

2007 - 2011 Virginia Retail Sales and Use Tax Expenditure Study

Volume 1, Number 3

Issued Pursuant to *Va. Code* § 58.1-609.12

Exemptions Studied:

- Nonprofit Entities (*Va. Code* § 58.1-609.11)
- Medicines and Drugs (*Va. Code* § 58.1-609.10(9))
- Hemodialysis and Peritoneal Dialysis Drugs and Supplies
(*Va. Code* § 58.1-609.10(11))
- Nonprescription Drugs (*Va. Code* § 58.1-609.10 (14))

December 1, 2009



COMMONWEALTH of VIRGINIA

Department of Taxation

December 1, 2009

The Honorable Harry R. Purkey
General Assembly Building, Room 415
Capitol Square
Richmond, Virginia 23219

The Honorable Charles J. Colgan
General Assembly Building, Room 317
Capitol Square
Richmond, Virginia 23219

Dear Delegate Purkey and Senator Colgan:

Enclosed is Report 3 of the 2007-2011 Virginia Retail Sales and Use Tax Expenditure Study prepared by the Department of Taxation ("TAX") pursuant to *Va. Code* § 58.1-609.12.

This is the third report in the series on the Miscellaneous Retail Sales and Use Tax exemptions provided by *Va. Code* § 58.1-609.10 and the Nonprofit Entity Retail Sales and Use Tax exemption provided by *Va. Code* § 58.1-609.11. There are nineteen exemption categories scheduled to be studied during the 2007-2011 period, and every five-year period thereafter.

The report includes a detailed analysis of exemptions that pertain to medicines, drugs, and medical supplies (*Va. Code* § 58.1-609.10). It also includes updated information concerning the cost of purchases of tangible personal property by nonprofit entities that have applied to TAX and received an exemption certificate. *Va. Code* § 58.1-609.11 previously required an annual report on entities seeking a nonprofit exemption. Legislation enacted during the 2009 General Assembly authorized TAX to combine its Nonprofit Exemption Report with its yearly Retail Sales and Use Tax Expenditure Study. This is the first year the two reports have been combined.

As you will see, the revenues foregone as the result of these exemptions are significant. However, our analysis of the exemptions is not limited solely to foregone revenues, but also includes detailed information on the policy and economic impacts of



each exemption. This includes a thorough analysis of the sales and use tax structures of other states, with particular emphasis on the tax structures of our neighboring states. As a result, this study will be unique among the numerous tax expenditure studies that have been conducted by other states, in that it will provide a complete and readily understandable analysis of the major issues surrounding each of these tax exemptions.

The Virginia Retail Sales and Use Tax Expenditure Study Report can be an important tool in the ongoing efforts to oversee the process by which tax exemptions and other tax preferences are granted. Over the past several years, both the executive and legislative branches have developed enhanced budget control and oversight tools to ensure the more effective use of state funds. However, during the same period, Retail Sales and Use Tax exemptions and other tax expenditures have received only limited scrutiny. Unlike expenditures under the budget process, Retail Sales and Use Tax exemptions and preferences tend to remain in effect indefinitely and rarely undergo review to ensure that they are accomplishing in an effective and cost-efficient manner the purpose for which they were enacted. This report will help remedy that situation by evaluating at least that portion of Retail Sales and Use Tax expenditures related to miscellaneous exemptions.

This report is being submitted to the Division of Legislative Automated Systems.

Sincerely,



Janie E. Bowen
Tax Commissioner

JEB/amm
Enclosures

c: The Honorable Richard D. Brown, Secretary of Finance
Division of Legislative Automated Systems
The Honorable Robert D. Hull

VIRGINIA RETAIL SALES AND USE TAX EXPENDITURE STUDY

Volume 1, Number 3

Richard D. Brown
Secretary of Finance

Janie E. Bowen
Tax Commissioner

December 2009

This report provides a detailed analysis of the following Retail Sales and Use Tax exemptions:

- Nonprofit Entities (*Va. Code* § 58.1-609.11)
- Medicines and Drugs (*Va. Code* § 58.1-609.10 (9))
- Hemodialysis and Peritoneal Dialysis Drugs and Supplies (*Va. Code* § 58.1-609.10 (11))
- Nonprescription Drugs (*Va. Code* § 58.1-609.10 (14))

Future reports will cover other subgroups of the Retail Sales and Use Tax exemptions provided by *Va. Code* §§ 58.1-609.10 and 58.1-609.11.

OFFICE OF TAX POLICY, POLICY DEVELOPMENT DIVISION

William J. White
Assistant Tax Commissioner

Mark C. Haskins
Director of Policy Development

Stuart S. Carter
Chief Economist

Joseph E. Mayer
Lead Tax Policy Analyst

Judith C. Waldron
Senior Economist

Andrea M. Muse
Tax Policy Analyst

Josh A. Silverman
Economist

Kristen D. Peterson
Tax Policy Analyst

We appreciate the assistance provided by the numerous individuals who made it possible for us to complete this report. However, the study staff is responsible for devising the methodology used in calculating the revenue impacts and performing the analysis of the various exemptions. Thus, those who assisted us or provided information are not accountable for any of the results or analytical conclusions presented in this report.

We express a special thank you to all contributing dialysis centers, which provided answers to surveys, and IMS Health Academic Affairs, which provided data regarding the medicines and drugs exemptions addressed in this report.

We hope that the study will be a valuable tool to policymakers in formulating the Retail Sales and Use Tax policies of the Commonwealth of Virginia, as well as to policymakers in other states.

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EXECUTIVE SUMMARY

Authorization for Study

Pursuant to *Va. Code* § 58.1-609.12, the Department of Taxation (“TAX”) is charged with the responsibility of determining the fiscal, economic and policy impact of each of the Retail Sales and Use Tax exemptions provided for by *Va. Code* §§ 58.1-609.10 and 58.1-609.11 and reporting such findings to the chairmen of the House and Senate Finance Committees no later than December 1 of each year.

Subgroups of these exemptions are to be reviewed in periodic cycles and reports issued on a rotating basis in accordance with a schedule determined by the Tax Commissioner. When the reports have been completed for all of the subgroups, TAX is required to repeat the process beginning with the subgroup of exemptions for which a report was made in 2007. With the exception of the nonprofit exemption granted pursuant to *Va. Code* § 58.1-609.11, no exemption shall be analyzed more frequently than once every five years. Legislation enacted in 2009 (*Acts of Assembly* 2009, Chapter 24) authorized TAX to combine its yearly Sales and Use Tax Expenditure Study (“SUTES Study”) with its yearly report on the fiscal impact of the Sales and Use Tax exemption for nonprofit entities (“the Nonprofit Exemption Report”), previously required under *Va. Code* § 58.1-609.11. Thus, the fiscal impact of the nonprofit exemption is included in each SUTES Study going forward.

There are nineteen exemption categories scheduled to be studied during the 2007-2011 period, and every five-year period thereafter. This is the third report of the 2007-2011 series and, in addition to the yearly update on the nonprofit exemption, includes a detailed analysis of exemptions that pertain to:

- *Va. Code* § 58.1-609.10(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; 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.

- *Va. Code § 58.1-609.10(11)* - Drugs and supplies used in hemodialysis and peritoneal dialysis.
- *Va. Code § 58.1-609.10(14)* - Nonprescription drugs and proprietary medicines purchased for the cure, mitigation, treatment, or prevention of disease in human beings; and any samples of nonprescription drugs and proprietary medicines distributed free of charge by the manufacturer, including packaging materials and constituent elements and ingredients.

This report includes detailed information on the policy and fiscal impacts of these three exemptions, as well as the apparent rationale for these exemptions and their legislative history. This report also includes a comparison of the Virginia exemptions with the sales tax structures of other states, with particular emphasis placed on a comparison with the exemptions provided in contiguous states.

Retail Sales and Use Tax Exemption for Medicines and Drugs

The exemption for medicines and drugs available 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 crutches, braces, prosthetic devices, and eyeglasses. In 1972, the exemption was expanded to include controlled drugs purchased by a physician for his practice. Several more times between 1973 and 2005, 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.

The original exemption for hemodialysis and peritoneal drugs and supplies was available only when purchased by an individual for his own use. The exemption was revised in 1984 to include purchases of hemodialysis and peritoneal drugs and supplies made by physicians and other medical professionals.

Prior to July 1, 1998, only medicines and drugs dispensed on prescription could be purchased exempt of the Retail Sales and Use Tax. Effective July 1, 1998, nonprescription drugs and proprietary medicines became exempt of the Retail Sales and Use Tax. Cosmetics and toiletry items, as well as vitamins and mineral concentrates sold as dietary supplements or adjuncts do not qualify as nonprescription drugs, and therefore, are not eligible for this exemption.

Evaluation of Retail Sales and Use Tax Exemption Expenditures

Unlike expenditures under the budget process, sales tax exemptions tend to remain in effect indefinitely. These tax exemptions raise profound questions of public policy. Because these exemptions are the equivalent of a subsidy, it is vital to determine to which endeavors limited government resources should be allocated.

Expenditures are provisions such as exclusions, exemptions, preferential tax rates, deductions, deferrals or credits that are designed to provide an economic incentive for a certain activity or provide financial assistance in the form of tax relief to taxpayers in certain situations. The impact of exemption expenditures produces fiscal impacts that constitute foregone tax revenue. For purposes of this study, exemption expenditures are measured by the reduced tax collections, instead of the normal expenditure authorized through the legislative appropriation process.

Below is a summary of the revenue impact of the sales and use tax exemptions for the exemptions that are the subject of Report 3 of the 2007-2011 Virginia Retail Sales and Use Tax Expenditure Study.

Medicines and Drugs Exemption

Table 1 reflects the total state and local Retail Sales and Use Tax expenditure resulting from the exemption for Medicines and Drugs, which includes prescription drugs (with controlled substances as a subset), hearing aids, and eyeglasses and related items. Table 2 reflects the total state and local Retail Sales and Use Tax expenditure resulting from the exemption for Hemodialysis and Peritoneal Dialysis Drugs and Supplies. Table 3 reflects the total state and local Retail Sales and Use Tax expenditure resulting from the exemption for nonprescription drugs.

Table 1: Total State and Local Sales Tax Expenditure Resulting from Medicines and Drugs Exemption

Fiscal Year	Prescription Drugs*	Controlled Substances*	Hearing Aids	Eyeglasses, Etc.	Total
2005	\$307,574,649	-	\$3,227,798	-	\$310,802,447
2006	\$330,808,318	\$20,138,441	\$3,533,672	\$23,290,926	\$357,632,916
2007	\$351,625,144	\$22,959,098	\$3,772,980	\$23,741,834	\$379,139,958
2008	\$360,954,247	\$24,638,614	\$3,951,736	\$23,778,165	\$388,684,148
2009	\$384,490,134**	\$27,714,285**	\$4,123,028**	\$24,100,052**	\$412,713,214
2010	\$403,762,636**	\$29,930,142**	\$4,286,986**	\$24,350,730**	\$432,400,352
2011	\$423,035,137**	\$32,113,024**	\$4,444,007**	\$24,601,284**	\$452,080,428

* Controlled Substances are a subset of Prescription Drugs and that expenditure is included in the Prescription Drug expenditure

** Projected using the Linear/Holt Exponential Smoothing Model (from SAS Time Series Forecasting System) and the Excel Forecasting System

Table 2: Total State and Local Sales Tax Expenditure Resulting from Dialysis Drugs and Supplies Exemption

<u>Fiscal Year</u>	<u>Purchases of Dialysis Drugs</u>	<u>Purchases of Dialysis Supplies</u>	<u>Total Revenue Estimate</u>
2006	\$5,667,538	\$2,253,675	\$7,921,213
2007	\$6,081,470	\$2,102,490	\$8,183,960
2008	\$6,035,109	\$2,143,852	\$8,178,962
2009	\$6,232,494*	\$2,093,887*	\$8,326,381
2010	\$6,436,335*	\$2,045,086*	\$8,481,421
2011	\$6,646,843*	\$1,997,422*	\$8,644,265

*Projected using the Average Growth Rate

Table 3: Total State and Local Sales Tax Expenditure Resulting from Nonprescription Drugs Exemption

2001	\$22,909,080
2002	\$22,123,761
2003	\$21,574,315
2004	\$22,031,379
2005	\$22,726,812
2006	\$23,695,267
2007	\$24,541,412
2008	\$25,712,279
2009	\$26,824,857*
2010	\$27,884,739*
2011	\$28,893,445*

*Projected using the Damped Trend Exponential Smoothing (from SAS Time Series Forecasting System)

Nonprofit Entities

Under the authority requiring this study, TAX is restricted from studying any exemption provided by *Va. Code* § 58.1-609.10 more frequently than once every five years. However, *Va. Code* § 58.1-609.11 previously required an annual report on entities seeking a nonprofit exemption. Legislation enacted during the 2009 General Assembly

authorized TAX to combine its Nonprofit Exemption Report with its yearly Retail Sales and Use Tax Expenditure Study. Given the importance of this exemption for nonprofit entities provided by *Va. Code* § 58.1-609.11, TAX will include in each volume of the Retail Sales and Use Tax Expenditure Study an estimate of the foregone revenue attributable to the nonprofit entity exemption. This estimate is based on information reported to TAX by nonprofit entities seeking to obtain a new or renewed exemption under *Va. Code* § 58.1-609.11. No nonprofit entities were surveyed to obtain this data.

Table 4 sets forth TAX's estimate of the total annual state and local Retail Sales and Use Tax revenue impact of the Nonprofit Entity Exemption.

Table 4: State and Local Retail Sales and Use Tax Expenditure Resulting from Purchases Made by Nonprofit Organizations.

2008	\$175,364,334
2009	\$176,586,624*
2010	\$ 179,450,859*

* Projected using the Consumer Pricing Index for All Urban Consumers (CPI-U).

INTRODUCTION

Study Mandate

Pursuant to *Va. Code* § 58.1-609.12, enacted by House Bill 2852 (*Acts of Assembly* 2005, Chapter 853) and amended by House Bill 1370 (*Acts of Assembly* 2006, Chapter 559), the Department of Taxation (“TAX”) is charged with the responsibility of determining the fiscal, economic and policy impact of each of the Retail Sales and Use Tax exemptions provided for by *Va. Code* §§ 58.1-609.10 and 58.1-609.11 and report such findings to the chairmen of the House and Senate Finance Committees no later than December 1 of each year.

Subgroups of these exemptions are to be reviewed in periodic cycles and reports issued on a rotating basis in accordance with a schedule determined by the Tax Commissioner. When the reports have been completed for each subgroup, TAX is required to repeat the process beginning with the subgroup of exemptions for which a report was made in 2007. With the exception of the nonprofit exemption granted pursuant to *Va. Code* § 58.1-609.11, no exemption shall be analyzed more frequently than once every five years. Legislation enacted in 2009 (*Acts of Assembly* 2009, Chapter 24) authorized TAX to combine its yearly Retail Sales and Use Tax Expenditure Study (“SUTES study”) with its yearly report on the fiscal impact of the Sales and Use Tax exemption for nonprofit entities (“the Nonprofit Exemption Report”), previously mandated by *Va. Code* § 58.1-609.11. Thus, the fiscal impact of the nonprofit exemption is included in each Sales and Use Tax Expenditure Study going forward.

There are nineteen exemption categories scheduled to be studied during the 2007-2011 period, and every five-year period thereafter.

TAX plans to study these exemptions as follows:

<u>Citation</u>	<u>Volume</u>	<u>Year</u>	<u>Exemption</u>
<i>Code of Va.</i> § 58.1-609.11	1	2007	Nonprofit Entities
<i>Code of Va.</i> § 58.1-609.10(15)	1	2007	Donations Withdrawn from Inventory
<i>Code of Va.</i> § 58.1-609.10(16)	1	2007	Nonprofit churches
<i>Code of Va.</i> § 58.1-609.10(5)	2	2008	Food Stamp and WIC Purchases
<i>Code of Va.</i> § 58.1-609.10(8)	2	2008	School Lunches and Textbooks
<i>Code of Va.</i> § 58.1-609.10(9)	3	2009	Medicines and Drugs
<i>Code of Va.</i> § 58.1-609.10(11)	3	2009	Dialysis Drugs and Supplies

<i>Code of Va. § 58.1-609.10(14)</i>	3	2009	Nonprescription Drugs and Nonprescription Drug Samples
<i>Code of Va. § 58.1-609.10(17)</i>	4	2010	Medical Products and Supplies Purchased by Medicaid Recipients
<i>Code of Va. § 58.1-609.10(10)</i>	4	2010	Durable Medical Equipment
<i>Code of Va. § 58.1-609.10(12)</i>	4	2010	Motor Vehicle Equipment for Handicapped Persons
<i>Code of Va. § 58.1-609.10(13)</i>	4	2010	Communication Equipment for Handicapped Persons
<i>Code of Va. § 58.1-609.10(1)</i>	5	2011	Domestic Consumption of Heating Fuels
<i>Code of Va. § 58.1-609.10(2)</i>	5	2011	Occasional Sales
<i>Code of Va. § 58.1-609.10(3)</i>	5	2011	Purchases for Taxable Lease
<i>Code of Va. § 58.1-609.10(4)</i>	5	2011	Delivery of Property outside VA
<i>Code of Va. § 58.1-609.10(6)</i>	5	2011	Property Purchased for Maintenance of Nuclear Power Plants outside VA

This is the third report of the 2007-2011 Retail Sales and Use Tax Expenditure Study and includes a detailed analysis of exemptions that pertain to:

- *Va. Code § 58.1-609.10(9)* – Certain medicines, drugs, and related supplies dispensed on written prescriptions by certain specified medical professionals; controlled drugs purchased for use by certain specified medical professionals; medicines and drugs purchased for use by licensed hospitals, nursing homes, clinics, and similar entities; and certain samples of prescription drugs.
- *Va. Code § 58.1-609.10(11)* – Drugs and supplies used in hemodialysis and peritoneal dialysis.
- *Va. Code § 58.1-609.10(14)* - Nonprescription drugs and proprietary medicines purchased for the cure, mitigation, treatment, or prevention of disease in human beings; and any samples of nonprescription drugs and proprietary medicines distributed free of charge by the manufacturer, including packaging materials and constituent elements and ingredients.

This report includes detailed information on the policy and fiscal impacts of these three exemptions, as well as the apparent rationale for the exemptions and their legislative history. This report also includes a comparison of the Virginia exemptions with the sales tax structures of other states, with particular emphasis placed on a comparison with the exemptions provided in contiguous states.

The goal of the SUTES Study is to provide a more complete picture of the revenue impact and policy issues surrounding each of the exemptions contained in the Retail

Sales and Use Tax Act. Great care has been taken to provide the most accurate and comprehensive analysis possible. It is our hope that legislators, government officials, and other decision makers will find this report a useful tool in the formulation of public policy decisions on the goals to be furthered by the use of the Commonwealth's revenue resources.

Tax Expenditures Defined

Tax expenditures are provisions in the tax code, such as exclusions, exemptions, preferential tax rates, deductions, deferrals or credits that are designed to provide an economic incentive for a certain activity or provide financial assistance in the form of tax relief to taxpayers in certain situations. The tax expenditure concept recognizes that the fiscal impact of a tax provision is similar to the outlay of a direct expenditure. One of the major differences between a tax expenditure and a direct expenditure is that the "cost" is measured by reduced tax collections, instead of by the level of expenditure authorized through the normal legislative appropriation process.

Tax expenditure studies are used more and more frequently as a method of ensuring that tax expenditures are subject to periodic review in a manner similar to direct budget expenditures. Because tax expenditures may escape periodic review, they generally remain in effect indefinitely, with only limited review as to whether they are accomplishing a worthwhile public purpose in a cost-effective manner. However, since tax expenditures are designed to accomplish certain public goals that otherwise might be met through direct expenditures, it is only reasonable to apply to tax expenditures a review and analysis similar to that provided for direct expenditures.

The Virginia Retail Sales and Use Tax incorporates numerous tax expenditures, which, taken together, substantially reduce the revenues that could potentially be generated by the tax. This study focuses on one type of tax expenditure, the Miscellaneous Retail Sales and Use Tax exemptions. The periodic review of such exemptions that will be undertaken in the Retail Sales and Use Tax Expenditure Study provides a comprehensive tool for evaluating the revenue, economic and policy impact of each exemption. This type of review is particularly relevant considering the number of entities that have obtained sales and use tax exemptions since the enactment of the tax in 1966.

Exemption Analysis Criteria

As mandated by *Va. Code* § 58.1-609.12, eight criteria are used to analyze the fiscal, economic and policy impact of each exemption:

- Revenue Impact – Estimate the state and local retail sales and use tax foregone as a direct result of the exemption.

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- Beneficiaries of the Exemption – Identify taxpayers or industries that actually benefit from the exemption. This includes identifying those persons who benefit directly from an exemption. It will also entail identifying the extent to which the benefit is passed on to others, such as customers or suppliers, who are considered to benefit indirectly from the exemption.
 - Direct or Indirect Government Assistance – Identify the direct or indirect state budgetary assistance received by taxpayers or industries. Where possible, the federal budgetary assistance received by these groups will also be identified.
 - Other States – Compare Virginia exemptions to the tax systems of other states and the District of Columbia which impose a sales, use or receipts tax. This will include determining whether the other taxing jurisdictions have exemptions or other tax expenditures analogous to the Virginia exemption. Particular attention will be given to the tax preferences in the states bordering Virginia, which include the District of Columbia, Kentucky, Maryland, North Carolina, Tennessee, and West Virginia.
 - External Mandates – Identify whether the exemption is required as the result of constitutional, judicial, or statutory mandates, either federal or state.
 - Other State and Local Tax Burdens – Ascertain whether the taxpayer, industry, property, or service, is subject to other Virginia state taxes.
 - Similar Taxpayers – Identify taxpayers or industries that do not enjoy the exemption, even though they are similar in nature to taxpayers or industries that do enjoy the exemption.
 - Other Criteria – Focuses on other relevant issues that are unrelated to the first seven criteria. Such issues might include the impact of state regulation, state or local license fees, or local taxes upon exempt taxpayers and industries, and the special impact that an exemption or the lack thereof may have upon a particular locality or region of the state.

Revenue Analysis Methodology

Since tax expenditures are not funded by direct appropriations, but rather by uncollected revenues, their costs are difficult to determine and often not directly recorded. The goal of the revenue estimating process is to quantify (as accurately as possible) the costs of each sales and use tax exemption in terms of foregone state and local revenues. What follows is a general outline of the methodology used to determine the estimates and the inherent limitations placed upon those estimates.

In each case, the most accurate and complete sources of data were utilized. Forecasts and changes in taxpayer behavior were taken into account when appropriate and feasible. The revenue analysis in this study considers only the immediate and direct impact that elimination of an exemption would have on sales and use tax revenue. Not included is an examination of possible subsequent indirect effects on, for example, location decisions and employment in the affected industry due to imposition of the tax. An analysis of such secondary effects is beyond the scope of this study.

The information for this study was received from a number of sources.

A few general guidelines were used in devising and conducting the surveys:

- Surveys were used only when no acceptable alternative sources of the information existed.
- Survey forms were made as simple as possible to minimize the time and effort required for completion.
- Attempts were made to identify and notify an industry representative before devising a survey to get input and cooperation.

Study Limitations

For several reasons, the reader should exercise caution in interpreting the estimates of fiscal impacts found in this report. Some of the major limitations of the estimating methodologies are discussed below.

The goal of the revenue estimating process is to quantify the costs of each sales tax exemption in terms of foregone state and local revenues. Because tax expenditures are funded not by direct appropriations, but rather by uncollected revenues, their costs normally are not directly recorded. Thus, it is important to understand the methodology used to determine the estimates and the inherent limitations placed upon those estimates.

Report Organization

This report contains a detailed analysis of the exemptions pertaining to:

- *Va. Code* § 58.1-609.10(9) – Certain medicines, drugs, and related supplies dispensed on written prescriptions by certain specified medical professionals; controlled drugs purchased for use by certain specified medical professionals; medicines and drugs purchased for use by licensed hospitals, nursing homes, clinics, and similar entities; and certain samples of prescription drugs.

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- *Va. Code* § 58.1-609.10(11) – Drugs and supplies used in hemodialysis and peritoneal dialysis.
 - *Va. Code* § 58.1-609.10(14) - Nonprescription drugs and proprietary medicines purchased for the cure, mitigation, treatment, or prevention of disease in human beings; and any samples of nonprescription drugs and proprietary medicines distributed free of charge by the manufacturer, including packaging materials and constituent elements and ingredients.

A summary of each exemption is provided. For each exemption, the following information is provided:

- **Authorization:** The legal authorization for the exemptions, including the text of the statute.
- **Exemption Summary:** A description of the exemption.
- **Rationale:** The background of the enactment of the exemptions, including the legislative history and information on any revisions, in addition to the rationale for the exemption.
- **Methodology:** A description of how TAX studied the exemptions, including sampling methods, and survey techniques.
- **Revenue Analysis:** A summary of the estimated foregone state and local revenues as a result of the exemptions.
- **Beneficiaries:** A description of taxpayers and entities which benefit from the exemptions.
- **Direct or Indirect Government Assistance:** Explanation of any direct or indirect government assistance that inures to the beneficiaries of the exemptions.
- **State Comparisons:** A comparison of the Virginia exemptions with those in other states, particularly contiguous states.
- **External Mandates:** A description of any statutory, constitutional, or judicial mandates that are related to, or impacted by, the exemptions.
- **Other State and Local Tax Burdens:** Identification of any other state and local tax burdens on the beneficiaries of these exemptions.
- **Similar Taxpayers:** A discussion of those taxpayers and entities which are similar, but do not benefit from the exemptions.

- Other Criteria: If available, any other issues relevant to the exemptions. This category may be excluded if there is no added information.

NONPROFIT ENTITY EXEMPTION

SUMMARY

The 2003 General Assembly enacted Chapters 757 and 758, 2003 *Acts of Assembly* (House Bill 2525 and Senate Bill 743) to simplify the process of qualifying nonprofit organizations for sales and use tax exemptions. As part of this legislation, TAX is required to file an annual report by December 1 of each year disclosing the annual fiscal impact of the sales and use tax exemptions for nonprofit entities.

BACKGROUND

Prior to the 2003 General Assembly, there was no general exemption from Virginia's Retail Sales and Use Tax for nonprofit organizations. Virginia's Retail Sales and Use Tax exemptions were generally tailored for specific nonprofit organizations, although any organization meeting the exemption criteria would qualify for the exemption. When the Sales and Use Tax first took effect in 1966 there were 22 exemptions. By 2003 this number had increased to 1,702. In general, Sales and Use Tax exemptions were granted through legislative action by the General Assembly. An organization seeking an exemption could acquire one in two ways. If the organization met the statutory language of an existing exemption by classification, it could apply directly to TAX for an exemption by providing evidence that it met the statutory classification. If the organization did not meet the criteria of an existing classification, the organization had to acquire one by designation through the enactment of a new exemption or the amendment of an existing exemption.

With the exception of certain Sales and Use Tax exemptions that applied to broad classes of businesses, most exemptions were enacted with a sunset date. Virginia law required that nonprofit organizations periodically update information about the organization with TAX in order to renew their exemption. This information was identical to the information required when an organization requested a new exemption. TAX reviewed the information and certified that the organization met the requirements. This information was then given to the Division of Legislative Services for drafting legislation to extend the individual exemptions.

NEW EXEMPTION PROCESS

House Bill 2525 and Senate Bill 743 were based on recommendations made by the 2003 House Special Study Committee studying Retail Sales and Use Tax exemptions. With the passage of this legislation, the process was simplified and many nonprofit organizations may now apply to TAX to receive an exemption certificate provided they meet certain qualifications. The legislation also grandfathered the exemptions held by nonprofit organizations under the old exemption system for a limited time. This legislation grants to qualifying nonprofit organizations an exemption from paying Retail Sales and Use Tax on purchases of tangible personal property. Additionally, certain

grandfathered entities are allowed an exemption from the Retail Sales and Use Tax on services that are subject to the tax.

To be granted an exemption by TAX, an entity must meet all the applicable criteria:

- Exemption from federal income taxation under *Internal Revenue Code ("IRC")* §§ 501 (c) (3) or 501 (c) (4), or have annual gross receipts of less than \$5,000 and be organized for a charitable purpose.
- The entity must be in compliance with state solicitation laws, if applicable.
- The entity must have annual administrative costs that are 40% or less of annual gross receipts.
- If the entity's gross annual revenue was at least \$750,000 in the previous year, the entity must provide a financial review performed by an independent certified public accountant. If the entity's gross annual revenue was at least \$1 million in the previous year, the Department has the discretion to require the entity to provide a financial audit performed by an independent certified public accountant.
- The entity must provide TAX with a copy of its federal Forms 990 or 990 EZ or a list of its Board of Directors.
- The entity must provide TAX with an estimate of its total taxable purchases.

The process requires renewal on a five to seven-year cycle, but eliminates the need for legislative action. Nonprofit organizations that held a valid exemption certificate under the old system would enjoy their exemption status, but are required to file under the new process when their exemption sunsets. As shown below, all of the original exemption groups have expired and many have applied for an exemption using the new process.

ORIGINAL EXEMPTION SUNSET DATES

Civic and community service (first half) (*Va. Code* § 58.1-609.8) July 1, 2004
Civic and community service (second half) (*Va. Code* § 58.1 -609.8) July 1, 2005
Cultural and Miscellaneous (*Va. Code* §§ 58.1 -609.9 and 58.1 -609.10) July 1, 2006
Educational (*Va. Code* § 58.1 -609.4) July 1, 2007
Medical-Related (*Va. Code* § 58.1 -609.7) July 1, 2008

TECHNICAL AMENDMENTS TO NEW EXEMPTION PROCESS

There have been several technical amendments made to this process over the last four years. In 2004, Chapters 515 and 536, *Acts of Assembly* (House Bill 515 and Senate Bill 585), clarified that churches have two options. They may continue using the self-issued exemption certificate, which entitles them to the Retail Sales and Use Tax exemption available under the law as it existed on June 30, 2003, or they could apply

for a general exemption certificate under the new process. An additional provision was added to ensure that nonprofit organizations that provide rescue or firefighting services but do not have IRC §§ 501 (c)(3) or 501 (c)(4) status may obtain an exemption via the new process from July 1, 2004 through June 30, 2006. This bill also grandfathered the exemption from collecting the tax on fundraiser sales that was enjoyed by certain organizations, and clarified that TAX is authorized to refuse to grant exemption certificates to applicants that fail to disclose their total taxable purchases for the preceding year.

In 2005, the General Assembly passed a technical amendment clarifying the law as it applies to taxable services for certain organizations. Under Chapters 42 and 89, 2005 *Acts of Assembly* (House Bill 2100 and Senate Bill 1105), organizations holding a valid exemption as of June 30, 2003, may continue to purchase taxable services exempt of the tax, provided they complied with certain procedures and met certain requirements. This legislation affected the exemption status of only twelve organizations, some of which actually renewed under the new process, and two of which did not qualify under the new process, as they have a federal designation of IRC § 501 (c)(19) and no longer qualified for an exemption.

The 2006 General Assembly expanded the Retail Sales and Use Tax exemption for nonprofit churches exempt from taxation under IRC § 501 (c) (3), or whose real property is exempt from local taxation pursuant to the provisions of *Va. Code* § 58.1 -3606. Under Chapter 338, Acts of Assembly (House Bill 576) the exemption was expanded to include tangible personal property used for recording and reproducing services. The exemption applies to a nonprofit church's purchase of video recording equipment, microphones, cassette players, and similar items that are used for recording and reproducing services.

The exemption for nonprofit churches was originally enacted in 1979 and was limited to tangible personal property used by a nonprofit church in its religious worship services or in a regular school of religious education. Since its enactment, the exemption has been expanded several times.

As a result of this change, a nonprofit church has two processes by which they can obtain an exemption for tangible personal property used for recording and reproducing services:

- They may use their self-issued exemption certificate (Form ST-13A) which has been expanded by this bill; or
- They may apply to TAX for a broader exemption under the new nonprofit entity exemption process, which was enacted during the 2003 Virginia General Assembly session.

Legislation passed in 2007 also expanded the Retail Sales and Use Tax exemption for nonprofit churches exempt from taxation under IRC § 501 (c)(3) or whose real property

is exempt from local taxation pursuant to the provisions of *Va. Code* § 58.1-3606. House Bill 2724 (Chapter 758) expanded the exemption to include tangible personal property used in the care or maintenance of any property owned by these churches. The exemption would include, but not be limited to, such items as mowing equipment and building materials that are installed by the church rather than through a contract. This report studies the cost of exempt purchases made by churches under the nonprofit entity exemption. The cost of the self-issued exemption certificate authorized under *Va. Code* § 58.1-609.10(16) was addressed in Report 1 of the 2007-2011 SUTES Study.

During the Special Session of the 2006 General Assembly, House Bill 5002 (Chapter 3, Special Session 1 of 2006) and House Bill 5012 (Chapter 2, Special Session 1 of 2006) modified the criteria that nonprofit entities were required to meet in order to qualify for a Retail Sales and Use Tax exemption. Previously, one of the criteria required organizations with gross annual revenues of \$250,000 or greater during the previous year to provide a financial audit performed by an independent certified public accountant to TAX. These bills changed this requirement to allow an entity with between \$250,000 and \$500,000 of gross annual revenue in the previous year to provide a review of its financial statements in lieu of a full audit. The review had to be performed by an independent certified public accountant. Entities with more than \$500,000 of gross annual revenue were still required to provide a full audit performed by an independent certified public accountant. Entities with less than \$250,000 of gross annual revenue continued to have no requirement to provide any type of financial audit or review.

The 2007 General Assembly passed legislation that modified the audit requirement for nonprofit organizations applying for a Retail Sales and Use Tax exemption. House Bill 2545 (Chapter 698), House Bill 3062 (Chapter 704) and Senate Bill 743 (Chapter 709) allowed nonprofit organizations with gross annual revenues between \$750,000 to \$1,000,000, the choice of providing a full "financial audit" or a "financial review" in lieu of a full financial audit, both of which had to be performed by an independent certified public accountant. Nonprofit organizations with gross annual revenues of \$1 million or greater were required to provide a full financial audit performed by an independent certified public accountant. Entities with less than \$750,000 of gross annual revenue had no requirement to provide any type of financial audit or review.

In 2009, legislation was enacted that modified these audit requirements again. House Bill 2330 (Chapter 106) and Senate Bill 1222 (Chapter 526) required that nonprofit organizations with \$750,000 in gross annual revenues in the previous year file a financial review performed by an independent certified public accountant. For nonprofit organizations with at least \$1 million in gross annual revenues in the previous year, TAX has the discretion to require that entity to provide a financial audit in lieu of a financial review.

ONLINE EXEMPTION PROCESS

Since June 2003, over 12,000 nonprofit organizations have accessed Nonprofit Online. Nonprofit Online, (<https://www.npo.tax.virginia.gov>) is an online application that was developed to provide a quick, efficient and secure way for an organization to apply for a Virginia sales and use tax exemption for the first time or renew its exemption certificate. Customers accessing Nonprofit Online may print out a copy of their Virginia sales and use certificate, edit certain registration information as it changes, as well as reprint lost certificates without having to contact TAX. TAX continues to receive high marks for its online application from organizations that have submitted applications online.

REVENUE IMPACT

Table 4 sets forth TAX's estimate of the total annual state and local Retail Sales and Use Tax revenue impact of the Nonprofit Entity Exemption. This estimate is based on information reported to TAX by nonprofit entities seeking to obtain a new or renewed exemption under *Va. Code* § 58.1-609.11. No nonprofit entities were surveyed to obtain this data.

Based on the original exemption sunset dates, the exemption categories are scheduled to renew on the following dates:

- Civic and community service (first half) (*Va. Code* § 58.1-609.8) July 1, 2009
- Civic and community service (second half) (*Va. Code* § 58.1 -609.8) July 1, 2010
- Cultural and Miscellaneous (*Va. Code* §§ 58.1 -609.9 and 58.1 -609.10) July 1, 2011
- Educational (*Va. Code* § 58.1 -609.4) July 1, 2012
- Medical-Related (*Va. Code* § 58.1 -609.7) July 1, 2013

Exemption certificates issued for nonprofit entities in Fiscal Year 2009 totaled 1,292. This included 282 renewed exemption certificates and 1,010 new exemptions. Each organization granted a new exemption retains that exemption for a five-year period, after which time, they must renew their exemption.

Table 4: State and Local Retail Sales and Use Tax Expenditure Resulting from Purchases Made by Nonprofit Organizations.

2008	\$175,364,334
2009	\$176,586,624*
2010	\$ 179,450,859*

* Projected using the Consumer Pricing Index for All Urban Consumers (CPI-U).

EXEMPTIONS FOR MEDICINES, DRUGS, AND MEDICAL SUPPLIES

AUTHORIZATION

Va. Code § 58.1-609.10(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. (Enacted 1966; Amended 1978, 1979, 1980, 1987, 1992, 1993, 1995, 1996, 1999, 2000, and 2006)

Va. Code § 58.1-609.10(11) - Drugs and supplies used in hemodialysis and peritoneal dialysis. (Enacted 1966; Amended 1984)

Va. Code § 58.1-609.10(14) - Any nonprescription drugs and proprietary medicines purchased for the cure, mitigation, treatment, or prevention of disease in human beings; and any samples of nonprescription drugs and proprietary medicines distributed free of charge by the manufacturer, including packaging materials and constituent elements and ingredients. 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. (Enacted 1990 - effective July 1, 1992; Amended 1992 - effective July 1, 1994; Amended 1996 – effective July 1, 1998; Amended 1997)

EXEMPTION SUMMARY

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

- 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;
- controlled 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;
- hemodialysis and peritoneal dialysis equipment;
- medicines purchased for use or consumption by a licensed hospital nursing home, clinic, or similar corporation;
- nonprescription or "over the counter" drugs and medicines when purchased for the cure, mitigation, treatment or prevention of disease in human beings; and
- samples of prescription and nonprescription drugs, distributed free of charge in certain instances.

Prior to 1993, the controlled drug exemption was limited to those drugs purchased for use by a licensed physician in his professional practice when the practice was organized as a sole proprietorship, partnership or professional corporation. Other entities, such as corporations, were not entitled to this exemption. In 1993, the General Assembly enacted legislation (*Acts of Assembly* 1993, Chapter 154) to include purchases of controlled drugs for use by physicians when organized as a corporation in which shareholders and operators are all licensed physicians practicing medicine.

The provision related to dialysis equipment and supplies exempts from the tax hemodialysis and peritoneal dialysis equipment, and supplies and drugs used in dialysis and is applicable regardless of the nature of the purchaser.

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 principally used for medical purposes, however, are taxable. This exemption is applicable regardless of the nature of the purchaser.

RATIONALE AND BACKGROUND

RATIONALE

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 not only to reduce the tax burden on the poor, but also to minimize the burden on those who may require large expenditures for medicines. 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. These drugs no longer are covered by or qualify for co-payments under numerous health insurance plans.

Historically, Virginia has opted to exempt various consumer necessities from its Retail Sales and Use Tax in order to reduce the regressivity of the tax. Sales and use taxes are inherently regressive in nature in that the relative burden of the tax falls most heavily upon those at the lowest income levels. Effectively, the proportion of income which must be expended on essential consumables such as food, clothing, medicine, and utilities is greater for low income persons. Thus, the sales tax exemptions for prescription and nonprescription medicines and drugs tend to make Virginia's sales tax less regressive.

LEGISLATIVE HISTORY

Medicines and Drugs: The original exemption for medicines and drugs included various items, such as crutches, braces, prosthetic devices, and eyeglasses. This exemption has undergone several changes through the years. The following briefly outlines how this exemption has evolved since its inception:

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 on prescriptions or work orders of licensed physicians, dentists, optometrists, ophthalmologists or opticians.

1972 – The exemption was expanded to include controlled 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.

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 controlled 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.

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.

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.

Hemodialysis and Peritoneal Dialysis Drugs and Supplies: The original exemption for hemodialysis and peritoneal drugs and supplies was available only when purchased by an individual for his own use. The exemption was revised in 1984 to include purchases of hemodialysis and peritoneal drugs and supplies made by physicians and other medical professionals.

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

In 1997, the exemption for nonprescription drugs and proprietary medicines was expanded to include samples of nonprescription drugs and proprietary medicines distributed free of charge by the manufacturer, including packaging materials and constituent elements and ingredients.

SCOPE

Together, these exemptions effectively exempt from the sales and use tax all prescription and nonprescription drugs and medicines, as well as hemodialysis and peritoneal dialysis drugs and supplies. Each exemption is explained in greater detail below.

Medicines and Drugs: The current medicines and drugs exemption includes the following categories of medicines, drugs, and related supplies:

- medicines, drugs, and hypodermic syringes dispensed by or sold on prescriptions or work orders of licensed physicians, dentists, ophthalmologists, etc.;
- hearing aids, eyeglasses, contact lenses, etc, dispensed by or sold on prescriptions;
- medicines and drugs when sold on prescription of a veterinarian;
- medicines and drugs purchased by veterinarians to be used in the cure and treatment of agricultural production animals; and
- controlled drugs purchased for use by a licensed physician, optometrist, licensed nurse practitioner, or licensed physician assistant in his professional practice.

Prescription Drugs

Sales of medicines or drugs, including oxygen, on written prescriptions of physicians, dentists, optometrists, ophthalmologists, opticians, audiologists, hearing aid dealers and fitters, nurse practitioners, physician assistants, and veterinarians are exempt from the tax. Unlike the nonprescription drug exemption which is available to anyone, the prescription medicine exemption is applicable only to sales of such to users or consumers. The exemption is also applicable to medicines or drugs sold as a prescription refill. Purchases of drugs by a dealer for filling prescriptions, while nontaxable, must be made under a resale certificate of exemption.

Sales of medicines to licensed hospitals and nursing homes conducted for profit for use or consumption by these entities are also exempt from the sales and use tax. Sales to nonprofit hospitals, nursing homes, or certain other nonprofit health-related entities for which an exemption exists under *Va. Code* § 58.1-609.11 are similarly nontaxable.

Hearing Aids, Eyeglasses, Contact Lenses

Sales of hearing aids, contact lenses, and eyeglasses ground on prescriptions, including frames as an integral part, are not subject to the tax. However, other optical goods not prescribed by a licensed optometrist or ophthalmologist are taxable. Taxable items include eyeglass frames that are not sold in connection with the repair or replacement eyeglasses ground on prescription, sunglasses that are not ground on prescription, cases, solution for cleaning eyeglasses, and various other optical supplies. Dealers that make sales of such items may purchase these items for resale under an exemption certificate. The nonprescription drug exemption renders rewetting and lubricating solutions for contact lenses exempt of the tax; however, disinfecting solutions for contact lenses remain taxable.

While sales of telescopes, binoculars, opera glasses and similar items are generally taxable, such items may be exempt from the tax when intended for use by the visually handicapped to take the place of or enhance eyeglasses. TAX has determined that monocular telescopes, hyperocular microscopic and prismatic spectacles which are dispensed only by prescription in Virginia qualify for an exemption from the tax when purchased for use by a visually handicapped individual.

Veterinarians

All sales of medicines and drugs on prescription or work order of licensed veterinarians are exempt from the tax. The exemption is also applicable to refills of prescription diets used in the treatment of animals and prescription treatments for flea control and animal skin conditions. Veterinarians, however, remain the users or consumers of all medicines and drugs that they purchase and thus are required to pay the tax on such at the time of purchase. An exception to this general rule was enacted in 2006 to allow veterinarians to purchase medicines and drugs that will be used or consumed directly in the care, medication and treatment of agricultural production animals exempt of the Retail Sales and Use Tax. As a result of this legislative change, veterinarians may also purchase medicines and drugs exempt of the Retail Sales and Use Tax if they will be resold to a farmer for direct use in producing an agricultural product for market.

The tax treatment of veterinarians on their purchases of medicines and drugs differs from that of licensed physicians in that dealers of prescription drugs may purchase the drugs for resale under an exemption certificate. As explained below, physicians may also purchase controlled drugs exempt from the tax. Both veterinarians and physicians, however, are deemed to be the users and consumers of all other tangible personal property used in their practices, such as furniture, equipment and instruments. Veterinarians may purchase nonprescription pet foods and flea sprays, pet supplies and similar items for subsequent resale under an exemption certificate.

This exemption was enacted because veterinarians and physicians are licensed separately in Virginia and the term "licensed physician" is defined in Title 23 of the *Virginia Administrative Code*, Section 10-210-940 as including only those persons

licensed as medical doctors and not veterinarians, chiropractors, opticians, optometrists and similar persons.

Controlled Drugs

Prior to the enactment of legislation in 1992, TAX's policy with respect to the controlled drug issue had been based on a literal interpretation of the statute and consistent with Virginia court opinions dealing with bulk purchases of drugs. It essentially provided that only controlled drugs purchased by a physician for use in his private practice were nontaxable and that bulk sales to a clinic or group practice were taxable. TAX settled out of court in 1991 on litigation involving this issue due to changes in the nature of the medical practice since the enactment of the exemption in 1972. While TAX's literal interpretation of the law was correct and in agreement with case law, the basis for the settlement was the perceived legislative intent that all purchases of controlled drugs for use by physicians, whether organized as a sole proprietorship, partnership, or professional corporation, should be exempt.

Nonprofit hospitals and licensed nursing homes may purchase controlled drugs exempt from the tax under *Va. Code* §§ 58.1-609.11 and 58.1-609.10 respectively. However, for-profit hospitals and nursing homes, and other entities not specifically exempt by law are liable for the tax on their purchases of controlled drugs. TAX's policy as it relates to bulk purchases of drugs by other entities remains unchanged.

The term "controlled drugs" is defined in Title 23 of the *Virginia Administrative Code*, Section 10-210-940, as those drugs itemized under *Va. Code* § 54.1-3400 *et seq.* but includes only medicines and drugs and not devices.

Hemodialysis and Peritoneal Dialysis Drugs and Supplies: *Va. Code* § 58.1-609.10(11) provides an exemption from the Retail Sales and Use Tax for drugs and supplies used in hemodialysis and peritoneal dialysis. This exemption is applicable regardless of the nature of the purchaser and overlaps with the medicines and drugs exemption in that sales of dialysis drugs on written prescriptions of physicians are exempt under *Va. Code* § 58.1-609.10(9).

This exemption was enacted to provide tax relief to people who, because of medical necessity, must purchase hemodialysis and peritoneal dialysis equipment to facilitate their recovery, rehabilitation or return to normal or near-normal functioning.

While the controlled drug provisions of the medicines and drug exemption in *Va. Code* § 58.1-609.10(9) were originally interpreted as exempting kidney dialysis equipment, hemodialysis and peritoneal drugs and supplies when purchased by an individual for his own use, this exemption was enacted to create a specific exemption for any purchases of dialysis drugs, equipment and supplies, regardless of whether purchased by physicians, hospitals, etc., or persons medically in need of such drugs or supplies.

The exemption extends to all drugs, supplies and equipment that are purchased for and used in the actual treatment of patients. Exempt items include, but are not limited to, solutions, needles, syringes, tape, bandages, alcohol, and catheters. General purpose supplies such as face masks, paper towels, and trays, as well as examination tables and instruments such as stethoscopes, forceps and surgical scissors are taxable.

This exemption is applicable regardless of the nature of the purchaser. Thus, any hospital, or other medical related entity, physician, or any individual may purchase dialysis drugs, equipment, and supplies exempt from the tax. This exemption effectively provides a broader exemption to physicians, hospitals, and clinics specializing in kidney dialysis treatment than available to other physicians and hospitals.

Nonprescription Drugs and Proprietary Medicines: Nonprescription drugs or "over-the-counter drugs" which are generally sold for use in the cure, mitigation or treatment of disease in human beings are exempt from the tax. Cosmetics and toiletry items, however, are taxable unless they contain medicinal ingredients and are principally used for medical treatment. Likewise, vitamins and mineral concentrates sold as dietary supplements or adjuncts are taxable, unless these items are sold pursuant to a written prescription by a licensed physician, nurse practitioner, or physician's assistant.

Like the prescription drug exemption, this exemption is limited to medicines and drugs and does not extend to devices such as test kits, non-medicinal bandages, gauze, etc. However, unlike the prescription drug exemption, this exemption is applicable regardless of the nature of the purchaser. Thus, nonprescription drugs and proprietary medicines may be purchased exempt of the tax by individuals, physicians, profit and nonprofit hospitals and other entities.

COURT CASES

The exemption for medicines and drugs has been interpreted by the Virginia Supreme Court in Northern Virginia Doctors Hospital v. Department, 213 Va. 504, 193 S.E.2d 684 (1973) and Commonwealth v. Bluefield Sanitarium, 216 Va. 686, 222 S.E.2d 526 (1976). In addition, the Circuit Court of the City of Richmond specifically dealt with the issue of purchases of medicines and drugs by a clinic in Biomedical Applications of Roanoke v. Commonwealth (June 3, 1988 opinion).

In Northern Virginia Doctors Hospital, medicines and drugs were obtained from a pharmacy independent from the hospital. When a specific patient required medication, a physician's order sheet was completed and the appropriate medication was dispensed by the pharmacy. The court concluded that this procedure constituted the exempt sale of medicines or drugs on the prescription or work order of a licensed physician.

In Bluefield Sanitarium, however, the hospital maintained its own pharmacy, which purchased bulk quantities of medicines and drugs. Medication was in turn dispensed by the pharmacy to patients on an as needed basis. Based on this distinction, the court concluded that the hospital exercised a taxable use over the medicines and drugs prior

to their dispensation to patients on the prescription or work order of a licensed physician.

METHODOLOGY

Medicines and Drugs

Separate datasets were obtained for each of the components of the medicines and drugs exemption, including prescription drugs, controlled drugs, hearing aids, and eyeglasses and related items.

The impact from the repeal of the prescription drugs sales tax exemption was derived from a dataset provided by IMS Health, an international market research and consulting firm that specializes in providing sales data to the pharmaceutical and medical industries. The data was scaled to the state level using Virginia's population relative to the United States (approximately 2.56%) and necessary calendar-to-fiscal year adjustments were made.

IMS Health also compiled a special dataset for controlled substances, based upon the number of controlled substances prescribed in Virginia each month between calendar year 2005-2008. This dataset was divided into four different classifications for controlled substances and by patient co-pay amounts. Because controlled drugs are a subset of prescription drugs, this estimate was not added to the prescription drug revenue estimate.

The hearing aids' revenue estimate was taken from a dataset of Virginia sales of hearing aids (in units) provided by the Hearing Industry Association, which was multiplied by the average cost per unit (in Virginia, approximately \$1,800).

The fiscal impact of the exemption available for eyeglasses, eyeglass cases, contact lenses, contact lens solution, and contact lens storage and sterilization kits was derived from data supplied by the Jobson Publishing Company. The data was limited to three fiscal years, and data regarding ocular prosthetics was not available.

Hemodialysis and Peritoneal Dialysis Supplies

Hemodialysis and peritoneal dialysis data was obtained through a survey developed by TAX and sent to the 136 dialysis units in Virginia. These units were obtained from the U.S. Food and Drug Administration. The survey sought the total dollar amounts of drugs and supplies used directly in hemodialysis and peritoneal dialysis in the last five years and the number of treatments performed each year. The dialysis units were given the discretion to use calendar or fiscal years when reporting data. Because TAX did not receive all of the requested data by the specified deadline, TAX used the response rates of 35.3% for Fiscal Year 2006 and 36.03% for Fiscal Year 2007 and 2008 to extrapolate the data to the total population.

See the attachments for the survey instruments.

Nonprescription Drugs

Two datasets were used to derive the revenue estimate of nonprescription drugs. The first dataset was taken from the Consumer Healthcare Products Association (CHPA), and included calendar year data from 2000 to 2008 of over-the-counter (“OTC”) drugs at the national level, excluding sales made by Wal-Mart. The second dataset, obtained directly from Wal-Mart’s Sales Tax Department, provides fiscal year 2008 OTC sales at the Virginia level.

REVENUE ANALYSIS

Medicines and Drugs

Based on TAX’s data, it is estimated that the state and local revenues would increase by approximately \$440,427,499 in Fiscal Year 2009, \$462,330,494 in Fiscal Year 2010 and \$484,193,452 in Fiscal Year 2011 if the exemption for medicines and drugs is repealed. See Table 1 below. Following Table 1 are charts that provide a breakdown of the revenue impact for prescription drugs (with controlled substances as a subset), hearing aids, and eyeglasses and related items.

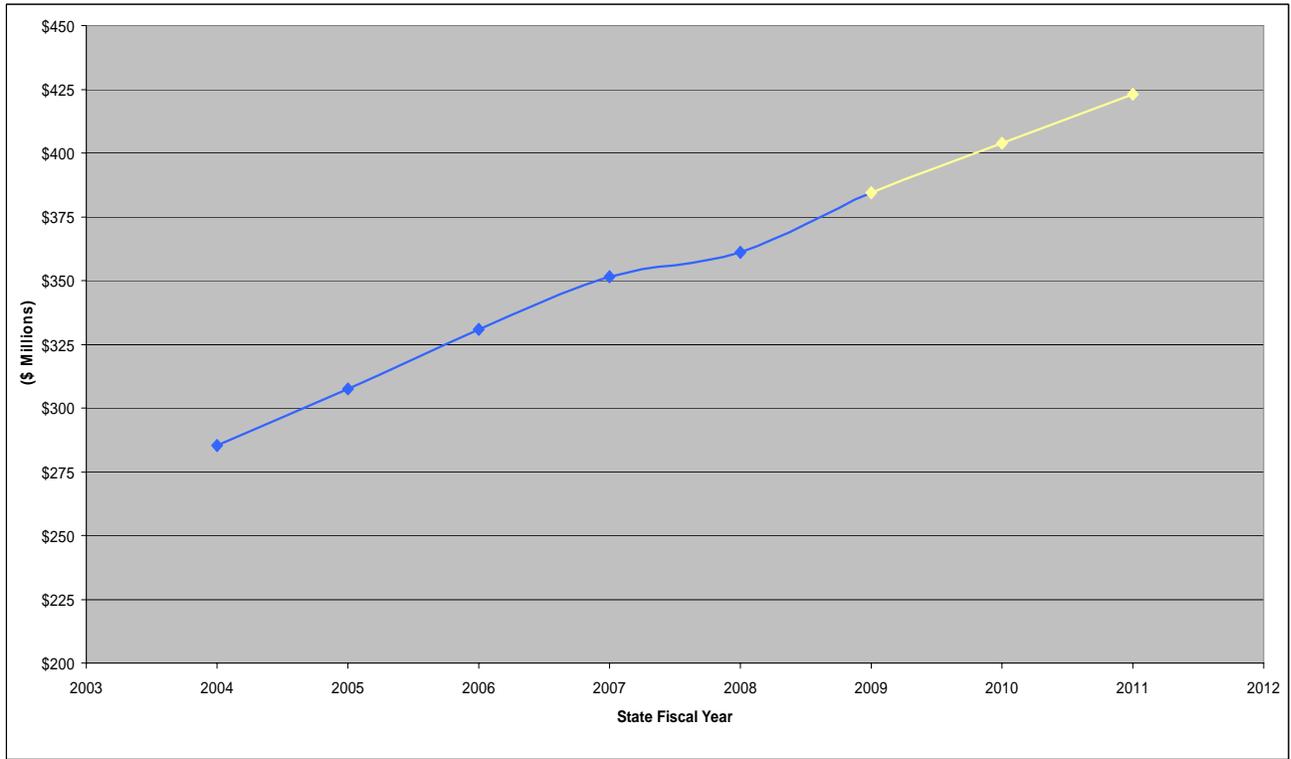
Table 1: Total State and Local Sales Tax Expenditure Resulting from Medicines and Drugs Exemption

Fiscal Year	Prescription Drugs	Controlled Substances	Hearing Aids	Eyeglasses, Etc.	Total
2005	\$307,574,649	-	\$3,227,798	-	\$310,802,447
2006	\$330,808,318	\$20,138,441	\$3,533,672	\$23,290,926	\$357,632,916
2007	\$351,625,144	\$22,959,098	\$3,772,980	\$23,741,834	\$379,139,958
2008	\$360,954,247	\$24,638,614	\$3,951,736	\$23,778,165	\$388,684,148
2009	\$384,490,134**	\$27,714,285**	\$4,123,028**	\$24,100,052**	\$412,713,214
2010	\$403,762,636**	\$29,930,142**	\$4,286,986**	\$24,350,730**	\$432,400,352
2011	\$423,035,137**	\$32,113,024**	\$4,444,007**	\$24,601,284**	\$452,080,428

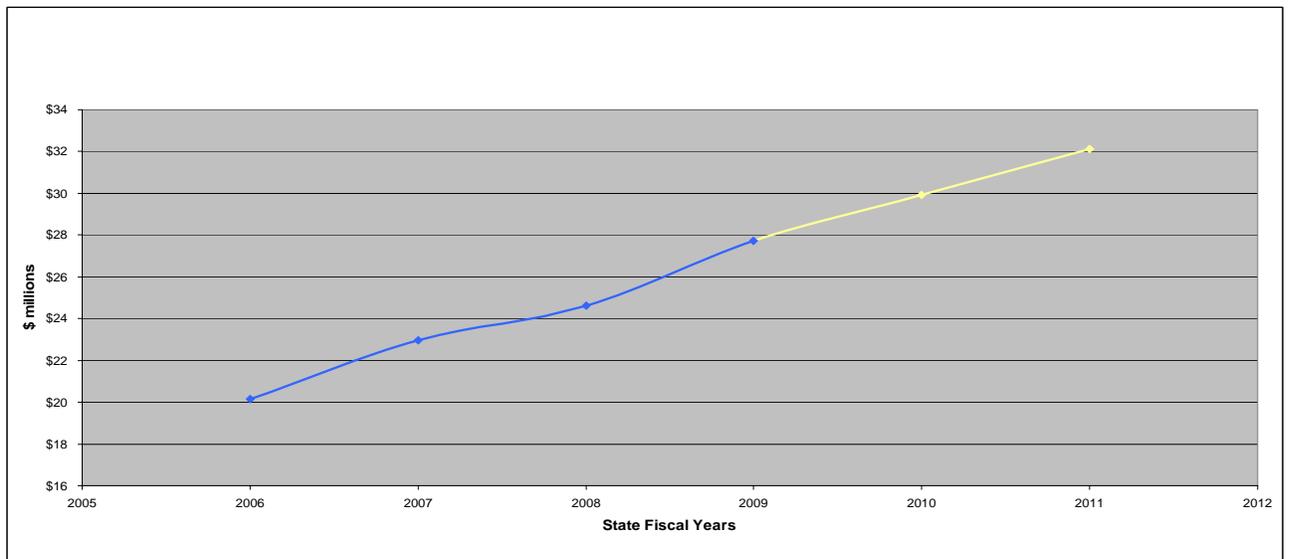
* Controlled Substances are a subset of Prescription Drugs and that expenditure is included in the Prescription Drug expenditure

** Projected using the Linear/Holt Exponential Smoothing Model (from SAS Time Series Forecasting System) and the Excel Forecasting System

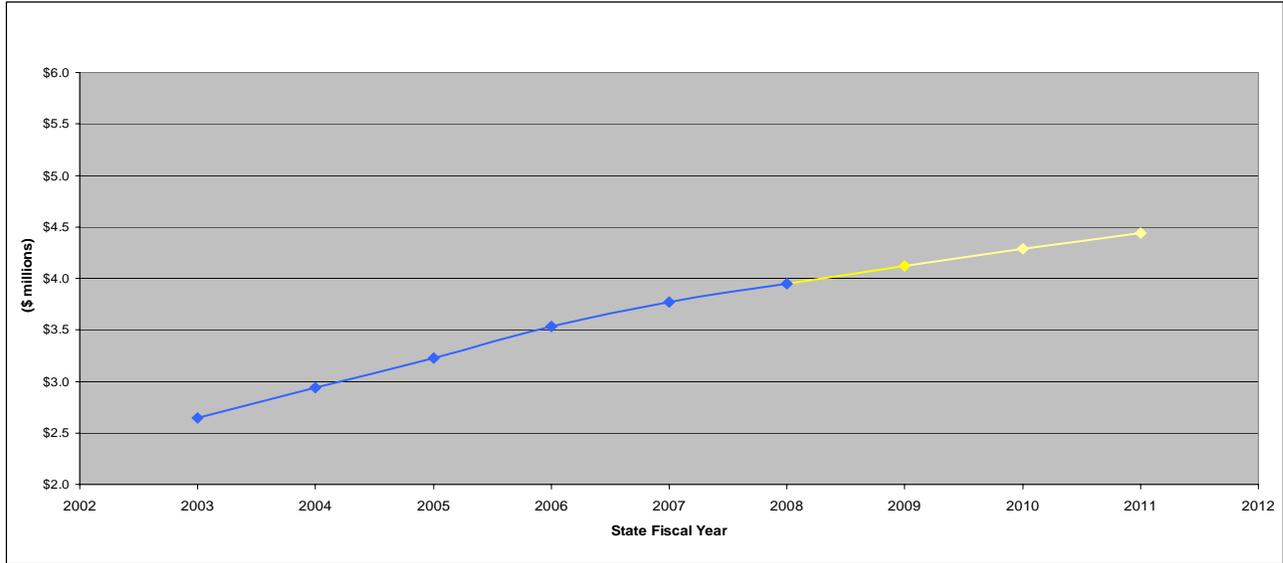
Revenue Impact – Prescription Drug Exemption
State Fiscal Year 2004-2011



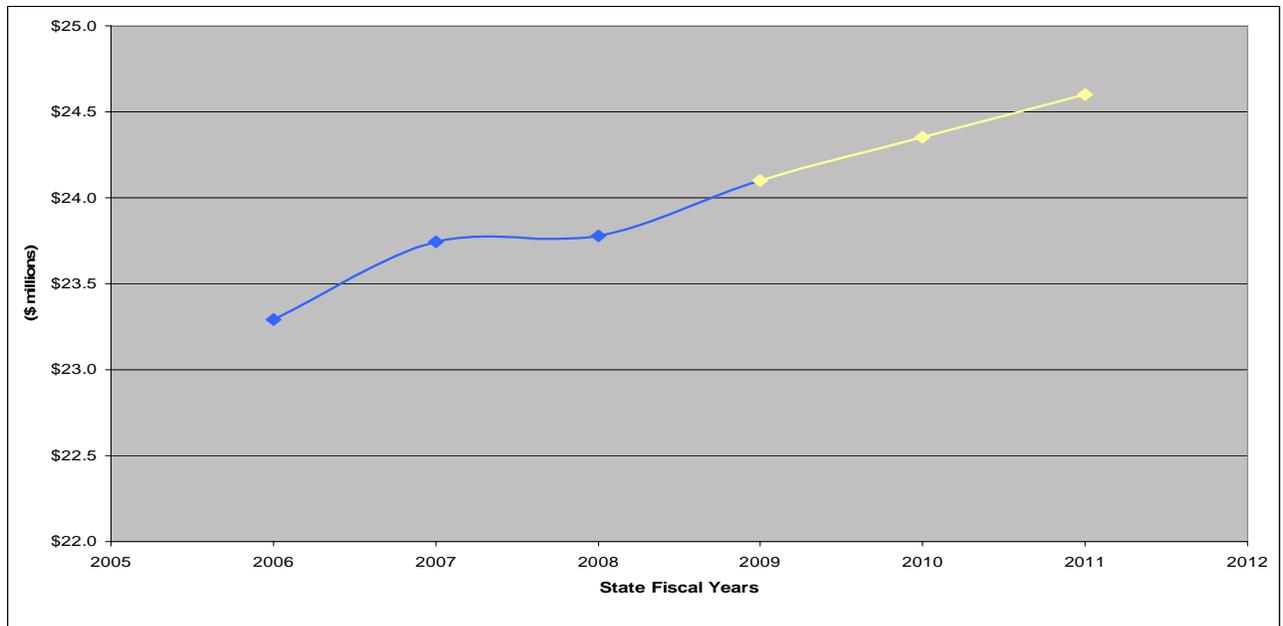
Revenue Impact – Controlled Substances Exemption
State Fiscal Years 2006-2011



**Revenue Impact – Exemption on Hearing Aids
State Fiscal Years 2003-2011**



**Revenue Impact – Exemption for Eyeglasses, Eyeglass Cases, Contacts,
Contact Lens Solution
State Fiscal Year 2006-2011**



Hemodialysis and Peritoneal Dialysis Supplies

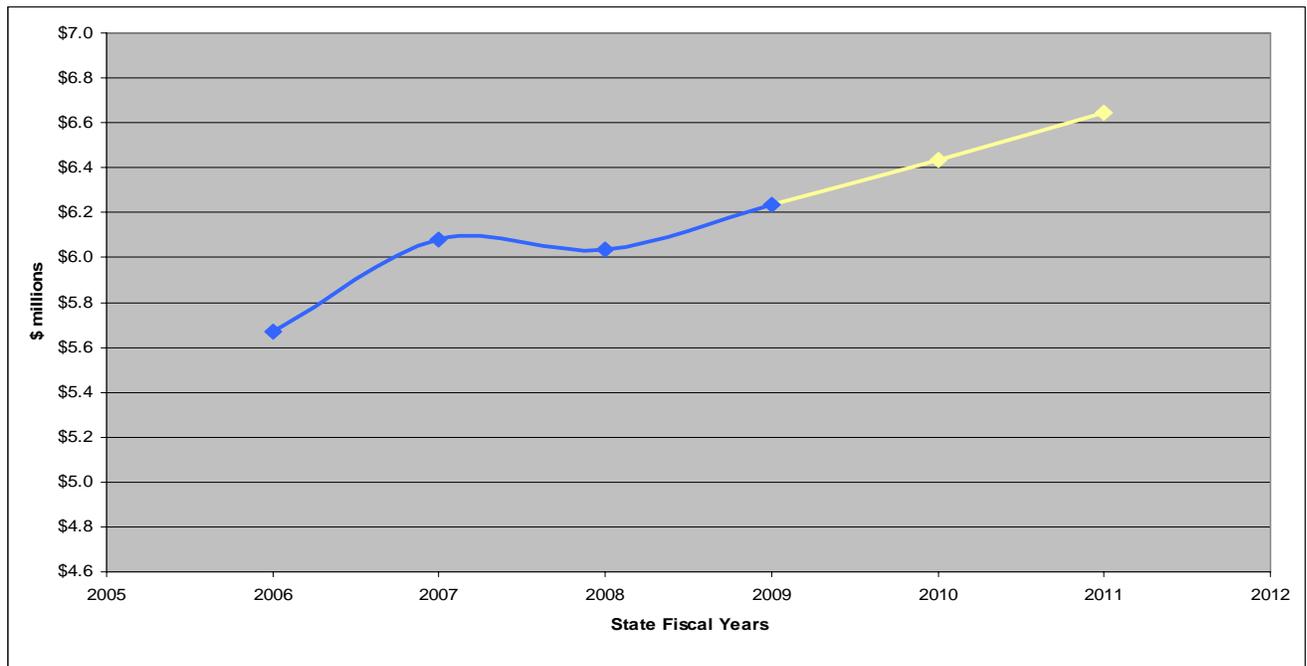
Based on TAX’s data obtained from responses to a survey sent to 136 dialysis units in Virginia, it is estimated that the state and local revenues would increase by approximately \$8,326,381 in Fiscal Year 2009, \$8,481,421 in Fiscal Year 2010, and \$8,644,265 in Fiscal Year 2011 if the exemption for hemodialysis and peritoneal dialysis drugs and supplies is repealed. See Table 2 below.

Table 2: Total State and Local Sales Tax Expenditure Resulting from Dialysis Drugs and Supplies Exemption

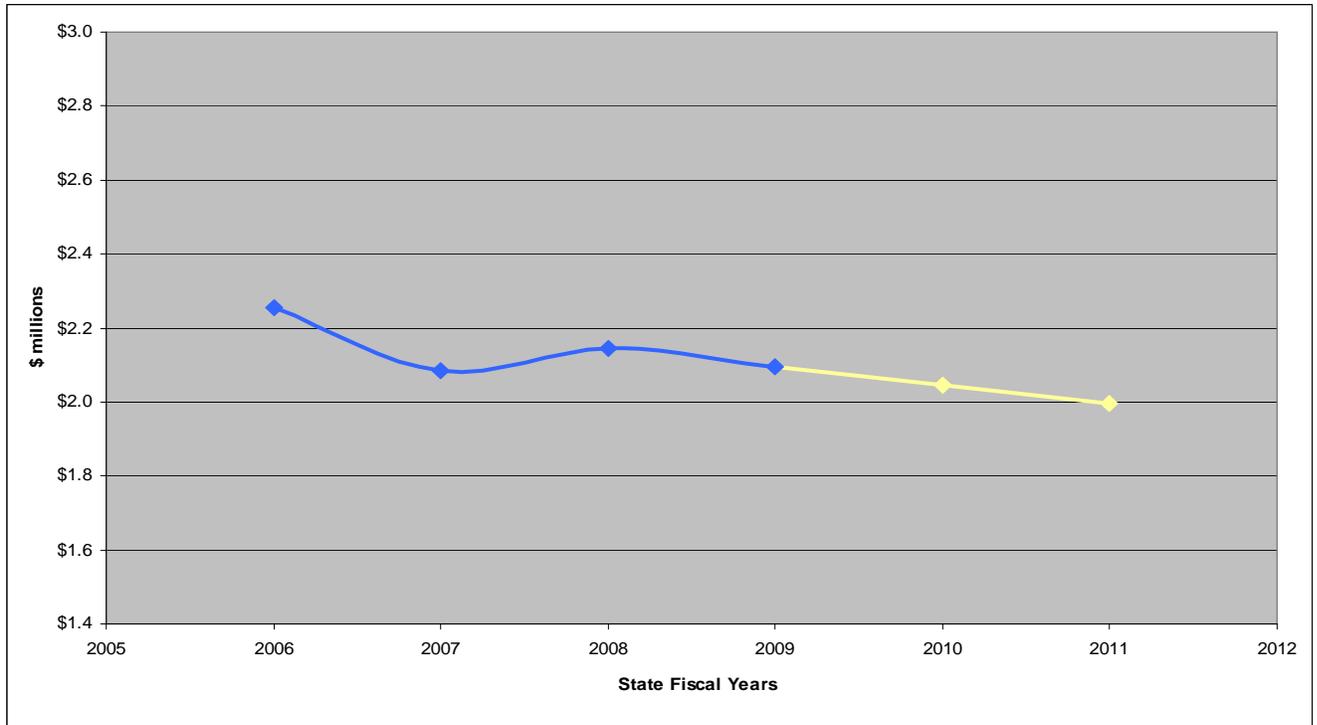
<u>Fiscal Year</u>	<u>Purchases of Dialysis Drugs</u>	<u>Purchases of Dialysis Supplies</u>	<u>Total Revenue Estimate</u>
2006	\$5,667,538	\$2,253,675	\$7,921,213
2007	\$6,081,470	\$2,102,490	\$8,183,960
2008	\$6,035,109	\$2,143,852	\$8,178,962
2009	\$6,232,494*	\$2,093,887*	\$8,326,381
2010	\$6,436,335*	\$2,045,086*	\$8,481,421
2011	\$6,646,843*	\$1,997,422*	\$8,644,265

*Projected using the Average Growth Rate

**Revenue Impact – Exemption Regarding Purchases of Dialysis Drugs
State Fiscal Years 2006-2011**



**Revenue Impact – Exemption Regarding Purchases of Dialysis Supplies
State Fiscal Years 2006-2011**



Nonprescription Drugs

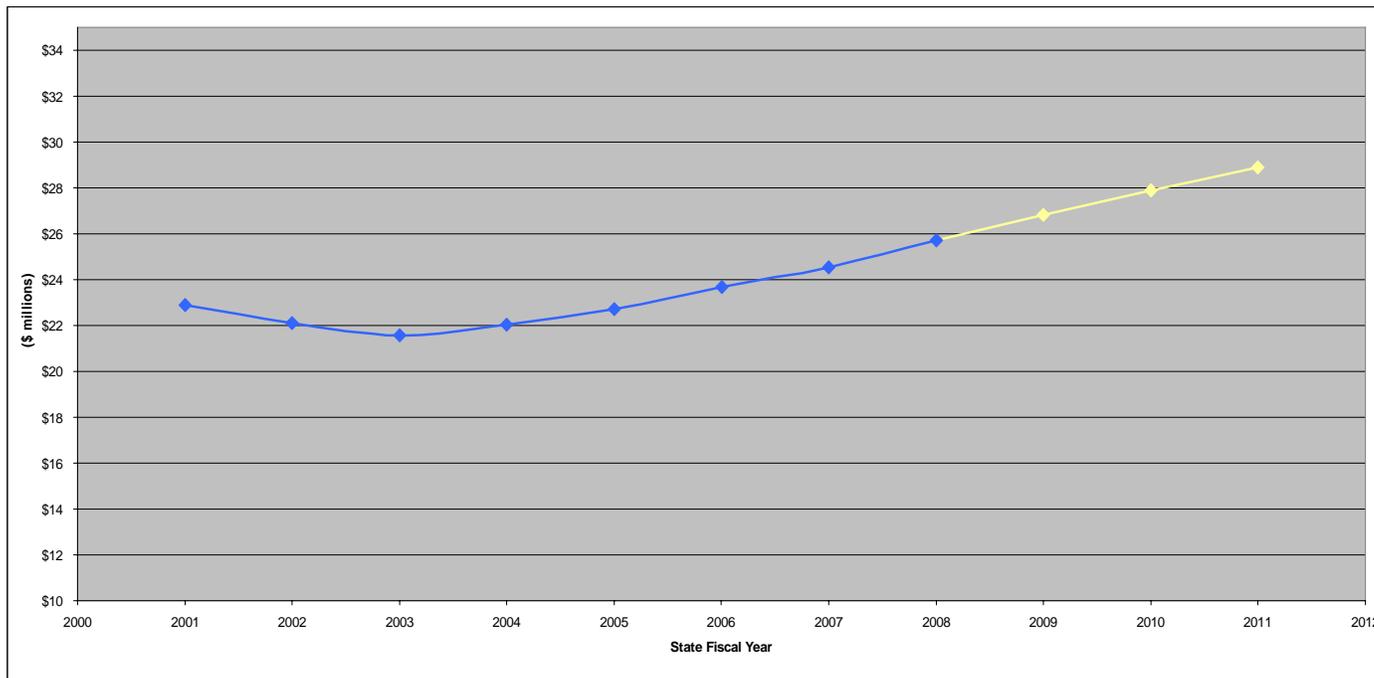
Unlike the previous exemptions, the exemption for nonprescription drugs was not reviewed during the previous Sales and Use Tax Expenditure Study in 1992. The increase in state and local revenues that would result from the repeal of the nonprescription drugs exemption is estimated to be \$26,824,857 in Fiscal Year 2009, \$27,884,740 in Fiscal Year 2010, and \$28,893,445 in Fiscal Year 2011. See Table 3.

Table 3: Total State and Local Sales Tax Expenditure Resulting from Nonprescription Drugs Exemption

2001	\$22,909,080
2002	\$22,123,761
2003	\$21,574,315
2004	\$22,031,379
2005	\$22,726,812
2006	\$23,695,267
2007	\$24,541,412
2008	\$25,712,279
2009	\$26,824,857*
2010	\$27,884,739*
2011	\$28,893,445*

*Projected using the Damped Trend Exponential Smoothing (from SAS Time Series Forecasting System)

**Revenue Impact – Nonprescription Drug Exemption
State Fiscal Year 2001-2011**



BENEFICIARIES

Beneficiaries of these exemptions include purchasers of both prescription and nonprescription drugs, and hypodermic syringes, artificial eyes, contact lenses, eyeglasses and hearing aids dispensed by or sold on prescriptions. The exemption also benefits licensed physicians, dentists, optometrists, ophthalmologists, opticians, audiologists, nurse practitioners, physician assistants, and veterinarians that purchase controlled drugs. Additionally, the exemption benefits veterinarians that are purchasing medicines and drugs to be used in agricultural production.

All purchasers of nonprescription drugs, including individuals, physicians, and medical entities (e.g., hospitals, nursing homes), may make such purchases exempt of the tax. Nonprofit hospitals and other nonprofit health-related entities may purchase nonprescription drugs and all other tangible personal property exempt of the tax pursuant to *Va. Code* § 58.1-609.11. In addition, for-profit licensed hospitals, nursing homes, clinics, and similar corporations may purchase medicines and drugs for their use or consumption exempt of the tax.

While service providers directly benefit from these exemptions, patients may also benefit indirectly as a result of this exemption. To the extent that the costs of medicines, drugs, and other eligible items are lower for service providers due to the availability of the exemption, they can provide their services at a lower cost to their patients.

To the extent that the cost of these services are lower due to the existence of these exemptions, their patients also benefit.

STATE COMPARISONS

OTHER STATES

Of the 45 other sales tax jurisdictions (including Washington, D.C.):

Prescription Drugs for Humans

- 43 exempt sales of prescription drugs as does Virginia; and
- 1 fully taxes such sales (Hawaii); and
- 1 taxes at a reduced rate of 1 percent (Illinois).

Controlled Drugs Purchased by Physicians

- 32 exempt purchases of controlled drugs by physicians as does Virginia;
- 10 fully tax;
- 1 taxes at a reduced rate of 1 percent (Illinois);
- 1 taxes unless furnished to a patient (Colorado); and
- 1 exempts if it is a prescription drug (Washington).

Nonprescription Drugs for Humans

- 10 exempt sales of nonprescription drugs as does Virginia;
- 32 fully tax such sales;
- 1 taxes at a reduced rate of 1 percent (Illinois);
- 1 provides an exemption if the drugs are required to be labeled with a "Drug Facts" panel (Texas); and
- 1 provides an exemption if sold for use by individuals with a disability (Missouri).

Prescription Drugs for Animals

- 15 exempt sales of prescription drugs for animals as does Virginia;
- 18 fully tax such sales; and
- 12 provide exemptions based upon which type of animal the drug is used.

Drugs Purchased by Veterinarians

- 9 provide exemptions based upon which type of animal the drug is used or what the drugs are used for as does Virginia;
- 26 fully tax; and
- 10 exempt.

Nonprescription Drugs for Animals

- 25 tax sales of nonprescription drugs for animals as does Virginia;
- 6 exempt such sales; and
- 14 provide exemptions based upon which type of animal the drug is used.

Dialysis Drugs and Supplies

- 7 exempt sales of dialysis drugs and supplies as does Virginia;
- 15 exempt sales of prescription dialysis drugs and prescription dialysis supplies;
- 1 exempts sales of dialysis drugs and prescription dialysis supplies (Rhode Island);
- 2 exempt sales of dialysis drugs but tax dialysis supplies;
- 2 exempt sales of prescription dialysis drugs and exempt all dialysis supplies;
- 15 exempt sales of prescription dialysis drugs but tax all dialysis supplies;
- 1 exempts sales of dialysis drugs and supplies by a licensed pharmacist or person with a permit (Maryland);
- 1 fully taxes such sales (Hawaii); and
- 1 taxes at a reduced rate of 1 percent (Illinois).

Vision Aids

- 21 exempt sales of prescription vision aids as does Virginia;
- 1 exempts when sold by an ophthalmologist, but not if sold by an optician or optometrist (Alabama);
- 1 exempts sales of prescription vision aids excluding contact lenses (Michigan);
- 8 exempt sales of vision aids generally;
- 8 fully tax such sales to the customer
- 4 tax such sales to the provider
- 1 taxes sales of eyeglasses to the customer in a retail establishment but taxes sales to an ophthalmologist or optometrist if it manufactures the eyeglasses (Mississippi); and
- 1 taxes at a reduced rate of 1 percent (Illinois).

Hearing Aids

- 14 exempt sales of prescription hearing aids as does Virginia;
- 1 exempts sales of hearing aids by licensed hearing aid dispensers (California);
- 24 exempt sales of hearing aids generally;
- 5 fully tax; and
- 1 taxes at a reduced rate of 1 percent (Illinois).

See Appendices 1 and 2 for a complete breakdown of the tax treatment of the above items, as well as other items.

BORDER STATES

Of Virginia's border jurisdictions (District of Columbia, Kentucky, Maryland, North Carolina, Tennessee, and West Virginia), all provide exemptions from the retail sales and use tax for sales of prescription drugs and exempt controlled drugs purchased by physicians. Only West Virginia taxes samples of prescription drugs; all other jurisdictions exempt samples of prescription drugs just as Virginia does. Nonprescription drugs, however, are exempt as in Virginia only in Maryland and the District of Columbia.

Only the District of Columbia and North Carolina exempt prescription sales by veterinarians as Virginia does. Sales of nonprescription drugs for animal use are taxed as in Virginia by all jurisdictions except the District of Columbia. In addition, purchases by veterinarians of drugs are taxed in Maryland, Tennessee, and West Virginia as they are in Virginia.

All of Virginia's border jurisdictions provide some form of exemption for medical equipment and supplies such as hearing aids and eyeglasses. Specific exemptions for dialysis drugs and supplies are only provided for in Tennessee; however, all of the other jurisdictions do provide some form of exemption, though they are narrower than the one Virginia provides.

DIRECT OR INDIRECT GOVERNMENT ASSISTANCE

Individuals purchasing exempt medicines and drugs, hypodermic needles, eyeglasses, etc., may receive reimbursement for all or a portion of the costs of such through federal or state funded insurance programs.

LICENSURE

Physicians, optometrists, hearing aid dealers, ophthalmologists, veterinarians, etc., are required to be licensed by the state. Physicians in Virginia may dispense under certain circumstances without being required to obtain a license to dispense from the Board of Pharmacy. Those circumstances include the dispensing of manufacturer's samples appropriately labeled as samples and not for sale, dispensing in a bona fide medical emergency, and dispensing when pharmaceutical services are not otherwise available. Except for in those circumstances, physicians must be licensed by the Virginia Board of Pharmacy and have a Drug Enforcement Agency number in order to handle drugs. Certain pharmacists, nurses, and technicians may administer drugs and vaccines to humans under the direction and supervision of a medical practitioner that has the authority to prescribe medications.

Veterinarians in Virginia may only prescribe, dispense and administer controlled substances in good faith for use by animals within the course of his professional practice. Veterinarians may not prescribe controlled substances for human use.

Assistants and orderlies may administer drugs to animals under the direction and supervision of a veterinarian.

EXTERNAL MANDATES

There are no apparent state or federal statutory or constitutional mandates having an impact on these exemptions.

OTHER STATE AND LOCAL TAX BURDENS

Individuals purchasing medicines and drugs and other medical items exempted by these provisions are subject to Virginia state income taxes and the sales and use tax on purchases of tangible personal property. In addition, they are generally subject to local property taxes.

Licensed physicians, veterinarians, dentists, optometrists, ophthalmologists, opticians, audiologists, hearing aid dealers and fitters are subject to Virginia state income taxes and generally subject to the sales and use tax on their purchases of items used in the rendition of their professional services. In addition, they are subject to local property and license taxes. The maximum local license taxes for professional, finance, and real estate services is \$0.58 per \$100 of gross receipts, as compared to \$0.20 per \$100 for retail businesses and \$0.36 per \$100 for repair, personal, and business service providers.

SIMILAR TAXPAYERS

Purchasers of medical devices, supplies and cosmetics which do not meet the statutory or regulatory requirements under these or other exemptions are required to pay the tax on such. In addition, purchasers of nonprescription sunglasses and other optical devices not sold on a written prescription, e.g., binoculars, telescopes, and opera glasses, are required to pay the tax on such purchases. For-profit hospitals, nursing homes, and other entities not specifically exempt by law are taxable on their purchases of controlled drugs.

APPENDIX 1
Medicine and Drug Exemptions by State

	Prescription Drugs for Human Use	Controlled Drugs Purchased by Physicians	Nonprescription Drugs for Human Use	Prescription Drug Samples for Human Use	Nonprescription Drug Samples for Human Use	Prescription Drugs for Animal Use	Drugs Purchased by Veterinarians	Nonprescription Drugs for Animal Use
Alabama	E	T	T	T	T	T	T	T
Arizona	E	T	T	T	T	E	T	T
Arkansas	E	E	T	E	T	T	T	T
California	E	E	T	E	E	T*	T*	T*
Colorado	E	T*	T	E	E	T	T	T
Connecticut	E	E	E	E	E	E	E	E
District of Columbia	E	E	E	E	E	E	E	E
Florida	E	E	E	E	E	E	E	E
Georgia	E	E	T	E*	E*	T	T**	T
Hawaii	T	E	T	T	T	T	T	T
Idaho	E	T	T	E	T	T*	T	T*
Illinois	T*	T*	T*	T*	T*	T	T	T
Indiana	E	E	T	E	E	E	E	T
Iowa	E	E	T	E	T	E	E	T
Kansas	E	T	T	E	T	E	T	T
Kentucky	E	E	T	E	T	T	E	T
Louisiana	E	T	T	T*	T*	T**	T	T**
Maine	E	E	T	E	T	T*	T	T*
Maryland	E	E	E	E	E	T*	T	T*
Massachusetts	E	T	T	T	T	T	T	T
Michigan	E	T	T	E	T	T	T	T
Minnesota	E	E	E	E	E	T	T	T
Mississippi	E	E	T	E	T	T*	T	T*
Missouri	E	T	T*	E	T	E	T**	T
Nebraska	E	T	T	E	T	T	T	T

	Prescription Drugs for Human Use	Controlled Drugs Purchased by Physicians	Nonprescription Drugs for Human Use	Prescription Drug Samples for Human Use	Nonprescription Drug Samples for Human Use	Prescription Drugs for Animal Use	Drugs Purchased by Veterinarians	Nonprescription Drugs for Animal Use
Nevada	E	E	T	E	E	T	T	T
New Jersey	E	E	E	E	E	T	T	T
New Mexico	E	E	T	E	T	E	T	T*
New York	E	E	E	E	E	T*	T	T*
North Carolina	E	E	T	E	T	E	E	T
North Dakota	E	E	T	E	T	T*	T*	T*
Ohio	E	E	T	E	T	T*	T*	T
Oklahoma	E	E	T	E	T	T*	T*	T*
Pennsylvania	E	E	E	E	E	E	E	E
Rhode Island	E	E	E	T	T	E	E	E
South Carolina	E	T	T	E	T	E	T*	T*
South Dakota	E	E	T	E	T	T	T	T
Tennessee	E	E	T	E	T	T*	T*	T*
Texas	E	E	E*	E	E*	E	T	T**
Utah	E	E	T	E	E	T	T	T
Vermont	E	E	E	E	E	E	E	E
VIRGINIA	E	E	E	E	E	E	T*	T
Washington	E	E*	T	E	T	T	T	T
West Virginia	E*	E	T	T	T	T	T	T
Wisconsin	E	E	T	E	T	T*	T*	T*
Wyoming	E	E	T	E	E	T	T	T

KEY:

E = Exempt

T = Taxable

NOTES:

The following states do not have a general sales and use tax: Alaska, Delaware, Montana, New Hampshire, and Oregon.

California	* - Drugs administered to food animals or as an additive or component of their feed or drinking water primarily to prevent or control disease are exempt.
Colorado	* - Drugs furnished to patients are exempt.
Georgia	* - As of September 1, 2008, taxation of free samples was suspended by the Governor until the General Assembly can act. ** - New animal drugs dispensed without charge for clinical trials are exempt.
Idaho	* - Drugs sold to a cattle rancher, dairyman, or other person operating a stock, dairy, poultry, fish, fur or other ranch for profit are exempt.
Illinois	* - Taxable at a reduced rate of 1%.
Louisiana	* - Taxable at a reduced rate of 1%. ** - Pharmaceuticals administered to livestock for agricultural purposes animals are exempt.
Maine	* - Medicines and antibiotics used in commercial agricultural and aquacultural production are exempt.
Maryland	* - Medicines sold for use by animals, including pets, for agricultural purposes are exempt.
Mississippi	* - Medicines, antibiotics, hormones, and vaccines used in producing and growing fish, livestock, and poultry are exempt.
Missouri	* - Nonprescription drugs sold for use by individuals with a disability are exempt. ** - Medicines and vaccines administered to livestock and poultry used to produce food and fiber are exempt.
New Mexico	* - Medicines used in the medical treatment of cattle used or raised on New Mexico farms and ranches are exempt.
New York	* - Drugs sold by a veterinarian for use by domestic animals and poultry are exempt.
North Dakota	* - Drugs used for livestock and poultry are exempt.
Ohio	* - Veterinarians are the users or consumers of prescription drugs even if sold to others.
Oklahoma	* - Veterinarians are the users or consumers of drugs even if sold to others.
South Carolina	* - Drugs used to treat animals raised on a farm for sale are exempt.
Tennessee	* - Drugs used to treat livestock are exempt.
Texas	* - Nonprescription drugs for humans are exempt if required to be labeled with a "Drug Facts" panel. ** - Nonprescription drugs for animals are exempt when purchased by farmers to care for agricultural products for sale, working dogs and horses, and animals that are marketed.
Virginia	* - Purchases of drugs by veterinarians are exempt if used for agricultural production animals. However, drugs are taxable if used in treating animals in general.
Washington	* - Only prescription drugs purchased by physicians are exempt.
West Virginia	* - Sales of prescription drugs other than to the final consumer are taxable.
Wisconsin	* - Medicines used on livestock are exempt.

APPENDIX 2
Medical Equipment and Supplies Exemptions by State

	Dialysis Drugs and Supplies	Hearing Aids	Vision Aids- Eyeglasses, etc.	Orthodontic Appliances	Syringes	Bandages, etc.	Vitamins/ Dietary Supplements
Alabama	T/E*	T	E**	T***	T	T	E****
Arizona	T/E*	E	E**	T	T***	T	T
Arkansas	T/E*	E**	T	T	T	T	T
California	E	E*	T	T	T**	T	T***
Colorado	E*	E	E**	E	T***	T	T
Connecticut	E	E	E	T*	T**	T	E
District of Columbia	E*	E	E*	E	T	T	T
Florida	E*	E	E*	E	E	T	T
Georgia	E*	E*	E*	T**	T***	T	T
Hawaii	T	T	T	T*	T	T	T
Idaho	E*	E*	T	E**	E*	T	T
Illinois	T*	T*	T*	T*	T**	T	T
Indiana	T/E*	E**	E**	E**	E***	T	T
Iowa	E*	E	E	E	E	T	T
Kansas	E*	E*	E*	E*	T	T	T
Kentucky	T/E*	E	T**	T**	T***	T	T
Louisiana	E*	E*	E*	E*	T	T	T
Maine	T/E*	E**	E**	E**	T***	T	T
Maryland	E*	E	E	T	T**	T***	T
Massachusetts	E*	E	E**	E	T***	T	T
Michigan	E*	E**	E***	T****	T	T	T
Minnesota	E	E	E*	E	T	T	T
Mississippi	T/E*	T	T**	T***	T	T	T
Missouri	T/E*	E	E**	E**	T	T	T
Nebraska	T/E*	E**	E**	E**	E**	E**	T
Nevada	E*	T	T	E**	T	E**	T
New Jersey	T/E*	E	E	E	T**	T	T
New Mexico	T/E*	E	E	E	T**	T**	T

	Dialysis Drugs and Supplies	Hearing Aids	Vision Aids- Eyeglasses, etc.	Orthodontic Appliances	Syringes	Bandages, etc.	Vitamins/ Dietary Supplements
New York	E	E	E	E	E	E	E
North Carolina	T/E*	E	E**	E	T	T	T
North Dakota	T/E*	E	E**	E	T	T	T
Ohio	T/E*	E**	T	T	T	T	T
Oklahoma	T/E*	T	T**	E	T	T	T***
Pennsylvania	E	E	E	E	E*	E	E
Rhode Island	E*	E	E**	E**	E**	T	T
South Carolina	E*	E	T	E**	E**	T	T
South Dakota	E*	E*	E*	E*	E*	T	E*
Tennessee	E	E	T*	T*	E	T	T
Texas	T/E*	E	E**	E	E	T	E
Utah	E*	E	T	T	E**	T	T
Vermont	E	E	E	E*	E	E	E**
VIRGINIA	E	E*	E*	E*	E*	T	T
Washington	E*	E*	E*	E*	E*	T	E*
West Virginia	E*	E*	E*	E*	T	T	T
Wisconsin	T/E*	E	E**	E**	T***	T	E**
Wyoming	E*	E*	E*	E*	T	T	T

KEY:

E = Exempt

T = Taxable

NOTES:

The following states do not have a general sales and use tax: Alaska, Delaware, Montana, New Hampshire, and Oregon.

- Alabama * - Dialysis drugs are exempt when prescribed. Dialysis supplies are taxable.
 ** - Exempt when sold by an ophthalmologist. Taxable when sold by opticians/optometrists.
 *** - Taxable to the provider.
 **** - Vitamins and dietary supplements are exempt when prescribed.
- Arizona * - Dialysis drugs are exempt when prescribed. Dialysis supplies are taxable.
 ** - Exempt when prescribed.
 *** - Exempt when used for insulin.

Arkansas	* - Dialysis drugs are exempt when prescribed. Dialysis supplies are taxable. ** - Exempt when prescribed.
California	* - Exempt when sold by a licensed hearing aid dispenser. ** - Exempt when used for diabetes. *** - Exempt when prescribed.
Colorado	* - Dialysis drugs are exempt when prescribed. Dialysis supplies are exempt. ** - Exempt when prescribed. *** - Exempt when used for insulin.
Connecticut	* - Dentures are exempt when sold by dental laboratories. Sales to dentists are exempt. ** - Exempt when prescribed.
District of Columbia	* - Exempt when prescribed.
Florida	* - Exempt when prescribed.
Georgia	* - Exempt when prescribed. ** - Taxable to the provider. *** - Exempt when used for insulin.
Hawaii	* - Supplies sold for orthodontic appliances are also subject to the excise tax at a reduced 0.5% rate.
Idaho	* - Exempt when prescribed. ** - Fillings are taxable.
Illinois	* - Taxable at a reduced rate as drugs and medical appliances. ** - Taxable at the reduced rate when used for diabetes.
Indiana	* - Dialysis drugs are exempt when prescribed. Dialysis supplies are taxable. ** - Exempt when prescribed. *** - Exempt when used for insulin.
Iowa	* - Exempt when prescribed.
Kansas	* - Exempt when prescribed.
Kentucky	* - Dialysis drugs are exempt when prescribed. Dialysis supplies are taxable. ** - Taxable to the provider. *** - Exempt when used for diabetes.
Louisiana	* - Exempt when prescribed.
Maine	* - Dialysis drugs are exempt when prescribed. Dialysis supplies are taxable. ** - Exempt when prescribed. *** - Exempt when used for diabetes.
Maryland	* - Dialysis drugs and supplies are exempt when sold by licensed pharmacist or person with a permit. ** - Exempt when sold by a physician or hospital. *** - Elastic bandages are exempt. Other bandages are exempt when sold by a physician or hospital.
Massachusetts	* - Dialysis drugs are exempt when prescribed. Dialysis machines are exempt. ** - Exempt when prescribed. *** - Exempt when used for insulin and prescribed.

Michigan	<ul style="list-style-type: none">* - Dialysis drugs are exempt when prescribed. Dialysis equipment is exempt when prescribed and for home use.** - Exempt when prescribed.*** - Exempt when prescribed, except for contact lenses. Contact lenses are taxable.**** - Taxable to the provider.
Minnesota	<ul style="list-style-type: none">* - Exempt when prescribed.
Mississippi	<ul style="list-style-type: none">* - Dialysis drugs are exempt when prescribed. Dialysis supplies are taxable.** - Taxable to an ophthalmologist or optometrist that manufactures glasses. Taxable when sold by opticians and optometrists with retail establishments.*** - Taxable to the provider.
Missouri	<ul style="list-style-type: none">* - Dialysis drugs are exempt when prescribed. Dialysis supplies are taxable.** - Taxable to the provider.
Nebraska	<ul style="list-style-type: none">* - Dialysis drugs and supplies are exempt when prescribed.** - Exempt when prescribed.
Nevada	<ul style="list-style-type: none">* - Dialysis drugs are exempt when prescribed. Dialysis supplies are taxable.** - Exempt when prescribed.
New Jersey	<ul style="list-style-type: none">* - Dialysis drugs are exempt. Dialysis supplies are taxable.** - Exempt when used for diabetes.
New Mexico	<ul style="list-style-type: none">* - Dialysis drugs are exempt when prescribed. Dialysis supplies are taxable except when provided to doctors for use in their practices.** - Supplies, bandages, syringes, and similar items are exempt when sold to doctors for use in their practices.
North Carolina	<ul style="list-style-type: none">* - Dialysis drugs are exempt when prescribed. Dialysis supplies are taxable.** - Exempt when prescribed.
North Dakota	<ul style="list-style-type: none">* - Dialysis drugs are exempt when prescribed. Dialysis supplies are taxable.** - Exempt when prescribed.
Ohio	<ul style="list-style-type: none">* - Dialysis drugs are exempt when prescribed. Dialysis supplies are taxable.** - Exempt when prescribed.
Oklahoma	<ul style="list-style-type: none">* - Dialysis drugs are exempt when prescribed. Dialysis supplies are taxable.** - Taxable to the provider.*** - Vitamins and dietary supplements sold by a chiropractor to a patient are exempt.
Pennsylvania	<ul style="list-style-type: none">* - Only disposable syringes are exempt, reusable syringes are taxable.
Rhode Island	<ul style="list-style-type: none">* - Dialysis drugs are exempt. Dialysis supplies are exempt when prescribed.** - Exempt when prescribed.
South Carolina	<ul style="list-style-type: none">* - Dialysis drugs and supplies are exempt when prescribed.** - Exempt when prescribed.
South Dakota	<ul style="list-style-type: none">* - Exempt when prescribed.
Tennessee	<ul style="list-style-type: none">* - Taxable to the provider.
Texas	<ul style="list-style-type: none">* - Dialysis drugs are exempt. Dialysis supplies are taxable.** - Exempt when prescribed.

Utah	* - Dialysis drugs and supplies are exempt when prescribed. ** - Exempt when prescribed.
Vermont	* - Exempt when prescribed. ** - Vitamins and dietary supplements are exempt as drugs when prescribed, and exempt as food when not prescribed.
Virginia	* - Exempt when prescribed.
Washington	* - Exempt when prescribed.
West Virginia	* - Exempt when prescribed.
Wisconsin	* - Dialysis drugs are exempt when prescribed. Dialysis supplies are taxable. ** - Exempt when prescribed. *** - Exempt when used for diabetes.
Wyoming	* - Exempt when prescribed.

Va. Code § 58.1-609.10. Miscellaneous exemptions.

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:

1. Artificial or propane gas, firewood, coal or home heating oil used for domestic consumption. "Domestic consumption" means the use of artificial or propane gas, firewood, coal or home heating oil by an individual purchaser for other than business, commercial or industrial purposes. The Tax Commissioner shall establish by regulation a system for use by dealers in classifying individual purchases for domestic or nondomestic use based on the principal usage of such gas, wood, coal or oil. Any person making a nondomestic purchase and paying the tax pursuant to this chapter who uses any portion of such purchase for domestic use may, between the first day of the first month and the fifteenth day of the fourth month following the year of purchase, apply for a refund of the tax paid on the domestic use portion.
2. An occasional sale, as defined in § 58.1-602.
3. Tangible personal property for future use by a person for taxable lease or rental as an established business or part of an established business, or incidental or germane to such business, including a simultaneous purchase and taxable leaseback.
4. Delivery of tangible personal property outside the Commonwealth for use or consumption outside of the Commonwealth. Delivery of goods destined for foreign export to a factor or export agent shall be deemed to be delivery of goods for use or consumption outside of the Commonwealth.
5. Tangible personal property purchased with food coupons issued by the United States Department of Agriculture under the Food Stamp Program or drafts issued through the Virginia Special Supplemental Food Program for Women, Infants, and Children.
6. Tangible personal property purchased for use or consumption in the performance of maintenance and repair services at Nuclear Regulatory Commission-licensed nuclear power plants located outside the Commonwealth.
7. Beginning July 1, 1997, and ending July 1, 2006, a professional's provision of original, revised, edited, reformatted or copied documents, including but not limited to documents stored on or transmitted by electronic media, to its client or to third parties in the course of the professional's rendition of services to its clientele.
8. School lunches sold and served to pupils and employees of schools and subsidized by government; school textbooks sold by a local board or authorized agency thereof;

and school textbooks sold for use by students attending a nonprofit college or other institution of learning, when sold (i) by such institution of learning or (ii) by any other dealer, when such textbooks have been certified by a department or instructor of such institution of learning as required textbooks for students attending courses at such institution.

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.

12. Special equipment installed on a motor vehicle when purchased by a handicapped person to enable such person to operate the motor vehicle.

13. Special typewriters and computers and related parts and supplies specifically designed for those products used by handicapped persons to communicate when such equipment is prescribed by a licensed physician.

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.

15. Tangible personal property withdrawn from inventory and donated to (i) an organization exempt from taxation under § 501 (c) (3) of the Internal Revenue Code or (ii) the Commonwealth, any political subdivision of the Commonwealth, or any school, agency, or instrumentality thereof.

16. Tangible personal property purchased by nonprofit churches that are exempt from taxation under § 501 (c) (3) of the Internal Revenue Code, or whose real property is exempt from local taxation pursuant to the provisions of § 58.1-3606, for use (i) in religious worship services by a congregation or church membership while meeting together in a single location and (ii) in the libraries, offices, meeting or counseling rooms or other rooms in the public church buildings used in carrying out the work of the church and its related ministries, including kindergarten, elementary and secondary schools. The exemption for such churches shall also include baptistries; bulletins, programs, newspapers and newsletters that do not contain paid advertising and are used in carrying out the work of the church; gifts including food for distribution outside the public church building; food, disposable serving items, cleaning supplies and teaching materials used in the operation of camps or conference centers by the church or an organization composed of churches that are exempt under this subdivision and which are used in carrying out the work of the church or churches; and property used in caring for or maintaining property owned by the church including, but not limited to, mowing equipment; and building materials installed by the church, and for which the church does not contract with a person or entity to have installed, in the public church buildings used in carrying out the work of the church and its related ministries, including, but not limited to worship services; administrative rooms; and kindergarten, elementary, and secondary schools.

17. Medical products and supplies, which are otherwise taxable, such as bandages, gauze dressings, incontinence products and wound-care products, when purchased by

a Medicaid recipient through a Department of Medical Assistance Services provider agreement.

18. Beginning July 1, 2007, and ending July 1, 2012, multifuel heating stoves used for heating an individual purchaser's residence. "Multifuel heating stoves" are stoves that are capable of burning a wide variety of alternative fuels, including, but not limited to, shelled corn, wood pellets, cherry pits, and olive pits.

SURVEY INSTRUMENT (Dialysis Clinics)

1. Please provide the **name of the dialysis unit, name, title, address, phone number, and FAX number** of the person completing this survey.

2. For the last five (5) calendar or fiscal years (or the last five years available), please provide the total dollar amount of the **drugs and supplies used directly in hemodialysis or peritoneal dialysis in Virginia**. If exact figures are not available, then please provide an estimated amount.

Please check one: __ Calendar Year __ Fiscal Year	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Drugs					
Supplies					

3. How many dialysis stations does your Virginia facility currently operate in Virginia? _____
4. How many dialysis treatments were performed at your facility each year? If exact figures are not available, then please provide an estimated amount.

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Treatments					

5. Is your dialysis facility owned, operated, or affiliated with any level of government?

Yes _____ No _____

6. If yes, with what government is the facility associated?
