

1 Community Mutual Insurance Company, Appellee and Cross-Appellant, v.
2 Tracy, Tax Commissioner, Appellant and Cross-Appellee.

3 [Cite as Community Mut. Ins. Co. v. Tracy (1995), _____ Ohio St.3d
4 _____.]

5 Taxation -- Sales and use taxes -- Health insurance company's transaction
6 with company that coded and organized litigation documents into a
7 computer-accessible format not taxable -- Health insurance
8 company's transactions with company that provided information on
9 adjudication of claims on computer tapes and transaction with
10 company that transferred a license to use application software are
11 taxable.

12 (No. 94-705 -- Submitted June 6, 1995 -- Decided August 30, 1995.)

13 Appeal and Cross-Appeal from the Board of Tax Appeals, No. 91-J-
14 418.

15 Community Mutual Insurance Company ("Community Mutual"),
16 appellee and cross-appellant, a health insurance company based in
17 Cincinnati, is a member of the National Association of Blue Cross/Blue
18 Shield organizations. The Tax Commissioner, appellant and cross-appellee,

1 audited Community Mutual's purchases from April 1, 1985 through
2 September 30, 1985. He assessed Community Mutual on transactions with
3 (1) Document Automation Corporation, which coded and organized
4 litigation documents into a computer-accessible format, (2) Nationwide
5 Insurance Company, which provided information on its adjudication of
6 claims on computer tapes, (3) and Business Systems Corporation of
7 America, which transferred a license to use application software to
8 Community Mutual. On appeal, the Board of Tax Appeals found that these
9 transactions were exempt legal or personal services.

This cause is now before this court upon an appeal and cross-appeal
as of right.

Vorys, Sater, Seymour & Pease, Raymond D. Anderson and Anthony L. Ehler, for appellee and cross-appellant.

Betty D. Montgomery, Attorney General, and *Lawrence D. Pratt*,
Assistant Attorney General, for appellant and cross-appellee.

1 *Per Curiam.* We affirm the BTA’s decision as to the transaction with
2 Data Automation Corporation and reverse its decision as to the transactions
3 with Nationwide Insurance Company and Business Systems Corporation of
4 America.

I

LITIGATION SUPPORT

A. FACTS

8 The National Association of Blue Cross/Blue Shield organizations
9 sued Community Mutual for trademark infringement and antitrust
10 violations. In responding to discovery, Community Mutual's attorneys
11 needed to code one hundred thirty-five banker boxes of records. At first,
12 Community Mutual's attorneys, their paralegals, and law students
13 performed this coding. However, the attorneys needed quicker progress,
14 and they hired Document Automation Corporation ("DAC").

15 Following a manual prepared by Community Mutual's attorneys and
16 under their supervision, DAC coded the documents so that the attorneys
17 could readily interpret them. DAC coded the documents bibliographically
18 by names mentioned, date, author, recipient, and relationship of an author.

1 DAC also summarily or subjectively coded the documents. In this
2 coding, the coder reviewed and abstracted the document, pulling specific
3 information from the document per the instructions of the attorneys or
4 paralegals. DAC coded four different fields required by the attorneys. First,
5 the attorneys required the coders to determine whether an attorney-client
6 privilege applied to the document. Second, the coders determined whether
7 the documents fell into one of twelve legal or factual categories. Third, the
8 coders determined whether the document had some factual or legal
9 significance to the matters in the case. Fourth, the coders prepared a
10 summary indicating the supporting and damaging information they found
11 within the document and briefly describing the document in a “memo” field,
12 to be searched like Lexis or Westlaw. DAC placed this information on
13 computer-readable media and delivered a tape to the attorneys, who
14 downloaded the tape into their computer system. The attorneys, after
15 settling the suit, now store the tape in their vault.

16 DAC billed a charge to the law firm, which the firm billed to
17 Community Mutual. The commissioner assessed this charge. In its
18 decision, the BTA found that these services qualified as “legal services,”

1 because DAC analyzed the material to categorize it properly. Thus, the
2 BTA found these to be exempt personal services to which automatic data
3 processing and computer services (“ADP and computer services”) were
4 incidental or supplemental.

5 B. ANALYSIS

6 Former R.C. 5739.01(B)(3)(e) defined “sale” and “selling” to include
7 transactions in which:

8 “Automatic data processing and computer services are or are to be
9 provided for use in business when the true object of the transaction is the
10 receipt by the consumer of automatic data processing or computer services
11 rather than the receipt of personal or professional services to which
12 automatic data processing or computer services are incidental or
13 supplemental. * * *”

14 Former R.C. 5739.01(Y)(1) defines “automatic data processing and
15 computer services” as:

16 “[P]rocessing of others’ data, including keypunching or similar data
17 entry services together with verification thereof; providing access to
18 computer equipment for the purpose of processing data or examining or

1 acquiring data stored in or accessible to such computer equipment; and
2 services consisting of specifying computer hardware configurations and
3 evaluating technical processing characteristics, computer programming, and
4 training of computer programmers and operators, provided in conjunction
5 with and to support the sale, lease, or operation of taxable computer
6 equipment or systems. ‘Automatic data processing and computer services’
7 shall not include personal or professional services.

8 “(2) As used in divisions (B)(3)(e) and (Y)(1) of this section,
9 ‘personal and professional services’ means all services other than automatic
10 data processing and computer services, including but not limited to:

11 “(a) Accounting and legal services such as advice on tax matters,
12 asset management, budgetary matters, quality control, information security,
13 and auditing and any other situation where the service provider receives
14 data or information and studies, alters, analyzes, interprets or adjusts such
15 material[.]”

16 The commissioner argues that only attorneys can provide legal
17 services and that the disputed purchase is taxable because nonlawyers
18 provided the interpretation and analysis in this case. Community Mutual

1 responds that services provided by trained individuals acting under a
2 lawyer's direct supervision qualify for this exemption.

3 According to the evidence, DAC's service qualifies as legal services.

4 Its employees received the documents, studied them, analyzed the
5 documents to determine how to code them, and interpreted them for the
6 lawyers. The attorneys relied on DAC to determine whether the document
7 was privileged, whether it pertained to one of the twelve legal or factual
8 categories, and whether it was significant to that category, and to summarize
9 it for computer retrieval. These are typical actions that lawyers take in
10 preparing a case for trial.

11 As to the commissioner's argument that only lawyers can provide
12 legal services, the argument ignores Canon 3 of the Code of Professional
13 Responsibility. In EC 3-6, the code provides:

14 "A lawyer often delegates tasks to clerks, secretaries, and other lay
15 persons. Such delegation is proper if the lawyer maintains a direct
16 relationship with his client, supervises the delegated work, and has complete
17 professional responsibility for the work product. This delegation enables a
18 lawyer to render legal service more economically and efficiently."

In fact, we recognized this practice and disciplined a lawyer for not properly supervising his office personnel. In *Disciplinary Counsel v. Ball* (1993), 67 Ohio St.3d 401, 404, 618 N.E. 2d 159, 161, we stated:

“Delegation of work to non-lawyers is essential to the efficient operation of any law office. But, delegation of duties cannot be tantamount to the relinquishment of responsibility by the lawyer. Supervision is critical in order that the interest of clients are effectively safeguarded. * * * It is the respondent’s total failure to supervise any work done by his non-lawyer employee which is the gravamen of this case.”

Thus, laypersons can perform legal services if accomplished under an attorney's supervision. Consequently, the service that DAC performed for Community Mutual's attorneys is a professional, legal service, and the BTA's conclusion that the true object was the professional service to which ADP and computer services were incidental or supplemental is reasonable and lawful.

II

ADJUDICATION INFORMATION

A. FACTS

1 Nationwide Insurance Company contracts with the federal Health
2 Care Finance Administration to administer the federal Medicare Part B
3 program. Nationwide receives a claim, assigns a control number to it, and
4 forwards the claim to its claims examiners, whom Nationwide trains in
5 medical terminology and claims adjudication. The claims examiners study
6 the claim and the file, and determine whether and how much to pay on the
7 claim.

8 Community Mutual provides supplementary Medifill B coverage. In
9 this program, the Medicare claimant may receive additional benefits on a
10 Medicare claim from Community Mutual. Community Mutual will receive
11 information on Nationwide's ruling on the claim upon the claimant's
12 authorization. Community Mutual will then pay supplementary benefits to
13 the claimant if due.

14 During the audit period, Community Mutual purchased this
15 information from Nationwide at a charge established by the federal
16 government. To receive the information on these adjudications, Community
17 Mutual delivered an eligibility tape to Nationwide, which listed eligible
18 claimants. Nationwide, with its computers, ran that tape against its

1 beneficiary master file. When Nationwide found a match, it spun the
2 information about the adjudication onto a tape, an Explanation of Medicare
3 Benefits (“EOMB”) tape, that it then sent to Community Mutual.
4 Community Mutual could then determine what to pay on the supplementary
5 claim. These EOMB transactions occurred weekly.

6 The commissioner assessed tax on Nationwide’s charges for these
7 EOMB tapes. On appeal, the BTA, without actually determining that
8 Nationwide provided Community Mutual a personal service, determined
9 that the overriding purpose of the transaction was to obtain the information
10 contained on the tapes and that the transaction was an exempt personal
11 service.

12 B. ANALYSIS

13 In defining “sale” and “selling,” R.C. 5739.01(B)(5) provides:

14 “Other than as provided in this section, ‘sale’ and ‘selling’ do not
15 include professional, insurance, or personal service transactions which
16 involve the transfer of tangible personal property as an inconsequential
17 element, for which no separate charges are made.”

1 The commissioner maintains that this transaction is simply the
2 mechanical retrieval of requested information from a pre-existing computer
3 data base and the sale of this information on an encoded magnetic tape. He
4 claims that this is not a personal service, and that the BTA erred in deciding
5 whether an overriding purpose existed. Community Mutual claims that
6 Nationwide sold it the skill of its trained individuals who adjudicated the
7 claim. It also claims that this sale is the purchase of intangible personal
8 property or, furthermore, an insurance service transaction.

9 In *Emery Industries, Inc. v. Limbach* (1989), 43 Ohio St. 3d 134, 539
10 N.E. 2d 608, in which we formulated a new approach to personal service
11 transactions, we noted that Ohio taxed transactions in tangible personal
12 property and certain specified services. We continued to note that, until the
13 General Assembly had recently begun to tax some personal services, “all
14 services were excluded from the tax because, by definition, they were not
15 sales and, thus, not retail sales, the basis for the tax.” Under the personal
16 services exception, “[h]owever, when inconsequential personal services
17 accompanied a transfer of consequential tangible personal property and their

1 charge was not separated from the charge for property, the service was
2 taxed.” *Id.* at 135, 539 N.E. 2d at 610.

3 We reviewed the definition of “personal service” adopted in *Koch v.*
4 *Kosydar* (1972), 32 Ohio St.2d 74, 61 O.O. 2d 329, 290 N.E. 847, paragraph
5 one of the syllabus. We determined the definition to be lacking because it
6 did not simply define a personal service; rather, it included a test for
7 determining the inconsequentiality of the tangible personal property. Thus,
8 we decided to remove that test from the definition. In paragraph one of the
9 syllabus in *Emery*, we defined a “personal service” as:

10 “Any intellectual or manual act involving a recognized skill
11 performed by a person who is specifically engaged by the purchaser to
12 perform the act. (*Koch v. Kosydar* [1972], 32 Ohio St. 2d 74, 61 O.O.2d
13 329, 290 N.E.2d 847, modified.)”

14 In this case, the BTA apparently assumed a personal service occurred
15 and went directly to deciding, under paragraph four of the syllabus of
16 *Emery*, what the overriding purpose of the purchaser was in the transaction.
17 However, under paragraph three of the syllabus in *Emery*, if no personal
18 service occurred, the entire transaction is taxable.

1 According to the definition of “personal service” contained in *Emery*,
2 Nationwide did not perform a personal service for Community Mutual.
3 Nationwide did not direct its intellectual effort to profit Community Mutual;
4 Nationwide had, in adjudicating the claim, directed this effort to determine
5 what, if any, benefits to pay its claimants. It simply reported to Community
6 Mutual the results of these intellectual acts. This action does not appear far
7 different from a legal publishing company’s selling casebooks containing
8 our decisions. We employed intellectual effort in resolving the
9 controversies presented us by the parties. However, the sale of the
10 published reports of the decisions to the legal community is the transfer of
11 tangible personal property and a taxable sale. Thus, we reverse the BTA’s
12 decision.

13 We also conclude that Community Mutual did not purchase
14 intangible property. Virtually all books and recordings memorialize
15 intangible efforts by the author or artist. Recording and marketing the
16 intellectual effort render that effort more economically available to
17 purchasers. Nevertheless, the medium on which the intellectual effort is
18 transferred is tangible and subject to the sales tax. If the transaction

1 contains a “personal service,” as defined in *Emery*, it may be exempt if the
2 purchaser’s overriding purpose is to obtain the personal service. Here, no
3 personal service occurred.

4 As to Community Mutual’s argument that this is an insurance
5 transaction, Community Mutual purchased taped adjudication information.
6 This was the purchase of tangible property; it was not the sale of an
7 insurance service.

8 **III**

9 **APPLICATION SOFTWARE**

10 **A. FACTS**

11 Community Mutual desired to improve its business operations. It
12 studied application software programs created by Electronic Data Systems,
13 McDonnell-Douglas, and Business Systems Corporation of America. It
14 purchased a license to use the program offered by Business Systems.

15 Business Systems began business as a committee of the National
16 Association of Blue Cross/Blue Shield organizations. It was to develop
17 software to improve its members’ operations. At some point the association
18 established Business Systems separately from the association, and Business

1 Systems continued to develop and then market software. Business Systems
2 developed a computer program it called “Long Range Systems Planning”
3 (“LRSP”), which it sold to Community Mutual. LRSP will allow the
4 subscriber’s computer system to process group and subscriber records and
5 transactions, maintain group and subscriber data, handle billing of groups
6 and subscribers, process claims, store records on physicians, store pricing
7 schedules, accumulate statistical records for later analysis, and produce
8 checks and explanations of benefits. LRSP is application software; it solves
9 business problems for Community Mutual. It does not manage the hardware
10 of the systems; hence, it is not system software.

11 Community Mutual was the seventh or eighth association member to
12 purchase LRSP, and it paid \$1,250,000 for the license to use LRSP.
13 Community Mutual, paid only \$210,000 in the assessment period and was
14 assessed only on that amount. Community Mutual received encoded
15 magnetic tapes containing the LRSP program. For this fee, Business
16 Systems also installed and implemented the program and provided hard-
17 copy documentation. In installing LRSP, Business Systems agreed to
18 establish the program in Community Mutual’s computer system and perform

1 baseline tests with satisfactory results. In implementing LRSP, Business
2 Systems agreed to bring the program up to operational use and to consult
3 with Community Mutual in so doing. Community Mutual provided no
4 evidence on the extent of this installation and implementation.

5 During the audit period, Community Mutual also purchased
6 enhancements, known as a “customer request,” or a “CR,” from Business
7 Systems, which cost Community Mutual at least an additional \$314,000.
8 Business Systems later bundled these CRs with LRSP to sell a higher-level
9 LRSP.

10 After installation, Community Mutual, in separate billings, paid
11 Business Systems \$1,023,048.34 and several other programmers
12 \$2,113,403.72 to tailor LRSP to Community Mutual’s computer
13 environment.

14 The commissioner assessed tax against the \$210,000 installment for
15 the LRSP and against the amount for CRs; it did not assess Community
16 Mutual for the separately billed programming charges. The BTA, in
17 reversing the commissioner, determined that the overriding purpose in the

1 transaction was to obtain the information contained on the software without
2 first determining whether a personal service existed.

3 B. ANALYSIS

4 The commissioner maintains that Community Mutual purchased
5 tangible personal property in the form of taped computer software and
6 supporting hard-copy documentation and did not purchase a personal
7 service. Community Mutual, on the other hand, maintains that it purchased
8 a personal service to which computer tapes are an inconsequential tangible
9 element. It also maintains that computer software is intangible property.

10 Under R.C. 5739.01(B)(1), “sale” and “selling” include “all
11 transactions by which *** a license to use or consume tangible personal
12 property is or is to be granted[.]” Under *Interactive Information Systems,*
13 *Inc. v. Limbach* (1985), 18 Ohio St.3d 309, 18 OBR 356, 480 N.E. 2d 1124,
14 encoded magnetic tapes are tangible personal property. Moreover, as we
15 earlier mentioned, a “personal service” is “any intellectual or manual act
16 involving a recognized skill performed by a person who is specifically
17 engaged by the purchaser to perform the act.” *Emery Industries, Inc. v.*
18 *Limbach, supra*, paragraph one of the syllabus.

1 Community Mutual did not specifically engage Business Systems to
2 design LRSP for Community Mutual. Business Systems had designed and
3 developed this program to satisfy the needs of Blue Cross/Blue Shield
4 members generally. It sold the license to use this program to Community
5 Mutual and delivered the program to Community Mutual on magnetic tapes.
6 Under *Emery* and *Interactive Information Systems, Inc.*, Community Mutual
7 did not receive a personal service from Business Systems; Community
8 Mutual received tangible personal property.

9 Furthermore, we do not adopt Community Mutual's argument that we
10 should consider all the charges that Community Mutual paid to tailor the
11 system to its computer environment. The purpose of *Emery's* true object
12 test is to determine the consequentiality of personal property when a mixed
13 transaction is at issue and no separate charges have been made for the
14 service or the property. Here, Community Mutual paid a separate price for
15 the property and another price for the service in separate billings. The
16 transactions do not invoke the true object test.

17 Accordingly, we affirm, as reasonable and lawful, the BTA's decision
18 in exempting the purchases of litigation support from DAC and reverse, as

1 unlawful, the BTA's decisions as to the purchases of information from
2 Nationwide and application software from Business Systems.

3 *Decision affirmed in part*
4 *and reversed in part.*

MOYER, C.J., DOUGLAS, WRIGHT, RESNICK, F.E. SWEENEY, PFEIFER
and COOK, JJ., concur.

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