



North Carolina Department of Revenue

Roy Cooper
Governor

Ronald G. Penny
Secretary

May 29, 2018

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

Re: [REDACTED]
Private Letter Ruling Request
FEIN: [REDACTED]

Dear [REDACTED]:

The Department has completed its review of your firm's request for a written determination on behalf of your client, [REDACTED] ("Taxpayer"). In making this written determination, the Department has considered the facts presented in your initial request as well as any supplemental information provided to the Department in written form or via telephone conference.

This private letter ruling is a written determination issued under N.C. Gen. Stat. § 105-264.2 and applies the tax law to a specific set of existing facts furnished by you on behalf of Taxpayer. This written determination is applicable only to the taxpayer addressed herein and as such has no precedential value except to the taxpayer to whom the determination is issued on behalf of the Department.

Overview and Relevant Facts

Taxpayer is "a wholly owned subsidiary of [REDACTED] [which] is engaged in the sale and rental of medical equipment and related supplies. [Taxpayer] sells and leases the equipment and supplies to customers, including hospitals, health care providers, and individuals on a nationwide basis, including North Carolina. Some of the hospitals and health care providers are nonprofit organizations for North Carolina sales/use tax purposes, while others are not.

"One of the products that [Taxpayer] makes available to its customers is the [REDACTED] ["Product"], a [REDACTED] assisted wound care and closure system. [Product] is a system that applies controlled negative pressure [REDACTED] to a specialized wound dressing to help promote wound healing. [Product] also helps direct drainage out of the body in order [to] reduce the risk of exposure to fluids and infectious materials. [Product] is prescribed for a variety of chronic and acute wound types, such as pressure ulcers, diabetic wounds, abdominal wounds, partial-thickness burns, trauma wounds, flaps and grafts to promote healing and prevent future decline of the malfunction or deformity. [Product] must be prescribed by a physician or other individual licensed to issue a prescription for use by a patient for home care, and/or hospital,

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clinic, nursing facility and other settings. [Product] is made available to patients using one of the methods listed below:

- Physician prescribes to patient for home use and [Taxpayer] is compensated by patient or patient's insurance company (unit retained by [Taxpayer] once patient no longer requires).
- Physician prescribes to patient for use in a facility and [Taxpayer] is compensated by facility (unit retained by [Taxpayer] once patient no longer requires).
- Facilities purchase and retain ownership only administering to patient on the order or direction of an individual licensed to issue a prescription.

"[Product] consists of a computer-controlled therapy unit, canister, sterile plastic tubing, [foam] dressing, and clear . . . drape. The foam dressing is typically placed inside the wound, and one end of the tube will connect to the foam. This allows the system to perform the functions that a healthy body would. The other end of the tube will connect to the canister that connects to the [Product]. The wound area will be sealed with the drape, which creates a moist environment essential to healing and protects the wound from outside contaminants. [Product] will pull infectious materials and other fluids from the wound through the tube and collect them inside the canister.

"The Healthcare Common Procedure Coding System (HCPCS), a system developed by the Centers for Medicare and Medicaid Services, designates an allowable reimbursement amount for certain products and services, including most types of the [Product]. Thus, the [Product] is designated for reimbursement by Medicare. Also, under FDA rules, [Product] requires a prescription by the individual patient's treating physician."

During a telephone conference a representative of the Department conducted with [REDACTED], who is no longer with your firm, and [REDACTED] employee of Taxpayer, the Department was informed Taxpayer makes one initial charge for the unit, canister, foam dressing, tubing, and drapes prescribed by the patient's physician. The canister, foam dressing, tubing, and drape are disposed of after one use. Therefore, more than one of each of these items is included in the initial package. The pricing of [Product] is determined by the doctor's prescription of the number of days of therapy for the patient. The number of canisters, foam dressing, tubing, and drapes sold to the patient is based on the duration of the therapy prescribed by the doctor.

In addition, Taxpayer maintains records for sales on prescription in two ways:

1. Sales to patient (at home or in medical facility) – Taxpayer has copies of the prescriptions from these sales.
2. Sales to medical facilities – These are rentals to medical facilities. Taxpayer does not have copies of prescriptions for these sales because the medical facilities maintain copies of the prescriptions. The patient's name is made available to Taxpayer, and Taxpayer may possibly request a copy of the patient's prescription, if needed.

Your firm's letter states that "[Taxpayer] began collecting and remitting sales tax on all of its sales and leases of products in North Carolina." It also states that "while the FDA requires that a patient be prescribed [Product] for wound care therapy by a physician, [Taxpayer] has not previously retained copies of all prescriptions because many of the [Products] prescribed are used on a

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patient in a medical facility, and the medical facilities are required to retain copies of the prescriptions.”

Issue

Are Taxpayer’s sales and leases of Product to customers in North Carolina subject to sales and use tax?

Applicable Statutes and References

Under Chapter 105 of the North Carolina General Statutes, Article 5 (“Article”) of the North Carolina Revenue Act (“Act”)¹, N.C. Gen. Stat. § 105-164.1 *et. seq.*; Subchapter VIII, Local Government Sales and Use Tax, N.C. Gen. Stat. § 105-463 *et. seq.*; and Chapter 1096 of the 1967 Session Laws; the applicable State, applicable local, and applicable transit rates of sales and use taxes are imposed on a retailer engaged in business in the State on the retailer’s net taxable sales or gross receipts of tangible personal property, certain digital property, and certain services. N.C. Gen. Stat. §§ 105-164.3(1k), 105-164.3(9), 105-164.3(14), 105-164.3(24), 105-164.3(35), 105-164.3(46), 105-164.4, 105-164.8, 105-467, 105-468, 105-483, 105-498, 105-507.2, 105-509.1, and 105-537.

N.C. Gen. Stat. § 105-164.13(12)(c) and (d) provide exemptions from sales and use tax for the sale at retail and the use, storage, or consumption in this State of “[d]urable medical equipment sold on prescription” and “[d]urable medical supplies sold on prescription.”

N.C. Gen. Stat. § 105-164.3(8b) defines the term “durable medical equipment” as “[e]quipment that meets all of the conditions of this subdivision. The term includes repair and replacement parts for the equipment. The term does not include mobility enhancing equipment.

- a. Can withstand repeated use.
- b. Primarily and customarily used to serve a medical purpose.
- c. Generally not useful to a person in the absence of an illness or injury.
- d. Not worn in or on the body.”

N.C. Gen. Stat. § 105-164.3(8c) defines the term “durable medical supplies” as “[s]upplies related to use with durable medical equipment that are eligible to be covered under the Medicare or Medicaid program.”

N.C. Gen. Stat. § 105-164.3(29) defines the term “prescription” as “[a]n order, formula, or recipe issued orally, in writing, electronically, or by another means of transmission by a physician, dentist, veterinarian, or another person licensed to prescribe drugs.”

N.C. Gen. Stat. § 105-164.4(a)(2) provides that “[t]he applicable percentage rate applies to the gross receipts derived from the lease or rental of tangible personal property by a person who is engaged in business of leasing or renting tangible personal property, or is a retailer and leases or rents property of the type sold by the retailer. The applicable percentage rate is the rate and the maximum tax, if any, that applies to a sale of the property that is leased or rented. A person

¹ References to the Act and North Carolina General Statutes are based on the laws in effect as of the date of issuance of this private letter ruling except as otherwise noted herein.

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who leases or rents property shall also collect the tax imposed by this section on the separate retail sale of the property.”

17NCAC 07B.1801 provides in part, “[h]ospitals, sanitariums, nursing homes, and rest homes are primarily engaged in rendering services and are considered the users or consumers of all tangible personal property they purchase for use in connection with these institutions.”

N.C. Gen. Stat. § 105-164.22 provides, in part, that “[r]etailers . . . must keep records that establish their tax liability . . . [a] retailer’s records must include records of the retailer’s gross income, gross sales, net taxable sales, and all items purchased for resale. Failure of a retailer to keep records that establish that a sale is exempt under [Article 5 of Chapter 105 of the North Carolina General Statutes] subjects the retailer to liability for tax on the sale.” Additionally the local and transit sales and use taxes imposed under Articles 40, 42, 43, and 46 of Chapter 105 of the North Carolina General Statutes and Chapter 1096 of the 1967 Session Laws are administered in the same manner as the taxes imposed under Article 5 of Chapter 105 of the North Carolina General Statutes with a few exceptions.

N.C. Gen. Stat. § 105-164.11(a) provides, in part, that when tax “is collected on an exempt or nontaxable sale, the total amount collected must be remitted to the Secretary. . . . If the Secretary determines that the seller overcollected tax on a transaction, the Secretary may allow a refund of the tax. The Secretary may allow the refund only if the seller gives the purchaser credit for or a refund of the overcollected tax.”

The North Carolina Division of Medical Assistance defines the term “negative pressure wound therapy (NPWT)” as “the use of an electrical pump to convey sub-atmospheric pressure to a specialized wound dressing and thereby promote wound healing” in Section 5.3.5 of the Medicaid and Health Choice Clinical Coverage Policy No: 5A as amended November 1, 2016.

Ruling

Based on the information provided, the Product sold or leased by Taxpayer consists of a computer-controlled therapy unit which meets all the required elements of the term “durable medical equipment” as defined in N.C. Gen. Stat. § 105-164.3(8b) and a canister, foam dressing, sterile plastic tubing, and a clear drape, all of which meet the definition of the term “durable medical supplies” as defined in N.C. Gen. Stat. § 105-164.3(8c). Therefore, Taxpayer’s sales and leases of the Product directly to patients are exempt from North Carolina sales and use tax when sold or leased on prescription pursuant to N.C. Gen. Stat. § 105-164.13(12)(c) and (d).

Taxpayer advises that the foam dressing, tubing, drape, and canister can be sold separately if the patient needs extra supplies. These items meet the definition of the term “durable medical supplies,” as defined in N.C. Gen. Stat. §105-164.3(8c); therefore, retail sales of these items directly to patients qualify for an exemption from sales and use tax pursuant to N.C. Gen. Stat. § 105-164.13(12)(d), *provided the items are sold on prescription. [Emphasis added.]*

Pursuant to N.C. Gen. Stat. § 105-164.22 “[f]ailure of a retailer to keep records that establish that a sale is exempt . . . subjects the retailer to liability for the tax.” Therefore, Taxpayer must retain copies of the prescriptions for direct sales to patients of durable medical equipment and durable medical supplies as Taxpayer’s authority to exempt these transactions from sales and use tax. If copies of the prescriptions are not retained by Taxpayer, Taxpayer is liable for the general 4.75%

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State, applicable local (2.00% or 2.25%), and applicable transit (0.50%) rates of sales and use tax on these sales.

As provided in 17NCAC 07B.1801, “[h]ospitals, sanitariums, nursing homes, and rest homes are primarily engaged in rendering services and are considered the users or consumers of all tangible personal property they purchase for use in connection with these institutions.” Although the facility administers the Product to the patient on the order or direction of a physician or an individual licensed to issue a prescription, the facility is providing such property to the patient and is considered the user of the property for the purposes of North Carolina sales and use tax. In *Feeling Great, Inc. and Sleep Medical Center, Inc. v. N.C. Department of Revenue*, 14 CVS 11139, Wake County Superior Court Division, the Court concluded that the exemption for durable medical supplies “will only apply if the supplies at issue were sold. . . on prescription.” Taxpayer’s sales of Product to facilities are not considered to be the sale of durable medical equipment or durable medical supplies on a prescription since the facilities retain ownership of Product. Notwithstanding the prescription is in the name of the patient, the Product is purchased by the facilities without a prescription to provide a medical service. When Taxpayer sells the Product to facilities for use in providing a service, Taxpayer is selling the Product to the consumer. Therefore, Taxpayer’s retail sales of Product to facilities are subject to the general 4.75% State, applicable local (2.00% or 2.25%), and applicable transit (0.50%) rates of sales and use tax.

This ruling is based solely on the facts submitted to the Department of Revenue for consideration of the transactions described. If the facts and circumstances given are not accurate, or if they change, then the taxpayer requesting this ruling may not rely on it. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material aspect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that this document is not to be cited as precedent and that a change in statute, a regulation, or case law could void this ruling.

Issued on behalf of the Secretary of Revenue
By the Sales and Use Tax Division