



PRIVATE TAXPAYER RULING LR08-011

Janet Napolitano
Governor

Gale Garrriott
Director

October 29, 2008

The Department issues this private taxpayer ruling in response to your request of September 10, 2008, submitted on behalf of . . . ["Contractor"]. Your letter requests a determination of the application of Arizona transaction privilege tax ("TPT") to gross receipts derived from [Contractor]'s prospective business activities in Arizona, as described in a Request for Proposal ("RFP") to operate and maintain [a project ("Project")].

Statement of Facts:

The following is a restatement of the facts relevant to the operation and maintenance of the [Project], as presented in your letter:

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

[Contractor] is submitting a proposal on the [Project]. . . .

[Contractor] will operate the [Project] from the . . . Control Center on behalf of the [Owner]. A major portion of the . . . control equipment will be located at the Center. [Contractor] will perform scheduled and non-routine maintenance and repairs to ensure that the . . . [Project] continues to operate. . . .

[Contractor] is also required to maintain the Maintenance and Storage Facility ("M&SF"), which it will design and construct. The M&SF will be real property.

Your Issues:

Based on the arguments presented in your request, you raise the following issues:

1. Are [Contractor]'s gross receipts subject to TPT under the . . . classification?
2. Are purchases of repair and replacement parts for the [Project] exempt from TPT?
3. Does labor involved in repairing and maintaining exempt machinery and equipment constitute exempt retail service labor?
4. Is the construction of the M&SF taxable under the prime contracting classification?
5. Is the maintenance of the M&SF and anything else under the [Project] contract that was taxable contracting when constructed taxed as prime contracting when repaired and maintained?

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Your Positions:

. . . .

[Contractor] will perform its duties under the [Second Contract] as an agent of the [Owner]. The [Owner] cannot be held liable for TPT under the . . . classification, as the [Owner] will be operating and maintaining the [Project] Likewise, [Contractor], acting as the [Owner]'s agent, would not be taxable in carrying on the [Project]. . . . Therefore, [Contractor]'s gross receipts derived from the [Second Contract] will not be subject to Arizona TPT.

Regarding repair and replacement parts, [Contractor] is required to maintain the [Project], which is comprised of exempt machinery, equipment, and tangible personal property under Arizona Revised Statutes ("A.R.S.") §§ 42-5061(B)[] and 42-5061(B)[]. Under the [Second Contract], [Contractor] is required to purchase spare and replacement parts for the [Project]. If the [Project] is exempt from TPT under either the A.R.S. § 42-5061(B)[] or 42-5061(B)[] retail deduction, then related repair and replacement parts are also exempt.

Labor involved in repairing and maintaining the exempt machinery and equipment would constitute exempt retail service labor.

The construction of the M&SF will be subject to TPT under the prime contracting classification. The maintenance of the M&SF and anything else under the [Project] contract that was taxable contracting when constructed will continue to be taxed as prime contracting when repaired and maintained.

Relevant Law:

Arizona Transaction Privilege Tax

Arizona TPT differs from the sales tax imposed by most states. It is a tax on the privilege of conducting business in the State of Arizona, and is imposed on the entity conducting the business. The business may pass the burden of the tax on to its customers, but the business is ultimately liable to Arizona for the tax.

TPT is imposed under sixteen separate business classifications, including the retail, transporting, and prime contracting classifications discussed below. Additionally, county excise taxes "piggyback" the imposition of the state's transaction privilege tax. All transactions subject to TPT are also subject to applicable county excise taxes.

A.R.S. § 42-5061 imposes TPT under the retail classification as follows:

- A. The retail classification is comprised of the business of selling tangible personal property at retail. The tax base for the retail classification is the gross proceeds of sales or gross income derived from the business.

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B. In addition to the deductions from the tax base prescribed by subsection A of this section, the gross proceeds of sales or gross income derived from sales of the following categories of tangible personal property shall be deducted from the tax base:

....

G. If a person is engaged in an occupation or business to which subsection A of this section applies, the person's books shall be kept so as to show separately the gross proceeds of sales of tangible personal property and the gross income from sales of services, and if not so kept the tax shall be imposed on the total of the person's gross proceeds of sales of tangible personal property and gross income from services.

....

A.R.S. § 42-5075 imposes TPT under the prime contracting classification on the business of prime contracting and dealership of manufactured buildings. The tax base for the contracting classification is sixty-five percent of the gross proceeds of sales or gross income derived from the business.

Arizona Use Tax

In contrast to the TPT, A.R.S. § 42-5155(A) provides that “[t]here is levied and imposed an excise 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.”

A.R.S. § 42-5155(E) provides that “[e]very person storing, using or consuming in this state tangible personal property purchased from a retailer or utility business is liable for the tax. The person’s liability is not extinguished until the tax has been paid to this state.”

A.R.S. § 42-5152 provides that “[i]t shall be presumed that tangible personal property purchased by any person and brought into this state is purchased for storage, use or consumption in this state.”

A.R.S. § 42-5159 provides the following exemptions from the use tax:

B. In addition to the exemptions allowed by subsection A of this section, the following categories of tangible personal property are also exempt:

....

Arizona Administrative Code ("A.A.C.") R15-5-2304(B) provides that “[t]he burden of proof that a purchase is not subject to use tax rests upon the purchaser.”

Conclusions and Ruling:

Based on the facts presented in your request, the Department rules as follows:

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1. [Contractor] is subject to TPT . . . for its receipts from the [Owner] for operating the [Project].

[Contractor] argues that the . . . [Project] is . . . not subject to TPT. . . . [Contractor] is engaged in its own profit-seeking activities.

[Contractor] is not acting as an agent of the [Owner] in the operation or maintenance of the [Project]. . . .

. . . .

Imposing Arizona TPT on federal contractors was upheld by the Arizona Court of Appeals in *Tucson Mechanical Contracting, Inc. v. Arizona Department of Revenue*,¹ and was also upheld by the United States Supreme Court when imposed on a non-Indian contractor who contracted with the Bureau of Indian Affairs to construct highway improvements on a reservation in *Arizona Department of Revenue v. Blaze Construction Co.*² Analogous to these two holdings, state TPT is equally applicable to a person contracting with the [Owner].

. . . The purpose of the [Project] will be [Contractor] will be compensated for this activity. It is not necessary for the compensation to come directly from the³

2. Whether [Contractor] is subject to Arizona use tax for the purchase of repair and replacement parts for the [Project] will depend on the item purchased.⁴

Repair and replacement parts for machinery and equipment that are exempt from TPT or use tax would also be exempt. To the extent that machinery, equipment, and other materials that comprise the system are not exempt from TPT or use tax, repair and replacement parts for them would likewise not be exempt.

While it is not possible to give an exhaustive list of items that may be purchased during the five-year term of the agreement, should the bid be accepted and the [Project] becomes operational, the Department can provide the following guidance:

¹ 175 Ariz. 176, 854 P.2d 1162 (Ct. App. 1992).

² 526 U.S. 32 (1999).

³ See *Carriage Trade Mgmt. Corp. v. Ariz. State Tax Comm'n*, 27 Ariz.App. 584, 587, 557 P.2d 183, 186 (1976).

⁴ As explained above, TPT is imposed on vendors, not purchasers. A private taxpayer ruling makes specific tax determinations. The Department will only issue a ruling when it affects the taxpayer or potential taxpayer requesting the ruling. See A.R.S. § 42-2101(A). To the extent [Contractor] is a purchaser and not a vendor of the machinery and equipment at issue, this private taxpayer ruling will only address the use tax consequences of [Contractor]'s purchases of machinery and equipment.

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The A.R.S. § 42-5061(B)[] retail TPT deduction and 42-5159(B)[] use tax exemption are limited The purchase of repair and replacement parts for the following items would be exempt from use tax:

[List omitted.]

All other items of machinery or equipment would fall outside the scope of the TPT deduction and use tax exemption. Such nonexempt items would include ancillary or supporting machinery and equipment . . . , except to the extent that they are component parts

In addition, A.R.S. §§ 42-5061(C) and 42-5159(C) exclude the following categories of items from the TPT deduction and use tax exemption:

1. Expendable materials. For the purposes of this paragraph, expendable materials do not include any of the categories of tangible personal property specified in subsection B of this section regardless of the cost or useful life of that property.
2. Janitorial equipment and hand tools.
3. Office equipment, furniture and supplies.
4. Tangible personal property used in selling or distributing activities, other than the telecommunications transmissions described in subsection B, paragraph 16 of this section.
5. Motor vehicles required to be licensed by this state, except buses or other urban mass transit vehicles specifically exempted pursuant to subsection B, paragraph 11 of this section, without regard to the use of such motor vehicles.
6. Shops, buildings, docks, depots and all other materials of whatever kind or character not specifically included as exempt.
7. Motors and pumps used in drip irrigation systems.

Items falling into the above categories would also not be exempt.

3. Whether [Contractor]’s gross receipts derived from labor involved in repairing and maintaining exempt machinery and equipment are exempt will depend on the nature of the equipment repaired and how [Contractor] accounts for its income.

[Contractor]’s labor in repairing and maintaining machinery and equipment, whether or not exempt at the time of purchase, would be exempt retail service labor if the repairs are made to items that do not become permanently attached to real property. Some of the items that may be purchased would include Labor used in repairing and maintaining machinery and equipment that are permanently attached to real property would be taxable under the prime contracting classification.

In order to exclude exempt retail service labor, the taxpayer must comply with A.R.S. § 42-5061(G) in separately identifying income derived from the sale of tangible

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personal property and income derived from the sale of nontaxable services. Subsection G states:

If a person is engaged in an occupation or business to which subsection A of this section [retail classification] applies, the person's books shall be kept so as to show separately the gross proceeds of sales of tangible personal property and the gross income from sales of services, and if not so kept the tax shall be imposed on the total of the person's gross proceeds of sales of tangible personal property and gross income from services.

As the subsection provides, if the books and records are not maintained to separately show income from sales of tangible personal property and from sales of services, all of the income will be subject to the transaction privilege tax.

4. The construction of the M&SF is taxable under the prime contracting classification.

[Contractor] agreed in its request that the construction of the M&SF is taxable under the prime contracting classification.

5. Whether [Contractor]'s gross receipts derived from repairing and maintaining the M&SF or anything else under the [Project] contract that, when constructed, was taxable contracting activity will continue to be taxed as prime contracting depends on the nature of the repair or maintenance activity.

Generally, repair or maintenance of real property or improvements to real property would constitute contracting activity unless the repair or maintenance is minor. For example, . . . the RFP includes maintenance duties such as cleaning or minor item replacement such as light bulbs etc. Services such as cleaning are nontaxable services. Replacement of minor items, such as light bulbs, would be a retail sale.

The conclusions in this private taxpayer ruling do not extend beyond the facts presented in your correspondence of September 10, 2008.

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 the future change depending on changes in the statutes, administrative rules, case law or notification of a different Department position.

The determinations in this private taxpayer ruling are applicable only 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.