PRIVATE TAXPAYER RULING LR03-007

June 13, 2003

This private taxpayer ruling is in response to your letter dated July 25, 2001, as updated on October 23, 2001 and March 20, 2003. First and foremost, I apologize on behalf of the Department for the long delay in responding to your request. You have requested a ruling on behalf of your client, . . . ("Taxpayer"), regarding the Arizona Transaction Privilege Tax ("TPT") implications associated with Taxpayer's instate sale and purchase of automobiles through an intermediary.

Your letter discusses the TPT consequences for the dealer-vendor with respect to Taxpayer's acquisition of new motor vehicles. Pursuant to Arizona Revised Statutes ("A.R.S.") § 42-2101, the Department may issue private taxpayer rulings to taxpayers and potential taxpayers on request. Based on the information provided in your request, Taxpayer is not subject to TPT with respect to the acquisition portion of its like-kind exchanges. Therefore, this private taxpayer ruling is limited to the TPT taxability of Taxpayer's dispositions of motor vehicles in like-kind exchange transactions described in your letter.

Pursuant to your request, this ruling does not directly address the TPT consequences of Taxpayer's leasing of motor vehicles under the personal property rental classification.

Statement of Facts:

The following is a restatement of the facts presented in your letter dated July 25, 2001.

Taxpayer leases motor vehicles. At the conclusion of a lease, Taxpayer sells the motor vehicle in a "like-kind exchange" transaction (pursuant to Internal Revenue Code ("IRC") § 1031) through which Taxpayer subsequently (within the time period prescribed under IRC § 1031) purchases a replacement motor vehicle for purposes of leasing. These disposition and acquisition transactions take place through an IRC § 1031-qualified intermediary (the "Intermediary"), a banking entity which facilitates Taxpayer's like-kind exchange of previously-leased vehicles for replacement vehicles. These like-kind exchanges enable Taxpayer to defer recognition of capital gain on its sales of the previously-leased vehicles for federal income tax purposes.

The disposition portion of Taxpayer's like-kind exchange transactions may take one of two forms. In the first type of sale, Taxpayer directs the Intermediary to sell the motor vehicle to the former lessee or another consumer ("Scenario I"). In the second type of sale, Taxpayer directs the Intermediary to sell the motor vehicle to a dealer that will subsequently resell that vehicle to the former lessee or another consumer ("Scenario II"). In both these scenarios, title of the motor vehicle goes directly from Taxpayer to the consumer or the dealer. Sale proceeds go to an account that is jointly held by Taxpayer and the Intermediary for purposes of acquiring replacement motor vehicles (the "Account"). The Account restricts Taxpayer’s right to receive or otherwise obtain the immediate benefit of the sale proceeds. Although the purchaser remits the purchase price to the Intermediary, the funds deposited into the Account are held in interest for Taxpayer, who ultimately receives consideration, through its interest and ownership rights in the Account, equal to the purchase price paid by the consumer or dealer.

In addition to the facts provided in your letter, the master exchange agreement dated March 5, 1999 between Taxpayer and the Intermediary (the "Agreement") explains that Taxpayer directs investment of funds in the Account and initiates transfers from the Account to fund purchase prices for replacement property. Once a vehicle is relinquished, however, the Agreement restricts Taxpayer’s rights with respect to that relinquished vehicle’s proceeds. Taxpayer has no right to receive, pledge, borrow or otherwise obtain the benefit of any relinquished property proceeds until after the IRC § 1031 exchange period has elapsed.

The Agreement also explains the Intermediary’s role with respect to vehicle dispositions as follows:

> [The Intermediary] will, in accordance with [Taxpayer]’s specific instructions, (1) accept assignments of [Taxpayer]’s rights (but not [Taxpayer]’s obligations) with respect to each [r]elinquished [p]roperty [sales contract], (2) acquire each [r]elinquished [p]roperty from [Taxpayer] and transfer such [r]elinquished [p]roperty to the relevant [p]urchaser,… (5) receive and hold [r]elinquished [p]roperty [p]roceeds, and (6) disburse [r]elinquished [p]roperty [p]roceeds, any earnings thereon and such other funds supplied by [Taxpayer] as may be necessary to pay the [r]eplacement [p]roperty [a]cquisition [c]ost.

With respect to the vehicle dispositions and acquisitions, the Agreement states,

> [E]ach and every [r]elinquished [p]roperty and [r]eplacement [p]roperty shall be transferred directly from [Taxpayer] to the [p]urchaser or directly from the [s]eller to [Taxpayer], as the case may be. As a result, [the Intermediary] shall not (1) take actual or constructive possession of, (2) hold legal title to, or (3) be the registered or beneficial owner of any [r]elinquished [p]roperty or [r]eplacement [p]roperty.

Your letter explains that the Intermediary's role in Taxpayer's motor vehicle disposition transactions is solely to ensure that Taxpayer satisfies certain like-kind exchange requirements for beneficial capital gain treatment under IRC §1031. The Intermediary receives a fee for performing this role. You emphasize that in both Scenario I and Scenario II, "[t]he Intermediary's involvement is primarily limited to the receipt, management, and subsequent distribution of funds obtained from the sale and purchase of the motor vehicles."

Issues:

1. What is the TPT treatment of Taxpayer's disposition of its motor vehicles to an Arizona purchaser under Scenario I?
2. What is the TPT treatment of Taxpayer's disposition of its motor vehicles to an Arizona purchaser under Scenario II?

Your Position:

It is your position that Taxpayer's Arizona dispositions of motor vehicles by means of an IRC §1031 like-kind exchange Intermediary are subject to TPT as follows:

1. Scenario I:

   The sale of a motor vehicle at the conclusion of the lease (e.g., sale to the lessee) is a taxable transaction for transaction privilege tax purposes between the Taxpayer and the individual purchaser. The Taxpayer would be the party responsible for remittance of the appropriate transaction privilege tax to the State of Arizona. The required IRC §1031 payment to the Account, managed by an Intermediary, does not change the billing and payment process of the Taxpayer.

2. Scenario II:

   > The sales of a motor vehicle at the conclusion of the lease (e.g., sale to a dealer) is a nontaxable transaction for transaction privilege tax purposes between the Taxpayer and the dealer. The Taxpayer is required to secure the necessary sale for resale exemption documentation (valid resale exemption certificate or exemption number) to document the exempt status of the sale of the motor vehicle. The required IRC §1031 payment to the Account, managed by an Intermediary, does not change the exchange of the motor

vehicle title for a valid resale exemption certificate between the buyer (i.e., dealer) and the seller (i.e., lessor or Taxpayer).

Conclusion and Ruling:

On the basis of the information provided, since the Intermediary never holds title to or possession of the motor vehicles Taxpayer transfers in its IRC § 1031 like-kind exchange transactions, it is not the seller in such transactions. Taxpayer conveys title and possession directly to the third party purchaser and receives consideration in the form of Account funds or replacement property. Therefore, Taxpayer's disposition of a motor vehicle in a like-kind exchange via the Intermediary constitutes a sale by the Taxpayer to the consumer or motor vehicle dealer, as applicable.

The following ruling is given based on the facts presented in your request.

The Department rules that Taxpayer's sale of a motor vehicle in a like-kind exchange via the Intermediary to the former lessee or other consumer is subject to Arizona Transaction Privilege Tax under the retail classification.

The Department further rules that Taxpayer's sale of a motor vehicle in a like-kind exchange via the Intermediary to a dealer that will subsequently resell that vehicle in the regular course of business is excluded from Arizona Transaction Privilege Tax under the retail classification, provided Taxpayer receives and maintains the requisite documentation evidencing a sale for resale.

The conclusions in this private taxpayer ruling do not extend beyond the facts presented in your letter dated July 25, 2001.

This response is a private taxpayer ruling and the determination herein is 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.