

**M e m o r a n d u m****425.0165**

To: Mr. M. Rodriguez  
Out-of-State Auditing

Date: February 5, 1991

From: John L. Waid  
Tax Counsel

Subject: X---, Inc.  
SS --- XX-XXXXXX

Your memorandum to the Legal Division of December 18, 1990, has been referred to me for a response. You have requested advice as to the statutory and regulatory basis for applying use tax to the distribution of free samples of medicines in situations in which the sales of the same items would be exempt.

You attached to your memorandum a copy of the taxpayer's Petition for Redetermination. The taxpayer, X---, Inc. (hereinafter "X---") recites the factual context as follows:

"Petitioner is in the business of manufacturing and wholesaling prescription drugs and medicines. These drugs may not be lawfully dispensed to patient-consumers without a prescription, and they are intended only for human use. Petitioner employs field representatives who call upon doctors, hospitals, and other entities that are in the business of either distributing or prescribing pharmaceutical products, to inform them about our company's products. This activity is commonly referred to as detailing. During these contacts, sales representatives discuss existing products, review package inserts, provide information on new products, distribute promotional literature, and answer questions. In addition, the representatives distribute samples of our prescription drugs to licensed physicians who will in turn dispense these drugs to their patients. Field representatives may only give drug samples to qualified medical personnel. Federal law requires that we keep detailed records of the drug samples we distribute, and also prohibits us from selling those samples.

"Our pharmaceutical drug products cannot be sold directly to patient-consumers, instead they are sold to drug wholesalers and hospitals. However, these drugs will eventually be used by patient-consumers. The only difference between the drug

samples we distribute to physicians and the products we sell is that the sample products are generally packaged in smaller quantities; and just like our regular pharmaceutical drug products, these samples will ultimately be used by patient-consumers.”

## I. OPINION

The distinction between sales tax (§§ 6051 et.seq.) and use tax (§§ 6201 et.seq.) becomes very important when we examine the nature of the prescription medicine exemption. Section 6009 provides that a taxable “use” includes “the exercise of any right or power over tangible personal property incident to the ownership of that property, ... except that it does not include the sale of that property in the regular course of business.” Section 6369(a)(4) provides that the prescription medicine exemption applies to medicines “[s]old to a licensed physician and surgeon, podiatrist, dentist, or health facility for the treatment of a human being.” (Emphasis added.)

The annotation mentioned by the taxpayer (280.0900) is only one of a series of annotations applying the terms of Section 6009 to promotional samples. The gift of free samples as a marketing device is a use made by the manufacturer. By the very fact that the item has been given away, the promotional use cannot be related to the ultimate sale of that item. (Compare, Hawley v. Johnson (1943) 58 Cal.App.2d 232, 239 [136 P.2d 638].) Therefore, the manufacturer has made a taxable use of the product and owes use tax unless a statutory exemption applies.

When X--- give away a drug sample, it is making its own use of the drugs. The physician’s subsequent use – furnishing it to his patient is not attributable to X---’s use, and X---’s use of the medicine in giving it to the physician is not a use set forth in Regulation 1591(a). This gift of the medicines for promotional purposes thus creates a taxable use of the medicine in California in circumstances where the sale of the product would have been exempt. As a result, X--- owes use tax measured by the cost of the materials which it used to manufacture the sample medicines.

As X--- notes, its citations to the sales and use tax laws of other states with different tax schemes cannot support its position. (See, Kaiser Steel Corp. v. St. Bd. of Equalization (1979) 24 Cal.3d 188, 197 [154 Cal.Rptr. 919, 593 P.2d 864].) It is significant, however, that in the two examples cited, both states provide an exemption for gift samples by specific statute.