

Newest Court Ruling That Could Save Your Hospital Millions

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A recent decision by the California Court of Appeal provides an opportunity for healthcare providers in California to obtain significant refunds on past equipment purchases and significantly reduce sales tax costs on future purchases. The refund potential could range from 5% to 9% of past equipment purchases. For a typical hospital that spent \$50 million on equipment during the relevant look-back period, there could be a refund opportunity in the range of \$2 million to \$4 million. We'll discuss how to approach the refund process and how to work with vendors to reduce sales tax costs on future purchases.

Background

An obscure California sales tax exemption on intellectual property (e.g., manufacturing designs) delivered on tangible media (e.g., discs, drawings) was found to have much wider applications than originally intended.

The court's interpretation of the Technology Transfer Agreement (TTA) exemption expands the scope to include any purchase of tangible personal property that utilizes either patented processes or copyrighted intellectual property, including software. This is particularly important to healthcare providers because of their extensive use of expensive equipment with patented software and/or embedded patented processes.

What is particularly attractive about the TTA exemption is that only the value of the tangible personal property is taxable. The value of software, as well as copyrighted and/or patented processes, is exempt from tax. This means a potential majority of the purchase price of high-tech medical equipment should be exempt from tax.

In addition to reducing sales taxes on future equipment purchases, the court's decision is retroactive, which makes it possible to recoup excess sales tax paid on equipment purchases in prior years. The time frame from which to recover tax is at least 3 years, but it is more likely to be 6 years and could even include periods back into the early 2000s.

Refund Process

It is critically important to file a refund claim with the California State Board of Equalization (SBE) to avoid

the statute of limitations closing on any prior periods. It is also important to assess your facts to know whether you should handle your claim through an audit or whether it is likely to be handled in SBE settlement. Separating your low and high-risk claims may allow you to obtain a refund more quickly. Engaging a California SBE audit specialist will help to maximize your refund.

To identify qualifying purchases, you should first review a comprehensive fixed-asset report and corresponding invoices. After identifying qualifying purchases and vendors, you will need to determine if you have the authority to file a refund claim or if you need the vendor to file it on your behalf. This decision hinges on who the tax is imposed on. California imposes use tax on the customer, but sales tax is imposed on the vendor and collected from the customer as sales tax reimbursement. You will need to evaluate your purchases to know which purchases should be handled directly with the SBE as a refund claim and which should be requested through your vendors.

The difficult and potentially time-consuming part of the refund process is the collection of pricing information and any supporting documentation from a vendor. Vendors will be reluctant to provide confidential information to assist healthcare providers with valuing the tangible personal property and related exempt intangibles. Engaging a firm that specializes in the valuation of healthcare assets will help you avoid vendor-related difficulties and delays, as well as ensure the value of intangibles is accurately determined, which will most likely result in the greatest refund.

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Prospective Equipment Savings Method

Because medical device and software vendors have not yet changed their billing practices to reflect this tax exemption, you will need to take immediate action to reduce your tax cost on new purchases. You can lock in the tax savings if your vendor agrees to use an approved safe harbor invoicing method. For example, if invoiced correctly, a pending \$5 million technology asset purchase could net \$200,000 to \$450,000 in savings. To start, identify any material pending purchase orders for software and/or sophisticated medical equipment.

Conclusion

A California sales tax exemption provides opportunities for healthcare providers to recover sales taxes paid on prior software and technology asset purchases. To avoid having the statute of limitations close on any prior periods, it is important to file a refund claim with the SBE for use taxes and to request sales tax refunds directly from vendors. Looking forward, you can reduce your prospective taxes on new assets by working with your vendors to take advantage of a safe harbor invoicing method.

ECG Management Consultants provides valuation and advisory services to the healthcare industry. Eric can be reached at 858-436-3220. THINK LLP delivers comprehensive tax services and has been working with the State of California's SBE and the industry to assist with the tax changes described in this article.



PROFESSIONALISM, ENGAGEMENT, ACHIEVEMENT AND KNOWLEDGE

Our chapter has taken the concept of the Early Careerist program, and broadened it to meet the needs of our Northern California members. The PEAK program is a resource to anyone who is looking to advance and enrich their careers regardless of age, number of years in the business, or job title.

In March, we had our Spring Conference event that was a blast! For those of you who submitted your thoughts through our Career Advancement survey - THANK YOU! Your survey results were the answers in our Family Feud game! "Hindsight is 20/20, what do you THINK is the most common advice people give to their "younger" selves? Survey says....." Thank you so much. Having chapter-wide participation made the game that much more authentic and fun! In addition, our evening consisted of small group discussion and networking. Professional relationships were born and our PEAK committee was formed.

We start this 2016-17 HFMA year with a new name and a clearer vision. We welcome anyone looking to participate, whether that be in one event or throughout the year. We strive to provide insight into constantly evolving professionalism. We work towards engagement between mentors and mentees, colleagues and teams. We push for achievement of professional and personal goals and we seek knowledge, garnered through group discussion, learning from others, practicing leadership and working together.