

STATE OF COLORADO

DEPARTMENT OF REVENUE
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PLR-13-002

May 15, 2013

XXXXXXXXXXXXXXXXXXXXX
ATTN: XXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXX

Re: Private Letter Ruling

Dear XXXXXXXXXXXX,

You submitted on behalf of XXXXXXXXXXXXXXXX ("Company") a request for a private letter ruling to the Colorado Department of Revenue ("Department") pursuant to Regulation 24-35-103.5. This letter is the Department's private letter ruling.

Issues

1. Which of the enumerated invoice component fees that Company charges using Delivery Method One are subject to Colorado sales and use tax?
2. Which of the enumerated invoice component fees that Company charges using Delivery Method Two are subject to Colorado sales and use tax?

Conclusion

1. None of the enumerated invoice component fees are subject to Colorado sales and use tax. Inseparable fees from the sale of a non-taxable service are not subject to sales and use tax. In addition, if fees are separable from the sale of a non-taxable service or taxable tangible personal property or services, they are also not subject to Colorado sales and use tax.
2. None of the enumerated invoice component fees are subject to Colorado sales and use tax. Inseparable fees from the sale of a non-taxable service are not subject to sales and use tax. In addition, if fees are separable from the sale of a non-taxable service or taxable tangible personal property or services, they are also not subject to Colorado sales and use tax.

Background

Company enters into agreements with hospitals, health systems, physician practices and clinics (collectively referred to herein as (“Hospitals”)) to process and fulfill medical record requests (known in the industry as the release of information process). Company makes photocopies of medical records, furnishes them directly to the requesting party, and bills the requesting party for the copies. The requesting parties typically are patients, attorneys, insurance companies, government entities, or hospitals (“Customers”).

A Company employee acquires Hospital's medical records through Company's technology platform, which creates digital copies of Hospital's paper and electronic records. The digital medical records are then electronically transmitted to Company's release of information processing center, located outside of Colorado.

Company uses two different methods to deliver medical records to Customers. Delivery Method One provides paper copies of the medical records, which are printed, packaged, and delivered either by the United States Postal Service or a private common carrier with whom Company contracts for delivery. Delivery Method Two provides Customers access to digital copies of the medical records either through Company's web portal or by electronic file transfer (File Transfer Protocol (FTP)) to Customer's computer.

There are a variety of costs associated with the release of medical records because of the strict procedural and highly regulated steps involved in the release of information process. Fees for Company's services and/or products are normally based on rates regulated by state statutes, rules, or policies. If there is no governing state authority, Company sets a reasonable fee for its services and/or products in accordance with the Health Insurance Portability and Accountability Act of 1996 (HIPAA) guidelines.

Below are the various possible fees that can make up a typical invoice and a short explanation of each fee.

Delivery Method One

1. Affidavit Fee: A separately stated flat fee charged for a written statement, confirmed by oath or affirmation, for use as evidence in court.
2. Basic Fee: A separately stated flat, unregulated fee for searching, retrieving, reviewing, and preparing copies of medical records for delivery to Customers.
3. Certification Fee: A separately stated flat fee to certify the medical records.
4. Deposition Fee: A separately stated fee to affirm that the information is suitable to be utilized in a legal deposition.
5. Handling Fee: A separately stated flat fee distinct from the charge for postage, but associated with mailing paper copies of the individual's medical record.
6. Labor Fee: A processing service fee (e.g., an additional fee charged for retrieving records stored off-site).

7. No Records Found Fee: A flat fee for conducting a search and no medical records were found to provide to Customer.
8. Notary Fee: A separately stated flat fee to notarize the medical records.
9. Photo Fee: A separately stated fee for each page of the medical record that is photocopied.
10. Per Page Fee: A separately stated fee for each page of the medical record that is captured by scanning from microfilm.
11. Postage Fee: A separately stated fee for the actual postage cost associated with mailing paper copies of the medical record when it is mailed via the United States Postal Service or delivery fee when the records are shipped via FedEx. This fee does not contain a markup for profit.
12. Retrieval Fee: A separately stated flat, regulated fee for searching, retrieving, reviewing, and preparing copies of medical records for delivery to Customers.
13. Shipping and Handling Fee: A fee charged for postage or FedEx shipping and handling. This fee does not contain a markup for profit.
14. Shipping (only) Fee: A fee charged for actual postage costs or FedEx shipping costs. This fee does not contain a markup for profit.

Delivery Method Two – Invoice Line Items

1. Affidavit Fee: A separately stated flat fee charged for a written statement, confirmed by oath or affirmation, for use as evidence in court.
2. Basic Fee: A separately stated flat, unregulated fee for searching, retrieving, reviewing, and preparing copies of medical records for delivery to Customers.
3. Certification Fee: A separately stated flat fee to certify the medical records.
4. Deposition Fee: A separately stated fee to affirm that the information is suitable to be utilized in a legal deposition.
5. Handling Fee: A separately stated flat fee distinct from the charge for postage, but associated with mailing paper copies of the individual's medical record.
6. Labor Fee: A processing service fee (e.g.: an additional fee charged for retrieving records stored off-site.)
7. No Records Found Fee: A flat fee for conducting a search and no medical records were found to provide to Customers.
8. Notary Fee: A separately stated flat fee to notarize the medical records.
9. Photo Fee: A separately stated fee for each page of the medical record that is photocopied.
10. Per Page Fee: A separately stated fee for each page of the medical record that is captured by scanning or from microfilm.
11. Retrieval Fee: A separately stated flat, regulated fee for searching, retrieving, reviewing, and preparing copies of medical records for delivery to Customers.
12. Quickview Delivery Fee: A separately stated flat fee to electronically access and view the contents of the delivered information via our web portal.
13. Electronic FTP Fee: A separately stated fee to electronically receive medical records pushed to the customer via FTP.

Because Company's employees perform the enumerated services within Colorado, Company concludes that it has sufficient nexus in Colorado for sales and use tax purposes. Additionally, Company characterizes its release of information process as essentially a simple retail photocopying process, and its business model as one of selling copies of medical records as a retail enterprise with a profit-making objective. Given their business model, Company states the true object of Customers is to obtain the information contained in the medical record.

Discussion

The principal issue raised in this ruling request is whether the various charges constitute taxable sales of tangible personal property or non-taxable sales of services. We begin with the simple observation that Colorado levies sales and use tax on the sale or use of tangible personal property, but not on services.¹ However, there are a number of important instances in which services are taxed. The first, and perhaps most common, exception is when the price of a taxable good is a composite not only of the manufacturer's cost of materials but also of labor and other costs incurred to bring the product to market. Colorado law requires that the calculation of sales tax include the manufacturer's labor costs.

...the sales tax is imposed on the full purchase price of articles sold after manufacture or after having been made to order and includes the full purchase price for the material used and the service performed in connection therewith ...²

This inclusion of labor costs in the sales tax calculation has exceptions. Labor costs are not included in the tax calculation if the service is "separable" from the sale of the taxable property. For example, a retailer of a finished dress who also performs alteration services cannot collect sales tax on the alteration service because the sale of the service is "separable" from the sale of the finished dress.³

Services incurred prior to bringing finished goods to market are generally considered an inseparable part of the cost of goods. In such cases where the service component is inseparable from the sale of goods, the question then arises whether the entire transaction should be treated as the sale of a service or a sale of tangible personal property. One common test for making this determination is the "true object" test.

The true test then is one of basic purpose of the buyer. When the product of the service is not of value to anyone other than the purchaser, either because of the confidential character of the product, or because it is prepared to fit the purchaser's special need — a contract or will prepared by a lawyer, or the accident investigation report prepared for an insurance

¹ §§39-26-104(1)(a) and 202, C.R.S.

² §39-26-102(12), C.R.S.

³ *A.D. Stores v Department of Revenue*, 19 P.3rd 680 (Colo. 2001).

company — this fact is evidence tending to show that the service is the real purpose of the contract. When the purpose of the contract is to produce an article which is the true object of the agreement, the final transfer of the product should be a sale, regardless of the fact that special skills and knowledge go into its production. Under this analysis, printing work, done on special order, and of significant value only to the particular customer, is still a sale. The purchaser is interested in the product of the services of the printer, not in the services per se. Similarly, it would seem that contracts for custom-produced articles, be they intrinsically valuable or not, should be classified as sales when the product of the contract is transferred.

...

If the article sold has no value to the purchaser except as a result of services rendered by the vendor, and the transfer of the article to the purchaser is an actual and necessary part of the services rendered, then the vendor is engaged in the business of rendering service, and not in the business of selling at retail. If the article sold is the substance of the transaction and the service rendered is merely incidental to and an inseparable part of the transfer to the purchaser of the article sold, then the vendor is engaged in the business of selling at retail, and the tax which he pays ... [is measured by the total cost of the article and services]. If the service rendered in connection with an article does not enhance its value and there is a fixed or ascertainable relation between the value of the article and the value of the service rendered in connection therewith, then the vendor is engaged in the business of selling at retail and also engaged in the business of furnishing service, and is subject to tax as to the one business and tax exempt as to the other.⁴

In *City of Boulder v. Leanin' Tree*, 72 P3d 361 (Colo. 2003), the Colorado Supreme Court reviewed a variety of tests, including the true object test, used by states to make this distinction and concluded that,

“Varied as these analyses may be, they largely share in common some attempt to identify characteristics of the transaction at issue that make it either more analogous to what is reasonably and commonly understood to be a sale of goods, or more analogous to what is generally understood to be the purchase of a service or intangible right.

In *Treece, Alfey, Musat & Bosworth, P.C. v. Denver Dept. Finance, Colo. Ct. App., Dkt. No. 11CA0026, 11/23/2011*, the Division II of the Colorado Court of Appeals concluded, based on facts substantially similar to those set forth in this ruling request and after reciting a number of the tests discussed in *Leanin' Tree*, that the true object

⁴ 9 Vanderbilt Law Review 231 (1956), cited with approval in South Carolina Revenue Ruling 04-5, 03/30/2004.

of the transaction is the sale of a service, not the sale of tangible personal property.

Among other conclusions, the court noted that the dominant cost in this transaction is the labor and that the value of the paper was nominal. The court also emphasized that the object of the transaction was information (i.e., patient data), which it characterized as intangible, and that the use of the information was strictly controlled.

As in any case, and particularly with respect to cases involving application of the "true object" test, the issues are not simple. For example, the principal thrust of the true object test is to ask, "what does the buyer want?" The test is viewed, as noted in the Vanderbilt Law Review article discussed above, from the buyer's perspective. In this instance, the medical records are generally available to patients and their agents who could, if they so choose, retrieve these records themselves. However, they choose to pay for Company's service of compiling the medical information for them. Therefore, what the lawyer or insurance company who purchase the record is principally interested in is the service of compiling the medical information.

As noted above, there are a variety of factors to consider in making these determinations and the applicability of those factors and their application to specific set of facts are debatable. Although the Department is neither bound by nor does it necessarily agree with the court's reasoning, the Department, nevertheless, concludes that this is the sale of a service and not the sale of tangible personal property. This is similar to custom compilations of data, such as a market survey made at the direction of and for the specific use of a company (as opposed to a market survey generally made for public distribution) which the Department has previously opined is a service and not the sale of property.⁵ The *Treece* decision is consistent with this approach.

Having ruled that the transaction is primarily for the sale of a non-taxable service, we rule that all the fees associated with Method One and Two are non-taxable.

Miscellaneous

This ruling applies only to sales and use taxes administered by the Department. Please note that the Department administers state and state-collected city and county sales taxes and special district sales and use taxes, but does not administer sales and use taxes for self-collected home rule cities and counties. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes. Visit our web site at www.colorado.gov/revenue/tax for more information about state and local sales taxes.

This ruling is premised on the assumption that Company has completely and accurately disclosed all material facts. The Department reserves the right, among others, to independently evaluate Company's representations. This ruling is null and void if any such representation is incorrect and has a material bearing on the

⁵ Colorado General Information Letter GIL-07-27, 12/04/2007. You can view this ruling at www.colorado.gov/revenue/tax > Tax Library > Rulings > Topic by Number.

conclusions reached in this ruling. This ruling is subject to modification or revocation in accordance to Department Regulation 24-35-103.5.

Enclosed is a redacted version of this ruling. Pursuant to statute and regulation, this redacted version of the ruling will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted version of the ruling.

Sincerely,

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