

# MEDICAL SUPPLIES SALES TAX EXEMPTIONS



APRIL 2020  
2020-TE10

## EVALUATION SUMMARY

THIS EVALUATION WILL BE INCLUDED IN COMPILATION REPORT SEPTEMBER 2020

REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	\$216 million
NUMBER OF TAXPAYERS	Could not determine
AVERAGE TAXPAYER BENEFIT	Could not determine
IS IT MEETING ITS PURPOSE?	Yes

### ENACTMENT YEARS FOR INDIVIDUAL EXEMPTIONS

PRESCRIPTION DRUGS	1965
PROSTHETIC DEVICES	1965
INSULIN	1977
GLUCOSE FOR INSULIN REACTIONS	1979
URINE AND BLOOD TESTING KITS	1979
INSULIN MEASURING AND INJECTING DEVICES	1979
DURABLE MEDICAL EQUIPMENT AND MOBILITY ENHANCING EQUIPMENT	1980
NONPRESCRIPTION DRUGS FURNISHED WITH PROFESSIONAL SERVICES	1980
CORRECTIVE EYEGLASSES, CONTACT LENSES, AND HEARING AIDS	1980
OXYGEN DELIVERY EQUIPMENT	2011
SUPPLIES FOR INCONTINENCE, INFUSION, ENTERAL NUTRITION, OSTOMY, UROLOGY, AND DIABETIC AND WOUND CARE	2011
EQUIPMENT FOR SLEEP THERAPY, INHALATION THERAPY, AND ELECTROTHERAPY	2011

#### WHAT DO THESE TAX EXPENDITURES DO?

The Medical Supplies Exemptions allow purchases of certain medical supplies to be exempted from Colorado state sales tax, sometimes requiring that the items be dispensed pursuant to a prescription in order for the exemption to apply.

#### WHAT DID THE EVALUATION FIND?

We determined that the Medical Supplies Exemptions are meeting their purpose because they are likely applied to most direct purchases of medically necessary supplies by individuals. However, we were unable to determine whether patients derive any benefit from the exemptions when the medical supplies are paid for indirectly, such as via health insurance premiums or payments for medical services that include the price of medical supplies.

#### WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute does not directly state a purpose for the Medical Supplies Exemptions. We inferred that the exemptions are intended to ensure that sales tax is not applied to medically necessary supplies purchased or consumed by patients.

#### WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

We did not identify any policy considerations related to the Medical Supplies Exemptions.

# MEDICAL SUPPLIES SALES TAX EXEMPTIONS

## EVALUATION RESULTS

### WHAT ARE THESE TAX EXPENDITURES?

Colorado exempts a number of medical supplies from state sales tax under Section 39-26-717(2), C.R.S., as shown in EXHIBIT 1.1 and collectively referred to in this report as the Medical Supplies Sales Tax Exemptions (Medical Supplies Exemptions).

#### EXHIBIT 1.1. DESCRIPTION OF ITEMS EXEMPT FROM SALES TAX UNDER THE MEDICAL SUPPLIES EXEMPTIONS

DESCRIPTION OF EXEMPT ITEMS	ENACTMENT YEAR
Prescription drugs	1965
Prosthetic devices	1965
Insulin	1977
Glucose for the treatment of insulin reactions	1979
Urine and blood testing kits and materials	1979
Insulin measuring and injecting devices, including hypodermic syringes and needles	1979
Durable medical equipment and mobility enhancing equipment <sup>1</sup>	1980 <sup>2</sup>
Nonprescription drugs or medical materials furnished as part of professional services	1980
Corrective eyeglasses, contact lenses, or hearing aids	1980
Oxygen delivery equipment and related supplies <sup>1</sup>	2011
Medical, feeding, and disposable supplies for incontinence, infusion, enteral nutrition, ostomy, urology, diabetic care, and wound care <sup>1</sup>	2011
Equipment and accessories for sleep therapy, inhalation therapy, and electrotherapy <sup>1</sup>	2011

SOURCE: Office of the State Auditor review of Colorado Revised Statutes.

<sup>1</sup> These exemptions require a prescription in order for the exemption to apply. Therefore, they are not available when purchased by hospitals and medical service providers.

<sup>2</sup> When enacted in 1980, this exemption included only hospital beds and wheelchairs. The language was expanded to include all durable medical equipment and mobility enhancing equipment that meet the statutory definitions in 2011 with the enactment of House Bill 11-1091.

Statute provides specific eligibility requirements for some of these exempt items. For example, in order for durable medical equipment to be eligible for the Medical Supplies Exemptions, statute specifies that

the item in question must withstand repeated use, be primarily and customarily used to serve a medical purpose, generally not be useful in the absence of illness or injury, and not be worn in or on the body [Section 39-26-717(1)(a)(I), C.R.S.]. Statute also provides a number of examples of items considered to be durable medical equipment, including hospital beds, intravenous poles and pumps, and bath and shower aids [Section 39-26-717(1)(a)(II), C.R.S.]. Similar qualifications and examples are also provided for mobility enhancing equipment [Sections 39-26-717(1)(b)(I) and (II), C.R.S.].

In addition, the Department of Revenue has promulgated regulations that provide more specific instructions regarding most of the exempt items [1 CCR 201-4 39-26-717]. For example, items to be exempted as prosthetic devices must be adjusted to fit a particular individual and replace a missing or defective body part or function. In addition, in order for nonprescription drugs and materials provided as part of professional services to qualify for the exemption, regulations require that the item either be consumed by the patient at the medical facility or leave the facility with the patient, which excludes purchases of nonprescription drugs at retail locations from the exemptions. Non-medical materials are not considered to be included in this exemption, nor are items that are used or consumed primarily by the medical provider.

The Medical Supplies Exemptions are typically applied at the point of sale. Vendors selling the items that may qualify for the exemptions are responsible for determining whether purchases of these items are exempt, based on the statutory and regulatory requirements. Vendors report the amount of their exempt sales on the Department of Revenue's Colorado Retail Sales Tax Return (Form DR 0100, Schedule A).

### WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

Statute does not specifically identify the intended beneficiaries of the Medical Supplies Exemptions. Based on the statutory language of the exemptions, we inferred that the intended beneficiaries of the exemptions are Coloradans who incur expenses as a result of purchasing supplies that are medically necessary.

Although many Coloradans likely benefit from the exemptions to some degree, the exemptions provide more significant benefits to those with larger health care expenses, which are highly concentrated among a small portion of the population. For example, a 2014 report published by the United States Agency for Healthcare Research and Quality (AHRQ) estimated that the top 5 percent of the population accounted for about 50 percent of national health care expenditures in 2012. AHRQ research has also found that the presence of multiple chronic conditions can have a multiplicative effect on individuals' health and health care costs, which indicates that the exemptions would tend to benefit these individuals more significantly. According to the Colorado Department of Public Health and Environment, about 62 percent of Coloradans have at least one chronic condition.

In addition, the exemptions provide a more significant benefit to individuals who have higher out-of-pocket health care expenses, with individuals who are uninsured, elderly, and/or managing multiple chronic conditions paying higher out-of-pocket costs, on average, than other individuals. EXHIBIT 1.2 compares average out-of-pocket health care expenses for different age groups and individuals with or without chronic medical conditions.

EXHIBIT 1.2. AVERAGE OUT-OF-POCKET HEALTH CARE EXPENSES <sup>1</sup> PAID BY AGE GROUP, 2014				
	<18	18-64	65+	OVERALL
Average annual out-of-pocket expenses, all individuals	\$288	\$685	\$1,253	\$688
Average annual out-of-pocket expenses, individuals without multiple chronic conditions (0-1 chronic condition)	– <sup>2</sup>	\$568	\$839	\$595
Average annual out-of-pocket expenses, individuals with multiple chronic conditions (2+ chronic conditions)	– <sup>2</sup>	\$1,152	\$1,437	\$1,294
Percentage of population with average annual out-of-pocket expenses greater than \$2,000	3.5%	7.8%	17.3%	8.4%

SOURCE: The United States Agency for Healthcare Research and Quality, 2016 and 2017 statistical briefs.

<sup>1</sup> Does not include amounts paid out-of-pocket for health insurance premiums.

<sup>2</sup> Data on individuals with chronic conditions was unavailable for this age group.

Furthermore, the median annual out-of-pocket expenses for all individuals in each age group were substantially lower than the averages provided above. For example, the overall median for all individuals was \$204, as opposed to the average of \$688. This indicates that a small proportion of the population had very high out-of-pocket health expenses.

In addition, on average, the uninsured population pays more out-of-pocket expenses than other groups, with the uninsured paying about 24 percent of healthcare expenses out-of-pocket and all other groups paying less than 15 percent out of pocket. About 9 percent of the uninsured population have average annual out-of-pocket expenses greater than \$2,000.

#### WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute does not directly state a purpose for the Medical Supplies Exemptions. Based on our review of statute, the legislative history of the statutory provisions, and other states' evaluations of similar exemptions, we inferred that the exemptions are intended to ensure that sales tax is not applied to medically necessary supplies purchased or consumed by patients. Specifically, the items exempted are either generally useful only to individuals with a medical condition or they require a prescription for the relevant exemption to apply. Therefore, the exemptions are available only when the item in question provides a direct benefit to an individual with a demonstrated medical need. This is consistent with other sales tax exemptions in Colorado and other states, which commonly exempt items that are considered to be basic necessities for living from sales tax. For example, in addition to medical supplies, Colorado and many other states exempt food purchases from sales tax.

#### ARE THE TAX EXPENDITURES MEETING THEIR PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We determined that the Medical Supplies Exemptions are meeting their

purpose because they are likely applied to most direct purchases of medically necessary supplies by individuals to reduce the after-tax cost of eligible medical supplies. However, we were unable to determine whether patients derive any financial relief from the Medical Supplies Exemptions when the medical supplies in question are paid for indirectly, such as via health insurance premiums or payments for medical services that include the price of medical supplies.

Statute does not provide quantifiable performance measures for these tax expenditures. Therefore, we created and applied the following performance measure to determine whether the Medical Supplies Exemptions are meeting their purpose:

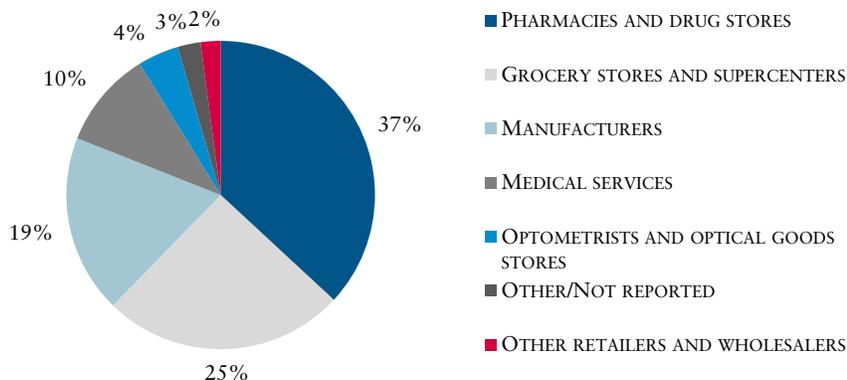
**PERFORMANCE MEASURE:** *To what extent are medical supplies being exempted from Colorado's sales and use tax when the supplies are purchased by individuals for whom they are medically necessary?*

**RESULT:** We found that the exemptions are likely applied to most sales of medical supplies when purchased directly by individuals for whom they are medically necessary. Although we lacked data necessary to estimate the proportion of eligible sales to which the exemptions were applied, our interviews with businesses that sell medical supplies indicate that the exemptions are commonly applied, and Department of Revenue data indicate that about \$7.5 billion in sales were reported exempt from state sales tax under the exemptions during Calendar Year 2017 by 2,278 business locations across the state.

In addition, we examined data from the Department of Revenue to identify the most common types of businesses that sell exempt medical supplies. Of the business locations that reported exempt sales, 971 (43 percent) reported annual exempt sales of medical supplies over \$1 million in Calendar Year 2017. The amounts exempted by these large taxpayers represented over 96 percent of the total amounts exempted by all taxpayers. We examined a non-statistical sample of 100 of these taxpayers to identify their industry, as self-reported to the Department of Revenue. We found that three industries constituted 81 percent of the total sales exempted by large taxpayers: pharmacies and drug stores (reporting 37

percent of the exempt sales), grocery stores and supercenters (25 percent), and manufacturers (19 percent). EXHIBIT 1.3 provides further details on the amounts exempted by different industries.

**EXHIBIT 1.3. PERCENTAGE OF TOTAL AMOUNTS EXEMPTED BY A SAMPLE OF TAXPAYERS<sup>1</sup> REPORTING OVER \$1 MILLION IN ANNUAL EXEMPT SALES, BY INDUSTRY, CALENDAR YEAR 2017**



SOURCE: Office of the State Auditor analysis of Department of Revenue data.

<sup>1</sup> These percentages reflect data from a non-statistical sample of 100 of the 971 taxpayers reporting over \$1 million in exempt sales of medical supplies during Calendar Year 2017.

Based on our interviews with businesses in those industries most likely to apply the exemptions, we found that these businesses are aware of the exemptions and apply them to applicable sales. Specifically, we used the Department of Regulatory Agencies' publicly available information on businesses licensed for medical service operations to identify businesses operating in Colorado that fit the profiles of the industries that we found were most likely to sell large amounts of medical supplies. We selected a non-statistical, randomly selected sample of 12 businesses that sell medical supplies directly to patients, focusing on the three major industries reporting exempt sales. We spoke with each of these 12 businesses and, based on our discussions with them, all are likely applying the exemptions correctly to sales of medical supplies.

Though the exemptions appear to be commonly applied to direct sales of medical supplies, we were unable to determine the extent to which patients benefit from the exemptions when they are applied to sales of medical supplies for which patients do not pay directly. We identified two

main considerations that would factor into this determination. First, the cost of medical items is often built into the overall cost of medical services that require the use of such items, and we were unable to determine the extent to which medical providers include or do not include sales tax considerations in developing prices for medical services. Second, the prices of health insurance premiums are determined, in part, by the costs of medical services and medical supplies to be paid partly or fully by the insurer on behalf of insureds. As with the medical providers, we were unable to determine the extent to which insurers do or do not include sales tax considerations in developing the price of insurance premiums. To the extent that insurers incorporate the savings from the exemptions into the overall price of insurance premiums, policyholders would realize the financial benefits, though insurers may instead benefit if they do not pass the savings on to their customers.

#### WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURES?

The Department of Revenue (Department) estimated a total state revenue impact of about \$216 million due to the Medical Supplies Exemptions in Calendar Year 2017 in its *2018 Tax Profile and Expenditure Report*. The Department confirmed that its estimate of the Medical Supplies Exemptions' revenue impact includes only those exempt sales that were reported on Line 4 of the Retail Sales Tax Return. However, for sales tax returns filed for tax periods through the end of 2019, Line 4 was titled "Sales of drugs by prescription and prosthetic devices." Therefore, taxpayers may have reported amounts exempted under the other types of medical supplies exemptions on the line for "Other Deductions," which includes several other exemptions that cannot be disaggregated for analysis. Although Department staff indicated that most of the Medical Supplies Exemptions are likely included in its estimate, to the extent that some sellers of eligible medical supplies reported exempt sales on this alternate line, the Department's estimate would not capture these sales.

Additionally, statute [Section 29-2-105(1)(d)(I), C.R.S.] mandates that statutory cities and counties apply most of the State's sales tax exemptions, including all of the Medical Supplies Exemptions. Therefore,

these local governments' revenue would be reduced to the extent that sales eligible for the exemptions occur within their jurisdictions. However, we lacked data necessary to estimate the eligible sales and total amount exempted in these jurisdictions. Home-rule cities established under Article XX of the Colorado Constitution have the authority to set their own tax policies independent from the State and are not required to exempt medical supplies from their local sales tax.

### WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

If the Medical Supplies Exemptions were eliminated, individuals would see at least a 2.9 percent increase (equivalent to the state sales tax rate) in their out-of-pocket costs paid for eligible medical supplies, and could see an additional increase if they purchase supplies in a local jurisdiction for which the State collects sales tax. However, individuals' out-of-pocket costs are highly variable due to the wide diversity of these beneficiaries' medical needs, varying costs of their medical supplies, their insurance plans, and their financial situations, and we lacked data necessary to determine the average financial impact to individuals benefitting from the exemptions. Therefore, to provide a sense of the range of potential financial impacts that eliminating the exemptions might have on different patients, we estimated the exemptions' impact on three hypothetical individuals with different medical conditions:

- Patient A, minimal impact: Myopia (nearsightedness)
- Patient B, moderate impact: Diabetes
- Patient C, high impact: Cancer

For these three patients, we estimated the minimum and maximum impact if the exemptions were repealed. The maximum benefits for each are based on an individual who has no health insurance and pays for their medical supplies entirely out-of-pocket. To the extent that the patients are covered by health insurance, the direct financial impact of the exemptions would be lessened, with the patients liable for sales tax only on the portion of medical supplies expenses not paid for by their

insurance plans. Therefore, the minimum direct impact to these patients could be as low as \$0, if their insurance plans completely cover their medical supplies expenses. EXHIBIT 1.4 provides more details on each patient's purchased medical supplies and their overall costs.

EXHIBIT 1.4. ESTIMATED DIRECT FINANCIAL IMPACT <sup>1</sup> TO THREE TYPES OF PATIENTS IN THE EVENT OF REPEAL			
	PATIENT A MINIMAL IMPACT	PATIENT B MODERATE IMPACT	PATIENT C HIGH IMPACT
Medical condition	Myopia (nearsightedness)	Diabetes	Cancer
Exempt supplies purchased	Corrective eyeglasses	Insulin and other antidiabetic agents Prescription drugs Other supplies (e.g., hearing devices, prostheses)	Newly available anticancer drugs
Total estimated annual cost of supplies	\$200	\$4,333	\$100,000+
Minimum direct annual impact to patient (expenses fully covered by insurance)	\$0	\$0	\$0
Maximum direct annual impact to patient (expenses paid entirely out-of-pocket)	\$6	\$126	\$2,900+

SOURCE: Office of the State Auditor calculations based on average medical supplies costs reported by Consumer Reports, the American Diabetes Association, and a 2017 article published in Nature Reviews Clinical Oncology.

<sup>1</sup> The medical supplies and estimated costs for Patients A and B represent typical treatments and estimated average expenses for each patient's condition. For Patient C, the estimated expenses are based on a 2017 article that found that the average price of new anticancer drugs often exceeds \$100,000 per course of treatment.

Additionally, if the exemptions were eliminated, medical providers and insurers may be liable for an additional 2.9 percent in sales tax applied to their purchases of medical supplies, in which case they would experience an increase in expenses and may pass on these costs to patients in the form of higher costs for medical services and insurance premiums. However, we lacked data to determine the extent to which this would occur.

## ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

We reviewed the tax codes of the 44 other states (excluding Colorado) and the District of Columbia that levy a sales tax and found that some of the items covered by Colorado's Medical Supply Exemptions are also commonly exempted by other states, though there is variation regarding the specific items covered, as shown in EXHIBIT 1.5.

### EXHIBIT 1.5. NUMBER OF STATES EXEMPTING CERTAIN MEDICAL SUPPLIES FROM SALES TAX

MEDICAL SUPPLY ITEMS	NUMBER OF STATES WITH EXEMPTION (OUT OF 45) <sup>1</sup>
Insulin	44
Prescription drugs	43
Prosthetic devices	40
Mobility enhancing equipment	38
Hearing aids	37
Oxygen delivery equipment	36
Durable medical equipment	36
Corrective eyeglasses	32
Contact lenses	28

SOURCE: Office of the State Auditor analysis of Bloomberg Law resources and other states' statutory provisions, accessed in September 2019.

<sup>1</sup>Includes the District of Columbia.

Similar to Colorado, some of these states require that medical supplies be purchased pursuant to a prescription or furnished by a licensed medical provider in order for the exemption to apply, although others do not. This often varies depending on the medical item in question. Additionally, some states allow sales tax exemptions for medical supplies only when the supplies are paid for and/or reimbursed by Medicare or Medicaid.

## ARE THERE TAX EXPENDITURES OR PROGRAMS WITH A SIMILAR PURPOSE IN THE STATE?

We identified the following programs that reduce individuals' costs for medical supplies in Colorado:

**MEDICARE LOW-INCOME SUBSIDY AND LIMITED INCOME NEWLY ELIGIBLE TRANSITION PROGRAM.** Medicare Part D, which provides prescription drug coverage, has a Low-Income Subsidy that provides additional

financial assistance to individuals with limited income and assets and can help pay for premiums, deductibles, and co-payments. Additionally, Medicare's Limited Income Newly Eligible Transition Program provides financial assistance at the pharmacy counter in the form of reduced co-payments on prescription drugs for individuals who qualify for the Low-Income Subsidy but are not enrolled in a Medicare Part D plan.

**HOUSE BILL 19-1216 [SECTION 10-16-151, C.R.S.]**. House Bill 19-1216 requires Colorado insurers to cap covered individuals' co-payments for prescription insulin at no more than \$100 for a 30-day supply. The bill was signed into law on May 22, 2019, making Colorado the first state to cap insulin prices, and applies to health insurance plans issued or renewed on or after January 1, 2020.

**OTHER FINANCIAL ASSISTANCE PROGRAMS FOR MEDICAL EQUIPMENT AND SUPPLIES.** We identified numerous other programs available in Colorado that assist individuals in obtaining medical goods at a reduced cost. These programs may be offered by a variety of entities, including nonprofit organizations, pharmacies, drug manufacturers, local governments, and membership organizations, and include:

- *Prescription drug discount programs.* Reduce the cost of prescription drugs to patients.
- *Lending programs for durable medical equipment and/or mobility enhancing equipment.* Provide equipment to patients on a temporary basis, either at no cost or at a reduced cost.
- *Financial assistance programs for prostheses.* Provide funding for patients to obtain prostheses when they have no other funding source available to them.
- *Hearing aid banks.* Provide hearing devices to individuals in need at no or reduced cost.
- *Organizations for specific conditions.* Provide medical equipment or supplies to individuals with specific medical conditions, including multiple sclerosis, spinal cord injury, and muscular dystrophy.

## WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURES?

The Department of Revenue reported that it intends for all sales that qualify for the Medical Supplies Exemptions to be reported on Line 4 of the Retail Sales Tax Return (Form DR 0100) for filing periods prior to 2020 and believes that most sellers of medical supplies have been reporting exempt sales this way. However, for Tax Year 2019 and prior, the description for Line 4 was “Sales of drugs by prescription and prosthetic devices.” According to a plain reading of this description, this line encompasses only two of the Medical Supplies Exemptions. Therefore, some vendors may have reported sales exempt under the Medical Supplies Exemptions on the line for “Other deductions.” To the extent that some sellers of eligible medical supplies reported exempt sales on this alternate line, the Department’s revenue impact estimate would not capture these sales, since the estimate includes only those amounts reported on Line 4. However, the Department revised Form DR 0100 for Tax Year 2020, and the line for the Medical Supplies Exemptions (now Line 6) has been renamed to “Sales of exempt drugs and medical devices,” which more fully encompasses the exemptions. With this change, there may be more consistency in how taxpayers report exemption amounts, and this data constraint may not be as significant of a factor for Tax Years 2020 onward.

Additionally, because the Retail Sales Tax Return does not have a separate line for each type of exempt medical supplies, vendors must lump together the value of the exemptions, either on the “Sales of drugs by prescription and prosthetic devices” line or on the “Other Deductions” line. Therefore, although the Department was able to report the estimated revenue impact for the exemptions collectively, there is no data on how much Colorado businesses are claiming for each of the exemptions individually. This data would allow us to provide a more accurate and reliable estimate of the revenue impact to the State resulting from each individual exemption. Therefore, if the General Assembly determined that more precise figures are necessary, it could direct the Department of Revenue to add additional reporting lines on its Retail Sales Tax Return and make changes in GenTax, its tax

processing and information system, to capture and pull this additional information. However, according to the Department of Revenue, this type of change would require additional resources to develop the form and complete the necessary programming in GenTax (see the Tax Expenditures Overview Section of the Office of the State Auditor's *Tax Expenditures Compilation Report* for additional details on the limitations of Department of Revenue data and the potential costs of addressing the limitations).

#### WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

We did not identify any policy considerations related to the Medical Supplies Exemptions.