

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION BOARD HEARING SUMMARY

3 In the Matter of the Petition for Redetermination)
 4 And Claim for Refund Under the Sales and Use)
 4 Tax Law of:)
 5) Account Number: SR EA 97-514505
 5 TEAM POST-OP, INC.) Case ID's 447342, 448811
 6)
 6 Petitioner/Claimant) Santa Ana, Orange County
 7

8 Type of Business: Sellow/lessor of medical devices and supplies

9 Audit period: 4/1/03 – 3/31/06

10 <u>Item</u>	<u>Disputed Amount</u>
11 Understated taxable lease receipts	\$725,053
12 Understated taxable sales	\$ 93,594
13 Tax determined	\$63,021.72
13 Adjustment - Appeals Division	<u>-14,829.16</u>
14 Proposed redetermination	\$48,192.56
14 Credit concurred in	<u>16,421.67</u>
15 Balance, protested	<u>\$64,614.23</u>
15 Proposed tax redetermination	\$48,192.56
16 Interest	<u>12,533.64</u>
17 Total tax and interest	\$60,726.20
17 Payments	<u>-60,726.20</u>
18 Balance Due	<u>\$ 0.00</u>

19 UNRESOLVED ISSUE

20 **Issue:** Whether petitioner's leases of Game Ready (GR) units and sales of Cold Therapy (CT)
 21 units qualify as exempt transactions. We conclude they do not.

22 Petitioner purchased GR units without payment of tax or tax reimbursement through April
 23 2004, when it started purchasing most of its GR inventory on a tax-paid basis, and leased the GR units
 24 in substantially the same form as acquired to patients under a physician's prescription, and billed
 25 insurance companies directly without adding tax or tax reimbursement to the billing. Petitioner
 26 purchased the CT units without payment of tax or tax reimbursement and resold them to patients, again
 27 under a physician's prescription and billed to insurance companies without adding tax reimbursement
 28 to the billing. The GR and CT units sit on the floor or table, provide temperature therapy to a patient's

1 injured body part by circulating temperature-controlled water through tubes that insert into a wrap
2 attached to the injured body part or provide modulated temperature through pads applied to the injured
3 body part, and provide compression therapy to the patient’s injured area. The Department determined
4 that petitioner’s leases of GR units and sales of CT units did not qualify as exempt transactions. It
5 computed the percentage of the GR inventory that was not tax-paid for each quarter, adjusted for
6 estimated product losses and disposals, applied those percentages to the recorded GR lease receipts to
7 arrive at audited taxable GR lease receipts, compared the taxable GR lease receipts to reported
8 amounts, and established the \$725,053 difference in the audit. For CT units, it compared the recorded
9 and reported taxable sales and established the \$93,594 difference in the audit.

10 Petitioner claims that the GR and CT units qualify as exempt medicines because they are used
11 for the mitigation or cure of disease, and are intended to mitigate swelling and pain. Petitioner
12 contends that they are comparable to pain pumps and continuous passive motion (CPM) devices, both
13 of which qualify as medicines. Petitioner asserts that they are prescribed by a physician and are fully
14 worn on the patient’s body when in use. Petitioner argues that the Department’s reliance on annotation
15 425.0022.700, which states that devices that apply controlled compression and cold temperature to
16 minimize swelling and pain are not medicines, is just an interpretation, is not authoritative, and is
17 incorrect. Petitioner also contends that the adjustment for GR product losses and disposals is
18 insufficient.

19 We find that the GR and CT units at issue are “apparatus, contrivances, appliances, devices or
20 other mechanical, electronic ... or physical equipment” that are *excluded* from the term “medicines”
21 pursuant to Revenue and Taxation Code section (Regulation) 1591, subdivision (c). They do not
22 qualify as “preparations or similar substances,” “permanently implanted articles,” “artificial limbs and
23 eyes,” “orthotic devices,” or “prosthetic devices.” Regulation 1591, subdivision (b)(4) states, “If any
24 part of [an] orthotic device is not worn on the person, the device is not a medicine for the purposes of
25 this regulation.” We conclude that the GR and CT units are mechanical devices that are excluded from
26 the definition of medicines pursuant to Regulation 1591, subdivision (c), and because they are not fully
27 worn on the body, would not qualify as medicines even if they qualified as orthotic devices.

1 Petitioner's reliance on Regulation 1591, subdivision (b)(1) in support of its position that its
2 GR and CT units qualify as exempt medicines is misplaced because the examples of "preparations and
3 similar substances" in the regulation do not reference mechanical devices. The memorandum opinion
4 adopted by the Board in *Action Medical Products* on April 18, 2002, is distinguishable from the facts
5 here. Since petitioner's GR and CT units are not orthotic devices, they cannot be compared to the
6 CPM machines which the memorandum opinion found to be exempt orthotic devices even though not
7 fully worn on the body.¹ We conclude that the memorandum opinion is not applicable.

8 In a prior appeal of petitioner before the Board on September 21, 2005, the Board granted the
9 appeal. However, that decision involved facts different from those here, whether petitioner's pain
10 control infusion pumps, which were not fully worn on the body, qualified as programmable drug
11 infusion devices. The Board held that the pain pumps qualified as medicines as programmable pumps
12 because the doctor could control the amount of the dosage applied to the body. We conclude that
13 neither the CT units nor the GR units qualify as medicines.

14 Petitioner has not provided documentation supporting its allegation that its GR units have a
15 useful shelf life of 12 to 18 months, nor has it identified any errors in the Department's computations
16 or provided an alternative audit method to compute a more accurate measure of taxable lease receipts.
17 We thus conclude no adjustments are warranted for this contention.

18 OTHER DEVELOPMENTS

19 Petitioner filed a claim for refund of the amounts it paid toward the determination, and after the
20 appeals conference, amended that claim for refund to include tax erroneously paid during the audit
21 period on sales of crutches, canes, and walkers. In a post-D&R reaudit, the Department computed that
22 the measure of tax erroneously paid on exempt sales of crutches, canes, and walkers was \$187,773,
23 which was applied as an offset against the audit deficiency. Our understanding is that petitioner agrees
24

25
26 ¹ The memorandum opinion notes that orthotic devices qualify for exemption if worn on the body, and that the regulation
27 expressly states that if *any* part of the device is not worn on the person, the device does not qualify for the exemption. The
28 opinion notes that the taxpayer in that matter provided CPM machines that were fully worn on the body (and thus qualified
for exemption under the statute and regulation), and also the ones in dispute that were not fully worn on the body (and thus
were expressly excluded from exemption under the statute and regulation). The opinion goes on to note that both types of
devices provided the "identical medical rehabilitation purpose," and finds that the devices in dispute in that appeal should
be regarded as medicines even though not fully worn on the patient's body as required by the regulation.

1 with the amount of this adjustment. With this adjustment, for the reasons explained above, we
2 conclude that the claim for refund should be denied.

3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

Summary prepared by David H. Levine, Tax Counsel IV