SELMA ANIMAL HOSPITAL 501 Cahaba Road Selma, Alabama 36701,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 95-231
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

PRELIMINARY ORDER
DENYING APPLICATION FOR REHEARING

To the average retail customer, the sales tax is the easiest of all taxes to understand. This case proves otherwise.

The Opinion and Preliminary Order entered on November 2, 1995 held that those prescription drugs in issue that were dispensed by a veterinarian to an animal owner for take home use were not being sold at retail so as to be subject to sales tax, but rather were being provided incidental to the veterinarian's professional services. The Department applied for a rehearing, and strenuously argues that the drugs dispensed to the owners are being sold at retail.[1] The Department's application for rehearing is denied for the reasons explained below.

[1]The Department concedes that the same prescription drugs administered by the veterinarians in the clinic were not being sold at retail. The Department apparently had never attempted to tax any of the drugs until veterinarians also started selling flea collars, supplies, etc. over-the-counter at retail in the mid to late 1980s.

The Department first argues that the Administrative Law Division has usurped the authority of the Legislature by exempting the prescription drugs from sales tax. However, the drugs are not being exempted from tax. Rather, sales tax is due when the drugs are purchased by the veterinarian from the supplier.[2] That is the taxable retail sale. The drugs are then prescribed and dispensed to the animal owner incidental to, and as a part of, the diagnosis and treatment of the animal by the veterinarian. In accordance with the cases discussed below, that transfer by the veterinarian is not a retail sale subject to sales tax.

The Alabama Supreme Court addressed the issue of whether tangible property is being sold at retail or provided tax-free incidental to a service as early as 1937 in Doby v. State Tax Commission, 174 So. 233 (1937). The issue in Doby was whether materials, parts, supplies, etc. used by a garage in repairing automobiles was subject to sales tax. The Court held that the repair parts, accessories, etc. that became a part of the automobile were taxable, whereas paints, lubricants, etc. consumed by the garage in repairing the vehicles were furnished incidental to the repair service and were not taxable.

> In dealing with a business, like that here involved, operating an automobile repair shop, in which tangible

[2]The drugs in issue can thus be distinguished from drugs prescribed and dispensed for human consumption because those drugs are specifically exempted from sales tax by Code of Ala. 1975, §40-23-4.1. Sales tax is never paid on those drugs.

> articles of personal property are disposed of in connection with services rendered, the act should be so construed that such portion of the business as reasonably represents sales of tangible articles to the customer be subject to the tax . . . .
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> Under the agreed facts, automobile repair shops are liable for the tax upon the proceeds of sales of automobile parts, accessories, tires, batteries, used by them in repairing and refitting automotive vehicles for their customers.
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> On the other hand, the proprietor, the automobile repair shop, is not liable for this tax upon the price or value of material and supplies, such as paints, lubricants, or minor supplies consumed in the rendition of service to the customer.

Doby, supra, at page 236.

The issue was next addressed in the companion cases of State v. Hopkins, 176 So. 210 (1937), and Long v. Roberts and Son, 176 So. 213 (1937). In Hopkins, the Court held that the manufacture and sale of eyeglasses by optometrists constituted a taxable retail sale of tangible property. In Long, the Court relied on its rationale in Hopkins in holding that sales tax was owed on tangible property prepared and sold by a commercial printer. Justice Bouldin, in a concurring opinion, made the following statement:

> . . . if the transaction is essentially one for service, the fact that some materials are used as an incident to such service, and consumed in the using, does not render it a sale of tangible property within the act. But, where the aim and end of the transaction is the passing of a tangible article from one to the other for the latter's use or consumption, the fact that service or materials, or both, have been put into the article, or that it is useful only to the party who

> received it, does not remove such business from the scope of the act.

Long, supra, at page 219.

In Haden v. McCarty, 152 So.2d 141 (1963), the Supreme Court held that dentistry was a "learned profession", and consequently that the transfer of dentures was only incidental to the professional service provided by the dentist, and thus not subject to sales tax.[3] Haden was the first case in which the Supreme Court held that the transfer of the end product, the dentures, to the consumer was not a taxable transaction. The Court also distinguished between dentists and optometrists by holding that optometry was not a "learned profession", thus reaffirming its holding in Hopkins that optometrists were making taxable retail sales. The Supreme Court again reaffirmed that optometry was not a "learned profession" in Lee Optical Company of Alabama v. State Board of Optometrists, 261 So.2d 17 (1972).

In State v. Harrison, 386 So.2d 460 (1980), the Court of Civil Appeals, relying on Haden, ruled that catalogs and brochures provided by an advertising agency to its customers were only incidental to the professional services provided by the agency, and thus were not being sold at retail. By its ruling in Harrison, the Court thus expanded the "learned profession" rationale of Haden to also apply to an activity other than one of

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[3]Hamm v. Proctor, 198 So.2d 782 (1967), and Crutcher Dental Supply v. Rabren, 246 So.2d 415 (1971), were subsequently decided concerning the sales tax liability of the dental supply house or laboratory that supplies the dental materials to the dentist.

the traditional "learned professions". The Court compared the activities of the advertising agency to those of a lawyer, as follows:

> Just as a lawyer depends upon his legal expertise in preparing a deed or will, the appellee (advertising agency) must rely upon his creativity in producing a catalogue or brochure suitable for his individual client. We think the creation of a catalogue or brochure by the appellee and the subsequent transfer of these materials to a client after being printed is incidental to the professional service being rendered.

Harrison, supra, at page 461.

In 1981, the Supreme Court again reaffirmed that optometry was not a "learned profession" in Alabama Board of Optometry v. Eagerton, 393 So.2d 1373 (1981). Chief Justice Torbert dissented, arguing that if the "learned profession" rationale is to be followed, then optometrists should also be entitled to that honor. Justice Jones filed a one paragraph concurring opinion as follows:

I concur in the result. I would overrule *Haden v. McCarty*, 275 Ala. 76, 152 So.2d 141 (1963). After careful study of the issue here presented, I am of the opinion that the "practice of a learned profession" dichotomy is wholly irrelevant to an appropriate interpretation and application of the taxing statute in question. Alabama Board of Optometry, supra, at page 1378.

Finally, in State, Department of Revenue v. Kennington, No. 2940736 (Ala.Civ.App., November 3, 1995), the Court of Civil Appeals, citing Harrison and Haden, held that commissioned

portraits sold by the artist that painted the portraits were not being sold at retail. Rather, the Court held that "the transfer of the canvas is a mere incident to the professional service rendered by the taxpayer." Kennington, supra, at page 7 of slip opinion.[4]

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[4]I respectfully disagree with Kennington. The artist in Kennington certainly uses her professional skill and creativity in painting a portrait. However, the finished portrait is not incidental to the artist's skills. Rather, the portrait itself is the end product and the artist simply supplies the labor necessary to make the portrait. The artist's labor is skilled, but it is labor nonetheless. I agree with Justice Bouldin's concurring opinion in Long, quoted infra, at page 3, in which he states that "where the aim and end of the transaction is the passing of a tangible article from one to the other for the latter's use or consumption, the fact that service or materials, or both, have been put into the article, or that it is useful only to the party who received it, does not remove such business from the scope of the act." The "aim and end of the transaction" in Kennington was the transfer or sale of the portrait to the customer. That transaction is clearly a taxable retail sale.

The artist in Kennington also paints landscapes and concedes that sales tax is due when she sells a landscape. I see no distinction between a landscape and a portrait for taxation purposes. The same "professional service" is rendered in both cases. Just as the artist may visit and "get to know" her individual subjects, she may also visit and "get to know" a particular landscape. The fact that the artist contends that her portraits may have "no value except to those for whom the portrait is painted", Kennington, at page 2 of slip opinion, is argumentative, subjective, and should not be relevant in determining if a retail sale has occurred. The same may also apply to a landscape painted by the artist. The fact that a painting, or any item, may have more or less sentimental value or use to one person than another is irrelevant for tax purposes.

If the rationale of Kennington is logically extended, then any taxpayer that uses skill or special labor in creating or manufacturing special ordered items could argue that sales tax is not due on the subsequent sale of the item. For example, the professional photographer in Thigpen Photography v. State, Admin. Law Docket S. 95-127, decided March 22, 1996, and the skilled hand-engraver in State v. Mary Montgomery, Admin. Law Docket S. 94-132, decided December 29, 1994, could argue that the photographs and engraved plaques, trophies, etc. that they sell are only incidental

Veterinarians, as highly skilled members of the medical profession, are members of a "learned profession". Following the rule of law established in Haden and subsequent cases, when a licensed veterinarian examines an animal and then prescribes and dispenses drugs in treating the animal, those drugs are being provided incidental to the veterinarian's diagnosis and treatment of the animal, and are not being sold at retail.

The Department points out that if veterinarians are not liable for tax on the prescription drugs in issue, then logically non-prescription drugs prescribed and dispensed by a veterinarian in treating an animal also should not be taxed. Theoretically, the Department is correct, but as a practical matter, the rule should apply only to those regulated prescription drugs that can only be prescribed and dispensed incidental to a physical examination of the animal. Any unregulated drugs or other items that can be sold over-the-counter by anyone are taxable.

The fact that the veterinarians in this case made a separate charge for the prescription drugs on the customer's itemized bill also does not convert the transaction into a taxable retail sale. The veterinarians charged the same itemized amount when the drugs were administered by a veterinarian in the clinic. Apparently, the dentures at issue in Haden were also separately

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to their professional skill in producing or preparing the product for sale. Photographs and engraved plaques, trophies, etc. have always been taxed. But I can find no substantive difference for taxation purposes between those items and the portraits in Kennington.

charged for by the dentist - "The denture itself could not be separated from the treatment, examination, and other things leading up to fitting it in one's mouth, and separately charged for." (emphasis added). Haden, supra, at page 143.

I agree with Justice Jones' concurring opinion in Alabama Board of Optometry, quoted infra, at page 4, that perhaps the "practice of a learned profession" dichotomy should not be applied at all concerning sales tax. That is, any transfer of tangible personal property for a price, unless specifically exempted or at wholesale, should be treated as a taxable retail sale. (See, Code of Ala. 1975, §40-23-1(a)(5), and Code of Ala. 1975, §7-2-106(1) - "Sale" defined as "passing of title from the seller to the buyer for a price.")

Certainly if a doctor uses stitches and bandages when operating on a patient, the tangible thread and bandages are inconsequential to and consumed in the treatment, and are not being sold at retail. But if the tangible property is itself the end product, then it is being sold at retail, and sales tax is due. See Justice Bouldin's concurring opinion in Long, supra, quoted infra, at page 3. If the taxpayer also performs services separate and apart from the sale, those separately charged for services would not be taxable. But the sale of the end product itself, even if it constitutes only a relatively small portion of the total cost, is still taxable, including all labor and services necessary in preparing the product for sale. The

taxpayer should itemize and keep adequate records verifying the taxable and non-taxable charges.

But for Haden and subsequent cases, I would hold that the prescription drugs in issue are being sold by the veterinarians at retail.[5] However, the rule of law established in those cases applies in this case and must be followed. The veterinarians in issue are members of a "learned profession", and are providing the prescription drugs incidental to their examination, diagnosis, and treatment of the animals. Consequently, they are not selling the drugs at retail, and should instead pay sales tax when they purchase the drugs from their supplier.

The Opinion and Preliminary Order previously entered in this case is affirmed. The Department should recalculate the Taxpayer's liability as set out therein. A Final Order will then be entered. This Preliminary Order Denying Application For Rehearing is not an appealable order. The Final Order, when

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[5]The facts in Haden, Harrison and this case are similar in that the taxpayers did not actually make the final product. Rather, they only used their professional knowledge in designing the brochures or selecting which denture or drug to provide. The actual end product was then ordered or purchased from a third party. Kennington can thus be distinguished because the artist herself supplied the labor and actually made or produced the final product.

If the "learned profession" rationale must be followed at all, it should be strictly construed to apply only where the intangible service is itself the end product. Healing a patient or providing legal services fits that criteria. But if the tangible property is itself the end product, as in Kennington, then it should be taxed, notwithstanding the high degree of skilled labor or creativity necessary to make the product. That same logic would also apply, in my opinion, to the catalogs and brochures in issue in Harrison. Those items were the end product sought by the customer.

entered, may be appealed by either party to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered March 26, 1996.

BILL THOMPSON
Chief Administrative Law Judge