

Sales Tax Attacks

Department of Taxation and Finance is looking to dental practices to help resolve budget crisis. Best course of action is to deal with your sales tax liability before DOTAF comes gunning for you.

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WITH ITS COFFERS RUNNING PERILOUSLY LOW and a budget crisis looming, the New York State Department of Taxation and Finance (DOTAF) has turned to a trusted source of revenue enhancement: dental practices that have not paid the proper sales tax on certain items.

The number of sales tax audits of dental practices throughout the state is on the rise and, largely due to the arcane and often inexplicable tax classifications of dental items, many dental offices end up having to pay large sales tax bills.

Also contributing to the problem is the fact that many dental laboratories do not properly charge sales tax in the first place, and even some accountants are not fully up to speed on policing this area for their clients who are dentists. What follows is as simple and practical a guide as is possible to create for dentists to use in what is, admittedly, a very complex area.

Basic Rules for Levying Sales Tax on Dental Items

1. All drugs and medicines are exempt from sales tax no matter who buys them from whom. This includes nitrous oxide and other anesthetics.
2. Supplies like gold, amalgam, porcelain, resins and other raw materials are taxable when the dentist buys them, because the dentist is using them in the patient for compensation.
3. Supplies like gold, amalgam, porcelain, resins and other raw materials are exempt from sales tax if a dental laboratory buys them, because the laboratory is only going to resell the item to the dentist. If the dentist has his or her own in-house laboratory that manufactures items just like an outside dental laboratory would, then supplies like gold, amalgam, porcelain,

resins, and other raw materials that are attributable to the laboratory in the dentist's office would be exempt from sales tax. Note that this in-house laboratory exception is rare and to qualify the laboratory must be a substantial and real operation.

4. Orthodontic appliances, except for space maintainers, are taxable when the dentist purchases them. Orthodontic appliances are exempt from sales tax when a patient purchases them. Space maintainers are exempt from sales tax no matter who purchases them.

5. Crowns (both full and partial, and permanent and temporary), bridges, dentures, inlays, onlays and all other dental services are exempt from sales tax when a patient purchases them, because they are classified as either medical services or prosthetic devices.

6. Crowns (both full and partial, and permanent and temporary), bridges, dentures, inlays, and onlays are exempt from sales tax when a dentist purchases them, because their designation as prosthetic devices overrides anything else.

7. Laminate veneers are taxable when the dentist purchases them, because they are not considered prosthetic devices.

There are Exemptions

How did DOTAF arrive at these rules? Believe it or not, the department has a logic, albeit not always a consistent one. There are three main categories of sales tax exemption relevant to dental practices. They are:

1. Drugs and medicines intended for use, internally or externally, in the cure, mitigation, treatment or prevention of illnesses

or diseases in human beings, including medical equipment and supplies required for such use or to correct or alleviate physical incapacity, and products consumed by humans for the preservation of health.

2. Prosthetic aids and artificial devices and component parts thereof purchased to correct or alleviate physical incapacity in human beings.
3. Items purchased solely for the purpose of manufacturing tangible personal property for resale to another.

The first two categories of exemptions are designed to facilitate getting necessary health care to the public without sales taxes interfering with that process. The third category is based on the principle that sales tax is to be charged and collected only once, generally at the end point in a process that may involve a chain of events. When a raw material is purchased for use in a non-taxable service—such as in providing a dental service to a patient—then it is not deemed to be a purchase for resale. Thus, when a laboratory buys raw materials, it does not pay sales tax because those same materials are going to be resold to the dentist, who will pay the sales tax at the resale end point.

Then it Gets Confusing

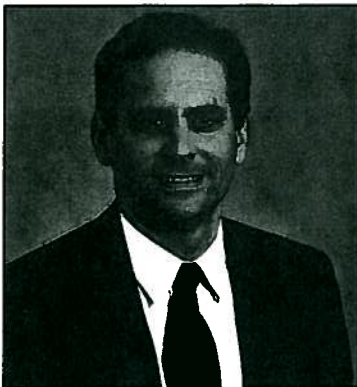
So far, that all seems simple enough and would lead one to believe that lots of items should be exempt from sales tax. But the layers of the tax law run deep, and there are two other critical requirements that turn this around and make a lot of items taxable that one

would assume, based on the rules, were not taxable. These two additional rules are:

1. When a health care professional purchases any medical supplies to use as part of services performed on patients for a fee or other compensation, then the items are taxable.
2. For the prosthetic device exemption to apply, the item must completely or partially replace a missing body part or the function of a permanently inoperative or permanently malfunctioning body part. It must be primarily and customarily used for such purposes and not be generally useful in the absence of illness, injury or physical incapacity.

As a result of the last rule noted above, the repair of teeth with fillings or cosmetic bonding does not qualify as a prosthetic device because the repair does not replace missing body parts, but merely guards against further decay of a tooth.

This issue was actually litigated by NYSDA with DOTAF. NYSDA lost the argument in court. NYSDA also pursued the issue of inlays, onlays and laminate veneers with DOTAF and managed to finally get DOTAF to exempt inlays and onlays, but not laminate veneers—DOTAF insisted that the laminate veneers were cosmetic in nature rather than prosthetic. The laminate veneers failed the test that they are not primarily and customarily used to replace missing teeth or the functions of decayed or damaged teeth, and they also were generally useful in the absence of illness, injury or physical incapacity. While NYSDA did not agree with that analysis of laminate veneers, DOTAF stood firm on the point.



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One Way or Another

DOTAF has broad power to collect unpaid sales tax. While the department most often looks to the entity that should have collected the sales tax for the monies—those sellers are legally deemed to be agents of DOTAF for the purpose of collecting sales tax—it can also look to the purchasers for the sales tax, as they would have been the persons paying the tax on the purchase in the first place.

The problem for most dental offices, as well as for most purchasers of anything, is that the buyer rarely scrutinizes a bill to see if the sales tax is correct. Nevertheless, it is imperative that a dental practice do just that—not only to make sure the correct sales tax has been paid on a taxable item, but also to be sure that the tax is not being overpaid or collected on non-taxable items.

But DOTAF's bottom line is quite clear: It will get its sales tax money and it will collect it from whomever it needs to. It can be relentless as a taxing authority in this regard and the law gives the department many weapons to use in its audit and collection process.

To give you an idea of the thinking of DOTAF, below is its official opinion on inlays and onlays, the last major statement it made in the dental area.

The Department of Taxation and Finance has reconsidered the sales and compensating use tax ("sales tax") treatment of certain products that are purchased by dentists for use in performing restorations of teeth. Until this time, the department has considered onlays and inlays to be taxable dental supplies that did not qualify for the prosthetic aid exemption from sales tax. While that was a rational

application of the Tax Law, the department has now decided to adopt an alternative interpretation of the Tax Law under which these products are exempt from sales tax as prosthetic aids. This change in policy will take effect for sales and uses occurring on or after June 1, 2006.

Dental supplies

Section 1115(a)(3) of the Tax Law provides, in pertinent part, the following exemption from sales tax:

Drugs and medicines intended for use, internally or externally, in the cure, mitigation, treatment or prevention of illnesses or diseases in human beings... and supplies required for such use or to correct or alleviate physical incapacity... but not including... supplies, other than such drugs and medicines, purchased at retail for use in performing medical or similar services for compensation.

Section 528.4(h)(1) of the sales tax regulations provides, in part:

Medical... supplies purchased for use in performing medical or similar services for compensation are not exempt from tax.

Example 4: Dental supplies such as porcelain, mercalloy, gold, silver, acrylic denture base, amalgam, composite resin, silicate, and dental floss are not exempt when purchased by a dentist who will use them in performing a dental service for compensation.¹

Accordingly, dental supplies, other than drugs and medicines, used by a dentist (including his or her employees) in providing dental care for compensation are subject to sales tax. Dental supplies include all products used or consumed by the dentist in the practice of dentistry, such as direct-filling materials used in the restorations of patients' teeth, but do not include prosthetic dental devices as described in this memorandum. A dentist is not considered to be purchasing dental supplies for resale to patients as part of his or her dental practice, nor are such supplies considered to be used by the dentist in the production of any tangible personal property for sale.

Prosthetic dental devices

Section 1115(a)(4) of the Tax Law provides an exemption from sales tax for:

Prosthetic aids, hearing aids, eyeglasses and artificial devices and component parts thereof purchased to correct or alleviate physical incapacity in human beings.

Section 528.5(b) of the sales tax regulations provides, in part:

Qualifications. (1) In order to qualify as a prosthetic aid, a hearing aid, eyeglasses or an

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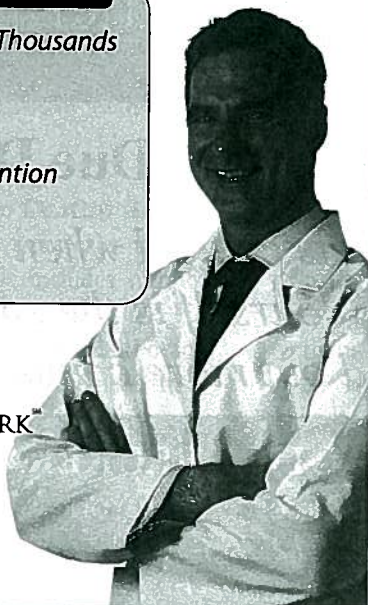
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1. See Dental Society of the State of New York v. New York State Tax Commission, 110 A.D.2d 988 aff'd 66 N.Y.2d 939.

artificial device, the property must either completely or partially replace a missing body part or the function of a permanently inoperative or permanently malfunctioning body part and must be primarily and customarily used for such purposes and not be generally useful in the absence of illness, injury or physical incapacity.

Example 1: Artificial hands, arms, legs, false teeth, etc. are exempt.

Example 4: A crown which is permanently attached to a tooth by a dentist is exempt.

Section 528.5(c)(2) of the regulations provides:

Supplies used in conjunction with prosthetic aids, hearing aids, eyeglasses and artificial devices are not exempt from the tax.

Based on the foregoing, prosthetic dental devices (including their component parts, but not related supplies) that completely or partially replace missing teeth or the functions of permanently inoperative or permanently malfunctioning teeth are prosthetic devices exempt from sales tax. These prosthetic dental devices include implants, dentures, bridges, full and partial crowns (both temporary and permanent), onlays, and inlays. Prosthetic dental devices do not include any products that are not primarily and customarily used for such purposes and that are generally useful in the absence of illness, injury, or, physical incapacity. This includes products that are cosmetic in nature, such as laminate veneers, decorative caps, and specialty or jewelry teeth.

Be Proactive

As is readily seen, DOTAF is not a government agency that is easy to convince, much less understand. However, all dentists need to take extra care to be certain they are not hit with an unexpected audit and bill for back sales taxes. Make sure your staff knows what it is doing when looking at invoices, and make sure all invoices are screened for sales tax. If there is ever a question as to what is subject to sales tax, DOTAF is happy to provide official advice to taxpayers. You can request an advisory opinion from the Office of Counsel of DOTAF at Building 9, W.A. Harriman Campus, Albany, NY 12227, or by telephone at either: (518) 457-2153 or (518) 457-2070.

An advisory opinion is limited to the facts set forth and is binding on the department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An advisory opinion is based on the law, regulations and department policies in effect as of the date the opinion is issued or for the specific time period at issue in the opinion.

You can also request assistance from the sales tax branch of the Taxpayer Guidance Division at Building 9, Room 163, W.A. Harriman Campus, Albany, NY 12227, or by telephone at: (518) 485-2889.

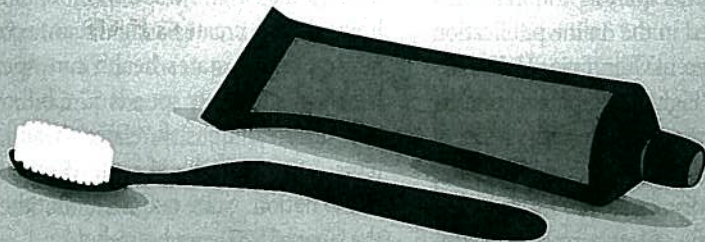
Do not guess when in doubt on an issue. Make use of DOTAF before it makes use of you and your dental practice. ■

The material contained in this column is informational only and does not constitute legal advice. For specific questions, dentists should contact their own attorney. An archive of previously published legal articles can be accessed in the members-only area of the NYSDA Web site, www.nysdental.org.

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