Private Letter Ruling No. 06-010
Redacted Version
Sales Tax
Sales and Use Tax Treatment of Medical Imaging Equipment
July 24, 2006

Facts

Guidance was requested regarding the sales and use tax treatment of sales of durable medical imaging equipment to be installed into a Louisiana hospital sold by a vendor with sufficient Louisiana contacts to support jurisdiction. The vendor, (Vendor), sought guidance from the Department of Revenue as to the application of La. R. S. §§47:302, 321, and 331 and La. Civ.Code Ann. art 466 to the sale of its medical imaging equipment, especially in light of the recent decision in *Willis-Knighton Medical Center v. Caddo-Shreveport Sales and Use Tax Commission* [1]and the legislative response to the decision.

The Department has issued *Private Letter Ruling No.02-003* (March 11, 2002) regarding the application of the sales tax to magnetic resonance imaging scanners and *Private Letter Ruling No. 03-005* (March 17, 2003) regarding the application of the sales tax to already-installed durable medical equipment. Both rulings address the type of equipment at issue in this request, but the relevant facts are distinguished. Vendor's equipment attachment and contract terms differ from those described in *Private Letter Rulings No. 02-003 and 03-005*.

Vendor designs and manufactures the medical imaging equipment to perform a specific function in a standard, reliable and predictable way. The equipment is mass-produced and is not manufactured to a specification supplied by the customer. However, customers do choose different configurations of the equipment based upon their varying needs. Any equipment options above the base offering, such as additional monitors or specialized attachments, are at the discretion of the purchaser.

The sales agreement provides for the sale and installation of the equipment. The sales price is a fixed lump-sum amount. The cost of installation is typically 1% to 3% of the sale amount. Under the contract, title and risk of ownership of the MRI equipment passes from Vendor to its customers at Vendor's shipping dock.[2] Although the sales contract includes Vendor's installation of the equipment, customers are not required to use Vendor to install the equipment. However, should the customer decide not to use Vendor to install the equipment, Vendor will not ratably reduce the lump sum agreed to by both parties for the sale of the equipment.

Installation involves calibrating the equipment, securing electrical power, connecting the control systems to the hardware with cabling, connecting the equipment to a base, and customer training. The equipment consists of numerous identifiable and distinct pieces. The typical system arrangement consists of a major core (magnet or detector), patient table, central computer and control systems, power cabinet, and a cooling cabinet. All of these pieces are typically free standing except for the core and patient table that are bolted to the floor for stability. Due to the size and/or weight of these pieces, they must be secured to a base to insure patient and operator

[1] 903 So.2d 1071(La. 4/1/05).

[2] For discussion and analysis purposes only, we presume the shipping dock is in Louisiana. In this case the dock is not in Louisiana and it is determined that the sale has occurred outside of Louisiana. The vendor is obligated to collect vendor's use tax due in Louisiana, unless an exemption applies, on the retail value when the machinery is brought into the state to be installed into the hospital facility.

safety. However, all of the equipment can be readily detached with no substantial harm to the equipment or the building. The entire installation or de-installation process may only consume one to three days excluding calibration testing and customer training.

The equipment requires a protected electric power source and may require water, drain, and vent utilities. Vendor completes the electrical connection from the power cabinet, which contains the power control equipment, to a main disconnect panel that is installed by the customer. Vendor does not install nor wire the main disconnect panel to the facility electrical system. A few systems may require an outside air vent to expel excess gas. The vent tube connection from the machine to the facility is not permanent and is attached solely by a temporary vent-glass wrap secured by four removable hose clamps. A water source may be required for the cooling system but typically only for the initial cooling system filling. The cooling system is usually a closed-loop system and does not rely on the water connection during operation. Connection to the water source may be maintained for emergency back-up service at the discretion of the customer.

Most of the equipment requires an area that is free from interference from radio and magnetic waves. The equipment may also produce waves that are unhealthy to the operator. The customer is responsible for providing this radiation, magnetic, and RK protective environment for the equipment and its operators. The RF and magnetic shielding planes must be removable or adjustable to maintain an effective barrier. The shield may or may not be permanently attached to the buildings and should be removable to permit access to the equipment. Equipment that produces waves that are unhealthy to the operators requires the facility to be lined with protective material. This material is offered as an option but is sold without installation. Vendor does not provide advice in terms of minimum radiation protection. All protective measures are the responsibility of the customer. The minimum requirements for operating the equipment are provided to the customer in a pre-installation guide. The customer engages and directs the appropriate contractors to make all necessary structural and facility preparations. Vendor has no role in the construction or renovation of the customer's facility. Other than the bolting of the components that must be bolted into the floor for stability and the calibration done by Vendor after installation, all of the setting up of the systems necessary to enable the machinery to function as intended is provided by the customer. These "rigging or site preparation services" are not part of the sales contract with Vendor and are completed by the customer prior to installation

The equipment is typically crated and transported to the customer's location via truck. The equipment gantry and patient tables are then maneuvered through the facility on a dolly and set into place. The heaviest magnet may be lowered by crane through a removable opening in the facility roof. The hospital must provide the removable opening and rigging services. The removable opening should be retained for future repairs and equipment removal.

Issue

Is the medical imaging equipment sold by Vendor properly subject to Louisiana sales or use taxes?

Law and Analysis

Sales tax is imposed on "any transfer of title or possession, or both, exchange, barter, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property, for a

consideration."[3] Therefore, in situations where an item of tangible personal property is brought into Louisiana to be installed into an immovable, one must analyze whether the item is movable or immovable at the moment of the incidence of taxation to determine the proper tax treatment.

When a vendor of tangible personal property incorporates or attaches the property to an immovable prior to the transfer of ownership, no sales tax is due by the purchaser. This is because the purchaser is taking possession of immovable property upon which the sales tax is not imposed. Although a sales tax is not collectible from the purchaser of immovable property in these circumstances, a sales or use tax is still due to the state for the value of the (formerly) tangible personal property over which the vendor has exercised use and control. The tax will be collectible from the vendor and can either take the form of a sales tax or a use tax.

If the vendor purchased the (formerly) tangible personal property within Louisiana, then a sales tax would have been due upon the sales transaction, providing no other exemption or exclusion applied. If the sales tax was not paid on the initial acquisition of the tangible personal property purchased within Louisiana but was later used or consumed in a Louisiana sales transaction, then a use tax will be due on the "cost price," based on the lower of the actual cost or the reasonable market value of the tangible personal property, whichever is less.[4]

A use tax will also be due by the vendor if the (formerly) tangible personal property was purchased outside of the state and then brought into the state for use or consumption in a Louisiana transaction. As described above, the use tax will be due on the "cost price," the lower of the actual cost or the reasonable market value of the tangible personal property, whichever is less. Once the appropriate "cost price" is calculated under the guidelines established in § 47:301(3)(a), the vendor is responsible for remitting the use tax to the Department of Revenue. In some instances, however, contracts may provide for indemnification allowing vendors to recover from the purchaser any taxes that may arise as a result of the implementation of the contract terms.

In the facts at hand, the title and risk of ownership of the MRI equipment passes from Vendor to its customer at Vendor's shipping dock, long before the installation of the equipment occurs. At the time that the title passes, the equipment is clearly corporeal movable property, as defined in La. Civ. Code Ann. art. 471 as a thing, whether animate or inanimate, that physically exists and normally moves or can be moved from one place to another. The Louisiana Supreme Court ruled in *City of New Orleans v. Baumer Foods, Inc.*, 532 So.2d 1381 (La. 1988), that tangible personal property is equivalent to corporeal movable property. Since there is no indication that any other exemption or exclusion to taxation applies in your summary of the facts, the Department finds that sales tax is due on the sales price of the MRI equipment. Because the contract is a lump sum contract with no itemization for each element of the contract, the entire cost would be taxable.

In the event that the contract did not state that title passed at the shipping dock (and therefore a sale clearly occurred), the transaction could still be taxable under two different theories: 1) if the MRI machinery was brought into the state of Louisiana as tangible personal property by Vendor for its use to fulfill its contractual obligations with the hospital, Vendor would be liable for the

[3] La. Rev. Stat. Ann. § 47:301(12).
[4] La. Rev. Stat. Ann. § 47:301(3)(a).

payment of use tax equal to the cost price of the machinery less applicable credits;[5] or 2) if the installed MRI equipment did not become a component part of the underlying immovable hospital structure, the hospital would be liable for sales tax on the retail sales price. Although, the Department will not specifically go into the use tax issue in this ruling, we briefly touch on how we would rule on the issue of whether or not the MRI equipment are component parts under current La. Civ. Code Ann. art. 466.[6]

La. Civ. Code Ann. art.466 *Component parts of an immovable* provides:

> Things permanently attached to an immovable are its component parts.
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> Things, such as plumbing, heating, cooling, electrical or other installations, are component parts of an immovable as a matter of law.
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> Other things are considered to be permanently attached to an immovable if they cannot be removed without substantial damage to themselves or to the immovable or if, according to prevailing notions in society, they are considered to be component parts of an immovable.

Article 466 sets forth two mutually exclusive tests, hereinafter set forth as Test 1 and Test 2, to determine if an item attached to an immovable is a component part of the immovable, such that it should be treated as immovable for tax purposes.

The first test addresses property referred to as "immovable as a matter of law." If an item clearly falls within one of the categories listed (plumbing, heating, cooling, electrical or other installations), facility of removal is immaterial, and the item is deemed immovable by its component part status. Since the MRI machinery is clearly not a cooling, heating, or plumbing installation, the only question is whether or not the MRI machinery qualifies as an "electrical or other installation." These terms are not defined.

In Article 466, all the other listed items are systems actually running throughout the immovable structure and functioning as a whole to make the entire structure usable for its intended purpose. In contrast, the MRI machinery is confined to a specific portion (room or series of rooms) of the medical facility and does not run throughout the entire facility. In addition, the MRI machinery is not constantly functioning and does not affect portions of the immovable property other than the room or rooms in which it is physically housed. Unlike plumbing, heating and air conditioning systems and the hardwiring of lights into the wall of a residential dwelling, if an MRI machine were removed from a medical facility, such removal would not render the hospital or medical

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[5] This assertion presumes the vendor is subject to personal jurisdiction in Louisiana.

[6] Prior to the Louisiana Supreme Court's decision in *Willis-Knighton Medical Center v. Caddo-Shreveport Sales and Use Tax Commission*, 903 So.2d 1071 (La. 4/1/05), and the subsequent legislative amendment to La. Civ. Code Ann.art 466, much confusion existed as to the application of the former La. Civ. Code Ann. art 466. In *Willis Knighton*, the Louisiana Supreme Court attempted to clearly enunciate the proper interpretation of the former code article, finding both paragraphs under the old articles had to be met for an item to be considered a component part and dispensing with the jurisprudentially-created societal expectation test. In response to the court's ruling, the Legislature immediately responded by amending La. Civ. Code Ann. art. 466.

facility unable to operate. Such removal would just mean the facility would not be able to perform MRI scans on patients.

In the Louisiana Civil Code, prior to the 1978 revisions, a more exhaustive listing of examples of property considered immovable as a matter of law was provided. The former La. Civ. Code Ann. art. 467 read as follows:

> Wire screens, water pipes, gas pipes, sewerage pipes, heating pipes, radiators, electric wires, electric and gas lighting fixtures, bathtubs, lavatories, closets, sinks, gasplants, meters and electric light plants, heating plants and furnaces, when actually connected with or attached to the building by the owner for the use or convenience of the building are immovable by nature.

In no case does the property listed in the former article represent extraordinary or non-standard property. In *Coulter v. Texaco*, 117 F.3d 909 (5th Cir.1997), the court explained that the unique nature of a drilling platform excluded it from the list of enumerated items even though it had electrical and plumbing connections. The rationale was that the petroleum and gas industry did not view the equipment as an "electrical or other installation." The drilling platform, due to its uniqueness from the items in the enumerated list, did not qualify as a component part of an immovable under Test 1. The aforementioned case establishes the principle that property of an uncommon nature and not facilitating building operation fails the first test. Removal of component parts, by their nature, renders a building or other immovable structure inoperable.[7] Under this rationale, the MRI equipment does not qualify as an electrical or other installation.

The second test for determining whether an item is considered permanently attached to an immovable may be met in one of two ways. First, if the item cannot be removed without damage to itself or the underlying immovable, it is considered a component part of the underlying immovable. Otherwise, the affixed item will be treated as "permanently attached" if it is considered to be a component part of an immovable according to prevailing notions of society.

Although the code article has been amended since the decision in *Willis-Knighton Medical Center v. Caddo-Shreveport Sales and Use tax Commission*, 903 So.2d 1071, 2004-0473 (La. 4/1/05), that case may still be instructive as to the application of the "substantial damage" analysis to the facts at hand. *Willis-Knighton* was a suit for refund of sales tax paid on repair services to installed nuclear camera machinery. In that case, one of the major issues was the characterization of the nuclear camera equipment as either movable or immovable. The court held that there would be no substantial damage to either the equipment or the hospital structure if the equipment were removed even though there was testimony that it would be necessary to repair sheet rock and floor tiles upon the removal of the equipment. In your situation, although there would be a need for some repair to the underlying immovable after the MRI is removed, the repair is not such that it can be considered as repairing "substantial damage" to the underlying immovable. Furthermore, the existence of a secondary market for used MRI equipment shows that there is no substantial damage to the removed MRI machinery itself.

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[7] See *Exxon Corporation v. Foster Wheeler Corporation*, 805 So.2d 432 (La. 2001).

The "societal expectations" test looks to whether the item to be classified is considered to be a component part of the underlying immovable under the prevailing notions of society. Although this test has been around for some time in the jurisprudence, it was only codified into the legislation dealing with component parts in the 2005 Regular Legislative Session. Historically, courts have had some difficulty in applying this test. The legislative pronouncement did not aid in determining what the proper application of this test is when dealing with non-residential, commercial installations of items that are of an uncommon nature. How the courts will apply the test in such circumstances as the case at hand is largely speculative.

In your facts, the sales agreement clearly describes the property as equipment and contains no reference to construction contracting as part of the activities to be performed. The equipment price is negotiated and clearly indicates that sales tax will be added to the invoice unless an exemption certificate is supplied. The parties to the agreement both agree to the terms dealing with taxation prior to execution. The clear intent of each party is to conduct commerce in regard to tangible personal property.

The tax policy of the health care industry supports the assertion that there is no intent for the MRI machines to become permanently attached even temporally. Since the time MRI technology was developed, retailers have charged, collected, and remitted the sales taxes as agent for the various Louisiana taxing authorities.

Furthermore, a vibrant secondary market exists for used imaging equipment. Vendor has a specific business operation dedicated to the removal and resale of used MRI equipment. With installation times of one to three days, and shorter de-installation times, this equipment can be quickly replaced or removed. When removed, it is usually sold to another party or may be upgraded and then resold. The removal, relocation, and remarketing of this technologically advanced equipment is commonplace and indicative of its movable nature.

There is significant leasing activity with MRI equipment. Because of its high initial cost and relatively quick obsolescence, many consumers choose to enter into lease arrangements with a finance or leasing company. All types of leases are available whether termed an operating lease, a financed lease, or a loan. Two commonalities among these leasing arrangements are that the lessors retain the right to repossess the property in the event of default and require that a financing statement in compliance with the Uniform Commercial Code be filed against the equipment. The UCC-1 financing statement clarifies that both parties specifically and intentionally agree that the equipment will remain tangible personal property after installation. Given these facts, society would most probably find that the equipment in question remains movable property.

Conclusion

In determining whether an item to be installed into immovable property in Louisiana will be subject to sales or use tax, one must determine the characterization of the property as either movable or immovable at the incidence of taxation—either the earlier of the time the sale is perfected as evidenced by passage of title or delivery or some other reasonable proof or the time of the property's first use, consumption, distribution or storage for use or consumption in the state. If contracts indicate that the incidence of taxation occurred before the installation of the

tangible personal property into the immovable structure, sales or use tax is due. In our case, the contracts between the parties state that title passed and the risk of loss on the equipment was shifted at a point in time before the equipment was installed so the equipment was still tangible personal property when the taxable transaction occurred and should be subject to taxation. In cases where the taxable event occurs after the installation of the item in question, one must determine whether or not the attached property has become a component part of the underlying movable using the tests provided in La Civ. Code. Ann. art. 466—whether the item is a component part as a matter of law, whether the removal of the item would cause substantial damage to the item or the underlying immovable, and whether the prevailing notions of society would find that the item becomes a component part of the immovable.

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