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**OFFICE OF TAX APPEALS**

**STATE OF CALIFORNIA**

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| In the Matter of the Appeal of: | ) OTA Case No. 21037436 |
| | ) CDTFA Case ID 025-008 |
| **REDWOOD MEMORIAL HOSPITAL INC.** | ) |
| | ) |
| | ) |
| | ) |

## OPINION

Representing the Parties:

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| For Appellant: | Randy Ferris, Attorney<br>Mark Stefan, Representative<br>Sara Gaudreau, Representative |
| For Respondent: | Amanda Jacobs, Tax Counsel III<br>Scott Claremon, Tax Counsel IV<br>Jason Parker, Chief of Headquarters Ops. |
| For Office of Tax Appeals: | Corin Saxton, Tax Counsel IV |

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6901, Redwood Memorial Hospital Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's claim for refund for the period July 1, 2013, through December 31, 2018 (claim period).

Office of Tax Appeals (OTA) Administrative Law Judges Teresa A. Stanley, Andrew J. Kwee, and Huy "Mike" Le held an oral hearing for this matter in Sacramento, California, on January 24, 2023. At the conclusion of the hearing, OTA closed the record, and this matter was submitted for an opinion.

### ISSUE

Is appellant entitled to a refund of tax and tax reimbursement?

[1] Sales and use taxes were formerly administered by the State Board of Equalization (board). In 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to events that occurred before July 1, 2017, "CDTFA" shall refer to the board.

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## FACTUAL FINDINGS

1. Appellant, a California Corporation, operated a 25-bed critical care access hospital located in Fortuna, California.
2. During the claim period, appellant made tax-paid and ex-tax[2] purchases of tangible personal property (TPP), such as medical equipment and supplies, which it furnished in connection to medical services rendered to patients under Medicare Part A.[3]
3. Appellant's contracts with the U.S. Government did not contain title passage clauses, and appellant did not separately state its charges for the TPP. Appellant's contracts with Medicare Part A patients did not have title passages clauses.
4. Appellant filed a timely claim for refund of tax and tax reimbursement, on the basis that appellant made exempt sales of TPP to the U.S. Government in connection with services rendered to patients insured by Medicare Part A.
5. CDTFA denied appellant's claim for refund because appellant's contracts with the U.S. Government did not contain title passage clauses.
6. After an internal appeals conference, CDTFA denied appellant's claim for refund in a Decision, as amended by a Supplemental Decision.
7. This timely appeal followed.
8. Based on new exhibits submitted by appellant prior to the hearing, CDTFA conceded that appellant paid sales tax or sales tax reimbursement on seven transactions totaling $50.58 in tax and, as such, if appellant were to prevail on the legal merits (i.e., establishing nontaxable sales for purposes of resale to the U.S. government), then appellant would be entitled to a refund of at least $50.58.

## DISCUSSION

California imposes sales tax on a retailer's retail sales of tangible personal property sold in this state measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) For the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross

[2] In this context, "ex-tax" means without the payment of sales tax reimbursement or use tax.

[3] Under Medicare Part A, the healthcare provider has a contract with the U.S. Government to provide services, and sales of medicines, devices, appliances, and supplies paid for pursuant to Part A qualify as exempt sales to the U.S. Government. (Cal. Code Regs., tit. 18, § 1591(f)(2)(A).)

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receipts are subject to tax until the contrary is established. (R&TC, § 6091.) When sales tax does not apply, use tax, measured by the purchase price, applies to the storage, use, or other consumption of TPP in this state. (R&TC, §§ 6201, 6401.) Use tax is imposed on the person storing, using, or otherwise consuming the TPP. (R&TC, § 6202.) A retailer who resells TPP before making any use thereof (other than retention, demonstration, or display while holding it for sale in the regular course of business) may take a deduction of the purchase price of the property if, with respect to its purchase, the retailer has reimbursed the vendor for the sales tax or has paid the use tax. (R&TC, § 6012(a)(1); Cal. Code Regs., tit. 18, § 1701(a).)

Exemptions from tax are strictly construed against the taxpayer, who has the burden of proving that it comes clearly within the terms authorizing the exemption. (*H.J. Heinz Co. v. State Board of Equalization* (1962) 209 Cal.App.2d 1, 4.) A taxpayer seeking an exemption or exclusion bears the burden of proving by credible evidence that the statutory requirements have been satisfied. (*Appeal of Thomas Conglomerate*, 2021-OTA-030P.) The applicable burden of proof is by a preponderance of the evidence. (*Ibid*.)

Sales to the United States or its unincorporated agencies and instrumentalities are generally exempt from tax. (R&TC, § 6381; Cal. Code Regs., tit. 18, § 1614(a).) Tax does not apply to the sale of items to a person insured pursuant to Part A of the Medicare Act as such sales are considered exempt sales to the United States. (Cal. Code Regs., tit. 18, § 1614(f).) A medical service facility is the retailer of property furnished to persons other than residents and patients for a charge. (Cal. Code Regs., tit. 18, § 1503(b)(2)(A).) Operative April 1, 2001, except as provided in California Code of Regulations, title 18, (Regulation) section 1503(b)(2), medical service facilities are service providers to their patients and residents, including patients and residents insured pursuant to Part A of the Medicare Act, and are the consumers of TPP furnished in connection with those services, and sales of that TPP to the medical service facilities are taxable retail sales unless specifically exempted. (Cal. Code Regs., tit. 18, § 1503(b)(1).) A medical service facility is the retailer of TPP for which it makes a separately itemized charge if the property is furnished to a patient or resident with the intent that the patient or resident remove the property from the premises of the medical service facility for use by the patient or resident. (Cal. Code Regs., tit. 18, § 1503(b)(2)(B).) Prior to January 1, 2019, a medical service facility is the retailer of any property furnished in connection with its medical services if its contract with the medical service facility's resident or patient or other customer specifically provides that title

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to the subject TPP passes to the resident or patient or other customer. (Cal. Code Regs., tit. 18, § 1503(b)(2)(C).)

Appellant argues R&TC section 6381 was originally intended to apply whenever the U.S. Government made direct payments to hospitals under Medicare Part A for TPP used in the treatment of Part A patients, and appellant argues that a medical service facility should be considered a retailer of TPP furnished to patients pursuant to Medicare Part A contracts when there are sufficient indicia of intent to make an exempt sale of TPP. Appellant argues that transfer of possession of the TPP to appellant's patients constitutes sufficient indicia of intent to make an exempt sale of TPP.

Appellant asserts that Regulation section 1503 is a "general interpretive regulation" that does not specifically address Medicare Part A transactions.[4] Appellant argues that, in contrast, Regulation section 1614(f) is a "quasi-legislative regulation" that specifically and expressly provides that the Medicare Part A exemption operates through sales to Part A patients that are considered direct exempt sales to the U.S. Government by operation of law under R&TC section 6381. Consequently, appellant argues that, to the extent the general interpretive language of Regulation section 1503(b)(2) conflicts with the plain language of Regulation section 1614(f), the conflicting language of Regulation section 1503(b)(2) is invalid, and, consequently, it is immaterial that appellant's contracts did not contain title passage clauses.

Appellant argues that it is incontrovertible that none of the general provisions of Regulation section 1503(b)(2) operative during the claim period expressly address Medicare Part A. Additionally, appellant argues that Regulation section 1503(b)(2)(B) only addresses when sales of certain TPP occur with respect to discharged patients who will use the TPP off the premises of the medical service facilities. Therefore, appellant argues that Regulation section 1503(b)(2)(B) does not apply to Medicare Part A transactions because Medicare Part A only applies to inpatient care. Appellant further argues that Regulation section 1503(b)(2)(C) is inapplicable here because title passage clauses have never existed between participating hospitals and the federal government, and it is unreasonable to assume that Regulation section 1503(b)(2)(C) was promulgated to address the possibility that such title passage clauses with the federal government might exist in the future. Appellant claims that CDTFA made an

[4] Appellant asserts that Regulation section 1503 is an interpretive regulation because it merely construes Regulation section 1501, and in support of this argument appellant cites to *Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1.

"administrative error" in 2001 when it promulgated Regulation section 1503(b) and encourages OTA to return to the statutory mooring of R&TC section 6381 as implemented by Regulation section 1614(f). Appellant further asserts that any attempt to rely on the plain language of Regulation section 1503(b)(2)(C) to require title passage clauses in Medicare Part A transactions must fail because such an approach necessarily involves improperly treating Medicare Part A patients as federal instrumentalities.

Here, Regulation section 1503(b) expressly states that medical service facilities are service providers to their patients and residents, including patients and residents insured pursuant to Part A of the Medicare Act, and are the consumers of TPP furnished in connection with those services, except as provided in subdivision (b)(2) of Regulation section 1503. It is undisputed that the requirements of subdivision (b)(2) have not been met. Therefore, appellant was not the retailer of the TPP at issue but was instead the consumer of TPP provided to its patients, and appellant is not entitled to a refund of tax and tax reimbursement.

With respect to appellant's argument that a medical service facility should be considered a retailer of TPP furnished to patients pursuant to Medicare Part A contracts when there are sufficient indicia of intent to make an exempt sale of TPP, OTA finds this argument lacks merit as it is contrary to the plain language of Regulation section 1503. Furthermore, given that exemptions from tax are strictly construed against the taxpayer, OTA finds unpersuasive appellant's argument that the plain language of Regulation section 1503 should be rejected. Regarding appellant's argument that none of the general provisions of Regulation section 1503(b)(2) operative during the claim period expressly address Medicare Part A, OTA notes that Regulation section 1503(b)(2)(C) applies to property furnished prior to January 1, 2019, and, given that the claim period precedes this date, this argument lacks merit.

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## HOLDING

Appellant is not entitled to a refund of tax or tax reimbursement.

## DISPOSITION

OTA sustains CDTFA's action denying appellant's claim for refund.

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Teresa A. Stanley
Administrative Law Judge

We concur:

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Andrew J. Kwee
Administrative Law Judge

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Huy "Mike" Le
Administrative Law Judge

Date Issued: 4/4/2023