

STATE OF ALABAMA
DEPARTMENT OF REVENUE,

§

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

§

v.

§

DOCKET NO. S. 86-105

MOBILE INFIRMARY ASSOCIATION §
P.O. Box 2144
Mobile, AL 36654, §

Taxpayer. §

ORDER

This matter involves five disputed joint refund petitions filed by Mobile Infirmary Association (Taxpayer) and either Durr-Fillauer Medical, Inc. or Durr Drug of Mobile, Inc. involving various periods during 1982. A hearing was conducted by the Administrative Law division on March 19, 1986. The parties were represented at the hearing by attorneys E. Watson Smith and R. Gregory Watts, for the Taxpayer, and assistant counsel J. Wade Hope, for the Department. Subsequent to the hearing the parties submitted briefs and reply briefs. Based on the evidence as taken at the hearing, and in consideration of the authorities and arguments presented by both parties, the following findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

The Taxpayer owns and operates a private hospital in Mobile, Alabama. During the periods in issue, the Taxpayer purchased drugs from both Durr Drug of Mobile, Inc. and Durr-Fillauer Medical, Inc. (suppliers). The Taxpayer paid sales tax on said purchases, which was duly remitted to the Department by the suppliers. The drug

were maintained in inventory in the hospital's pharmacy. The majority of the drugs were dispensed through the pharmacy by a licensed pharmacist to the hospital's patients, as prescribed by a staff physician. Less than one percent of the drugs were sold by the pharmacy to employees of the hospital, as prescribed by the employees' private physicians.

Prior to 1981, the Alabama sales tax law contained an exemption for prescription drugs at Code of Alabama 1975, §40-23-4(31), as follows:

(31) The gross proceeds of the sale or sales of all medicines prescribe by physicians for persons who are 65 years of age or older, and when said prescriptions are filled by licensed pharmacists, shall be exempted under this division or under nay county or municipal sales tax law. The exemption provided in this section shall not apply to any medicine purchased in any manner other than is herein provided.

In 1981, the Legislature passed Act No. 81-663, presently codified at Code of Alabama 1975, §40-23-4.1, which 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 times exempt from gross ales tax, certain drugs, as defined in subsection (a) of this section, shall be exempt from state gross sales taxes as defined in §40-23-2.

On January 11, 1985, the Alabama Legislature passed House Joint Resolution 30, which professed to express the legislative intent behind §40-23-4.1 by adding the following underlined words

to the language of the statute:

(a) The term "drugs" shall include any medicine prescribed by physicians when the prescription is filled by a licensed pharmacist, or sold or otherwise dispensed to the patient by the physician, for human consumption or intake.

Prior to the passage of House Joint Resolution 30, the Revenue Department had interpreted §40-23-4.1 so as to not exempt from sales tax any drugs used or dispensed as in the present case. The Department's position was based on State v. Tri-State Pharmaceutical, 371 So.2d 910, cert. denied 371 So.2d 914, which holds in substance that a hospital does not sell drugs to its patients, but rather, is primarily in the business of rendering services. Consequently, the Department took the position, as enunciated by the Court of Civil Appeals in the above case, that the sale of drugs to a hospital by its supplier is the taxable retail sale, and that tax is due to be collected from the hospital by the supplier and thereafter remitted to the State.

Subsequent to the passage of House Joint Resolution 30, the Revenue Department bent to the expressed intent of the legislature and interpreted the addition of the words "or otherwise dispensed" in the resolution to mean that any drug dispensed by a hospital could be purchased by the hospital without sales tax. Consequently, upon application by the Taxpayer for a sales tax exemption certificate, the Department issued exemption No. EX2959 to the Taxpayer, dated April 19, 1985, which provided as follows:

This certificate shall be limited to medicine prescribed

by a physician when such prescription is filled by a licensed pharmacist or sold or otherwise dispensed to the patient by the physician for human consumption or intake.

On September 26, 1985, the Legislature passed House Joint Resolution 215, which in pertinent part rescinded House Joint Resolution 30. Based thereon, the Department readopted its pre-Joint House Resolution 30 position that sales to hospitals were taxable, and issued to the Taxpayer a letter by regular mail dated December 18, 1985, therein revoking the Taxpayer's exemption No. 2959, effective October 1, 1985.

Thereafter, by separate letters dated January 21, 1986, the Revenue Department denied the five joint refunds in issue. Based thereon, the Taxpayer requested a hearing in the matter before the Administrative Law Division.

CONCLUSIONS OF LAW

The determinative issue in the case concerns the applicability of the §40-23-4.1 exemption to the transactions in issue, i.e. the sale of drugs by the suppliers to the Taxpayer and the subsequent dispensation of the drugs by the Taxpayer to its patients.

The Taxpayer takes the position that §40-23-4.1 was intended to exempt all transactions by which prescription drugs are dispensed to sick people, not just those involving a pure "retail sale" situation. The Taxpayer further contends that the issuance of the exemption certificate to the Taxpayer was an admission by the Department that the transactions in issue are exempt, and also

that the exemption certificate has not been effectively revoked as required under the provisions of the Administrative Procedure Act at Code of Alabama 1975, §41-22-19.

The State bases its case on State v. Tri-State Pharmaceutical, supra. As stated, that case holds that a hospital does not sell drugs to its patients, but rather, used the drugs in the performance of a service. Consequently, the sale to the hospital by the supplier is the taxable retail sale. Accordingly, the Department argues that because the subsequent prescription and dispensation of the drugs by the Taxpayer to its patients is not the taxable event, the §40-23-4.1 exemption relative to such transactions is inapplicable. The Department further explains that the issuance and subsequent attempted revocation of the Taxpayer's exemption certificate was done by the Department only in an effort to comply with the stated intention of the Legislature as set out in House Joint Resolutions 30 and 215. The Department now agrees with the Taxpayer that a legislative resolution has no effect of law and cannot be used to amend an existing statute.

Upon consideration, it is hereby determined that the Department's argument is the better reasoned view and more in conformity with the language of the exemption provision and also the general scheme of the sales tax law.

Section 40-23-4.1(b) exempts only certain drugs from sales tax. The term "drugs" is defined in subsection (a) to include "any

medicine prescribed by physicians when the prescription is filled by a licensed pharmacist". Thus, a medicine becomes an exempt drug only when it is prescribed by a doctor and dispensed by a licensed pharmacist. If the dispensation by the pharmacist involves a retail sale, which is most often the case, the sale would clearly be exempt under §40-23-4.1. However, if the retail sale of the medicine occurs prior to the medicine becoming a "drug" under §40-23-4.1, as in the present case, then the exemption would not apply.

When the Tri-State Pharmaceutical decision was rendered in 1979, the narrower prescription drug exemption then found at §40-23-4(31) was in effect. The Taxpayer now argues that the broader exemption provisions of §40-23-4.1 should apply to the sales by the suppliers and, in effect, override the Tri-State Pharmaceutical case. However, the rationale of the Tri-State Pharmaceutical case is still valid, and the broadening of the exemption through the enactment of §40-23-4.1 does not change the fact that the sale by the supplier to the hospital is the retail sale, which, as discussed above, does not involve a drug as defined by the exemption provision, and consequently, is not an exempt transaction.

The determination herein is supported by the rule of law that an exemption from taxation must be strictly construed against the exemption and that any doubt as to legislative intent must be

construed in favor of the right to tax. Brundidge Milling Co. v. State, 228 So.2d 475 (1979). In light of the above rule, it would be unreasonable to expand the scope of the exemption beyond its wording to include the sale of drugs by the suppliers to the Taxpayer. The Legislature could have easily included those transactions within the exemption by including in the definition of "drugs" the following or similar language:

. . .; and any medicine sold by a medical or pharmaceutical supplier to any hospital, infirmary or like institution, when said medicine is to be dispensed by a licensed pharmacist to the institution's patients, pursuant to a physician's prescription.

However, given the present wording of the statute, it would be improper to exempt the retail sale of drugs that involved neither a physician's prescription nor a licensed pharmacist.

The Taxpayer points out that there are three alternative methods by which drugs can be dispensed. First, they can be sold to the patient directly by the physician. Secondly, the patient can purchase the drugs from a retail pharmacy if he has a physician's prescription. Thirdly, the patient can receive the drugs from a licensed pharmacist employed by a hospital pursuant to a physician's prescription given during the course of patient care, as in the present case. The Taxpayer argues that it is illogical to exclude drugs from sales tax in the first two situations and yet tax the third alternative.

The point overlooked by the Taxpayer is that the first two alternatives involve a retail sale which is specifically exempted by §40-23-4.1, whereas the third alternative is not taxable in the first instance because it does not involve a retail sale, and thus cannot be the subject of a statutory exemption. Even though the drugs in question are eventually prescribed by a physician and dispensed by a licensed pharmacist, the exemption would not relate back to an earlier retail sale that is clearly outside of the scope of the exemption.

As to the effect of House Joint Resolutions 30 and 215, the parties are in agreement that the resolutions could not and did not have any substantive effect on the statute in question. Opinion of the Justices, 381 So.2d 183 (1980).

Finally, the Taxpayer argues that the issuance of the exemption certificate by the Department was an admission that the transactions in issue are exempt under §40-23-4.1. However, the Department adequately explains that the certificate was issued only as an attempt to comply with the perceived will of the Legislature as set out in House Joint Resolution 30. Upon passage of House Joint Resolution 215, which in effect revoked House Joint Resolution 30, the Department sought to return to its pre-House Joint Resolution 30 position by attempting to revoke the Taxpayer's exemption certificate. The evidence is clear that the Department's attempted revocation did not comply with the requirements of the

Alabama Administrative Procedure Act, Code of Alabama 1975, §41-22-19. However, the Department's failure to comply with the procedural requirements of the Administrative Procedure Act clearly would have no bearing on the tax period in issue, 1982, which was prior to the issuance of the certificate in 1985.

Based on the above, it is hereby determined that the refund petitions in issue were properly denied by the Department, and that said denials are due to be upheld.

Done this 26th day of June, 1986.

BILL THOMPSON
Chief Administrative Law Judge