

**SYNOPSIS**

**PURCHASERS’ USE TAX – PURCHASES FOR RESALE AS TANGIBLE PERSONAL PROPERTY** – Purchases of office supplies, office equipment, medical supplies, medical equipment and pharmaceuticals, which are used or consumed in the provision of professional medical services to patients, are not purchases for the purpose of resale in the form of tangible personal property by the medical service provider and, therefore, are not exempted from the consumers’ sales and service tax or purchasers’ use tax by reason of the provisions of W. Va. Code § 11-15-9(a)(9).

**PURCHASERS’ USE TAX – SALES OF DRUGS DISPENSED PURSUANT TO A PRESCRIPTION** – Sales of pharmaceuticals to a medical services provider, which are placed in the inventory of the medical services provider, to be used later in the provision of medical services to its patients, are not sales of drugs dispensed upon prescription, which sales are exempted from the consumers’ sales and service tax or purchasers’ use tax by reason of the provisions of W. Va. Code § 11-15-9(a)(11). *Cf. Syl. pt. 5, Syncor International Corp. v. Palmer*, 208 W. Va. 658, 542 S.E.2d 479 (2001).

**BROAD-BASED HEALTH CARE PROVIDER TAX – LIABLE PROVIDER** – A provider of physician’s services who receives gross receipts from the provision of said services may not contractually require another person or entity to pay the broad-based health care provider tax, W. Va. Code § 11-27-1, *et seq.*

**BROAD-BASED HEALTH CARE PROVIDER TAX – PRIVATE CONTRACT NOT BINDING AGAINST COMMISSIONER** – The State Tax Commissioner is not bound by a contract between two taxpayers, to which she is not a party, which requires one party to the contract to pay a tax that, by statute, is incurred, owed and required to be paid by the other party to the contract.

**FINAL DECISION**

The Auditing Division of the State Tax Commissioner’s Office issued two assessments against the Petitioner-taxpayer. One assessment was for purchasers’ use tax, the other was for the broad-based health care provider tax.

The purchasers’ use tax assessment was issued pursuant to the authorization of the Commissioner, under the provisions of Chapter 11, Articles 10 and 15A of the West Virginia Code. The assessment was for the period of July 1, 1997, through June 30, 2002. The total

amount of the assessment consisted of tax and interest, computed through October 31, 2002. Written notice of this assessment was served on the Petitioner.

The broad-based health care provider tax assessment was issued pursuant to the authorization of the Commissioner, under the provisions of Chapter 11, Articles 10 and 27 of the West Virginia Code, for the period of January 1, 1997, through December 31, 2001, for tax, interest, computed through October 31, 2002, and additions to tax. Written notice of this assessment was served on the Petitioner.

Thereafter, by mail postmarked November 24, 2002, received November 27, 2002, the Petitioner timely filed a petition for reassessment with the Office of Hearings and Appeals of the State Tax Commissioner. On or about December 31, 2002, pursuant to the authority of W. Va. Code § 11-10-9, this matter was transferred to the docket of this tribunal, the West Virginia Office of Tax Appeals (“WVOTA”).

Subsequently, notice of a hearing on the petition was sent to the Petitioner and a hearing was held in accordance with the provisions of W. Va. Code § 11-10A-10 [2002]. This matter was submitted for decision on July 3, 2003, upon the filing of the reply brief by the Petitioner.

### **FINDINGS OF FACT**

1. The Petitioner operates a dialysis center in West Virginia. (Petitioner’s Exhibit No. 1, p. 1).
2. During most of the period that is covered by the two assessments, the Petitioner was a party to a management agreement (the “Contract”), whereby another corporation managed the day-to-day operations of the Petitioner. (Transcript, pp. 31-33; Petitioner’s Exhibit No. 1, p. 1).
3. The Contract required the other corporation to apply for and maintain all state and federal licenses, permits, certifications and approvals necessary to operate the dialysis center for

the Petitioner; to design, implement, and maintain a billing collection system and procedures appropriate to the Petitioner's operations; to promptly deposit all funds received on behalf of the Petitioner into an account maintained by the Petitioner in its own name, and to promptly pay all operating expenses; to implement and maintain an appropriate accounting system adequate for the Petitioner's needs and to deliver to the Petitioner monthly unaudited financial statements; to negotiate and enter into such administrative agreements as the other corporation deemed necessary or advisable for the furnishing of utilities, services, concessions, and non-physician services and supplies for the maintenance and operation of the Petitioner; to prepare and submit all necessary reports and filings and to take all other appropriate actions necessary for regulatory compliance or otherwise advisable in order that the Petitioner be in compliance with any requirements of local, state, or federal agencies having jurisdiction over it; and to perform all functions reasonable necessary for the effective management of the operations of the Petitioner (collectively referred to herein as "Management Services"). (Petitioner's Exhibit No. 1, pp. 3–5).

4. As consideration for such Management Services, the Contract required the Petitioner to pay to the other corporation a management fee of five percent (5%) of its annual net revenues. (Petitioner's Exhibit No. 1, p. 5).

5. In order to perform its Management Services under the Contract, the other corporation employed and paid salaries, benefits, and other related costs (the "Personnel Costs") of those persons employed by it to carry out the Management Services, to wit: registered nurses, licensed practical nurses, technicians, and administrative personnel (referred to herein collectively as "Personnel"). (Petitioner's Exhibit Nos. 1, 4, p. 2; Transcript, pp. 44-51).

However, the Contract required the Petitioner to reimburse the other corporation for such Personnel Costs (Petitioner's Exhibit No. 1, p. 2).

6. Also, the other corporation appointed an individual as administrator (the "Administrator") for the Petitioner, the salary for whom was paid directly by the Petitioner. (Petitioner's Exhibit No. 1, p. 2, Transcript, p. 30).

7. The Petitioner hired a physician<sup>1</sup> as its medical director (the "Director"). The physician is a licensed physician specializing in nephrology. Her duties included supervising all professional medical services performed, undertaking overall coordination of utilization review, quality assurance, and related functions, and other duties that the Petitioner deemed appropriate. The physician was responsible for obtaining and paying for her own medical liability insurance. The Contract states that the physician is also the Petitioner's President. The Petitioner was responsible for paying the physician's salary. (Petitioner's Exhibit No. 1, Transcript, p 33).

8. The other corporation either hired, or had to approve hiring of the Personnel. (Transcript, p. 47; Petitioner's Exhibit No. 1, p. 2).

9. Neither the other corporation nor the Petitioner could independently terminate the Personnel. (Transcript, pp. 47-48).

10. The other corporation and the Petitioner jointly set the hours of work for the Personnel. (Transcript, pp. 47-48).

11. Although the Personnel performed all job duties at the Petitioner's physical location in West Virginia, the other corporation was responsible for both training and supervising the Personnel. (Transcript, pp. 48-49; Petitioner's Exhibit No. 1, p. 2).

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<sup>1</sup> The spelling of the physician's first name, as set forth herein, is based on her signature on the Contract. It may not be correct.

12. By way of background, dialysis is “a method of removing toxic substances (impurities or wastes) from the blood when the kidneys are unable to do so.” (MEDLINEplus Health Information, a service of the U.S. National Library of Medicine and the National Institutes of Health, at <http://www.nlm.nih.gov/medlineplus/ency/article/003421.htm>.)

13. In his testimony at the hearing the Petitioner’s Administrator, described the dialysis process as follows:

A: . . . The dialysis machine is like an artificial kidney that processes their blood and gets rid of toxins that are in the blood. Like I said, it takes about three and a half to four hours, depending on the weight of the patient . . . it’s a machine, and it has a dialyzer which is about this size (indicating). It’s like a filter. The blood flows through one end of the filter, and there are three solutions which we call it a concentrate: the bicarb and the auto water and a mixture of that. That flows on the other side of the dialyzer. Due the semi-membrial pressure, it separates toxins from the blood. The blood, in return, goes back into the patient’s body, and the toxins are disposed of. That is the process of dialysis. It takes anywhere from three and a half to four hours, and the patient has to do this every other day at the center.

(Transcript, pp. 35-36).<sup>2</sup>

14. Each dialyzer varies in size, depending upon the prescription issued by the physician. (Transcript, pp. 36, 38).

15. In addition, the dialyzer uses three solutions, auto water, a solution for concentrate, and a bicarbonate solution (referred to herein collectively as the “Solution”), that combine to form what is termed a “dialysate flow.” (Transcript, pp. 36-37).

16. In addition to the Solution, the physician prescribed a number of drugs to dialysis patients receiving treatment at the Petitioner’s corporation.

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<sup>2</sup> In regard to the Petitioner’s Administrator, there is no evidence in the record to show that he is a medical doctor, registered nurse, license practical nurse, or any other sort of medical professional.

17. Epogen,<sup>3</sup> one of the most expensive drugs purchased by the Petitioner, is utilized to increase the red blood cells in dialysis patients. (Transcript, p. 37; Petitioner's Exhibit 2). Epogen is prescribed by the physician and administered by the registered nurse. The quantity of Epogen prescribed varies with each patient treated at Petitioner's corporation. (Transcript, p. 37).

18. Epogen, and all other purchases, are ordered by the other corporation based upon the Petitioner's projected patient-by-patient usage, are shipped directly to the Petitioner's location and are billed to the other corporation. (Transcript, p. 38-39).

19. Depending upon actual drugs and other supplies used, the other corporation sends the Petitioner a monthly invoice for reimbursement. (Transcript, pp. 38-39; Petitioner's Exhibit Nos. 2, 3, 5). Each monthly invoice detailed, in summary fashion, all reimbursable expenses under the Contract, including purchases, payroll, management fees, and all other reimbursable expenses under the Contract. (Petitioner's Exhibit 5).

20. Under the direction of the Director, the Personnel performed all dialysis services. (Petitioner's Exhibit No. 1, Transcript, p. 33). The registered nurses administered medication to the patient, perform general patient care, and delegated various duties to the licensed practical nurses and to the technicians, such as mixing the Solution, connecting patients to the dialysis machine, and ensuring that the patients receive the proper amount of dialysis. (Petitioner's Exhibit No. 1, Transcript, pp. 42-43).

21. In order to be licensed in West Virginia, registered nurses and licensed practical nurses are required to meet a variety of formal education, professional experience and competency testing requirements. (Transcript, pp. 44-45). In addition, each registered nurse

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<sup>3</sup> Epogen is "a glycoprotein which stimulates red blood cell production [and] is produced in the kidney and stimulates the division and differentiation of committed thyroid progenitors in the bone marrow." PHYSICIANS'

performing dialysis services at the Petitioner's facility is required by Medicare to complete a specialized training program. (Transcript, pp. 44-45).

22. The Management Services provided under the Contract encompassed a variety of administrative, financial and regulatory services provided by the other corporation to the Petitioner in return for the management fee. (Petitioner's Exhibit No. 1, pp. 3-5).

23. The Management Services included billing and collection of patient accounts. (Petitioner's Exhibit No. 1, p. 3).

24. Another of the Management Services provided by the other corporation is the collection of fees for the Petitioner, which fees are received for the performance of the dialysis services for the Petitioner's patients. The fees collected are deposited into account owned by the Petitioner. The Petitioner then makes payments to the other corporation as called for by the Contract.

25. Effective March 1, 2001, the Petitioner terminated the Contract. (Transcript, p. 10).

26. Since that time, the Petitioner itself has performed all Management Services, except for certain accounting services which are performed by the Petitioner's independent accountant. (Transcript, p. 55).

27. The Administrator testified that based upon his experience since March 1, 2001, the Petitioner devoted seventy percent (70%) to seventy five percent (75%) of the time it generally devotes to administrative tasks to billing and collection functions. (Petitioner's Exhibit No. 1, pp. 3-5).

28. Subsequent to the hearing, the Petitioner submitted its calculation of the purchasers' use tax it should have paid for the years of 1997 through 2000. The Petitioner's calculation, which is based on its taxable expenditures derived from certain of its regulatory and financial

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REFERENCE (Thomson PDR, 57<sup>th</sup> ed. 2003, at 576).

records, demonstrates that the assessment overestimated its use tax for 1997 through 2000. By letter dated April 11, 2003, the State Tax Commissioner accepted the Petitioners figures, conceding that the assessment should be reduced for those years.

29. With its initial brief in support of its petitions for reassessment, the Petitioner submitted a similar calculation for the months of January and February of 2001. This calculation, which shows that the assessment should be reduced for those two months, was also accepted by the Tax Commissioner. The assessment for 2001 must be reduced.

### **DISCUSSION**

The purchasers' use tax in West Virginia is governed by W. Va. Code § 11-15A-1, *et seq.* W. Va. Code § 11-15A-3 provides, in relevant part:

(a) The use in this state of the following tangible personal property and services is hereby specifically exempted from the tax imposed by this article to the extent specified:

(4) Tangible personal property or services, the sale of which in this state is *not subject to the West Virginia consumers sales tax*. (Emphasis added.)

As more specifically discussed below, the Petitioner contends that there are two exemptions that apply to its purchases: (1) The exemption of purchases made for resale in the form of tangible personal property, contained in W. Va. Code § 11-15-9(a)(9); and (2) The exemption for the sales of drugs dispensed upon prescription, contained in W. Va. Code § 11-15-9(a)(11).

#### EXEMPTION FOR PROPERTY PURCHASED FOR THE PURPOSE OF RESALE IN THE FORM OF TANGIBLE PERSONAL PROPERTY

The first argument advanced by the Petitioner is that virtually all of its purchases are exempt from imposition of the purchasers' use tax because, with limited exception, the items it purchases are resold to its patients who receive and retain possession of items as end users or ultimate consumers of the same.

W. Va. Code § 11-15-9(a)(9) provides, in relevant part, that “[s]ales of tangible personal property to a person for the purpose of resale in the form of tangible personal property” are exempt from the consumers’ sales and service tax. The legislative rules pertinent to this exemption, as applicable to the Petitioner provide as follows:

9.3. Exemptions for Which Exemption Certificate or Material Purchase Certificate Required. - The following sales of tangible personal property and taxable services shall be exempt from tax but only if the purchaser presents to, and the vendor thereof accepts, in good faith, a properly executed exemption certificate or material purchase certificate, or the purchaser presents his direct pay permit number issued by the Tax Commissioner under W. Va. Code §§ 11-15-9d and 11-15A-3a:

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9.3.4. Sales of tangible personal property for the purpose of resale in the form of tangible personal property: . . . .

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9.3.4.2. The exemption allowed by this Section permits vendors of tangible personal property, whether they be wholesalers, distributors, jobbers, retailers, providers of taxable services (*but not providers of services excepted from tax under W. Va. Code § 11-15-8*) or others to purchase tangible personal property for the purpose of resale in the form of tangible personal property without paying the consumers sales and service tax or the use tax. However, when such vendors purchase tangible personal property or services for use or consumption in their business of selling tangible personal property, they must pay the consumers sales and service tax or the use tax on such purchases. Therefore, purchases of janitorial services, equipment repairs, adding machines, etc., are taxable. In other words, vendors of tangible personal property are exempt from tax only on purchases of tangible personal property which are purchased for the purpose of resale in the form of tangible personal property, unless the purchases are exempt under some other provision of this Section. For application of this exemption for personal services providers, see Section 35 of these regulations.

9.3.4.3. *For providers of taxable services and sellers of tangible personal property subject to the consumers sales and service tax or use tax*, property purchased is presumed to be purchased for resale if the final consumer or end user of the property sold will obtain possession of the property upon consummation of the final sale of the property or service sold.

9.3.4.3.a. Example: Property sold for resale relating to sales of taxable services would include: sales of plastic dry cleaning bags and hangers to persons in the business of dry cleaning, sales of television picture tubes, solder and wire to television and electronics repair businesses and sales of primers and paint to persons in the automobile body repair business.

9.3.4.3.b. Example: Property not sold for resale to such service providers would include: sales of dry cleaning fluid, cash registers or other office equipment or dry cleaning equipment to persons in the business of dry cleaning, and sales of soldering irons, electronic test equipment, office or shop furniture or electronics manuals and technical books to television or electronics repair businesses.

9.3.4.3.c. Sales of carpet shampoo to persons in the carpet cleaning business would not constitute sales for resale because, although the shampoo is applied to the customer's carpet in the cleaning process, it is extracted from the carpet, allowed to evaporate or otherwise effectively used up in the process rather than being the subject of a transfer of possession. (Emphasis added.)

The Petitioner cites 110 C.S.R. 15, § 9.3.4.3<sup>4</sup> in support of its position that items of tangible personal property purchased by it are resold to its patients in the form of tangible personal property. It specifically cites the example set forth in 110 C.S.R. 15, § 9.3.4.3.a, likening the items it purchased to hangers and plastic dry cleaning bags provided to customers by a dry cleaning business; solder, wire and picture tubes provided to customers by television repair businesses; and primer and paint provided to customers by automobile body shops.

The Tax Commissioner responds by contending that there is a critical difference between the Petitioner's business, and that of dry cleaners, television repair shops and automobile body shops. She maintains that the businesses described in the legislative rule are engaged in the provision of services subject to the consumers' sales and service tax and, to the extent that the property provided constitutes the sale of tangible personal property, the sale of those items are subject to the consumers' sales and service tax or the purchasers' use tax. On the other hand, she contends that the Petitioner is engaged in providing a professional service that is not subject to

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<sup>4</sup> In its brief, the Petitioner erroneously cites the legislative rule as 110 C.S.R. 15, § 9.3.4.1.a.

the consumers' sales and service tax. *See* W. Va. Code § 11-15-8. Therefore, while dry cleaners, television repair businesses and automobile repair shops collect consumers' sales and service tax on the services they provide and on items of tangible personal property they provide to the customer, either as a separately-billed item on the invoice or as part of the overall cost of the service to the customer, the Petitioner does not, because it collects no tax at all on the services it provides.

In fact, the legislative rule supports the Tax Commissioner's position. First, a plain reading of 110 C.S.R. 15, § 9.3.4.3, as emphasized above, shows that the legislative rule applies only to those businesses that "[P]rovide . . . taxable services and [sell] tangible personal property subject to the consumers [sic] sales and service tax or use tax." Since the Petitioner was neither providing a taxable service nor selling tangible personal property subject to or upon which it was collecting consumers' sales and service tax, this legislative rule simply does not apply to it.

Second, even if the Petitioner was selling tangible personal property and providing services subject to consumers' sales and service tax or the purchasers' use tax, the remainder of the legislative rule cited by the Petitioner does not support its contention. Instead, it supports the contention of the Tax Commissioner. Consistent with 110 C.S.R. 15, § 9.3.4.3.b, the provider of the service or seller of tangible personal property must pay tax on all machinery, equipment, supplies and other items used or consumed by the business, and which are not resold to the purchaser. 110 C.S.R. 15, § 9.3.4.3.c demonstrates that supplies that are used up or consumed in the provision of the service, are not considered items that are purchased for resale. The items purchased, as identified in the audit work papers, consist of equipment, machinery or supplies, such as pharmaceuticals, used in the provision of dialysis services, or supplies that are used up or consumed in the administration and management of the Petitioner's business. This is contrary to

the Petitioner's assertion that "virtually all items" purchased by the other corporation on behalf of the Petitioner are for resale to its patients.<sup>5</sup>

The first category of items identified in the audit work papers consists of supplies and equipment used in the office or in the administration of the Petitioner's business. The items are identified in the audit work papers as follows:

1. Supplies,<sup>6</sup>
2. Foam cups;
3. Office supplies;
4. Creamer/sugar;
5. Computer;
6. Filters;<sup>7</sup>
7. Drinking water;
8. Can liners;
9. Forks;
10. Paper towels;
11. Cups;
12. Coffee;
13. Forms;
14. Software;
15. Calendars;
16. Interconnect;<sup>8</sup>
17. Labels;
18. Phone repairs;
19. Training booklets;
20. Control CPU (Central Processing Unit)<sup>9</sup>;
21. Advance Directive Books;

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<sup>5</sup> Testimony respecting the items purchased by the Petitioner during the audit period is incomplete. The most comprehensive approach to determining taxability of the Petitioner's purchases is to categorize them, as set forth in the audit work papers.

<sup>6</sup> It is not clear from the audit work papers whether "supplies" are used in the administrative end of the operation of the Petitioner's business, or in the provision of medical services. The evidence in the record provides no guidance.

<sup>7</sup> It is not clear whether these filters are coffee filters or filters used in the dialysis process.

<sup>8</sup> On a separate invoice, there is an item identified as "power interconnect."

<sup>9</sup> On a separate invoice, there is an item identified as "pressure control CPU."

22. O-Rings;<sup>10</sup> and
23. Multiport.

These are not items of tangible personal property which are purchased by the Petitioner for resale to its patients. The Petitioner concedes that office supplies are taxable. Office supplies include items like computers, can liners, forms, software, calendars, labels, phone repairs, training and advance directive books, CPUs, O-rings and, it appears, the multiport. Items such as foam cups, creamer, sugar, (coffee) filters, drinking water, forks, paper towels, cups, and coffee clearly are not items that are resold to the Petitioner's patients. For the most part, they are used or consumed by the employees or the patients on the premises. Some of these items may be removed from the premises by patients,<sup>11</sup> but not because the Petitioner sells them to its patients and charges consumers' sales and service tax. These items are clearly not tangible personal property purchased for the purpose of resale in the form of tangible personal property.

The next category of items shown as purchases in the audit work papers constitutes equipment that is used by the Petitioner in the provision of dialysis services. They are as follows:

1. Dialyzer;
2. Emesis bath;
3. Pumps;
4. Pump/motor;
5. Resuscitator;
6. Electrode;
7. Test tubes;
8. O-Rings;<sup>12</sup>
9. Hydrometer;
10. Vortex mixer;

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<sup>10</sup> It is not clear whether or not the O-rings are used in office equipment or, as seems more likely, in the equipment used in the dialysis process.

<sup>11</sup> For example, a patient may take a cup of coffee or a cup of water when he or she leaves the Petitioner's premises after undergoing dialysis.

<sup>12</sup> See footnote 10, *supra*.

11. Dri-Bath;
12. Flow Sensor;
13. Cell cleaner; and
14. Incubator.

Clearly, these items are not tangible personal property purchased by the Petitioner for resale to its patients. They constitute equipment purchased by the Petitioner for use in the provision of kidney dialysis to its patients. They are of a type that leads this office to conclude that they are used more than once by the Petitioner or, in some instances, used only once and discarded. There is no evidence to show that any of these items are sold by the Petitioner to its patients in a sale subject to the consumers' sales and service tax.

A third category of items shown as purchases in the audit work papers constitute non-pharmaceutical medical supplies that are used in the provision of professional services by the Petitioner:

1. Supplies;<sup>13</sup>
2. Towels;
3. Filters;<sup>14</sup>
4. Gloves;
5. Lab coats;
6. Paper towels; and
7. Tubes.

These items are supplies that are used in the provision of kidney dialysis. Some items are used once in the provision of the service.<sup>15</sup> There is no evidence to show that the Petitioner does anything but discard those items that are used once. Items used once and discarded are not resold to the Petitioner's patients in the form of tangible personal property. Other items appear to be reusable, such as the towels and lab coats. Clearly, reusable items are not resold to the

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<sup>13</sup> See footnote 6, *supra*.

<sup>14</sup> See footnote 7, *supra*.

<sup>15</sup> For example, it is hard to imagine that paper towels and latex gloves are reused by the Petitioner.

Petitioner's patients. As with the equipment used in the provision of kidney dialysis, these items are not purchased for the purpose of resale to the Petitioner's patients in the form of tangible personal property.

The final category shown as purchases in the audit workpapers consists of pharmaceuticals<sup>16</sup> that are used and consumed in the provision of professional services by the Petitioner. By means of independent research, this Office has identified the following as pharmaceuticals:<sup>17</sup>

1. Amikacin – An aminoglycoside, used as an antibacterial;
2. Buprenex (buprenorphine) – Narcotic analgesic for surgery and obstetrics, or pain relief;
3. Carnitor (levocarnitine) – used to treat l-carnitine deficiency;
4. DexFerrum – Iron Supplement (Iron Dextran);
5. Diphenyd – This Office's research showed nothing by this name;
6. Dri-Sate – A Dry Acid Mix for Hemodialysis – See [www.rockwellmed.com](http://www.rockwellmed.com);
7. Engerix - Hepatitis B Vaccine Recombinant (see Recombivax);
8. Epogen - A synthetic version of human erythropoietin, that increases and maintains the red blood cell level;<sup>18</sup>
9. 15GXI Single w/Plat-2 CS – This product was ordered from Rockwell Medical Technologies, Inc., a supplier of hemodialysis products;
10. Hectorol (doxercalciferol) - A Vitamin D related compound, administered by injection;
11. Heparin – An anticoagulant;
12. Metoclopramide – Used for diagnosing certain stomach problems, or to prevent nausea and vomiting;
13. Naturalyte – Dextrose and electrolytes, used to treat or prevent dehydration;
14. Neparin – This Office surmises that this is a typographical error, and that this invoice is for Heparin;
15. Nipro – This product was ordered from Rockwell Medical Technologies, Inc., a supplier of hemodialysis products;

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<sup>16</sup> This Office is not certain that all of the pharmaceuticals shown in the audit work papers are drugs that may be dispensed only upon prescription. Some of these items, such as DexFerrum, an iron supplement, and naturalyte, which is a sugar and electrolyte solution similar in nature to Pedialyte, may not require a prescription. On the other hand, they may be dispensed in dosages sufficient to require a prescription. The record is devoid of any evidence which shows whether or not these items must be dispensed only pursuant to a prescription.

<sup>17</sup> Except where noted, information was obtained from MEDLINEPlus, a service of the U. S. National Library of Medicine and the National Institutes of Health, at [www.nlm.nih.gov/medlineplus/druginformation.html](http://www.nlm.nih.gov/medlineplus/druginformation.html).

<sup>18</sup> Based on the testimony of the Petitioner's Administrator, Epogen is a pharmaceutical that is used or consumed in the provision of dialysis services. See also Finding of Fact No. 17.

16. Recombivax – Hepatitis B Vaccine Recombinant (*see* Engerix);
17. Tubersol - Tuberculin, Purified Protein Derivative (PPD), used to diagnose tuberculosis ;
18. Vancomycin – An antibiotic, used to treat bacterial infections ;
19. Venofer – Iron Sucrose, an iron supplement; and
20. Zemplar (paricalcitol) – A Vitamin D related compound, administered by injection.

The only evidence in the record demonstrating how the Petitioner purchases and uses pharmaceuticals is the testimony of Petitioner’s director respecting the purchase and use of Epogen. He testified that the Petitioner purchases Epogen based on its projections of patient-by-patient use. When a patient needs Epogen, the prescribed amount is withdrawn from its inventory and is administered to the patient. As such, it is consumed by the patient, not resold in the form of tangible personal property. In the absence of evidence to show that other pharmaceuticals are prescribed and resold to the Petitioner’s patients in the form of tangible personal property, this Office will presume that they are prescribed and used in the same general manner as Epogen.

Considering pharmaceuticals used in the provision of dialysis services in the context of the legislative rules, this Office is of the opinion that they are consumed in the provision of the service. They are more in the nature of the carpet cleaners described in 110 C.S.R. 15, § 9.3.4.3.c, in that they are effectively used up in the dialysis process, rather than retaining their form as tangible personal property that is transferred to the patients. The pharmaceuticals are not comparable to the solder, wire and automobile body paint described in 110 C.S.R. 15, § 9.3.4.3.a, because they are not items that are transferred to the possession of the patient, and which the patient carries away with him, either as a separate item of tangible personal property, or as a component part of an item of tangible personal property. The pharmaceuticals purchased by the Petitioner are not resold to the Petitioner’s patients in the form of tangible personal property.

The Tax Commissioner also cites 110 C.S.R. 15, § 9.3.4.2, which is set forth above. It states that a taxpayer providing services that are not subject to the consumers' sales and service tax by reason of the provisions of W. Va. Code § 11-15-8 is subject to the consumers' sales and service tax or purchasers' use tax on its purchases. The Petitioner provided a professional service, which was exempt from the consumers' sales and service tax by reason of W. Va. Code § 11-15-8. Therefore, it was required to pay the tax on its purchases. This provision expressly supports the position of the Tax Commissioner.

This provision is entirely consistent with the overarching, "anti-pyramiding" scheme of the Code and the legislative rules respecting purchases for resale in the form of tangible personal property. A purchase is exempt if the item is subsequently to be resold in a sale subject to tax. If the item is to be subsequently used or consumed in the provision of a service that is not subject to consumers' sales and service tax, then the purchase by the provider of the exempt service is subject to the tax.

Also to be considered is 110 C.S.R. 15, § 36, which provides, in relevant part:

**§ 110-15-36. Hospitals.**

36.1. The . . . sale of drugs, blood, oxygen, dressings, appliances and other tangible personal property to patients is a part of the services rendered by hospitals. These sales and services are so interrelated with professional and personal services, that such sales and services rendered to patients by hospitals are not subject to the consumers' sales and service tax.

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36.4 Hospitals are engaged in the business of providing a professional service not subject to the consumers' sales and service tax. Therefore, they are taxable on purchases of property and services for use in the conduct of their professional services, and are not considered to be making purchases for resale. See Section 9.3.1 of these regulations for rules governing sales to hospitals owned by state, county or municipal governments.

The Petitioner is not, strictly speaking, a hospital. However, it provides a service that is in the nature of a service that is often provided by hospitals. This Office recognizes that there are differences between the Petitioner and hospitals.<sup>19</sup> However, as applicable to this action, these distinctions are not critical. The salient fact is that both the Petitioner and hospitals provide professional, medical services to patients at their own medical facilities. In the same manner as the services provided by a hospital, the provision of drugs, dressings, appliances and other items to the Petitioner's patients were so interrelated with the professional services that they were not subject to consumers' sales and service tax. 110 C.S.R. 15, § 36.1. However, the Petitioner is subject to tax on its purchases of property and services for use in the conduct of its professional service business. 110 C.S.R. 15, § 36.4 The services provided in both instances are not subject to consumers' sales and service tax or purchasers' use tax by reason of the fact that they are professional services. *See also* 110 C.S.R. 15, § 99.<sup>20</sup>

West Virginia Code § 11-15-8 provides that the consumers' sales and service tax applies to the furnishing of all services, but that, *inter alia*, the furnishing of professional services are excepted from the tax. The legislative rules pertaining to the furnishing of professional services provide, in relevant part:

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<sup>19</sup> A hospital provides both inpatient and outpatient services, while the Petitioner provides only outpatient services. Also, a hospital usually provides a wide range of medical services, while the Petitioner is limited to providing a single service.

<sup>20</sup> The legislative rule provides:

**§ 110-15-99. Professionals - Lawyers, Doctors, Etc.**

99.1. Persons who are engaged in a business and are deemed to be professionals, such as lawyers, doctors, and any other person considered to be a professional pursuant to Section 8.1.1 of these regulations, are not required to collect and remit consumers sales and service tax on their services rendered or on any sales of tangible personal property incidental to such services. However, such professionals must pay consumers sales and service tax on all purchases for use in their business, except for purchases for resale when the resale is a nonprofessional sale subject to the consumers [sic] sales and service tax, for which an exemption certificate may be issued.

**§ 110-15-8. Furnishing of Services Included; Exceptions.**

The consumers' sales and service tax and the use tax shall apply not only to selling tangible personal property, but also to the furnishing of all services, except professional services, . . . .

8.1. Sales of the following services are excepted from the imposition of the consumers' sales and service tax and the use tax.

8.1.1. Professional Services.

8.1.1.1. Professional services, as defined in Section 2 of these regulations, are rendered by physicians, dentists, . . . registered professional nurses, . . . . Persons who provide services classified as nonprofessional for consumers sales and service tax purposes include . . . hospital administrators; the foregoing listing is not all-inclusive but intended as containing examples of trades and occupations. . . .

\* \* \*

8.1.1.3. *Professional persons who make sales of tangible personal property or who engage in activities which are not professional services shall collect consumers' sales and service tax on such sales or services.* For example, kennel services provided by a veterinarian are subject to tax.

8.3. *The purveyors of those services which are excepted from the imposition of the consumers' sales and service tax, enumerated in Sections 8.1.1 through 8.1.3 above, are not required to collect the consumers' sales and service tax on the sale of services to consumers. As a result, the purveyors of such services are required to pay the consumers sales and service tax on all purchases of tangible personal property and services which are used or consumed in their business: Provided, That purchases which qualify under Sections 9.4.1 or 9.4.4 of these regulations shall be exempt from the sales and service tax. (Emphasis added.)*

The Petitioner clearly was engaged in the provision of professional services, not the retail sale of tangible personal property. It provides dialysis services to its patients, a professional medical service. The Petitioner did not sell tangible personal property to its patients. If it did, it would be required to collect consumers' sales and service tax on those purported sales. 110 C.S.R. 15, § 8.1.1.3. It did not collect such tax because, as the provider of a professional service, it was excepted from collecting the tax. Because of the exception, it was required to pay

consumers' sales and service tax (or purchasers' use tax) on its purchases used or consumed in the business. 110 C.S.R. 15, § 8.3.

Based on the foregoing, this Office **DETERMINES** that the Petitioner's purchases do not constitute purchases for the purpose of resale in the form of tangible personal property. Consequently, they are not exempt pursuant to the provision of W. Va. Code § 11-15-9(a)(9).

#### EXEMPTION FOR DRUGS SOLD UPON PRESCRIPTION

The second issue raised by the Petitioner is whether drugs sold to the Petitioner, which are used and consumed in the provision of dialysis to its patients, constituted “[s]ales of drugs dispensed upon prescription,” which are exempted from imposition of the consumers’ sales and service tax by the provisions of W. Va. Code § 11-15-9(a)(11).

In *Syncor International Corp. v. Palmer*, 208 W. Va. 658, 542 S.E.2d 479 (2001), the Supreme Court discussed the exemption provided by W. Va. Code § 11-15-9(a)(11), as it applies to the sales of pharmaceuticals to medical service providers who use those pharmaceuticals in the provision of professional medical services to patients. In Syllabus Point 5, *Syncor, supra*, the Supreme Court held:

The sale of a radiopharmaceutical to a medical service provider is exempt from the consumer sales tax under the provisions of West Virginia Code § 11-15-9(a)(11) (1997) where the radiopharmaceutical is purchased and dispensed pursuant to physician’s prescription that was prepared for a particular individual patient.

In reaching this conclusion, the Supreme Court considered 110 C.S.R. 15, §§ 92.1 - 92.3, the legislative rules pertaining to the sale of drugs. These rules provide:

92.1. Sales of drugs dispensed upon written prescription and sales of insulin to consumers for medical purposes are exempt from consumers’ sales and service tax. The term "drug" shall include all sales of drugs or appliances to a purchaser, upon written prescription of a physician or dentist and any other professional person licensed to prescribe. This is a *per se* exemption and no exemption certificate or direct pay permit is needed to obtain the exemption.

92.2. Drugs sold to hospitals, licensed physicians, nursing homes, etc., which are to be consumed in the performance of a professional service are subject to consumers sales and service tax.

92.3 Sales to consumers of non-prescription drugs are subject to consumers' sales and service tax.

In discussing § 92.2, the Court acknowledged the possibility that the purpose of this legislative rule was to merely differentiate between drug sales dispensed pursuant to a prescription, and drug sales that are made without a prescription, such as “bulk” sales. *Id.* at 662, n. 7, 542 S.E.2d at 483, n.7. Regarding § 92 in its entirety, the Court stated, “[T]he regulatory provisions emphasize the distinction between those sales pursuant to prescription (the exempt) and those that are sold to medical service providers in bulk form without the issuance of prescriptions (the non-exempt).” *Id.* at 663; 542 S.E.2d at 484.

The Petitioner takes the position that the taxpayer in *Syncor* conceded that “bulk” sales of drugs to the medical service provider were taxable. It maintains that the Supreme Court did not expressly decide the issue of whether or not “bulk” sales of drugs by a supplier to a medical service provider are exempt from the consumers’ sales and service tax or the purchasers’ use tax. It contends that any sale of pharmaceuticals that will ultimately be dispensed pursuant to a prescription is exempt from consumers’ sales and service tax, regardless of whether or not the sale under consideration is made pursuant to a prescription.

The Petitioner is correct that, in *Syncor*, that taxpayer conceded that bulk sales were taxable. It is also correct that the Supreme Court's pronouncements respecting bulk sales appear to be *dicta*. However, this tribunal is of the opinion that the Supreme Court's analysis of the statute and the legislative rules, while not the express holding of the Court in *Syncor*, is correct and remains correct. This tribunal is also of the opinion that the sales of pharmaceuticals in the

present action are governed by the statute and the legislative rules, as analyzed by the Supreme Court in *Syncor*.

The pharmaceuticals purchased by the Petitioner are set forth in the preceding section of this decision. It is important to keep in mind that the only evidence in the record relating to the Petitioner's practices respecting the purchase of pharmaceuticals is Petitioner's director's testimony respecting purchases of Epogen.<sup>21</sup> The director's testimony makes it clear that the Petitioner does not purchase Epogen for each individual patient, pursuant to an individual prescription prepared by a physician for that patient. Instead, the Petitioner *purchases larger* quantities of Epogen, based on a *projected* patient-by-patient use. As Epogen is needed for use in providing dialysis, the amount *then prescribed* by the patient's physician is withdrawn from the Petitioner's inventory and, at that time, dispensed to a patient pursuant to a physician's prescription prepared for that particular patient.

There is no testimony in the record to show that the Petitioner purchases other pharmaceuticals for patients pursuant to a prescription for that individual patient. In the absence of evidence with respect to that particular issue, this tribunal must find that the Petitioner makes bulk purchases of the other pharmaceuticals, and not pursuant to an individual prescription. There are two reasons for this.

First, the Petitioner has the statutory burden of proving that the assessment is incorrect. W. Va. Code § 11-10A-10(e). *See also* 121 C.S.R. 1, § 63 (Apr. 20, 2003). Stated differently, the assessment is presumed to be correct, unless the Petitioner proves otherwise.

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<sup>21</sup> The other corporation purchases its Epogen in bulk. The Epogen is then sold, in bulk, to the Petitioner. This sale to the Petitioner occurs in the form the Petitioner reimbursing the other corporation for its purchase, as required by the management contract.

In the context of this action, for the assessment to be upheld, this tribunal must find that the Petitioner makes "bulk" purchases of drugs. Conversely, for this tribunal to vacate the assessment, on the basis of this assertion by the Petitioner, then the Petitioner would have to prove that its purchases of drugs were pursuant to a prescription prepared for a particular individual. In the absence of evidence, this tribunal must presume that the Petitioner's purchases of drugs were "bulk" purchases.

Clearly, the evidence shows that its purchases of Epogen are "bulk" purchases. Because the Petitioner has not provided evidence to show that its purchases of other drugs are pursuant to a prescription prepared for a particular individual, It must be presumed that its purchases were "bulk" purchases.

Second, the evidence establishes that the Petitioner makes "bulk" purchases of Epogen. It is reasonable to assume that the Petitioner handles its purchases of other drugs in a similar manner. In the absence of evidence showing that it purchases other drugs pursuant to a prescription prepared for a particular individual, there is no reason for this tribunal to find that its purchases of other drugs are handled in a manner that is any different than its purchases of Epogen. Thus, this tribunal must find that the Petitioner's purchases of other drugs were "bulk" purchases.

Based on the foregoing, this Office **DETERMINES** that the Petitioner's purchases of drugs were not pursuant to a prescription prepared for a particular individual. Consequently, they are not exempt pursuant to the provisions of W. Va. Code § 11-15-9(a)(11).

## BROAD-BASED HEALTH CARE PROVIDER TAX

The Petitioner also challenges the assessment of broad-based health care provider tax, W. Va. Code § 11-27-1, *et seq.* The tax is a gross receipts tax imposed on providers of certain health care services. The rate of taxation is based on the type of services provided by the taxpayer. The Petitioner was taxed at the rate provided in W. Va. Code § 11-27-16, for physician's services.

The Petitioner contends that it is the other corporation, not it, that is subject to the tax. This argument is based on the contract between the Petitioner and the other corporation. The contract provides that the individuals who actually perform the "hands-on" dialysis services are employees of the other corporation. The Petitioner reimburses the other corporation for the cost of wages, salaries and benefits for the employees who provide the dialysis services. Based on this, the Petitioner contends that it is the other corporation that provides the service and, therefore, it is the other corporation that is liable for payment of the tax.

This is not grounds for holding that the Petitioner is not liable for the health care provider tax. The Petitioner is the entity that is responsible for providing the dialysis services. The evidence in the record shows that funds remitted for dialysis services belong to the Petitioner. The other corporation collects those funds and deposits them into an account owned by the Petitioner. The Petitioner then reimburses the other corporation for all of its management services, including the cost of the employees providing dialysis services. These factors lead this tribunal to conclude that it is the Petitioner that is providing the services and, therefore, is responsible for the payment of the tax.

W. Va. Code § 11-27-16 provides:

(a) *Imposition of tax.* – For the privilege of engaging or continuing within this state in the business of providing physician's services, there is hereby levied and shall be collected from every person rendering such service an annual broad-based health care related tax.

(b) *Rate and measure of tax.* – The tax imposed in subsection (a) of this section shall be two percent of the gross receipts derived by the taxpayer from furnishing physician’s services in this state.

(c) *Definitions.*

(1) “Gross receipts” means the amount received or receivable, whether in cash or in kind, from patients, third-party payors and others for physicians; services furnished by the provider, including retroactive adjustments under reimbursement agreements with third-party payors, without any deduction for any expenses of any kind:

The Petitioner has contracted with the other corporation to provide services on its behalf, and it is the Petitioner who receives gross receipts from the provision of dialysis services to its patients. As such, it is a provider of health care services. Therefore, it subject to the tax.

Another factor leading to this conclusion is the fact that the Medical Director is the President of and is employed by the Petitioner. As such she is responsible for supervision of all medical services performed by the Petitioner, and is responsible for all quality control and related functions. Thus, it is the Petitioner that bears ultimate responsibility for provision of the medical services at the facility.

The Petitioner also contends that the other corporation is liable for payment of the health care provider tax because, pursuant to the contract, the other corporation is required to ensure compliance with all regulatory requirements of the State. It maintains that the health care provider tax is one of these regulatory requirements.

The Petitioner is incorrect in its contention that the Contract renders the other corporation liable for payment of the health care provider tax. The Petitioner is statutorily responsible for payment of the health care provider tax. The parties can make whatever arrangements they want between themselves pursuant to the Contract. However, regardless of what arrangements they make between themselves, their agreement does not bind the State Tax Commissioner or the State of West Virginia – who is not a party to the contract. The Petitioner is statutorily liable for the payment of the health care provider tax, irrespective of its agreement with the other corporation.

Additionally, while the other corporation is responsible for ensuring with all regulatory requirements of the State, the Contract makes clear that it undertakes this activity "on behalf of and in the name of [the Petitioner]." Thus, if the Petitioner is correct that payment of the health care provider tax is a regulatory requirement the other corporation is contractually bound to perform, it performs that requirement for the benefit of and in the name of the Petitioner.

Based on the foregoing, this Office DETERMINES that the Petitioner is liable for the payment of the health care provider tax, as set forth in the assessment.<sup>22</sup>

### CONCLUSIONS OF LAW

Based upon all of the above it is **DETERMINED** that:

1. In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment, the burden of proof is upon the Petitioner to show that the assessment is incorrect. See W. Va. Code § 11-10A-10(e) [2002] and 121 C.S.R. 1, § 63.1 (Apr. 20, 2003).

2. The items of tangible personal property purchased by the Petitioner consisted of office supplies, office equipment, medical supplies, medical equipment and pharmaceuticals, which were used or consumed in the provision of professional medical services to patients, and were not purchases for the purpose of resale in the form of tangible personal property by the Petitioner.

3. The Petitioner has failed to satisfy its burden of proving that items of tangible personal it purchases are for resale to its patients in the form of tangible personal property, which would render its purchases exempt pursuant to the provisions of W. Va. Code § 11-15-9(a)(9).

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<sup>22</sup> Even if the Petitioner were correct in its contention that the other corporation was responsible for paying the health care provider tax, the assessment would not be totally voided. The Petitioner would still be liable for payment of the tax for the period subsequent to the termination of the Contract.

4. The Petitioner has failed to satisfy its burden of proving that its purchases of pharmaceuticals were pursuant to a prescription, which would render its purchases exempt pursuant to the provisions of W. Va. Code § 11-15-9(a)(11).

5. The transactions in which the Petitioner purchased pharmaceuticals were not transactions whereby the pharmaceuticals were dispensed pursuant to a prescription. W. Va. Code § 11-15-9(a)(11). *See also* Syl. pt. 5, *Syncor International Corp. v. Palmer*, 208 W. Va. 658, 542 S.E.2d 479 (2001).

5. A provider of physician's services who receives gross receipts from the provision of said services may not contractually require another person or entity to pay the broad-based health care provider tax, W. Va. Code § 11-27-1, *et seq.*

6. The State Tax Commissioner is not bound by a contract between two taxpayers, to which she is not a party, which requires one party to the contract to pay a tax that is incurred, owed and required to be paid by the other party to the contract.

7. The parties are in agreement that, based on the Petitioner's methodology for determining the purchases by the Petitioner over the course of the audit period, the assessment for purchasers' use tax should be reduced.

#### **DISPOSITION**

**WHEREFORE**, it is the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the purchasers' use tax assessment issued against the Petitioner for the period of July 1, 1997, through June 30, 2002, for tax and interest, computed through October 31, 2002, should be and is hereby **MODIFIED** in accordance with the above Conclusions of Law for **revised** tax.

Because the modifications to the purchasers' use tax assessment agreed to by the parties results in an increase to the amount of purchasers' use tax estimated by the State Tax Commissioner for the period July 1, 1997 through December 31, 1997, and decreases to each of the amounts estimated by the State Tax Commissioner for the years 1998, 1999 and 2000, and for the period January 1, 2001, through February 28, 2001, it is necessary to compute the amount of interest on the revised purchasers' use tax due. This Office will require the State Tax Commissioner to compute the amount of interest due on the revised tax and submit the same to the Petitioner for review, within fifteen (15) days of receipt of this decision. Upon review, if the Petitioner agrees with the State Tax Commissioner's revised interest computation, Petitioner's counsel will notify both this Office and counsel for the State Tax Commissioner. If the Petitioner disagrees with the Tax Commissioner's computation, then within ten (10) days the parties are to confer in an attempt to reach an agreed upon interest computation. If, at that time, the parties are unable agree upon a computation of interest, each party shall submit a detailed computation of interest to this Office, with an explanation of why its computation is correct and the opposing party's computation is incorrect. Based on those statements, this Office will render a decision as to the correct computation of interest on the purchasers' use tax assessment.

It is **ALSO** the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the broad-based health care provider tax assessment issued against the Petitioner for the period of January 1, 1997, through December 31, 2001, for tax, interest, updated through January 15, 2004, and additions to tax, should be and is hereby **AFFIRMED**

**Interest continues to accrue** on this unpaid tax at a daily rate until this liability is fully paid.