

**TENNESSEE DEPARTMENT OF REVENUE  
REVENUE RULING # 07-40**

**WARNING**

**Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.**

**SUBJECT**

Application of the Tennessee sales and use tax to medical equipment and support services provided for rigid laparoscopic procedures.

**SCOPE**

Revenue Rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue Rulings are advisory in nature and are not binding on the Department.

**FACTS**

The “Vendor” is a clinical services company that supplies medical equipment and disposable medical accessories and performs specific services for the “Taxpayer” for rigid laparoscopic procedures. The Vendor provides sufficient primary and backup reusable rigid laparoscopic surgical hand instrumentation (the “Equipment”) to support the Taxpayer’s scheduled rigid laparoscopic cases. In addition, the Vendor’s employees are available on-site or via pager at the Taxpayer’s location (the “Facility”) each day for the retrieval, set-up, technical support, cleaning, inspection, sterilization and storage of said Equipment. The Vendor retains ownership to such Equipment, and the Taxpayer may purchase such Equipment upon termination of the Agreement. The actual laparoscopic procedures are performed by employees or contracted professionals working for the Taxpayer.

The Vendor’s Instrument and Support Services Agreement (the “Agreement”) with the Taxpayer provides in part as follows:

**Instrument and Support Services**

- (a) **Instrument**: ...The Vendor shall provide all Equipment needed to support the Facility’s rigid laparoscopic cases.... All Equipment shall be purchased through the Vendor. The Vendor will clean, maintain, and repair all Equipment purchased by the Taxpayer.... The Taxpayer must send all Equipment for repair.... The Vendor will provide loaner Equipment as determined by the Vendor Staff.
- (b) **Record of Physician Preference**: The Vendor shall determine the specific items of Equipment preferred by each surgeon who performs surgical procedures at Facility, and

shall maintain a record of such preference, and shall, within reason, provide adequate selections sufficient to satisfy all surgeons utilizing such Equipment.

- (c) Retrieval of Equipment and Set-Up: Prior to each rigid laparoscopic surgical procedure, the items of Equipment preferred by the surgeon scheduled to perform the procedure shall be retrieved from storage by the Vendor personnel (or other Facility personnel expressly authorized by Facility). The Vendor personnel shall assist the Facility personnel with room set up as it relates to such Equipment.... The Vendor personnel will bring into the room, position, and hook up all video units, suction irrigation, and other required instrumentation, and troubleshoot same during each case in cooperation with Facility personnel. The Vendor personnel will inventory all Equipment prior to the start of each case to ensure proper Equipment and backups are available....
- (d) Technical Support: During all listed surgical procedures, Monday through Friday, 7:00 a.m. to 5:00 p.m. excluding all major holidays, the Vendor personnel shall be available, on-site or via pager, to the Facility to advise the surgeon regarding the structure, mechanics and function of the Equipment. Additionally, the Vendor will provide technical support via pager twenty-four (24) hours a day, seven (7) days a week. Technical support shall not include medical advice, advice on the manner in which the surgeon shall use the Equipment, or advice regarding the medical purpose of the Equipment; moreover, the Technician will not be scrubbed and shall not perform any patient care. The Vendor will develop and implement basic competency training for current and new Facility employees to ensure proper use of the Vendor and Facility equipment for cases when the Vendor is not onsite at Facility locations.
- (e) Cleaning and Inspection: The Vendor agrees to clean the Equipment after each use, following manufacturer's suggested guidelines and procedures developed by the Vendor that are consistent with the community standard of care....
- (f) Sterilization and Storage: The Vendor shall be responsible for placing Equipment after each use into Facility's sterilization units. Upon completion of the sterilization process, the Vendor personnel will transport the Equipment to the storage area located in and designated by Facility....
- (g) Maintenance and Notice of Damage: The Vendor agrees to maintain its Equipment in good working condition normal wear and tear excepted.
- (h) Training: The Vendor shall provide an initial in-service for Facility for the purpose of familiarizing its operating room personnel with the Equipment, its features, its assembly, proper handling of the Equipment, and systems to optimize the efficient use of the Equipment.... The Vendor shall provide additional in-servicing for the Facility personnel to provide information about new Equipment or new information about existing equipment. The Vendor personnel shall work regularly with the Facility personnel to improve all aspects of rigid laparoscopic surgical techniques performed in the Facility.

- (i) Budget: The Vendor shall exercise diligence in assisting the Facility in keeping controllable costs of the operating room to a minimum. The Vendor shall develop and maintain an Equipment Budget for the Agreement....
- (j) Location and Inspection: Facility shall not remove the Equipment outside of the Equipment Location without the prior written consent of the Vendor. The Vendor shall have the right to enter upon the premises where the Equipment is located or the purpose of confirming its existence, condition, and proper maintenance.

The Vendor's Agreement with the Taxpayer states that the Vendor will be the exclusive provider of both equipment and services for all rigid laparoscopic procedures to the Facility. (However, in certain cases, upon physician request, equipment and/or instrumentation owned by the Facility may be utilized.) Additionally, the Agreement provides that "the Term of this Agreement shall be for a period of thirty-six (36) months from the date the Vendor begins cases coverage with the new Equipment." The Vendor charges the Taxpayer a fee for each rigid laparoscopic procedure performed by the Taxpayer for which the Vendor supplies equipment and/or services. Specifically, "Facility shall pay to the Vendor a fee for each case in which the Vendor provides Equipment and service or one of the two components. Each case shall include Equipment, service, and technical support as described" in the Agreement. In addition, the Vendor charges a base fee regardless of the type of case.

The Vendor collected and remitted sales tax on the transactions described above. Additionally, the Vendor collected and remitted sales tax on disposable supplies provided by the Vendor to the Taxpayer for use during procedures governed by the Agreement. Furthermore, the Taxpayer agrees that the sale of separately stated disposable supplies is subject to the Tennessee sales and use tax.

### **QUESTIONS**

- 1. Are the medical equipment and support services related to such equipment described herein, as provided by the Vendor to the Taxpayer, subject to the Tennessee sales and use tax?
- 2. Is the Vendor liable for the sales and use tax on the initial purchase of the medical equipment?

### **RULINGS**

- 1. Yes.
- 2. No, provided that the Vendor supplies a valid resale certificate at the time the Vendor purchases the medical equipment.

### **ANALYSIS**

Under the Retailers' Sales Tax Act, Tenn. Code Ann. § 67-6-101 *et seq.*, the sale of tangible personal property, which includes medical equipment, is generally subject to sales and use tax. An item of tangible personal property is exempt for purposes of the Tennessee sales and use tax

only if the item is specifically included within the scope of a statutory exemption. Tenn. Code Ann. § 67-6-102(70)(A) (Supp. 2007) defines “sale” as “any transfer of title or possession, or both, exchange, barter, *lease or rental*, conditional or otherwise, in a manner or by any means whatsoever of tangible personal property for a consideration.” (Emphasis added.) Furthermore, Tenn. Code Ann. § 67-6-102(44) (Supp. 2007) defines “lease or rental” as “any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration.” However, under Tenn. Code Ann. § 67-6-102(44)(A)(iii), “lease or rental” does not include providing tangible personal property along with an operator, provided that “the operator is necessary for the equipment to perform as designed” and “must do more than maintain, inspect, or set-up the tangible personal property.”

Additionally, Tenn. Code Ann. § 67-6-204(a) (Supp. 2007) imposes a tax on the sales price of all leases and rentals of tangible personal property, and subsection (b) addresses the issue of providing an operator along with the lease. Specifically, Tenn. Code Ann. § 67-6-204(b) (Supp. 2007) (referred to for purposes of this revenue ruling as the “continuous supervision” exclusion) provides that if the owner of the property “maintains continuous supervision over the personal property being leased” and furnishes an operator to operate the property, then the operator is rendering a service and is not subject to sales or use tax as the lease or rental of tangible personal property.

Furthermore, the Tennessee Supreme Court has interpreted the legislative intent of the “continuous supervision” exclusion in Tenn. Code Ann. § 67-6-204(b) “to be limited to tangible personal property that requires continuous presence of an operator or a crew in order for the property to perform the function it is designed to accomplish.” *Hyatt v. Taylor*, 788 S.W.2d 554, 556 (Tenn. 1990) (holding that service men did not qualify as operators of water conditioning units that purified water automatically where the service men installed, cleaned and repaired the units and the customers did not turn the units on or off or exercise any control over the units installed). The Court also provided examples of leases of tangible personal property with an operator that would qualify for the exclusion under Tenn. Code Ann. § 67-6-204(b), including the leasing of drag lines, backhoes, and buses furnished with an operator. *Id.*

Note that the burden is on the taxpayer to establish entitlement to an exemption from taxation. The Tennessee Supreme Court has stated that “[a]lthough the rule is well-established that taxing legislation should be liberally construed in favor of the taxpayer and strictly construed against the taxing authority, it is an equally important principle of Tennessee tax law that ‘exemptions from taxation are construed against the taxpayer who must shoulder the heavy and exacting burden of proving the exemption.’” *American Airlines, Inc. v. Johnson*, 56 S.W.3d 502, 506 (Tenn.Ct.App. 2000) (quoting *Rogers Group, Inc. v. Huddleston*, 900 S.W.2d 34, 36 (Tenn.Ct.App. 1995)). The Tennessee Supreme Court has also stated that the burden is on the taxpayer to establish the exemption, and any well-founded doubt is sufficient to defeat a claimed exemption from taxation. *American Airlines, Inc. v. Johnson*, 56 S.W.3d at 506 (citing *Tibbals Flooring Co. v. Huddleston*, 891 S.W.2d 196, 198 (Tenn. 1994); *United Cannery, Inc. v. King*, 696 S.W.2d 525, 527 (Tenn. 1985)).

In this case, pursuant to the Agreement, the Vendor provides all medical equipment for the Taxpayer’s rigid laparoscopic procedures for a term of 36 months, and the Taxpayer pays a fee for each laparoscopic procedure where the equipment is utilized. In other words, the Vendor

transfers possession of the equipment to the Taxpayer for the Taxpayer's use in rigid laparoscopic procedures during the term of the Agreement for a consideration. Accordingly, the Vendor leases the medical equipment to the Taxpayer as defined in Tenn. Code Ann. § 67-6-102(44) (Supp. 2007), such that the lease is subject to the sales and use tax under Tenn. Code Ann. § 67-6-204(a) (Supp. 2007) unless the exclusion under subsection (b) applies.

To qualify for the exclusion under Tenn. Code Ann. § 67-6-204(b) (Supp. 2007), the Vendor's Agreement with the Taxpayer must constitute a contract for services instead of a lease of tangible personal property by meeting the following requirements: (1) The Vendor maintains constant supervision over the personal property being leased; and (2) The Vendor furnishes an operator that is necessary for the equipment to perform as designed.

The Vendor's Agreement does not qualify for the "continuous supervision" exclusion under Tenn. Code Ann. § 67-6-204(b).

First, the Vendor does not maintain constant supervision over the medical equipment leased to the Taxpayer. For example, the Agreement provides that the Vendor's personnel will be available either on-site or via pager during the surgical procedures. Similarly, the training provided by the Vendor for Facility employees is "to ensure proper use of the Vendor and Facility equipment for cases *when the Vendor is not onsite at Facility locations.*" (Emphasis added.) In addition, the Equipment is retrieved from storage either by Vendor personnel or other Facility personnel; thus, the Vendor's personnel are not required to retrieve the equipment. Moreover, the Taxpayer's employees utilize the equipment during the laparoscopic procedures, and the Vendor's technician is not scrubbed and, therefore, cannot maintain "constant supervision" as required. As a result, the Vendor does not meet the first requirement for the exclusion under Tenn. Code Ann. § 67-6-204(b) (Supp. 2007).

Second, the Vendor does not provide an operator that is necessary for the equipment to perform as designed. According to the Agreement, Vendor personnel primarily provide set-up, inspection, cleaning, maintenance, technical support and training for the medical equipment. However, the actual laparoscopic procedures are performed by employees or contracted professionals working for the Taxpayer who are responsible for operating the equipment during each laparoscopic procedure. The medical equipment is designed to perform laparoscopic procedures, which is utilized by the Taxpayer's personnel, not the Vendor's personnel. Additionally, the Agreement provides that the technical support provided by the Vendor "shall not include medical advice, advice on the manner in which the surgeon shall use the Equipment, or advice regarding the medical purpose of the Equipment." It is the surgeon provided by the Taxpayer, rather than the technician provided by the Vendor, who is necessary for the equipment to perform as designed. Therefore, the Vendor does not meet the second requirement for the exclusion under Tenn. Code Ann. § 67-6-204(b) (Supp. 2007).

As a result, the Vendor's Agreement does not qualify for the "continuous supervision" exclusion under Tenn. Code Ann. § 67-6-204(b) as set out in the statute and further interpreted by the Tennessee Supreme Court. *Hyatt*, 788 S.W.2d at 556. Accordingly, the provision of the medical equipment and supplies to the Taxpayer constitutes a lease of tangible personal property subject to the Tennessee sales and use tax.

To the extent that the Vendor's Agreement includes nontaxable services<sup>1</sup> in addition to the lease of the medical equipment, the Agreement remains subject to the sales and use tax as a lease of tangible personal property because the "primary purpose" of the Agreement is to provide the medical equipment. *Nashville Mobilephone Co., Inc. v. Woods*, 655 S.W.2d 934, 937 (Tenn. 1983).

In this case, the Taxpayer performs rigid laparoscopic procedures, and the Vendor provides the necessary medical equipment for each procedure. The support services provided along with the Equipment are just that: services to support the lease of the equipment. In addition, under Tenn. Code Ann. § 67-6-102(71)(A)(iii), the definition of "sales price" includes "charges by the seller for any services necessary to complete the sale" of the Equipment. The following terms of the Agreement support the conclusion that the services provided by the Vendor are secondary to the primary purpose of the notably titled "Instrument and Support Services Agreement," which is to furnish medical equipment necessary for the Taxpayer to perform laparoscopic procedures: (1) The Vendor provides all Equipment needed to support the Facility's rigid laparoscopic procedures; (2) The Vendor and Facility personnel retrieve the items of Equipment from storage and perform room set up as it relates to the Equipment; (3) The Vendor personnel are available via pager as well as on-site during the scheduled procedures; (4) The Vendor's technician is not scrubbed for procedures; (5) The technical support provided by the Vendor does not include medical advice or advice regarding the use of the Equipment or the medical purpose of the Equipment; and (6) The training provided by the Vendor is intended to ensure proper use of the equipment for cases when the Vendor is not on-site. It is clear from the terms of the Agreement that the primary purpose is to provide the medical equipment necessary for the Taxpayer to perform rigid laparoscopic procedures, thus, medical equipment and support services are subject to the sales and use tax.

Finally, because the medical equipment and support services are subject to the sales and use tax, the Vendor is not liable for the sales and use tax on the initial purchase of the medical equipment so long as valid resale certificate is presented at the time of the purchase. Tenn. Code Ann. § 67-6-102(67) (Supp. 2007) defines a "sale for resale" as "the sale of the property, services, or taxable item intended for subsequent resale by the purchaser" and requires any sales for resale to be "in strict compliance with rules and regulations promulgated by the commissioner." Additionally, TENN. COMP. R. & REGS. 1320-5-1-.32(3) provides that "tangible personal property sold to be used exclusively for renting or leasing may be sold upon a resale certificate." Furthermore, TENN. COMP. R. & REGS. 1320-5-1-.68(1) requires dealers to collect resale certificates for all tangible personal property sold in Tennessee for the purposes of resale. As a result, the Vendor can purchase the medical equipment leased to the Taxpayer with a resale certificate in lieu of paying the sales and use tax.

## CONCLUSION

The medical equipment and support services provided to the Taxpayer are subject to the sales and use tax because the Agreement constitutes a lease of tangible personal property subject to sales and use tax under Tenn. Code Ann. § 67-6-204(a) (Supp. 2007). Furthermore, the

---

<sup>1</sup> Under Tenn. Code Ann. § 67-6-205 (Supp. 2007) only services that are enumerated in subsection (c) are subject to the sales and use tax, and the services provided by the Vendor are not included in the list of taxable services.

“continuous supervision” exclusion under Tenn. Code Ann. § 67-6-204(b) (Supp. 2007) does not apply because the Vendor does not maintain continuous supervision over the equipment, and the operator, or Technician, furnished by the Vendor, is not required for the equipment to function as designed. Accordingly, the Vendor is not liable for the sales and use tax on the initial purchase of the medical equipment, provided that the Vendor supplies a valid resale certificate at the time of the purchase.

Rachel Wheeler  
Tax Counsel

APPROVED: Reagan Farr  
Commissioner of Revenue

DATE: 12/20/07