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PRIVATE TAXPAYER RULING LR08-009

October 15, 2008

The Department issues this private taxpayer ruling in response to your letter of September 10, 2008, requesting a ruling on behalf of . . . ("Contractor"). Specifically, you request that the Department rule on the applicability of Arizona transaction privilege tax for Contractor's design and construction of the operations and maintenance facility, and purchase, manufacture, fabrication, delivery, installation, implementation, and testing of [a project ("Project")]. . . for the . . . ("Owner").

Statement of Facts:

Contractor's September 10 request provides the following excerpted facts:

.I. BACKGROUND

[Contractor] will be submitting a responsive proposal to design, build, operate and maintain [the Project] that will be constructed for the [Owner]. . . .

. . . [Contractor] is not requesting a [private taxpayer ruling] on the heavy . . . operations, which include but are not limited to: earth moving activity, fixed facilities, . . . [and] support structures

[Contractor] is requesting a [private taxpayer ruling] on the subject matter of the [Project] contract, which will be divided into two separate contracts if [Contractor] is awarded its bid: the Design and Build Contract and the [Second] Contract The Design and Build contract includes, but is not limited to, all aspects of the purchase, manufacture, fabrication, delivery, installation, implementation and testing . . . , the design and construction of the operations and maintenance center that will house the . . . control center, and the associated power equipment and . . . control systems used

The [Project] contract that [Contractor] hopes to be awarded is comprised of several major components and subsystems summarized below:

1. [Project] Equipment.

. . . .

2. . . . Distribution System.

This equipment consists of the . . . distribution system

3. . . . [Equipment].

. . . .

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4. [Project] . . . Equipment

. . . .

5. . . . Control Center

The . . . Control Center . . . houses all of the . . . control equipment used in operating, testing, and maintaining the [equipment]. The . . . control equipment inside of the . . . Control Center includes but is not limited to: all computers, software, monitors, . . . the telecommunications system, backup generators, conduit and wiring used to control and operate the system, additional HVAC climate control for the . . . control facility, specialized flooring, etc.

6. Maintenance Facility and Maintenance Equipment

Equipment needed for maintenance work will be stored inside of the maintenance facility, which includes but is not limited to air compressors, vacuum cleaners, lifting Jack, maintenance vehicle, etc. . . .

7. [Project] Management and Administration

. . . [Contractor] will operate the [Project] from the . . . Control Center, where a major portion of the . . . control equipment is located. In addition . . . , [Contractor] will perform scheduled and non-routine maintenance and repairs to ensure that the . . . [Project] continues to operate as intended

You supplement your request with . . . the [Owner]'s Request for Proposals ("RFP") on the project. The RFP addresses the successful bidder's responsibilities under both the Design and Build Contract and [the Second Contract].

Your Issues:

Based on the arguments presented in your request, Contractor raises the following issues:

1. Are the various services Contractor proposes to provide under the Design and Build contract exempt design phase services for purposes of the prime contracting transaction privilege tax, pursuant to Arizona Revised Statutes ("A.R.S.") § 42-5075(M)?
2. Do the items of tangible personal property listed in numbered subsections 1, 2, 3, 4, 5, and 7 qualify for the A.R.S. § 42-5061(B)[] retail classification deduction?
3. Do the items of tangible personal property listed in numbered subsections 1, 2, 3, 4, 5, and 7 qualify for the A.R.S. § 42-5061(B)[] retail classification deduction?

Your Positions:

Contractor's positions for the above-stated issues are as follows:

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1. The exempt design phase services provided for in A.R.S. § 42-5075(M) include, but are not limited to, the activities outlined in Contractor's ruling request.

2. The following items of tangible personal property fall within the scope of the A.R.S. § 42-5061(B)[] deduction:

[List omitted.]

3. The following items of tangible personal property fall within the scope of the A.R.S. § 42-5061(B)[] deduction:

[List omitted.]

In discussing your position on the A.R.S. § 42-5061(B)[] deduction, you cite to *State ex rel. Arizona Department of Revenue v. Capitol Castings, Inc.*¹ (hereinafter *Capitol Castings III*) and *Duval Sierrita Corp. v. Arizona Department of Revenue*², in which Arizona courts examining the A.R.S. § 42-5159(B)(1) use tax exemption for machinery or equipment used "ultimate function" and "integrated rule" tests, as support for broadly reading the A.R.S. § 42-5061(B)[] deduction to include most machinery and equipment that Contractor is supplying and installing for the [Project] under the Design and Build Contract.

Conclusions and Ruling:

Arizona transaction privilege tax is imposed under sixteen tax classifications, with exclusions and deductions separately provided for under each classification. The retail classification, found at A.R.S. § 42-5061, imposes transaction privilege tax on a person's gross proceeds of sales or gross income derived from "the business of selling tangible personal property at retail." The A.R.S. § 42-5075 prime contracting classification imposes the tax on the gross proceeds of sales or gross income from "the business of prime contracting and dealership of manufactured buildings," wherein a taxable "prime contractor" is, *inter alia*, the contractor supervising, performing, or coordinating of a modification or improvement to real property and is the contractor responsible for the completion of the contract.

The A.R.S. § 42-5061(B)[] and [] Retail Classification Deductions

A.R.S. § 42-5061(B)[] provides a retail classification deduction for the gross proceeds of sales or gross income derived from sales of [specified tangible personal property at retail] A.R.S. § 42-5061(B)[] provides another retail deduction for gross receipts derived from sales of [specified tangible personal property at retail]. . . .

Because terms used in the deduction language of A.R.S. § 42-5061(B)[] and (B)[] are not defined in statute, as a general rule of construction, courts will consult an established and

¹ 207 Ariz. 445, 88 P.3d 159 (2004) (en banc).
² 116 Ariz. 200, 568 P.2d 1098 (Ct. App. 1977).

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widely used dictionary to determine their common and ordinary meaning.³ Another general rule of construction is that tax exemptions should be strictly construed, as they violate the policy that all taxpayers should share the common burden of taxation.⁴

For A.R.S. § 42-5061(B)[] and (B)[], the *Oxford English Dictionary* defines key terms used in the deductions as follows

[Definitions omitted.]

The A.R.S. § 42-5075(M) Prime Contracting Exclusion

A.R.S. § 42-5075(M) provides a prime contracting classification exclusion for the gross proceeds of sale or gross income attributable to a "separate, written design phase services contract or professional services contract, executed before modification begins, . . . regardless of whether the services are provided sequential to or concurrent with prime contracting activities that are subject to tax under this section." Nontaxable "design phase services" are "services for developing and completing a design for a project that are not construction phase services," while taxable "construction phase services" are "services for the execution and completion of any modification." In defining these terms, A.R.S. § 42-5075(M) further provides numerous examples of design phase and construction phase services.

Although the RFP does not explicitly state the manner in which the final contract for Design and Build contract services will be drafted, this response assumes that the contract will meet the threshold requirement of A.R.S. § 42-5075(M) that the terms and conditions for the design phase services will be contained in a written contract that is separate from the written contract for construction phase services.

The Department is unable to issue blanket determinations, and is consequently unable to provide a generalized taxability determination of broad categories of activities submitted by Contractor, for which Contractor requests that the Department rule on activities "including but not limited to" those specifically identified in its request. This ruling specifically discusses only such outlined activities, using the RFP citations Contractor provides for each activity. To the extent that other activities described in the bid proposal documents may fall within the scope of A.R.S. § 42-5075(M), this ruling does not make a taxability determination for them.

Separate Lines of Business and Contractor's Activities

Although Contractor does not address the issue in its ruling request, whether Contractor is solely acting as a prime contractor taxable under the prime contracting classification or additionally engaged in a separate line of business that is subject to tax under the retail

³ See, e.g., *United Dairymen of Ariz. v. Rawlings*, 217 Ariz. 592, 596, 177 P.3d 334, 338 (Ct. App. 2008).

⁴ See, e.g., *Excell Agent Servs., L.L.C. v. Ariz. Dep't of Revenue*, 2008 AZ App 1 CA-TX 07-0003 ¶ 9, 2008 WL 4108082, at *2 (Sept. 4, 2008).

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classification impacts how activities involving certain tangible personal property . . . are treated for purposes of the tax.

The Arizona Supreme Court has stated that "[i]f activities are incidental in the sense that they are inseparable from the principal business and interwoven in the operation thereof to the extent that they are in effect an essential part of the major business, they cannot be taxed as a separate business."⁵ Whether a taxpayer has more than one line of business depends upon evaluating the relevant facts and circumstances pursuant to a three-part test established by the Supreme Court in *State Tax Commission v. Holmes & Narver, Inc.*⁶

The *Holmes & Narver* test provides that whether activities constitute a separate business depends on whether: (1) the portions of the separate activities can be readily ascertained without substantial difficulty, (2) the amounts attributable to the activities in relation to the taxpayer's total taxable Arizona business are not inconsequential, and (3) the activities cannot be said to be incidental to the taxpayer's principal business.⁷ If the relevant facts and circumstances fail to satisfy the three-prong test, all gross proceeds or gross income would be merged into the taxpayer's principal business. If the facts and circumstances meet the three prongs, however, the activities would exist as a separate line or lines of business, and taxpayer's gross proceeds or gross income would be subject to tax under the appropriate tax classification for each line of business.

Consequently, the tax treatment of Contractor's sales of tangible personal property depends in part on whether Contractor is engaged in a separate retail line of business: if it is, then the exempt nature of the sale of a particular item of machinery or equipment will depend on whether it falls within one or both of the retail deductions discussed above. If, however, it is solely engaged in the business of prime contracting, Contractor must also consider A.R.S. § 42-5075(B)[], which allows a prime contractor to deduct the gross proceeds of sales or gross income attributable to the purchase of tangible personal property that is exempt under, inter alia, A.R.S. § 42-5061(B).

An additional concern for Contractor is whether the tangible personal property it installs for Owner as part of the Design and Build Contract is permanently attached to real property. If an item of tangible personal property is exempt under an A.R.S. § 42-5061(B) retail deduction *and* does not become a permanent attachment to the real property, the gross proceeds of sales or gross income for the installation, assembly, repair, or maintenance of the item is exempt under the A.R.S. § 42-5075(B)(7) prime contracting deduction.

Ruling

Based on the facts and documentation provided, the Department rules as follows:

⁵ *Trico Electric Coop., Inc. v. State tax Comm'n*, 79 Ariz. 293, 297, 288 P.2d 782, 784 (1955).

⁶ 113 Ariz. 165, 548 P.2d 1162 (1976) (en banc).

⁷ *Id.* at 169, 548 P.2d at 1166.

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1. A.R.S. § 42-5075(M): Provided that the final Design and Build contracts between the Owner and Contractor *separately contract* for design phase services and construction phase services such that the terms and statement of gross proceeds to be paid to Contractor for design phase services are addressed and contained in a written contract that is separate from the terms and statement of gross proceeds to be paid to Contractor for construction phase services, the activity may be excluded from tax under A.R.S. § 42-5075(M), with the stated conditions:⁸

A1	<u>Activity:</u> <i>The site visits, field measurements and field conditions that must be examined prior to commencing construction to determine the accuracy of grades, elevation, dimensions, etc. required. . . .</i>
	<u>Taxability:</u> The activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.
A2	<u>Activity:</u> <i>The project management, quality assurance, design, analysis, and documentation that Contractor will perform under the contract as design phase services. . . .</i>
	<u>Taxability:</u> The activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service, provided that Contractor does not conduct the project management, quality assurance, design, analysis, and documentation in response to modification work being performed. An activity performed in response to modification work being performed constitutes a construction phase service subject to tax under the prime contracting classification.
A3	<u>Activity:</u> <i>Site conditions that must be inspected to determine whether a site must be cleared or if modification must be done prior to the commencement of construction. . . .</i>
	<u>Taxability:</u> The activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service, provided that the inspections are not conducted in response to modification work being performed.
A4	<u>Activity:</u> <i>Contractor is required to research and determine the ambient environmental conditions in the . . . area. . . .</i>
	<u>Taxability:</u> The activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.
A5	<u>Activity:</u> <i>Contractor is required to conduct a Predesign Corrosion Control Survey to investigate stray currents, soil resistivity, soil pH, soil sulfites, . . . and other factors affecting the level of corrosion that the Project may experience and conduct activities such as evaluations of surveys, reports, and tests of on-site conditions and physical characteristics. . . .</i>
	<u>Taxability:</u> The activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.

⁸ All activities are descriptions paraphrased from Contractor's Sept. 10, 2008 ruling request. The citations to particular sections of the RFP documents limit the scope of activities to which the Department's taxability determinations apply. The determinations should not be construed to apply to activities that are described in other sections of the RFP or to activities found only in subsequent modifications or revisions of the cited language.

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A6	<u>Activity:</u> <i>Addendum . . . states that all reference drawings will be provided in CAD format to the successful proposer. . . .</i>
	<u>Taxability:</u> Contractor's evaluation of reference drawings for developing and completing a design for the [Project] falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.
A7	<u>Activity:</u> <i>As a programming requirement for the contract, Contractor is responsible to design and write a safety program for the work. . . .</i>
	<u>Taxability:</u> Contractor's preparation of a Project Site Safety Plan . . . falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.
A8	<u>Activity:</u> <i>Contractor's preparation of the required Project Management Plan for the Owner's review and acceptance will involve evaluating surveys, reports, on-site conditions, and require additional programming and coordination with other parties to create an initial schedule. . . .</i>
	<u>Taxability:</u> Contractor's preparation of a Project Management Plan . . . falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.
A9	<u>Activity:</u> <i>Contractor is required to review of site conditions and coordinate scheduling with public utilities, governmental bodies, and other contractors. . . .</i>
	<u>Taxability:</u> To the extent that Contractor is not performing its review and coordination in response to modification work being performed, the activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.
A10	<u>Activity:</u> <i>Contractor is required to submit a Quality Control and Assurance Program Plan that will include Contractor's quality system procedures for the preparation of the Program Plan. . . .</i>
	<u>Taxability:</u> Contractor's activity in defining and documenting its policy and ensuring that its policy is implemented in practice as part of a Quality Control and Assurance Program Plan . . . falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service, except where it is performed pursuant to the administration or supervision of modification activities.
A11	<u>Activity:</u> <i>During the design phase Contractor is responsible to form a Safety and Security Committee to design and develop a safety and security program.</i>
	<u>Taxability:</u> Contractor's formation of a Safety and Security Committee during the design phase falls within the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.
A12	<u>Activity:</u> <i>Contractor is required to create, design and implement a System safety program and to submit a Safety Critical Software and Verification and Validation Plan. . . .</i>
	<u>Taxability:</u> Contractor's activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service, except where implementation requires the execution and performance of any modification work, thereby constituting a construction phase service.
A13	<u>Activity:</u> <i>Contractor must prepare the Design/Construction Interface Document ("D/CID") that addresses the interface of the system. . . .</i>
	<u>Taxability:</u> Contractor's activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service, except for preparation of documents such as as-built deliverables and updates to the D/CID These latter services are performed in response to modification work being performed, and are consequently construction phase services.

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A14	<u>Activity:</u> Contractor must prepare drawings, diagrams, illustrations, narratives, analyses, schedules, performance charts, and other design documents and samples
	<u>Taxability:</u> Contractor's activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service, except when Contractor's preparation is performed pursuant to change orders, change directives, or to otherwise illustrate modification work being performed.
A15	<u>Activity:</u> Contractor must hold meetings with the Owner to review Contractor's designs and plans before commencing construction. These meetings will permit exchange of information regarding the interface between Contractor's and the Owner's related work, which will help avoid delays and save costs. . . .
	<u>Taxability:</u> Contractor's activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.
A16	<u>Activity:</u> Contractor must participate in three separate phases of design reviews: preliminary design reviews; in-progress design reviews; and final design reviews. . . .
	<u>Taxability:</u> Contractor's activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.
A17	<u>Activity:</u> Contractor is required to prepare and submit the Operating System Design Review Data which includes design criteria, equipment and system detailed descriptions, specifications, performance and functional characteristics, analyses, calculations, simulations, and drawings. . . .
	<u>Taxability:</u> Insofar as the data is either submitted during the Operating System Design Review period, in that it occurs during a design review phase . . . , or otherwise is not prepared in response to modification work being performed, the activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.
A18	<u>Activity:</u> Contractor must submit a Design/Construction Interface Document that describes how the equipment will interface with other pieces of equipment. . . .
	<u>Taxability:</u> The activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.
A19	<u>Activity:</u> Contractor is required to provide the complete design and construction of the Maintenance and Storage Facility ("M&SF"). Contractor must provide all evaluations, surveys, drawings, design documents, and architectural and other professional services for the M&SF. . . .
	<u>Taxability:</u> Excluding construction of the M&SF, which is taxable modification activity, the activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service, unless performed in response to modification work being performed, thereby constituting a construction phase service.
A20	<u>Activity:</u> Contractor must design and construct the Operations and Maintenance Center to comply with relevant codes, standards, and regulations . . . and must produce architectural program documents, schematics, and design documents. . . .
	<u>Taxability:</u> Contractor's design activity falls within the scope of the A.R.S. § 42-5075(M) Exclusion as an exempt design phase service, unless performed in response to modification work being performed. Contractor's construction of the Operations and Maintenance Center, is modification activity that is subject to tax under the prime contracting classification.

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A21	<i>Activity: Contractor is responsible for dividing the work among subcontractors and must prepare schedules in order to do so. . . .</i>
	<i>Taxability: The activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service unless performed in response to modification work already performed, thereby constituting a construction phase service.</i>
A22	<i>Activity: The Owner will provide a survey and work milestone dates that Contractor must incorporate into the work schedule, which will divide all of the subcontractor's work to meet the work milestone dates. In addition, Contractor must evaluate surveys, reports, and tests. . . .</i>
	<i>Taxability: The activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design service unless performed in response to modification work being performed, thereby constituting a construction phase service.</i>
A23	<i>Activity: Contractor must prepare all initial schedules for the project. Moreover, Contractor will have to cooperate with the owner and subcontractors in preparing the initial schedules. . . .</i>
	<i>Taxability: The activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service unless performed in response to modification work being performed (e.g., through updates and status reports), thereby constituting a construction phase service.</i>
A24	<i>Activity: Contractor must schedule and coordinate Work Milestone Dates when preparing the initial schedule for the project. . . .</i>
	<i>Taxability: Insofar as the activity is conducted for preparing the initial schedule, the activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.</i>
A25	<i>Activity: After Contractor is awarded the contract and has reviewed the additional information provided by the Owner, Contractor will expand its proposal and update its schedule for the design and construction to be performed. . . .</i>
	<i>Taxability: The activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service unless performed in response to modification work being performed, thereby constituting a construction phase service.</i>
A26	<i>Activity: Contractor must create the Network Analysis, which defines each task or activity of design and construction that must be performed under the contract. . . .</i>
	<i>Taxability: The activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service unless performed in response to modification work being performed (e.g., Network Analysis updates), thereby constituting a construction phase service.</i>
A27	<i>Activity: Contractor will prepare a detailed final Work Schedule, which will be a time-scaled, bar chart summary of the Network Analysis showing the order in which Contractor proposes to carry out the work. . . .</i>
	<i>Taxability: The activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service unless performed in response to modification work being performed (e.g., schedule updates showing actual modification progress made and revisions), thereby constituting a construction phase service.</i>

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A28	<i>Activity: Contractor is responsible for the design, analysis, and engineering of the Operating System for the [Project]. . . .</i>
	<i>Taxability: The activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service unless performed in response to modification work being performed, thereby constituting a construction phase service.</i>
A29	<i>Activity: Addendum . . . states that for all areas outside of the [Facility] yard the Owner will provide and install the . . . equipment, cable trays, duct banks, conduits and cables up to and terminating at the Contractor transformer. For the [Facility], the Owner will provide and install equipment located in the Distribution Yard and cabling, duct banks, conduits connecting . . . equipment and connecting to High-Voltage Isolation Switches throughout the System. . . .</i>
	<i>Taxability: Contractor is not liable for tax on the Owner's contracting activity, as it is not the prime contractor for such activity.</i>
A30	<i>Activity: Contractor must obtain a performance bond. . . .</i>
	<i>Taxability: Contractor's preparation of a cost estimate or schedule of values for obtaining a performance bond falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.</i>
A31	<i>Activity: Contractor is required to obtain multiple insurance policies, bonds, and letters of credit and guaranty</i>
	<i>Taxability: Contractor's preparation of cost estimates or a schedule of values for obtaining such policies, bonds, and letters falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.</i>
A32	<i>Activity: Contractor must separately state the tax. . . .</i>
	<i>Taxability: Contractor's preparation of cost estimates of any applicable taxes fall within the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.</i>
A33	<i>Activity: Contractor must review documents and develop written quality control procedures for construction, manufacturing, and installation of certain items. . . .</i>
	<i>Taxability: The activity falls within the scope of scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.</i>
A34	<i>Activity: Contractor is required to develop a Software Quality Assurance Plan ("SQAP"). . . .</i>
	<i>Taxability: The activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.</i>
A35	<i>Activity: Contractor must perform qualification testing on materials selected during the proposal review process or selected during the design review process. . . .</i>
	<i>Taxability: The activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.</i>
A36	<i>Activity: Contractor is required to supply the Owner with a list of proposed subcontractors and then to use procedures to select . . . approved subcontractors and to divide work appropriately. . . .</i>
	<i>Taxability: The activity may be excluded from tax.</i>

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A37	<u>Activity:</u> Contractor is required to design and construct the [Facility] based on the requirements shown on the Reference Drawings and the [Facility] Architectural and Engineering Specifications To meet these requirements, architects and engineers will be employed to evaluate surveys, reports, test results, etc. and to prepare drawings and specifications and prepare an initial schedule for the construction of the [Facility] building. . . .
	<u>Taxability:</u> The activity falls within the scope of the A.R.S. § 42-5075(M) exclusion as an exempt design phase service.

Contractor should note that activities that are construction phase services could be exempt under another deduction or exclusion.⁹

The following activities are subject to tax under the prime contracting classification for the specific reasons stated:

B1	<u>Activity:</u> Contractor is required to submit shop drawings, product data, samples and similar submittals. . . .
	<u>Taxability:</u> This activity is a construction phase activity subject to tax under the prime contracting classification.
B2	<u>Activity:</u> Contractor is required to prepare drawings, schematic designs, development documents to support change orders and change directives that are outside the scope of the current construction project. The change orders and change directives are separate and distinct from the administration or supervision of any modification made pursuant to a change order. . . .
	<u>Taxability:</u> The activity is performed in furtherance of a change order or change directive for modification activities to be performed by Contractor on the Project, after execution of the written contract for design phase services. Consequently, the activity is a construction phase activity subject to tax under the prime contracting classification.
B3	<u>Activity:</u> Contractor will coordinate with other contractors and the Owner to review their work schedules in the process of creating the Contractor Work Schedule
	<u>Taxability:</u> Based on the description provided . . . , the activity appears to be furtherance of the administration of construction phase services (e.g., coordination of on-site activities, review of work schedules, and revisions to the Contractor Work Schedule), such that it constitutes a construction phase service.
B4	<u>Activity:</u> Contractor is required to supervise and direct the work of subcontractors and must also select a qualified and experienced project manager. . . .
	<u>Taxability:</u> While preparation of the plan and procedures for selecting subcontractors and a project manager would constitute design phase services, Contractor's supervision and direction of their work are construction phase services and subject to tax.

The Department is unable to issue a ruling on the following activities:

⁹ For example, A.R.S. § 42-5075(J) exempts gross proceeds of sales for "actual direct costs of providing architectural or engineering services that are incorporated in a contract." For additional information, see *Arizona Transaction Privilege Tax Ruling TPR 06-2* (Dec. 19, 2006).

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C1	<p><u>Activity:</u> <i>Contractor is required to develop a training program for the Owner. . . .</i></p> <p><u>Taxability:</u> Viewed in isolation, this activity is neither a design phase nor construction phase activity, as training is not generally considered a contracting activity. Nevertheless, whether the gross proceeds of sales or gross income derived from Contractor's activity is for a nontaxable service or subject to tax as part of Contractor's business of prime contracting depends on whether Contractor is engaged in separate lines of business (see " Separate Lines of Business and Contractor's Activities" subsection above).</p>
C2	<p><u>Activity:</u> <i>Contractor will submit color renderings and a . . . scale model . . . in the . . . Design Review. . . .</i></p> <p><u>Taxability:</u> Viewed in isolation, this activity is neither a design phase nor construction phase activity, as it involves . . . tangible personal property that do[es] not become permanently attached to the real property. Nevertheless, whether the gross proceeds of sales or gross income derived from Contractor's activity is for exempt labor in addition to a retail sale or subject to tax as part of Contractor's business of prime contracting depends on whether Contractor is engaged in separate retail and contracting lines of business (see " Separate Lines of Business and Contractor's Activities" subsection above).</p>
C3	<p><u>Activity:</u> <i>Contractor must prepare estimates and schedules for anticipated modification and repair work, such as required stocking levels for repair parts that must be maintained to ensure continuous operation of the [Project]. . . .</i></p> <p><u>Taxability:</u> In this instance, Contractor is not necessarily preparing estimates and schedules for activities that constitute modification or contracting. Whether maintenance and repair work is subject to tax under either the retail or prime contracting classification depends on a variety of factors, including the type of machinery or equipment, whether the machinery or equipment is permanently attached to real property, and whether they are related to warranty repairs. Because the determination of the estimating and scheduling activity is dependent on the type of modification or repair work and on the machinery or equipment for which the parts are stocked, it is not possible to provide a generalized taxability determination at this time.</p>
C4	<p><u>Activity:</u> <i>. . . Addendum . . . requires Contractor to obtain insurance policies such as: commercial general liability; automobile liability; worker's compensation and employer's liability; and, contractor's pollution liability. . . .</i></p> <p><u>Taxability:</u> While Contractor's preparation of cost estimates for such insurance policies would fall within the A.R.S. § 42-5075(M) exclusion as an exempt design phase service if the policies related to modification work to be performed under the Design and Build Contract for the [Project], these policies relate to Contractor's post-modification operations and maintenance services for the [Project]. For the reasons mentioned in the previously discussed in Activity C3 above regarding the question of whether underlying maintenance and repair work performed pursuant to the [Second Contract] constitutes activity subject to tax under the prime contracting classification, it is not possible to provide a generalized taxability determination at this time.</p>

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C5	<u>Activity:</u> Contractor must ensure that the work is only performed by competent and qualified personnel. To do so, Contractor must prepare a plan and procedure for the selection of qualified subcontractors. . . .
	<u>Taxability:</u> While Contractor's preparation of plan and procedure for the selection of qualified subcontractors would fall within the A.R.S. § 42-5075(M) exclusion as an exempt design phase service if it was related to modification work to be performed under the Design and Build Contract for the [Project], the activity specified in this instance relates to Contractor's post-modification operations and maintenance services For the reasons mentioned in the previously discussed in Activity C3 above regarding the question of whether underlying maintenance and repair work performed pursuant to the [Second Contract] constitutes activity subject to tax under the prime contracting classification, it is not possible to provide a generalized taxability determination at this time.

If the design phase services contract is not contained within a separate written contract from the construction phase services contract, the A.R.S. § 42-5075(M) exclusion will not apply. Such services would have to qualify for the A.R.S. § 42-5075(J) exemption of architectural and engineering services or otherwise be exempted under the section to be exempt from the prime contracting transaction privilege tax.

2. A.R.S. § 42-5061(B)[]: Using the common and ordinary meaning . . . , the [tangible personal property] would fall within the scope of the retail deduction. Similarly, [another group of tangible personal property] would constitute [exempt tangible personal property] for purposes of the deduction. Finally, [exempt] equipment includes the equipment described in numbered subsections 4 and 5 above . . . , excluding ancillary or supporting machinery and equipment . . . that, while functioning as supplemental features of the [exempt] equipment, are not themselves [exempt] equipment. Such ancillary or supporting machinery and equipment may nevertheless fall within the deduction if they are component parts

3. A.R.S. § 42-5061(B)[]: The holdings of *Capitol Castings III* and *Duval Sierrita* for the current A.R.S. § 42-5061(B)(1) deduction do not transfer to the A.R.S. § 42-5061(B)[] deduction. The legislative history of A.R.S. § 42-5061(B)(1) that the Arizona Supreme Court noted in great detail as its justification for broadly interpreting the scope of the deduction does not exist for A.R.S. § 42-5061(B)[]. Moreover, in reviewing the plain language of the statutory deductions, the A.R.S. § 42-5061(B)(1) deduction itself does not extend to machinery or equipment used for [the] purposes [of A.R.S. § 42-5061(B)[]], and A.R.S. § 42-5061(B)[] exempts specific items of tangible personal property . . . , used for specific purposes . . . , rather than broad categories of tangible personal property (*i.e.*, "machinery or equipment") used in enumerated operations, as is the case with A.R.S. § 42-5061(B)(1). Contractor, if awarded the Design and Build and Operations and Maintenance contracts, would operate the [Project] for the Owner Nevertheless, no part of the system other than the actual [equipment] would constitute [exempt equipment]. Consequently, the A.R.S. § 42-5061(B)[] deduction would

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therefore only exempt from tax . . . the [equipment] that already qualify as [exempt tangible personal property] for purposes of the A.R.S. § 42-5061(B)[] deduction.

This private taxpayer ruling does not extend beyond the facts presented in your letter and enclosed documents of September 10, 2008.

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, or introduced into evidence in any proceeding by a taxpayer other than the taxpayer who has received the private taxpayer ruling.