COLORADO
Department of Revenue
Taxation Division

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PLR-2010-003

May 6, 2010

XXXXXXXXXXXXXX
Attn: XXXXXXXXXX
XXXXXXXXXXXXXX
XXXXXXXXXXXXXX
XXXXXXXXXXXXXX

Re: private letter ruling re: food service company

Dear **XXXXXXXXXX:**

XXXXXXXXXXXXX ("Company") submitted a request for a private letter ruling pursuant to Department Regulation 24-35-103.5 and relating to the application of sales and use tax to various contractual arrangements concerning the provisioning of food and management services to for-profit healthcare facilities. This letter is the Department's private letter ruling.

Issue

Are charges by Company to a for-profit medical institution for costs incurred to prepare patient meals and related management fee subject to sales tax?

Conclusion

Charges for costs of food, labor costs for food preparation, and the related management fee (except to the extent the fee is not related to patient meals) are subject to sales tax.

Background

Company provides food and facilities management services to for-profit and non-profit medical institutions and other institutions. Company supplies patient meals and operates a cafeteria within these medical institution. Company provides the following goods and services:

- Purchasing all necessary foods and supplies for food service and housekeeping operations;
- Employing and paying all necessary personnel for operation of the food service and housekeeping operations;
- Obtaining and paying for all necessary permits and licenses for operation of the food service;
- Obtaining and maintaining commercial general liability insurance in an amount designated by the institution;
- Providing worker's compensation and employer's liability insurance for all employees employed by Company in an amount designated by the institution;
- Managing, supervising, and operating the housekeeping and nutrition departments for the institution; and
- Collecting and remitting any applicable taxes.

Company charges institutions for all costs it incurs, which include food, labor, insurance, licensing fees. Company separately charges a management fee that generally reflects Company's overhead costs. Institutions, in turn, charge patients a flat daily rate that includes the cost of patient meals. Company asks whether its labor charges and management fees are subject to sales or use tax when the institution is a for-profit entity.

Discussion

A few general observations will set the background for our discussion. Colorado levies sales tax on the sale of tangible personal property but not on the sale of services, with a few exceptions not relevant here.[1] Colorado levies sales tax on repared meals sold by restaurants, caterers, and other similar business operations. Finally, sales tax is calculated on the sales price, which includes, for products made to order, the retailer's costs for labor and overhead.[3] The issue presented here is whether a for-profit[4] medical facility, which engages a food service company to provide patient meals, must pay tax on separately stated charges for labor and management fees related to the preparation of patient meals.

Most states appear to treat medical facilities as providers of services.[5] As such, these facilities are the ultimate consumer of the tangible personal property used to provide their services and must pay sales tax on the purchases of those goods. These states treat patient

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[1] §39-26-104(1)(a), C.R.S.

[2] §39-26-104(1)(e), C.R.S. Tax is levied on "the amount paid for food and drink served or furnished in or by restaurants ... caterers ... and other like places of business at which prepared food or drink is regularly sold ... "

.[1] §39-26-102(12), C.R.S. ("[s]ales tax is imposed on the full purchase price of articles sold after manufacture pr after having been made to order and includes the full purchase price for material used and the services performed in connection therewith,... ").

Hospitals are exempt from sales tax if they are charitable entities. §39-26-718, C.R.S. Our discussion here is limited to for-profit hospitals which are not charitable entities.

[5] California SBE Information Publication No. 45, 02/01/2009 ("Hospitals and other medical service facilities are predominantly service enterprises for tax purposes and are generally considered consumers, rather than retailers, of tangible personal property [including patient meals]. As consumers, hospitals will generally pay tax to their suppliers"); Washington DOR regulation 458-20-119(3)(c) ("Purchases of prepared meals by not-for-profit organizations, such as hospitals, which provide the meals to patients *as* a *parl of the services they render'* are subject to tax); Washington Tax Determination No. 89-447, 8 WTD 175, 08/30/1989; Tennessee Revenue Ruling 95-36, 11/02/1995.

meals as part of the service provided by the medical facility and not as a separate sale of property to the patient.[6] Tennessee has succinctly stated this view:

> Hospitals are engaged in the business of rendering services, and are the consumers or users of all tangible personal property or taxable services purchased for use or consumption in connection with their operations as a hospital... The Hospital is clearly liable for tax on its purchase of food for feeding its patients. If the food is acquired tax-free by the Hospital, the Hospital, as user and consumer, would be responsible for self-reporting sales or use tax on the cost of the portion of the food used in providing patient meals.

Tennessee Revenue Ruling 95-36, 11/02/1995. However, at least two states view a food service company as a service provider, just as the medical facility is viewed as a service provider.[7] In these two states, the food service company is the consumer of the patient meals and liable for sales and use taxes when it purchases food products.

Finally, some states have addressed claims that a food service company is not selling taxable patient meals because the company is (1) acting as agent for the medical facility when purchasing food ingredients (and, therefore, can purchase the food exempt of tax if the medical facility is exempt from tax), and (2) is merely filling the shoes of the medical facility's own employee and, therefore, is providing only a non-taxable service.

We believe the better analysis is that a food service company preparing patient meals for a for-profit medical facility is a retailer of prepared meals and must collect sales tax on all charges necessarily related to patient meals, including related labor and management charges. Had the for-profit medical facility engaged a local restaurant or caterer to prepare and serve patient meals, the medical facility could not reduce its sales tax obligation on the meals by having the restaurant or caterer separately charge for its labor costs, general overhead costs, and food product costs and then pay sales tax only on the charge for food products.[8] In the facts presented here, Company operates as a caterer. It purchases food ingredients, employs cooks and other staff necessary to prepare and serve patient meals, buys worker's compensation insurance and general liability insurance, employs administrative staff for supervision and other general administrative tasks, and incurs other overhead costs typically incurred by restaurants and caterers. We believe it would be inconsistent to levy sales tax on the total cost of a meal of a caterer or restaurant and not levy sales tax on the total cost of the same patient meals prepared by the Company.

We note that most states have reached the same conclusion: a food service company's separately stated charge for labor and management fee are included in the calculation of

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[6] Colorado does not have a statute, regulation, or publication that directly addresses the taxability of patient meals.

[7] See, e.g., *ARA Hospital Food Management, Inc. v. State of Alabama.,* 437 So 2d 530, 02/02/1983; *Sodexo Operations, LLC. v. Division of Taxation* (New Jersey) 001793-2001, 08/13/2003.

[8] In *AD Store v. Department of Revenue,* 19 P.3rd 680 (Colo. 2001}, the Colorado supreme court held that a retailer must exclude separately stated charges for services if they are "separable" from the sale of the taxable property. *AD Stores* is not applicable here. The true object of the transaction here is the prepared meal, not the separate food ingredients which constitute the meal. The prepared meal is a "product made to order," and the labor and overhead incurred by a food service company to prepare such meals are inseparable from the sale of the prepared meal. See §39-26-102(12), C.R.S. quoted in footnote 3.

sales tax. See, e.g., New York Advisory Opinion TSB-A-95(39)S, 10/10/1995; Virginia Public Document Ruling No. 96-93, 05/16/1996 (food service company's management fee charged to a for-profit medical institution is subject to tax); Virginia Public Document Rulings 85-202 (10/28/85), 85-214 (12/9/85) ("true object" of contract was the sale of prepared meals, not food management service), 85-216 (12/9/85), and 86-112 (6/25/86); Missouri Private Letter Ruling No. LR 1431, 05/29/2003 (fees paid by for-profit medical facility to food service company to prepare and serve meals to patients are subject to sales tax); South Carolina Revenue Ruling 93-9, 08/04/1993 (charges by food service company to medical institution for patient meals are subject to tax); Washington Tax Determination No. 89-447, 8 WTD 175, 08/30/1989.

We also conclude that, based on the facts set forth in the Company's letter, the Company acts as an independent contractor and not as agent for the medical facility. As we noted earlier, some medical facilities have argued that the food service company staff are agents of the medical facility, are merely supplanting the medical facility's own staff, and, therefore, the food service company's labor charge is non-taxable service. Whether a food service company is acting as an agent or independent contractor is determined by a number of factors, including the degree of control exercised by the company. In this case, Company has substantial control over the food service operations. Indeed, the management fee is assessed precisely for the Company's time and expertise in exercising this control.

Moreover, Company incurs costs and engages in activities that are more characteristic of an independent contractor than of an agent. For example, Company purchases its own worker's compensation and general liability insurance, obtains all the necessary licenses to operate a food service, and purchases in its own name the food ingredients that are used to make the meals.

Together, these factors compel the determination that Company is an independent contractor, not an agent of the medical facility. States which have considered similar claims have reached the same conclusion.[9]

We acknowledge that had the institution itself employed the cook staff and the Company simply acted as a supplier of food products to the medical facility, the medical facility's sales or use tax liability would be limited to the cost of the food products and not included the institution's own labor and overhead costs. Moreover, we do not address a case in which the institution itself purchases the food products and separately contracts with a third-party who only provides the staff necessary to cook and serve the patient meal.[10] We are satisfied that Company is a caterer as this term is used in statute and, therefore, must collect sales tax on

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[9] See, e.g., *Hospital Dietary Service, Inc. v. Michigan Deparlment of Treasury, Revenue Division.,* 1391, 03/29/1979; *In the Matter of the Petition of Sodexho USA, Inc. for Revision of* a *Determination or for Refund of Sales and Use Taxes under Arlie/es 28 and 29 of the Tax Law for the Period March 1, 1998 through February* .. ... , New York Tax Appeals Tribunal, Docket Nos. 820020; 820021; 820022; 820023; 820024, 11/21/2007. (food service company not an agent of exempt charitable entity to whom company provided patient meals).

[10] South Carolina Revenue Ruling 93-9, 08/04/1993); compare *Hospital Dietary Service, Inc. v. Department of Treasury, Revenue Division,* 1391, 03/29/1979 (food service company not the agent of a tax exempt hospital and, therefore, sales of patient meals, including food service company's management fee, to hospital are subject to sales tax); Virginia Public Document Ruling No. 85-214, 12/09/1985.

all costs necessary for patient meals, including labor costs and the management fee. However, labor costs and other overhead costs that are not related to patient meals are not subject to tax. For example, that portion of the management fee, if any, related to general housekeeping should not be included in the tax calculation, except if the housekeeping is related to patient meals (e.g., labor costs for dishwashing).

The for-profit medical facility, as purchaser of tangible personal property (i.e., patient meals), is liable for sales tax, which includes separately stated charges for labor and the management fee. The medical facility, as a service provider of patient care, is the consumer of these patient meals. The medical facility cannot, therefore, claim a resale exemption on such purchases. The Company, as a retailer, is obligated to collect from the for-profit medical facility sales tax calculated as set forth herein.

Miscellaneous

This ruling applies only to sales and use taxes administered by the Department. We encourage you to consult with local governments which administer their own sales or use taxes about the applicability of their taxes.

This ruling is premised on the assumption that the Company has completely and accurately disclosed all material facts. This ruling is null and void if any representation by the Company or assumption made by the Department in this ruling is not factually correct and such have a material bearing on the conclusions reached in this ruling. The Department reserves the right, among others, to independently evaluate Company's representations. This ruling is subject to modification or revocation in accordance to Department Regulation 24-35-103.5

Enclosed is a redacted version of this ruling. Pursuant to statute and regulation, this redacted version of the ruling will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted version of the ruling.

Respectfully,

Office of Tax Policy
Colorado Department of Revenue