



Janice K. Brewer  
Governor

## PRIVATE TAXPAYER RULING LR11-003

Gale Garriott  
Director

March 28, 2011

The Department issues this private taxpayer ruling in response to your request of December 4, 2009, submitted on behalf of your client . . . (the "Company"). You request a determination of the applicability of Arizona transaction privilege tax ("TPT") or use tax to the Company's purchases of tangible personal property for ultimate use outside the country, but shipped by common carrier to a freight-forwarding center that the Company subleases in Arizona.

### **Statement of Facts:**

Your December 4 request provides the following excerpted facts:

In the past, [the Company] operated a manufacturing facility in [Arizona]. In November 2006, [the Company] closed its manufacturing facility . . . and moved its manufacturing plant to Mexico ("maquiladora").

As part of its current operations, [the Company] purchases items such as machinery, equipment, raw materials, tools, office equipment, and supplies for use at the maquiladora. [The Company]'s corporate office makes payment for these purchases once the items arrive in Mexico.

The purchase orders issued by the maquiladora indicate that the items are for shipment to Mexico. Upon receipt of a purchase order, a vendor will ship the items via common carrier with a certificate of origin. The common carriers transport the items from the vendor's docks to [Arizona], where the orders are processed by a freight-forwarding center subleased by [the Company].

The freight-forwarding center in [Arizona] is staffed by three independent contractors and a part-owner of the freight-forwarding center who is a customs broker. In addition, two of [the Company]'s employees work in the subleased facility to assist with customs and shipment into Mexico. To process the export documentation, the freight-forwarding center will review each item's packaging list, copy the vendor's invoice and certificate of origin, and enter the shipment data into [the Company]'s system.<sup>1</sup> At the freight-forwarding center, a customs broker does an inspection for customs purposes. Customs documentation is generally prepared the same day the items are received at the freight-forwarding center. Within one or two days, the items are shipped to the manufacturing plant

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<sup>1</sup> On rare and unusual circumstances, the freight-forwarding center may return a shipment to the vendor when the shipment: is obviously damaged; is labeled as containing the incorrect items; or, is a duplicate order. In such circumstances, the order is returned to the vendor. If the items were obviously damaged, the vendor will resend the items that conform to the original purchase order. Packages are returned only when it is obvious that the package is damaged, labeled as containing the incorrect items, or labeled as a duplicate order. [The Company] does not open the packaged boxes at the freight-forwarding center. The packages are only opened once they are received at the maquiladora in Mexico.

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in Mexico. Once the packaged items are received in Mexico, the maquiladora employees will open the shipment and perform a quality inspection.

### **Your Issues:**

Based on the subjects addressed in your discussion, analysis, and conclusion, you ask whether the Company is subject to Arizona retail TPT or use tax on manufacturing items, machinery and equipment used directly in manufacturing at the Company's maquiladora in Mexico, and raw materials that become ingredient or component parts of manufactured products at the maquiladora.

### **Your Positions:**

Based on the discussion and conclusions reached in your request, your position is that the Company is neither subject to retail TPT nor use tax on the aforementioned items of tangible personal property.

### **Discussion:**

Arizona imposes use tax on "the storage, use or consumption in this state of tangible personal property purchased from a retailer or utility business, as a percentage of the sales price."<sup>2</sup> Use tax liability falls upon the person who stores, uses, or consumes tangible personal property in this state, and that the liability is not extinguished until the tax has been paid.<sup>3</sup>

By statute, "storage" is defined as "keeping or retaining tangible personal property purchased from a retailer for any purpose *except* sale in the regular course of business or *subsequent use solely outside this state*."<sup>4</sup> Arizona Administrative Code ("A.A.C.") R15-5-2304(B) explains that tangible personal property brought into Arizona is presumed to be subject to use tax, and that the burden of proof that the purchase is not subject to use tax falls upon the purchaser.

While the plain language of the statute leaves unambiguous the point that tangible personal property currently located in Arizona and purchased from a retailer but to be used solely outside the state is not subject to Arizona use tax, a question remains as to how a taxpayer may meet its burden of proof to show that the property was purchased for such nontaxable subsequent use.

Although there is no statute or administrative rule that explicitly governs the documentation requirements for this situation, the circumstances are very similar to those found in an exempt sale of tangible personal property made in interstate or foreign commerce under the retail classification for TPT. To satisfy this retail exemption,

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<sup>2</sup> Arizona Revised Statutes ("A.R.S.") § 42-5155(A).

<sup>3</sup> A.R.S. § 42-5155(E).

<sup>4</sup> A.R.S. § 42-5151(18) (emphasis added).

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A.A.C. R15-5-170(A) explains that a retail business needs to demonstrate that the order was received from a location outside of Arizona and that it subsequently ships or delivers the tangible personal property to a location outside of Arizona for use outside of Arizona. Regarding documentation requirements for such exempt interstate and foreign transactions, A.A.C. R15-5-170(C) provides:

Suitable records shall be kept to substantiate the deduction for a sale made in interstate commerce. As such, records shall identify the tangible personal property sold and the delivery destination. The following records may be sufficient to substantiate the exemption:

1. Suitable records for substantiating the receipt of an order from out-of-state may include purchase orders, letters, or written memoranda on the receipt of orders placed by telephone.
2. Suitable records for substantiating out-of-state shipments include:
  - a. Internal delivery orders supported by receipts of expenses incurred in delivering the property and signed on the delivery date by the person who delivers the property;
  - b. Common carrier's receipt or bill of lading;
  - c. Parcel post receipt;
  - d. Export declaration;
  - e. Receipt from a licensed broker; or
  - f. Proof of export or import signed by a customs officer.

Nearly identical documentation provisions are found in the administrative rule addressing the interstate or foreign commerce exemption for sales of printing under the job printing classification for TPT.<sup>5</sup>

The A.A.C. R15-5-170(C)(1) requirement for substantiating that an order is received from outside the state is clearly inapplicable for the purposes of temporary storage. Nevertheless, the examples of suitable records for substantiating out-of-state shipments provided in A.A.C. R15-5-170(C)(2) are likewise instructive for showing that property is being stored temporarily within the state.

Given the functions of the Arizona freight-forwarding center and staffing by the Company and third parties at the center, as described in the December 4 ruling request, the Company should be capable of meeting its burden of proof for documenting shipments out of state through tracking, at the freight-forwarding center level, the shipment of products and supplies from the location to the maquiladora for use solely outside of Arizona. In considering the specific examples provided in the administrative

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<sup>5</sup> See A.A.C. R15-5-1102(D).

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rule, the Company may find the first three described in A.A.C. R15-5-170(C)(2)(a)-(c) particularly applicable to its operations.

Based on the facts provided, it does not appear that, outside of routine inspection measures, the Company directly or indirectly performs any repackaging or use of items at the freight-forwarding center before shipping them to the maquiladora.<sup>6</sup>

### **Ruling:**

Based on the facts and supporting materials provided with its ruling request, the Department rules that the Company is not liable for Arizona use tax on manufacturing items, machinery and equipment used directly in manufacturing at the Company's maquiladora in Mexico, and raw materials that become ingredient or component parts of manufactured products at the maquiladora that the Company purchases from outside the state and temporarily stores in Arizona before subsequently shipping or delivering the property to its maquiladora for use solely outside the state. The Company may use any of the various forms of documentation described in A.A.C. R15-5-170(C)(2) to substantiate the shipment or delivery of the property.

Because the Company is not the taxpayer or potential taxpayer for the purposes of any Arizona TPT liability on the gross receipts derived from sales of the tangible personal property at issue, pursuant to A.R.S. § 42-2101, the Department does not make a definitive ruling as to the TPT liability of the Company's vendors for their gross receipts derived from such sales.

This private taxpayer ruling does not extend beyond the facts presented in your letter and enclosed documents of December 4, 2009.

**This response is a private taxpayer ruling and the determinations herein are based solely on the facts provided in your request. The determinations are subject to change should the facts prove to be different on audit. If it is determined that undisclosed facts were substantial or material to the department's making of an accurate determination, this private taxpayer ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law or notification of a different department position.**

**The determinations in this private taxpayer ruling are only applicable to the taxpayer requesting the ruling and may not be relied upon, cited nor introduced into evidence in any proceeding by a taxpayer other than the taxpayer who has received the private taxpayer ruling. In addition, this private taxpayer ruling only**

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<sup>6</sup> This ruling does not cover a scenario, for instance, in which the Company receives a bulk quantity of an item in Arizona and repackages it (e.g., taking a bulk container of cleaning solvent and repackaging it into smaller bottles) before shipment outside the state. Under such circumstances, the Company's activities may constitute use sufficient to subject it to Arizona use tax on the purchase price of the item.

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**applies to transactions that occur or tax liabilities that accrue from and after the date the taxpayer receives the ruling.**

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