REQUEST LETTER

04-019

NAME
ADDRESS

Subject: Request for Private Letter Ruling

Dear Commissioners:

COMPANY, has been retained by a local hospital to examine its records to verify the institution's Utah sales and use tax liability for several recent filing periods. The hospital is not currently under audit by the Utah State Tax Commission for sales tax purposes, nor has it been contacted for such an audit in the foreseeable future. The ongoing review has disclosed several different transactions and types of transactions for which we are requesting an opinion as to how the Utah Sales and Use Tax Act impacts the hospital in those transactions.

Having dealt with many of these types of transactions many times over the last 33 years, most recently as a Sales and Use Tax Audit Manager with the 2ND COMPANY, I am not unfamiliar with the historical treatments of most of these transactions, but since there is little in writing, we feel it to be in the best interest of both the State of Utah and our client to seek the Commission's determinations based on the following facts.

Backup Electrical Generators

For obvious reasons, the hospital is required by law to have backup electrical power in the case of power failures on the normal utility company's power supply. For this purpose, and in connection with the upgrading and expansion of the hospital, the hospital has engaged a contractor to furnish and install a large electrical generator to provide backup power to the entire hospital facility. The power from the generator will be initiated to provide full power to the entire facility within 6 seconds of a power failure. It is important to note that the generator will not simply be used to power equipment within the hospital, but will supply all normal power needs to the real property structures of the hospital grounds, including a number of buildings physically separated from the hospital itself. Historically, a generator of this type, supplying electricity to these types of facilities would have been viewed as an integral part of the real property that it serves. The functions for which this generator supplies power are the normal functions of a real property structure.

A backup generator of this type should be distinguished from some backup generator installations and similar equipment for several reasons. A backup generator that supports primarily tangible personal property types of equipment rather than the entire real property facility may properly be considered as an extension of the tangible personal property. Administrative Rule R865-19S-85 is supportive of this treatment when it indicates that the term "machinery and equipment" includes "gas, water, electricity, or other similar supply lines installed for the operation of the manufacturing equipment, but only if the primary use of the

supply line is for the operation of the manufacturing equipment." In Admin. Rule R865-19S-58, discussing the treatment of items being converted to realty, and providing examples of items that are viewed as not becoming part of the realty, the examples of items viewed as remaining tangible personal property are mentioned as: "1. moveable items that are attached to the real property merely for stability or for an obvious temporary purpose; 2. manufacturing equipment and machinery and essential accessories appurtenant to the manufacturing equipment and machinery; and 3. items installed for the benefit of the trade or business conducted on the property that are affixed in a manner that facilitates removal without substantial damage to the real property or to the item itself." The subject generator is installed in a structure especially designed, remodeled, and modified for the specific installation. Part of the structure would literally have to be torn down to remove the generator as installed. Its anchoring system, foundation, and electrical/cooling/exhaust system make it anything but "moveable." The generator does not support any significant equipment that could be considered as "manufacturing equipment." While the generator will support the trade or business conducted on the property, it clearly could not be removed without substantial damage. Since neither the new generator nor those that it will replace fit any of these examples or any logical expansion from them, we believe that the subject generators should be treated as having become an integral part of the real property upon installation. Backup power has become more and more of a standard for many types of businesses, governmental agencies, and even residential property. It has been our experience that the electrical contractors that make those installations are treating them just as they would any other job providing permanent power to and around a real property structure. Additionally, this type of generator should be distinguished from turbine generators that are used by the entities that are in the business of massive power generation for distribution to customers. The backup generator(s) at the hospital should be considered as part of the real property, and we ask for the Commission to concur with that position.

Power Switching Systems

Switching from normal utility company electricity requires extensive modification and addition to the facility's electrical power system that includes detection equipment and switching equipment to move from the public utility power to the power generated by other sources such as a backup generator. The switching systems are even more integral to the real property, since they are constantly in use in some mode, even if normal utility power is still available. We ask that the Commission verify this determination as well.

MRI and CT Equipment

Magnetic Resonance Imaging equipment and its methods of installation clearly meet many criteria for consideration as becoming an integral part of the real property in which it is installed. Its installation is necessarily extremely solid and stable for it to accurately function. The building structure is literally built around it. Removal and replacement entail extensive destruction and consequential rebuilding of the structure. We have been advised that another hospital in the immediate area has been granted treatment of a new MRI machine acquisition and installation as a conversion of tangible personal property to realty. We ask that our client be allowed the same treatment.

Meals Provided

Senate Bill 147 in the 2003 Utah Legislative General Session amended Utah Code Annotated Subsection 59-12-104(12) [effective July 1, 2004], deleting the word “inpatient” from meals (food, food ingredients, etc.) exempted by that subsection of the law. The plain language of the statute would now appear to exempt the hospital from collecting tax on its sales of food through its cafeteria, continue to exempt its providing of food to patients, and exempt its purchases of food, food ingredients, etc. when those items are provided free-of-charge to various personnel of the hospital, guests, visitors, doctors, etc. We ask that the Commission confirm this interpretation of the plain language of the statute as it now exists. The hospital has indicated that it is both willing and able to continue collection of the tax on its sales of meals through the cafeteria.

The hospital is committed to full compliance with the Utah law, but needs additional direction from the Commission in order to meet that goal. We would sincerely appreciate an expeditious response to this letter request. The hospital is in need of the information in order to properly and timely prepare payments on outstanding obligations and well as to modify bookkeeping systems and contracting processes based on your responses. Thank you for your prompt consideration of this request.

Respectfully,
NAME

Subsequent Email From NAME

On the backup electrical generators question, here's some background. The backup generators that are primarily for the operation of tangible personal property items have been treated as an extension of the TPP. On the other hand, those that provide power to an entire real property structure in which the primary consumption of the power is for normal functions of a building rather than for manufacturing equipment, computers, etc. have been treated a part of the realty. I know I've written letters on the subject over the years, and seems like recently one to BUSINESS. Back in the early '80's, in the BUSINESS appeal, the backup generator at the CITY sewage treatment plant was determined to be tangible personal property because of the type of installation and the fact that, by far, most of the power consumption was for items determined to have remained tangible personal property after installation. You'll also find that the subject came up in the construction of the NAME building (which I think has two big backup generators) and they were treated as becoming part of the real property structure. I don't know who else may have run into the question before, but my answer over the years has been consistent with these postures. I'm only aware of one local electrical contractor that collects the tax on his sales/installation of backup generators, but then, he's one of those that collects tax on materials all the time anyway. The others I'm aware of are treating installations of backup generators and switching systems as just another part of the real property job.

I suspect that the NAME OF EQUIPMENT backup generator at the Tax Comm. building was done under a real property contract also, even though I suspect most of the power may go the computers.

RESPONSE LETTER

March 29, 2005

NAME
BUSINESS

RE: Private Letter Ruling Request – Hospital Transactions Involving Tangible Personal Property

Dear NAME,

We have received your request for a private letter ruling concerning the application of sales tax to certain transactions involving your client, a Utah hospital. In your letter, you ask whether the hospital's purchase and installation of backup electrical generators (including their associated mufflers and radiators), power switching systems, and magnetic resonance imaging ("MRI") and computed axial tomography ("CT" or "CAT scan") equipment are subject to sales and use tax. In subsequent telephone conversations, you also ask whether the amounts paid for labor and parts to repair these items or install other tangible personal property to them are taxable. Lastly, you ask about the Legislature amending the sales tax exemption effective July 1, 2004, relating to sales of inpatient meals and ask whether the amendment expands the exemption for purposes of hospital sales.

We will first address the issue of the purchase, installation, and repair of the equipment you identified. Before doing this analysis, however, we will outline the statutory and administrative authorities that apply to the transactions. Next, we shall determine whether, upon installation, each item of tangible personal property you describe: 1) becomes part of the underlying real property (in this case, the hospital structures); 2) remains tangible personal property that is considered permanently attached to real property; or 3) remains tangible personal property that is not considered permanently attached to real property. Finally, after making this determination for each item at issue, we shall apply the statutory and administrative guidelines to determine whether the transactions about which you inquire are taxable or not.

I. Real versus Personal Property.

A. Sales of Tangible Personal Property (including Installation).

Utah Code Ann. §59-12-103(1)(a) provides that sales of tangible personal property are subject to sales and use tax. If tangible personal property remains tangible personal property after installation, its sale is taxable, even if the item is considered permanently attached to real property. Under Utah law currently in effect, the "purchase price" of taxable tangible personal property includes any charge for services to install the property if the installation charge is not separately stated. If tangible personal property that remains tangible personal property is installed to real property, a separately stated installation charge is nontaxable. Otherwise, the installation charge is taxable. Please be advised that, effective July 1, 2005, Senate Bill 127 (S.B.

127) amends the Utah Sales and Use Tax Act to provide that "purchase price" and "sales price" do not include "an installation charge."

Sales of real property are nontaxable. For tangible personal property that becomes part of the underlying realty upon installation, the transaction to purchase and install the tangible personal property is considered the sale of real property and, accordingly, is nontaxable.

B. Repairs. [1]

UCA §59-12-103(1)(g)(i) provides that amounts paid for services for repairs or renovations of tangible personal property are subject to taxation, except when the services are performed on tangible personal property that is exempt under UCA §59-12-104. On the other hand, amounts paid for services for repairs or renovations of real property (including personal property that has previously become part of the realty upon installation) are nontaxable.

Under Utah Admin. Rule R865-19S-78(B) ("Rule 78"), the Commission also excludes from taxation amounts paid for services for repairs or renovations of tangible personal property that is considered permanently attached to real property. However, Rule 78(B) does not exclude from taxation amounts paid for repair parts associated with such nontaxable repair labor.

C. Installation of Tangible Personal Property in Connection with Other Tangible Personal Property.

UCA §59-13-103(1)(g)(ii) provides that amounts paid for services to install tangible personal property in connection with other tangible personal property are subject to taxation, unless the tangible personal property being installed is exempt from taxation under Section 59-12-104. On the other hand, amounts paid for services to install tangible personal property to real property (including personal property that has previously become part of the realty upon installation) are nontaxable.

The Commission's practice is to also exclude from taxation amounts paid for services to install tangible personal property to tangible personal property if the latter property is considered permanently attached to real property as described in Rule 78(B). With this practice, amounts paid for services to install tangible personal property in connection with other tangible personal property are treated, for taxation purposes, the same as those paid for repairs or renovations of tangible personal property. Thus, any charges for the purchase of tangible personal property installed to other tangible personal property permanently attached to real property are taxable,

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1 Effective July 1, 2005, S.B. 127 codifies current rules and Commission policy concerning services for repairs and renovations, as well as services to install tangible personal property in connection with other tangible personal property. S.B. 127 defines taxable services for "repairs or renovations of tangible personal property" to now include services for "attaching tangible personal property to other tangible personal property if the other tangible personal property to which the tangible personal property is attached is not permanently attached to real property." Accordingly, the Commission does not consider S.B. 127 to have any effect upon its current practice concerning the taxability of services for repairs and renovations and to install tangible personal property in connection with other tangible personal property.

even though the related charges for the labor to install the tangible personal property is nontaxable.

II. Taxation of Equipment.

A. Back-up Electrical Generators (including Power Switching Systems Radiators and Mufflers)

The back-up generators at issue have been installed in a maintenance building located on the hospital grounds and provide hospital-wide electrical service in case the primary electrical service fails. You have provided photographs of an older back-up generator, a new back-up generator, as well as the power switching equipment, the outdoor radiators and the roof-top mufflers associated with both generators. By telephone, you state that neither of the generators exists only to serve a specific piece or pieces of equipment, but that both provide complete electrical power replacement for the hospital in the case of a primary power outage. Your descriptions and photographs indicate that the generators are large machines that are bolted onto concrete foundations specifically designed to support their weight and are connected to the underlying realty through a series of pipes, vents and other conduits. The power switching equipment is located in metal housing units that are anchored to the hospital floors and walls, with the switching equipment itself "hard-wired" into the hospital's primary electrical system as well as to the back-up generators. The radiators, located outdoors and bolted onto concrete foundations poured to support their weight, are connected to the generators by conduits running through holes cut into the outside walls of the hospital maintenance building. Venting conduits connect the back-up generators to mufflers that are located on the roof of the building in which the generators are housed.

The back-up generators, powers switching systems, radiators, and mufflers are necessary to serve the utility needs of the hospital and are both functionally and physically incorporated into the underlying real property improvement; i.e., the hospital. You indicate that Auditing Division ("Division") has issued letters in the past where it determined back-up generator systems with similar characteristics became part of the underlying realty upon installation. The Division, however, informs the Commission that it is not aware of such letters or such past determinations.

In fact, under different circumstances, the Commission has found generators, including back-up generators, to remain tangible personal property after their installation. A generator that is installed to provide back-up electrical power to a specific piece of equipment has generally been considered to remain personal property after installation because the equipment it serves is itself tangible personal property. In this case, however, the generators' primary function is to provide power to the entire underlying real property structures. Providing electricity to specific equipment, which is considered tangible personal property, is an indirect or secondary function.

Furthermore, the back-up generating systems at issue are large pieces of equipment not easily moved and, as your photographs indicate, are intricately integrated into the underlying realty with numerous connections to power sources, switching equipment, roof mufflers, and outdoor radiators. These factors also differentiate the back-up generators at issue from many

generators found in homes and other businesses. Those generators are usually smaller, more easily moved and less integrated into the underlying real property and are, therefore, generally considered to remain tangible personal property after installation. The Commission also notes that while even larger generators used by energy production facilities, such as power plants, are considered to remain tangible personal property after installation, such generators are used primarily as equipment to generate a product for sale, not as equipment incorporated into and used primarily to serve the electrical needs of the underlying real property improvement, as is the case here.

Because of the specific circumstances surrounding the installation and use of the power generating systems you describe, the Commission finds that the back-up generators, the power switching systems, the radiators and the mufflers at issue are sufficiently integrated into the underlying realty so that they are considered to become part of the realty upon their installation.[2]

As these particular back-up generators and other items at issue are considered part of the realty upon installation, any transaction by the hospital to purchase and install these items is a nontaxable event. However, the real property contractor is responsible for any sales and use tax on tangible personal property it consumes in fulfilling such transactions. In addition, because these items have become real property, amounts paid for services for their repair or renovation and amounts paid for services to install tangible personal property in connection to them would also be nontaxable events. Any charges for parts or other tangible personal property associated with the labor services for repairs or installations would also be nontaxable.

B. MRI and CT Equipment

You have also asked whether an MRI machine purchased by the hospital and CT scan equipment become part of the underlying realty upon their installation. You refer to the Tax Commission recently allowing another hospital to treat the purchase and installation of a new MRI machine as the conversion of tangible personal property to real property, thereby allowing the hospital to treat the sales and installation transaction as a nontaxable event. The Commission is unaware of any decision in which it has considered an MRI machine to become part of the underlying realty upon installation. However, in *Utah State Tax Commission Private Letter Ruling 98-012*, the Commission considered the classification of hospital equipment described as nuclear medicine equipment weighing between 3,500 and 8,000 pounds. That piece of equipment was anchored to a custom-poured, self-leveling concrete pad in the hospital. The Commission found that that equipment did not become part of the underlying realty upon installation. Instead, the Commission determined that, under Rule 78(B), the equipment qualified for classification as tangible personal property permanently attached to real property for purposes of sales and use tax.

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2 Although these specific items become part of the underlying realty under these circumstances, this ruling does not necessarily extend to other tangible personal property that may be purchased to support or be used in connection with the items specifically discussed. Whether such additional items, should they exist, remain tangible personal property or become part of the underlying realty upon installation will depend upon the unique circumstances associated with the use and installation of each item.

You have provided photographs of the installation process required for an MRI machine recently installed at the hospital. In addition, you have described other aspects of the installation process by telephone. The photographs show that a large hole had to be cut into the outside wall of the hospital and that a crane was required to lift and position the MRI machine into the hospital. The hospital's outside wall was replaced after the MRI machine was installed. Prior to installing the machine, the floor on which the MRI machine sits required extensive modification to support and provide stabilization for the machine, including the addition of horizontal steel beams integrated into the concrete floor and attached to the building's support beams. The MRI machine is bolted through the concrete flooring to the steel beams that were installed. Furthermore, the cafeteria on the floor below the MRI machine location was required to close for a month because its space was required to be vacant to accommodate the building modifications required to support the MRI machine.

It is clear that the underlying real property, specifically the hospital structure, required extensive alteration in order for the MRI machine to be installed and would require extensive alteration to remove the machine. However, the MRI machine is a piece of equipment used for professional purposes (i.e. medical diagnoses) and not to serve the underlying realty or the building itself. In addition, while the MRI machine, because of its size and weight, requires the building in which is it installed to have certain unique characteristics, the machine is not integrally incorporated into the building other than the bolts that are affixed to the steel beams located in the concrete floor. When these factors are considered as a whole, the Commission finds that medical equipment such as MRI and CT equipment remains tangible personal property, for purposes of sales and use tax, after the equipment is installed in a hospital.

This being the case, we can address the taxability of its sale and its installation to the underlying real property, even before we decide if the MRI machine is "permanently attached." The sale of the MRI machine is considered the sale of tangible personal property and is, therefore, taxable. If the charges to install the MRI machine to the underlying real property are separately stated, they relate to services to install tangible personal property to real property and are, therefore, nontaxable. However, if the installation charges are not separately stated, the entire charge for the sale and installation of the MRI machine is considered taxable sale of tangible personal property.

To determine the taxability of amounts paid for services for the repair or renovation of the MRI machine and to install tangible personal property in connection to the MRI machine, we must first determine whether the machine is permanently attached. For purposes of charges for labor to repair, renovate, wash, or clean, Rule 78(B)(2)(c) provides that tangible personal property is considered permanently attached if:

> (i) attachment is essential to the operation or use of the item and the manner of attachment suggests that the item will remain affixed in the same place over the useful life of the item; or
> (ii) removal would cause substantial damage to the item itself or require substantial alteration or repair of the structure to which it is affixed.

If either of these conditions is present, the tangible personal property is considered permanently

attached for sales and use tax purposes. You have provided sufficient information to show that removal of the MRI machine from the hospital would require substantial alteration and repair of the hospital. The Commission also believes that the MRI machine is affixed to the hospital because of the bolts that connect it to the structure itself. Accordingly, under Rule 78, the MRI machine is considered tangible personal property permanently attached to real property upon its installation.

Any amounts paid for services to repair or renovate tangible personal property permanently attached are exempt from taxation under Rule 78(B). Accordingly, charges for labor to repair or renovate the MRI machine are nontaxable. Nevertheless, any amount paid for a repair part associated with the nontaxable repair labor is itself taxable because it is the sale of tangible personal property.

For labor to install tangible personal property in connection with other tangible personal property, Commission policy is to tax this "installation" labor in the same manner as it taxes the labor to repair or renovate the property at issue. Because amounts paid for labor to repair the MRI machine are nontaxable, amounts paid for labor to install tangible personal property in connection with the machine would be nontaxable, as well. However, any amounts paid for the tangible personal property that is installed in connection with the MRI machine are taxable as the sale of tangible personal property, even though the charges for the labor to install are nontaxable.

Our determinations concerning the MRI machine are based on the specific circumstances surroundings its purpose and its installation as you have described them and as indicated by the photographs you have provided. Whether we would reach the same determination for CT equipment or any other medical equipment would require an analysis of the unique circumstances surrounding the purpose and installation of that specific equipment.

III. Sales of Food Items at a Hospital.

You also inquire whether an action by the 2003 Legislature to delete the word "inpatient" from a specific sales tax exemption impacts the application of that exemption. For many years, UCA §59-12-104(12)(b) provided an exemption for sales of "inpatient meals provided at medical or nursing facilities" ("old exemption"). Effective July 1, 2004, the Legislature amended the exemption to currently exempt "sales of [food and food ingredients, prepared food, and alcoholic beverages] provided at a medical facility or a nursing facility" ("current exemption").

This current exemption is different from the old exemption in several aspects. First, the old exemption was limited to sales made to a particular class of purchasers or consumers, namely "inpatients." Sales of meals to or consumed by "outpatients" and "non-patients" remained taxable. The current exemption is not limited to a particular class of purchasers or consumers.

Secondly, the old exemption applied to sales of "meals." The current exemption applies to sales of "food and food ingredients," "prepared food," and "alcoholic beverages." These latter terms are defined by law and exclude tobacco and a container or packaging used to transport the food. See UCA §59-12-102(6), (27), and (52). Arguably, the set of items eligible for exemption under the current law (i.e., food and food ingredients, prepared food, and alcoholic beverages) is

broader than the set of items eligible for exemption under the old law (i.e., meals).

Third, under both the old law and the current law, the exemption specifically applies to sales "provided at" a medical facility. In *Utah State Tax Commission Appeal No. 91-0822*, the Commission considered an exemption from sales and use tax for "sales of meals **served by** public elementary and secondary schools" (emphasis added). In that appeal, a vending machine company requested a refund of taxes remitted on its vending machine sales made at elementary and secondary schools. In its decision denying the refund request, the Commission found the vendor's sales to be taxable, noting that the Legislature used the words "served by" public schools not "served at" public schools when it drafted the exemption. The current law exempts sales "provided at" the medical facility not sales "provided by" the medical facility. Accordingly, neither the old nor current law limited the exemption to sales "provided by" a medical facility.

However, the 2005 Legislature amended the current exemption in S.B. 127. Effective July 1, 2005, the "new exemption" exempts "sales of [food and food ingredients, prepared food, and alcoholic beverages] provided **for a patient by** a medical facility or a nursing facility" (emphasis added). The amendment of the word "at," as found in the current exemption, to the word "by" in the new exemption would further suggest that the current exemption applies to sales associated with a specific location, not a specific vendor, while the new exemption would apply to sales associated with a specific vendor, not location. Please note also that the proposed language would also narrow the exemption to sales made to a "patient."

Because your client is a hospital, we assume it qualifies as a "medical facility" as defined in Utah Admin. Rule R861-19S-61(A)(1). Under the current exemption that became effective July 1, 2004, your client may sell those items specifically listed for exemption in Sections 59-12-102 and 59-12-104 at its medical facility tax-free as described herein. Your client may also purchase tax-free under the resale exemption an item that becomes an ingredient or component part of the exempted items. Please be advised, however, that some sales that currently qualify for exemption will become taxable on July 1, 2005.

The above determinations are based on the specific circumstances as described in this letter. Should the actual circumstances be different, our response could also be different. Please feel free to contact us if you have any other questions.

For the Commission,

Commissioner

KC/MBJ
04-019