



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE ENROLLED BILL ANALYSIS**

Date Amended:	Enrolled	Bill No:	AB 249
Tax:	Sales and Use	Author:	Matthews, et al.
Board Position:	Section 1 – No position Section 2 - Support	Related Bills:	AB 208 (Frommer)

BILL SUMMARY

This bill would 1) codify the Board’s regulation relating to the exemption for sales and purchases of lancets and blood glucose test strips, and 2) specify that acupuncturists are consumers, rather than retailers, of herbs and medicines, as described, furnished in connection with their services.

ANALYSIS

Acupuncturists
(Section 6018.3)

Current Law

Under existing law, sales tax is imposed on retailers for the privilege of selling tangible personal property at retail in this state. Persons engaged in the business of rendering services are generally not considered retailers, but instead, are considered consumers of any tangible personal property incidentally transferred in the performance of their services. As consumers, tax applies to the service providers’ purchase of any property used in the performance of their services.

The Board’s Sales and Use Tax Regulation 1501, “Services Enterprises Generally,” provides that the basic distinction in determining whether a particular transaction involves a sale of tangible personal property or the transfer of tangible personal property incidental to the performance of a service is one of the true object of the contract; that is, is the real object sought by the buyer the service per se or the property produced by the service. If the true object of the contract is the service per se, the transaction is not subject to tax, even though some tangible personal property is incidentally transferred.

Current law already regards acupuncturists as consumers of any tangible personal property used incidentally in the performance of their services where no separate charge is made to their clients for any tangible personal property sold, and the price of any tangible personal property incidentally transferred to the client is built into the acupuncturists’ fee schedule. However, where a separate charge is made by the acupuncturist to the client for any tangible personal property transferred to the client, current law requires that tax applies to that charge.

Under the law, the following service providers have specifically been deemed to be consumers, rather than retailers, of certain items that they use or furnish in the performance of their professional services:

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- Optometrists, physicians and surgeons, and registered dispensing opticians with respect to ophthalmic materials for the treatment of conditions of the human eye. (Section 6018)
- Veterinarians with respect to certain drugs and medicines. (Section 6018.1)
- Chiropractors with respect to vitamins, minerals, dietary supplements and orthotic devices. (Section 6018.4)
- Podiatrists with respect to prosthetic materials and inlays in the diagnosis, treatment, or correction of conditions of the human foot. (Section 6018.5)
- Licensed hearing aid dispensers with respect to hearing aids. (Section 6018.7)
- Producers of x-ray films or photographs with respect to materials and supplies used for the purpose of diagnosing medical or dental conditions of humans. (Section 6020)

Proposed Law

This bill would add Section 6018.3 to the Sales and Use Tax Law to provide that a licensed acupuncturist is a consumer of, and shall not be regarded as a retailer with respect to, any herb, herbal formulas or preparations, vitamins, minerals, dietary supplements, orthotic devices, or other naturally occurring substances included in the Encyclopedia of Traditional Chinese Materia Medica that is used or furnished by him or her in the performance of his or her professional services.

The provisions of the bill would become operative on the first day of the first calendar quarter commencing more than 90 days after the bill becomes law.

Background

Two similar measures have been considered in previous sessions. Assembly Bill 410 (Gallegos) was considered during the 1997-98 Legislative Session. AB 410 was held in the Senate Appropriations Committee. The Board was originally opposed to that measure due to an undefined term used in the bill that would have lead to uncertainties in the Board's administration of the law. However, the bill was later amended to remove the undefined term, which resulted in the Board's removal of its opposition. Assembly Bill 2764 (Knox) was considered during the 2000 Legislative Session. AB 2764 was held in the Assembly Appropriations Committee. The Board voted to support AB 2764.

COMMENTS

1. **Sponsor and purpose.** The sponsor of this provision is the Council of Acupuncturists and Oriental Medicine. Its purpose is to treat acupuncturists in a similar manner as the law currently treats other healthcare professionals, such as chiropractors and podiatrists.
2. **The bill's effect is limited.** This bill would make acupuncturists consumers of specified items used or furnished in the performance of his or her professional services, regardless of the method of billing. As a consumer, the acupuncturist would pay tax only on his or her cost of the items. However, it should be noted that

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any retail sales of these items that are made separately from the professional services rendered would continue to be subject to tax based on the retail selling price to the consumer. For example, even with the enactment of this measure, the acupuncturist would continue to be responsible for tax based on the selling price of an item to the client if the acupuncturist separately charges an amount and does not provide professional services in conjunction with the supplying of the item. Therefore, an acupuncturist that operates a retail vitamin, mineral, or dietary supplement store, for example, would continue to be required to report the tax on the retail selling price of the items sold, unless he or she can show that they were furnished along with his or her professional services.

3. **Enactment of this measure would not complicate the Board's administration of the law.** Since the Board already administers similar provisions for chiropractors, podiatrists, eye care professionals, and others, staff does not anticipate any problems with administering the provisions proposed in this measure.
4. **Related legislation.** A measure containing this provision was introduced this year – AB 208 (Frommer). The Board voted to be neutral on that measure.

Test Strips and Lancets (Section 6369)

Current Law

Under existing law, except where specifically exempted by statute, sales or use tax is imposed on all retailers for the privilege of selling tangible personal property at retail in this state. Section 6369 of the Sales and Use Tax Law provides that sales of medicine, when prescribed and sold or furnished under certain conditions for the treatment of a human being, are exempt from sales and use tax. Although an item, device, or apparatus may be prescribed by a physician for the treatment of a patient, for the sale to be exempt from tax, the item must qualify as a "medicine" under Section 6369.

Under this section, certain named devices, instruments, apparatus, devices, and physical equipment are included within the term "medicine" and therefore qualify for the exemption from tax. For example, the sale or use of insulin and insulin syringes furnished by a registered pharmacist for treatment of diabetes are specifically included within the term "medicine" and therefore currently qualify for an exemption from tax.

The Board's Regulation 1591.1, *Specific Medical Devices, Appliances, and Related Supplies*, interprets and makes specific the provisions of Section 6369. Under the regulation, sales and purchases of glucose test strips and skin puncture lancets furnished by a registered pharmacist that are used by a diabetic patient to determine his or her own blood sugar level and the necessity for and amount of insulin and/or other diabetic control medication needed to treat the disease in accordance with a physician's instructions are considered an integral and necessary active part of the use of insulin and insulin syringes and, accordingly, are not subject to sales or use tax. Sales and purchases of these items over-the-counter without being furnished by a registered pharmacist, however, remain subject to tax.

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Proposed Law

This bill would amend Section 6369 of the Sales and Use Tax Law to include within the term “medicines,” blood glucose strips and lancets, whether or not furnished by a registered pharmacist, to a person for the treatment of diabetes as directed by a physician.

The provisions of the bill would become operative on the first day of the first calendar quarter commencing more than 90 days of date the bill becomes enacted.

Background

Last year, during the 2000 Legislative Session, AB 2587 (Cardenas, et al.) was considered by the Legislature to 1) provide a sales and use tax exemption for the sale and purchase of blood glucose monitors whether or not the devices are furnished by a registered pharmacist, 2) codify the Board’s regulation relating to the exemption for sales and purchases of lancets and blood glucose test strips, and 3) expand the regulation by eliminating the requirement that these items be furnished by a registered pharmacist in order for the exemption to apply. That measure, which the Board voted to support, was held in the Assembly Appropriations Committee.

COMMENTS

1. **Sponsor and purpose.** The sponsor of this provision is the California Pharmacists Association. Its purpose is to codify the Board’s regulation concerning the application of sales and use tax to sales and purchases of blood glucose test strips and lancets furnished for the treatment of diabetes, and to delete the requirement that these items be furnished by a registered pharmacist.
2. **This bill would not materially affect the Board’s administration of the Sales and Use Tax Law.** Since this bill would basically codify the Board’s interpretation of the law, it would not materially affect the Board’s workload.

COST ESTIMATE

Enactment of this provision would result in a minor decrease in administrative and audit costs due mainly to a reduction in the number of acupuncturists required to hold a seller’s permit. However, any savings would be offset by the minor additional costs that would be incurred in notifying acupuncturists, closing out permits, and revising the Board’s affected regulation.

REVENUE ESTIMATE

Acupuncturists. Under this provision, a licensed acupuncturist is a consumer of, and shall not be considered a retailer with respect to, any herb, herbal formula or preparation, vitamin, mineral, dietary supplement, orthotic device, or other naturally occurring substance included in the Encyclopedia of Chinese Materia Medica that is used or furnished by him or her in the performance of his or her professional services.

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According to the Department of Consumer Affairs, Acupuncture Board, currently there are 5,281 active, licensed acupuncturists in California. According to the Council of Acupuncture and Oriental Medicine Association, of the 5,281 acupuncturists, only 3,485 or 66 percent sell herbs, vitamins, or other naturally occurring substances. For the year 2000, an analysis of the sales and use tax returns filed with the Board of Equalization by acupuncturists shows that, on average, an acupuncturist does about \$11,024 per year in taxable sales. Estimated sales for all acupuncturists in the state of California reselling herbal products are \$38.4 million (3,485 acupuncturist x \$11,024). The mark-up on herbal products sold to patients by acupuncturists is approximately 33.2 percent. The total cost of the herbal products to acupuncturists is \$28.8 million (\$38.4 / 1.332). The amount that would be exempt under this proposal is the difference between total sales by acupuncturists and what the acupuncturists paid for the products they sell: \$9.6 million (\$38.4 million - \$28.8 million).

Test strips and lancets. Enactment of this measure would enable diabetics to purchase the blood testing devices over-the-counter, rather than through the pharmacist, and retain the sales and use tax exemption. Deleting the requirement that a registered pharmacist furnish these items in order for the exemption to apply would therefore not affect state or local revenues.

Revenue Summary

Exempting the \$9.6 million from the sales and use tax would result in the following revenue loss:

	Revenue Loss
State loss (5.00%)**	\$ 480,000
Local loss (2.25%)	216,000
Special district loss (0.67%)	<u>64,000</u>
Total	<u>\$ 760,000</u>

** While the state tax rate is 4.75 percent for 2001, it is assumed the tax rate will return to 5.0 percent in 2002.

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