

**SUMMARY OF PROPOSAL #31**  
*for consideration by the*  
**ARKANSAS TAX REFORM AND RELIEF LEGISLATIVE TASK FORCE**

**TOPIC: Sales Tax Exemption on the Sale of Prescription Drugs**

**Summary of Proposal for Consideration**

To repeal the sales tax exemption on the sale and purchase of prescription drugs by licensed pharmacists, hospitals, or physicians and oxygen prescribed by a licensed physician for human use under Arkansas Code § 26-52-406, effective for tax years beginning on or after January 1, 2019.

**Fiscal Analysis**

Repeal of the exemption may result in an estimated \$144,620,434 per year increase to General Revenue based upon FY17, as provided by the Department of Finance and Administration's "Sales and Use Tax Revenue Impact of Exemptions" presentation to the Arkansas Tax Reform and Relief Legislative Task Force on March 19, 2018.

**Legal Analysis**

***Background***

Arkansas currently has a sales tax exemption on the sale and purchase of prescription drugs by licensed pharmacists, hospitals, or physicians and oxygen prescribed by a licensed physician for human use.

ACT 54 of 1979 created the sales tax exemption on the sale and purchase of prescription drugs by licensed pharmacists, hospitals, or physicians and oxygen prescribed by a licensed physician for human use.

ACT 416 of 1987 added prescriptions sold and administered by oncologists to the sales tax exemption.

ACT 704 of 1997 added the withdrawal of prescription drug samples for free distribution from a stock or inventory to the exemption, and has not been amended since.

***Potential Legal Issues***

Repealing the sales tax exemption for prescription drugs would require a system that meets the requirements of the federal Medicare and Medicaid programs, as illustrated by the following examples:

**Illinois**

Illinois is the only state that has a sales tax on prescription drugs, and levies a one percent (1%) sales tax, and a higher sales tax rate of six and one-half percent (6.5%) for medicines

prescribed by veterinarians for animals. Customers purchasing prescriptions incur a sales tax liability. Pharmacists are required to collect the sales tax from the customers by either separately stating the tax from the price of service or including the tax in the total price. Traditionally, most pharmacists have included the sales tax in the total price.

Under the Illinois system, prescription drug sales made to Medicare or Medicaid are exempt from tax as a sale to a government body, as long as the exemption is properly documented. However, if Medicare directly pays for eighty percent (80%) of the prescription drug and the remaining twenty percent (20%) is billed to the patient or an insurance company, the eighty percent (80%) would be tax exempt while the twenty (20%) would be taxable. Sales of prescription drugs are not exempt from the sales tax if the prescription is covered by a Medicare Part D Prescription Plan. The sales tax is due on sales of prescription drugs under a Part D Prescription Plan, but the sales tax cannot be charged to the beneficiary, instead the sales tax must be charged to the prescription drug providers.

### Federal Law

Federal Medicaid law has additional provisions relating to a “health care-related tax”. These provisions have typically been applied to provider taxes (i.e. hospital assessment fees and other fees on specific providers to increase the amount of state funds available to match to receive federal funds for Medicaid); however, these provisions have also been applied to the insurance premium taxes regarding Managed Care Organizations. If a state tax scheme meets these requirements, then the state tax scheme will not be in violation of Medicaid law.

The federal rules for administering the Medicare program contemplate the payment of state sales taxes on sales covered by the Medicare Program. Under § 2122.1 of Part 1 of the Medicare Providers Reimbursement Manual, the general rule is that taxes assessed against the healthcare provider are allowable costs to the extent that the taxes are actually incurred and related to the care of beneficiaries. However, § 2122.2 states that certain taxes, including sales taxes levied against the patient and collected and remitted by the provider, are not allowable, or reimbursable, costs under the Medicare Program.

### *Other States*

- Iowa: Sales tax exemption for sales of prescription drugs. (IA St. § 423.3)
- Louisiana: Constitutionally protects sales tax exemption on prescription drugs. (La. Const. art. VII, § 2.2)
- Mississippi: Sales tax exemption for sales of prescription drugs. (MS St. § 27-65-111)
- Missouri: Sales tax exemption for sales of prescription drugs. (MO St. § 144.030.2)
- Oklahoma: Sales tax exemption for sales of prescription drugs. (OK St. 68 § 1357)
- Tennessee: Sales tax exemption for sales of prescription drugs. (TN St. § 67-6-320)
- Texas: Sales tax exemption for sales of prescription drugs. (TX St. § 151.313)