

Cite as Det No. 12-0305, 32 WTD 163 (2013)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition for Correction of ) D E T E R M I N A T I O N  
Assessment of )  
 ) No. 12-0305  
... )  
 ) Registration No. ....  
 ) Document No. ....  
 ) Audit No. ....  
 ) Docket No. ....

- [1] RCW 82.08.0283: RETAIL SALES TAX – PROSTHETIC DEVICES. CPAP devices that are not entirely worn on the body are not exempt prosthetic devices under RCW 82.08.0283. Portable CPAP devices that are entirely worn on the body are exempt prosthetic devices under RCW 82.08.0283.
  - [2] RCW 82.08.0281: RETAIL SALES TAX – PRESCRIPTION DRUGS. CPAP devices are not prescription drugs that exempt from retail sales tax under RCW 82.08.0281.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Sohng, A.L.J. – A medical equipment provider protests the assessment of retail sales tax on sales of its continuous positive airway pressure machines on the grounds that they are (i) exempt prosthetic devices, or (ii) exempt legend drugs. The petition is denied in part and granted in part.<sup>1</sup>

## ISSUES

1. Are CPAP machines exempt from retail sales tax as a prosthetic device under RCW 82.08.0283(1)?
  2. Are CPAP machines exempt from retail sales tax as a “legend drug” under WAC 458-20-18801(1)(j)?

<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

## FINDINGS OF FACT

[Taxpayer] is [an out-of-state] corporation that makes retail sales of medical devices, including continuous positive airway pressure (“CPAP”) machines. CPAP machines are used to treat obstructive sleep apnea by providing positive air pressure to support the walls of the airway during sleep. Most of Taxpayer’s CPAP machines consist of a mask and a base unit. The mask fits over the nose and forces air into the airway through the nostrils. The mask is connected by a hose to a heated base upon which a water reservoir is placed. The water reservoir supplies the desired level of humidity to the forced air.

Some of Taxpayer’s CPAP machines, however, are comprised of a solitary unit, with no separate base units or cords. These CPAP machines are powered by rechargeable batteries and the entire unit fits over the user’s face during sleep, forcing air through the nostrils. There are no additional components to these portable CPAP machines.

The Taxpayer Account Administration Division (“TAA”) examined Taxpayer’s books and records for the period July 1, 2008, through September 30, 2010 (the “Audit Period”). On October 19, 2011, TAA issued Assessment No. . . . in the amount of \$. . . , including \$. . . in taxes, \$. . . in interest, and \$. . . in penalties. TAA assessed retail sales tax and retailing business and occupation tax on Taxpayer’s sales of CPAP machines during the Audit Period.

## ANALYSIS

### 1. Prosthetic Device

[1] Under RCW 82.08.020, Washington imposes retail sales tax on “each retail sale in this state.” RCW 82.08.0283<sup>2</sup> provides a retail sales tax exemption for sales of certain prosthetic devices. RCW 82.08.0283(1) provides an exemption for “[p]rosthetic devices prescribed, fitted, or furnished for an individual by a person licensed under the laws of this state to prescribe, fit, or furnish prosthetic devices . . . .” RCW 82.08.0283(3) further provides that the exemption does not apply to durable medical equipment. “Prosthetic device” is defined as:

a replacement, corrective, or supportive device, including repair and replacement parts for a prosthetic device, worn on or in the body to:

- (i) Artificially replace a missing portion of the body;
- (ii) Prevent or correct a physical deformity or malfunction; or
- (iii) Support a weak or deformed portion of the body.

RCW 82.08.0283(4)(a)(emphasis added.)

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<sup>2</sup> RCW 82.08.0283 was amended in 2007 with an effective date of July 1, 2008. 2007 Wash. Laws ch. 6, § 1101.

"Durable medical equipment" means "equipment, including repair and replacement parts for durable medical 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 not worn in or on the body."

RCW 82.08.0283(4)(b).

The Legislature amended RCW 82.08.0283 in 2003 to comply with the Streamlined Sales and Use Tax Agreement ("SSUTA"),<sup>3</sup> effective July 1, 2004.<sup>4</sup> Laws of 2003, ch. 168, §409. SSUTA member states must adopt the definitions in the SSUTA Library of Definitions without qualification, except those allowed by SSUTA.<sup>5</sup> Consequently, the retail sales tax exemption for the sales of certain prosthetic devices in RCW 82.08.0283 now mirrors SSUTA.

In *North Central Washington Respiratory Care Services, Inc. v. Dep't of Revenue*, 165 Wn. App. 616, 268 P.3d 972 (2011), the court held that a CPAP machine was not an exempt prosthetic device under RCW 82.08.0283 because it was not entirely worn on the body. The court stated, "The SSUTA makes a distinction between 'C.P.A.P.—Not worn' as '[d]urable medical equipment,' while listing 'C.P.A.P.—Worn' as a '[p]rosthetic device.'" *Id.* at 644; *see also* Det. No. 07-0150, 27 WTD 114, 117 (2008) (holding that CPAP machines were not exempt prosthetic devices because they were not "worn on the body as a complete system."). Thus, portable CPAP machines worn entirely on the body qualify as "prosthetic devices" under RCW 82.08.0283.

Based on the *North Central* holding, we conclude that CPAP machines that are not entirely worn on the body are not exempt prosthetic devices under RCW 82.08.0283(1)(a), while portable CPAP machines that *are* entirely worn on the body are exempt prosthetic devices under

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<sup>3</sup> The Streamlined Sales Tax Project was organized in March of 2000 with a wide range of participation from state and local tax administrators, state and local government representatives, and private industry groups. Kentucky Sales Tax Facts, Vol. 6 No. 3 (June 1, 2004). SSUTA is a multi-state project intended to simplify the administration of sales and use taxes in order to substantially reduce the burden of tax compliance. *Indiana Dep't of Revenue v. Kitchin Hospitality, LLC*, 907 N.E.2d 997, 1000 n.2 (Ind. 2009). SSUTA seeks to accomplish this goal by, among other things, providing uniform definitions within tax laws. *Id.* For states to participate, the state must enact laws, rules, and regulations that conform to its provisions. Kentucky Sales Tax Facts, *supra*. On November 12, 2002, Washington, along with 30 other states and the District of Columbia, approved SSUTA. Hallie Hostetter & Carl Gipson, *The Streamlined Sales and Use Tax Agreement* (Feb. 2007), available on the Washington Policy Center Website at <http://www.washingtonpolicy.org/publications/notes/streamlined-sales-and-use-tax-agreement> (last visited November 1, 2012.)

<sup>4</sup> During the 2003 legislative session, the Legislature began its effort to conform Washington laws to SSUTA. As a result, it passed the Streamlined Sales Tax Act, 2003 Wash. Laws, ch. 168.

<sup>5</sup> SSUTA § 328. Washington became a full member state on July 1, 2008. A full member state is a state that is in compliance with SSUTA through its laws, rules, regulations, and policies. *See* Streamlined Sales Tax Governing Board, Inc. website at <http://www.streamlinesalestax.org/> (last visited October 30, 2012).

82.08.0283(1)(a). Taxpayer's petition is denied in part and granted in part with respect to this issue.

## 2. Legend Drugs

[2] Taxpayer next argues that its CPAP machines are exempt "legend drugs" under WAC 458-20-18801 ("Rule 18801") because they treat ailments and may only be legally dispensed upon the written prescription of a physician. Taxpayer further claims that because CPAP machines, as "prescription legend devices," are regulated similarly to "prescription legend drugs" under the Federal Food, Drug, and Cosmetic Act,<sup>6</sup> they should also be considered "legend drugs" under Washington law.

RCW 82.08.0281 provides an exemption from retail sales tax for the sale of prescription drugs. The legislature amended RCW 82.08.0281 in 2003 to comply with SSUTA, effective July 1, 2004. RCW 82.08.0281 provides that the retail sales tax does not apply to "sales of drugs for human use dispensed or to be dispensed to patients, pursuant to a prescription." . . .

. . . Rule 18801 was issued in 1992, prior to the adoption of the current prescription drug exemption statute. Because Rule 18801 has not been amended since the statute that it interprets was changed in 2003, provisions of the rule that are inconsistent with the amended statute are not valid. See, e.g., *Kabbae v. Dep't of Social and Health Services*, 144 Wn. App. 432, 435, 192 P.3d 903, 904 (2008); *Dep't of Revenue v. National Indem. Co.*, 45 Wn. App. 59, 62, 723 P.2d 1187, 1189 (1986). Thus, the definition of "drug" contained in the statute, rather than the definition of "legend drug" contained in the rule, governs whether Taxpayer's CPAP machines qualify for the exemption. RCW 82.08.0281 defines a drug as:

"Drug" means a compound, substance, or preparation, and any component of a compound, substance, or preparation, other than food and food ingredients, dietary supplements, or alcoholic beverages:

(i) Recognized in the official United States pharmacopoeia, official homeopathic pharmacopoeia of the United States, or official national formulary, or any supplement to any of them; or

(ii) Intended for use in the diagnosis, cure, mitigation, treatment, or prevention of disease

RCW 82.08.0281(4)(b). . . .

. . . A CPAP machine is not a "compound," "substance," or "preparation" as used in RCW 82.02.0281. These terms are not defined in the statute or the rule. When statutory terms are not defined in the statute, we generally turn to their ordinary dictionary meaning. *Western Telepage, Inc. v. City of Tacoma*, 140 Wn. 2d 599, 609, 998 P.2d 884 (2000); see also *Palmer v. Dep't of Revenue*, 82 Wn. App. 367, 372, 917 P.2d 1120 (1996).

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<sup>6</sup> The Federal Food, Drug, and Cosmetic Act, 21 U.S.C. §301 *et seq.*, was passed in 1938 and grants authority to the U.S. Food and Drug Administration to oversee the safety of food, drugs, and cosmetics.

“Compound” is defined, among other things, as “a chemically distinct substance formed by union of two or more ingredients (as elements) in definite proportion by weight and with definite structural arrangement.”<sup>7</sup> “Substance” is defined, among other things, as “matter of definite or known chemical composition: an identifiable chemical element, compound, or mixture.”<sup>8</sup> “Preparation” is defined, among other things, as “something made, equipped, or compounded for a specific purpose.”<sup>9</sup>

Under the doctrine of *noscitur a sociis*, “the meaning of words may be indicated or controlled by those with which they are associated.” *State v. Jackson*, 137 Wn.2d 712, 729, 976 P.2d 1229 (1999)(quoting *Ball v. Stokely Foods, Inc.*, 37 Wn.2d 79, 87-88, 221 P.2d 832 (1950); *Shurgard Mini-Storage v. Dep’t of Revenue*, 40 Wn. App. 721, 727, 700 P.2d 1176 (1985)). In applying this doctrine to determine the meaning of a word in a series, “[i]t is . . . familiar policy in the construction of terms of a statute to take into consideration the meaning naturally attaching to them from the context, and to adopt the sense of the words which best harmonizes with the context.” *Jackson*, 137 Wn.2d at 729, 976 P.2d at 1237. Applying this doctrine to the series of terms “compound,” “substance,” and “preparation,” we conclude that these words connote a chemical compound or mixture. A CPAP machine is not a chemical compound or mixture. We hold that because a CPAP machine is neither a compound, substance, or preparation, as those terms are used in the statute, it is not a “drug” as defined by RCW 82.08.0281(b).

Under the statutory scheme, a CPAP machine is more accurately described as a “device,” rather than a “drug.” A “device” is “a piece of equipment or a mechanism designed to serve a special purpose or perform a special function.”<sup>10</sup> Unlike prescription drugs, prescription devices are not exempt from retail sales tax under RCW 82.08.0281.

The fact that the federal government may regulate CPAP machines in addition to prescription drugs has no bearing on what constitutes a “drug” for Washington state excise tax purposes. Taxpayer has not met its burden to show that it is entitled to the retail sales tax exemption provided under RCW 82.08.0281. Taxpayer’s petition is denied as to this issue.

#### DECISION AND DISPOSITION

Taxpayer’s petition is granted in part, denied in part, and remanded to the Taxpayer Account Administration Division for possible recalculation of the assessment in accordance with this determination.

Dated this 6<sup>th</sup> day of November 2012.

STATE OF WASHINGTON DEPARTMENT OF REVENUE

<sup>7</sup> WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY 466 (1993).

<sup>8</sup> *Id.* at 2279.

<sup>9</sup> *Id.* at 1790.

<sup>10</sup> *Id.* at 618.