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ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 22-\_\_

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**Date Proposed: April 11, 2022**

**Date Final:**

**Issue:**

What constitutes a prosthetic appliance exempt from the retail transaction privilege tax ("TPT") classification under Arizona Revised Statutes ("A.R.S.") § 42-5061(A)(9)<sup>1</sup> following the Arizona Court of Appeals decision in *VHS Acquisition Subsidiary Number 1 Inc. v. Arizona Department of Revenue*, No. 1, CA-TX 20-0007 (May 4, 2021)?

**Ruling Summary:**

Prosthetic appliances exempt from the retail TPT classification are those artificial devices prescribed or recommended by licensed health professionals, which devices are necessary to support or take the place of a part of the body, or to increase the acuity of a sense organ. A.R.S. §§ 23-501(7), 42-5061(A)(9). Further, exempt prosthetic appliances include those devices that are necessary to integrated prosthetic processes (*e.g.*, equipment, supplies, and solutions necessarily used in the integrated process of kidney dialysis) or that are necessary to apply a prosthetic appliance. *Renal West v. Arizona Department of Revenue*, 189 Ariz. 409, 414 (1997); *VHS Acquisition*, CA-TX 20-0007 at ¶ 25.

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<sup>1</sup> Per A.R.S. §§ 42-6017, -6130, Arizona's TPT statutes govern the imposition of county excise and city privilege taxes as it pertains to the retail classification and the prosthetic appliance exemption therefrom. Accordingly, this ruling also applies to the exemption from county excise and city privilege taxes for retail sales of prosthetic appliances. Further, A.R.S. § 42-5159(A)(17) contains a parallel exemption from Arizona use tax for the storage, use, or consumption of prosthetic appliances. Accordingly, this ruling also applies to the exemption from use tax for prosthetic appliances.

### **Applicable Law:**

A.R.S. § 42-5061 imposes TPT under the retail classification. The retail classification is comprised of the business of selling tangible personal property at retail. The tax base for the retail classification is the gross proceeds of sales or gross income derived from the business. All sales of tangible personal property are subject to TPT under the retail classification unless specifically exempted or deductible by statute.

A.R.S. § 42-5061(A)(9) exempts from the retail classification “[p]rosthetic appliances as defined in § 23-501 prescribed or recommended by a health professional licensed pursuant to title 32, chapter 7, 8, 11, 13, 14, 15, 16, 17 or 29.” These chapters refer to podiatrists, doctors of chiropractic, dentists, physicians and surgeons, naturopathic physicians, nurses, osteopathic physicians and surgeons, and homeopathic physicians.<sup>2</sup>

A.R.S. § 23-501(7), in turn, defines a “prosthetic appliance” as “an artificial device necessary to support or take the place of a part of the body, or to increase the acuity of a sense organ.”

Arizona Administrative Code (A.A.C.) R15-5-156(A)(12) further defines a “prosthetic appliance” as “an artificial device that fully or partially replaces a part or function of the human body or increases the acuity of a sense organ.” In *VHS Acquisition*, citing its previous definitions and ruling in *Renal West*, the Arizona Court of Appeals used the *Webster’s Ninth New Collegiate Dictionary* to define “device” as a “mechanism designed to serve a special purpose or perform a special function,” and “mechanism” as a “process or technique for achieving a result.” CA-TX 20-0007 at ¶ 11.

A.A.C. R15-5-156(B)(4) provides that gross receipts from sales of “prosthetic appliances,” prescribed or recommended by a statutorily-authorized individual are not subject to tax. Additionally, A.A.C. R15-5-156(C) exempts the sale of “component and repair parts” of prosthetic appliances. Therefore, items that meet the definition of a prosthetic appliance, or a component or repair part of an exempt prosthetic appliance, are exempt from Arizona TPT.

### *Application of Use Tax and TPT Exemptions for Prosthetic Appliances*

In *Renal West*, the court addressed whether kidney dialysis machines, solutions, testing equipment, and supplies constitute exempt prosthetic appliances. *See generally*, 189 Ariz. at 409-16. The court determined that: (1) “processes” may fall within the meaning of “prosthetic appliance”; (2) the dialysis process is within the meaning of prosthetic appliance because it replaces the process performed by the kidneys; and (3) all equipment, supplies, and solutions essential to the dialysis process are therefore prosthetic appliances. *Id.* at 414. The court broadly interpreted the definition of prosthetic appliances to include items that were necessary to the integrated process of dialysis. *Id.* Accordingly, the court determined that

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<sup>2</sup> Similarly, the use tax exemption in A.R.S. § 42-5159(A)(17) exempts “[p]rosthetic appliances, as defined in A.R.S. § 23-501, prescribed or recommended by a person who is licensed, registered or otherwise professionally credentialed as a physician, dentist, podiatrist, chiropractor, naturopath, homeopath, nurse or optometrist.”

the use of the items used in dialysis constitute devices necessary to substitute for failed kidneys, as they were all necessary parts of the integrated process of dialysis, and thus qualified for the prosthetic appliance exemption. *Id.*

In *VHS Acquisition*, the court looked at whether adhesive skin closures, liquid skin adhesives, mesh fixation devices, bone wax, surgical clips, ligature loops, staples, and sutures<sup>3</sup> qualify as exempt “prosthetic appliances.” *See generally*, CA-TX 20-0007 at ¶¶ 8-21. Rejecting the Department’s argument that these items would only constitute “medical and surgical supplies” as separately defined in A.R.S. § 23-501(6), the court determined that each of these items also were included in the definition of “prosthetic appliance” because they were necessary components of particular bodily processes—those that support, keep together, seal, and otherwise contain bodily fluids like skin and other body tissues do in the body, as well as facilitate healing. *Id.*

The court in *VHS Acquisition* further broadened its definition of “prosthetic appliances” when it ruled that items *necessary to apply* prosthetic appliances also fall within the definition and thus are exempt from Arizona TPT and use tax. *Id.* at ¶¶ 22-31. In this case, the court stated that these items included preloaded mesh fixation, clip applicators, staplers, suture devices, pens, and ampules used to apply the above items that kept body tissues together and sealed. *Id.* The court said the facts were analogous to the “complicated, integrated process” of kidney dialysis in *Renal West* and the central holding in that case that “essential parts of a prosthetic process are prosthetic appliances” applied. *Id.* at ¶ 24. So, even though the items used to apply prosthetic appliances are not “prosthetic appliances” when viewed in isolation, they still fall within the definition and exemption of “prosthetic appliances” because they are necessary for the safe application of such appliances. *Id.* at ¶ 25.

The court in *Renal West* addressed the requirement that a prosthetic appliance must be “prescribed or recommended by” a licensed health professional under A.R.S. § 42-5159(A)(17) (the parallel use tax exemption to the TPT exemption in A.R.S. § 42-5061(A)(9)). 189 Ariz. at 412-415. There, the dialysis center was the party claiming the use tax exemption rather than the individual patient, even though the dialysis center was not the party who had the prescription or recommendation. The court acknowledged that individuals holding prescriptions routinely (1) directly purchase or use prosthetic appliances for their own personal use, but also (2) may go to health care providers who purchase the prosthetic appliances and then use them to treat the individual. The court ruled that it was appropriate for the dialysis center to claim the exemption even though they themselves did not have the prescription because the “the statutory language defines the *type* of appliances exempt from tax, rather than *who* receives the exemption.” *Id.* at 412. Accordingly, health care providers may claim the prosthetic appliance exemption, even though the prosthetic appliance was not prescribed or recommended to them, so long as the prosthetic appliance was prescribed or recommended by the licensed health professional to the patient.

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<sup>3</sup> Each of these items support, seal, or otherwise keep together various body tissues.

### *County Excise and Municipal Privilege Taxes*

A.R.S. § 42-6103 provides that the state's TPT provisions shall govern the imposition of county excise taxes. Accordingly, all sales subject to TPT are also subject to applicable county excise taxes.

The imposition of city privilege taxes is separate and distinct from the imposition of the state's TPT and accompanying county excise taxes. However, like the state's TPT, city privilege taxes are also imposed on the vendor for the privilege of engaging in business in the city. The Model City Tax Code ("MCTC") was created in order to impose and administer city privilege taxes. Similar to Arizona's TPT, city privilege taxes are imposed "upon persons on account of their business activities." MCTC § -400(a)(1). All Arizona cities follow the MCTC in their imposition of the privilege tax based upon their local ordinances.

A.R.S. § 42-6017 addresses the city privilege taxes in relation to the retail classification. Effective as of October 1, 2019, it provides that "[e]xcept as provided in this section, section 42-5061 supersedes all city or town ordinances or other local laws insofar as the ordinances or local laws now or hereafter relate to the taxation of business activities classified under section 42-5061." That section also provides certain exceptions where a city may exempt or tax specific items that are not taxable or exempt by the state provisions, but prosthetic appliances are not included within those exceptions. Accordingly, A.R.S. § 42-5061(A)(9) also governs the imposition of city privilege tax on prosthetic appliances.

#### **Discussion:**

As laid out above, A.R.S. § 42-5061(A)(9) exempts "prosthetic appliances" from TPT on a retail sale. "Prosthetic appliances" are defined as artificial devices necessary to support or take the place of a part of the body, or to increase the acuity of a sense organ. See A.R.S. § 23-501. Further, A.A.C. R15-5-156 defines a "prosthetic appliance" as "an artificial device which fully or partially replaces a part or function of the human body or increases the acuity of a sense organ." Note that the statutory definition requires that the prosthetic appliance be artificial, so it would not include transplanted organs or body parts.

The courts in *Renal West* and *VHS Acquisition* further explained that the definition of "prosthetic appliances" includes equipment, supplies, and solutions necessary to integrated prosthetic processes, such as kidney dialysis, as well as items necessary to apply prosthetic appliances, even when such items by themselves may not be prosthetic appliances. *Renal West*, 189 Ariz. at 409-16; *VHS Acquisition*, CA-TX 20-0007 at ¶¶ 22-31.

Based on the statutes, administrative code, and court rulings, the Department advises using the following guidelines to determine whether a device meets the definition of “prosthetic appliance” provided under A.R.S. § 42-5061(A)(9)<sup>4,5</sup>:

1. Identify if the device is “prescribed or recommended by a licensed podiatrist, chiropractor, dentist, physician or surgeon, naturopath, optometrist, osteopathic physician or surgeon, psychologist, hearing aid dispenser, physician assistant, nurse practitioner or veterinarian.” A.R.S. § 42-5061(A)(9). Note that the party claiming the exemption does not have to be the party with the prescription or recommendation per *Renal West*. This scenario would apply in the case of a medical or other healthcare facility purchasing equipment to be used on patients to whom the prosthetic appliance was prescribed or recommended by the licensed health professional. If a non-licensed professional or other individual purchases the device, that person must show that the prosthetic was prescribed or recommended by a healthcare professional.
2. Identify whether the device is artificial; the exemption does not include human or other naturally occurring tissue.
3. Identify the body part or body function the device is seeking to support or replace.
4. Identify whether the device is necessary to support that part of the body or body function, take the place of that part of the body or body function, or if the device increases the acuity of one of the senses.
5. If the device is necessary to support a part of the body or function, take the place of a part of the body or function or increase the acuity of one of the senses, then it would qualify as a “prosthetic appliance” under A.R.S. § 42-5061(A)(9).
6. Even if a particular device does not appear to directly qualify as a “prosthetic appliance” under the analysis, above, analyze whether the device is (1) an essential part of an integrated prosthetic process (*e.g.*, equipment, supplies, and solutions necessarily used in the integrated process of kidney dialysis) that satisfies the elements of a prosthetic appliance as described above, or (2) necessary to apply a prosthetic appliance, as such items also qualify for the “prosthetic appliance” exemption under A.R.S. § 42-5061(A)(9) under the broad meaning Arizona courts have applied to the term “device.” See generally *Renal West*, 189 Ariz. 409; *VHS Acquisition*, CA-TX 20-0007.

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<sup>4</sup> This analysis would also be applicable to the definition of “prosthetic appliance” under the use tax exemption for the same under A.R.S. § 42-5159(A)(17).

<sup>5</sup> Whether the prosthetic appliance exemption applies to bundled kits containing both exempt and non-exempt items shall be addressed on a case-by-case basis depending on the specific kit in question.

**Ruling:**

Prosthetic appliances exempt from the retail TPT classification are those artificial devices prescribed or recommended by licensed health professionals, which devices are necessary to support or take the place of a part of the body, or to increase the acuity of a sense organ. A.R.S. § 23-501(7). Further, exempt prosthetic appliances include those devices that are necessary to integrated prosthetic processes such as dialysis (e.g., equipment, supplies, and solutions necessarily used in the integrated process of kidney dialysis) or are necessary to apply a prosthetic appliance. *Renal West v. Arizona Department of Revenue*, 189 Ariz. 409, 414 (1997); *VHS Acquisition*, CA-TX 20-0007 at ¶ 25.

To substantiate the prosthetic appliance exemption from TPT, county excise tax, and city privilege tax under A.R.S. § 42-5061(A)(9)<sup>6</sup>, a person must be able to show, through a proper exemption certificate or other acceptable documentation as discussed in detail in *Arizona Transaction Privilege Tax Procedure* TPP 17-1, that the device falls under the definition of a prosthetic appliance discussed in detail, above, and that he or she was prescribed or recommended the prosthetic appliance by a licensed health professional, or, in the case of a medical facility purchasing the prosthetic appliance for use on a patient, that the patient was prescribed or recommended the prosthetic appliance by a licensed professional. A taxpayer is not required to provide an actual prescription, but they should indicate on the exemption certification that they are purchasing for someone who has a prescription or recommendation from a licensed health professional. The Department does not maintain a list of exempt or non-exempt devices, as each instance or potential exemption must be analyzed on a case-by-case basis under the circumstances.

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Robert Woods, Director

Signed: , 2022

**Explanatory Notice**

**The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement that provides interpretation, details or supplementary information concerning the application of the law. Relevant statute, case law or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.**

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<sup>6</sup> This ruling is also applicable to the parallel use tax exemption for prosthetic appliances under A.R.S. § 42-5159(A)(17).