

STATE OF CALIFORNIA

BOARD OF EQUALIZATION

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:

Petitioner

DECISION AND RECOMMENDATION

No.

The Appeals conference in the above-referenced matter was held on January 28, 1992 by Susan M. Wengel in Sacramento, California.

Appearing for Petitioner:

X-----

Appearing for the Sales and Use Tax Department:

Jack Warner
District Principal Advisor

Protested Item

The protested tax liability for the period July 1, 1985 through September 30, 1988 is measured by:

<u>Item</u>	<u>State, Local and County</u>
B. Unreported taxable receipts from the rental of life support systems to hospitals, which was based on a test of the month of July 1988.	\$1,627,249

Contentions of the Petitioner

1. The leases to the hospitals are sales for resale as the hospitals, by billing their patients separately for the ventilators, are re-leasing the equipment.

2. In the alternative, the sales are exempt from tax by Revenue and Taxation Code Section 6369.5, Medical Oxygen Delivery Systems.

Summary of Petition

Petitioner is a corporation, headquartered in New Jersey, which engages in the business of renting medical ventilators and respiratory therapy supplies to hospitals. This appeal is concerned with the rental of ventilators by petitioner to hospitals for use by both children and adults who are admitted to the hospital for care. None of the equipment at issue is leased to a patient for use in his own home.

Petitioner maintains warehouses which are strategically located throughout the state so that equipment can be delivered to a hospital within the hour. If a hospital has a need for a respirator, it will call petitioner and the specific unit will be delivered to the hospital. The hospital then pays for the unit by the day. At the appeals conference, X----- testified that most rentals are for short periods of time which usually do not exceed 60 days. He noted that during the flu season hospitals may negotiate a long term lease, but that usually a hospital pays a daily or hourly rate. Petitioner rents the ventilators only to hospitals because the expertise of a respiratory therapist is needed to correctly operate the equipment. A patient who needs the type of ventilators leased by petitioner is a patient who needs assistance to breathe or who cannot breathe at all on his own. In other words, the patient is in need of the type of medical supervision given at a hospital.

An audit was conducted by the Sales and Use Tax Department (Department). It was ascertained that when petitioner leased the ventilators to California hospitals, a taxable use took place in California and petitioner was responsible for collecting and reporting the use tax measured by the rental receipts. The hospitals did not issue resale certificates to petitioner when the equipment was leased. XYZ letters were sent to the hospitals to determine whether any of the hospitals had self-reported the use tax. Several hospitals had self-reported the tax so these leases were removed from the sampling. If the hospital responded that the equipment was "for resale" or "exempt under Revenue and Taxation Code Section 6369.5" the transaction was left in the sample. The percentage of error was computed and projected throughout the entire audit period.

Petitioner contends that the leases to the hospitals are not sales at retail because the sales to the hospitals are for the purpose of reselling or re-leasing the ventilators to its patients X----- for petitioner, has stated that hospitals bill a patient for the use of a ventilator as a line item and that this is an hourly charge for the equipment only. The Department, however, notes that there is a large difference between the amount charged for the lease to the hospital and the amount charged to the patients by the hospital. The audit staff ascertained that in one instance the hospital leased a ventilator from petitioner for \$450 for three months yet charged a patient \$928.08 for a 24-hour period.

In the alternative, if the leases are found to be at retail, petitioner contends that they are exempt under Revenue and Taxation Code Section 6369.5 as leases of medical oxygen delivery systems.

Analysis and Conclusions

1. Petitioner's initial contention is that its leases of the ventilators to the hospitals are not retail sales subject to tax because the hospitals are re-leasing the equipment to their patients. Thus the leases, which are defined as "sales" in Revenue and Taxation Code Section 6006(g), are nontaxable sales for resale. In support of this position petitioner asserts that because the hospital bills the patient for the ventilator as a separate line item, this is evidence that the equipment is re-leased and not used or consumed by the hospitals.

It is acknowledged that Revenue and Taxation Code Section 6007 defines a "retail sale" to mean a sale for any purpose other than resale in the regular course of business in the form of tangible personal property. Likewise, leases of ex-tax tangible personal property are sales for purposes of defining a retail sale. The first question to be resolved is whether the equipment was re-leased to the hospital's patients. The term "lease" is defined in Sales and Use Tax Regulation 1660(a)(1) to include a contract under which a person secures for a consideration the temporary use of tangible personal property which, although not on his premises, is operated by, or under the direction and control of the person. First, there is no evidence that the hospital and the patient enter into any type of contract, oral or written, for the lease of the equipment. Secondly, there is no evidence that the patient ever takes possession of the ventilator or has any control as to the ventilator's operation. As petitioner's representative has testified, the ventilators require the expertise of trained respiratory technicians which can only be supplied by the hospital and on the hospital's premises. It is well established that hospitals are predominantly service enterprises and as such are "generally considered to be consumers of all tangible personal property used in providing services. The Tax Tips Pamphlet for Hospitals specifies that "equipment" is a category of items that is taxable when purchased by a hospital. The use of the ventilators by the hospitals appears to be consistent with this above-referenced finding of "use" by a service enterprise consumer. Although an amount for the ventilator is separately stated on the patient's bill, the respiratory functions associated with the ventilator must be performed by trained respiratory technicians. Petitioner's representative has testified that the equipment will not be leased to individual doctors because even these trained practitioners are not qualified to operate the ventilators properly. It must be concluded that there is no evidence that the hospitals re-leased the equipment to the patients. There is likewise no evidence that the hospitals ever intended to re-lease the equipment as the hospitals did not give petitioner resale certificates or indicate that the equipment would be resold or re-leased. It is clear that possession or control of the equipment was never passed to the hospital's patients as the ventilators are too complicated to be operated by anyone but a trained respiratory therapist.

Petitioner asserts that based solely on Regulation 1503(b)(1) the leases of the ventilators should be excluded from the tax. This section provides, in part, that sales to institutions are sales for resale when a separate charge is made by the hospital to its patient. We would conclude that although the above statement, and the other statements concerning the application of tax to sales to institutions are, in a general sense, correct, this regulation cannot apply to the present facts involving the ventilators. To make such an application would be inconsistent with Revenue and Taxation Code Section 6006 which defines a "sale". In other words, for Regulation 1503(b)(1) to apply, there has to be a "lease" to the hospital's patients. Without this "lease", there cannot be a sale for resale by petitioner. As was discussed in detail above, without a transfer of control or possession, there cannot be a sale. Consequently, Regulation 1503(b)(1) does not apply.

It is noted that the language found in Sales and Use Tax Regulation 1503(b)(2) which relates to property "administered" to a patient is not applicable to this analysis and conclusion. Under the Board's long standing interpretation, equipment such as ventilators is not "administered" to patients. "Administration" involves "internal applications" not "external application".

2. In the alternative, petitioner contends that its leases to the hospitals are exempt pursuant to Revenue and Taxation Code Section 6369.5. This statute provides that:

"There are exempted from the taxes imposed by this part the gross receipts from the sale, and the storage, use, or other consumption, in this state of any medical oxygen delivery system, including, but not limited to, liquid oxygen containers, high pressure cylinders, and regulators, when sold, leased, or rented to an individual for the personal use of that individual as directed by a physician." (Underlining added.)

This statute is further clarified in Sales and Use Tax Regulation 1591(m) which provides:

"Effective January 1~ 1983, tax does not apply to the sale of medical oxygen delivery systems when sold, leased or rented to an individual for the personal use of that individual as directed by a licensed physician. "Medical oxygen delivery systems" includes liquid oxygen containers, high pressure cylinders, regulators, oxygen concentrators, tubes, masks and related items necessary for the delivery of oxygen to the person. The term also includes repair and replacement parts for use in such a system." (Underlining added.)

It is quite clear that this exemption will apply only to sales directly to individuals who are using the oxygen delivery systems. As petitioner is leasing to hospitals, and not individual patients, the requirements for exemption have not been met.

Recommendation

It is recommended that the tax be redetermined without adjustment.

Susan M. Wengel, Staff Counsel

March 11, 1992