

EXECUTIVE SUMMARY:

DRUGS & OTHER MEDICAL ITEMS

(SALES TAX)

JULY, 2014

JOINT SUBCOMMITTEE TO EVALUATE TAX PREFERENCES

- PREFERENCES:

§ 58.1-609.10 (9), (10), (11), & (14)

- SUMMARY:

Provides sales and use tax exemptions on the purchase of prescription and nonprescription drugs, and other medical items such as durable medical equipment (e.g. wheelchairs and prosthetic devices), hypodermic syringes, eyeglasses, and hearing aids.

- REVENUE IMPACT:

The sales tax exemption for prescription drugs and other medical items accounts for approximately \$494 million in reduced state and local tax revenue (FY 2014).

The sales tax exemption for nonprescription drugs accounts for approximately \$35 million annually in reduced state and local tax revenue (FY 2014).

- JOINT SUBCOMMITTEE RECOMMENDATION:

The Joint Subcommittee recommended to continue the preferences.

PREFERENCE REPORT:

DRUGS & OTHER MEDICAL ITEMS

(SALES TAX)

JULY, 2014

JOINT SUBCOMMITTEE TO EVALUATE TAX PREFERENCES

Preference Description

Subsections 9, 10, 11, and 14 of § 58.1-609.10 of the Code of Virginia provide sales and use tax exemptions on the purchase of prescription and nonprescription drugs, and other medical items such as durable medical equipment (e.g. wheelchairs and prosthetic devices), hypodermic syringes, eyeglasses, and hearing aids.¹

These exemptions effectively exempt all medicines and drugs, whether on a prescription or physician's work order or available over the counter and other medical items. Specifically, the above provisions provide exemptions for:

(1) prescription medicines, hypodermic syringes, artificial eyes, eyeglasses and related items, contact lenses, etc., when sold on prescription by a licensed physician, dentist, optometrist, ophthalmologist, optician, audiologist, hearing aid dealer or fitter, nurse practitioner, physician assistant, and veterinarian;

(2) prescription drugs purchased for use by a licensed physician, optometrist, licensed nurse practitioner, or licensed physician assistant in his professional practice despite the legal structure of the practice;

(3) hemodialysis and peritoneal dialysis equipment;

(4) medicines purchased for use or consumption by a licensed hospital, nursing home, clinic, or similar corporation;

(5) nonprescription or "over the counter" drugs and medicines when purchased for the cure, mitigation, treatment or prevention of disease in human beings. Only those nonprescription drugs and proprietary medicines purchased for the cure, mitigation, treatment or prevention of disease in human beings qualify for the nonprescription drugs exemption. Cosmetics and toiletry items, except those which contain medicinal ingredients and which are

¹ See Appendix A for text of the exemptions.

principally used for medical purposes, are taxable.;

(6) samples of prescription and nonprescription drugs, distributed free of charge in certain instances;

(7) durable medical equipment and devices, and equipment, devices or chemical reagents that may be used by a diabetic to test or monitor blood or urine.

Purpose of the Preference

The exemption from the Retail Sales and Use Tax for medicines and drugs has been in existence since the inception of the Retail Sales and Use Tax in 1966. Exemptions for controlled drugs, hemodialysis and peritoneal dialysis supplies and nonprescription drugs were later enacted. These medical-related exemptions were introduced to reduce the cost of medical necessities. In addition, the nonprescription drug exemption was enacted partly due to the change in classification and regulation of many drugs, formerly classified as prescription drugs. Such drugs no longer are covered by or qualify for co-payments under numerous health insurance plans.

Legislative History & Background

The exemptions for medicines and drugs available to consumers pursuant to written prescriptions has been in existence since the inception of the Retail Sales and Use Tax in 1966. In addition to exempting medicines and drugs, the original exemption applied to various items, such as prosthetic devices and eyeglasses. Several times between 1973 and 2006, the exemption was revised to clarify the category of individuals from whom exempt items could be purchased and to add items, such as eyeglass cases and contact lenses, to which the exemption would apply. Nonprescription drugs became exempt in 1998.

1966: The original exemption for medicines and drugs was enacted. The exemption applied to medicines, drugs, crutches, braces, artificial eyes, contact lenses, eyeglasses, hearing aids, prosthetic devices and orthopedic appliances dispensed by or sold to patients on prescriptions or work orders of licensed physicians, dentists, optometrists, ophthalmologists or opticians.

1972: The exemption was expanded to include prescription drugs purchased by a physician for use in his practice.

1978: The exemption was further expanded to include medicines, drugs, prosthetic devices, and orthopedic appliances sold on prescriptions of hearing aid dealers and fitters. In addition, wheelchairs

sold on prescriptions or work orders of licensed physicians were included among the exempt items.

1979: A separate exemption was enacted for nonprescription purchases of prosthetic devices, orthopedic appliances, wheelchairs, crutches, braces, catheters, and urinary accessories by an individual for his own use.

1984: A separate exemption for hemodialysis and peritoneal drugs and supplies was enacted and applied to all purchasers.

1987: The medicines and drugs exemption was expanded to include prescriptions issued by veterinarians; however, veterinarians remained the taxable users or consumers of all prescription medicines and drugs that they dispense.

1991 and 1992: Legislation was enacted that granted licensed nurse practitioners and licensed physicians' assistants limited prescriptive authority.

1992: The exemption was expanded to include controlled drugs purchased for use by a licensed physician in his professional practice regardless of whether such practice is organized as a sole proprietorship, partnership or professional corporation.

1993: The exemption was expanded to include prescription drugs purchased by and for physicians when organized as a corporation in which shareholders and operators are all licensed physicians practicing medicine.

1995: Legislation was enacted that clarified that the exemption for medicines and drugs dispensed by certain practitioners on prescription orders was applicable to prescriptions issued by licensed nurse practitioners and licensed physicians' assistants.

1998: The exemption for nonprescription drugs and proprietary medicines became effective. The General Assembly enacted the exemption in 1990 with an effective date of July 1, 1992, however the effective date, was deferred until July 1, 1994 by the 1992 General Assembly, and then again in 1996, from July 1, 1996 to July 1, 1998.

1999: The exemption was expanded to include eyeglass cases and contact lens storage containers, solutions or sterilization kits or other similar devices when distributed free of charge by optometrists, ophthalmologists, and opticians. As a result of a legislative change, the exemption available for controlled drugs purchased for use by a licensed physician was expanded to include optometrists, licensed nurse practitioners, and licensed physician assistants. The exemption was also expanded to include medicines and drugs purchased for use by a licensed hospital.

2004: Enactment of the exemption for medical products and supplies, which are otherwise taxable, when purchased by a Medicaid recipient through a Department of Medical Assistance Services provider

agreement

2006: The exemption was expanded to include medicines and drugs purchased by a veterinarian, provided the items are used or consumed directly in the care and treatment of agricultural production animals.

Revenue Impact

Prescription Drugs

The sales tax exemption for prescription drugs accounts for approximately \$494 million in reduced state and local tax revenue (Fiscal Year 2014).²

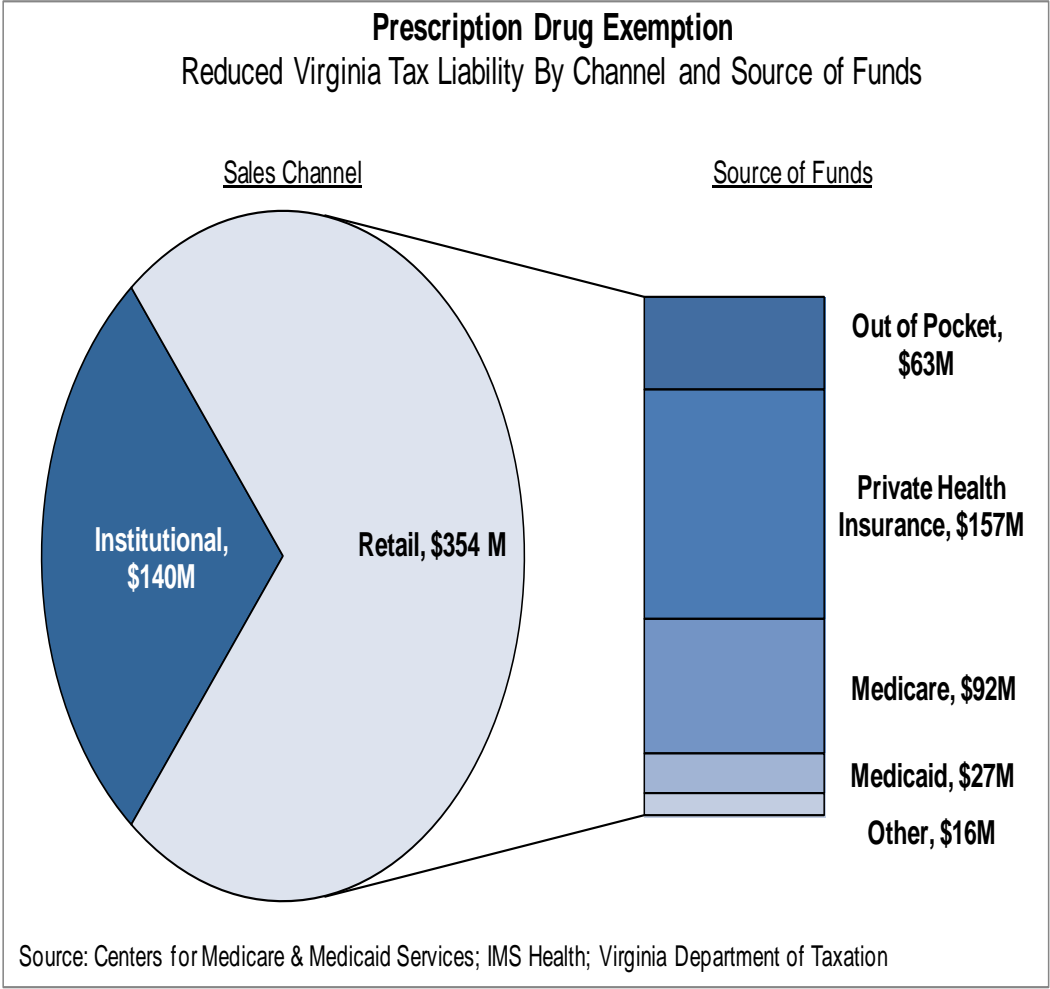
The estimate is based on total prescription drug sales in Virginia and includes both institutional and retail sales. Based on national statistics, sales to institutions account for approximately 28.3% of sales, which translates to \$140 million in reduced Virginia tax revenue, while retail sales account for 71.7% of sales or \$354 million.³

The estimated reduction in tax revenue includes payments that would have been made by: private insurers, \$157 million, Medicare and Medicaid, \$118 million, and consumers' out-of-pocket, \$63 million, or 17.8% of retail prescription drug sales. Other insurers and third-party payers account for an estimated \$16 million in reduced tax liability.⁴

² Department of Taxation calculations using data from IMS Health.

³ IMS Health: Channel Distribution by Non-Discounted Spending (U.S.), http://www.imshealth.com/deployedfiles/imshealth/Global/Content/Corporate/Press%20Room/2012_U.S/Channel_Distribution_by_Non-Discounted_Spending_U.S.pdf

⁴ Department of Taxation calculations using data from Centers for Medicare & Medicaid Services, Office of the Actuary, National Health Statistics Group, <http://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/Downloads/tables.pdf>



The institutional channel includes purchases of prescription drugs by hospitals, clinics, long-term care facilities and the like. A significant portion of these institutions may be nonprofit entities and may also be eligible for the nonprofit organizations’ sales tax exemption (§ 58.1-609.11).

Nonprescription Drugs

The sales tax exemption for nonprescription drugs accounts for approximately \$35 million in reduced state and local tax revenue (Fiscal Year 2014).⁵

⁵ Department of Taxation calculations using data from the Consumer Healthcare Products Association.

Other States

As depicted in the following chart, of the forty-six states (including the District of Columbia) imposing the sales and use tax (i) only one, Illinois, imposes tax on prescription drugs (at a reduced rate of 1%); and (ii) thirty-six impose the tax on nonprescription drugs.

STATE TABLE OF TAX TREATMENT FOR DRUGS

State	Prescription Drugs	Nonprescription Drugs
Alabama	Exempt	Taxable
Arizona	Exempt	Taxable
Arkansas	Exempt	Taxable
California	Exempt	Taxable
Colorado	Exempt	Taxable*
Connecticut	Exempt	Taxable
District of Columbia	Exempt	Exempt
Florida	Exempt	Exempt
Georgia	Exempt	Taxable
Hawaii	Exempt	Taxable
Idaho	Exempt	Taxable
Illinois	Taxable**	Taxable**
Indiana	Exempt	Taxable
Iowa	Exempt	Taxable
Kansas	Exempt	Taxable
Kentucky	Exempt	Taxable
Louisiana	Exempt	Taxable
Maine	Exempt	Taxable
Maryland	Exempt	Exempt
Massachusetts	Exempt	Taxable
Michigan	Exempt*	Taxable
Minnesota	Exempt	Exempt
Mississippi	Exempt	Taxable
Missouri	Exempt	Taxable*
Nebraska	Exempt	Taxable
Nevada	Exempt	Taxable
New Jersey	Exempt	Exempt
New Mexico	Exempt	Taxable
New York	Exempt	Exempt
North Carolina	Exempt	Taxable
North Dakota	Exempt	Taxable
Ohio	Exempt*	Taxable
Oklahoma	Exempt	Taxable

State	Prescription Drugs	Nonprescription Drugs
Pennsylvania	Exempt	Exempt
Rhode Island	Exempt	Taxable
South Carolina	Exempt	Taxable
South Dakota	Exempt	Taxable
Tennessee	Exempt	Taxable
Texas	Exempt	Exempt
Utah	Exempt	Taxable
Vermont	Exempt	Exempt
Virginia	Exempt	Exempt
Washington	Exempt	Taxable
West Virginia	Exempt	Taxable
Wisconsin	Exempt	Taxable
Wyoming	Exempt	Taxable

* - Some exceptions or limitations apply.

** - Taxable at reduced rate

Joint Subcommittee Recommendation

At its July 24, 2014 meeting, the Joint Subcommittee to Evaluate Tax Preferences recommended that the preferences set forth at Subsections 9, 10, 11, and 14 of § 58.1-609.10 of the Code of Virginia providing for exemptions from the states sales and use tax for prescription and nonprescription drugs and other medical equipment be continued.

§ 58.1-609.10. Miscellaneous exemptions. (excerpt)

The tax imposed by this chapter or pursuant to the authority granted in §§ 58.1-605 and 58.1-606 shall not apply to the following:

9. Medicines, drugs, hypodermic syringes, artificial eyes, contact lenses, eyeglasses, eyeglass cases, and contact lens storage containers when distributed free of charge, all solutions or sterilization kits or other devices applicable to the wearing or maintenance of contact lenses or eyeglasses when distributed free of charge, and hearing aids dispensed by or sold on prescriptions or work orders of licensed physicians, dentists, optometrists, ophthalmologists, opticians, audiologists, hearing aid dealers and fitters, nurse practitioners, physician assistants, and veterinarians; controlled drugs purchased for use by a licensed physician, optometrist, licensed nurse practitioner, or licensed physician assistant in his professional practice, regardless of whether such practice is organized as a sole proprietorship, partnership, or professional corporation, or any other type of corporation in which the shareholders and operators are all licensed physicians, optometrists, licensed nurse practitioners, or licensed physician assistants engaged in the practice of medicine, optometry, or nursing; medicines and drugs purchased for use or consumption by a licensed hospital, nursing home, clinic, or similar corporation not otherwise exempt under this section; and samples of prescription drugs and medicines and their packaging distributed free of charge to authorized recipients in accordance with the federal Food, Drug, and Cosmetic Act (21 U.S.C.A. § 301 et seq., as amended). With the exceptions of those medicines and drugs used for agricultural production animals that are exempt to veterinarians under subdivision 1 of § 58.1-609.2, any veterinarian dispensing or selling medicines or drugs on prescription shall be deemed to be the user or consumer of all such medicines and drugs.

10. Wheelchairs and parts therefor, braces, crutches, prosthetic devices, orthopedic appliances, catheters, urinary accessories, other durable medical equipment and devices, and related parts and supplies specifically designed for those products; and insulin and insulin syringes, and equipment, devices or chemical reagents that may be used by a diabetic to test or monitor blood or urine, when such items or parts are purchased by or on behalf of an individual for use by such individual. Durable medical equipment is equipment that (i) can withstand repeated use, (ii) is primarily and customarily

used to serve a medical purpose, (iii) generally is not useful to a person in the absence of illness or injury, and (iv) is appropriate for use in the home.

11. Drugs and supplies used in hemodialysis and peritoneal dialysis.

14. a. (i) Any nonprescription drugs and proprietary medicines purchased for the cure, mitigation, treatment, or prevention of disease in human beings and (ii) any samples of nonprescription drugs and proprietary medicines distributed free of charge by the manufacturer, including packaging materials and constituent elements and ingredients.

b. The terms "nonprescription drugs" and "proprietary medicines" shall be defined pursuant to regulations promulgated by the Department of Taxation. The exemption authorized in this subdivision shall not apply to cosmetics.