

## PRIVATE TAXPAYER RULING LR02-005

April 29, 2002

The following private taxpayer ruling is in response to your request of October 18, 2001 and the receipt of subsequent information on November 19, 2001, November 26, 2001 and January 14, 2002. Your letter requests a determination regarding whether ... ("Taxpayer") artistic activity can be taxed as prime contracting under A.R.S. § 42-5075 or if the activity is exempt under A.A.C. R15-5-151 (C)(2).

Statement of Facts:

The following is a restatement of the facts as presented in your letter.

The Taxpayer enters into lump sum contractual relationships with various cities within the state of Arizona for the design, fabrication, construction and installation of original commissioned artwork. Taxpayer is wholly owned by a single artist.

First, Taxpayer must submit a proposal to be approved by city officials before any design, fabrication and installation activities are authorized. Once a proposal has been approved by the city and a Notice to Proceed has been issued, Taxpayer may begin actual fabrication of the commissioned artwork.

The artist creates the commissioned artwork in congruence with the details specified in the contract. Materials used in fabricating the commissioned artwork consist of various metals that are sculpted and connected by artists according to approved design plans. Every step in creating the commissioned artwork requires special tools to cut, shape and weld the metal into its final form.

You indicate that although the contracts specify for installation of the commissioned artwork, the contracts also contain a provision allowing a general contractor, designated by the city, to complete site preparation and install footings to secure the commissioned artwork in place. However, the contract provided with your request does not contain such a provision. The contract provided states that the ... is responsible for the cost and installation of any lighting and any structural support, footing or base required. The contract goes on to say that construction must be performed in accordance with City Codes. (Sections I.A.4 and I.F) After a complete installation, the original commissioned artwork becomes permanently affixed to real property.

The contract provided by the Taxpayer is for a Ramada/Seating structure at a Fire Station approximately 30'x30'x30' and with a seating compacity of up to 26 people. Section VII

General Considerations, subsection (J) of the contract provides that "... it is the City's intent to permanently retain and publicly display ..." the structure.

In addition to the above contract, Taxpayer included the picture of a Transit Shelter as an example of a second project. Included in both of these projects is the construction or installation of concrete bases supporting the structures.

### Your Position:

It is your position that Taxpayer's income from the sale of commissioned artwork, which is billed in a lump sum contract that includes installation of the commissioned artwork, is not taxable pursuant to Arizona Administrative Code (A.A.C.) R15-5-151(C)(2).

### Applicable Law:

Arizona's transaction privilege tax differs from the sales tax imposed by most states. Transaction privilege tax is a tax imposed on the privilege of conducting business in the State of Arizona. This tax is levied on the vendor, not the purchaser. The vendor may pass the burden of the tax on to the purchaser. However, the vendor is ultimately liable to Arizona for the tax. The Arizona transaction privilege tax is imposed under 17 separate business classifications, including retail sales of tangible personal property and the business of prime contracting.

Arizona Revised Statutes (A.R.S.) § 42-5061, *Retail classification*, imposes the transaction privilege tax on the business of selling tangible personal property at retail. A.R.S. § 42-5061(V)(3) defines "selling at retail" as a sale for any purpose other than for resale. Therefore, sales for resale are not taxable. The tax base for the retail classification is the gross proceeds of sales or gross income derived from the business. All retail sales are subject to tax unless specifically exempted by statute.

A.A.C. R15-5-151 states:

A. Gross receipts from the sale of paintings, drawings, etchings, sculptures, craftwork, other artwork or reproductions of such items to final consumers shall be taxable under the retail classification if the person is making regular sales of these items.

B. Gross receipts from the sale of paints, canvasses, frames, sculpture ingredients,

and other items which will become an integral part of the finished product shall not be taxable if sold to a creating artist who is regularly engaged in the business of creating and selling paintings, drawings, etchings, sculptures, craftwork, other artwork, or reproductions of such items. Sales of brushes, easels, tools, and similar items to be consumed by the creating artist shall be taxable.

C. Gross receipts from the sale by the creating artist of a painting, drawing, etching sculpture, or a piece of craftwork that is not a reproduction of an original work shall not be taxable if:

1. The sale is a casual sale pursuant to the definition in R15-5-1812 [currently R15-5-2001]; or

2. The sale of commissioned artwork by an individual artist. For purposes of this rule, "commissioned artwork" is custom, one-of-a-kind art creation made by the individual artist pursuant to the particular requirements of a specific purchaser.

A.R.S. §42-5075(A) imposes the transaction privilege tax on the business of prime contracting.

A.R.S. § 42-5075(B), *Prime contracting classification*, states that the tax base for prime contracting is 65% of the gross proceeds of sales or gross income derived from the business. Sales of tangible personal property to a person engaged in the business of prime contracting are not subject to tax if the property is incorporated or fabricated into the real property or project by the contractor. A.R.S. § 42-5061(A)(27).

### Discussion:

According to your letter, Taxpayer is wholly owned by a single artist that contracts with cities for the design, fabrication and installation of sculptured commissioned artwork. At issue is a contract for the design and fabrication of an specially designed gazebo and a transit shelter. It is your position that Taxpayer's income from such a transaction billed in a lump sum contract that includes installation of the commissioned artwork, is not taxable pursuant to A.A.C. R15-5-151(C)(2), which allows for an exemption for commissioned artwork.

Although A.A.C. R15-5-151(C)(2) addresses commissioned artwork, it does not address the installation of commissioned artwork. The installation of commissioned artwork onto real property constitutes an improvement to real property and is taxable under the prime contracting classification. This private taxpayer ruling does not address the issue of whether this is art because it is not relevant to the issue of contracting.

A.R.S. § 42-5075(B), *Prime contracting classification*, states that the tax base for prime contracting classification is 65% of the gross proceeds of sales or gross income derived from the business.

The term "contracting" means "engaging in business as a contractor." A.R.S. § 42-5075(H)(2) provide the following definition for the term "contractor":

"Contractor" is synonymous with the term "builder" and means any person, firm, partnership, corporation, association or other organization, or a combination of any of them, that undertakes to or offers to undertake to, or purports to have the capacity to undertake to, or submits a bid to, or does personally or by or through others, construct, alter, repair, add to, subtract from, improve, move, wreck or demolish any building, highway, road, railroad, excavation, manufactured building or other structure, project, development or improvement, or to do any part of such a project, including the erection of scaffolding or other structure or works in connection with such a project, and includes subcontractors and specialty contractors. For all purposes of taxation or deduction, this definition shall govern without regard to whether or not such contractor is acting in fulfillment of a contract.

Installation of equipment, which is incorporated into real property, is taxable as a contracting activity. A.A.C. R15-5-608. The Administrative Code also discusses the distinction between retail sales and contracting. A.A.C. R15-5-614 gives examples of prime contracting activities:

[C]ontracting activities include the installation of a central air conditioning system, the replacement of an air conditioning unit, water heater, electrical wiring, roof, plumbing, landscaping; the installation of a soft water system, remodeling of a kitchen, and the installation of new appliances, wallpaper, and other fixtures.

Under A.R.S. § 42-5075, one is acting as a contractor when one alters or adds to any building, structure or real property. The Arizona Court of Appeals in *Arizona Department of Revenue v. Arizona Outdoor Advertisers, Inc.*, 41 P3d 632, 3/7/2002, adopted a reasonable person test for determining whether an item of personalty has become part of the realty. The *Court* announced that the test is "[w]ould a reasonable person, after considering all the relevant circumstances, assume that the item in question belongs to and is part of the real estate on which it is located?" Under the reasonable person test, considering all the facts presented to the Department, a gazebo structure and transit shelter would be considered to belong to and be apart of the real estate on which it is installed. Therefore, the installation onto real-property of a gazebo or transit structure, that may be a sculpture is a taxable prime contracting activity subject to tax on 65% of the gross income received from the project, without counter indicative elements.

According to the contract you sent on January 14, 2002, "the Artist (defined in the contact as Taxpayer) shall be solely responsible for designing, fabricating, constructing, delivering and installing the Work." *Contract No. 88382 Section I(A)(3)*. Because Taxpayer is ultimately responsible for the installation, Taxpayer is engaged in a contracting activity under A.R.S. § 42-5075. Thus, the entire transaction is taxable under A.R.S. § 42-5075(B). Although Taxpayer, under the contract, can sub-contract for the installation of the gazebo or transit structure, the Taxpayer is still considered to be a prime contractor and the entire transaction is subject to tax under A.R.S. § 42-5075. There is no commissioned artwork provision under the contracting statutes. Deductions under the retail classification may not be used under the prime contracting classification unless specifically delineated.

As seen above, the contract contains both the sale and installation of the gazebo or transit structure, therefore, the contract is for prime contracting. The contact is for a lump sum, therefore, the entire contract amount is taxable.

### Conclusion:

The Department rules that ... contract for the sale and installation of a gazebo or transit structure is a contract for prime contracting services and is taxable under A.R.S. § 42-5075.

The conclusions in this private taxpayer ruling do not extend beyond the facts as presented in the request for a private taxpayer ruling of October 18, 2001 and the receipt of subsequent information on November 19, 2001, November 26, 2001 and January 14, 2002.

In addition, the conclusions in this private taxpayer ruling apply to contracts entered into from and after the date of this ruling.

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 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.