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**LETTER RULING 2019-3**

**LR 2019-3. Application of Sales and Use Tax to Information Management Services and Related Transactions.**

Taxpayer is a provider of information management services to healthcare providers, patients, insurers, and other entities involved in the healthcare industry. Taxpayer seeks guidance concerning the sales and use tax consequences relating to transactions involving three of its lines of business.<sup>1</sup> Those lines of business are referred to in this letter ruling as Business Unit 1, Business Unit 2, and Business Unit 3, respectively. A general description of each line of business is provided below. The specific services and transactions for which Taxpayer seeks guidance are set forth in the Table found in the Conclusion of this letter ruling.

*Business Unit 1* operates the medical records departments of medical service providers through contractual arrangements. It charges a fee to the requester of a record, whether a patient, other medical provider, insurance company, or third-party representative of a patient, for retrieving the record and delivering the record (whether in electronic or paper format) to the requester. The requester is seeking the information contained in the medical record, regardless of the medium used to provide the information.

*Business Unit 2* provides records retrieval services primarily to health plans and other requesters. In some cases, these records are in a records department operated by *Business Unit 1*. In such cases, a Taxpayer representative retrieves the record. Where Taxpayer does not operate the medical records department, Taxpayer retrieves the record by remotely logging in the provider's electronic medical record ("EMR"), receiving a fax or mailed record from the provider, the provider dropping a file on Taxpayer's online portal or sending a representative to that provider's medical records department to either scan or copy those records.

*Business Unit 3* provides solutions for healthcare providers, and researchers for the collection, management, storage, and use of healthcare data and also facilitates the extraction of actionable information from that data. The two primary service options of *Business Unit 3* are: (i) coding services and (ii) scanning, storage and data abstraction services. Coding services involve translating medical information such as diagnoses, procedures, and treatments into industry-standard codes for use in EMR, risk adjustment services, insurance claims processing and other uses. Scanning, storage, and data abstraction services involve combining records and/or formatting records, scanning services to convert paper records to EMR and both physical and electronic records storage.

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<sup>1</sup> Due to the limited facts presented to determine nexus and sourcing issues, this letter ruling assumes that the transactions at issue are subject to the General Sales Tax Act, ("GSTA"), MCL 205.51 *et seq.*, and/or the Use Tax Act ("UTA"), MCL 205.91 *et seq.*, even if the transactions are ultimately determined to be exempt under either (or both) of these Acts.

**Summary of the Applicable Law.** The GSTA imposes a 6% sales tax on the gross proceeds of “all persons engaged in the business of making sales at retail, by which ownership of tangible personal property is transferred for consideration...” unless an exemption applies.<sup>2</sup> Tangible personal property includes “prewritten computer software.”<sup>3</sup> Gross proceeds (i.e., “sales price”) includes among other things “delivery charges incurred or to be incurred before completion of the transfer of ownership of tangible personal property subject to the tax” as well as any charges by the seller for any services necessary to complete the sale (unless otherwise excepted).<sup>4</sup> As a general rule, sales tax applies only to sales of tangible personal property, not sales of services.<sup>5</sup> The UTA levies a use tax upon (and to be collected from) “every person in this state ... for the privilege of using,<sup>6</sup> storing,<sup>7</sup> or consuming<sup>8</sup> tangible personal property in this state at a total combined rate equal to 6% of the price of the property or services specified in section 3a or 3b...” unless otherwise exempt.<sup>9</sup> Accordingly, unless specifically referenced, services are not taxable under the UTA. Tangible personal property under the UTA includes “prewritten computer software.”<sup>10</sup> The “price” or “purchase price” under the UTA includes “charges by the seller for any services necessary to complete the sale” (unless otherwise excepted) as well as “delivery charges incurred or to be incurred before the completion of the transfer of ownership of tangible personal property from the seller to the purchaser.”<sup>11</sup> The use tax and sales tax are “complementary” and “supplementary” such that absent an exception, tangible personal property sold and used in Michigan “is subject to both use and sales tax.”<sup>12</sup>

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<sup>2</sup> MCL 205.52(1).

<sup>3</sup> MCL 205.51a(r). “Prewritten computer software” means “computer software, including prewritten upgrades, that is delivered by any means and that is not designed and developed by the author or other creator to the specifications of a specific purchaser. Prewritten computer software includes the following: (i) Any combination of 2 or more prewritten computer software programs or portions of prewritten computer software programs[;] (ii) Computer software designed and developed by the author or other creator to the specifications of a specific purchaser if it is sold to a person other than that specific purchaser[;] [and] (iii) The modification or enhancement of prewritten computer software or portions of prewritten computer software where the modification or enhancement is designed and developed to the specifications of a specific purchaser unless there is a reasonable, separately stated charge or an invoice or other statement of the price is given to the purchaser for the modification or enhancement. If a person other than the original author or creator modifies or enhances prewritten computer software, that person is considered to be the author or creator of only that person's modifications or enhancements.” MCL 205.51a(p).

<sup>4</sup> MCL 205.51(c)-(d).

<sup>5</sup> *Catalina Marketing Sales Corp v Mich Dep't of Treasury*, 470 Mich 13, 19 (2004) (“*Catalina*”).

<sup>6</sup> The UTA defines “use” as the “exercise of a right or power over tangible personal property incident to the ownership of that property including transfer of the property in a transaction where possession is given. Converting tangible personal property acquired for a use exempt from the tax levied under this act to a use not exempt from the tax levied under this act is a taxable use.” MCL 205.92(b). The key feature in determining whether a party exercises a right or power over tangible personal property is “whether the party had some level of control over that property.” *Auto-Owners Ins Co v Dep't of Treasury*, 313 Mich App 56, 70 (2015) (“*Auto-Owners*”).

<sup>7</sup> The UTA defines “storage” to mean “a keeping or retention of property in this state for any purpose after the property loses its interstate character.” MCL 205.92(c).

<sup>8</sup> Because the UTA does not define the terms “consumption” or “consuming,” they are to be interpreted in accordance with their plain and ordinary meaning. It is proper to consult a dictionary to ascertain their plain and ordinary meaning. See MCL 8.3a and *ADVO-Sys, Inc v Dep't of Treasury*, 186 Mich App 419, 424 (1990).

<sup>9</sup> MCL 205.93(1); Under MCL 205.93a and 205.93b, the consumption of certain services are taxed in the same manner as tangible personal property is taxed under the UTA.

<sup>10</sup> MCL 205.92(k). “Prewritten computer software” is defined in the same manner as under the GSTA. See MCL 205.92b(p).

<sup>11</sup> MCL 205.92(f).

<sup>12</sup> *Andrie Inc v Dep't of Treasury*, 496 Mich 161, 167-168 (2014).

In the context of prewritten computer software “delivered in any matter,” the imposition of use tax was decided in *Auto-Owners*. The Court in *Auto-Owners* determined that the “mere transfer of information and data that was processed using the software of the third-party business did not constitute delivery by any means of prewritten computer software” so such transactions were not taxable under the UTA.<sup>13</sup> Under *Auto-Owners*, where all the computer code remains on a third-party server, is controlled and maintained by the third party, and the third party updates the code as it sees fit, the mere access of the computer code in a limited manner does not signify ownership to create a taxable use under the UTA.<sup>14</sup> On the other hand, the Court in *Auto-Owners* reasoned that if a taxpayer “exercise[s] control over a set of coded instructions that [is] conveyed or handed over by any means and [is] not designed and developed by the author or other creator to the specifications of a specific purchaser,” the transaction would be taxable under the UTA.<sup>15</sup>

In summary, the right to access/use prewritten computer software (e.g., cloud computing) will generally not be subject to sales or use tax if the consumer does not receive either a copy of the software program or any part of the program’s computer code. If a software program is electronically downloaded in its entirety, it will be taxable. If only a portion of a software program is electronically delivered to a customer (such as a “desktop agent” or “local client”), the “incidental to service” test adopted by the Michigan Supreme Court in *Catalina* will be applied to determine whether the transaction constitutes a rendition of a nontaxable service rather than the sale of tangible personal property.

Under *Catalina*, if a transaction is principally the transfer of taxable tangible personal property or taxable service(s), the entire transaction will be considered subject to sales or use tax. On the other hand, if the transaction is principally the transfer of exempt tangible personal property or exempt service(s), the entire transaction will be exempt from the sales and use tax. The *Catalina* “incidental to services” test examines the *totality* of the transaction objectively to determine whether it is subject to use tax by applying the following six factors:

1. What the buyer sought as the *object* of the transaction;
2. What the seller or service provider is in the *business of doing*;
3. Whether the goods were provided as a retail enterprise with a *profit-making motive*;
4. Whether the tangible goods were *available for sale without the service*;
5. The extent to which intangible services have *contributed to the value* of the physical item that is transferred, and;
6. Any *other factors relevant* to the particular transaction.

While all these six factors need to be considered, the Department holds that the first factor bears the most weight.<sup>16</sup>

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<sup>13</sup> *Auto-Owners* at 72-73.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.* at 71.

<sup>16</sup> See RAB 2015-25, p 3.

**Conclusion.** Applying the GSTA and UTA, and considering the *Catalina* and *Auto-Owners*' decisions, the following table summarizes the Department's determination of the likely tax treatment for each of the following transactions, services, and/or revenue streams for which Taxpayer seeks a determination from the Department:

<b>Transactions (Revenue Category)</b>	<b>Taxpayer's Proposed Tax Treatment</b>	<b>Likely Tax Treatment</b>
1. Abstraction Services – Data Processing <sup>17</sup>	<i>Exempt</i>	<i>Exempt</i>
2. Abstraction Services Research & Oncology Data Services <sup>18</sup>	<i>Exempt</i>	<i>Exempt</i>
3. Audit Services <sup>19</sup>	<i>Exempt</i>	<i>Exempt</i>
4. Audit Management Services <sup>20</sup>	<i>Exempt</i>	<i>Exempt</i>
5. Data Processing <sup>21</sup>	<i>Exempt</i>	<i>Exempt</i>
6. Data Storage – Electronic <sup>22</sup>	<i>Exempt</i>	<i>Exempt</i>
7. Data Storage – Physical <sup>23</sup>	<i>Exempt</i>	<i>Taxable</i>
8. Denial Management Services <sup>24</sup>	<i>Exempt</i>	<i>Exempt</i>
9. Postage (USPS)	<i>Exempt</i>	<i>Taxable</i>
10. Shipping Charges (FedEx, other courier)	<i>Exempt</i>	<i>Taxable</i>
11. Shipping and Handling Charges	<i>Exempt</i>	<i>Taxable</i>
12. Pass Through <sup>25</sup>	<i>Exempt</i>	<i>Exempt</i>
13. Information Services <sup>26</sup>	<i>Exempt</i>	<i>Exempt</i>
14. Labor – Special Projects <sup>27</sup>	<i>Exempt</i>	<i>Exempt</i>
15. Labor – Department Outsource <sup>28</sup>	<i>Exempt</i>	<i>Exempt</i>
16. Photocopy Fees – Electronic <sup>29</sup>	<i>Exempt</i>	<i>Exempt</i>
17. Photocopy Fees	<i>Exempt</i>	<i>Taxable</i>
18. Record Retrieval <sup>30</sup>	<i>Exempt</i>	<i>Exempt</i>
19. Scanning <sup>31</sup>	<i>Exempt</i>	<i>Taxable and Exempt</i> <sup>32</sup>

<sup>17</sup> Fee for employees reviewing and entering key clinical data into a clinical database or EMR. Electronic reports of abstraction services and ODS/research services.

<sup>18</sup> Professional services associated with reviewing and entering clinical data to meet key markers for research projects and cancer registries.

<sup>19</sup> Professional services to review prior coding determinations and correct or reclassify to more appropriate medical coding. Separate charge for a written report of audit services.

<sup>20</sup> Fees for accessing a database to manage EMR for audit review by various agencies.

<sup>21</sup> Fee for converting and updating EMR to new EMR.

<sup>22</sup> Fee for storage of electronic records on Taxpayer's servers.

<sup>23</sup> Fee for physical storage of records (paper, media, CD, roll film, microfiche, VHS tapes, X-rays) for customer.

<sup>24</sup> Charges associated with appealing denials of charges and associated recoding of billings for resubmission.

<sup>25</sup> Reimbursement of direct costs in obtaining medical records from other medical records providers.

<sup>26</sup> Fee for importation of data from provider to Taxpayer's system and exportation of data out of Taxpayer's system to provider. No additional services rendered.

<sup>27</sup> Charges for special labor incurred conducting special projects where the work is directed by the customer typically on an hourly basis.

<sup>28</sup> Charges associated with the outsource and management of a facility records management function – work not directed by customer.

<sup>29</sup> Charges for reproducing health records based on a per copy charge. Copies are electronic utilizing the method of fax or electronic delivery via FTP (standard protocol).

<sup>30</sup> Labor and other fees for search, retrieval and delivery of medical records including adding an item to a currently stored item, placing a retrieved item back into place and obtaining specific information from a retrieved item.

<sup>31</sup> Fee for paper charts and records scanned into repository or other storage/database solutions; set up fees, per keystroke cost and fees for indexing and burning records to CD's or DVD's.

20. Software as a Service (SaaS) <sup>33</sup>	<i>Exempt</i>	<i>Not Determinable</i> <sup>34</sup>
21. Software Training <sup>35</sup>	<i>Exempt</i>	<i>Not Determinable</i> <sup>36</sup>
22. Late Fees	<i>Exempt</i>	<i>Exempt</i>
23. Medical Records Coding <sup>37</sup>	<i>Exempt</i>	<i>Exempt</i>
24. Coding Audit Report of Findings <sup>38</sup>	<i>Exempt</i>	<i>Exempt</i>
25. Professional Services (configuration of electronically delivered services) <sup>39</sup>	<i>Exempt</i>	<i>Not Determinable</i> <sup>40</sup>

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<sup>32</sup> These charges may be taxable or exempt depending on the given facts. Based on Taxpayer's description, charges related to the burning of the information to a CD or DVD (i.e., tangible personal property) would be taxable.

<sup>33</sup> Charges for subscription access to software and services not licensed to customers which allow facilitation of retrieval of records.

<sup>34</sup> The facts presented are insufficient for the Department to make a determination under *Auto-Owners* and *Catalina*.

<sup>35</sup> Online support and training related to software that resides on Taxpayer's servers. Implementation and integration services for customer systems to access Taxpayer's systems.

<sup>36</sup> The facts presented are insufficient for the Department to make a determination under *Auto-Owners* and *Catalina*. For example, charges for technical support (if optional and separately stated on the invoice) would be exempt. Other hand, prewritten computer software installed on a user's desktop to aid in fixing problems would be taxable.

<sup>37</sup> Labor to perform medical coding and providing quality and productivity reports monthly.

<sup>38</sup> A report that reviews the number of records reviewed, types of records and coding quality and documentation findings.

<sup>39</sup> Configuration of electronically delivered software.

<sup>40</sup> The facts presented are insufficient for the Department to make a determination under *Auto-Owners* and *Catalina*. It is unclear, for example, if this is related to software maintenance contracts.