

**INTERNAL POLICY DIRECTIVE 2016-1
(Replaces IPD 2006-2)**

February 5, 2016

**SALES AND USE TAXES - TAXABILITY OF OVER-THE-COUNTER MEDICATIONS
DISPENSED BY PRESCRIPTION AND PAID FOR BY MEDICAID ARRANGEMENTS**

POLICY ISSUES

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

POLICY DETERMINATIONS

- I. Prior to March 14, 2014, over-the-counter medications that were dispensed by prescription and paid for through Medicaid arrangements were not subject to Michigan sales or use tax if sold to an entity that was entitled to a statutory tax exemption.

On and after March 14, 2014, over-the-counter medications that are paid for through Medicaid arrangements are not subject to Michigan sales or use tax if they are legally dispensed by prescription. If the over-the-counter medication is not legally dispensed by prescription, the taxability of the retail sale will depend on whether the sale is to an entity that qualifies for a statutory sales tax exemption.

- II. Prior to March 14, 2014, Medicaid client/patient co-pays associated with over-the-counter medications dispensed by prescription were not subject to Michigan sales or use tax if sold to an entity that was entitled to a statutory tax exemption.

On and after March 14, 2014, Medicaid client/patient co-pays associated with over-the-counter medications are not subject to Michigan sales or use tax if they are legally dispensed by prescription. If the over-the-counter medication is not legally dispensed by prescription, the taxability of the retail sale will depend on whether the sale is to an entity that qualifies for a statutory sales tax exemption.

DISCUSSION

- I. **Overview.** The law has been amended to provide an exemption from sales/use tax for retail sales of over-the-counter drugs for human use that are legally dispensed by

prescription. The amendment is effective for sales occurring on and after March 14, 2014.¹ Consequently, this IPD replaces IPD 2006-2.

II. Two Payment Models. There are currently two different models of Medicaid coverage in Michigan. One is a fee-for-service model and the other is described as an HMO model.

A. Fee-for-Service Model. The fee-for-service model 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 this model, the pharmacy has a seller/purchaser relationship with the State.

B. HMO Model. The second model is 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 and use tax purposes by the fact that the retail transaction is between the pharmacy and the HMO. The pharmacy does not have a seller-purchaser relationship with the State of Michigan.

III. Effect of Amendments.

A. Fee-for-Service Model. There is no change in the tax treatment for payments made under the fee-for-service model. No portion of the amount the pharmacy receives, including the co-pay, is subject to sales or use tax. Retail sales to the State of Michigan are statutorily exempt from taxation.²

B. HMO Model.

1. **Entity Eligible for a Statutory Exemption.** There is no change in the tax treatment for payments made by an HMO that is entitled to a statutory sales tax exemption. If an HMO qualifies for a statutory sales tax exemption [e.g., it is a qualified nonprofit entity], the purchase by the HMO of over-the-counter medications whether or not they are legally dispensed by prescription, including co-pay amounts, is exempt from sales and use tax.

2. **Entity Not Eligible for a Statutory Exemption.**

a. **Prior to March 14, 2014,** if the HMO did not qualify for a statutory sales tax exemption, the sale of over-the-counter medications to the HMO was subject to sales and use tax, including the amount paid by the client/patient.

¹ MCL 205.54g(1)(a) and MCL 205.94d(1)(a). Public Act 211 of 2013; Public Acts 171 and 172 of 2015.

² MCL 205.54h; MCL 205.94(g).

b. **On and after March 14, 2014**, if an over-the-counter medication is legally dispensed by prescription, no portion of the retail sale, including the co-pay, will be subject to the sales or use tax. However, over-the-counter medications not legally dispensed by prescription will remain taxable if sold to an HMO that does not qualify for a statutory sales tax exemption, including any co-pay amounts.

[**Note:** This IPD only addresses over-the-counter medications. Pursuant to MCL 205.54g(1)(a) and 205.94d(1)(a), sales of drugs for human use that can only be legally dispensed by prescription (including copays) are exempt from sales and use tax.]