

Cite as 10 WTD 327 (1990).

BEFORE THE DIRECTOR  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition	)	<u>F</u> <u>I</u> <u>N</u> <u>A</u> <u>L</u>
For Correction of Assessment of	)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u> <u>N</u>
	)	
. . .	)	No. 90-139A
	)	Registration No. . . .
	)	
	)	

[1] RULES 138, 151, 178, & 224: SALES TAX -- USE TAX --  
DENTAL PRACTICE -- PATIENT FILES -- PATIENT RECORDS  
--SALE OF. The sale of patient files and records by  
one dentist to another as part of the purchase of a  
dental practice is not a purchase of tangible  
personal property subject to sales or use tax.  
(Det. 90-139 overruled.)

Headnotes are provided as a convenience for the reader and are  
not in any way a part of the decision or in any way to be used  
in construing or interpreting this Determination.

DEPARTMENT OF REVENUE REPRESENTED BY DIRECTOR'S DESIGNEE:  
Anne Roys, Sr. Administrative Law Judge

TAXPAYER REPRESENTED BY: . . .

CONFERENCE DATE: September 14, 1990

NATURE OF ACTION:

The taxpayer seeks a reversal of Determination 90-139 which  
sustained an assessment of retail sales tax on the portion of  
the purchase price of a dental practice which was allocated to  
patient files and records.

FACTS AND ISSUES:

Roys, Sr. A.L.J. -- The taxpayer is a dentist. His books and  
records were examined by the Department of Revenue  
(Department) for the period February 1, 1983 through March 31,  
1987. As a result, a tax assessment, identified by the above-

captioned numbers, was issued for \$ . . . . The taxpayer appealed the portion of the assessment that assessed deferred sales or use tax on the patient records purchased in connection with the purchase of a dental practice.

The taxpayer had purchased the dental practice in July of 1985. \$ . . . of the purchase price was allocated to the patient files and records. \$ . . . was allocated for associated goodwill and the same amount was allowed for a covenant not to compete. The Department's auditor considered the files and records to be tangible personal property and subjected them to use tax. (Schedule IV "Capitalized Purchases Subject to Use Tax") The measure of the tax was the purchase price.

The taxpayer protested the assessment, contending patient files are intangible property and, consequently, that they may not be subjected to use tax. The taxpayer cited Boe v. Commissioner, 35 T.C. 720 (1961), in support of his assertion that patient files are intangible property.

Determination 90-139 sustained the assessment. The decision relied, in part, on the definitions of tangible and intangible property in Black's Law Dictionary, concluding patient files do not represent an intangible "right."

The decision states:

As to the patient files, their value lies in the information contained in or on the paper of which they are physically composed. That is not so with stocks, bonds, copyrights, contracts, and the like, however, as the information on the paper which represents those properties is essentially worthless. It is the right represented by the paper, not the information printed on the paper, that makes those properties valuable. The paper simply identifies what that right is.

. . .

The patient files take on a different character when they are sold to another dentist. Professional services were not a consideration in the transfer at issue. Only a sale of tangible personal property, as opposed to a service, took place as between the two dentists. If the purchasing dentist uses the files, he owes use tax based on their value. In

fact, and more accurately, before that, he owes deferred sales tax on the files because his purchase of them from the selling dentist was at retail. As to those patient files, tangible personal property was sold to a consumer.

The taxpayer appealed the decision. A brief on his behalf was submitted by the American Dental Association.

#### DISCUSSION:

RCW 82.08.020 imposes the retail sales tax on each "retail sale." Retail sales include sales of tangible personal property and certain enumerated services. RCW 82.12.020 imposes the use tax upon the use of any article of tangible personal property within this state. Neither the retail sales tax nor the use tax applies to the sale or use of intangible property.

Black's Law Dictionary defines tangible property as property which may be "felt or touched." Intangible property is defined:

As used chiefly in the law of taxation, this term means such property as has no intrinsic and marketable value, but is merely the representative or evidence of value, such as certificates of stock, bonds, promissory notes, and franchises.

An intangible asset is defined as:

Such values as accrue to a going business as good will, trademarks, copyrights, franchises, or the like. It exists only in connection with something else, as the good will of a business.

Clearly, good will and a covenant not to compete are intangible assets. Neither can be "felt or touched."

WAC 308-37-110 requires all dentists who treat patients in this state to maintain complete treatment records regarding patients treated. The records are to include x-rays, treatment plans, patient charts, patient histories, correspondence, financial data and billing. The records are to be maintained in an "orderly, accessible" file for a period of five years.

Although dental records can be "felt or touched," their primary value is in their use in a continuing professional relationship with patients--their "intangible" value. One reason the records are purchased is that the purchaser hopes to receive the future dental business of the existing patients of the practice purchased. The patients, not the files, have the potential to produce income to the purchaser. The information in the records can aid future treatment of the patients and sometimes serves as a forensic resource.

Determination 90-139 noted that the purchase price of \$ . . . was considerably more than the costs of the physical materials which comprise patient files and records. The Determination concluded that dental records were analogous to books, works of art, or products manufactured from raw materials. The taxpayer disagreed, arguing that such items all have an independent value. For example, five copies of Black's Law Dictionary would be worth more than one copy. On the other hand, multiple sets of the same dental records would be worth no more to the purchaser of a dental practice than one set.

The information in patient records is of value to the taxpayer only if the patients should continue treatment with him. If a patient were to go to another dentist, the purchased records would have no value to the taxpayer. WAC 308-37-110 provides that patients may request that x-rays or copies of their records be forwarded to a second party. A reasonable fee may be charged the patient to cover mailing and clerical costs. The taxpayer would not be able to recover his initial pro-rata cost for the records which were included in the purchase price of the dental practice.

Determination 90-139 noted that the taxpayer and his predecessor may have been motivated by favorable federal tax treatment in allocating \$ . . . of the selling price of the dental practice for the medical records. The Determination stated that "[a] taxpayer may not treat a transaction one way for federal tax purposes and yet another way for state tax purposes." The Determination went on to state "[t]hat is what the Department would be doing, if it used anything other than the \$ . . . selling price set by the parties as the measure of the sales tax." The Determination cited a previous Determination, Det. 87-354, 4 WTD 293 (1987), which held that a taxpayer may not treat a transaction one way (a sale/leaseback) for federal tax purposes, but another way (a loan) for state tax purposes.

For federal tax purposes, intangibles used in a trade or business which are subject to a limited and ascertainable useful life may be depreciated or amortized. 26 C.F.R. Section 1.167(a)-3 (1988), provides in pertinent part:

If an intangible asset is known from experience or other factors to be of use in a business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance. . . . No allowance will be permitted merely because, in the unsupported opinion of the taxpayer, the intangible asset has a limited useful life. No deduction for depreciation is allowable with respect to good will.

By amortizing the purchase of the records for federal tax purposes, the taxpayer did not treat the transaction as a sale of tangible personal property. The American Dental Association brief noted that the taxpayer listed the dental records in his federal tax filing, on Form 4562, as amortizable intangible assets. The association contends that it is the Department which is inconsistent by accepting the value stated on the federal tax declaration while rejecting the basis of the valuation.

Several federal cases have classified medical and dental records as amortizable intangible assets. In Chester Johnson Jr. v. United States, 61-1 USTC 9278, the Tax Court found an obstetrician could depreciate 90% of the acquisition costs allocated to patient charts over a six-year period. The remaining 10% was found to be good will and not depreciable. The six-year useful life for the charts was due to the high population turn-over in the area and the finding that women ordinarily have their babies in a short period of time.

In Los Angeles Central Animal Hospital, Inc., 68 T.C. 269 (1977) the issue was whether veterinary medical records constituted goodwill and were not depreciable. The tax court found that the records, while intangible and connected to goodwill, could have a defined useful life. The Court permitted a deduction based on amortization over the useful life of the records.

We agree with the federal tax decisions which classified medical records as intangible assets. We find medical records constitute intangible assets for state tax purposes and that

the sale of medical records as part of the sale of a dental practice is not a retail sale.

DECISION AND DISPOSITION:

The taxpayer's petition is granted.

DATED this 26th day of February, 1991.