



## PRIVATE TAXPAYER RULING LR13-009

Janice K. Brewer  
Governor

John A. Greene  
Director

July 15, 2013

The Department issues this private taxpayer ruling in response to the ruling request on behalf of ... ["Company"] dated March 13, 2012, and the additional information provided in your letters dated July 13, and November 7, 2012. You request the Department to rule as to the applicability of Arizona transaction privilege tax to [Company's] prospective formation of a wholly-owned Arizona subsidiary ("Proco") that will procure all equipment for [Company] and all of its foreign and domestic subsidiaries, and sell the equipment to these entities. Pursuant to Arizona Revised Statutes (A.R.S.) § 42-2101, the Department may issue private taxpayer rulings to taxpayers and potential taxpayers on request.

### Issues:

- 1) Will Proco's sales of content delivery equipment and other tangible personal property to [Company's] Arizona corporate headquarters be subject to transaction privilege tax?
- 2) Will Proco's sales of content delivery equipment and other tangible personal property to [Company's] controlled foreign corporations located outside of the United States be subject to Arizona transaction privilege tax?

### Ruling

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

If Proco is established as a separate and distinct entity for a proper business purpose; operates in its own best interests; maintains separate finances, books and records and files tax returns as appropriate, neither acts as agent nor alter ego of [Company], and all transactions between Proco and [Company] are made on an arm's length basis; then the Department rules as follows:

Proco's gross income derived from retail sales of tangible personal property at fair market value to [Company's] Arizona corporate headquarters or any of [Company's] affiliated companies, is subject to Arizona transaction privilege tax under the retail classification.

Proco's gross income derived from retail sales of tangible personal property at fair market value to [Company's] controlled foreign corporations located outside of the United States, is not subject to transaction privilege tax under the retail classification if the sale is made in foreign commerce pursuant to A.R.S. § 42-5061(A)(24) or if the tangible personal property is shipped or delivered directly to a foreign country for use in that foreign country pursuant to A.R.S. § 42-5061(A)(35).<sup>1</sup>

<sup>1</sup> Due to recent legislation, A.R.S. § 42-5061(A)(35) will be repealed as of January 1, 2015.

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### Statement of Facts:

The following is excerpted from your June 1, 2012 letter:

[Company] ... provides ... network services in the United States and many foreign jurisdictions. The Company's current activities within Arizona include administrative activities; research and development; configuration of equipment; and the solicitation of sales of services. The Company also has offices and holds personal property in Arizona.

As the Company has grown its need to organize itself structurally has increased and recently the Company has created several controlled foreign corporations ("CFC") to handle its operations in foreign countries.

In order to more effectively manage the purchase, configuration and delivery of ... network equipment in light of the new multinational operations, the Company intends to set up an Arizona based, wholly-owned procurement company ("Proco"). The Proco will register for the Arizona Transaction Privilege Tax and apply for a reseller certificate. The Proco will make all the equipment purchases and perform system configurations for the equipment that requires such configuration and will merely resell any additional equipment that does not require configuration. The Proco will then sell and ship the equipment, to either the domestic operating company or to the CFCs. The Company intends that the Proco will transfer title and possession of the equipment to the CFCs outside Arizona and to the domestic operating company inside Arizona. Much of the equipment sold to the domestic operating company will not remain in Arizona after the sale.

The following is excerpted from your July 13, 2012 response letter:

The configurations performed by the Proco will vary depending on the type of equipment being configured. In some cases servers will arrive at the Proco's location in Arizona and need to have software loaded, configured and tested. In other cases hardware itself may be incomplete and the Arizona team will have to build or install hardware, load and configure software, and test the equipment in its entirety.

... Configuration services may be performed by either the Proco, [Company], or both. If [Company] is performing the configuration services, there will be an intercompany agreement for the services with compensation from the Proco to [Company]. The only reason that the employee(s) would not be in the Proco would be if the same employee had to be used jointly by both the Proco and [Company]. [Company] intends to have a transfer pricing study establish the intercompany price for the sales of Proco products.

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The following is excerpted from your November 7, 2012 response letter:

Proco will be a separate legal entity from [Company] and will be formed as a Limited Liability Company (“LLC”).

[Company] has sales offices in several states and servers located in server farms owned by independent and unrelated third parties in several states. ... Currently, [Company] operates inside the United States as a single entity. [Company] also owns two small domestic subsidiaries both with primary locations outside of Arizona, and also owns a domestic subsidiary which operates as a holding company. It is intended that the Proco will also make equipment purchases for these entities as well, in the same manner as the equipment purchased by the Proco and resold to [Company].

Proco will not make sales to persons or entities other than [Company], its domestic subsidiaries, and its CFC’s ... .

### DISCUSSION AND LEGAL ANALYSIS:

Arizona’s transaction privilege tax is imposed on the privilege of conducting business in the State of Arizona. The transaction privilege tax is imposed on sales of tangible personal property at retail pursuant to the retail classification provided by A.R.S. § 42-5061. The tax base for the retail classification is the gross proceeds of sales or gross income derived from business, but sales of tangible personal property for resale are excluded from the retail classification.

A.R.S. § 42-5061 provides specific deductions from a retailer’s tax base. A.R.S. § 42-5061(A)(24) provides a deduction for income derived from the sale of tangible personal property made in interstate or foreign commerce. Arizona Administrative Code (A.A.C.) rule R15-5-170 *Interstate and Foreign Transactions*, provides the qualifying characteristics and documentation requirements for such transactions. A.R.S. § 42-5061(A)(35) provides a deduction for income derived from the sale of tangible personal property that is shipped or delivered directly to a foreign country for use in that country. For this deduction, in addition to documenting the shipment or delivery of the tangible personal property to a foreign country, the purchaser should also provide to the seller information attesting to the intended use of the tangible personal property in the foreign country.

In regard to the tax base under the retail classification, the sale of tangible personal property between affiliated persons must have the status of a transaction by unrelated parties, each acting in its own self interest. A.R.S. § 42-5012 provides that for such sales between affiliated persons, if the sales value is not “indicative of the true value of the subject matter of the sale, the department shall prescribe uniform and equitable rules for determining the value upon which the tax shall be levied ... .” Arizona Administrative Code (A.A.C.) R15-5-2010 addresses transactions between affiliated parties, and the imposition of transaction privilege tax on the fair market value of the transaction.

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A.R.S. § 42-5155(A) imposes Arizona's use tax on purchases of tangible personal property that are used, stored, or consumed in Arizona. Purchases of tangible personal property from a retailer for resale in the ordinary course of the purchaser's business are not subject to use tax. See A.A.C. rule R15-5-2309. The use tax applies to the purchase price of tangible personal property purchased for resale by a person who subsequently uses or consumes the property.

**This response is a private taxpayer ruling and the determinations herein are based solely on the facts provided in the Request. Therefore, the conclusions in this private taxpayer ruling do not extend beyond the facts presented in your correspondences dated March 13, July 13, and November 7, 2012. 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 private 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. In addition, this private taxpayer ruling only applies to transactions that occur or tax liabilities that accrue from and after the date the taxpayer receives the ruling.**