

**STATE BOARD OF EQUALIZATION**

1020 N STREET, SACRAMENTO, CALIFORNIA  
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)  
(916) 445-6557

January 23, 1991

---

Dear Ms. --:

Re: XX

Enclosed is a copy of the Supplemental Decision and Recommendation pertaining to the above-referenced petition for redetermination. I have again recommended that the petition be denied.

Your request for an oral hearing before the Board is already on file. By copy of this letter, I am recommending that this matter be returned to the roster of cases awaiting a Board hearing. You will be notified when the hearing is scheduled.

In the meantime, if you have new evidence or contentions not considered in the Supplemental Decision and Recommendation, you should file a Request for Reconsideration. Any such request must be sent to me within 30 days from the date of this letter, at the address listed above, with a copy to the Principal Tax Auditor at that same address. No special form is required, but the request must clearly set forth any new contentions, and any new evidence must be attached.

Very truly yours,

James E. Mahler  
Hearing Officer

JEM:ct  
Enc

cc: XX  
cc: (cont'd)

Ms. Janice Masterton  
Assistant to the Executive Director (w/enclosure)  
Please reschedule the Board hearing.

Mr. Glenn Bystrom  
Principal Tax Auditor (file attached)

Downey – District Administrator (w/enclosure)

Torrance – District Administrator (w/enclosure)

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION  
APPEALS DIVISION

**395.0275**

In the Matter of the Petition	)	SUPPLEMENTAL HEARING
for Redetermination Under the	)	DECISION AND RECOMMENDATION
Sales and Use Tax Law of:	)	
	)	
RACHELLE LABORATORIES, INC.)	)	No. SR ADA 16 093193-010
COMPANY, INC.	)	
	)	
<u>Petitioner</u>	)	

This matter was scheduled for an oral hearing before the Board on June 20, 1990. Prior to that date, petitioner requested and was granted a postponement to present additional evidence and arguments to the Hearing Officer. A supplemental appeal hearing was held for that purpose before Hearing Officer James E. Mahler on July 19, 1990, in Van Nuys, California.

Appearing for Petitioner:	Frederick A. Richman Attorney at Law
	Linda F. Nelson Attorney at Law
	Gerald A. Koris Attorney at Law
Appearing for the Department of Business Taxes	James Lehmann Supervising Tax Auditor

Protested Item

The protested tax liability for the period July 1, 1985 through May 21, 1986 is measured by:

<u>Item</u>	<u>State, Local County &amp; LATC</u>
A. Taxable sale of tangible personal property under Regulation 1595 not reported	\$2,995,012

Petitioner's Contentions

The products manufactured and sold by petitioner were property "of a kind" never taxable when sold at retail.

Summary

The petitioner corporation manufactured and sold "human antibiotics" at a plant in Los Angeles, California. By contract dated April 27, 1986, it sold the equipment held or used in this business to a third party. The question is whether that sale was an exempt occasional sale. Additional background information is set out in the original Decision and Recommendation dated July 17, 1989, which is incorporated herein by this reference.

The term "occasional sale" as defined in subdivision (a) of Revenue and Taxation Code Section 6006.5 does not include the sale of property held or used in an activity which requires a seller's permit. The Department of Business Taxes (DBT) argues that petitioner was required to hold and did hold a seller's permit for its business, so that the sale of equipment was not an occasional sale. Petitioner contends that, while it did in fact hold a seller's permit, it was not required to do so, and the sale was therefore occasional.

Section 6066 of the Code requires a seller's permit to be held by every person who wishes to engage in business as a "seller in this state. Section 6014 defines "seller" to include:

"...every person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of the sales tax.

"For purposes of this section, the phrase 'tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of the sales tax' includes all tangible personal property of a kind the gross receipts from the retail sale of which is, or would be, required to be included in the measure of the sales tax if sold at retail, whether or not the tangible personal property is ever sold at retail or is suitable for sale at retail."

DBT classified petitioner as a "seller" required to hold a seller's permit in reliance on Sales and Use Tax Annotation 410.0250 (11/9/71), which provides:

"Persons Making Nontaxable Sales. Persons selling 'medicines,' as that term is defined in Section 6369(b) of the Revenue and Taxation Code, are required to hold seller's permits even though all of their sales may be exempt under Section 6369(a) of the code.

“Medicines’ are not a property of a kind the gross receipts from the retail sale of which are not subject to the tax. It is the circumstances under which the property is sold which may result in an exemption.”

Petitioner believes that the annotation should not apply under the facts of this case. In support, petitioner points out that the prescription medicine exemption in Section 6369 has two prerequisites: the property must meet the definition of “medicines” in subdivision (b) of that section; and the property must be distributed by one of the methods specified in subdivision (a), such as sale under prescription from a licensed physician. Thus, drugs which qualify as “medicines” can logically be grouped into two categories: over-the-counter drugs like aspirin, which may or may not be exempt depending on how they are distributed; and prescription drugs, which can legally be distributed only in a manner which qualifies for the sales tax exemption.

According to petitioner, federal law restricts the sale of prescription drugs “because of the very nature of the drugs, not because of any ancillary characteristic or the circumstances under which they are sold.” Thus, prescription drugs are property “of a kind” which is never subject to sales tax, even when sold at retail, and persons who sell only prescription drugs are not “sellers” required to hold seller’s permits. Therefore, petitioner concludes, Annotation 410.0250 must apply only to persons who sell over-the-counter drugs, or some combination of over-the-counter and prescription drugs, but not to persons who sell only prescription drugs.

Petitioner has submitted affidavits from two employees or former employees to the effect that it manufactured and sold only prescription drugs. DBT accepts these affidavits as true. However, DBT believes that Annotation 410.0250 applies to all persons in the business of selling medicines, even persons who sell only prescription drugs, and that petitioner was therefore a “seller” required to hold a permit.

DBT points out that if prescription drugs are sold illegally (for example, without prescription) the sales do not qualify for exemption under Section 6369. Thus, the exemption does not depend on the nature of the property itself, but rather on the circumstances of the sale. DBT concludes that prescription medicines are property “of a kind” which may be taxable when sold at retail. Persons who sell prescription medicines must therefore be required to hold seller’s permits so they can be audited to verify that claimed exempt sales are in fact exempt.

Petitioner responds that the types of drugs it sold were not subject to abuse, and there was accordingly no illegal market for them. There is no evidence that drugs of the type sold by petitioner have ever been sold illegally. Petitioner contends that the hypothetical possibility of taxable illegal sales is so remote that it should not require the holding of a seller’s permit.

In this regard, Annotation 410.0320 (10/17/50) was discussed at the hearing. That annotation states that fish markets selling “only fish for human consumption” are not required to hold seller’s permits, apparently on the theory that fish for human consumption is not property “of a kind” which is taxable when sold at retail. Petitioner points out that some customers of fish

markets may purchase fish for cat food, in which case tax would apply. If the possibility of taxable sales does not require fish markets to hold seller's permits, petitioner concludes, the remote possibility of illegal drug sales should not require drug manufacturers to hold permits.

DBT also notes that the distinction between prescription and over-the-counter drugs depends on federal law. DBT argues that the classification does not depend on the nature of the drug itself, but rather on the interpretation and administration of federal regulations. Since the Federal Government's policies in this area are subject to change, persons who sell drugs must be required to hold permits so that periodic audits can verify whether their sales continue to be exempt from tax.

Petitioner agrees that the federal regulations can change, but states that the classification of the drugs it sold has not changed in the years since the sale at issue. Again, petitioner believes that the bare possibility of changes in federal law is not sufficient to require a drug manufacturer to hold a seller's permit.

#### Analysis and Conclusions

Annotation 410.0250 is based on an opinion letter issued by the Board's legal staff in November 1971. A copy of that letter, with confidential information deleted, is attached hereto as an exhibit.

The opinion dealt with a pharmacy which sold both taxable and nontaxable items. The question was whether a sale of property used exclusively in selling exempt prescription medicines would qualify for the occasional sale exemption. The author of the opinion recognized the distinction between over-the-counter drugs and prescription medicines, but concluded that prescription medicines are not property "of a kind" always exempt from tax, since the prescription medicine exemption depends in part on the conditions of sale and not exclusively on the nature of the property. The annotation based on this letter therefore expressly states that persons who sell medicines must hold seller's permits "even though all of their sales may" qualify for the prescription medicine exemption.

Annotations are not formal regulations. They are nonetheless evidence of how the Board has interpreted and administered the Sales and Use Tax Law. As contemporaneous administrative interpretations, they are entitled to great weight and should be followed unless clearly erroneous. (American Hospital Supply Corp. v. State Bd. of Equalization, 169 Cal.App.3d 1088.)

I believe that Annotation 410.0250 is a correct interpretation of the law. The distinction between over-the-counter drugs and prescription medicines depends on federal law, not on the nature of the property itself. The Federal Government regulates sales of some medicines because it believes they are more dangerous than others, but the difference is one of degree and not one of kind. Furthermore, the federal rules as to which medicines may or may not be sold without prescription are continuously updated. I see no reason why the duty to hold a California seller's permit should depend on changeable policies of the Federal Food and Drug

Administration, which have nothing to do with our Sales and Use Tax Law.

My decision at first glance may appear to conflict with Annotation 410.0320, which allows certain fish markets to operate without seller's permits. Fish is exempt only when sold for human consumption, not when sold for other purposes. Arguably, therefore, the exemption depends on the circumstances of sale, not on the nature of fish itself, and fish markets should therefore be required to hold permits.

The conflict is more apparent than real, however. With certain specific exceptions, the Board has previously decided that tax does not apply to sales of food products of a type ordinarily intended for human consumption, absent evidence that the food product was in fact sold for some purpose other than human consumption. (See Sales and Use Tax Annotation 245.0960 [9/13/57]; compare Sales and Use Tax Annotation 245.0520 [11.25/53], stating that sales of food products of a type not ordinarily intended for human consumption are presumed taxable.) Thus, when food products such as fish are sold, the seller need not charge tax reimbursement or require an exemption certificate from each individual customer; fish is property "of a kind" ordinarily intended for human consumption, and the sales are therefore deemed nontaxable, even though a few customer might purchase fish as pet food. Since the sales are deemed nontaxable, no audit verification of claimed exemptions is necessary, and there is accordingly no reason to require a seller's permit.

In short, food products of a type ordinarily intended for human consumption are property "of a kind" deemed nontaxable when sold at retail. Bakeries, fish markets and similar establishments selling only such food products are therefore not "sellers" required to hold seller's permits. Sales of medicines, on the other hand, are presumed subject to tax. (See Purdue Fredrick Co. v. State Bd. of Equalization, 281 Cal.App.3d 1021 at 1029, holding that plaintiff had "met its burden of proof" for exemption under Section 6369.) Persons who sell medicines must therefore report and pay tax to the Board, or retain evidence that the sales qualify for some statutory exemption, and audit verification of any claimed exemptions is necessary. Since medicines are property "of a kind" which is presumed taxable when sold at retail, persons who sell medicines are "sellers" and are required to hold seller's permits.

For these reasons, I remain of the opinion that petitioner was required to hold a seller's permit for its business. The sale of equipment in question therefore does not qualify as a nontaxable occasional sale.

At the supplemental appeal hearing, petitioner's representatives indicated that they may wish to present additional evidence or arguments on some other issues. Any such additional evidence or arguments should be presented to the Hearing Officer by a Request for Reconsideration. The procedures for filing a Request for Reconsideration are set out in the cover letter accompanying this Decision and Recommendation.

Recommendation

Redetermine without adjustment to the tax.

\_\_\_\_\_  
James E. Mahler, Hearing Officer

1/11/91  
Date