STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**04/24/07**	Bill No:	**AB 857**
Tax:	**Sales and Use**	Author:	**Galgiani**
Related Bills:			

BILL SUMMARY

This bill would specify that insulin, insulin syringes, skin puncture lancets, and glucose test strips furnished by a registered pharmacist or *any retailer* to a person for treatment of diabetes shall be deemed to be dispensed on prescription for purposes of the sales and use tax exemption for sales and purchases of medicines.

ANALYSIS

CURRENT LAW

Under existing law, except where specifically exempted by statute, sales 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, and physical equipment, are included within the term "medicine" and the sale or use qualifies 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.

The sale of glucose test strips or skin puncture lancets for use by a person other than the diabetic patient or the furnishing of such items by other than a pharmacist is subject to tax. This is true even if the items are furnished by a health facility or administered by hospital personnel. In addition, even though used in connection with the treatment of diabetes, the sales or use tax applies to the sale or use of test kits and equipment used to analyze, monitor, or test samples of blood or other bodily fluids, as for example, electric blood monitors. Also, sales and purchases of insulin delivery devices other than syringes, such as insulin pens, insulin pumps, and insulin jet injectors are subject to tax.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

PROPOSED LAW

This bill would amend Section 6369 of the Sales and Use Tax Law to include within the term "medicines," insulin and insulin syringes, skin puncture lancets and glucose test strips furnished by a registered pharmacist or any retailer to a person for 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 after the effective date.

BACKGROUND

During the 2001-02 Legislative Session a similar bill was vetoed by Governor Gray Davis. In his veto message Governor Davis wrote, "I am sympathetic to those who have a legitimate medical need for lancets and glucose test strips and whose medical treatment is under the supervision of a medical doctor. However, those persons may already purchase these products from a pharmacist without paying sales tax on these products. I am therefore vetoing this bill because it would continue to erode the tax base and could result in annual General Fund revenue losses in excess of $1 million."

COMMENTS

1. **Sponsor and purpose.** Assembly Member Galgiani is sponsoring this measure in an effort to, in part, codify the Board's regulation, and to eliminate the requirement that, to be exempt, the diabetes supplies must be furnished by a registered pharmacist. According to the author's office, these items may be purchased with or without the assistance of a registered pharmacist, and the Board "is unable to differentiate between those items sold by a pharmacist and those not sold by a pharmacist. This bill removes the pharmacist from the picture, simplifying the auditing of sales tax and ensuring that medically necessary items are not taxed."

2. **The bill would include sales of these items by any retailer, including a registered pharmacist, within the prescription medicine exemption.** Under the law and the Board's regulation, in order for the sale and purchase to be exempt from tax, the insulin and syringes, as well as test strips and lancets must be furnished by a registered pharmacist. This bill would, in addition, extend this exemption to these items when they are furnished by any retailer, provided the items are furnished to a person for treatment of diabetes as directed by a physician.

3. **Bill would ease administration and simplify record keeping for retailers.** As with all exemptions, the more conditions that apply, the more difficult the administration of that exemption becomes. Under current law, if a consumer purchases these items through the pharmacist's register, the exemption would apply. If they are purchased through a separate cashier, the exemption would not apply. From a practical standpoint, having an exemption hinge on what cash register the items are rung through seems illogical. This bill would eliminate that condition, and would simplify both the Board's administration of the exemption as well as retailers' compliance.

4. **Board has been involved in litigation indirectly related to this issue.** Last year, the Board was named as a cross-defendant in a California class action claim against several retailers, including Wal-Mart, Sav-On Drugs, Longs Drug Stores, Rite Aid, Walgreen, Target, Albertson's and Vons, where the plaintiffs moved for a legal determination that the Board's Regulation 1591.1 (discussed on the first page

of this analysis) renders purchases of lancets and glucose test strips exempt from tax in all circumstances and without exception. The plaintiffs argued that any retail store having a pharmacy is a "registered pharmacist" and that a purchase of these items anywhere in the store should be exempt. Among other things, the Court found that "furnished by a registered pharmacist" means the lancet or glucose test strip must be purchased behind the counter from a licensed pharmacist or his or her staff and that the language set forth in the Board's regulation demonstrates that the Board did not intend to unconditionally exempt lancet and glucose test strips. The case, although still pending, will likely be ultimately dismissed for lack of prosecution.

5. **Should the exemption include other insulin delivery devices?** The exemption for sales and purchases of insulin syringes was added to law in 1982. At that time, the syringe was essentially the only route of delivery of insulin therapy to diabetic patients. Since then, advances in medicine have resulted in replacing the needle and syringe with other insulin delivery devices that are less intrusive and less painful, such insulin pens, insulin pumps, and insulin jet injectors. Should the exemption incorporate sales and purchases of more modern forms of insulin delivery devices?

6. **Technical amendment recommended.** Since test strips and lancets are actually used for blood sugar testing, rather than for the *treatment* of diabetes, it is recommended that on page 4, line 22, the language be amended as follows:

   a person for <u>blood sugar testing for</u>, or treatment of<u>,</u> diabetes as directed by a physician shall

COST ESTIMATE

Some administrative costs would be incurred in notifying retailers, revising the Board's applicable regulation and responding to inquiries. An estimate of these costs is pending.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

According to the Center for Disease Control and Prevention (CDC), there were 20.8 million persons with diabetes in the U.S. in 2005; 14.6 million diagnosed and 6.2 million undiagnosed.

The California Department of Health Services has estimated that over 2 million Californians suffer from diabetes, with an estimated 600,000 of these undiagnosed. For this estimate, we consider the diagnosed cases only (1.4 million) since these are the patients buying the diabetic supplies. An estimated 10 percent or 140,000 of these cases are type 1 diabetics (10% × 1.4 million = 140,000). The remaining 90% or 1.3 million are type 2 diabetics (90% × 1.4 million = 1.3 million).

Sales of Glucose Test Strips. An article entitled, *Blood Glucose Monitors*, published by Southwestern Oklahoma State University, College of Pharmacy, disclosed that depending on the purchase location, a box of 50 blood glucose test strips may sell for $30 to $40.

A typical patient with type 1 diabetes may test about 4 times a day or even more. If all type 1 diabetics are using four strips a day at a cost of 70 cents per strip, sales to these patients would be $143 million ($0.70 × 4 × 365 × 140,000 = $143 million).

If half of the type 2 diabetics are using 2 strips per day, sales to these patients would be $332 million ($0.70 × 2 × 365 × 650,000 = $332 million).

Estimated total sales of test strips would be $475 million ($143 million + $332 million).

Sales of lancets. The number of lancets a diabetic patient uses is the same as test strips. This amounts to 679 million. Lancets cost $10 for 200 or 5 cents each. Total lancet sales therefore are $34 million (679 million lancets × $0.05 = $34 million).

Insulin. Persons with Type 1 diabetes no longer produce insulin, and they must have daily insulin injections to use the glucose they obtain from eating. In relation to Type 2 diabetes, some take insulin injections, but most do not. Literature reviewed suggests that at least 20% of adults diagnosed with diabetes take insulin. In California's case, this would be an estimated 280,000 cases (20% × 1.4 million = 280,000).

A January 11, 2007 New York Times article, *Bridling at Insulin's Cost, States Push for Generics,* disclosed that the average monthly cost of insulin treatment in the U.S is about $115.

If we apply the $115 per month average insulin cost to the estimated 20% of the population (280,000) taking insulin, total sales is estimated to be $387 million ($115 × 12 × 280,000 = $387 million).

Our conversations with an industry coalition indicated that about 2% of insulin sales would be purchased over-the-counter as majority of the patients purchase insulin with prescriptions. A 2007 diabetes resource guide produced by the American Diabetes Association, indicates that rapid–acting insulins, such as insulin lispro, insulin aspart and insuline glusine, are only available by prescription.

It is estimated that insulin sales furnished by retailers would be $8 million (2% × $387 million = $8 million) annually.

Insulin Syringes. A typical patient with Type 1 diabetes, on average, may dose insulin three times a day. Those with Type 2 diabetes, many of whom combine oral medication with injected insulin, dose insulin on average twice a day.

Syringes seem to come in various brands and specifications and prices for 100 syringes seem to range from $20 to $50. A study by the International Diabetes Federation indicated that the average cost of 100 insulin syringes in North America was about $24. This amounts to $0.24 per syringe ($24 / 100 syringes = $0.24 per syringe).

If all Type 1 diabetics were using syringes 3 times a day at a cost of $0.24 per syringe, sales to these patients would be $37 million ($0.24 × 3 × 365 × 140,000 = $37 million).

If 140,000 Type 2 diabetics were using syringes 2 times a day at a cost of $0.24 per syringe, sales to these patients would be $25 million ($0.24 × 2 × 365 × 140,000 = $25 million).

Total syringe sales are estimated to be $62 million annually.

<u>Total Annual Estimated Sales: Glucose Strips, Lancets. Insulin, Insulin Syringes</u>

- Glucose Test Strips $475 million

• Lancets	34 million
• Insulin	8 million
• Insulin Syringes	62 million
Total Estimated Sales	$579 million

The above-estimated sales of glucose test strips, lancets and insulin syringes reflect total sales in the market place, i.e., it is both prescription and over the counter. We do not know the amount or percentage that would reflect over-the-counter sales. We assume that about 20% of the total sales would be over-the-counter sales which would amount to $114 million (20% × $571 million = $114 million).

It is estimated that total sales of insulin, insulin syringes, glucose strips, and lancets furnished by any retailer would amount to $122 million ($114 million + $8 million insulin sales) annually.

REVENUE SUMMARY

The annual revenue loss from exempting $122 million in sales of insulin, insulin syringes, glucose strips, and lancets from the sales and use tax would be as follows:

	Revenue Effect
State loss (5%)	6.1 million
Fiscal Recovery Fund loss (0.25%)	0.3 million
State loss	6.4 million
Local & district loss	
Local loss (2.00%)	2.4 million
Special District loss (0.69%)	0.8 million
Local loss	$3.2 million
Total loss	$9.6 million

Analysis prepared by:	Sheila T. Waters	445-6579	05/08/07
Revenue estimate by:	Ronil Dwarka	445-0840	
Contact:	Margaret S. Shedd	322-2376	

0857-1sw.DOC

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.