

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION SUMMARY FOR BOARD HEARING

3 In the Matter of the Petition for Redetermination)
 4 Under the Sales and Use Tax Law of:)
 5 ULTRADENT PRODUCTS, INC.) Account Number: SC OH 97-322278
 6) Case ID 215829
 7)
 8 Petitioner) South Jordan, Utah

8 Type of Business: Manufacturer of dental products and materials

9 Audit Period 1/1/96 – 12/31/98

10 <u>Item:</u>	<u>Amount in Dispute</u>		
11 Unreported taxable sales of dental products	\$8,232,610		
		<u>Tax</u>	<u>Penalty</u>
12 As determined	\$1,125,522.84		\$107,552.34
13 Adjustments: Appeals Division	-62,296.22		-107,552.34
14 Proposed redetermination	\$1,063,226.62		<u>\$ 0.00</u>
15 Amount concurred in	417,661.66		
16 Protested	<u>\$ 645,564.96</u>		
17 Proposed tax redetermination	\$1,063,226.62		
18 Interest (tax fully paid on 6/30/05)	153,636.80		
Total tax and interest	\$1,216,863.42		
19 Payments received	-1,125,554.72		
Balance due	<u>\$ 91,308.70</u>		

20 This matter was previously scheduled for Board hearing on June 30, 2005, but was deferred for
 21 further review. It was then rescheduled for Board hearing on January 31, 2007, but was deferred so
 22 that the Sales and Use Tax Department (Department) could determine if any of the questioned
 23 transactions considered taxable in the audit qualify as exempt sales of prescription medicines under an
 24 amendment to California Code of Regulations, title 18, section (Regulation) 1591. The Department
 25 made several attempts to contact petitioner, but petitioner has not provided any new information
 26 regarding these products. The Department also made its own review, and concluded that the products
 27 in issue do not meet the definition of medicines under Regulation 1591, subdivision (a)(9).
 28 Accordingly, the Department recommends that no adjustments be made to the audit liability. This

1 matter was then rescheduled for Board hearing on April 15, 2009, but petitioner's representative
2 requested postponement for religious reason.

3 UNRESOLVED ISSUES

4 **Issue 1:** Whether petitioner has established that sales of six categories of its products were
5 sales of medicines exempt from tax under Revenue and Taxation Code section 6369. We conclude
6 that sales of the six categories of products were not exempt sales of medicines.

7 Petitioner is a Utah manufacturer of dental products and materials, selling them to dentists and
8 dental clinics, and is engaged in business in this state by virtue of its authorized representatives who
9 travel throughout the state demonstrating its products. Petitioner contends that many of its sales were
10 exempt sales of medicines. The Department asked petitioner to make a list of the items it contends are
11 medicines. The Department submitted that list, together with a copy of petitioner's catalog, to the
12 Legal Department requesting an opinion as to whether these items qualify as medicines for purposes of
13 the exemption. The Legal Department issued a memorandum dated August 16, 2001, concluding that,
14 for various reasons, most of the products do not qualify as medicines. Based upon this opinion, the
15 Department assessed tax on petitioner's sales of the respective items to California purchasers. The
16 Department issued a Notice of Determination to petitioner for \$1,125,522.84 tax, measured by
17 \$14,353,720 for unreported taxable sales of dental products. The determination also included a failure
18 to file returns penalty of \$107,552.34.

19 Thereafter, petitioner refined its list of medicines and filed its petition, contending that its sales
20 of eight categories of products qualify as exempt sales of medicines. We conclude that two of the
21 eight categories of products qualify as exempt sales of medicines. Thereafter, the Department prepared
22 reaudit schedules dated March 15, 2005, in which the sales of these two categories of products were
23 deleted. This resulted in the measure of tax being reduced by \$794,852, from \$14,353,720 to
24 \$13,558,868. The following is a discussion of the remaining six categories of products, which are still
25 in dispute. Next to each category title is the amount of measure applicable to that category.

26 EndoSeal (\$44,024)

27 EndoSeal is an endodontic sealant which is sold in a pre-filled syringe and which is used to
28 close off and protect the open end of a root canal. It is used to seal the opening, forming a barrier so

1 that bacteria in the bone do not enter the root canal system, and so that bacteria and tissue-breakdown
2 by-products do not leave the root canal system to infect the bone in either the maxilla or mandible.

3 Petitioner contends that EndoSeal is not a prosthetic application because it is not replacing or
4 augmenting the tooth, but is applied to prevent infection and pain. Petitioner argues that, since the
5 syringe is pre-filled with a substance that, it asserts, is a medicine, the sale of this product is exempt
6 from sales and use tax.

7 EndoSeal is applied as one of the steps performed after removal of the root in the preparation of
8 the tooth for filling. Petitioner does not dispute that the filling is a prosthetic material that is not a
9 medicine for purposes of the exemption. EndoSeal is merely a component part of the filling process
10 necessary to fill the hole left by the removal of the root; that is, EndoSeal is a dental prosthetic material
11 as that term is used in Regulation 1591, meaning that it is not a medicine for purposes of the
12 exemption. (Cal. Code Regs., tit. 18, § 1591, subd. (b)(5).) We, therefore, conclude that petitioner's
13 sales of EndoSeal are subject to tax.

14 Opalescence (\$6,770,073)

15 Petitioner's product catalogue states that Opalescence is the first ADA accepted, syringe-
16 delivered, take home bleaching gel. The Department concluded that this product does not treat a
17 medical condition but merely temporarily whitens teeth. Therefore, the Department concluded that
18 this product is cosmetic and does not qualify as a medicine under Regulation 1591, subdivision (b)(1).

19 Petitioner notes that while bleaching is often done for cosmetic reasons, there are a number of
20 other medical indications for tooth bleaching, such as abnormal staining and darkening caused by
21 trauma to a tooth or a root canal. In addition, darkening of the teeth can be a secondary effect of
22 certain drug treatments, especially in children. Petitioner notes that it sells to dentists, who may use
23 the material for any indicated purpose, and argues that it cannot be assumed that the product is used
24 only for cosmetic purposes. In addition, petitioner contends that there is a difference between cleaning
25 and bleaching. There are two types of tooth staining, external and internal. Bleaching penetrates the
26 tooth, treating internal staining. Petitioner contends that this is further evidence that this product is
27 medicine.

1 This is a bleaching agent that is cosmetic in nature, and it is irrelevant whether the bleaching
2 treats internal or external staining. It does not treat pain, nor does it treat any of the alleged medical
3 conditions that may result in darkening of the teeth. Accordingly, we conclude that Opalescence is not
4 medicine, and that petitioner's sales of this product are subject to tax.

5 Ultra-Blend Plus (\$62,944)

6 This material is used as a base cavity liner prior to placement of composite or amalgam fillings.
7 It is also used to treat or prevent pulpitis, which is an inflammation of the tooth. The Department
8 equates it with the composite or amalgam filling, and concluded that it was a dental prosthetic material
9 excluded from the medicine exemption as explained in subdivision (b)(5) of Regulation 1591.

10 Petitioner explained that this substance is not integral to the filling material. Ultra-Blend Plus
11 is used to seal the pulp area of the tooth to prevent pain and irritation. It is independent of the
12 composite or amalgam filling, which is the prosthesis. The composite or amalgam could be put in
13 without this product, and the patient would have the same built-up tooth, but there would be a greater
14 likelihood of having pain.

15 We conclude that this substance is a component part of the prosthesis, being one of the
16 recommended, if not necessary, parts of the process of preparing the tooth for the filling following a
17 dental procedure. Even if it has a separate role in making the filling less painful or subject to
18 inflammation, it is still being applied as a part of the filling process, which itself (even without this
19 product) presumably helps prevent pain and inflammation. As such, this product is a prosthetic
20 material as contemplated by subdivision (b)(5) of Regulation 1591, not a medicine, and its sales by
21 petitioner are subject to tax.

22 Ultra-Pak Knitted Displacement Cord (\$837,690)

23 This is a knitted cord that is used to displace or deflect gingival tissue around a tooth so that a
24 clean impression can be taken. The Department concluded that this material appeared to be a dressing
25 excluded from the medicine exemption as explained in subdivision (c)(2) of Regulation 1591.

26 Petitioner contends that this material is being applied to the body to treat the tooth. It further contends
27 that the cord is not used as a dressing and does not function as a cover over a sore or lesion to promote
28

1 healing or to protect the tooth or tissue. However, petitioner admits that the cord served the same
2 purpose as, and could be in the nature of, retractors.

3 We conclude that this product is not a medicine as defined in section 6369 and Regulation
4 1591, subdivision (b), but rather is a physical instrument, apparatus or device used to assist the dentist
5 to take the impression. Articles of this nature are excluded from the definition of medicines by the
6 provisions of Regulation 1591, subdivision (c)(2); petitioner's sales of this product are subject to tax.

7 UltraSeal XT (\$501,120)

8 UltraSeal XT is a sealant material intended for application on top of a normal, healthy tooth.
9 The Department treated this material as a dental prosthetic material excluded from the medicine
10 exemption as explained in subdivision (b)(5) of Regulation 1591. Petitioner contends that the purpose
11 of the application is to function as a barrier to seal out food, sugars, and bacteria so they do not invade
12 the grooves on the tooth and cause cavity-generating material, acting as a prophylactic to prevent
13 disease. Petitioner further contends that this material is not a prosthetic device in that it does not
14 replace or assist the functioning of a natural part of the human body.

15 We conclude that UltraSeal XT essentially replaces or supplements the function of the tooth
16 enamel, a natural part of the human body, and therefore is primarily a dental prosthetic device or
17 material, sales of which do not qualify for the medicine exemption.

18 Universal Dentin Sealant (\$16,759)

19 This is another sealant that forms a barrier against bacteria, acids, resins and cements.
20 According to petitioner, it is usually applied to the root of a tooth that has sensitivity due to toothbrush
21 abrasion or periodontal therapy and helps to eliminate or reduce the sensitivity. The Department
22 concluded that this product was a dressing excluded from the medicine exemption as explained in
23 subdivision (c)(2) of Regulation 1591. Petitioner contends this sealant qualifies as a medicine in that it
24 is applied to the body to treat and seal out pain and prevent infection. As such, it is used in the
25 treatment, cure, and prevention of disease.

26 We conclude that this material is used as a sealant, similar to UltraSeal XT discussed above.
27 That is, this product essentially replaces or supplements the function of the tooth enamel, a natural part
28

1 of the human body, and therefore is primarily a dental prosthetic device or material, sales of which do
2 not qualify for the medicine exemption.

3 **Issue 2:** Whether petitioner has established grounds for relief of interest on the tax owed. We
4 conclude that petitioner has not established grounds for relief of the interest.

5 Petitioner contends that it should be relieved of some or all of the interest because it voluntary
6 came forward to apply for a permit and participated in the Managed Audit Program. We note that the
7 only grounds set forth in statute for relief from interest are Revenue and Taxation Code sections 6593
8 (disaster), 6593.5 (unreasonable error or delay by an employee of the Board), and 6596 (reasonable
9 reliance on written advice from the Board). Petitioner has supplied no evidence that any of these
10 statutes are applicable. Therefore, we recommend no relief of any of the interest due on the tax owed.

11 **RESOLVED ISSUES**

12 As noted above, we conclude that two of the eight disputed products qualify as medicines.
13 Accordingly, we recommend that sales of these two items be deleted from the determination.
14 Additionally, we conclude that relief from the penalty for failure to file returns should be granted as
15 recommended by the Department. Petitioner initially contacted the Department, voluntarily
16 participated in the audit, and believed, in good faith, that all of its products approved by the United
17 States Food and Drug Administration were properly classified as medicines. Petitioner has also filed
18 the required statement under penalty of perjury pursuant to Revenue and Taxation Code section 6592.

19 **AMNESTY**

20 The amnesty interest penalty is not applicable in this matter because petitioner successfully
21 participated in the amnesty program.

22 **OTHER DEVELOPMENTS**

23 None.

24 **RECOMMENDATION FOR MEMORANDUM OPINION**

25 Whether particular items qualify as medicines for purposes of the exemption are often difficult,
26 and we believe that adoption of a memorandum opinion in this case will help to better educate
27 taxpayers and their representatives in this area. We thus recommend the adoption of a memorandum
28

1 opinion which covers the six products we conclude do not qualify as medicines as well as the two
2 products we conclude qualify as medicines.

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 Rey Obligacion, Business Taxes Specialist III