Revenue Ruling
No. 06-014
Sales Tax

Sales Taxability of Fees Paid for the Right to Use Eye Surgical Machine

September 19, 2006

The purpose of this Revenue Ruling is to discuss the sales taxability of fees that are sometimes charged to eye surgeons for the use of eye surgery equipment.

Facts

A group of eye surgeons performs surgery within its offices through the use of a machine that the surgeons have purchased from the manufacturer of the machine. When the manufacturer sold the machine, the manufacturer retained the intellectual property rights to the technology that is necessary for the operation of the machine. For each surgical procedure for which surgeons uses the machine, the surgeons must pay fees to the manufacturer for the use of the patented procedures that are necessary for the operation of the machine. The machine cannot be used for its intended purpose without the payment of the patent and license fees.

Issue

The question is whether the state sales or use tax is due on the fees that must be paid to the manufacturer of the machine for the use of the patented technology that is necessary to operate the machine for the machine's intended purpose.

Analysis

The right to use tangible personal property for its intended purpose must necessarily be acquired by the possessor or owner of the property in order for the property to have any value to the possessor or owner. The right to possess or own and the right to use are thus inextricably associated. One would not acquire ownership or possession of the surgical machine without also acquiring the right to use the property just as the buyer or lessee of a vehicle would not also acquire the right to drive the vehicle.

In ***Shirley McNamara v. The Electrode Corporation***, 418 So. 2d 652 (La. App. 1 Cir., 5/25/82), the First Circuit Court of Appeal held that the fees that a lessor derived under its "Technology and Patent License Agreement" from the lessees of its anodes were subject to the lease-rental tax, even though those fees were separately stated. Quoting the Court:

> "The substance of a contract, not the wording of it, nor the splitting or dividing it up by the contracting parties, is controlling. The taxpayer cannot defeat the Department's collection of taxes by either the wording, form, or label of a contract. ***Saenger Realty Corporation v. Grosjean***, 194 La. 470 (1940).
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> "The ***Saenger*** case, supra, dealt with a similar issue, and in its opinion, the Supreme Court stated:

> "'We are not concerned with the wording of the contract or how it is labeled, because this is not a suit between the contracting parties. If the State has a right to tax a subject matter of the contract, it could not be defeated by the label the contract was given or the words used by the contracting parties.'

"In ***Saenger***, as in the instant case, it is clear that the transfer of technology without the tangible personal property is worthless and therefore the technology (intangible item) is merely incidental to the tangible item and therefore subject to Louisiana sales/use and lease/rental tax. Many tangible items have certain intangible values without which the usage would be either impractical or impossible. The legislature, in enacting a Louisiana sales/use and lease/rental tax has authorized the taxing of intangible rights closely connected to items of tangible personal property. Otherwise, every contract would have to be closely scrutinized to determine what proportion of the money involved should be allocated to tangible personal property and what portion should be allocated to intangible rights.

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The split contracts (Technology and Patent License Agreement-Anode Lease Agreement) are in essence the same agreements but spelled out in different contracts and different words. The true object of these contracts, whether labeled "Technology and Patent License Agreement" or "Anode Lease Agreement", were the anodes. Without the anodes, the technology, know-how, etc. would have been of no use to Louisiana industries. The statutes and jurisprudence do not allow the separation of gross proceeds from a lease into nontaxable part attributable to royalty or a part deemed service. A thorough examination of the record does not reveal that substantial services were performed, especially for a particular lease, but merely portrays the availability of Electrode personnel to Electrode's customers for problem solving, technical advice, etc.

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In the instant case, any know-how or technology is certainly inseparable from the hardware (anodes). The anodes simply cannot be leased without the accompanying technology and know-how and are not even transferred to the lessee until various secrecy and other lease agreements have been signed. The alleged technology or know-how is an inseparable part of the hardware (anode) and for that reason must be included as part of the total price of the lease of anodes. No breakdown between "intangible technology" and "tangible personal property" is allowable in the instant case. Cf. ***Saenger***, supra."

Ruling

The department follows the logic of the Louisiana First Circuit Court of Appeal in ***McNamara v. Electrode***. Sellers, lessors, and their customers cannot separate the sale of the ownership of a thing from the right to use the thing for the purpose of taxing one portion of the price of the property and not the other.

The Louisiana state sales tax must be collected and remitted on the amount paid for the patent license fees for the use of the technology necessary to operate the surgical machine.

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