



**STATE BOARD OF EQUALIZATION**

1020 N STREET, SACRAMENTO, CALIFORNIA  
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001  
TELEPHONE (916) 920 - 7445

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August 29, 1994

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BURTON W. OLIVER  
*Executive Director*

X-----

Re: X-----  
Leasing Hemodialysis Equipment

Dear X-----,

I am responding to your fax to me of July 8, 1994, and our telephone conversation of the same day. You ask about the application of tax to X----- leases of Kidney Dialysis, Re-Use, and Reverse Osmosis machines in California. In you letter you in indicate that the Re-Use machine is used to clean artificial kidneys after they have been used on the hemodialysis machine. In our telephone conversation you clarified that the Reverse Osmosis machine is used to purify the dialysis water as it goes into the patient. I assume from the nature of your questions that X----- buys these machines ex-tax and collects tax, if any is owed, on the rental payments.

**OPINION**

**A. Sales and Use Tax Generally.**

In California, except where specifically exempted by statute, Revenue and Taxation Code section 6051 imposes an excise tax, computed as a percentage of gross receipts, upon all retailers for the privilege of selling tangible personal property at retail in this state. (Unless otherwise noted, all statutory references are to the Revenue and Taxation Code.) Likewise, section 6201 imposes a use tax on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer for use, storage, or other consumption in this state unless otherwise exempted from taxation by statute. The lease (or rental) of tangible personal property in California is a continuing sale unless that property is leased in substantially the same form as acquired by the lessor and the lessor has paid sales tax reimbursement or use tax measured by the purchase price of the property. (Rev. & Tax. Code §§ 6006(g) (5), 6006.1; Reg. 1660.) If the lease is a continuing sale under this definition, that lease is subject to use tax measured by rentals payable unless it is specifically exempted by statute. (Reg.1660(c) (1).) Where the lease is treated as a sale, but not a sale at the inception, the lessor may either pay the use tax measured by the sales price up front or may elect to purchase the item ex-tax and pay use tax measured by the rental receipts as to payments are made. (§§ 6010(c) (5) & 6011(b); Reg. 1660 (c) (1).) The lessor is treated as the retailer of the property and must collect the use tax from the lessee. (§ 6203(c); Reg. 1660(c)(1).

## B. Prescription Medicines.

Section 6369, interpreted and implemented by Title 28, California Code of Regulations, Regulation 1591, 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 or use tax. (Reg. 1591(a).) Subdivision (b) (1) defines "medicine" to "mean and include 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 which is commonly recognized as a substance or preparation intended for such use." However, Regulation 1591(c) (2) adds that "medicines" do not include "articles which are in the nature of splints, bandages, pads, compresses, supports, dressings, instruments, apparatus, contrivances, appliances, devices, or other mechanical, electronic, optical or physical equipment or article or the component -parts- -and accessories thereof." ( Sales and Use Tax Regulations are Board promulgations which have the force and effect of law.) As a rule, then, items used to diagnose a condition or to apply medicine or treatment to the patient are not considered to be medicines.

Regulation 1591(b) does provide that certain items which might otherwise be considered as being devices, etc., are defined as "medicines." Sub-division (j) includes any appliances and related supplies necessary as a result of any surgical procedure by which an artificial opening is created in the human body for the elimination of natural waste. Interpreting and implementing section 6369.1, it specifically defines kidney dialysis machines, and the tubing, pumps, blood sets, fistula sets, and shunts used in connection with such machines as "appliances" and "related supplies." We have previously determined that ":-elated supplies" must be necessary and integral to the proper functioning of the dialysis machines themselves or preparations intended for external or internal application to the body of the patient undergoing dialysis. Accordingly, items are used by technicians while operating the dialysis process or which are not utilized by the dialysis patient are not exempt from tax under this section.

## C. Tax Consequences to X-----

Hemodialysis machines themselves are specifically listed in Regulation 1591(j) as being deemed to be dispensed on prescription within the meaning of sub-division (a). We have already concluded that such machines qualify as medicines the sales or leasing of which are exempt from tax. We have also previously determined that products used to clean hemodialysis machines after treatment of a patient are not "related supplies" as they are not necessary and integral to the operation of the dialysis machine nor are they applied to the body of the patient. While we have not considered before the application of tax to sales of Re-Use machines, we have reviewed various other water-purification systems and determined that, while water purification may be necessary for proper hemodialysis it is not necessary and integral to the operation of the dialysis machine itself. The purified water goes into the hemodialysis machine, but the Re-use machine is not applied to the patient. These two machines are thus appliances or devices excluded from the term "medicines" under Regulation 1591(c) (2).

As a result of the foregoing, X----- must collect from the lessees use tax on such leases of the Re-Use and Reverse Osmosis machines as the leases are continuing sales and purchases in this state, as defined above. Such use tax would also include the use tax of any taxing district into which the machine was shipped. (Reg. 1827(c) (3).) If, however, X----- pays sales tax at the time it purchases the equipment or California use tax measured by the

purchase price when it leases the equipment into California, there is no tax owed on the rental payments. In that case, if the sales tax rate where X----- buys the equipment is less than California's statewide rate of 7.25%, then, in order to avoid use tax being applied to the rental payments when leasing it in California, X----- will need to report use tax on the purchase price measured by the California statewide rate and then take a credit against that amount in the amount of the purchasing state's sales tax. (§ 6406.) (District use tax does not apply in this case.) It would then remit the difference with the return for the period in which the machine is leased.

For your information, I have included a copy of Board of Equalization Pamphlet No. 44, "District Taxes," and Regulations 1660 and 1827. I hope the above discussion has answered your question. If you need anything further, please do not hesitate to write again.

Sincerely,

John. L. Waid  
Tax Counsel

JLW:es

Enclosures: Pamphlet No. 44  
                  Regs. 1660 & 1827

Cc: OH – District Administrator