
Opinion of the Tax Commissioner

Date Issued: October 20, 2004

Opinion No: 04-0002

Tax: Sales/Use

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Subject:Employee Benefit & Human
Resource Services

Dear XXXX:

This is an Opinion of the Tax Commissioner regarding the taxability of various employee benefit and human resource services. The request for this Opinion was dated January 15, 2004. There was no request that this Opinion be held confidential, so it will be made publicly available in redacted form.

FACTS

The Taxpayer provides various employee benefit and human resource services such as Health and Welfare Administration, Retirement Service Administration, Cobra/Flex Spending Administration, and Pre-employment Screening and Selection Service Administration. In your letter, you ask if these services are subject to Ohio's sales and use tax.

Start-up Services

The Taxpayer provides start-up and on-going services as part of the service they provide. Start-up services are generally provided upon commencement of each new contract for a client company and consist primarily of three basic functions: determining the size of the company, ascertaining the specific benefit plans the company wants to offer, and establishing the plan that is right for that company. This requires a substantial commitment of staff in reviewing the client's data and determining the client's needs. Charges to the client are based on the number of hours worked whether work is performed at the client's premises or at a Taxpayer site. The charge may also include reimbursable expenses, such as travel, lodging, meal allowance, phone calls, etc.

Upon completion of the start-up process design, the Taxpayer's standard automated system is configured to the client's requirements, programmed and tested, and all data errors are reconciled. The start-up charges for process design also include fees for implementing the program, otherwise known as moving the program into production. There is also a separate charge should the client request changes to the program's original design. All start-up service costs are one-time, up-front charges, which are separately stated on the invoice. This up-front fee may be billed in installments over a limited period of time. The up-front services consist of

mostly manual functions, considering the design and discovery nature of processes required for new clients.

Ongoing Services

On-going services are the recurring record keeping processes that take place over the life of a contract. These services provide clients and their employees information such as participant record maintenance, daily valuation of participant accounts, monthly plan activity reports, disbursement processing and automated contributions, and pre-employment screening information. The Taxpayer services consist of client/employee benefits record keeping, maintenance, and reporting functions for clients depending on the services contracted for. The services do not provide any advice, guidance or direction to the clients, rather the true object of the service is the record keeping, processing, and reporting. The on-going charges consist of a combination of manual and automated functions (80% automated, 20% manual). Manual effort is required at varying intervals of the process and primarily occurs when the Taxpayer completes some initial data entry, prepares paper forms and reports for mailing and performs call center services. The overall goal of the Taxpayer is to automate as much as possible.

Client service representatives at the call center assist clients in using the system, which includes troubleshooting, usage instruction, forms and reports as necessary. The call center may also assist client's participants with inquiries about available options. The Taxpayer also offers an option for a totally outsourced hosting environment where the Taxpayer provides and operates the software and handles all of the processes selected by the client from beginning to end (excluding any advice, direction, or control). The processes would include the day-to-day monitoring, data reporting, and data disaster recovery of the selected processes (functions performed are the same 80% automated and 20% manual).

The Pre-Employment Screening and Selection Services include Taxpayer staff searches of various public databases for client/employers. The tasks performed by the taxpayer include verifying the background of potential employment applicants of its clients in such categories as social security number, address, reference checks, credit standing, driving records, and worker compensation history. The system functions via a mostly automated environment (80% automated, 20% manual) and will include on-line job postings, applications, job tests, and resume submissions. The information is provided to client via a report, e-mail, or orally. The fees for on-going services may consist of a minimum base fee for the bare minimum of service provided, a per member/per account/per transaction fee, or a combination of both depending on the options the client has selected.

Categories of Services

Health & Welfare Administration

Health and Welfare Administration is an employee benefit service that streamlines benefit administration and services. It consists of:

Start-up Services

These services consist of the upfront consulting and plan analysis to establish the best Health & Welfare plan for the customer.

Start-up services include project management for programming and developing the interface between the client's information system and the Taxpayer's system. The consulting and plan analysis is a one-time, upfront service. The fee is separately stated on the invoice as a one-time, upfront amount for the consulting and plan analysis.

On-going Services

These services include:

- Maintenance of benefit plan rules, based on data gathered from the client (such as hours worked, service time, age, employment status-class-type, resident state-zip code, company, and pay group);
- Collection and maintenance of up-to-date employee data to determine benefit eligibility;
- Processing of benefit related-changes resulting from human resources (HR) activity (hiring, firing, promotions, etc.);
- Generating benefit worksheets resulting from HR activity;
- Collecting employee family status change information and process changes;
- Distributing confirmation materials to participants;
- Providing standard management reports that identify participants, plans, and coverage amounts;
- Maintaining call center support;
- Providing system/database maintenance (includes eligibility rules, statement templates, plan modifications, rate tables, zip codes, training materials, and system testing.).

The Health & Welfare Administration on-going service fees are separately stated on the invoice. The fees for the services provided are charged on the invoice as follows:

- A per member (client employee) per month fee for the standard menu of services.
- A minimum base fee for the bare minimum of service provided.

The Health & Welfare Administration data is collected, analyzed, and compiled to the specification of each client company, and assembled into reports accessible by or furnished to the client company. These services involve processing of data provided by the client (or the client's employees). The Taxpayer services consist of client/employee benefits record keeping, maintenance and reporting functions for clients depending on the services contracted. The services do not provide any advice, guidance or direction to the clients, rather the true object of the services is record keeping, processing, and reporting. The on-going charges consist of a combination of manual and automated functions (80% Automated, 20% Manual).

Retirement Service Administration

Retirement Service Administration consists of providing 401K plan record keeping and administration to clients, from initial plan design and enrollment through plan management and administration. It includes record keeping, provision of plan documents, trustee services, compliance reporting and employee communication support. It consists of:

Start-up Services

This service consists of the upfront consulting and plan analysis to establish the best plan for the customer. The consulting and plan analysis is a one-time, upfront service. The fee is unbundled and separately stated on the invoice. The fee for the service provided is charged on the invoice as a one-time, upfront amount for the consulting and plan analysis.

On-going Services

These services include:

- Daily valuation record keeping via common database rate data;
- Investment selection tools with investment performance monitoring;
- Employee communications via online, e-mail, and mail functions;
- An interactive website with a voice response system;
- Call center for special needs;
- Loan withdrawal processing either electronically or via paper forms;
- Daily investment transfer, investment allocation, and contribution rates;
- Rollover contribution processing;
- Disbursement processing;
- Electronic transmission/receipt of payroll data;
- Periodic management reports;
- Compliance testing and government reporting;
- Monthly plan activity reporting.

The Retirement Service Administration on-going service fees are separately stated on the invoice. The fees for the services provided are charged on the invoice as follows:

- A per member (client employee) per month fee for the standard menu of services;
- A minimum base fee for the bare minimum of service provided.

The Retirement Service data is collected, analyzed, and compiled to the specification of the client company, and assembled into reports accessible by or furnished to the client/company. This service does rely to some extent on externally provided data, such data on prices of securities in which the plan assets are invested. The Taxpayer services consist of

client/employee retirement benefits record keeping, maintenance, and reporting functions for clients depending on the services contracted. The services do not provide any advice, guidance, or direction to the clients, rather the true object of the services is record keeping, processing, and reporting. The on-going charges consist of a combination of manual and automated functions (80% automated, 20% manual).

Cobra and Flex Spending Account (FSA) Administration

Cobra Account Administration represents election based health plan processing for the client's qualifying employees. The qualifying event information, which includes reasons for eligibility, length of eligibility, plans offered, employee demographic data and health insurance information, is provided to the Taxpayer by the client. The client's employees are notified when there is a Cobra qualifying event (such as an employee termination). Electing employees are monitored by the Taxpayer to maintain coverage for premium reporting. There are no special start-up services for Cobra Administration. It consists of:

On-going Services

- Processing of open enrollment documents;
- Processing of initial Cobra notification letters to qualified participants;
- Set-up of initial participants into Cobra Services;
- Administration of enrollments, billing and carrier interaction for clients and their participants;
- Furnishing of reports pertaining to current status, activity, termination, new elections, and premium distribution;
- Collecting payments from the participants and transfer to carriers;
- Management of established accounts.

The Cobra service fee is separately stated on the invoice as follows:

- Per participant (client employee), per month, based on the number of qualifying events and the number of employee participants who elect to have coverage.
- Separate charge for extra services such as additional reports, multiple location set-up, reprints etc.

The Flex Spending Account (FSA) Service represents the administration of flexible spending plans, dependant care plans, and mass transportation reimbursement plans. The Taxpayer receives employee account, contribution, and enrollment eligibility records from the client and arranges the data into manageable records. Thereafter, the client's employees file claims against these contributions.

The Flex Spending Account services provided to the client by the Taxpayer consist of:

On-going Services

- Enrollment processing of employee data, check registers, and funding requirements;
- Employee contribution administration;
- Quarterly summarizing of activity by the employee;
- Forfeiture reporting of fund amounts in the plan, not used within the specified time.

The FSA data processing service fee is separately stated on the invoice as follows:

- Per participant (client employee), per month, based on the number of qualifying events and the number of employee participants who elect to have coverage.
- Separate charge for extra services such as additional reports, multiple location setup, reprints, etc.

The Cobra and FSA data is collected, analyzed, and compiled to the specification of client companies, and assembled into reports accessible by or furnished to the client company. Accordingly, the services consist of Cobra/FSA benefits record keeping, maintenance, and reporting functions for clients depending on the services contracted for. The services do not provide any advice, guidance, or direction to the clients, rather the true object of the services is record keeping, processing, and reporting. The on-going charges consist of a combination of manual and automated functions (80% automated, 20% manual).

Pre-Employment Screening & Selection Service Administration

Pre-Employment Screening & Selection Services provide employee background information services to client companies. The client companies match employee background information with the employee job requirements through the verification of job application background. The employee background reports are obtained through source document retrieval, public record database searches, company databases, and a national network of third party couriers. It consists of:

On-going Services

- Criminal record checks;
- Motor compensation histories;
- Motor vehicle records;
- Employment and personal reference checks;
- Credit histories;
- Name, address, social security number verification;
- Education and credential verification.

The Pre-Employment Screening & Selection Service fees are unbundled and separately stated in the invoice as follows:

- A package option that can include any combination of the available products and services is invoiced at a flat rate for the package based on the number of products chosen;

- If the package option is not chosen, each data and service option is charged separately.

This screening and selection information is gathered or compiled to the specification of each client and assembled into reports accessible by or furnished to each client. The data collected is obtained from sources and or databases that are public in nature and equally available to other parties. The information furnished is not proprietary in nature. The Taxpayer services consist of employee screening/background data retrieval and reporting functions for clients depending on the services contracted. The services do not provide any advice, guidance, or direction to the clients, rather the true object of the transactions is the provisions of information services. The on-going charges consist of a combination of manual and automated functions (80% automated, 20% manual).

OPINION REQUESTED

Are the Taxpayer's business categories of Human Resources, Benefit, and Screening Services subject to Ohio sales and use tax?

DISCUSSION

A) Health and Welfare Administration:

Automatic data processing is defined in Ohio Revised Code Section ("R.C.") 5739.01(Y)(1)(a) as "processing of others' data, including keypunching or similar data entry services together with verification thereof, or providing access to computer equipment for the purpose of processing data." The primary objective of the Taxpayer is to collect, process, and maintain the customer's health and welfare benefits. Based on the information provided, the services provided by the Taxpayer constitute automatic data processing that are taxable pursuant to R.C. 5739.01 (B)(3)(e).

Additionally, the start-up services are taxable since they are a part of the price for the services provided to your customers. "Price" is defined in R.C. 5739.01(H) as:

(1)(a) "Price," except as provided in divisions (H)(2) and (3) of this section, means the total amount of consideration, including cash, credit, property, and services, for which tangible personal property or services are sold, leased, or rented, valued in money, whether received in money or otherwise, without any deduction for any of the following:

(i) The vendor's cost of the property sold;

(ii) The cost of materials used, labor or service costs, interest, losses, all costs of transportation to the vendor, all taxes imposed on the vendor, and any other expense of the vendor;

(iii) Charges by the vendor for any services necessary to complete the sale;

(iv) On and after August 1, 2003, delivery charges. As used in this division, "delivery charges" means charges by the vendor for preparation and delivery to a location designated by the consumer of tangible personal property or a service, including transportation, shipping, postage, handling, crating, and packing.

(v) Installation charges;

(vi) The value of exempt tangible personal property given to the consumer where taxable and exempt tangible personal property have been bundled together and sold by the vendor as a single product or piece of merchandise.

Since the start-up services are a necessary component of the transaction, any charges for these services are taxable.

B) Retirement Service Administration:

From the facts presented, the primary service provided by the Taxpayer with regard to Retirement Service Administration is record keeping. The Taxpayer processes and maintains the records for their customers' retirement administration. Since the majority of the service provided is taxable as automatic data processing and the charges are not separately stated, the start-up and on-going services are taxable. However, if the Taxpayer begins itemizing their billing and separately stating the charges for automatic data processing and personal services, then tax would only need to be collected for the services related to the automatic data processing.

C) Cobra/Flex Spending Administration:

Although some services provided by the Taxpayer such as handling money are not necessarily automatic data processing, the majority of the on-going services provided qualify as a taxable service. Since the Taxpayer does not separately itemize the charges for the automatic data processing and the other services, the entire transaction is taxable. What the Taxpayer does separately state on their invoices is for automatic data processing services and is taxable. The Taxpayer processes and maintains information received from their customers to administer the Cobra/Flex Spending program and is not providing any personal services with regard to this business category. Based on the information provided, the Cobra/Flex Spending Administration provided by the Taxpayer is taxable as automatic data processing.

D) Pre-Employment Screening & Selection Service Administration:

The service provided by the Taxpayer with regard to pre-employment screening and selection service administration does not qualify as automatic data processing. Importantly, R.C. 5739.01 (Y)(1)(d) provides:

(d)"Automatic data processing, computer services, or electronic information services" shall not include personal or professional services.

R.C. 5739.01(Y)(2) provides the following definition of "personal and professional services":

As used in divisions (B)(3)(e) and (Y)(1) of this section, "personal and professional services" means all services other than automatic data processing, computer services, or electronic information services, including but not limited to:

(a) Accounting and legal services such as advice on tax matters, asset management, budgetary matters, quality control, information security, and auditing and any other situation where the service provider receives data or information and studies, alters, analyzes, interprets, or adjusts such material;

(b) Analyzing business policies and procedures;

(c) Identifying management information needs;

(d) Feasibility studies, including economic and technical analysis of existing or potential computer hardware or software needs and alternatives;

(e) Designing policies, procedures, and custom software for collecting business information, and determining how data should be summarized, sequenced, formatted, processed, controlled, and reported so that it will be meaningful to management;

(f) Developing policies and procedures that document how business events and transactions are to be authorized, executed, and controlled;

(g) Testing of business procedures;

(h) Training personnel in business procedure applications;

(i) Providing credit information to users of such information by a consumer reporting agency, as defined in the "Fair Credit Reporting Act," 84 Stat. 1114, 1129 (1970), 15 U.S.C. 1681a(f), or as hereafter amended, including but not limited to gathering, organizing, analyzing, recording, and furnishing such information by any oral, written, graphic, or electronic medium;

(j) Providing debt collection services by any oral, written, graphic, or electronic means.

The services listed in divisions (Y)(2)(a) to (j) of this section are not automatic data processing or computer services.

The Taxpayer checks and reports on the background of potential employees. This is not processing or maintaining data. The Taxpayer is in fact providing a personal service. The on-going service with regard to this category of business is not taxable because it is a personal service.

OPINION OF THE TAX COMMISSIONER

It is the Opinion of the Tax Commissioner, under the facts as presented by the Taxpayer:

1. The Health and Welfare Administration services are taxable automatic data processing services under R.C. 5739.01(B)(3)(e) and (Y). Tax should be collected on charges for both the start-up services and the on-going services in this category.
2. The Retirement Service Administration services are predominantly taxable automatic data processing services. Since there is no separation of charges between the automatic data processing and any separate personal or professional services, the entire charge, including both start-up charges and on-going charges, is subject to the tax.
3. The Cobra/Flex Spending Account Administration services are predominantly taxable automatic data processing services. Since there is no separation of charges between the automatic data processing services and any separate personal or professional services, the entire charge is subject to the tax.
4. The Pre-Employment Screening & Selection Service Administration services are predominantly personal services, rather than automatic data processing services. The charges for these services are not subject to Ohio sales tax.

This Opinion is limited to the legal issues addressed in the Opinion. This Opinion only applies to the taxpayer and may not be transferred or assigned. In addition, the tax consequences stated in this Opinion may be subject to change for any of the reasons stated in R.C. 5703.53(C). It is the duty of the taxpayer to be aware of such changes. See R.C. 5703.53(E).

Sincerely,

William W. Wilkins
Tax Commissioner