the HMO and not to the patient - tax applies to the sale of the item to the HMO.

> 3. "The health plan anticipates that some patients will move from acute hospitalization to extended care (ECF) or skilled nursing (SNF) facilities to continue convalescence. In other cases, patients will be placed in in-home care during recovery. ... The [HMO] plans to purchase the equipment and supplies and provide them to their members when so ordered by physicians. However, the entity will retain title to the equipment even though the products will almost never return

to the health plan, nor will the plan charge the patient for them."

As you also note, Regulation 1591(m) provides that tax does not apply to the sale of medical oxygen delivery systems "when sold, leased or rented to an individual for the personal use to that individual as directed by a licensed physician." Thus this scenario has the same problem as does Scenario #2: the HMO is making a gift or a bailment of its own property and is thus the consumer. There is no sale, lease or rental to the patient. In addition, if the patient may only use the equipment when in the ECF or SNF, the patient never obtains dominion and control over the equipment. For this reason also, there is no sale, lease or rental to the patient.

B. Are Cervical Diaphragms Medicines?

No. (Reg. 1591(c)(2).)

C. Are Hearing Aids Taxable When Provided under a Plan?

> "The health plan intends to cover the cost of hearing tests and hearing aid provided by suppliers of such products. Are the general rules applying to providers of prescription eyeglasses similar to those that dispense hearing aids, i.e., the provider is the consumer of the hearing aids, rather than the retailer?"

Yes, if they so qualify under Sections 6018 and 6018.7.

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