OKLAHOMA TAX COMMISSION

TAX POLICY AND RESEARCH DIVISION
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September 19, 2005

Re: Our File Number LR-05-095; Sales Tax on Sales of medical products

Dear

This is in response to your inquiry concerning the collection and remittance of sales tax on the sale of medical products. I have copied the sections in you letter labeled "Facts", "Issue" and "Summary" into this letter and our response follows those sections.

Your Facts

Company A, located in California, sells prescription and non-prescription medical products to consumers in Oklahoma. Many of the Company's products that are sold to consumers are of a type that are typically billed and reimbursed by Medicare and other medical insurance carriers. Company A has unique contracts with each of the several hundred medical insurance carriers with which it does business. Each of the contracts provides (1) the list price and/or negotiated contract price that each carrier is willing to pay (2) any agreed upon discount percent of the list and/or negotiated price and the time period for which the negotiated discount will apply; (3) whether the insurance carrier will be billed on a gross or net basis (i.e. list price versus predetermined price), and (4) the HCPCS (Healthcare Common Procedure Coding Systems) code that must be used for billing a given product. Further, the insurance carriers can cover one or multiple jurisdictions each of which (e.g. Oklahoma and Alabama) could have varying negotiated prices to comply with each carrier's unique billing requirements. Non-compliance with these requirements results in slowed or no payment from the insurance carrier. Each of these factors is also impacted by the level of health insurance carried by each patient (e.g. the insurance carrier may pay 80% of product cost for patients insured under plan 1 and 75% for patients insured under plan 2). Some patients are also required to pay deductibles which lower the payment required by each insurance carrier.

To further complicate this process, there can be multiple payers (primary carrier, secondary carrier, and ultimately the patient). Company A uses a downstream billing

system to coordinate the benefits/payments between these payers. The primary payer is billed according to the terms of the contract, and once payment is received, the secondary payer, if available, is billed the original amount (according to the terms of the primary payer) and along with a statement detailing the balance not paid by the primary payer. Once payment is received by all carriers, it will roll down to the patient for billing on the patient statement. As discussed above, all of these billings are sent on either a gross or net basis, with a predetermined price, subject to discounts, and under certain HCPCS codes.

Due to the complex nature of this billing process, Company A currently reports and pays tax on the entire amount collected from its billings; but it does not collect this tax from insurance carriers or patients. Company A has been working with the insurance carriers to develop a way to bill and collect the tax. Nevertheless, at this point the systems of the insurance carriers and Company A are not sophisticated enough to separately track the sales or use tax by payer especially given that the taxability of products, filing requirements, product costs, billing requirements, and tax rates vary by jurisdiction. Further, there is not a software product currently in existence that can accommodate this level of complexity and efforts to customize Company A's current system would jeopardize and add undue risk to its collections. Until an agreement is reached to address these issues, Company A is unable to separately collect and track the sales and use tax on these billings because the carriers will not pay the bill if it is not in complete compliance with the contracted terms.

Your Issues

Can Company A report and pay tax on the entire amount collected from its medical product billings without collecting the sales or use tax from the insurance carriers or patients?

Can Company A apply the Medicare model and back out the sales or use tax from the amount collected from insurance carriers and patients before arriving at taxable gross receipts?

Your Summary

As previously mentioned, we believe that Company A has two alternatives for reporting sales and use tax since the complications associated with medical billing make it unable to separately state the sales or use tax in its billings. Under option one, Company A would report and pay tax on the entire amount collected from its billings without collecting the sales or use tax from the insurance carriers or patients. Under option two, Company A could apply the Medicare model by factoring out the sales or use tax from the amount collected from insurance carriers and patients to arrive at taxable gross receipts.

Our Responses

In Oklahoma, sales of medical products that are "administered or distributed by a 'practitioner' or purchased or leased pursuant to a prescription or work order of a 'practitioner'" and where the item is "furnished to a Medicare or Medicaid program recipient and the cost of the said item will be reimbursed by Medicare or Medicaid" are exempt from sales tax. Please see 68 O.S. Section 1357.6 and Oklahoma Tax Commission Rule 710:65-13-173.

Other sales of medical products, with the exception of drugs (except for over the counter drugs) and prosthetics as defined in 68 O.S. Section 1357(20), are taxable when sold to an individual without regard as to whether the cost of the item sold is to be reimbursed by an insurance company.

Thus, your client appears to be in the same position as that of any vendor that is required to comply with the Sales Tax Code, including its competitors, in that they have to determine if the sale is exempt or taxable, then determine what rate to apply based on where the sale is sourced. They then have to bill the tax to the customer pursuant to 68 O.S. Section 1361(B). Statutory language requiring vendors to add the sales tax to the selling price of taxable sales has been in effect since at least 1951.

The language of 68 O.S. Section 1361(B) also states that once added, the tax becomes a part of the debt and is collectible as is any other part of the debt. Therefore, your client should add the tax to its billings and collect it as a part of its charges, without regard as to whether those charges are paid for by the patient or an insurance company.

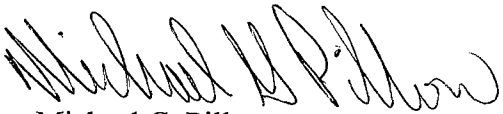
You state that your client has entered into "unique contracts" with "each of several hundred medical insurance carriers with which it does business" regarding payment of it charges. If your client has entered into contracts with insurance carriers in which it has agreed not to charge sales tax to its customers who are covered by insurance offered by those insurance carriers, it should consult its own legal counsel regarding the effects of those contracts in view of the language of 68 O.S. Section 1361.

All businesses doing business in Oklahoma, including your client and its competitors, are required to comply with the state's laws. A waiver cannot be granted of the statutory requirement that the sales tax on taxable sales be computed and added to the selling price.

This response applies only to the circumstances set out in your request of June 7, 2005. Pursuant to Commission Rule 710:1-3-73(e), this Letter Ruling may be generally relied upon **only** by the entity to whom it is issued, assuming that all pertinent facts have been accurately and completely stated, and that there has been no change in applicable law.

If I can be of further assistance, please feel free to contact me.

Sincerely,
OKLAHOMA TAX COMMISSION



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