

INTERNAL POLICY DIRECTIVE 2006-2

January 24, 2006

SALES AND USE TAXES

TAXABILITY OF OVER-THE-COUNTER MEDICATIONS DISPENSED PURSUANT TO A PRESCRIPTION AND PAID FOR AS PROVIDED BY EXISTING MEDICAID ARRANGEMENTS

POLICY ISSUES

1. Are over-the-counter medications that are dispensed pursuant to a prescription and paid for through existing Medicaid arrangements subject to Michigan sales or use tax?
2. Are Medicaid client/patient co-pays associated with over-the-counter medications dispensed pursuant to a prescription subject to Michigan sales or use tax?

POLICY DETERMINATIONS

Both the client/patient co-pay and payment received by the seller from an HMO under a "Medicaid" contract with the State of Michigan for sales of over-the-counter medications are subject to Michigan sales or use tax unless the HMO enjoys its own statutory exemption, such as that granted entities exempt from federal income tax under Internal Revenue Code Section 501(c)(3).

Both the client/patient co-pay and payment received by the seller from the State of Michigan under the Medicaid program model known as "fee-for-service" for sales of over-the-counter medication are not subject to Michigan sales or use tax.

DISCUSSION

Concerns have been raised as to the application of sales tax to sales of Medicaid-covered over-the-counter medications dispensed pursuant to prescription. The Department understands that in the State of Michigan, there are currently two differing models of Medicaid coverage.

The first model is described as the fee-for-service model, which involves the State of Michigan entering into an agreement with pharmacies. The nature of the agreement is that the State confirms the price it is willing to pay for the medication, as well as the amount of co-pay to be received from the client/patient. In the fee-for-service model, the pharmacy has a seller-purchaser relationship with the State of Michigan. The second model is described as the HMO model, where the State contracts with HMOs to provide all covered medical services for a set per-client/patient amount. The HMO model is distinguished for sales tax purposes by the fact that the sale transaction is between the pharmacy and the HMO; the pharmacy does not have a seller-purchaser relationship with the State of Michigan.

Under the fee-for-service model, no portion of the amount the pharmacy receives, including the co-pay, would be subject to sales tax. Under the HMO model, if the HMO enjoys a statutory sales tax exemption, such as that of a qualified nonprofit entity, the amount received from the sales of over-the-counter medications, including the co-pay amounts, would be exempt from sales tax. However, if the HMO does not enjoy a statutory sales tax exemption, the amount received from the sale of over-the-counter medications would be subject to sales tax, including the amounts paid by both the HMO and the client/patient.

The non-taxability determinations described in this IPD are dependent on whom the sale is to, rather than on what is sold. Consequently, the determination is not limited to sales of over-the-counter medications, or the fact that a prescription may be issued.

[Note: This IPD addresses "over-the-counter" medications. Pursuant to MCL 205.54g(1)(a), sales of drugs for human use that can only be legally dispensed by prescription (including co-pays) are exempt from sales tax.]