DEGC ENTERPRISES (U.S.), INC. 14255 49TH STREET N., SUITE 301 CLEARWATER, FL 33762,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 10-1011
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

DEGC Enterprises (U.S.), Inc. ("Taxpayer") appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(c)(5)a. concerning denied refunds of State sales tax for May and June 2009, and State use tax for July 2009 through May 2010. A hearing was conducted on June 23, 2011. Bruce Ely and Will Thistle represented the Taxpayer. Assistant Counsel Wade Hope represented the Department.

ISSUE

The issue in this case is whether glucose test strips sold by the Taxpayer to diabetes patients in Alabama during the subject periods were exempt from Alabama sales and use tax pursuant to the prescription "drug" exemption at Code of Ala. 1975, §40-23-4.1. That issue turns on whether the test strips are (1) a "medicine," and (2) intended for "human consumption or intake."

FACTS

The Taxpayer is a licensed Alabama pharmacy. It sold glucose test strips to diabetes patients in Alabama pursuant to physician prescriptions during the periods in issue. The Taxpayer initially paid Alabama sales or use tax to the Department on the strips. It subsequently petitioned for refunds of the tax paid, claiming that the strips were exempt pursuant to §40-23-4.1. The Department denied the petitions, and this appeal

followed.

The glucose strips in issue are used to monitor a diabetic's blood glucose level. The use of the test strips is a necessary and important part of a diabetes patient's self-monitoring and management of the disease. By monitoring their glucose level, diabetics can determine how to best treat the disease and avoid long-term complications.

A patient begins the self-monitoring process by pricking his or her finger with a small needle or lancet, which causes a droplet of blood to appear on the finger. The blood is transferred by capillary action to the test strip by touching the blood droplet to a blood "well" on the end of the test strip. The blood may be transferred to the strip without the strip actually touching the finger, although incidental contact may occur on occasion.

After the blood is absorbed onto the test strip, a chemical reagent in the strip reacts with the glucose in the blood to produce an electrochemical current. The strip is then inserted into a glucose meter, which measures the current and thereafter reveals the patient's blood glucose level. Each strip can be used only once, and must then be discarded.

ANALYSIS

The §40-23-4.1 exemption reads as follows:

> (a) The term "drugs" shall include any medicine prescribed by physicians when the prescription is filled by a licensed pharmacist, or sold to the patient by the physician, for human consumption or intake.
>
> (b) In addition to any and all items exempt from gross sales tax, certain drugs, as defined in subsection (a) of this section, shall be exempt from state gross sales taxes as defined in Section 40-23-2.

For the exemption to apply, the substance or item in issue must be (1) a medicine; (2) prescribed by a physician; (3) filled by a licensed pharmacist; and (4) for human

consumption or intake. See generally, *Baptist Medical Centers v. State*, 545 So.2d 45 (Ala. Civ. App. 1981). The parties agree that requirements (2) and (3) are satisfied. The case thus turns on whether glucose test strips are (1) a "medicine," and (2) "for human consumption or intake."

The §40-23-4.1 exemption was previously addressed by the Administrative Law Division in *Alcon Laboratories v. State of Alabama*, Docket S. 06-910 (Admin. Law Div. 5/7/2007). The issue in *Alcon* was whether a solution injected into a patient's eye during eye surgery was exempt. The Division held that the solution was a medicine used for human consumption or intake, and thus exempt.

> "Medicine" is not defined by the Alabama revenue code, Title 40, Code of Ala. 1975. In such cases, a word must be given its normal, generally accepted meaning. *State v. American Brass*, 628 So.2d 920 (Ala. Civ. App. 1993). The American Heritage College Dictionary, Fourth Ed., at 862, defines the term as "[a]n agent, such as a drug, used to treat disease or injury." "Drug" is defined by the same source, at 431, as "[a] substance used in the diagnosis, treatment, or prevention of a disease."
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> The viscoelastic solution in issue is a substance used in the treatment of eye disease, i.e., the removal of cataracts during surgery. The solution is thus a medicine as defined above.
>
> The solution is also prescribed for human consumption or intake. The solution is not taken orally, but rather is injected into the eye during surgery. Section 40-23-4.1 does not, however, require that a medicine or drug must be taken orally. A variety of drugs or medicines are absorbed through the skin or administered or taken intravenously, rectally, or otherwise. The viscoelastic solution is consumed or taken by a human for purposes of the §40-23-4.1 exemption when it is injected into the patient's eye during surgery.
>
> The fact that the solution is flushed or washed out of the eye after surgery also is of no consequence. There is no requirement that a drug, once administered, must remain in the patient for a specified period of time, or at all.

Alcon Laboratories at 2 – 3.

The Taxpayer agrees that the term "medicine" was correctly defined in *Alcon Laboratories* as "[a]n agent, such as a drug, used to treat disease or injury." Taxpayer's Brief at 5. It argues as follows:

> Thus based on the plain meaning of "medicine," a substance intended for use in the treatment of a disease or injury is a "medicine" for purposes of Alabama sales and use tax law. The Department, in Ala. Admin. Code r. 810-6-3.47.01, interprets that term broadly: "[s]ales of drugs which meet the definition contained in Section 40-23-4.1(a), *Code of Alabama* 1975, are exempt regardless of whether they are diagnostic in nature or they are used in preventing, treating, or mitigating diseases." Accordingly, a substance that is intended for use in the diagnosis, treatment, prevention, or mitigation of a disease is a qualifying "drug" for purposes of Alabama sales and use tax law. This definition is consistent with the primary definition of "drug" in *Black's Law Dictionary*. "A substance intended for use in the diagnosis, cure, treatment, or prevention of a disease." 8th Ed. (2004).
>
> It is undisputed that diabetes is a disease. . . Because diabetes is a disease, the test strips are "drugs" for Alabama sales and use tax purposes as they are used in the diagnosis, treatment, or prevention of diabetes.

Taxpayer's Post Hearing Brief at 5 – 6.

In *Alcon Laboratories*, the Administrative Law Division treated the terms "medicine" and "drug" as synonymous. But as pointed out by the Department in its Brief, at 12, the terms are not synonymous. The term "drug" is broader than the term "medicine." This is confirmed by §40-23-4.1(b), which exempts only "certain drugs." It follows that certain other drugs are not exempt. The term "drugs" is also defined at §40-23-4.1(a) as "any medicine." Consequently, for a substance or item to be exempt under §40-23-4.1, it must be a "medicine."

As indicated, the parties agree that the term "medicine" is correctly defined as "[a]n agent, such as a drug, used to treat disease or injury." A glucose test strip is not a

medicine as defined above because it does not itself treat diabetes. Rather, a test strip is "an aid to monitor the effectiveness of diabetes control." Department Ex. 2. That is, a test strip is used only to determine how the disease should be treated, if at all. It is not a medicine that is itself used to treat the disease.

Even if the exemption encompassed the broader term "drug," the test strips in issue still would not be exempt. Again, as stated in *Alcon Laboratories*, the *American Heritage College Dictionary*, at 431, defines "drug" as "[a] substance intended for use in the diagnosis, cure, treatment, or prevention of a disease." The test strips do not cure, treat, or prevent diabetes. And as discussed below, the test strips may be diagnostic in nature, but they do not diagnose a disease, i.e., diabetes, as required for the strips to be a drug. A patient has already been diagnosed with diabetes before the test strips are prescribed and used.

The above conclusion is affirmed by various other definitions of the term "drug." *Black's Law Dictionary, 5th Ed.*, p. 446, defines the term as "[a]n article intended for use in the diagnosis, cure, mitigation, treatment, or prevention of disease in man or other animals and any other article other than food intended to affect the structure or any function of the body of man or other animals." The test strips may be diagnostic in that they diagnose or measure a user's glucose level, but they are not "intended to affect the structure or any function of the (human) body. . . ." To the contrary, they have no effect on the human body, and are only intended to come into contact with a user's blood outside of the body. A test strip may touch the user's finger during use, but such contact is only incidental and of no consequence.

Merriam-Webster's Medical Desk Dictionary, Revised Ed., p. 228, defines "drug" as "[a] medicine or other substance which has a physiological effect when ingested or otherwise introduced into the body." It is undisputed that test strips are not "ingested or otherwise introduced into the body," and clearly they have no physiological effect on the user.

Finally, *Taber's Cyclopedic Medial Dictionary, 15th Ed.*, p. 494, defines the term as "[a]ny substance that when taken into the living organism may modify one or more of its functions." Again, the test strips are not "taken into the (human body)," nor do they "modify one or more of (the body's) functions."

The issue is complicated, however, by Department Reg. 810-6-3-.47.01, which addresses the §40-23-4.1 exemption. Paragraph (3) of the regulation provides that "[s]ales of drugs which meet the definition contained in Section 40-23-4.1(a) Code of Alabama 1975, are exempt regardless of whether they are diagnostic in nature or they are used in preventing, treating, or mitigating disease." Paragraph (3) expands the exemption to include substances or items that are purely diagnostic in nature, and that do not treat a disease. But the regulation still requires that the substance or item must first "meet the definition contained in Section 40-23-4.1(a). . . ." To meet that definition, the substance or item must be a "medicine," which, as discussed, must be a substance or item used to treat a disease or illness. A substance or item that is purely diagnostic in nature, i.e., a glucose test strip, is not a medicine as required by §40-23-4.1(a), and thus does not come within the scope of the exemption. Reg. 810-6-3-.47.01(3), to the extent it improperly expands the exemption to include substances or items that are purely diagnostic in nature and that do not treat a disease or illness, is rejected as contrary to the statute it seeks to interpret.

"Rules and regulations . . . cannot subvert nor enlarge upon statutory policy." *Jefferson County Board of Education v. Alabama Board of Cosmetology*, 380 So.2d 913, 918 (1980).

The test strips also are not "for human consumption" within the context of the exemption. The phrase "human . . . intake" clearly applies to medicines that are ingested or otherwise physically taken into the human body, either orally, rectally, absorbed through the skin, injected, or otherwise. Because the Legislature used the disjunctive "or" between the words "consumption" and "intake," the term "human consumption" must refer to a medicine consumed other than by intake.

The Taxpayer argues that the test strips are consumed within the context of the exemption because once they are used to test a diabetic's glucose level, they are "used up" for their intended purpose and cannot be reused. I agree that the strips are consumed in one sense of the word, but the phrase "human consumption" must be read in the context of the whole statute. "Furthermore, the Court must look to the entire act and not merely to an isolated part in construing a statute." *The Alabama State Board of Health ex rel. William J. Baxley v. Chambers County*, 335 So.2d 653, 655 (Ala. 1976).

To be exempt, a substance or item must be a medicine intended for human consumption (or intake). To be a medicine, the substance must treat a disease or illness, which necessarily requires that it must come in contact with the human body. Consequently, in context, a medicine for "human consumption" must be construed as a medicine applied, rubbed on topically, sprayed, or otherwise coming into contact with the human body. A test strip can be effectively used without the strip touching the user's skin,

and thus is not for human consumption within the context of the statute.[1]

An exemption statute must be strictly construed for the Department and against the taxpayer. "We note . . . exemptions from taxation are to be strictly construed against the person or party claiming the exemption and in favor of the right to tax." *Fleming Foods of Alabama, Inc. v. Dept. of Revenue*, 648 So.2d 577, 578, cert. denied 115 S. Ct. 1690 (1995); *State v. Chesebrough-Ponds, Inc.*, 441 So.2d 598 (1983). Strictly construing the §40-23-4.1 exemption against the Taxpayer, it is clear that glucose test strips, which are not a medicine used to treat a disease and that only incidentally come into contact with the human body, if at all, are not exempt.

The Department's denial of the Taxpayer's State sales and use tax refunds is affirmed.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered March 12, 2012.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Glenmore P. Powers, II, Esq.
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William T. Thistle, Esq.
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[1] If the Taxpayer's position is accepted that "human consumption" includes a person's use of a substance or item that never comes into contact with the human body, then a pet owner's application of tick or flea medicine onto the pet would also constitute "human consumption" because the pet owner, the human, would be using or consuming the medicine by applying it to the pet. Clearly that was not intended by the Legislature. The phrase "human consumption" must refer to medicine that is used and consumed by being applied to or on the human body.