216 VA. 886
SUPREME COURT OF VIRGINIA
RECEIVED
MAY 23 1975
RICHMOND, VIRGINIA

IN THE

Supreme Court of Virginia

AT RICHMOND

RECORD NO. 750233

COMMONWEALTH OF VIRGINIA,
Plaintiff in Error,

v.

BLUEFIELD SANITARIUM, INC.,
Defendant in Error.

APPENDIX TO BRIEF

ANDREW P. MILLER
Attorney General of Virginia

CHARLES K. TRIBLE
Assistant Attorney General

P. O. Box 6-L
Richmond, Virginia 23282

Counsel for Plaintiff in Error

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VIRGINIA: IN THE CIRCUIT COURT OF TAZEWELL COUNTY

BLUEFIELD SANITARIUM, INC.,
a corporation, trading and doing business as Clinch Valley Clinic Hospital, - - - - - - - - - - Petitioner,

VS ‖ PETITION

DEPARTMENT OF TAXATION OF VIRGINIA,
Sales and Use Tax Division, - - - - - - - - - - - - - - - - - Defendant.

TO THE HONORABLE VINCENT L. SEXTON, JR., JUDGE OF SAID COURT:

Your petitioner would respectfully set forth and allege as follows:

(1) Petitioner is a duly accredited and licensed hospital, located at Richlands, in Tazewell County, Virginia, with 18 physicians, 21 registered nurses and 65 licensed practical nurses on petitioner's staff, all of whom are duly licensed in their respective professions by the Commonwealth of Virginia. All patients in petitioner's hospital are the private patients of its staff physicians.

(2) On or about the 22nd day of February, 1971, the defendant erroneously assessed petitioner with a sales and use tax for the years 1967 through 1970, inclusive, on drugs dispensed by or sold on prescription or work orders of the licensed physicians on its staff to their patients in petitioner's hospital in the amount of $5,423.79, plus interest of $325.43.

(3) Petitioner's hospital maintains a pharmacy under the supervision of a licensed pharmacist and all drugs are dispensed therefrom pursuant to a written order by each patient's doctor that a specific drug be administered to such patient.

(4) §58-441.6(s) of the Code of Virginia, as amended, expressly exempts from the Virginia Retail Sales and Use Tax all drugs and medicines dispensed by or sold on prescriptions or work orders of licensed physicians, and inasmuch as all drugs and medicines acquired by petitioner and dispensed from its pharmacy are dispensed by

Filed in the Clerk's Office the 30th day of August, 19 73

Writ Tax $ 5.00 Teste:
Fee 1.00
Deposit 25.00 Leo D. Moore, Jr., Clerk
Total Paid $ 31.00 R. G. McReynolds, D.C.

1

prescriptions or work orders of licensed physicians, the assessment made against petitioner for sales and use tax on said drugs and medicines for the years 1967 through 1970 in said amount of $5,423.7 plus $325.43 interest, was erroneous.

WHEREFORE, your petitioner files its petition, pursuant to §58-1130 of the Code of Virginia, as amended, and prays that the assessment of said sales and use taxes for the years and in the amounts hereinabove set forth be declared to be erroneous and of no effect; that such taxes and interest be refunded to petitioner; and that petitioner be declared exempt from said tax, pursuant to §58-441.6(s) of the Code of Virginia, as amended; and that your petitioner may have such other relief in the premises as the nature of its case may require.

BLUEFIELD SANITARIUM, INC.,
a corporation, trading and doing
business as Clinch Valley Clinic
Hospital, Petitioner

By Carl C. Gillespie
Of Counsel

Gillespie, Gillespie & Hart
Tazewell, Virginia
Attorneys for Petitioner

VIRGINIA: IN THE CIRCUIT COURT OF TAZEWELL COUNTY

BLUEFIELD SANITARIUM, INC.,
a corporation, trading and doing business as Clinch Valley Clinic Hospital, - - - - - - - - Petitioner

v.

DEPARTMENT OF TAXATION OF VIRGINIA,
Sales and Use Tax Division, - - - - - - - - - - - - - - Defendant.

ANSWER

Now comes the defendant, Stuart W. Connock, Acting State Tax Commissioner, Virginia Department of Taxation, and answers the Petition in this cause and says:

1. The defendant admits the facts and allegations of paragraph (1) of the Petition to the effect that the petitioner is a duly accredited and licensed hospital located at Richlands, in Tazewell County, Virginia. The defendant neither admits nor denies the remainder of the facts and allegations in paragraph (1), and asserts that it has no knowledge thereof, and calls for strict proof.

2. The defendant admits that it made sales and use tax assessments against petitioner during December, 1970, and January, 1971, in the total amount of $26,492.11 including tax of $24,970.46 and interest of $1,521.65, covering the period from December 1, 1966, through November 30, 1970, which assessments were paid in full by petitioner. Said assessments were made with respect to purchases of hospital supplies, food and medicines and sales of merchandise through

vending machines. Defendant neither admits nor denies that the portion of said assessments made with respect to the purchase of drugs was in the amount of $5,423.79 plus interest of $325.43 and asserts that in the absence of a complete review of the audit report and working papers the amount of

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Court of Tazewell County, Virginia,
SEP 17 1973 19
Teste:
Clerk

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tax and interest assessed with respect to the purchase of drugs cannot be identified. Defendant denies, however, that any portion of said assessment was erroneous.

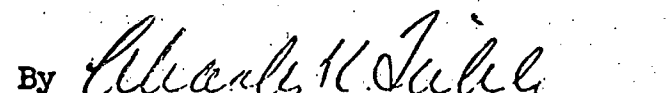
3. The defendant admits the facts and allegations of paragraph (3) of the Petition.

4. The defendant admits that § 58-441.6(s) exempts medicines and drugs dispensed by or sold on prescriptions or work orders of licensed physicians from taxable sales, but denies that said exemption has any application to petitioner's purchase of drugs in bulk quantities. The defendant submits that all medicines and drugs acquired by petitioner were purchased in bulk quantities and that the aforesaid exemption does not apply because the purchase of such medicines and drugs was not made pursuant to a prescription or work order of a licensed physician. The defendant further submits that it did not assess any tax against petitioner with respect to its sale of medicines and drugs to its patients pursuant to prescriptions or work orders of its physicians.

And now, having fully answered, the defendant prays that the Court declare the assessment not erroneous and deny the Petition.

COMMONWEALTH OF VIRGINIA
DEPARTMENT OF TAXATION

Stuart W. Connock
Acting State Tax Commissioner

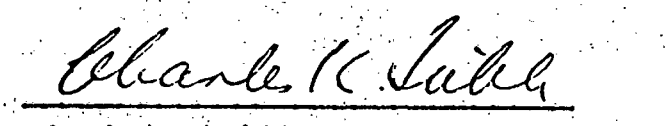
By 
Charles K. Trible
Assistant Attorney General

Andrew P. Miller
Attorney General of Virginia

Charles K. Trible
Assistant Attorney General
P. O. Box 6-L
Richmond, Virginia 23282

CERTIFICATION

I hereby certify that the original of the foregoing Answer has been mailed to the Clerk of this Court for filing and a true copy thereof has been likewise mailed to Carl C. Gillespie, Esquire, Gillespie, Gillespie & Hart, Tazewell, Virginia, counsel for petitioner, on this 14th day of September, 1973.


Assistant Attorney General

TWENTY - NINTH JUDICIAL CIRCUIT OF VIRGINIA

Counties of Bland, Buchanan, Dickenson, Giles, Russell and Tazewell

CIRCUIT COURT JUDGES:

VINCENT L. SEXTON, JR.
Bluefield, Virginia 24605

GLYN R. PHILLIPS
Clintwood, Virginia 24228

NICHOLAS E. PERSIN
Grundy, Virginia 24614

Tazewell, Virginia 24651
October 1, 1974

Gillespie, Gillespie, & Hart
Attorneys-At-Law
Tazewell, Virginia 24651

Attention Mr. Carl C. Gillespie

The Honorable Andrew P. Miller
Attorney General of Virginia
P.O. Box 6-11
Richmond, Virginia 23282

Attention Mr. Charles K. Trible, Assistant Attorney General

Gentlemen:

Re Bluefield Sanitarium, Inc., trading as Clinch Valley Clinic Hospital V. Department of Taxation of Virginia, Sales and Use Tax Division

and

Richlands Medical Association, trading as Mattie Williams Hospital V. Department of Taxation of Virginia, Sales and Use Tax Division

Clinch Valley Clinic filed its petition August 30, 1973, seeking relief from an assessment made by the Sales and Use Tax Division of the Department of Taxation of Virginia for the year 1967 through 1970 on drugs and medicines dispensed by petitioner from its pharmacy on prescriptions or work orders of licensed physicians to their respective patients in said Clinic, the amount being in the sum of $5,423.79 and interest.

The Richlands Medical Association, trading and doing business as Mattie Williams Hospital, filed its petition against the Sales and Use Tax Division of the Department of Taxation of Virginia on October 29, 1973, seeking relief of a like assessment against the Association in the sum of $9,000.35.

Counsel for petitioners and the Department of Taxation agreed that the operations of the two petitioners were fundamentally the same, and the cases were consolidated and heard together.

The two petitioners are hospitals operated for profit in the Town of Richlands, Virginia. The Clinic is a 135-bed institution with a separate out-patient clinic and has a closed staff of 21 licensed physicians. Patients in the hospital are the private patients of the staff physicians.

The Mattie Williams Hospital has 76 licensed beds and 9 licensed physicians on the staff. The patients in the hospital are the private patients of the staff physicians.

Each hospital maintains in and as a part of the hospital a pharmacy in charge of a licensed pharmacist. The hospital purchases drugs and medicines in bulk, based upon a formulary made up by the drug committee of licensed physicians and the licensed pharmacist. The pharmacist determines the necessary quantity of drugs and medicines to be kept on hand and purchases them in the name of the hospital. The hospital is the agent of the doctors who are a separate group. The hospital pays the bills for the drugs and the medicines from its general fund and collects the accounts for the doctors including the costs of drugs and medicines which are charged directly to the patient. The pharmacy is not open to the public and the hospital makes no purchases from the pharmacy unless upon prescription or a work order of a licensed physician.

Joseph F. Serino, Assistant Administrator of Clinch Valley Clinic, and a witness for petitioners, testified among other things that

> "Not as much as an aspirin tablet is dispensed from that pharmacy without a written order, work order, or prescription from one of the staff physicians to an in-patient in the hospital. The pharmacy is there purely and simply for the purpose of the hospital patients." (Serino, p.10)

Very comprehensive records are kept, not only in the patient's individual confidential record, but also entered on the emergency room log by the emergency room personnel and the witness details the content of these records.

The purpose for which the drugs and medicines are purchased for the pharmacy is

> "to have the drugs on hand as they're needed, in cases of emergency. When a patient needs

> a medication, it would be inconceivable for us to have to send to a retail pharmacy; the closest one to us is a mile. And for the convenience of having the drugs on hand when needed on a 24-hour basis." (Serino, p.8)

and Serino stated that the drugs are intended only for the hospital patients. W. R. Williams, Jr., Administrator for Richlands Medical Association, trading as Mattie Williams Hospital, who listened to the statements made by Mr. Serino and stated that the procedure testified to was the same as that followed by Mattie Williams Hospital, and the fundamentals are essentially the same. (Williams, p.33)

Mr. Williams stated that there were no outside sales so far as the pharmacy in his hospital was concerned.

It further appears from the evidence that there are no sales or deliveries from the pharmacy to the hospital or its employees of the drugs and medicines being sold and dispensed to the patients of the respective physicians on prescriptions or work orders of the physicians connected with the hospital.

As in the case of Doctors Hospital, Va. Department of Taxation, 213 Va. 504, the question to be determined is whether the drugs and medicines were a sale to the hospitals and subject to a sales tax or whether they were medicines and drugs dispensed or sold on prescriptions or work orders of licensed physicians and thereby exempt from the sales tax under Section 58-441.6(s). There can be no doubt that the legislatures intended that sick persons needing drugs and medicines would not be saddled with the extra expense of a sales tax, if the drugs and medicines were dispensed or sold on prescription or work order of a licensed physician.

As heretofore noted, the purchases in bulk by the hospital were for the purpose of having the drugs and medicines available when needed on a 24-hour basis and for sale only to hospital patients upon prescription or work order by the licensed physician treating and in charge of such patients.

It makes little difference if the pharmacy is a part of the hospital or a separate entity, the drugs and medicines were sold upon prescription to hospital patients and are exempt under the above section. Defendant's assertion that an assessment made by the Department of Taxation is prima facie correct and valid and the burden is upon the taxpayer to show that such assessment is erroneous and also that great weight should be

given to the construction of the statute given by the Department; And that a tax exemption provision must be strictly construed against the taxpayer and that any doubt as to whether the exemption applies must be resolved in favor of the Department of Taxation.

Even giving great weight to the construction given by the Department, that construction must fall in light of the clear provisions of Sub-section (s) exempting drugs and medicines prescribed by a licensed physician. The Court entertains no doubt as to the application of that provision under the facts of the two cases at bar, as shown by the evidence, and this is in line with the intention of the legislature.

~~The Department, in making its assessment of the use tax, overlooked the purpose for which the drugs and medicines were purchased, i.e., to be dispensed upon prescription or work order of licensed physicians for their patients, and clearly exempt under Sub-section (s).~~ The methods used by the hospitals clearly meet the provisions of that Sub-section.

The assessment of the "use" tax for the drugs and medicines was erroneous.

This Court is of opinion that the petitioners are entitled to the relief sought and proper order in each case may be submitted for entry in line with the Court's holding.

Very truly yours,

V. L. Sexton, Jr.

VLS:pfw

VIRGINIA: IN THE CIRCUIT COURT OF TAZEWELL COUNTY

BLUEFIELD SANITARIUM, INC.,
a corporation, trading and doing business as Clinch Valley Clinic Hospital,- - - - - - Petitioner

v.

DEPARTMENT OF TAXATION OF VIRGINIA,
Sales and Use Tax Division, - - - - - - - - - - - - Defendant

ORDER

This cause came on to be heard upon the Petition, the Answer, the testimony given ore tenus and exhibits introduced at the hearing on May 8, 1974, the legal memoranda filed by counsel, and was argued by counsel and defended by the Attorney General.

Whereupon, for the reasons more fully set forth in its opinion letter dated October 1, 1974, the Court is of the opinion that the use taxes assessed against petitioner with respect to its purchase of drugs and medicines for future use in administering medication to its patients pursuant to doctors' prescriptions are erroneous, and that said purchases are exempt from taxation pursuant to § 58-441.6(s).

NOW, THEREFORE, IT IS ADJUDGED, ORDERED AND DECREED that the defendant shall correct said assessment and refund to petitioner the sum of Four Thousand Four Hundred Nineteen Dollars and Twenty Cents ($4,419.20) representing use tax of Four Thousand One Hundred Sixty-Nine Dollars and Six Cents ($4,169.06) and interest of Two Hundred Fifty Dollars and Fourteen Cents ($250.14), and

That pursuant to Rule 5:9(a) of the Rules of the Supreme Court of Virginia the transcript of the hearing of May 8, 1974,

Law 29
S. 538

I hereby certify that I have this day mailed a duly certified copy of this Order to the State Tax Commissioner, Richmond, Virginia.
November 1, 1974
[illegible], Deputy Clerk

filed with the papers in this cause shall be a part of the record, and

That the Clerk shall certify a copy of this Order to the State Tax Commissioner, Box 6-L, Richmond, Virginia 23282, and place the papers in this matter among the ended causes, properly indexed.

Dated this 31st day of October, 1974.

Judge

I ask for this:

Carl C. Gillespie
Counsel for Petitioner

Seen and objected to:

Charles K. Trible
Assistant Attorney General
Of Counsel for Defendant

VIRGINIA: IN THE CIRCUIT COURT OF TAZEWELL COUNTY

BLUEFIELD SANITARIUM, INC.,
a corporation, trading and doing business as Clinch Valley Clinic Hospital,- - - - - - Petitioner

v.

DEPARTMENT OF TAXATION OF VIRGINIA,
Sales and Use Tax Division,- - - - - - - - - - - Defendant

NOTICE OF APPEAL AND ASSIGNMENT OF ERROR

TO: The Honorable Rhea F. Moore, Jr., Clerk

Pursuant to Rule 5:6 of the Rules of the Supreme Court of Virginia, the defendant, Commonwealth of Virginia, Department of Taxation, hereby gives notice that she will apply to the Supreme Court of Virginia for a Writ of Error from the final Order entered herein on October 31, 1974.

Counsel for defendant gives further notice that in the Petition for Writ of Error the defendant assigns and will rely upon the following error:

1. The Court erred in its conclusion that the Petitioner, Bluefield Sanitarium, Inc., was entitled to an exemption from Virginia use tax pursuant to § 58-441.6(s), Code of Virginia (1950), as amended, for drugs purchased by it and subsequently dispensed to patients.

No transcript of the evidence will be filed, as same was made a part of the record by the aforementioned Order.

Dated this 27th day of November, 1974.

COMMONWEALTH OF VIRGINIA
DEPARTMENT OF TAXATION

By Charles K. Trible
Charles K. Trible
Assistant Attorney General

Filed in the Clerk's Office Circuit Court of Tazewell County, Virginia.
NOV. 29 1974 19
Teste:
Clerk

38

Andrew P. Miller
Attorney General of Virginia

Charles K. Trible
Assistant Attorney General
P. O. Box 6-L
Richmond, Virginia 23282

CERTIFICATION

I hereby certify that the original of the foregoing Notice of Appeal and Assignment of Error has been mailed to the Clerk of this Court for filing and a true copy thereof has been likewise mailed to Carl C. Gillespie, Esquire, Gillespie, Gillespie & Hart, Tazewell, Virginia 24651, counsel for petitioner, on this 27th day of November, 1974.

Charles K. Trible
Assistant Attorney General

The following proceedings were had before the Honorable Vincent L. Sexton, Jr., Judge of the Circuit Court of Tazewell County on the 8th day of May, 1974, when the following were all the proceedings had and evidence taken, to-wit:

- - - - - -

All witnesses to be heard were duly sworn and allowed to remain in the court room.

Mary Jayne Williamson, Court Reporter, was sworn to make a true and accurate record of all proceedings.

- - - - - -

JOSEPH S. SERINO

a witness called on behalf of the Petitioner, having first been duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. GILLESPIE:

Q. Would you please state your name?

A. Joseph S. Serino.

Q. Where do you live, Mr. Serino?

A. Richlands, Virginia. Tazewell County.

Q. And what is your business?

A. I'm the Assistant Administrator, Clinch Valley Clinic Hospital, in Richlands.

Q. How long have you occupied that position?

A. For about ten (10) years.

Q. Would you please state to the Court just what type of institution the Clinch Valley Clinic Hospital is?

A. Clinch Valley Clinic Hospital is a division of the Bluefield Sanitarium, Incorporated. It's a proprietary hospital operating in the Commonwealth of Virginia and subject to all the rules and regulations of the Department of Health. It's a one-hundred and thirty-five (135) bed institution with an out-patient clinic separate, with twenty-one (21) licensed physicians.

Q. And it is an accredited and licensed hospital?

A. Yes, sir.

Q. Under the laws of Virginia?

A. Yes, sir.

Q. Does it have an open or closed staff?

A. It's a closed staff.

Q. Are all the physicians on the hospital staff duly licensed to practice law, to practice medicine in Virginia?

A. Yes.

Q. Now, Mr. Serino, are the patients in the hospital the private patients of the physicians on the staff?

A. Yes, sir.

Q. Does the hospital maintain a pharmacy?

A. Yes, sir.

Q. Can you tell us where the pharmacy is located?

A. The pharmacy is located on what we term "B" floor, the second floor of the hospital. It's staffed by a licensed pharmacist, James Sweet, Jr., and the pharmacy is charged with the

responsibility of stocking the drugs for the physician's patients.

Q. Well, now, when a patient in the hospital is to be administered a drug from the pharmacy, just explain to the Court what procedure the physician follows in procuring that drug or medicine for his patient?

A. The physician writes an order on a progress record which is made a part of the chart, a permanent part of the patient's chart, the prescription for the medication is then hand carried to the pharmacy where it is filled by the licensed pharmacist and then it is taken from there directly to the patient where it is administered to the patient.

Q. Is this prescription or work order signed by the physician?

A. Yes, sir. Signed and dated.

Q. Does it have the patient's name on it?

A. Yes, sir.

Q. And the drug or medicine to be administered and the dosage which is to be administered?

A. Yes, sir.

Q. Is this drug or medicine charged to the patient?

A. Yes, sir. The charge is entered at the time that it is administered, the charge is reported to the business office by the nurse in charge, the charge nurse on the floor.

Q. Now, are all these drugs or medicines which are prescribed and administered as you have described, drugs that the hospital has heretofore considered to be exempt under the retail sales and use tax?

A. Yes, sir. The staff, we have a drug committee, composed of three (3) physicians, three (3) licensed physicians on the staff, and the licensed pharmacist is also part of this committee, drug committee. They determine the drug formulary, the stock of drugs which is to be kept in the pharmacy. We have this, I'm sorry I didn't bring our drug formulary with me. We have a formal drug formulary which lists all the drugs which are stocked in the pharmacy. The pharmacist is then charged with seeing that these drugs are kept in stock. For the use of the physician's patients.

Q. Mr. Serino, I believe you stated that these drugs that are prescribed by and administered to the patients in the hospital, in the manner which you have described, are charged to the patients?

A. Yes, sir.

Q. Was any sales or use tax charged to these patients for the years 1967 through 1970?

A. No, sir. No taxes charged.

Q. Prior to February 22, 1971, was an audit made by the Department of Taxation to determine what it considered to be the sales and use tax due by the hospital?

A. Yes, sir.

Q. At that time, was an assessment made for the sales and use tax from the drugs and medicines administered in the manner in which you have described? Against the hospital?

A. Yes, sir.

Q. Has that tax been paid?

A. Yes, sir.

Q. At the time the assessment was made, did you and other representatives of the hospital discuss the assessment on a question of whether or not these drugs and medicines are exempt under the statute?

A. Yes, sir, we have taken this up with the officials of the State Examiner, claiming that we feel this is an unfair tax, and of course, we're still paying it. We still have not been made exempt.

Q. Did they make any statement to you as to whether this tax has been assessed against other hospitals, and if so, what type of hospitals?

A. When we talked to Mr. Lewis -.

Q. Who is Mr. Lewis?

A. He's the Director of the Sales and Use Tax in Richmond, for the State of Virginia. When we talked to Mr. Lewis, he confirmed to us that a sales tax on drugs is not charged to private physicians, it's not charged to community or non-profit hospitals, or it's not charged to retail pharmacies.

MR. TRIBLE: We object, Your Honor. This is all hearsay. Mr. Lewis is in the court room and will testify today and be subject to cross examination, and I think what he said can best be brought out by his own testimony.

THE COURT: I think that would be true if he's here.

Q. What was the amount of sales and use tax that was assessed by the Department of Taxation on the drugs and medicines

that were dispensed to the hospital patients from the period 1967 through 1970?

A. The tax was five thousand four hundred twenty-three dollars and seventy-nine cents ($5,423.79). The interest was three hundred twenty-five dollars and forty-three cents ($325.43), for a total of five thousand seven hundred forty-nine dollars and twenty-two cents ($5,749.22). That was paid in 1971. I don't have the exact date of the check, but -.

Q. I believe you say the hospital buys these drugs in, and medicines for its pharmacy, in bulk from the manufacturers?

A. Yes, sir.

Q. And what is the purpose of buying these drugs in bulk?

A. Of course, the primary purpose is to have the drugs on hand as they're needed, in cases of emergency, when a patient needs a medication, it would be inconceivable for us to have to send to a retail pharmacy. The closest one to us is a mile. And for the convenience of having the drugs on hand when needed, on a twenty-four (24) hour basis.

Q. Who are these drugs ultimately intended for?

A. Only for the hospital patients.

Q. I believe you may ask.

CROSS EXAMINATION

BY MR. TRIBLE:

Q. Mr. Serino, is this hospital operated for profit?

A. Yes, sir. It is a company.

Q. How are the drug purchases handled? In other words, when you buy in bulk, what are your procedures?

A. The hospital drug formulary has been made up by the drug committee of licensed physicians and licensed pharmacist. The pharmacist determines the necessary quantity of drugs to keep on hand, and in accordance with the established formulary, he purchases the drugs. The hospital merely acts as business agent, to pay the expenses for these drugs.

Q. Well, who is the hospital the agent for in this case?

A. For the physicians. You see, the doctors don't work for the hospital. They're a separate group.

Q. Well, who pays the bill for the drugs? Who pays the manufacturers?

A. The hospital. The hospital pays the invoice.

Q. Out of its own funds?

A. Yes. Out of the general fund.

Q. Well, then it's an expense of the hospital and not an expense of the doctor?

A. You'd have to go a little deeper into it. It's not quite that simple. There's a formula, you see, the hospital acts as business agent for the physicians and their charges and all

varies. In other words, the doctor doesn't submit a separate bill for his, for the services he renders. The hospital does the billing for the doctor and does his collecting for him. And there's a formula that's used to distribute the funds depending on the amount of the total funds received for the physicians and the hospital. The funds are all entered into one general fund but then are separated for the division of the physicians in the hospital.

Q. But the drug wholesaler or manufacturer is looking to the hospital for payment and not any particular doctor?

A. This is correct.

Q. So the formula that distributes the proceeds of the receipts of services is just a way of allocating the income amongst the doctors, is that right? In other words, does the doctor earn more money based on the purchase of drugs?

A. Oh, no, no. No.

Q. So it's a way of distributing income?

A. Right.

Q. Is the pharmacy incorporated or is it a part of the hospital?

A. It's part of the hospital.

Q. Is it open to the public?

A. No. No, it's, the pharmacy, you see, is operated by a licensed pharmacist, and not as much as an aspirin tablet is dispensed from that pharmacy without a written order, work order or prescription from one of the staff physicians to an in-patient in the hospital. The pharmacy is there purely and simply for the purpose of the hospital patients.

Q. Well, I'm glad you mentioned aspirin. Suppose, do you have an Emergency Room in the hospital?

A. Yes.

Q. Suppose I showed up at the emergency room and someone decided that I needed an aspirin. Would they write a prescription and carry it to the pharmacy and bring the aspirin, bring it back?

A. No. No, the pharmacy prepares medications that have been deemed necessary to stock the emergency room medicine cabinet. He distributes the drugs to the emergency room, labels them, and the physicians use it from that stock.

Q. So, at least with respect to those items, they would not be sold on a prescription or work order? For these particular patients?

A. That's not correct, no. The physician, the emergency room physician has to enter his order on the permanent record of the medication he's administering to the patients. It's accounted for in that manner.

Q. Every aspirin tablet?

A. Well, I mentioned an aspirin tablet to illustrate it. Whatever the drug is, he enters it on the permanent record.

Q. Well, don't they keep, say one hundred (100) aspirin tablets in the emergency room there?

A. Well, I don't know the number that they keep, but -.

Q. But they keep a supply?

A. They keep a supply.

Q. And you mean if the doctor gave me one, if I go there, that that's entered on a record?

A. Yes, sir.

Q. But the record is not delivered to the pharmacy in the sense that the in-patient would receive a prescription, is it?

A. In the particular area that you're talking about here, it's a right comprehensive record that's kept. The record is kept not only in the patient's individual confidential record, permanent record, but it's also entered on the emergency room log by the emergency room personnel. They show on here, if you came in there for treatment, they would show your name, the time that you arrived, the treatment that was rendered, the medication the patient was given and diagnosis, and the follow-up treatment or orders from the doctor to you if he wanted you to return, et cetera.

Q. Would the same thing be true of the operating room?

A. Yes, sir.

Q. So, there's a stock of routinely used drugs, I imagine, in the operating room as well as the emergency room, and if the doctor decides he needs to use a drug, at any particular point in time, he just gets it from a supply?

A. From the pharmacy. It comes from the pharmacy to that supply place.

Q. Right, but when it comes from the pharmacy, it couldn't be on a prescription, because at that time, they wouldn't have any particular patient in mind at all, would they?

A. Well, it's on an order from the physician that these rooms are stocked.

Q. Well, I understand that.

A. You see, the pharmacist doesn't determine, I'm going to put X number of tablets of such and such description in the emergency room or in the operating room. The physician orders him to stock the medicine cabinets with these medications. And when the physician prescribes these medicines to be used from this secondary stock, he enters a record as I have described.

Q. Would you bill the patient for that aspirin tablet, for example?

A. Yes.

Q. What do you charge for aspirin?

A. Well, I don't know. I'm not prepared to give you the price on an individual drug, but it's, each drug is charged.

Q. You mentioned that of the total amount of the assessment, some five thousand seven hundred forty-nine dollars and twenty-three cents ($5,749.23) represented the purchase of drugs and medicines. Now, how is that derived from? Did you do that, or was it broken down by the Department of Taxation?

A. The Department of Taxation's total assessment was twenty-four thousand nine hundred and seventy dollars and forty-six cents ($24,970.46). Interest was one thousand five hundred twenty-one dollars and sixty-five cents ($1,521.65), and the total amount paid was twenty-six thousand four hundred ninety-two dollars and eleven cents ($26,492.11). Now, from this assessment, we went back through the records for that period of time and got the invoices from our suppliers for these drugs, and I have a copy of these here,

which total one hundred thirty-five thousand five hundred ninety-four dollars and eighty-six cents ($135,594.86). The tax of Five thousand four hundred twenty-three dollars and seventy-nine cents ($5,423.79) is arrived at by multiplying the one hundred thirty-five thousand five hundred ninety-four dollars and eighty-six cents ($135,594.86) by four percent (4%). And then the assessment, the interest assessment is six percent (6%) of that figure, or three hundred twenty-five dollars and forty-three cents ($325.43).

Q. Were any of these drugs purchased prior to September 1, 1968?

A. The assessment that we have here is for the period from December 1, 1966 to December 1, 1970.

Q. Well, in the audit, I think you will find that for a period of time, that there was no local one percent (1%) use tax, and therefore, the amount assessed was three percent (3%) and not four percent (4%). Are you aware of that?

A. On the Report of Audit, with the identification Commonwealth of Virginia, Department of Taxation, towards the top portion of this under the category of liability, the state tax for the period of audit of 12-1-66 to 12-1-70, state tax, and then below that is local tax for the same period of time.

Q. Can I look at that for a minute? This form would not give you the rate of tax, would it? Oh, it does. Would you look on Page 2 and read me the entry on the first line? Can you make it out? Is it legible?

A. Let's see, it's 1966, oh, yes, December 1, 1966, to something, 1967. Sales tax is marked with an X, measure of tax, a dollar figure there, rate two (2), and then in the next column, additional tax, another dollar figure and the rate, twenty-five (25). And then the amount after this. In the next column, interest two (2) and the amount, the dollar amount, and then the total figure in dollars.

Q. What does that rate two (2) mean? That's two percent (2%), is it not?

A. Yes, sir, that would be two percent (2%).

Q. And that is all state tax, but do you have one for local tax? Is that a symbol or schedule there with an X in the local tax block?

A. I don't, at the top of this form here, it's state tax and then there's an X mark and local tax with the block left blank.

Q. Well, do you have another form with the local tax box marked and the state tax box left blank?

A. Not on this form here.

Q. Well, I think we, I don't have any doubt that the tax rate prior to June 30, 1968, was only three percent (3%), state and local. And therefore, if you multiplied the total base, measured your tax on the whole $135,000.00 by four percent (4%) without taking out the period of time prior to June 30, 1968, then you have more tax in there than we actually assessed in respect to that $135,000.00. And I wonder if you took that into account, if you were aware of it?

A. No, this was just taken on a four percent (4%) of the total assessment for that period of time.

Q. All right. I have no further questions.

MR. GILLESPIE: Mr. Serino, do you have your adding machine ribbon where it shows the dates and the purchases -.

A. Yes, sir.

MR. GILLESPIE: For the period for which assessment was made?

A. Yes, sir.

MR. GILLESPIE: Mr. Trible, when did you say the local tax became effective?

A. June 30, 1968.

MR. TRIBLE: Well, I may be, I may be thinking of something else, frankly, I believe in this case where we're involved with the tax rate, the tax rate, local and state, was three percent (3%) up to June 30th and it changed to four percent (4%) in 1968. And I think we'll find in the Code that the rate was three percent (3%) prior to June 30, 1968, and four percent (4%) thereafter. When we audited, we broke it down that way.

MR. GILLESPIE: Well, would you revise your determination of the taxes on the basis of three percent (3%) prior to June 30, 1968, and four percent (4%) thereafter?

A. Yes, sir, that would be very simple. I can do that in just a matter of a few minutes.

MR. GILLESPIE: All right, we'll ask you to do that, sir. We'd like an opportunity to present your revised figures. The proper amount of tax.

MR. TRIBLE: Well, I don't object to doing it that way. Generally, in a case where they've already approved some items that are not contested, the practice of the Department has been to go back and get together with the tax payer's representative, and they determine the amount of tax involved in the legal issue and then we agree on that.

MR. GILLESPIE: Well, anyway, we don't want to put in a claim for taxes that we don't feel are due, and if he can do that, then we can stipulate what the tax is, and if it's payable, fine, and if it's not payable, why - - -.

MR. TRIBLE: I understand.

THE COURT: Is that all?

MR. GILLESPIE: That's all, Your Honor.

(Witness stands aside)

MR. GILLESPIE: The Petitioner rests, Your Honor.

MR. TRIBLE: Your Honor, I'd like to call Frank Lewis to the stand.

FRANK W. LEWIS

a witness called on behalf of the Defendant, having first been duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. TRIBLE:

Q. Would you state your name and address for the Court, Sir?

A. Frank W. Lewis, 1903 South Cliff Road, Richmond, Virginia.

Q. And in what capacity are you employed, Mr. Lewis?

A. I'm Director of the Sales and Use Tax Division for the Department of Taxation.

Q. How long have you been in that position?

A. Three (3) years.

Q. Prior to that, where were you employed?

A. I was employed prior to that as head of field operations for the entire state for approximately a year. Prior to that, I was a District Supervisor for one of the district field offices for two (2) years, and prior to that, I was for one (1) year doing correspondence on tax policy with the Division, Sales Tax Division. Prior to that, I was with the State Corporation Commission for eight (8) years.

Q. So you have spent the last seven (7) years full-time in some respect with the Virginia Retail Sales and Use Tax Act?

A. Yes, that's right.

Q. Now, are you the highest policy-making official of the Department of Taxation that is involved solely with sales and use tax?

A. That's right.

Q. And to whom do you report?

A. To the Assistant Tax Commissioner and the Tax Commissioner.

Q. Now, you are familiar with the facts that led to the assessment in this case and you have heard the testimony on behalf of the Bluefield Sanitarium. Would you explain to the Court the basis for the Department's assessment?

A. Is it, am I supposed to give just a little background in order to explain?

Q. Well, I think if you, just a general narrative form, it would be helpful to the Court.

A. Well, generally, the sales tax, when it was enacted, did not tax services on the sale of tangible personal property. So in order to determine the application of a tax, it is necessary to look at the type of business as to whether it is a service business or a business that's engaged in selling tangible personal property at retail to consumers. For instance, a drug store, it's pretty obvious that when they sell toothpaste, they're selling tangible personal property to a consumer and that they should pay a tax on it. In the service area, for instance, a beauty shop, would be looked at as a pure service business, and the law would

require that they pay a tax on all items that they buy for use in providing that service. If they use shampoo on a lady's hair, they just pay tax on the shampoo. They don't charge the lady so much for the shampoo and so much sales tax, because they're looked at as a service business. So, looking at the nature of the business, you would look at a hospital as being, the nature of it in providing services to sick people to make them well. And in that respect, you would consider them in the same light as you would a beauty shop, in that all items that they buy for use in the performance of their service would be subject to the tax. However, they would not be required to collect tax on, for instance, meals that they serve or transient room rentals, the cost of rooms in the hospital, because they are looked at as a service only. And the second point that I believe applies in this particular situation, is that to apply a tax uniformly, you always have to look not only at the nature of the business, but at the moment of taxation. For instance, if I was to buy a television set in a department store, the moment of taxation would be when I bought it. The fact that I was intending later to transport it into another state for use in another state would not alter the fact that the tax would apply at that moment I purchased it. And comparatively speaking in this situation, the Department looked at the purchase of bulk drugs by these hospitals as the purchase, the moment of taxation was the moment of purchase of these bulk drugs. In order to exempt this moment of taxation, there would either have to be a purchase for

resale under the law, or there would have to be, these drugs would have had to have been bought as a result of a, a prescription by a licensed physician under Code Section 58.441.6 paragraph S. Since no licensed physician initiated the order, since the hospital is deemed to be the consumer of all items that they buy to provide services to their patients, we could see no alternative other than to consider this moment of taxation to be a taxable moment.

Q. So, in other words, you are not attempting to impose any tax on the hospital with respect to the transfer of drugs to any patient?

A. Would you repeat that, please?

Q. In determining where the imposition of tax is in this case, it is important that we distinguish between a tax on a purchase in bulk by the hospital as a consumer and a tax on a sale of a specific prescription as would be done by a pharmacist?

A. Yes, sir.

Q. Now, what I want to know is, was the basis of this tax the fact that a drug was being sold by the hospital to a patient or was it the fact that the hospital had purchased drugs in bulk?

A. It was considered that the hospital as a user consumer purchased for their own use in providing a service and that they had not purchased for resale. If they were to be looked at as a purchaser for resale, then it seems to me that you would have to look at the entire nature of hospital business and consider them to be selling meals, renting rooms, selling Coca-Colas, renting TV sets.

I don't think that the law intended this. They've all looked at the hospitals as providing services to sick people.

Q. Now, has this application of the law been uniform throughout the Commonwealth?

A. Yes, it has to my knowledge.

Q. In other words, there's nothing peculiar whatsoever about the imposition of tax in this case?

A. No.

Q. And any other hospital, that is, any other profit-making hospital in the Commonwealth with the same set of facts, would be subject to this tax on the bulk purchase in the opinion of the Department?

A. Yes, it would.

Q. Now, you mentioned something about the food, suppose the hospital, instead of including meals in the room charge, separately billed the patient for his room and for his meals, would the - -?

MR. GILLESPIE: Well, Your Honor, we're getting a little far afield. We're not involved with any claim for any tax for food or anything else other than these drugs or medicines, seems to me.

Q. Well, Your Honor, we're trying to determine exactly the nature of a hospital and show from the Commonwealth's standpoint that the exemption statute relied on by the Petitioner has no application under the facts of this case, and in order to do that, we are endeavoring to show that when the hospital purchases these drugs in bulk, then it is purchasing for consumption and not for resale. And the same applies with respect to the purchase of food

to be served to the patients. Admittedly, the tax in this case has been assessed on food and is not being contested, and if the basis of the Petitioner's case is that it's a purchase for resale, then it would seem to me that the same would apply to food, and I'm trying to find out from Mr. Lewis what would be his position if they were to bill food separately like they do drugs. It seems to me it all fits in.

MR. GILLESPIE: I believe, if Your Honor please, as Mr. Trible says, the tax has been paid on food, and no question has been raised by the Petitioner, that the tax was properly due and payable, because there is no exemption provided for food served in a hospital. But the statute that we are relying on provides that medicines, drugs, crutches, braces, artificial eyes, contact lenses, eye glasses, hearing aids, prosthetic devices and orthopedic appliances dispensed or sold on prescriptions or work orders of licensed physicians, dentists, optometrists, opthamologists or opticians, are exempt from the tax. We're talking about a specific commodity that we say is exempt under the statute, and all these other commodities that are not exempt and are not a party to this thing, we think are filling the record with non-essential and non-material evidence. And we respectfully submit that this is a question of whether or not these drugs for which the tax was assessed and paid were dispensed by the Petitioner pursuant to a work order or prescription from a physician to a patient. The fact that they are bought in bulk, it seems to me, has no relevancy at all. Drugs and medicines are bought in bulk by drug stores. They're not ordered by a physician but by a pharmacist.

They're operating a drug store or pharmacy. They're later dispensed or sold by the pharmacy to patients pursuant to a prescription. Whether it's a hospital or pharmacy that buys in bulk, we think is immaterial. The ultimate consumer or user of these drugs is the patient. Whether he's in the hospital or whether he's at home.

THE COURT: Well, let him answer the question.

Q. The question, Mr. Lewis, was in dealing with respect to the purchases of food in bulk, what would be the Department's position if the hospital, instead of computing food in it's room charge, decided to state the price of food separately and bill the patient for it, would the tax be exempt from the purchase of that food, or would it be taxable?

MR. GILLESPIE: We admit that that would not be exempt.

A. I think there's a misunderstanding. The exemption that he's applying to isn't on the purchase, it's on the sale. In other words -.

MR. GILLESPIE: It's on the sale. We admit that.

CROSS EXAMINATION

BY MR. GILLESPIE:

Q. Mr. Lewis, you say that these assessments are uniformly made against profit-making hospitals?

A. Under the same set of circumstances.

Q. Under the same set of circumstances? But they are not made against non-profit hospitals under the same set of circumstances, are they?

A. No, sir, but there's a specific exemption on that, Sir.

Q. Could you give me that law?

A. It's under the exemption section 58-441.6.

MR. TRIBLE: We might have to provide the witness with a copy of the statute. I think it's sub-section T.

Q. Do you have reference to sub-section T of the 46-441.6?

A. Yes, sir.

Q. Now, that deals with tangible personal property for use or consumption by a college or other institution of learning, a hospital or licensed nursing home provided such college or institution of learning, hospital or licensed nursing home does not conduct - - it applies to all. Tangible personal property. It's not limited. But an exemption for medicine and drugs is under paragraph S. isn't it?

A. Yes, sir.

Q. And it doesn't make any distinction between non-profit and profit-making hospitals, does it?

A. No, sir.

Q. But you do state that medicines and drugs dispensed in exactly the same manner that the Petitioner dispenses medicines and drugs in this hospital by a non-profit hospital are exempt and the Department has never made any assessment for sales and use tax against these institutions?

A. All purchases that a non-profit makes for their own use and consumption.

Q. So it's only against profit-making insitutions?

A. The law did not mention profit.

Q. It doesn't mention non-profit, either, does it? Under paragraph S?

A. Not under S, no, sir.

Q. Now, Mr. Lewis, a drug store is operating a pharmacy, buying drugs in bulk, aren't they?

A. Because they're purchasing for resale, yes, sir.

Q. These pharmacies you consider to be exempt as to the drugs which they purchase in bulk and sell to patients on a doctor's prescription?

A. Yes, sir.

Q. Now, the hospital purchases in bulk just the same way. Now, the hospital isn't going to take this medicine, is it?

A. No,sir.

Q. The hospital purchases in bulk so they will have these drugs on hand to be taken by patients that the doctors feel are in need of these medicines. When they're in the hospital. Now, do you think that the General Assembly intended to impose a tax on patients in a profit-making hospital and exempt those in a non-profit hospital?

A. Yes, sir. Had they intended to exempt the profit-making hospitals, they would have provided an exemption under law, which they did not.

Q. Well, actually, a retail sales and use tax is passed on to the consumer, isn't it?

A. Yes, sir.

Q. So, if your contention is proper and correct, then if a person who lives in an area where only a profit-making hospital is available, and he has to receive his medical treatment as a patient in that hospital, and that hospital has to charge this sales tax to the patient, he's having to pay more than a patient who has a non-profit hospital available to him?

A. Yes, sir. That's true.

Q. Well, that's sort of contrary to all the ordinary person has been led to believe, that the Virginia Constitution, sales constitution, grants these people, isn't it?

A. Yes, sir. A profit hospital has to pay tax on all of its beds, all of its sheets, all of its other things. A non-profit hospital does not.

Q. The ultimate result of your interpretation -.

A. But all of this will be passed to the patient.

Q. Well, the results of your interpretation would be that the patients in a profit-making hospital would be charged with the tax on the drugs administered to them, and the patients in a non-profit hospital wouldn't be charged?

A. Yes, sir.

Q. And you think that's a fair treatment to all people, all citizens of Virginia?

A. I think it's no basis of equity, but a basis of law.

Q. You think that's what the General Assembly intended?

A. Yes, sir.

Q. Well, can you tell us why they didn't make any distinctions between the paragraphs of the Code Section which provided exemptions for medicines either dispensed by or sold pursuant to a prescription or work order of a physician?

A. It's difficult to know what any body intended to be.

Q. Then you did tell Mr. Serino that they were operating their pharmacy and dispensing the medicines in this way, and if they were a non-profit hospital, they wouldn't be assessed of this tax?

A. Yes, sir. It would be a purchase for resale.

Q. You did tell him that?

A. Yes, sir.

Q. And that is true?

A. Yes, sir. All purchases for resale are exempt.

Q. I believe that's about all I have to ask you, Mr. Lewis.

THE COURT: What was the last answer you gave there, about purchases made for resale? What was that?

A. All purchases made for resale are exempt under the law because the transaction following that, when it's a sale to a consumer, will be the transaction where the tax is collected.

Q. May I ask one other question, please? Mr. Lewis, what earthly reason would the hospital buy these drugs in bulk for except to have them available for dispensation and sale to the patients?

A. None that I know of.

Q. That's all.

RE-DIRECT EXAMINATION

BY MR. TRIBLE:

Q. I'd like to clarify just a little your answer to the question regarding what you told the Assistant Administrator of this hospital concerning what would be the case if the hospital were non-profit. Now, I understood you to say that if the hospital operating exactly as this one does, without a separately incorporated pharmacy, was a non-profit hospital, that the tax would not apply, because they would be purchasing for resale. Now, is that the case, or would it be because of the exemptions in 441.6T?

A. It would be because there is a specific exemption in the 58-441.6 paragraph T to all purchases by non-profit hospitals for their own use and consumption in providing their services.

THE COURT: For their own use and consumption?

A. Yes, sir, that is the idea. The hospital is looked at as being the user of all it purchases to provide its services.

Q. Then the part about resale, that only comes into the case if you have a sale from a pharmacy that is a separately incorporated entity -.

MR. GILLESPIE: We object to that, Your Honor. We submit that whether there's a separate entity operating the pharmacy or not, the question boils down to whether or not the drugs are dispensed or sold to a patient pursuant to a work order or a prescription by a licensed physician.

Q. Well, I'll withdraw that question. I think really we're getting into a question of interpretation of law by the Court, and, I have no further questions.

THE COURT: Let me ask you some questions. So far as a purchaser of drugs is concerned, if I go to the drugstore with a prescription from a doctor, and that is filled, is that subject to the tax?

A. No, sir, it is not.

THE COURT: It is not? Then the drugstore would pay a tax on the purchase?

A. No, sir, because they would be buying for resale as opposed to the hospital buying for its own use.

THE COURT: So the drugstore pays a tax on its purchases?

A. On everything that it uses except the items that will resell. For instance, it would have to pay tax on its cash registers, counters, cleaning materials, but items that it's specifically going to resell, it would not pay a tax on, because it's buying for resale. For instance, if you did not have that prescription when you went in there, he would have to collect the tax from you, the consumer.

THE COURT: All right. Is that all with this witness?

MR. TRIBLE: No further questions.

(Witness stands aside)