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PRIVATE TAXPAYER RULING LR05-008

September 8, 2005

The Department issues this private taxpayer ruling in response to your letter of May 16, 2005, in which you request a ruling on behalf of your client, *** ("Company"), on the applicability of Arizona transaction privilege tax to certain revenue attained from Taxpayer's business operations. You also provided a supplemental letter on June 22, which provided additional procedural information for the original request.

Statement of Facts:

The following facts are excerpted from your May 16 letter:

*** [("Parent")], the parent company of ***, . . . is currently in the process of setting up a new business enterprise in *** Arizona. The new company's name is designated as *** [("Company")] and is currently being registered with the Arizona Secretary of State. . . .

. . . .

[Company] is designing and will be marketing a real time location device (similar to *** devices) and the related tracking station service. The device itself is the size of a small radio and will be installed by customers in their shipping containers, trailers, trucks, and other vehicles that require a surveillance capability. The devices will be manufactured by an unrelated third party.

Once installed, [Company] will provide customers with a tracking service using servers based in its Tucson facility. A customer will be able to locate their container/product in a virtual real time mode by logging onto the internet and accessing [Company]'s tracking service through its servers.

The tracking device will either continually or periodically emit a radio signal. The signal will be picked up by either a radio tower or a satellite depending on a customer's choice of available data access links. If the customer chooses mobile access, the signal will be picked up by the radio tower of a mobile provider such as ***. [Company] will not know the location of the radio tower that receives the signal. The provider will convert this radio wave to an electrical signal and place it on the internet. If the customer chooses satellite access, the signal will be picked up by an Iridium satellite. [Company] will not know the location of the satellite that receives the signal. The satellite would

PRIVATE TAXPAYER RULING LR05-008

September 8, 2005

Page 2

then transmit the radio signal to the Iridium collection station in Tempe, Arizona[,] where the signal will be converted to an electrical signal and placed on the internet. Regardless of the data access link chosen by the customer, this service will be billed to and paid by [Company]. Once information is available on the internet, it is retrieved and logged to the [Company] server housed in Tucson where it is converted to a customer useable format. A customer can access the [Company] website at any time from any location to determine the exact location of their tracked property. By year end, other functions such as time, temperature, humidity, and possibly photos may also be available with the tracking device.

Generally, communication with the tracking device will be one-way. On occasion, if a problem arises, [Company] can override the device remotely by sending a signal to the device. Currently, sending signals to the device is expected to be unusual and infrequent.

[Company] expects its customer base to be international and its service to be tracking customer property as it moves internationally and/or interstate. It will, therefore, be unusual for a customer's tracked property to be located exclusively in Arizona. There may, however, be occasions when the tracking device stays within Arizona and the radio signal is sent to a radio tower located in Arizona before the information is placed on the internet. Regardless, all information will be transmitted on the internet and be accessible to customers through [Company]'s server in Tucson.

[Company] will be offering three tracking service options:

1) The first option would involve a one time activation fee and a monthly subscription fee for the device and access to the tracking service website servers. The customer has the option of selecting either a mobile or satellite service. The device would be returned and the service deactivated at the end of the subscription period. The fee for leasing the tracking device could be separately stated from the activation fee and tracking service.

2) The second option would have the customer buy the tracking device outright and only subscribe to the website tracking service plus the original onetime activation fee. Again, the customer would have the option of selecting either a mobile or satellite service platform. The device would be customer property and would not be returned if the service is cancelled. The fee for buying the tracking device could be separately stated from the activation fee and tracking service.

3) [Company] is also considering, as part of a two phased business plan, to sell both the devices and related hardware to major customers. The

PRIVATE TAXPAYER RULING LR05-008

September 8, 2005

Page 3

[Company] application software would also be licensed to the customer. The customer would install the hardware and related software on their servers. Unlike the above scenarios, the customer would buy its own mobile or satellite service to track various assets. The sales price for the tracking device, hardware and canned software license could all be separately stated.

A copy of [a Company] service contract is attached. The contract is currently being revised to reflect the above structural change since the [Company] has been set up as a separate legal entity and will not be operated as a division of [Parent] as stated in the contract.

The Customer Subscriber Agreement¹ (“CSA”) you attached provided the following additional facts:

1. Services and Terms.

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1.2 Each Service's Initial Term is indicated on the applicable CSA Order Sheet. . . . The CSA will renew at the end of the Initial Term for successive Renewal Terms equal in length to the Initial Term until terminated as provided for herein.

....

4. Termination, Restrictions or Suspension.

4.2 If either Party terminates this CSA before or after the end of the Initial Term or a Renewal Term[,] Customer must return Tracking Equipment in good working order to [Company] within thirty (30) days of set termination date. If Tracking Equipment is not deemed to be in good working order by [Company] or is not returned within thirty (30) days, then Customer will be liable for the full purchase price of the Tracking Equipment.

....

7. Additional Provisions.

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7.7 The [Company] Service Infrastructure is owned by [Company], or its licensors, and is protected by copyright and other intellectual property laws.

¹ ***

PRIVATE TAXPAYER RULING LR05-008

September 8, 2005

Page 4

Customer agrees that title and ownership of the Services, in any form, shall at all times and in any event be held exclusively by [Company]. Customer shall be entitle[d] to only such rights with respect to Services as are specifically granted herein.

....

Definitions

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Customer The customer identified in the attached Order Sheet.

CSA The entire Customer Subscriber Agreement between [Company] and Customer for the provision of Service, consisting of the Order Sheet, and the Terms and Conditions.

....

Initial Term Initial length of the term for the Services as indicated on the Order Sheet.

....

Order Sheet The cover sheet to which the Terms are attached, identifying the specific Service(s) to be delivered.

Party or Parties [Company] and/or Customer individually or collectively.

Renewal Term Subsequent length of term for the Services after completion of the Initial Term.

Service(s) Asset tracking services provided by [Company] under the CSA.

Service Infrastructure The communication links, data center, and application environment that supports the customer application interface.

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PRIVATE TAXPAYER RULING LR05-008

September 8, 2005

Page 5

Terms	Terms and conditions that apply to the Services [Company] provides to Customer.
Tracking Equipment	Tracking units provided to customers that interfaces [sic] with the [Customer] Service Infrastructure.

Your Issues:

You presented the following three issues in your request:

1. In each of the above three scenarios, is [Company] engaged in business under the telecommunications classification for TPT purposes? If so, what communications will be considered intrastate and subject to the TPT on telecommunications? What documentation will be required to segregate exempt interstate calls? If there are taxable intrastate telecommunications, will both the activation fee and the monthly subscription fee be taxable?
2. If, under any of the above scenarios [Company] is taxable under the telecommunications classification for TPT purposes, will its purchase of service from data access providers such as *** be exempt from TPT for these providers as telecommunications resellers under A.R.S. § 42-5064(B)(10)(a)?
3. Will [Company]'s sale or lease of the tracking device to an Arizona customer be subject to TPT? Will sales or licensing of canned software be subject to tax? Will taxability depend on whether the price of the device is separately stated from services?

Your Positions:

Your stated positions on the above-mentioned three issues are as follows:

1. Under each of the above scenarios, [Company] will not be engaged in providing intrastate transmission of information subject to tax under the telecommunications classification. Therefore, neither its activation fee nor its monthly subscription fee will be subject to TPT.
2. Because [Company] will not be in the telecommunications business for TPT purposes, its purchase of service from data access providers will not be tax exempt purchases for resale.

PRIVATE TAXPAYER RULING LR05-008

September 8, 2005

Page 6

3. [Company]'s sales and leases of tracking devices and canned software to customers in Arizona will be subject to TPT under the retail classification. It will be necessary to separately state the charge for these items on invoices and in books and records in order to segregate taxable retail sales from non-taxable tracking services.

[Company]'s rentals and leases of tracking devices and canned software to customers in Arizona will be subject to TPT under the personal property rental classification. Any tracking services whether or not directly related to rentals of tracking devices and canned software to Arizona customers will not be subject to TPT.

Conclusion and Ruling:

As you may already know, Arizona transaction privilege tax is imposed under seventeen separate business classifications; of interest in this request are the following three classifications:

- a. *Retail classification:* Pursuant to Arizona Revised Statutes ("A.R.S.") § 42-5061, the retail classification for transaction privilege tax is comprised of the business of selling tangible personal property at retail. Prewritten or "canned" software sold at retail is subject to tax under the retail classification, as provided in Arizona Administrative Code ("A.A.C.") R15-5-154. A specific exemption exists at A.R.S. § 42-5061(A)(2) for services rendered in addition to selling tangible personal property at retail. A.A.C. R15-5-105 provides that "[a] charge in connection with a retail sale is taxable unless the charge for service is shown separately on the sales invoice and records."
- b. *Telecommunications classification:* A.R.S. § 42-5064 provides that the telecommunications classification is comprised of the business of providing intrastate telecommunications services, which are defined at A.R.S. § 42-5064(C)(3) as "transmitting signs, signals, writings, images, sounds, messages, data or other information of any nature by wire, radio waves, light waves, or other electromagnetic means if the information transmitted originates and terminates in this state."
- c. *Personal property rental classification:* A.R.S. § 42-5071(A) provides that the personal property rental classification is comprised of the business of leasing or renting tangible personal property for a consideration. A.A.C. R15-5-1502(D) explains that "[g]ross income from the rental of tangible personal property includes charges for installation, labor, insurance, maintenance, repairs, pick-up, delivery, assembly, set-up, personal property taxes, and penalty fees even if these charges are billed as separate items, unless a specific statutory exemption, exclusion, or deduction applies."

PRIVATE TAXPAYER RULING LR05-008

September 8, 2005

Page 7

A.A.C. R15-5-1503(C) provides that the gross proceeds of sales or gross income of a business subject to tax under the personal property rental classification are sourced to the "business location," which is "the business address that appears on a lessor's privilege license, but if the lessor does not have a business address in Arizona, business location means the lessee's residential or primary business street address." Two instances in which a lessor's gross proceeds of sales or gross income would not be subject to tax are:

- (1) Where the property is shipped or delivered outside of Arizona and intended, at the lease's inception, for use exclusively outside of the state.
- (2) Where the property is removed from Arizona for use exclusively outside the state; intermittent use does not constitute removal for use exclusively outside of Arizona.

Leases of tracking devices and canned software and sales of the devices and associated hardware and canned software clearly fall within the tax bases of the personal property rental and retail classifications, respectively, as proposed by Company. A principal issue of this private taxpayer ruling, however, is how gross proceeds of sales or gross income derived from Company's activation and monthly subscription fees are to be treated, for purposes of transaction privilege tax.

While Company is interested in information on the taxability of radio and satellite services that enable Company's tracking devices to function, the third-party providers, not Company, appear to be the true taxpayer with regard to such services. Instead, what Company appears to provide to its customers for the fees are access to its servers and maintenance of the service infrastructure, including the hardware and canned software, that is necessary to keep the tracking devices functional.

Pursuant to A.R.S. § 42-5061(A)(2), fees for such services are not subject to tax under the retail classification; when Company sells customers the tracking devices at retail, such services are nontaxable if Company separately states service charges on invoices and in its books and records. Nevertheless, no exemption analogous to A.R.S. § 42-5061(A)(2) exists under the personal property rental classification. In fact, as explained in A.A.C. R15-5-1502(D), such fees would be considered part of the labor and maintenance charges that are part of the business's gross income of renting or leasing tangible personal property.

Consequently, based on the facts and conclusions as stated above, the Department rules as follows:

1. Based on the description of its business activities, Company is not engaged in the business of providing or reselling intrastate telecommunications services and is not subject to transaction privilege tax under the telecommunications classification.

PRIVATE TAXPAYER RULING LR05-008

September 8, 2005

Page 8

Company derives its gross income from activation and subscription fees for maintaining and operating servers that its customers access to retrieve various data compiled from the tracking devices Company sells and leases, as well as for providing general maintenance and operation of the service infrastructure (including the associated hardware and canned software) that is necessary to keep the tracking devices functional. Company is not in the business of providing intrastate telecommunications services as defined in A.R.S. § 42-5064(E)(4), but rather, appears to be an end consumer of telecommunications services provided by third-party service providers.

2. Company's gross proceeds of sales or gross income derived from retail sales of tracking devices, hardware sold under the third service option listed above, and prewritten or "canned" software is subject to transaction privilege tax under the retail classification. Company's gross proceeds of sales or gross income derived from activation fees and subscription fees associated with these retail sales is exempt from transaction privilege tax, pursuant to A.R.S. § 42-5061(A)(2), as long as such fees are separately stated on invoices and in books and records.
3. Company's gross proceeds of sales or gross income derived from rentals of tracking devices and prewritten or "canned" software is subject to transaction privilege tax under the personal property rental classification. Company's gross proceeds of sales or gross income derived from activation fees and subscription fees is subject to transaction privilege tax as part of the business of leasing or renting tangible personal property, as discussed in A.A.C. R15-5-1502(D). The taxability of such fees does not depend on whether the fees are separately stated from rental charges for the tracking devices.

The conclusions in this private taxpayer ruling do not extend beyond the facts presented in your letters of May 16 and June 22, 2005.

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.