

STATE OF NORTH CAROLINA
COUNTY OF WAKE

IN THE OFFICE OF
ADMINISTRATIVE HEARINGS

Feeling Great Inc Petitioner v. NC DEPARTMENT OF REVENUE Respondent	13REV18080
Sleep Medical Center Inc Petitioner v. NC DEPARTMENT OF REVENUE Respondent	13REV18081

FINAL DECISION

THIS MATTER came on to be heard before the Honorable J. Randolph Ward, Administrative Law Judge presiding at the May 6, 2014 hearing held at the Office of Administrative Hearings in Raleigh, North Carolina.

APPEARANCES

For Petitioner: David C. Franklin
Attorney at Law
3400 Croasdaile Drive, Suite 205
Durham, North Carolina 27705

For Respondent: Perry J. Pelaez
Assistant Attorney General
North Carolina Department of Justice
Post Office Box 629
Raleigh, North Carolina 27602

ISSUES

Whether Petitioners have satisfied their burden to demonstrate that supplies purchased from an out-of-state vendor, which were stored, used, or consumed in the State of North

Carolina, should be exempt from use taxes pursuant to N.C. Gen. Stat. § 105-164.13(12)d., which authorizes an exemption for “durable medical supplies.”

EXHIBITS

The parties introduced the following exhibits admitted into evidence at hearing:

Petitioners:

Exhibit No.	Description
1	Sales and Use Technical Bulletin 13-3 (dated 8/1/2000)
2	Sales and Use Technical Bulletin 13-1 (dated 12/1/2008)
3	Sales and Use Technical Bulletin 11 (pages 1-2)
4	Petitioners’ Responses to Interrogatory Nos. 24 & 25
5	Copy of package inserts for products ordered from MVAP
6	Policy & Procedures of American Academy of Sleep Medicine page 55

Respondent:

1	2007 Invoices from MVAP
2	Sleep Study Prescription
3	Sleep Study Prescription
4	Sleep Study Prescription and Prescription to purchase supplies
5	Sleep Study Prescription and Prescription to purchase supplies
6	Sleep Medical Billing Statements
7	Sleep Medical Center 2014 Policies Procedures
8	MVAP Invoices 2004-2010
9	Feeling Great Notice of Final Determination
10	Sleep Medical Notice of Final Determination
11	The Department’s Spreadsheet of Feeling Great’s Purchases from MVAP
12	The Department’s Spreadsheet of Sleep Medical’s Purchases from MVAP

WITNESSES

For Petitioners: Sandra Wrightenberry, President of Petitioners
 Jeff Shumaker, Clinical Supervisor for Petitioners

For Respondent: Ginny Upchurch, Assistant Director of Sale and Use Tax Division, North Carolina Department of Revenue

UPON DUE CONSIDERATION of the written contentions of the parties, the exhibits admitted, and the sworn testimony of each witness presented at the hearing, assessing its weight and credibility in light of the demeanor of the witness; the opportunity of the witness to see, hear, know, and recall relevant facts and occurrences; the interests and predisposition of the witness; whether the testimony of the witness is reasonable and consistent with the other credible evidence; and, based upon the preponderance of the evidence, giving due regard to the demonstrated knowledge and expertise of the agency with respect to facts and inferences within the specialized knowledge of the agency, the undersigned Administrative Law Judge makes the following:

FINDINGS OF FACT

1. Petitioner Feeling Great, Inc. (hereinafter, "Feeling Great"), headquartered in Durham, North Carolina, began business in 2001 selling durable medical equipment. In 2003, it opened a sleep diagnostic testing facility. For business reasons attributed to a change in federal laws, the testing facility was separated and incorporated as Sleep Medical, Inc. ("Sleep Medical") in 2007. On April 4, 2012, Respondent issued Proposed Assessments totaling approximately \$29,000.00 for failure to pay use taxes, based on audit periods of July 1, 2004 through June 30, 2010 for Feeling Great, and January 1, 2008 through April 30, 2010 for Sleep Medical.
2. Sleep Medical uses sophisticated durable medical equipment--an Alice Diagnostic Sleep System--to perform sleep studies. Patients are attached to "the Alice" by electrodes in order to gather data diagnostic of various sleep disorders (e.g., sleep apnea). Each of the five (5) diagnostic tests or procedures that Sleep Medical offers is assigned a single five-digit Current Procedural Terminology ("CPT") Code number. The medical personnel who conduct the tests--licensed Respiratory Therapists and Sleep Technologists--are trained to follow a very specific sequence of steps for each test, including the utilization of consumable supplies, as set out in procedural manuals maintained by their respective governing professional associations. Based on these sources and their own selection of equipment and supplies complying with their requirements, Sleep Medical maintains an internal procedures manual, which itself is subject to audit by the American Association of Sleep Medicine.
3. Services at Sleep Medical are initiated by a comprehensive physician's prescription--known as a "Certificate of Medical Necessity"--that includes patient information, specific clinical observations or symptoms justifying the need for the test ordered (including IDC-9 diagnosis code(s)), and designates the specific test required, typically by name (or acronym) and CPT code. Based on this document, Petitioners' clinical supervisor orders supplies for each test. These may include, e.g., scissors, gauze, tape, nail polish remover, cotton tip applicators (Q-tips), stik-it, exam gloves, disinfectant, adhesive tape remover, air fragrance, AAA batteries, alcohol prep pads, a tape measure, and a marking pencil. Some portion of the creams or adhesives used during the procedure may be left over, but most of these supplies have a single use before they are consumed or discarded. Sleep

Medical's bill to the patient and/or the patient's third-party payor bears a single amount for each test. All of these tests are covered by Medicare and Medicaid. Petitioners charge all of their patients the Medicaid-allowable amount for each test-specific CPT code. No individual supply items or particular services rendered during the course of the sleep study are itemized in the bill submitted to the payor(s). All are "bundled" under the single officially-designated CPT code number into a single price.

4. Respondent audited Petitioners' purchases from their primary medical supply source, MVAP Medical Supplies, Inc. in California, including reviews of the companies' "purchase invoices" and Certificates of Medical Necessity, and concluded that use taxes were due on most of the supplies ordered. Respondent based its tax assessments on the determination that the supplies "are not sold or dispensed to the patients on prescription," and that the "majority of the supplies at issue are disposable items that are neither 'drugs required by federal law to be dispensed only on prescription,' nor over-the-counter drugs containing a 'Drug Facts' label," as referenced in the statutory definitions of these products.
5. In its Notices of Final Determination, Respondent complained that, "Taxpayer does not bill ... for the items used in conducting the sleep study test. Rather, Taxpayer bills the patient or the patient's insurance company for the sleep study test." When cross-examined about this practice, Petitioners' Clinical Supervisor responded that it could be "illegal" to do otherwise--an apparent reference to "unbundling," one of the more notorious forms of provider fraud. As described in a Centers for Medicare & Medicaid Services ("CMS") "fact sheet:"

"Unbundling" occurs when multiple procedure codes are billed for a group of procedures that are covered by a single comprehensive code. The way this form of fraud works is that the reimbursement for the individual codes billed separately is higher than the reimbursement for the single comprehensive code that should be used. For example, a laboratory might receive an order for a panel of tests on a patient. Instead of bundling the tests and billing for them together, the laboratory might attempt to increase its income by billing for each test separately. ... Providers should be familiar with applicable Medicaid rules on which services need to be bundled or billed together.

"Common Types of Healthcare Fraud," Centers for Medicare & Medicaid Services, <http://www.cms.gov/Medicare-Medicaid-Coordination/Fraud-Prevention/Medicaid-Integrity-Education/Downloads/fwa-factsheet.pdf> [Viewed 7/11/2014]

6. Petitioners argue that their supplies are "Durable medical supplies sold on prescription," exempted by N.C. Gen. Stat. Ann. § 105-164.13(12)d. This statute was not referenced in the Notices of Final Determination, but Respondent's Assistant Director of Sale and Use Tax Division testified that under the Department's interpretation of the statute, the supplies from MVAP did not fall within this exemption.

7. N.C. Gen. Stat. Ann. § 105-164.13 reads, in pertinent part:

The sale at retail and the use, storage, or consumption in this State of the following tangible personal property, digital property, and services are specifically exempted from the tax imposed by this Article:

* * *

Medical Group.

- (12) Sales of any of the following items:

* * *

c. Durable medical equipment sold on prescription.

d. Durable medical supplies sold on prescription.

NC Gen. Stat. 105-164.3 “Definitions,” includes “(8c) Durable medical supplies. - Supplies related to use with durable medical equipment that are eligible to be covered under the Medicare or Medicaid program.”

8. The exemption of “durable medical supplies” first became law in 1999. The original version of the statute read:

Durable medical equipment and related medical supplies that are covered under the Medicare or Medicaid program and are sold on either a certificate of medical necessity or a written prescription of a physician, dentist, or other professional person licensed to prescribe. This exemption applies whether or not the item is purchased by a Medicare or Medicaid beneficiary.

Session Laws 1999-438. This language was enacted as Section 5 of Senate Bill 1112, but it was initially proposed as Senate Bill 884, introduced by then-Senator Roy Cooper. A Fiscal Note prepared by the Legislature’s staff for Senate Bill 884 indicates that the aim of the legislation was to “exempt durable medical equipment and medical sundries” that were “covered by Medicare [but] taxable under North Carolina law.” Forty-nine such items had been identified. The fiscal note uses the term “medical sundries” to describe “easily and frequently disposed of items like latex gloves, gauze, medical tape, and syringes.”

9. Revenue regulation 17 NCAC 07B .1404, “Medical Supplies and Equipment,” describes §105-164.13(12)d as exempting from the use tax “durable medical equipment and related medical supplies that are covered under the Medicare or Medicaid program and are sold on either a certificate of medical necessity or a written prescription.”
10. Medicaid routinely authorizes the purchase of durable medical equipment and associated “supplies” under a single prescription. See also, e.g., *Mazer v. N.C. Department of Health and Human Services*, 12DHR01733, 2012 WL 6902865 (NC OAH, 20 Nov. 2012), concerning purchase of a wheelchair under a “proper Certificate of Medical Necessity and Prior Approval Form signed by a ‘Provider/Board Certified Practitioner,’” and a

form labeled Attachment C to Respondent's Clinical Coverage Policy No. 5A, titled "How a Recipient Obtains Durable Medical Equipment and Supplies."

11. The unambiguous wording of §§ 105-164.13(12)d and 105-164.3(8c), taken together, and its legislative history, evinces the Legislature's intention to exempt from the use tax consumable items necessary for or associated with the use of durable medical equipment such as, and including, Petitioners' Alice Diagnostic Sleep System.
12. Petitioners timely initiated this contested case hearing before the Office of Administrative Hearings on September 24, 2013 by filing Petitions seeking review of the Notices of Final Determination issued by the North Carolina Department of Revenue on July 30, 2013.
13. To the extent that portions of the following Conclusions of Law include Findings of Fact, such are incorporated by reference into these Findings of Fact.

CONCLUSIONS OF LAW

1. To the extent that portions of the foregoing Findings of Fact include Conclusions of Law, such are incorporated by reference into these Conclusions of Law.
2. The parties and the subject matter of this contested case hearing are properly before the Office of Administrative Hearings. N.C. Gen. Stat. §§ 150B-1(e) and 150B-23.
3. The North Carolina Sales and Use Tax Act generally imposes a State and local use tax on purchases of tangible personal property . . . purchased inside or outside this State for storage, use, or consumption in this State. N.C. Gen. Stat. §§ 105-164.3(44), 105-164.3(46), 105-164.3(49), 105-164.3(50), 105-164.6, 105-468, 105-483, 105-498, and 105-517. Use tax is payable by the person who purchases the taxable tangible personal property. N.C. Gen. Stat. § 105-164.6. "Use" means the "exercise of any right, power, or dominion whatsoever over tangible personal property." N.C. Gen. Stat. § 105-164.3(49). The taxable event for assessment of the use tax occurs when possession of the property is transferred to the purchaser within the taxing state for storage, use or consumption. *Colonial Pipeline Co. v. Clayton*, 275 N.C. 215, 166 S.E.2d 671 (1969). The burden of proof rests on the petitioner challenging an agency decision. *Overcash v. N.C. Dept. of Env't & Natural Res.*, 179 N.C. App. 697, 704, 635 S.E.2d 442, 447 (2006).
4. "Special canons of statutory construction apply when the term under consideration is one concerning taxation. When the meaning of a term providing for taxation is ambiguous, it is construed against the state and in favor of the taxpayer unless a contrary legislative intent appears. But when the statute provides for an exemption from taxation, a contrary rule applies, and any ambiguities are resolved in favor of taxation. The underlying premise when interpreting taxing statutes is: Taxation is the rule; exemption the exception. In all tax cases, the construction placed upon the statute by the Commissioner of Revenue, although not binding, will be given due consideration by a reviewing court. *Despite these special rules, our primary task in interpreting a tax statute, as with all*

other statutes, is to ascertain and adhere to the intent of the Legislature. The cardinal principle of statutory construction is that the intent of the Legislature is controlling. [Emphasis the Court's.] [Citing:] *Matter of North Carolina Inheritance Taxes*, 303 N.C. 102, 106, 277 S.E.2d 403, 407 (1981).” *Cape Hatteras Electric Membership Corp. v. Lay*, ___ N.C. App. ___, 708 S.E.2d 399, 403-04 (2011).

5. “Where there is one statute dealing with a subject in general and comprehensive terms, and another dealing with a part of the same subject in a more minute and definite way, the two should be read together and harmonized, if possible, with a view to giving effect to a consistent legislative policy; but, to the extent of any necessary repugnancy between them, the *special statute, or the one dealing with the common subject matter in a minute way, will prevail over the general statute, . . .* unless it appears that the legislature intended to make the general act controlling; and this is true *a fortiori* when the special act is later in point of time, although the rule is applicable without regard to the respective dates of passage.” *National Food Stores v. Board of Alcoholic Control*, 268 N.C. 624, 628-29, 151 S.E.2d 582, 586 (1966) (quoting 82 C.J.S. *Statutes* § 369 (1953)).
6. Supplies purchased and utilized by Petitioners with durable medical equipment in performing diagnostic studies, pursuant to physicians’ Certificates of Medical Necessity, and paid for by Medicare and Medicaid, as well as other payors, with an inclusive payment determined by the single CPT code applicable to the procedure, are exempted from use taxes by the terms of N.C. Gen. Stat. Ann. § 105-164.13(12)d.

FINAL DECISION

NOW THEREFORE, based on the foregoing, it is hereby **ORDERED** that Petitioners’ claim for exemption pursuant to N.C. Gen. Stat. Ann. § 105-164.13(12)d should be, and hereby is, **ALLOWED**.

NOTICE

Under the provisions of North Carolina General Statute 150B-45, any party wishing to appeal the final decision of the Administrative Law Judge must file a Petition for Judicial Review in the Superior Court of Wake County. **The appealing party must file the petition within 30 days after being served with a written copy of the Administrative Law Judge’s Final Decision.** In conformity with the Office of Administrative Hearings’ rule, 26 N.C. Admin. Code 03.0102, and the Rules of Civil Procedure, N.C. General Statute 1A-1, Article 2, **this Final Decision was served on the parties the date it was placed in the mail as indicated by the date on the Certificate of Service attached to this Final Decision.** N.C. Gen. Stat. §150B-46 describes the contents of the Petition and requires service of the Petition on all parties. Under N.C. Gen. Stat. §150B-47, the Office of Administrative Hearings is required to file the official record in the contested case with the Clerk of Superior Court within 30 days of receipt of the Petition for Judicial Review. Consequently, a copy of the Petition for Judicial Review must be

sent to the Office of Administrative Hearings at the time the appeal is initiated in order to ensure the timely filing of the record.

IT IS SO ORDERED.

This the 12th day of August, 2014.

J. Randolph Ward
Administrative Law Judge