

**STATE BOARD OF EQUALIZATION**

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June 24, 1996

E. L. Sorensen, Jr.
Executive Director

Mr. J--- E. D---, CPA
D--- & C---, P.L.L.C.
XXXXX --- Road, Suite XXX
---, Texas XXXXX

Re: Electronic Transmission Corporation

Dear Mr. D---:

This is in response to your March 19, 1996 letter to Deputy Director Glenn A. Bystrom requesting a letter ruling on the application of tax on various activities undertaken by your client, the E--- T--- C--- ("ETC"). I initially note that the Board staff does not issue rulings. Revenue and Taxation Code section 6596 sets forth the circumstances under which a taxpayer may be relieved of liability for taxes when reasonably relying on a written response to a written request for an opinion. In order to come within the provisions of section 6596, all relevant facts, including the identity of the taxpayer, must be disclosed. Since you have identified your client, our opinion below comes within the provisions of section 6596 to the extent that you have identified and clearly set forth all relevant facts surrounding the transaction(s) in question. We note, however, that not all aspects of ETC's transactions are entirely clear to us. Copies of contracts, leases, and other relevant documentation between ETC and its customers were not provided to use for review. Our opinion below may be different upon review of these documents.

You state:

"ETC, which is qualified to do business in Texas, is primarily engaged 'in the electronic receipt and transmittal of claims' on behalf of their customers. ETC does not have an office or any employees in California. The company plans to send employees into California to install computer software and train customer employees in the future.

“ETC moves claims electronically between providers of health care (Self-Insured/Self Administered business entities, Preferred Provider Organizations (PPOs), and Third Party Administrators (TPAs)) and payors of the claims. We have described three potential cases below that illustrate the paperless claim flow.

- “1. ETC will supply a computer software interface program to be installed at the customer’s corporate headquarters in California. However, the customer’s branches and retail stores are located in various states. All of the insurance claim forms will be sent to the corporate headquarters in California for processing.

“Along with this program, ETC may provide a scanner to be utilized in scanning the claim form into a personal computer at the provider’s (customer’s) California location. The data is edited at the provider’s location and then transmitted electronically to ETC’s computer located in Texas. ETC would change the file format but would not make any decisions regarding the information contained on the claim. The payor of the insurance claim may be located anywhere in the United States. The insurance provider (customer) of ETC was located in California.

- “2. This case is similar to number 1 except that the customer’s branches and retail locations send the insurance claim forms directly to ETC’s location in ---, Texas for further processing. The claims are not handled by the customer’s corporate location in California.

“After receipt of the claim by ETC, the claim is processed in the same manner as case number one.

- “3. This case differs from the other cases in that the claims are not scanned into the computer at the corporate headquarters located in California. The claims are filed electronically by the insurance provider (ETC’s customer) using a local clearinghouse. The claims are sent electronically from various states through the existing electronic claim networks (i.e., NEIC, Envoy, BCBS and others) to ETC. ETC processes the claim and transmits the claim electronically to the payor.”

You ask whether tax applies to specific charges by ETC under each of the foregoing scenarios. For purposes of clarity, we have lumped some of your specific inquiries together and have responded to these items below in a somewhat inverse order.¹ We further assume for purposes of this opinion that ETC’s customers are not insurance companies that pay California gross premiums insurance tax.

¹ We initially address the application of tax to ETC’s non-invoiced charges for computer software and hardware. We next address the application of tax on the various fees which relate to case numbers one and two. Lastly, we address the application of tax on the fees associated with case number three.

“ITEMS NOT BILLED (INVOICED) TO CUSTOMERS BY ETC:**“I. License of Computer Software:**

“ETC will install and furnish computer software to their customers located in California but will not charge a license fee or maintenance fee. The charges are included in the fees listed . . . [below (i.e., the fees for ‘claims conversion,’ ‘one-way transactions,’ ‘clearinghouse,’ and ‘archival’ fees)]. [W]ill any use tax be applicable for the computer software located in California?”

A lease of tangible personal property in California is a continuing sale and purchase unless the lessor leases it in substantially the same form as acquired and has made a timely election to pay California sales tax reimbursement or use tax measured by the lessor's purchase price of the property. (Rev. & Tax. Code §§ 6006(g)(5), 6006.1, 6010(e)(5), 6010.1, Reg. 1660(c)(2).) When the lease is a continuing sale and purchase because either or both of the foregoing conditions are not satisfied, the lease is subject to use tax measured by rentals payable. (Reg. 1660(c)(1).) The lessee owes the tax and the lessor is required to collect it from the lessee and pay it to this Board. (Rev. & Tax. Code §§ 6202, 6203, 6204; Reg. 1660(c).)

We assume that ETC manufactures the software it provides to its customers and that it provides this software to its customers in tangible form (i.e., ETC either provides its customers with floppy disks or installs the software into the computer hardware it provides to its customers). We further assume that ETC's customers are required to return this software to ETC upon the termination of any agreement(s) between the parties. Since you state that the charges for providing this software to ETC's customers are included as part of the other fees ETC charges its customers, we regard ETC as leasing tangible personal property to its customers not in substantially the same form as acquired. This means that tax applies to the rentals payable on this software and this tax must be separately stated on each customer's invoice. (Regs. 1660(c)(1), 1686(a).) ETC is required to collect this tax from its customers and pay it to this Board.

“II. Computer Hardware:

“ETC will lease computer hardware from vendors. The equipment will be leased exempt from sales tax because Texas has ruled that the processing of insurance claims is taxable in the State of Texas. ETC will ship the equipment to customers located in various states.

“Although ETC may furnish computer hardware and scanners to their customers located in your State, the sales invoice will not list a charge for this equipment. The charges are included in the fees listed above. [W]ill any use tax be applicable to the rental fees charged to ETC by the owner of the equipment located in California?”

“Can ETC pass the tax along to the customer and identify the use tax on their sales invoice?”

As set forth above, a lease of tangible personal property in California is a continuing sale and purchase unless the lessor leases it in substantially the same form as acquired and has made a timely election to pay California sales tax reimbursement or use tax measured by the lessor’s purchase price of the property. Similarly, a sublease of tangible personal property is a continuing sale and purchase subject to use tax on the rentals payable from the sublease unless the subleased property is leased in substantially the same form as acquired and the prime lessor paid California sales tax reimbursement or use tax measured by the purchase price of the property, or California use tax is paid on the rental receipts derived under the prime lease or any prior sublease. (Reg. 1660(c)(5).)

ETC’s customers are the sublessees of the computer equipment that ETC leases from its vendors for the same reasons we regard ETC as leasing software to its customers as discussed above. That is, you state that the charges for this hardware are included as part of the other fees ETC charges its customers and we assume that ETC’s customers are eventually required to return this hardware to ETC upon the termination of any agreement(s) between the parties. We further assume that ETC or its vendors did not pay California sales or use tax with respect to the leased property. Under these facts, ETC’s sublease of the equipment is a continuing sale and purchase. Tax therefore applies to the rentals payable on this hardware and must be separately stated on each customer’s invoice. (Regs. 1660(c)(1), 1686(a).) ETC is required to collect this tax from its customers and pay it to this Board.

“ITEMS BILLED (INVOICED) TO CUSTOMERS BY ETC: ...”

“A. Claims conversion fee”

“This is a fee charged to the customer for scanning the healthcare claim form and creating an electronic image which is stored on the customer’s computer. The image is then transmitted to ETC and finally to the payor of the claim. ETC would invoice their customer for this service on a per claim basis. This fee includes data analysis and reporting.

“This would apply to cases 1 and 2 above....

“....

“D. Archival fee”

“This is a fee ... charged to the customer [for] converting the claim from an electronic image to a CD. The CD is sent to the customer located in California.

“This revenue is applicable to cases 1, 2, and 3 above. Please address each of these cases in your response.”

California imposes a sales tax on a retailer’s gross receipts from the retail sale of tangible personal property inside this state unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code § 6051.) This tax is imposed on the retailer who may collect reimbursement from its customer if the contract of sale so provides. (Civ. Code § 1656.1; Reg. 1700.) When sales tax does not apply, use tax is imposed on the sales price of property purchased from a retailer for the storage, use or other consumption of that property in California. (Rev. & Tax. Code §§ 6201, 6401.) This tax is imposed on the person actually storing, using, or otherwise consuming the property. (Rev. & Tax. Code § 6202.) A retailer engaged in business inside this state is required to collect this tax from its customers and remit it to this Board. (Rev. & Tax. Code §§ 6202, 6203.) Taxable gross receipts or sales price generally include all amounts received with respect to the sale, with no deduction for the cost of the materials, service, or expense of the retailer passed on to the purchaser, unless there is a specific statutory exclusion. (Rev. & Tax. Code §§ 6011, 6012.)

Regulation 1502 (copy enclosed) explains the application of tax on activities involving data processing and related matters. Regulation 1502(d)(1) provides that tax applies to the conversion of customer-furnished data from one physical form of recordation to another unless the contract is for the processing of customer-furnished information. “Processing of customer-furnished information” means the developing of original information from data furnished by the customer and generally includes such processes as summarizing, computing, extracting, sorting and sequencing. (Reg. 1502(d)(5)(A).)

In cases one and two, we understand that ETC: 1) receives either an electronic or physical claim from its customers; 2) converts or reformats the claim to the proper format for the ultimate payor of the claim; 3) transmits the converted or reformatted claim to the appropriate insurance company (payor) for processing; and, 4) provides its customer with a copy of the claims it processed in a CD-ROM format. ETC charges its customers a “claims conversion fee” which includes “data analysis and reporting” and an “archival fee” for the providing of a copy of the claim on CD-ROM. We assume that the “data analysis and reporting” consists of the summarizing or extracting of information from customer-furnished claim forms for inclusion in a report wholly separate and apart from the CD-ROM provided as part of ETC’s archival fee. Under these facts, tax does not apply to ETC’s charges for claims conversion since that fee represents a charge for the processing of customer-furnished information.² Tax does, however, apply to ETC’s archival fee since it is only converting a claim from an electronic image to a CD-

² Tax does not apply to this fee only to the extent that any portion of this fee is not part of the rental receipts from the lease of the computer hardware or software as discussed above.

ROM and then selling that CD-ROM to its customers. Sales tax applies to this fee where the sale of the CD-ROM takes place inside this state and there is some local participation in the transaction by ETC. (See Reg. 1620(a)(2)(A).) When sales tax does not apply, use tax is imposed on the sales price of the CD-ROM. ETC must collect that amount from its customers and pay it to this Board.

“B. One-Way transaction fee”

“This is a fee charged to the customer for transmitting the claim from ETC to the payor.

“This revenue would apply only to case 3. Please address this case in your response.

“C. Clearinghouse fee”

“This is a fee charged to the customer for transmitting claims from the customer to ETC, repricing the claim and transmitting the claim to the payor. This fee includes data analysis and reporting.

“This revenue item would apply only to case 3. Please address this case in your response.

“D. Archival fee”

“This is a fee ... charged to the customer [for] converting the claim from an electronic image to a CD. The CD is sent to the customer located in California.

“This revenue item is applicable to cases 1, 2, and 3 above. Please address each of these cases in your response.”

We understand in case three that ETC: 1) receives customer information already in an electronic format; 2) converts or reformats the claim to the proper format for the ultimate payor of the claim; 3) transmits the converted or reformatted claim to the appropriate insurance company (payor) for processing; and, 4) provides its customer with a list of the claims it processed in a CD-ROM format. Under these facts, we regard ETC’s operations in case three similar to those of case one. That is, we assume that the “clearinghouse fee” is similar to the “claims conversion fee” in that ETC summarizes or extracts information from customer-furnished claims for inclusion in a report wholly separate and apart from the CD-ROM provided as part of ETC’s archival fee. As such, tax does not apply to ETC’s clearinghouse fee since that fee represents a charge for the processing of customer-furnished information. Tax does, however, apply to ETC’s archival fee since it is only converting a claim from an electronic image to a CD-ROM and then selling that CD-ROM to its customers. Finally, tax does not apply to ETC’s “one-way transaction fee” since this fee only relates to the electronic transmission of a claim from ETC to the payor. (See Reg. 1502(f)(1)(D).)

We hope this answers your questions. If you have any further questions, please write again.

Sincerely,

Warren L. Astleford
Tax Counsel

WLA:rz

Enclosure: Reg. 1502

cc: Out-of-State District Administrator - (OH)