Like a spider trapping its prey, Texas ensnares consultants in the web of taxable insurance services. The latest victims are physician consultants. (The Texas Comptroller previously held that certain legal services constituted taxable insurance services.)

Serving as the web-building material, Texas Comptroller Rule 3.355(b) provides that an insurance service is taxable if it is performed on behalf of an insurance carrier, its insured, its policyholder, or others pertaining to a policy of insurance.

Policy-related services provided to an insurance carrier, an insured, or a policyholder, generally fall subject to Texas sales tax. But, what about various types of billing services provided to a Texas physician?

Recognizing the inherent danger of providing services to physicians who accept assignments of insurance proceeds and file claims on behalf of patients, a healthcare consulting firm ("Healthcare") sought guidance from the Texas Comptroller's Office regarding taxability of the services Healthcare provides to Texas physicians. Healthcare provided various services including Recovery Services, Zero Balance Recovery Services, and Medical Billing Services.

Recovery Services

Recovery Services typically involve the review, analysis, and correction of health insurance claims with defects in the claim paperwork. According to the Comptroller,
services to correct claims that were previously submitted by another party are taxable. The claims process begins for a particular claim when it is initially received by the insurance company or third-party payor.

Although medical billing has been ruled not a taxable service because it is performed before a claim is initiated, subsequent activities provided by a company other than the originator are not considered incidental to the non-taxable billing. Instead, services performed after the initiation of the insurance claim are considered taxable insurance claims adjustment services, which include any activity to supervise, handle, investigate, pay, settle or adjust claims. It does not matter that the services were not provided to an insurance company or an HMO because there is no specific requirement that the taxable activity be restricted to an insurance company or HMO.

The Comptroller has ruled that services provided for physicians by a medical billing company to complete or correct an initial claim are incidental to the original pre-insurance-initiated claim, and that such services do not constitute insurance services. To qualify as non-insurance services, claim corrections must be made either by the party originating the claim or in response to a request by the payor to provide additional information.

Zero Balance Recovery Services

Zero Balance Recovery Services involve the review, analysis, and billing of charges not originally included in the health insurance claim filed by a physician. The Comptroller considers these services to be the nontaxable initial filing of an insurance claim and does not consider these services to be an insurance service.

However, to the extent that the service locates short payments from the insurance companies and the service provider bills the short payments to the appropriate payor on behalf of the physicians, the service would be a taxable insurance claims adjustment service, which includes any activities to supervise, handle, investigate, pay, settle or adjust claims.

i. Lump-sum Charges May Be Presumed Taxable

If nontaxable filing services are provided along with a taxable insurance service for a single charge and the portion relating to taxable services represents more than 5.0% of the total charge, the total charge is presumed to be taxable. The presumption may be overcome by the insurance service provider at the time the transaction occurs by

---

5 Tex. Comptroller Ruling, No. 200207227L (July 2, 2002) “If the insurance company or its designee requests the medical billing company to provide additional information or to make adjustments to the submitted billing, then the service performed by the medical billing company in response to the request is incidental to the medical billing services.”

6 Id. “Medical billing services require trained individuals to understand and create technical medical codes, which are entered into computers to prepare the actual bills. Thus, the service provider creates data that are entered into the computer, which is distinguishable from processing information furnished by the purchaser of the service. For this reason, the agency does not consider medical billing to be taxable data processing services.”

7 See Rule 3.355 (c) (5).
separately stating to the customer a reasonable charge for the taxable services. In such situations, only the taxable portion is subject to tax.

ii. Proving Separate Charge

If the charge for the taxable portion of the services is not separately stated at the time of the transaction, the service provider or the purchaser may later establish for the Comptroller, through documentary evidence, the percentage of the total charge that relates to nontaxable unrelated services. The insurance service provider's books must support the apportionment between exempt and nonexempt activities based on the cost of providing the service or on a comparison to the normal charge for each service if provided alone. If upon review the charge for exempt services is unreasonable considering the cost of providing the service or a comparable charge made in the industry for each service, the Comptroller will adjust the charges and assess additional tax, penalty, and interest on the taxable services.8

Medical Billing Service

Medical billing of health insurance claims by a service provider for a healthcare provider typically encompasses the initial filing of claims through payment posting into the provider's billing system. As with the Zero Balance Recovery Services, the medical billing portion of the claim is not taxable. However, if the service provider is not providing a billing and collection function, the subsequent posting of payments into the provider's billing system is considered taxable data processing. Taxable data services would include generating any reports. If these taxable services are combined in a single charge, they are subject to the 5% rule as addressed above. Once the taxable amount has been determined, tax is due on 80% of any taxable data processing.9

Will You Walk Into My Parlor?10

With the Comptroller continuing to spin its subtle but ever expanding web of taxable insurance services, it becomes increasingly easy for service providers to become trapped in the taxable services web. To the extent that services are being provided to any client that may involve an insurance policy, service providers must carefully structure engagement letters, invoices, and other evidence of the services provided. Although some policy-related services may become entangled in the web, at least some services may be structured to minimize sales tax exposure. Seeking the advice of a tax attorney experienced in this confusing and complex web of sales taxation might well be the first step to untangle the web and avoid becoming the spider's next feast.■

---

8 See Rule 3.355 (i) (2).
9 See Rule 3.330.
10 The Spider and the Fly by Mary Howitt.