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Recent Ohio Sales Tax Action on Services Impacts Banking Industry

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Sales tax on goods and services purchased by your business is always an element of cost that must be considered. This has become especially important to the Ohio banking industry. Recently, vendors, accountants, and even the Ohio Department of Taxation have contacted banks about the application of sales tax on the purchase and consumption of certain services known as “automatic data processing” and “electronic information services.” Previously, a vendor such as your data processing vendor may not have collected Ohio sales tax on these transactions. Now, however, vendors such as Jack Henry and FiServ are generally charging sales tax on all types of computer assisted services, and some banks have been asked to remit the tax on older, untaxed, invoices by either the vendor or by the Ohio Department of Taxation upon audit.

Automatic data processing, or “ADP,” refers to the processing of others’ data, including keypunching or similar data entry services together with verification of the data, or providing access to computer equipment for the purpose of processing data. Examples of ADP include processing a request for specific stored data requested by the consumer, changing the medium on which data is stored (e.g., from paper to electronic form), and preparing business documents such as checks and bills and reports.

Electronic information services (EIS) is a general term, meaning to provide access to computer equipment by means of telecommunications equipment (*i.e.*, the internet or dedicated line) for the purpose of either a) examining or acquiring data stored in or accessible to the computer equipment, or b) placing data into the computer equipment to be retrieved by designated recipients with access to the computer equipment. Essentially, EIS refers to providing access to computers for business purposes. EIS includes providing internet access, access to a database by electronic means, such as when you log into an account, or even providing access to electronic mail.

ADP and EIS services fall within the definition of “sale” for the Ohio sales tax purposes and either the vendor or consumer may be taxed by the Department of Taxation when those services are provided for business purposes (e.g., personal or home internet access is not taxable). Tax on those services has been around for over 20 years, but the Department of Taxation recently has placed greater emphasis on the audit and tax compliance of those services.

Specifically, in 2015 the Department of Taxation began pursuing a more aggressive policy of taxing an ever-broadening scope of computer assisted services that it classifies as being either ADP or EIS. In a world of internet banking, electronic bill-pay, and the outsourcing of services such as the processing of account statements and platform processing providers, banks operating in Ohio may see more of their vendors seeking to collect tax on electronic and computer-related services. These transactions also are increasingly under scrutiny from the Department of Taxation during audit.

Despite what appears to be a comprehensive tax on computer assisted services being pushed by the Department of Taxation, not all services in which computers are used constitute automatic data processing, and not every instance of granting access to data is the provision of a taxable electronic information service. Such services may or may not constitute ADP and EIS services depending upon the “true object” of the service provided. The sale of the services for use in business is considered taxable when the “true object” of the service is the receipt of automatic data processing or electronic information services. However, if the object of the transaction is the receipt of exempt personal or professional services, for which the ADP or EIS elements are incidental or supplemental, then sales tax does not apply.

A general example of a personal and professional service is hiring someone to audit books. This service arguably is not ADP even though a computer is used by the person doing the auditing. It is the knowledge and professional service of the auditor that is the true object of the transaction. The use of the computer is incidental to the service. Other personal and professional services carved out from taxable ADP and EIS include legal and accounting services, providing credit information by a consumer reporting agency, debt collection services and identifying business management information needs.

Ohio case law also holds that, where the consumer receives no access to computer equipment for the purpose of processing, examining, or acquiring data, ADP and EIS have not occurred. An example of this occurs when a merchant swipes a credit card to seek an authorization for a purchase. The merchant does not get access to the card holder’s credit information but only receives a “yes” or “no” authorization response. Such an inquiry is not considered to be ADP.

Ultimately, whether a transaction (or part thereof) is taxable is dependent on the details of the service performance and the wording of the service agreement. An intimate understanding of those details can help determine whether the transaction is subject to the sales tax. Details, such as the level of professional or personal services (intellectual effort) provided along with the use of computers, whether those involved in providing the service are specially trained or must hold certifications or licenses, and the level and type of information exchanged or made available to the customer, and in what form, may each help determine whether a particular transaction constitutes taxable ADP or EIS.

Understanding what is being provided is key. If you find yourself questioning whether you are purchasing taxable ADP or EIS services or if you are being audited by the Ohio Department of Taxation, please feel free to contact Vorys.