
State of South Carolina
Department of Revenue
301 Gervais Street, P. O. Box 125, Columbia, South Carolina 29214
Website Address: <http://www.sctax.org>

SC PRIVATE LETTER RULING #12-2

SUBJECT: Application Service Provider Software and Claims and Billing Services
(Sales and Use Tax)

REFERENCES: S. C. Code Ann. Section 12-36-910 (2000; Supp. 2011)
S. C. Code Ann. Section 12-36-1310 (2000; Supp. 2011)
S. C. Code Ann. Section 12-36-1110 (Supp. 2011)
S. C. Code Ann. Section 12-36-60 (2000)
S. C. Code Ann. Section 12-36-100 (2000)
SC Regulation 117-329.4 (Supp. 2011)

AUTHORITY: S. C. Code Ann. Section 12-4-320 (2000)
S. C. Code Ann. Section 1-23-10(4) (2008)
SC Revenue Procedure #09-3

SCOPE: A Private Letter Ruling is an advisory opinion issued to a specific taxpayer by the Department to apply principles of law to a specific set of facts or a particular tax situation. It is the Department's opinion limited to the specific facts set forth, and is binding on agency personnel only with respect to the person to whom it was issued and only until superseded or modified by a change in statute, regulation, court decision, or another Departmental advisory opinion, providing the representations made in the request reflect an accurate statement of the material facts and the transaction was carried out as proposed.

Question:

Is the nonitemized, monthly charge by Company A to Company B for use of its "X" and "Y" products, as described in the facts, subject to the sales and use tax?

Conclusions:

The transaction between Company A and Company B, as described in the facts, is the sale of a nontaxable data processing as defined in Code Section 12-36-910(C) since (1) "Y" is a service where information furnished by Company B is manipulated by Company A through all or part of a series of operations involving an interaction of procedures, processes, methods, personnel, and computers; (2) the billing and claims information on "X" is the result of the "data processing" performed by Company A as part of the "Y" service; (3) "data processing" includes "the

electronic transfer of or access to that information;” and (4) “X” is the means through which Company B has access to the “data processing” performed by Company A.

Therefore, the entire, nonitemized monthly charge by Company A to Company B, as described in the facts, is for “data processing” - the manipulation of the customer’s information and “the electronic ... access to that information” - and is not subject to the tax based on the facts presented. The portion of the charge for “X” software via an Application Service Provider, which would be subject to the tax if purchased alone, is not subject to the tax in the transaction described in the facts since the “true object” of the transaction where “X” and “Y” are sold together for one nonitemized monthly charge is “data processing” as defined in Code Section 12-36-910(C).

Facts:

Company B is a medical practice that has entered into a contract with Company A. Under this contract, Company B has use of Company A’s “X” and “Y” products.

“X”:

“X” is a software product that can be sold to a customer as:

1. a one-time charge for software placed on the customer’s in-house server; or,
2. a periodic charge for software that the customer accesses via an Application Service Provider¹.

Company B has purchased the right to use “X” via the Application Service Provider in conjunction with Company A’s “Y” service.

“X” is Company A’s electronic health record (“EHR”), practice management and interoperability solution that provides a single-database platform for integration of clinical, financial and administrative functions. It makes information available in real time throughout a practice, giving a practice’s staff on-demand access to the data. Some of the features of “X”, with respect to the areas of EHR and Practice Management, are:

EHR

E-Prescribe: Provides the ability to submit a prescription electronically to the patient’s preferred pharmacy.

User Settings: Allows settings of numerous chart preferences.

¹ Company A refers to this access to the software as via “the cloud.”

Patients' Lists: Practice workflow-centered list of patients to be seen with role-specific user filtering.

Clinical Alerts: Allows creation, modification of guidelines that trigger reminders.

Clinician Desktop: Provides key features on the main login page for quick provider access.

Order Tracking: Allows order tracking straight from the desktop.

Customized Clinical Templates: Allows for any specialty.

Practice Management

Scheduling: Integrates scheduling capabilities, providing a complete, up-to-the-minute view of schedules for the entire organization.

Patient Registration: Patient registration through an easy-to-use electronic template.

Accounts Receivables: Fully automates and optimizes workflows for all aspects of accounts receivables, including billing, claims processing, applying payments, etc.

Reporting: Offers standardized and customizable reports.

Messaging: Provides a platform for messaging, enabling staff to track, categorize and manage electronic communications.

“Y”:

“Y” is a medical billing service offered to Company A customers. Company A logs into their customers’ “X” site (Company A’s software) and manages their revenue cycle. Company A’s revenue cycle management service can be divided into four main functions: charge entry, payment posting, insurance accounts receivables, and patient accounts receivables. The following briefly outlines each of these functions:

Charge Entry: Company A reviews charges for correct coding and enters charges for office, inpatient, and outpatient services.

Payment Posting: Company A reviews and posts insurance remittances and reviews and posts patient payments.

Insurance Accounts Receivables: Company A submits electronic and/or paper claims to public/private payers (directly or via a clearinghouse), accepts and verifies claims, and reviews and follows up on outstanding claims.

Patient Accounts Receivables: Company A reviews and submits patient statements weekly, produces and submits collection letters to appropriate patients, and fields incoming calls regarding patient accounts.

Every action that Company A performs as part of its “Y” service is recorded in the Company B’s “X” account. Company A “adds” to Company B’s “X” account the charges to the visits, the claims, payments both for insurance and patients, and notes related to both insurance and patients. Company A also closes claims and/or makes adjustments and write offs.

Company A charges each customer a percentage of their total collections for the “Y” service. Every fee is unique, but the fee ranges from 2.5% to 7% of collections.

The “Y” service cannot be purchased unless the customer has purchased “X”. However, the customer who purchases “X” does not have to purchase the “Y” service. Some customers who purchase the Application Service Provider version of “X” purchase “Y” at the same time for one bundled monthly fee.

Company B pays a nonitemized, monthly charge for both “X” (via the Application Service Provider) and “Y”.

Discussion:

Code Section 12-36-910(A) states:

A sales tax, equal to [six]² percent of the gross proceeds of sales, is imposed upon every person engaged or continuing within this State in the business of selling tangible personal property at retail. (Emphasis added.)

Code Section 12-36-1310(A) reads:

A use tax is imposed on the storage, use, or other consumption in this State of tangible personal property purchased at retail for storage, use, or other consumption in this State, at the rate of [six]³ percent of the sales price of the property, regardless of whether the retailer is or is not engaged in business in this State. (Emphasis added.)

Code Section 12-36-60 defines the term “tangible personal property” to mean:

...personal property which may be seen, weighed, measured, felt, touched, or which is in any other manner perceptible to the senses. It also includes services and intangibles, including communications, laundry and related services, furnishing of accommodations and sales of electricity, the sale or use of which is

² Code Section 12-36-1110 increased the sales and use tax rate by 1% beginning June 1, 2007.

³ See footnote #2.

subject to tax under this chapter and does not include stocks, notes, bonds, mortgages, or other evidences of debt. ... (Emphasis added).

Therefore, the term tangible personal property includes the sale or use of intangibles, including communications, that are subject to South Carolina sales or use taxes under Chapter 36 of Title 12.

Communications are subject to sales and use taxes under Chapter 36 of Title 12 pursuant to Code Sections 12-36-910(B)(3) and 12-36-1310(B)(3)⁴, which impose the tax on the:

gross proceeds accruing or proceeding from the charges for the ways or means for the transmission of the voice or messages, including the charges for use of equipment furnished by the seller or supplier of the ways or means for the transmission of the voice or messages (Emphasis added.)

The Department has long held that Code Sections 12-36-910(B)(3) and 12-36-1310(B)(3) impose the sales and use tax on the total amount of money derived, exclusive of deductions, from a commercial venture and accruing or proceeding from charges for the manner, method or instruments for sending a signal of the voice or of messages. See SC Revenue Ruling #89-14, SC Revenue Ruling #04-15 and SC Revenue Ruling #06-8.

Furthermore, the definition of tangible personal property, as defined in Code Section 12-36-60, includes services and intangibles “the sale or use of which is subject to tax under [Chapter 36],” such as “communications.” The Second College Edition of the American Heritage Dictionary defines “communication,” in part, as “[t]he exchange of thoughts, messages or information, as by speech, signals or writing.” “Communications” is defined, in part, as, “a means of communicating esp.: a system of sending and receiving messages, such as mail, telephone and television.” The Department has long used the definition found in the Second College Edition of the American Heritage Dictionary for the term “communications.”

Based on the above discussion, it is the Department’s position that charges for the ways or means of communication include charges for access to, or use of, a communication system (the manner, method or instruments for sending or receiving a signal of the voice or of messages), whether this charge is based on a fee per a specific time period or per transmission. This is further supported by the definition of the terms “sale” and “purchase,” which are defined in Code Section 12-36-100 to include “a license to use or consume.” See SC Revenue Ruling #89-14, SC Revenue Ruling #04-15 and SC Revenue Ruling #06-8.

The Department of Revenue has taxed communication services such as telephone services, paging services, cable television services, satellite programming services (includes, but is not limited to, emergency communication services and television, radio, music or other programming services), fax transmission services, e-mail services, and database access transmission services (on-line information services), such as legal research services, credit reporting/research services, and charges to access an individual website.

⁴ See SC Revenue Ruling #06-8 for other statutes concerning communications subject to the sales and use tax. These other communications statutes are not relevant to this discussion.

Furthermore, SC Revenue Ruling #03-5 describes software received via an Application Service Provider as follows:

... some Internet websites also allow a customer use of software on that website. Companies that provide customers access or use of software in this manner are generally referred to as Application Service Providers (ASP).

In this revenue ruling, the Department, in answering whether a charge by Application Service Provider (ASP) that allows a customer to access the ASP website and use the software on that website is subject to the sales and use tax, held that such charges by an Application Service Provider are similar to charges by database access services and are therefore subject to the sales and use tax under the provisions of Code Sections 12-36-910(B)(3) and 12-36-1310(B)(3).

In addition, SC Regulation 117-329.4 states in part:

The following are examples of communication services that are subject to the sales and use tax (unless otherwise listed as non-taxable in 117-329.5 or otherwise exempt or excluded under the law):

* * * *

(k) Database Access Transmission Services or On-Line Information Services, including, but not limited to, legal research services, credit reporting/research services, and charges to access an individual website (including Application Service Providers) Emphasis added.

* * * *

Based on the above, when sold separately, charges for use of the “X” software via an Application Service Provider are subject to the sales and use tax under the provisions of Code Sections 12-36-910(B)(3) and 12-36-1310(B)(3).

Now, we must address the taxability of charges for use of “X” software via an Application Service Provider when it is sold with “Y” as described in the facts.

Code Section 12-36-910(C) states:

Notwithstanding other provisions in this article or Article 13, Chapter 36, of this title, the sales or use tax imposed by those articles does not apply to the gross proceeds accruing or proceeding from charges for or use of data processing. As used in this subsection, “data processing” means the manipulation of information furnished by a customer through all or part of a series of operations involving an interaction of procedures, processes, methods, personnel, and computers. It also means the electronic transfer of or access to that information. Examples of the processing include, without limitation, summarizing, computing, extracting, storing, retrieving, sorting, sequencing, and the use of computers.

Based on the above, “Y” is a nontaxable data processing service.

From time to time it is necessary to determine if the transaction is a sale or rental of tangible personal property or the furnishing of a service. The so-called “true object” test is generally used to delineate sales of services from sales of tangible personal property. In this case, the “true object” test can assist in determining what is the “true object” of the transaction between Company A and Company B when “X” and “Y” are sold together for one nonitemized monthly charge as described in the facts.

The “true object” test is best described in 9 *Vanderbilt Law Review* 231 (1956), wherein it is stated:

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 company - this fact is evidence tending to show that the service is the real purpose of the contract. When the purpose of a 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.

The *Vanderbilt Law Review* article, in quoting *Snite v Department of Revenue*, 398 Ill. 41, 74 N.E.2d. 877 (1947), also establishes the following general rule:

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 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.

While the above quotes do not establish rigid rules, they do provide general guidance in determining the purpose of a transaction, and are particularly helpful in addressing the issues at hand.

Based on the above, the transaction between Company A and Company B, as described in the facts, is the sale of a nontaxable data processing as defined in Code Section 12-36-910(C) since (1) “Y” is a service where information furnished by Company B is manipulated by Company A through all or part of a series of operations involving an interaction of procedures, processes, methods, personnel, and computers; (2) the billing and claims information on “X” is the result of the “data processing” performed by Company A as part of the “Y” service; (3) “data processing” includes “the electronic transfer of or access to that information;” and (4) “X” is the means through which Company B has access to the “data processing” performed by Company A.

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SOUTH CAROLINA DEPARTMENT OF REVENUE

s/James F. Etter

James F. Etter, Director

June 11, 2012
Columbia, South Carolina