STATE OF CALIFORNIA

425.0483.400

BOARD OF EQUALIZATION

LEGAL DIVISION, APPEALS SECTION

In the Matter of the Claims for Refund Under the Sales and Use Tax Law of:	)	DECISION AND RECOMMENDATION
E--- M--- H---	)	Nos. SY --- XX-XXXXXX-001
E--- M--- C---	)	SR --- XX-XXXXXX-002
Claimants	)	

The Appeals conference in the above-referenced matters was held by Tax Counsel James E. Mahler on January 28, 1997, in Sacramento, California.

Appearing for Claimants:	R--- G. D---, Jr. Attorney at Law
	P--- E. G--- Attorney at Law
	A--- B. H--- Certified Public Accountant
Appearing for the Sales and Use Tax Department:	Norman E. Williams Supervising Tax Auditor
	Donald R. Herrmann Staff Tax Auditor
Reporter:	C--- S--- CSR No. XXXX
Type of Business:	Medical Care

Subject of Claims

Claimants seek refunds of sales and use taxes allegedly paid with respect to "IV sets" and "reagents" for the period October 31, 1989, through December 31, 1992. The amounts of the claimed refunds are not stated.

Claimants' Contentions

1. The claims should be accepted as a class claim.

2. The IV sets and reagents are exempt prescription medicines.

Introduction

Claimants' representatives attempted to file a class refund claim under Revenue and Taxation Code Section 6904(b). The proposed class included alleged vendors and purchasers of property described as "IV sets" and "reagents". Senior Staff Counsel W. E. Burkett held an Appeals conference on the claim of the proposed "lead claimant", a vendor, on October 5, 1993.

Mr. Burkett concluded that the group of claims met the statutory requirements for a class claim, but that they should not be processed as a class claim for various reasons described below. Regarding the prescription medicine issues, he noted that the vendor acting as "lead claimant" sold reagents but did not sell IV sets. He nevertheless issued a recommendation on both types of property because the issues had been briefed and argued. He concluded that neither the IV sets nor the reagents qualified as exempt prescription medicines. Claimant's representatives requested an oral hearing before the Board.

The Board hearing was scheduled for January 11, 1995. At that hearing, the Board members found that they could not hear the matter since, among other things, claimant's representatives had not provided campaign disclosure statements from all members of the purported class. The Board hearing was continued to September 20, 1995, by which time claimants' representatives had secured disclosure statements from 109 entities. On that later date, the Board concluded that the group of claims should be handled individually, not as a class. The Board also decided to defer decision on the prescription medicine issues because the "lead claimant" did not sell IV sets. Notice of the Board's decision was mailed to claimants' representatives on November 16, 1995, and modified by letter dated January 4, 1995 (sic: should be 1996), as follows:

> "... The Board ordered the request for class claim denied. However, no action was taken with regard to the individual claim. The Sales and Use Tax Department is to identify and bring before the Board a hospital and a vendor which includes every major product category identified in all claims filed in the group. The Board's decision could then be applied to all other pending claims."

Claimants' representatives then petitioned the San Francisco Superior Court for a writ of mandate to compel the Board to hear the group of claims as a class claim. A hearing was held before the Honorable William Cahill on August 1, 1996. During the discussion, Judge Cahill indicated that he would deny the writ because the "lead claimant" was not a proper class representative, but would "probably be ordering the writ" if there were a proper class representative. (See the litigation transcript, page 10, lines 4-7, copy in claim file, folder 2.) He suggested that a class action would be necessary and proper "to be sure that there is a uniformity of rulings", but denied the writ because "the class doesn't work as presently constituted." (Litigation transcript, page 11, lines 18-25.)

At the September 20, 1995 Board hearing, claimants' representatives had alleged that one member of the purported class is both "a vendor and a hospital; sells to itself with a subsidiary...." They did not identify that entity, but stated they would "probably select that one" as the new "lead claimant". (Board hearing transcript, page 15, lines 5-14.) For reasons not revealed in the record, the Department apparently concluded that claimants' representatives were referring to E--- M--- H--- and E--- M--- C---, the named claimants herein. The Department

selected these claims to comply with the Board's order to "bring before the Board a hospital and a vendor which includes every major product category".

The instant matters were thereupon assigned to me for an Appeals conference on the prescription medicine issues. At the conference, however, claimants' representatives were not prepared to discuss those issues. They contended that they represent claimants only as members of the purported class and not as individual entities. They also alleged that the "nature" of their representation of their clients "barred" them from presenting evidence on the substantive issues until the class issue is resolved. They expressed an intention to relitigate the class claim issue before the Board and in Superior Court if necessary. (Appeals conference transcript, pages 12-15.)

Since the Board has already decided that this matter is not suitable as a class claim, that issue is not properly before me. Because claimants' representatives intend to relitigate the issue, however, I will discuss it to insure that the Board has a complete record for review.

The Class Claim Issue - Summary

Claimants' representatives filed an Appeals Conference Memorandum. On page 4 thereof, they state that E--- M--- C--- is a major tertiary care center which uses and sells the types of items at issue in the refund claim. They assert that, prior to the periods in question, E--- M--- C--- purchased these items directly from vendors and reported tax under account number SY --- XX XXXX95. Thereafter, and throughout the periods in question, it reported tax under account number SR --- XX XXXX19.

The allegations made at the Appeals conference are somewhat different. There, claimant's representatives alleged that one of the claimants operated as a "purchasing entity" and the other operated a hospital. Both claimants may sometimes have used the "Medical Center" name, however. Some property bought by the purchasing entity was stored in a warehouse controlled by that company, then later distributed to the hospital. At other times, vendors may have drop shipped the property directly to the hospital. The purchasing entity did not make sales to third parties. (Appeals conference transcript, pages 7-10.)

Claimant's representatives further alleged that both claimants have been filing returns and reporting tax on sales of the IV sets and reagents. They stated that they "have the detail on that hospital, on the sales from the purchasing corporation to the hospital", but they did not have the information with them. (Transcript, pages 8-9.) After the conference, by letter dated January 29, 1997, I asked claimants and their representatives to present sales tax worksheets or similar documents showing that they reported and paid tax on sales or purchases of IV sets and reagents. No such evidence has been presented.

I have examined the Board's central files in an attempt to reconcile the allegations made by claimants' representatives. Information in the files supports some of the allegations and contradicts others. However, with exceptions not relevant here, Revenue and Taxation Code Section 7056 prohibits me from revealing information in the Board's files to anyone other than the taxpayers and their authorized representatives. Claimants' representatives have been equivocal about the extent to which they represent claimants and, since a copy of this Decision and Recommendation will be mailed to them, I have decided to err on the side of caution and not

include any confidential information. (See the discussion below.) Of course, claimants may waive confidentiality, if they wish to do so, by sending me a letter authorizing me to reveal confidential information in the Board's files to their named representatives.

The Class Claim Issue - Analysis and Conclusions

Subdivision (b) of Revenue and Taxation Code Section 6904, which was added to the statute effective January 1, 1988, provides:

> "(b) A claim [for refund] filed for or on behalf of a class of taxpayers shall do all of the following:
>
> "(1) Be accompanied by written authorization from each taxpayer sought to be included in the class.
>
> "(2) Be signed by each taxpayer or taxpayer's authorized representative.
>
> "(3) State the specific grounds on which the claim is founded."

Although they do not expressly articulate the argument, claimants' representatives appear to believe that they have a right to class certification because the statutory requirements have been satisfied. I cannot agree. The statute does not require the Board to accept all purported class claims. As a threshold question whenever such a claim is filed, it must first be determined whether the matter is amenable to treatment as a class action. This threshold question is a matter within the Board's sound discretion and the Board has established standards to use in resolving the issue. Hearing Procedure Regulation 5057.5, as amended June 14, 1978, was in effect when the claims at issue were filed. Effective January 1, 1996, the former regulation was renumbered and readopted without substantive change as Rule of Practice 5024 (California Code of Regulations, Title 18, Division 2, Chapter 10). A copy of Rule 5024 is appended hereto.

Claimant's representatives cite Santa Barbara Optical Co. v. State Bd. of Equalization (1975) 47 Cal.App.3d 244, to support an argument that class refund claims are "appropriate" whenever there is an ascertainable class with a community of interest. However, the California Supreme Court has expressly disapproved Santa Barbara Optical and similar cases which had held that class refund claims are appropriate under the general provisions of the Code of Civil Procedure. (Woosely v. State of California [1992] 3 Cal.4th 758.) The Supreme Court stated, at 3 Cal.4th 792: "[T]he California Constitution precludes this court from expanding the methods for seeking tax refunds expressly provided by the Legislature." Revenue and Taxation Code Section 6904(b) is therefore the exclusive authorization for class refund claims. Cases cited by claimants' representatives, suggesting that class actions are appropriate whenever there is a cognizable class with common interests, were decided under other statutes or under common law and are therefore irrelevant.

In fact, the specific holding of Santa Barbara Optical has been overruled by the Legislature. The Court held that a class claim for refund of taxes need not identify the names and account numbers of each member of the class. The Legislature subsequently enacted Section 6904(b)(1) to require a "written authorization from each taxpayer sought to be included in the class", which perforce requires identification of the purported class members.

I also note that Section 6094(b) was enacted almost ten years after the Board adopted former Regulation 5057.5. Adoption of the statute constitutes Legislative approval of the Board's procedures for handling class refund claims. (See Action Trailer Sales v. State Bd. of Equalization [1975] 54 Cal.App.3d 125 at 133-134.) Further, as an agency of constitutional authority, the Board's decision to deny class certification can be overturned only if the Board has abused its discretion. A court may not exercise its independent judgment on the weight of the evidence, but must uphold the Board's finding if it is "supported by substantial evidence in light of the whole record." (See Strumsky v. San Diego County Employees Retirement Assn. [1974] 11 Cal.3d 28 at 44-45.)

In sum, taxpayers have no right to a class refund claim. They can prosecute such claims only if the Board, in the sound exercise of its discretion under the Hearing Procedure Rules and Regulations, allows them to do so. Merely alleging the existence of an ascertainable class with convergent interests does not prove that a class refund claim is appropriate.

In his Decision and Recommendation issued with respect to the previous alleged "lead claimant", Mr. Burkett focused on the requirement in subdivision (b)(1) of former Regulation 5057.5, that is, whether it is more beneficial to the class and to the state to proceed as a class rather than individually. He concluded for the following reasons that there was no significant benefit to proceeding as a class claim:

> "1. The number of claims is not too large to be handled on an individual basis.
>
> 2. The nature of each claim is such that individual files and audits will be required of each claimant.
> 3. There is a genuine issue about whether a single common classification can be made for the various items claimed to constitute exempt IV sets.
> 4. There is little danger of a lack of uniformity in applying the law.
> 5. It has not been demonstrated that it would be beneficial to the state or the claimants to process these individual claims as a single class claim." (Citation omitted.)

For several reasons described below, I agree with Mr. Burkett's analysis. Claimants' representatives have failed to show that class certification would benefit either the state or the members of the proposed class. More importantly, I have also concluded that class certification would be detrimental to the members of the proposed class because their economic interests are antagonistic -- the members of the proposed class have conflicting interests regarding certain issues in the case. Finally, I have found that the named claimants would not be proper class representatives even if the proposed class were certified. My reasons are as follows.

The requirement to prove benefit to the class and the state is vitally important to class certification, because class refunds pose problems which are either not present or are present to a lesser extent in other types of class actions. For example, a judgment in a suit for refund is *res judicata* as to the claimant's tax liability for the entire claim period. (Rule 5024, *supra*, subd. (d)(2).) In Pope Estate Co. v. Johnson (1941) 43 Cal.App.2d 170, the Court said at page 174:

> "A suit for a recovery of the whole or a portion of a tax for a particular year throws open all questions relating to the same tax year. Neither the tax collecting authorities nor the taxpayer are at liberty to split up the question and prosecute in the courts the question as to liability for that year piecemeal. The rule is quite absolute in its character...."

A class claim for refund of taxes is an attempt to "split up" the liability of each individual member of the class, and consider only such issues as are common to all class members. It is not possible to leave for separate resolution issues which are particular to individual class members. Thus, a taxpayer who prosecutes a class claim risks losing the right to sue for a refund on other issues, and the Board risks losing the right to assess deficiencies on other issues. These risks are justifiable only when proceeding as a class will clearly yield material benefits to both the taxpayer and the state, benefits which would not be available by proceeding with individual claims.

Confidentiality presents another problem in tax refund claims. As noted above, Revenue and Taxation Code Section 7056 prohibits the Board and its employees from divulging information in the Board's files about the business operations of taxpayers. A class representative, however, will necessarily have access to the Board's files for all members of the class.

Confidentiality is a particularly sensitive concern in this case. The purported class includes several vendors selling allegedly similar items who are presumably in competition with one another. Resolution of the claims could require disclosure of detailed information about pricing policies, sales techniques, delivery methods, and the recommended uses and advantages of one product as opposed to others. I will discuss the relevance of these points more fully below. For the moment, it is sufficient to note that handling this matter as a class claim could compromise legitimate trade secrets.

Subdivision (b)(4) of Rule 5024 addresses this problem. The provision is not a model of clarity: It could be interpreted to require an express waiver of confidentiality in class claims, but has generally been read to mean that a written authorization to act as class representative is an implied waiver. However, since claimants' representatives allege that they represent their clients only for limited purposes, I believe that information in the Board's files should not be disclosed to them without an express waiver of confidentiality. (See Rule of Practice 5073.)

I do not mean to imply that the confidentiality and *res judicata* problems can never be overcome. Of course they can, in a suitable case. The point is that these problems oblige the Board to proceed cautiously, and to certify a class claim only upon a showing that class treatment will benefit all parties.

No such showing has been made in this case. Claimants' representatives have argued that class certification would avoid the risk of "inconsistent or varying adjudications with respect to individual members of the class...." At the same time, they also argue that handling the claims individually "would, as a practical matter, be dispositive of the interests of other members not party to the adjudications...." (See their Petition for Writ of Administrative Mandamus, page 14.) In other words, they complain that a decision on an individual claim both will and will not be determinative.

I find these arguments disingenuous at best. No adjudicator can promise that a decision on any case will remain the law for time immemorial. After all, even the Supreme Court changes its mind occasionally. What the Board can promise is that it will fulfill its function as a Board of Equalization to the best of its ability, and treat all taxpayers as equally as possible. Any decision on the merits of the prescription medicine issues will be followed until such time as new evidence or arguments warrant a change, without regard to whether the decision is rendered in an individual or a class claim. Further, a refund to class members would not necessarily preclude the Board from later issuing assessments for those same taxes, if it were discovered that the refunds were erroneous. (Rev. & Tax. Code §§ 6961 *et seq.*) Thus, a class claim results in neither greater nor lesser certainty than individual claims.

According to claimants' representatives, one vendor of IV sets or reagents has been told that the items are nontaxable. This allegedly shows that inconsistent tax treatment already exists. No copy of this alleged prior decision has been offered in evidence, and I have been unable to find any reference to such a ruling in the Board's records. It is possible, of course, that some member of the Board's staff has issued such an opinion, but that possibility is irrelevant. A decision by the Board itself, whether issued in connection with an individual claim or a class claim, would overrule any prior inconsistent staff decisions.

Claimants' representatives have also argued that the claims are too numerous to be handled on an individual basis. I think the Department and the Board members are in a much better position to judge the administrative burdens than are claimants' representatives. The Board and its staff are well equipped to hear tax claims and, in my view, the time and effort required to handle these claims individually would not exceed that necessary to hear and decide any of the other problems the agency routinely faces.

Assuming that one claimant has paid tax to the Board with respect to all types of products in question, one hearing (on either an individual or a class claim) could resolve the prescription medicine issues. However, I am not optimistic that such a claimant can be found. At least seven types of IV sets and an unknown number of reagents are involved, and it may therefore be necessary to hold several hearings (with different "lead claimants") even if the matter is certified as a class. I realize that the Department selected the instant claims to comply with the Board's order for a case which includes every major product category, but the selection was apparently based on the unsupported allegations of claimants' representatives. I have asked claimants for evidence showing that they in fact paid tax on the products at issue and they have declined to present any. To my mind, that is in effect an admission that they have not in fact paid tax on every major product category.

A hearing with each claimant might also be necessary, even if the matter were certified as a class, to resolve issues unique to the particular taxpayer. The unique issues would most likely include questions about the amount of the refund, if any, such as: sales prices, discounts, delivery and other service charges, returned merchandise, bad debts, *etc*. The existence of such unique issues might not in itself preclude certification as a class. It does raise confidentiality problems, though, since the class representative would have access to information which most businesses would prefer not to reveal to competitors. More importantly, since hearings on the individual issues are equally likely whether the matter is handled as a class or as individual claims, class claim treatment saves nothing. To the contrary, class certification would probably

delay resolution of these cases. It is not likely that claimants' representatives could handle the individual aspects of all these cases at the same time, and would instead have to deal with each case one by one. That could take months or years.

The unique issues would also include factual and legal questions which are potentially much more serious. I understand that the proposed class includes out-of-state vendors as well as in-state vendors and purchasers. The applicable tax for in-state vendors would normally be a sales tax due from the vendor. (Rev. & Tax. Code § 6051.) Even for out-of-state vendors, sales tax might apply depending on how the property was ordered and from where it was delivered. (See, generally, Sales and Use Tax Reg. 1620, subd. (a)(2).) On the other hand, if the property were delivered into California from an out-of-state location, the applicable tax would probably be a use tax on the purchaser, but it would also be necessary to determine whether the vendor was engaged in business in this state so as to have a duty to collect the tax. (Rev. & Tax. Code §§ 6201 *et seq*.) Furthermore, if an out-of-state vendor acquired the property from a California wholesaler for delivery directly to a California purchaser, the applicable tax could even be a sales tax on the wholesaler. (Rev. & Tax. Code § 6007, 2nd paragraph.)

These types of issues would of course be more important in the context of an assessment, where the question is who should pay the tax rather than who has paid it. Nevertheless, they are also relevant in this refund claim, since the proposed class does not include all vendors and purchasers of IV sets and reagents. Particularly where a vendor who is in the class has made sales to hospitals who are not, and where hospitals who are in the class have made purchases from vendors who are not, it would have to be determined whether the applicable tax was a sales tax or a use tax. This would involve an investigation into the extent of each vendor's selling activities in-state, as well as each hospital's individual purchasing policies, confidential information that most businesses would not want revealed to competitors. These individual issues, which might appear peripheral at first glance, could easily require more time and effort to resolve than the prescription medicine issues which are allegedly common to all members of the proposed class.

Identifying the applicable tax would also create dissension among the members of the proposed class because their economic interests are antagonistic on this point. Assuming a refund is due, vendors who collected tax reimbursement and paid sales tax to the state would be entitled to the refund only if they returned the tax reimbursement to their customers. (Rev. & Tax. Code § 6901.5.) But the Board could also pay interest on the refund to the vendors, and in several prior unpublished decisions, the Department has concluded that the Sales and Use Tax Law does not require vendors to pay the interest to their customers. Vendors have been allowed to retain the interest as an additional inducement to claim refunds of erroneous sales tax payments where they might otherwise have no economic incentive to do so (that is, an inducement in addition to the desire to maintain good customer relations).

If the applicable tax was a use tax, however, the purchaser would be entitled to a direct refund from the Board, including interest on the refund. I know of no provision which would allow the vendor to retain the interest in that situation, even if the vendor had collected the tax from the customer and remitted it to the state. The nature of the tax thus determines who is entitled to the interest.

This problem is far from theoretical. Given the time these refund claims have been pending, interest on any refunds could well approximate the tax amount. Vendors who are awarded a refund of tax paid to the state will find it profitable to argue that the tax was a sales tax, so that they can retain the interest. The purchasers, however, will want to argue that the tax was a use tax, so that they can get the interest. Since the economic interests of vendors and purchasers are antagonistic on at least this point, it is not possible for one representative to adequately represent all members of the proposed class.

I have been discussing whether it would be appropriate to handle these matters as a class claim. I turn now to a more specific question: If the cases are certified as a class claim, are the named claimants proper class representatives? The answer is no.

On a preponderance of the available evidence, I find that claimant E--- M--- H---, SY --- XX XXXX95, paid no sales or use tax on the types of property at issue. (The "available evidence" includes information in the Board's files, as well as claimants' failure to submit evidence on the point despite my request to do so.) The hospital may have paid sales tax reimbursement on purchases of such items, but it is not entitled to a refund of tax reimbursement from the Board. (State Bd. of Equalization v. Superior Court [1980] 111 Cal.App.3d 568.) Thus, the hospital is not even a member of the proposed class, let alone a proper class representative.

There is evidence from which I can assume that claimant E--- M--- C---, SR --- XX XXXX19, sold and paid sales tax on some of the various products at issue. However, I have no reason to assume that it sold and paid tax on all the items, and the failure to present evidence of tax payments suggests that it did not. Further, the available evidence indicates that it has never paid use tax to the Board on purchases of such products, nor has it ever collected and remitted use tax. Thus, while it might be able to represent vendors who paid sales tax, it cannot adequately protect the interests of in-state purchasers who paid use tax or out-of-state vendors who collected and paid use tax. It is thus not a proper representative of the proposed class.

I recommend that the Board not change its previous decision to deny class certification.

Prescription Medicine Issues - Summary

The Appeals Conference Memorandum filed by claimants' representatives (and incorporated herein by this reference) includes generalized descriptions of the types of items at issue. The general descriptions are similar to those previously reviewed by Mr. Burkett. Claimants' representatives asserted at the Appeals conference that they have new evidence or arguments, but they declined to present these materials. In my January 29, 1997 letter, I advised claimants and their representatives that I would be making a recommendation to the Board on the prescription medicine issues and invited them to present any new evidence or arguments. In response, I have received affidavits from three doctors (E--- C. L---, R--- DeB--- and N--- A. M---) which offer general descriptions of IV sets and reagents using (coincidentally, I am sure) the identical language as the Appeals Conference Memorandum.

As just noted, there is no direct evidence to show that either claimant actually paid any sales or use tax on the types of property at issue. The refund claims could properly be disallowed on that ground alone. There is evidence to warrant an assumption, however, that claimant E--- M--- C--- sold and paid sales tax on at least some of the items. Further, the Board should decide the substantive issues as soon as possible to provide certainty for persons in the industry. Even claimants' representatives have expressed a desire for an early decision, despite their tactical decision not to submit specific evidence pending resolution of the procedural points. For these reasons, I will discuss the prescription medicine issues.

My discussion is hampered by the failure of claimants and their representatives to present specific information, such as product brochures and user instructions, for any of the items at issue. I am forced to rely primarily on the statements of claimants' representatives regarding the types of items described as "IV sets" and "reagents", not with specific items. It is possible that some specific IV sets or reagents may qualify for exemption while the general category does not, but I am unable to address that possibility without evidence showing the actual uses of individual items. If claimants or their representatives wish to supplement the record with additional evidence or arguments, they may do so through a request for reconsideration. The procedures for filing such a request are outlined in the cover letter accompanying this Decision and Recommendation.

IV sets. As described in the Appeals Conference Memorandum (which I briefly summarize here), an IV set consists of tubing and an access device (either gravity feed or machine monitored) used to transfer liquid or gaseous medication from a bag or container into the patient. It is applied to the patient's body by means of a catheter connected to the tubing. It can only be used once on each patient.

IV sets are always sold separately from the bags containing the medicines. Various types of medicines may be mixed in and delivered by one set. Physicians attempt to deliver as many medications or solutions into the patient through the same tubing as is practical given the limits of drug interaction. IV sets are designed to allow multiple entry ports for injection of many types of drugs which are used in the various treatment regimes of the different diseases.

According to claimants' representatives, IV sets are "legend drugs" which, under federal law, may not be dispensed without a prescription. The representatives assume that when a physician orders an infusion requiring an IV set, the set is included either by specific mention or

by implication. (For example, if a physician orders a medicine to be administered intravenously, it is "understood" that the order includes the IV set even if it is not specifically mentioned.)

Also included in the general category of "IV sets" for purposes of this refund claim are:

- "Blood sets" used to deliver blood and blood products;

- "Hyperalimentation sets" used to deliver food into the patient through an incision through the stomach;

- "Nasogastric sets" used for artificial feeding through the patient's nose and down into the stomach;

- "Gastronomy parts" which are surgically implanted in a patient for use when injecting "meal replacements" into the body;

- "Anesthesia sets" to introduce anesthetics into the body, some of which are similar to IV sets, and others which introduce gaseous anesthetics through face covers;

- "Radiology sets" used to introduce contrast media into the body for diagnostic imaging purposes; and

- "Face covers and tubing" used to deliver gases via the respiratory system rather than the circulatory system.

Reagents. Reagents are biological and chemical substances which are applied to specimen samples of human tissue or fluids (such as serum, blood or urine). Usually the specimen is mixed with one or more reagents to ascertain the concentration of a specific substance in the specimen. Different tests require different types of reagents. Claimants' representatives have not specifically named the "biological and chemical substances" that they believe qualify for exemption.

Reagents may be used to diagnose diseases and determine the proper treatment, or to monitor the levels of medication in a patient (therapeutic drug monitoring). All of the various diagnostic and monitoring procedures are performed only pursuant to a physician's order, on either a prescription pad or a laboratory request form. Claimants' representatives state that some reagents "can be" classified as legend drugs controlled by federal law. They admit that reagents are never applied "in vivo" (i.e. directly to the patient's body).

Prescription Medicine Issues - Analysis and Conclusions

Revenue and Taxation Code Section 6369 allows exemption for "prescription medicines" which are distributed in certain specified manners. Subdivision (a) of the statute lists six alternative methods of distribution required for exemption. The first four methods, which appear particularly relevant here, are:

"(1) Prescribed for the treatment of a human being by a person authorized to prescribe the medicines, and dispensed on prescription filled by a registered pharmacist in accordance with law.

"(2) Furnished by a licensed physician and surgeon, dentist, or podiatrist to his or her own patient for treatment of the patient.

"(3) Furnished by a health facility for treatment of any person pursuant to the order of a licensed physician and surgeon, dentist, or podiatrist.

"(4) Sold to a licensed physician and surgeon, podiatrist, dentist, or health facility for the treatment of a human being."

In relevant part, subdivision (b) of the statute 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 commonly recognized as a substance or preparation intended for that use."

That subdivision goes on to provide that "medicines" does not include:

"(1) Any ... prosthetic ... device or appliance.

"(2) Articles that are in the nature of ... instruments, apparatus, contrivances, appliances, devices, or other mechanical, electronic, optical or physical equipment or article or the component parts and accessories thereof...."

Nevertheless, notwithstanding subdivision (b), subdivision (c) provides that "medicines" does mean and include:

"(4) Prosthetic devices, and replacement parts for those 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, other than auditory, opthalmic [sic], and ocular devices or appliances, and other than dentures, removable or fixed bridges, crowns, caps, inlays, artificial teeth, and other dental prosthetic materials and devices.

* * *

"(6) Programmable drug infusion devices to be worn on or implanted in the human body."

IV sets. IV sets are not "substances or preparations". They are "appliances, devices or other ... equipment" of the type specifically excluded from the definition of "medicines" under subdivision (b)(2) of the statute. Further, the specific mention of "[p]rogrammable drug infusion devices to be worn on or implanted in the human body" in subdivision (b)(6) indicates that the Legislature did not intend a broader exemption for drug infusion devices in general.

Claimants' representatives allege that some of the items described as "IV sets" (such as hyperalimentation sets and gastronomy parts) are prosthetic devices designed to be worn in the patient to replace or assist the functioning of a body part. The Board has consistently held that prosthetic devices qualify for the exemption only when they are implanted for a long term and are "fully worn" on the patient. (See Sales & Use Tax Annot. 425.0745 [3/31/92].) No evidence has been presented to indicate that any of the IV sets would qualify.

Claimants' representatives also assume and allege that IV sets are included by specific mention or by implication when a physician orders intravenous administration of a medicine. They presumably make these allegations in an attempt to show that the devices are distributed in a manner required by subdivision (a) of the statute. Assumptions and allegations are not evidence, however. As the record now stands, refund would not be allowable because of the failure to show that IV sets are distributed in one of the required manners.

If claimants or their representatives wish to present additional evidence that some types of IV sets are prosthetic devices sold in a manner qualifying for exemption, they may do so in a request for reconsideration. Absent such evidence, I find that IV sets are not exempt as prescription medicines.

Reagents. As noted, subdivision (b) of Section 6369 defines "medicine" as a "substance or preparation intended for use by external or internal application to the human body...." Reagents are applied to tissue, serum, blood or urine samples which have been removed from the patient and thus are no longer a "human body". (Cf. Moore v. Regents of University of California [1990] 51 Cal.3d 120 at 137, where the Court stated that human tissues and biological materials are treated as objects *sui generis*; see also Hecht v. Superior Court [1993] 16 Cal.App.4th 836.) Further, although claimants' representatives allege that reagents "can be" classified as legend drugs, they have not submitted evidence showing that reagents are distributed in a manner required by subdivision (a) of Section 6369. Accordingly, reagents do not qualify for exemption.

* * *

Claimants' representatives have cited an opinion of a Washington State Court to support their contention that IV sets and reagents ought to be exempt. Because the California statute controls this case, however, out-of-state authorities are not persuasive. (Beatrice Co. v. State Bd. of Equalization [1993] 6 Cal.4th 767, fn. 7.) Moreover, the Washington Court's decision was rendered on procedural grounds, not on the merits of whether any item does or does not qualify as an exempt medicine.

More importantly, Washington law differs substantially from California law on this point. Section 82.08.0281 of the Revised Codes of Washington allows exemption for prescription medicines, including "other substance" used in the diagnosis or treatment of disease. Unlike subdivision (b)(1) of Section 6369, the Washington statute has no requirement that exempt medicines be "intended for use by external or internal application to the human body...." The Washington statute also has no equivalent to subdivision (b)(2) of our statute, which prohibits exemption for "instruments, apparatus [*etc.*]...." Finally, Section 82.08.0283 of the Washington Code allows exemption for "prosthetic devices", without the requirement in subdivision (c)(4) of Section 6369 that such devices be "designed to be worn on or in the person of the user...."

Following the broad language in the Washington statutes, the administrative authorities in that state have adopted regulations allowing exemption for IV sets (including needles, tubing, bags, infusion pumps and catheters, but not including the stand) and reagents (including prepared slides, tubes and collection specimens devices). (WAC 458-20-18801 [Rule 188], subds. (1)(c), (5)(a) and (5)(d).) California law does not permit exemption for such items.

Finally, claimants' representatives argue strenuously that IV sets are "indistinguishable" from the medicines they deliver, and that both IV sets and reagents are essential to the diagnosis and treatment of disease. On these grounds they contend that IV sets and reagents should be exempt from tax. However, this Board's function is to determine whether property is or is not exempt under current California law. Tax policy arguments of the sort made by claimants' representatives must be addressed to the Legislature.

Recommendation

Deny class certification. Deny the individual claims.

James E. Mahler, Tax Counsel III — April 22, 1997 Date

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Appendix: Rule of Practice Regulation 5024

5024 COMBINED CLAIMS FOR REFUND. (Effective January 1, 1996)

5024. Combined Claims for Refund on Behalf of Class of Taxpayers. (Sales and Use Tax, including State-administered local sales, transactions, and use taxes.)

(a) This regulation applies only to combined claims for refund of the Sales and Use Tax, including State-administered local sales, transactions, and use taxes.

(b) Procedures Required of Class Representative.

The representative claiming a refund on behalf of members of a class shall establish:

(1) That it is more beneficial to the class and to the state to proceed as a combined claim for refund rather than individually.

(2) The existence and the composition of the class, including:

(A) A description of the members sufficient to identify the persons making up the class.

(B) The approximate number of persons in the class.

(C) The manner in which and the time when the class members shall be identified and notified of the pendency of the combined claim.

(3) The issues of law and the issues of fact which are common to all class members and those which are not, and the approximate number of class members affected by each issue that is not common to all.

(4) The representative's written authority to act as representative for each class member, which authority shall authorize the Board to release to the representative any confidential information in the Board's files which may be required in connection with the claim. This statement may include a separate claim for refund by the class member or may state that the class member joins in the combined claim.

(5) That the representative is a member of the class and when and how the representative became a member. In addition, any unique legal or factual issues pertaining to the representative's claim and any differences between the representative's status as a class member and that of any other class member shall be described.

(6) That the representative can fairly and adequately protect the interests of each member of the class and that the representative's interests are not antagonistic to members of the class.

(7) When requested by the Board, that each member of the class has been notified of the pendency of the claim and each member has had a reasonable opportunity to join in or be excluded from the combined claim.

(c) Action to be Taken by Board.

(1) If the Board finds that the claim is a proper combined claim it shall, to the extent possible, act upon the claim in the same manner that it would act on any other claim. If the Board finds that the claim is not a proper combined claim, it shall act only on claims by individual members and notify the representative that the claim is not valid as to others. In determining the amount of any refund due to any member of the class, the refund shall be limited

to the amount of tax overpayment by that member under the tax law pursuant to which the claim was filed.

(2) Before a refund will be made to any member of the class, the amount of the tax overpayment by the member shall be established and the representative or member shall furnish or make available to the Board all contracts, documents, or records (or copies thereof) necessary to verify the overpayment and the amount thereof. If such contracts, documents, or records are not presented to or made available to the Board, the representative or member, shall be deemed to have failed to exhaust the administrative remedies.

(d) Effect of Action on Combined Claims.

(1) Failure to commence a court action within 90 days after the mailing of the notice of the Board's action on a refund claim as provided in the tax law pursuant to which the claim was filed constitutes a waiver of any demand against the state on account of alleged overpayments. This waiver, however, does not apply with respect to persons who have not previously been notified of the claim, or who have notified the Board that they desire to be excluded from the combined claim. Nor does the waiver apply with respect to persons involved in a claim to the extent it has been declared invalid as distinguished from persons as to whom a claim has been denied.

(2) A judgment in any court action filed with respect to the denial of any claim is *res judicata* as to the claimant's tax liability or overpayments for the period involved.