Cite as Det. No. 15-0328R, 36 WTD 538 (2017)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 15-0328R
. . .	)	Registration No. . . .

[1] RCW 82.08.190(4)(c): BUNDLED TRANSACTIONS – DE MINIMIS EXCLUSION. A transaction that includes distinct taxable products and nontaxable products sold for one non-itemized price is not a bundled transaction if the price of the taxable products is de minimis. De minimis means that either the purchase price of the taxable products is ten percent or less of the total purchase price of the bundled products, or the sales price of the taxable products is ten percent or less of the total sales price of the bundled products, measured over the full term of a contract.

[2] RCW 82.08.190(4)(b): BUNDLED TRANSACTIONS – TRUE OBJECT EXCLUSION. A transaction that includes distinct retailing services and non-retailing services sold for one non-itemized price is not a bundled transaction if the retailing service is essential to the non-retailing service; the retailing service is provided exclusively in connection with the non-retailing service, and the true object of the transaction is the non-retailing service.

[3] RCW 82.08.195(1); RCW 82.12.195(1): BUNDLED TRANSACTIONS – RETAIL SALES TAX OR USE TAX APPLIES. A bundled transaction is subject to retail sales tax if the retail sale of any of its component products would be subject to retail sales tax. Similarly, the use of each product acquired in a bundled transaction is subject to use tax if the use of any of the component products is subject to use tax.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Poley, T.R.O. – A healthcare services provider petitions for reconsideration of Det. No. 15-00328, which held that the provider was liable for use tax on a contract for information technology and software support services, because neither the de minimis exclusion nor the true object exclusion from the definition of a bundled transaction applied. The petition for reconsideration is denied.[1]

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

ISSUE

Is the sale of information technology and software support services [to the taxpayer] a bundled transaction subject to retail sales tax or use tax under RCW 82.08.195 and 82.12.195, [where some of the information technology products and support services qualified as a retail sale under RCW 82.04.050 and were sold together with the non-retail services at one non-itemized price]?

FINDINGS OF FACT

. . . (Taxpayer) is a professional limited liability company that formed in 1997. Taxpayer operates three medical facilities, providing a broad range of outpatient healthcare services. Taxpayer maintains a data center with 45 servers, located off-site but connected to each facility via fiber optic cable. Taxpayer purchases software from third parties, then installs the software on its servers. Taxpayer's employees access the software using varying types of computer hardware, such as desktop terminals, tablets, and smart phones.

Taxpayer's primary software program, [Primary Software], is owned and maintained by [Healthcare]. [Primary Software] coordinates electronic medical records and patient billing. Taxpayer also uses additional software programs to operate its medical facilities, allowing it to communicate with patients, access the internet, view diagnostic and laboratory results, interact with insurance companies and pharmacies, send and receive documents securely, and perform other business activities, such as word processing.

To manage the data center servers, software, and hardware, Taxpayer contracted with an information technology vendor, [Vendor 1]. [Vendor 1] managed Taxpayer's information technology from January 2010 through December 2011, at which point [Vendor 1] went out of business. Taxpayer then contracted with [Vendor 2] from January 2012 through July 2013. On its website, [Vendor 2] states it was formed in 2007 by a group of physicians to "provide expert technical support and implementation guidance for the [Healthcare Primary Software] product." About [Vendor 2] . . . (last visited Nov. 14, 2012).[2] [Vendor 2] also offers 15 different services, such as help desk services, asset reporting, patch management, project management, hosting solutions, and interface development. Services at [Vendor 2] . . . (last visited Nov. 14, 2012).

Both [Vendor 1] and [Vendor 2] provided Taxpayer with help desk availability, technical support, and network system support services, as well as installation of software updates and computer hardware maintenance. In exchange for these services, Taxpayer paid [Vendor 1], and later [Vendor 2], a flat, non-itemized, monthly fee. Neither vendor charged retail sales tax on the monthly fee.

In 2014, the Department of Revenue (Department) investigated Taxpayer's activities from January 1, 2010, through December 31, 2013. The Department found that the services provided under the vendor contracts were a bundled transaction subject to retail sales tax. As Taxpayer did not pay retail sales tax on the monthly fees, the Department determined Taxpayer was liable for use tax on

[2] [Vendor 2's] parent company . . . has since dissolved, and the [Vendor 2] website is no longer maintained or published. A digital record of the entire website as it appeared on November 14, 2012, is available through www.archive.org.

the monthly fees paid under the contracts. On June 29, 2015, the Department issued a tax assessment against Taxpayer for $ . . . in use tax and $ . . . in interest, for a total of $ . . . .

Taxpayer claims that the vendor contracts fall under two exceptions to the bundled transaction rule. First, Taxpayer claims that the portion of its vendor contracts subject to retail sales tax is de minimis compared with the portion not subject to retail sales tax. Second, Taxpayer claims that the true object of the vendor contracts is non-retailing technology support services and thus the entire contract is not subject to retail sales tax.

In support of its arguments, Taxpayer provided copies of the following documents:

1. [Healthcare] change order, software license and maintenance agreement for [Primary Software];
2. [Healthcare] renewal letter, describing software license and maintenance agreement and upcoming price increase;
3. [Healthcare] annual support renewal;
4. [Vendor 2] data hosting and support services agreement (Agreement);
5. [Vendor 2] trouble ticket log (Log), showing service requests completed for Taxpayer; and
6. Letters from . . . , former director of [Vendor 2] (Letters).

The three documents from [Healthcare] ([Healthcare] Documents) indicate that Taxpayer purchased [Primary Software] software from [Healthcare] along with licenses to use the software.[3] Each license is valid for one medical provider for one year. The [Healthcare] Documents also show that Taxpayer purchased a monthly software support and services package from [Healthcare], which entitles Taxpayer to software maintenance, updates, and upgrades for [Primary Software].

The Agreement states that [Vendor 2] has support service capabilities and wishes to assist Taxpayer with management of electronic medical records systems related to [Primary Software]. Under the Agreement, [Vendor 2] will provide two full time equivalent employees to assist Taxpayer with [Primary Software], related computer systems, and other data center issues. The fee for this arrangement was a flat $ . . . per month. The Agreement did not state how the fee was divided among tasks or workers.

Two technicians, employees of [Vendor 2], were physically stationed at Taxpayer's data center and would travel to Taxpayer's different facilities as needed. Taxpayer maintains that its business cannot endure an unavailable network or server. Thus, Taxpayer claims, the two [Vendor 2] employees were hired to monitor the data center and network systems, maintain vendor relationships, anticipate and correct problems before they impacted Taxpayer's operations, and respond to Taxpayer's requests for assistance (referred to as "trouble tickets"). The [Vendor 2] employees would also undertake other tasks that support Taxpayer's objective of a continuously functioning network, such as consulting with Taxpayer regarding hardware and software upgrades, planning new projects, and installing software updates.

[3] The number of licenses purchased ranged from 39 to 70 depending on the year.

Section two of the Agreement explains, "[Vendor 2] shall provide application support services in connection with [Taxpayer's] license and use of the [Healthcare Primary Software] suite, including all required equipment located at the data center, infrastructure, and personnel support required for such services . . . described in Exhibit A . . . ." The Agreement also guarantees that "[Vendor 2] shall make the System available 24 hours per day, 7 days per week, 365 days per year . . . ."

Exhibit A of the Agreement, titled "Information Technology Full Outsource Solution," detailed the scope of services [Vendor 2] agreed to provide to Taxpayer[4]:

> [Vendor 2] will provide clinic with the full scope of IT services required to;
> - Maintain a healthy server infrastructure
>   - Pro-active system monitoring
>   - Regular maintenance and application of system updates, backups and downtime prevention measures
>   - Routinely work to optimize data center performance and security
> - Provide responsive helpdesk and on-site support
>   - Full software and hardware [desktop / laptop / tablet / thin] client support / break-fix
>   - Access to our helpdesk ticketing system
>   - 30 min response during production hours 7:30-5:30 / 60 mins during after-hours
>   - F/T Technicians stationed within greater Puyallup area
> - Provide IT Leadership
>   - Guidance for: Future technologies and updates, IT strategies, and ROI opportunities
>   - Communicated via regularly scheduled meetings
> - Provide project management
>   - Clinic and [Vendor 2] will agree on scope, complexity and time line of projects. Projects will be billed [Vendor 2] usual and customary amount for additional services. Project updates to be given across the length of the project including any situation that would cause the project time line to change.
> - Advise Regarding IT purchasing
> - Exceptions
>   - CPS application support, workflows, customizations and processes shall be maintained by the clinic in house CPS system managers
>   - [Vendor 2] has the capacity and desire to provide this support at an additional hourly rate.
>   - Anomalous / Complex Microsoft Support Cases
>   - Technical support from the above vendors is not free. In very rare cases its required to open a trouble ticket with a potential cost of up $400 / incident. Any such technical support expense will be passed through to Clinic at cost.

[4] The language quoted here is reproduced as it appears in Exhibit A, with no changes to spelling, grammar, or punctuation.

- Home Network Issues
  - This agreement does not guarantee support for Clinic user home or other offsite network connections, including; hotel, wifi hot spots and cellular broadband.
  - A reasonable effort will always be made to assist the end-user.

Exhibit B of the Agreement, titled "Client Responsibilities," states that Taxpayer "must provide a qualified application super user capable of managing Tier 1 application issues within [Primary Software]." The Agreement defines "Tier 1" as "basic support / onsite: changing passwords, adding users, basic break-fix etc. . . ." The Agreement also provided definitions for Tier 2 and Tier 3 level computer issues.

The Log lists all of Taxpayer's service requests, or trouble tickets, to [Vendor 2] between March 1, 2013, and July 29, 2013. During these five months, Taxpayer requested support service from [Vendor 2] 176 times, for a total of 139 hours and 35 minutes spent on Taxpayer's requests. Taxpayer has reviewed each request and identified which requests, in its opinion, involve retailing activities, such as installing prewritten software or fixing computer hardware. Taxpayer claims that 43 requests resulted in retailing activities, with 33 hours and 45 minutes spent on these requests. The Log does not account for the other activities the [Vendor 2] employees performed for Taxpayer – only the services provided through trouble tickets.

The Letters describe [Vendor 2's] service agreement with Taxpayer, its trouble ticket system, and its standard sales practices. [Vendor 2] states in the Letters that its service agreements are designed to be all inclusive. Taxpayer, however, had a fully operational data center for many years prior to contracting with [Vendor 2], and its major software programs, including [Primary Software], were well established. As a result, [Vendor 2] focused on maintaining the systems and infrastructure.

[Vendor 2] asserts that most of the trouble ticket requests are verbal solutions or established system adjustments that do not require hardware or software installation. Examples of these trouble ticket requests include granting an employee security access to certain computer systems, answering questions about the functionality of software, or configuring the different paper trays in a printer. [Vendor 2] estimates that only five percent of trouble tickets for all of its customers involve retailing activities, such as installing a new software package or replacing faulty hardware. Finally, [Vendor 2] maintains that it never sold retailing services, such as software installation, without a technical support or managed services agreement.

Taxpayer did not provide any documents relating to its contract with [Vendor 1]. However, Taxpayer maintains that the services provided by [Vendor 1] are essentially the same as the services provided by [Vendor 2].

Taxpayer filed a petition to review and correct the assessment of use tax, which we denied in Det. No. 15-0328. Taxpayer now petitions for reconsideration of Det. No. 15-0328, asserting legal error in our analysis of each exception to the bundled transaction rule.

ANALYSIS

Washington imposes retail sales tax on each retail sale in this state. RCW 82.08.020. The term "retail sale" encompasses many services that are relevant to this case. RCW 82.04.050 defines "retail sale" as "every sale of tangible personal property (including articles produced, fabricated, or imprinted) to all persons irrespective of the nature of their business . . . ." RCW 82.04.050(1)(a).

> The term "sale at retail" or "retail sale" includes the sale of or charge made for tangible personal property consumed and/or for labor and services rendered in respect to the following:
>
> (a) The installing, repairing, cleaning, altering, imprinting, or improving of tangible personal property of or for consumers . . . .
>
> . . .
>
> (g) The installing, repairing, altering, or improving of digital goods for consumers;

RCW 82.04.050(2). Retail sales tax also applies to "the sale of prewritten computer software to a consumer, regardless of the method of delivery to the end user." RCW 82.04.050(6)(a). It also applies to the right to access and use prewritten computer software. RCW 82.04.050(6)(b)(i).[5] In contrast, the sale of services, such as technical support, network system monitoring,[6] help desk response, remote diagnostic services, and consulting, are generally not included in the definition of "retail sale" and are taxable under the service and other activities B&O tax classification. WAC 458-20-15502(7)(d)(i).

Washington imposes a corresponding use tax on the privilege of using an article of tangible personal property in this state upon which retail sales tax has not been paid. RCW 82.12.020. Use tax applies to the above services that are defined as retail sales and to prewritten computer software. RCW 82.12.020(1)(b), (c).

Under RCW 82.08.195(1), a bundled transaction is subject to retail sales tax "if the retail sale of any of its component products would be subject to [retail sales] tax . . . ." RCW 82.08.190(1)(a) defines a "bundled transaction" as "the retail sale of two or more products . . . where: (i) [t]he products are otherwise distinct and identifiable; and (ii) [t]he products are sold for one nonitemized price." RCW 82.08.190(1)(a). The term "product" under these provisions is defined as "tangible

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[5] [Taxpayer purchased prewritten computer software from [Healthcare]/third-party vendors and not [Vendor 2]. We include this in our discussion of the relevant law to fully explain the definition of "retail sale" as it relates to digital goods.]

[6] Under RCW 82.04.192(3) and WAC 458-20-15503(203), if a computer program monitors the network, then the monitoring would be considered a digital automated service, a retailing activity. If an employee monitors the network primarily through human effort, then the monitoring would be a non-retailing service. *Id*. We do not have enough information before us to conclude what kind of network system monitoring occurred here, and thus decline to do so. For purposes of this determination, however, we will assume that [Vendor 2's] monitoring activity was a non-retailing service.

personal property, digital goods, digital codes, digital automated services, other services, extended warranties, and anything else that can be sold or used." RCW 82.32.023.

In this case, [Vendor 2] provided Taxpayer with several distinct and identifiable products listed in Exhibit A of the Agreement, only some of which fall within the definition of "retail sale."[7] Taxpayer obtained all of these services for one nonitemized price of $ . . . per month. Because, under the Agreement, [Vendor 2] sold Taxpayer a combination of products at a nonitemized monthly price, the Agreement meets the definition of a bundled transaction.

However, there are two relevant exclusions from the definition of a bundled transaction. RCW 82.08.190(4) provides:

> A transaction that otherwise meets the definition of a bundled transaction is not a bundled transaction if it is:
>
> . . .
>
> (b) The retail sale of services[8] where one service is provided that is essential to the use or receipt of a second service and the first service is provided exclusively in connection with the second service and the true object of the transaction is the second service; or
>
> (c) A transaction that includes taxable products and nontaxable products and the purchase price or sales price of the taxable products is de minimis;
>
> (i) As used in this subsection (4)(c), de minimis means the seller's purchase price or sales price of the taxable products is ten percent or less of the total purchase price or sales price of the bundled products;
>
> (ii) Sellers shall use either the purchase price or the sales price of the products to determine if the taxable products are de minimis;
>
> (iii) Sellers shall use the full term of a service contract to determine if the taxable products are de minimis; . . . .

Taxpayer claims the Agreement is not a bundled transaction under either one of these exclusions.

As we stated in Det. No. 15-0328, we are unable to accurately determine whether the price of the taxable products sold in the Agreement constituted ten percent or less of the total contract price. Taxpayer has provided a breakdown of [Vendor 2's] retailing and non-retail activities tracked in the Log. [The Statute requires us to rely on purchase or sales price information for the taxable

[7] [Those products which fall within the definition of "retail sale" include computer program monitoring the network, such as pro-active system monitoring, regular maintenance and application of system updates, backups and downtime prevention measures, and routine work to optimize data center performance and security. RCW 82.04.050(6)(a)]

[8] When RCW 82.08.190(4) uses the term "retail sale of services," it is referencing those items included in the definition of "retail sale" in RCW 82.08.010(11).

products.] Because we cannot calculate the percentage [under the statute,] we find that the Agreement does not qualify for the exclusion from the definition of a bundled transaction under RCW 82.08.190(4)(c).[9]

Turning to the true object exclusion found in RCW 82.08.190(4)(b), a combination of bundled services ceases to be a bundled transaction if it meets a three-part test: 1) the retailing activity is essential to a non-retailing service, 2) the retailing activity is provided exclusively in connection with the non-retailing service, and 3) the true object of the transaction is the non-retailing service. *Id*. The Agreement must meet all three parts of this test in order to be excluded from taxation as a bundled transaction. *See* RCW 82.08.195(2).

The first question for us to decide is whether [Vendor 2's] retailing activities, namely software installation, system updates, and on-site hardware maintenance, are "essential" to the use or receipt of the non-retailing services. The word "essential" in RCW 82.08.190(4)(b) is an undefined statutory term. When a term in a statute is not defined, it will be given its ordinary and common meaning. *John H. Sellen Construction Co. v. Dep't of Revenue*, 87 Wn.2d 878, 883, 558 P.2d 1342 (1976); Det. No. 04-0147, 23 WTD 369 (2004).

The dictionary defines the adjective "essential" as: "**2 a**: necessary, indispensable; **b**: unavoidable; **c**: important in the highest degree; **d**: minimal but fundamental to achievement of an end." *Webster's Third New International Dictionary,* 777 (1993). When used as a noun, the dictionary defines "essential" as: "**a**: something basic or fundamental esp. belonging to or forming part of the minimal indispensable body, character, or structure of a thing; **b**: something necessary, indispensable, or unavoidable." *Id.*; *see, e.g.*, Det. No. 11-0006, 32 WTD 7 (2013).

Here, the installation of software or software updates is not essential to use or receive help desk services. The nature of help desk services does not require the provider of such services to perform software installation or updates. Many help desk vendors will limit their services to answering questions, troubleshooting, and advice on how to obtain further assistance.[10] Taxpayer claims that it was necessary and unavoidable for [Vendor 2] to install software and software updates in order to provide help desk services. However, [Vendor 2] could have instructed an employee of Taxpayer's how to install software. [Vendor 2 also] could have referred software installation and updates to Taxpayer's designated Tier 1 employee, which Taxpayer is required to provide under Exhibit B of the Agreement.

Similarly, the installation or repair of computer hardware is not essential to use or receive network system monitoring. The act of monitoring only refers to skills of observation. An individual who monitors a network has numerous potential actions to take in response to a negative observation, such as making notes in a log, alerting another person and awaiting instructions, requesting repair from another person, or repairing the network outright; none of these potential actions is essential

[9] [Our holding in this case does not imply that the Department would accept a taxpayer's calculation of the percentage of time spent on retailing and non-retailing activities as a viable alternative to using documentation of the "purchase price" or "sales price" when determining whether the de minimis exception in RCW 82. 82.08.190(4)(c) applies.]

[10] *See* www.dataprise.com/it-services/help-desk, http://www.ghdsi.com/Help_Desk_Outsourcing.html, or https://www.continuum.net/products/rmm-software/it-help-desk for examples of vendors that offer help desk services without software installation.

to monitoring a network. . . . Taxpayer criticizes the Department's "overly literal" interpretation of the term "essential"; however, the record before us does not suggest that Taxpayer's retail purchases at issue were essential to its receipt of network system monitoring or help desk services. Moreover, nothing prohibits a vendor of network system monitoring from also offering hardware repair and installation, but the repair and installation are not essential to the monitoring.

Finally, Taxpayer argues that there is no point in hiring a vendor for technical support services if the vendor cannot perform each and every technical support activity asked of them, including retailing activities. But [Vendor 2] recognized that it couldn't perform every support activity that Taxpayer might need, which is why it stated in Exhibit A of the Agreement that Taxpayer would be responsible for any charges incurred due to assistance from other vendors, such as Microsoft.

For all of the above reasons, [Vendor 2's] retailing activities were not essential to the use or receipt of its allegedly non-retailing services. Because we find that the Agreement does not meet the first requirement of RCW 82.08.190(4)(b), we need not address the remaining requirements. The Agreement is not excluded from the definition of a bundled transaction.

A bundled transaction is subject to retail sales tax if the retail sale of any of its component products would be subject to retail sales tax. RCW 82.08.195(1). Since some of the products in the Agreement would be subject to retail sales tax if sold separately, the entire bundled transaction is subject to retail sales tax. Likewise, the use of each product acquired in a bundled transaction is subject to use tax because the use of any of the component products is subject to use tax. RCW 82.12.195(1).

Based upon the above analysis, we conclude that the services provided in the Agreement are a "bundled transaction" under RCW 82.08.190(1)(a). Because the retailing activities provided to Taxpayer under the Agreement are subject to retail sales tax or use tax, under RCW 82.08.195(1) and RCW 82.12.195(1), Taxpayer is liable for use tax on all fees paid under the Agreement.

DECISION AND DISPOSITION

Taxpayer's petition for reconsideration is denied.

Dated this 11th day of January 2017.