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Governor

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PRIVATE TAXPAYER RULING LR18-008

December 10, 2018

Thank you for your letter requesting a private taxpayer ruling on behalf of your unnamed client ("Taxpayer"). Specifically, you requested a ruling regarding whether the Taxpayer's gross income from its business is subject to Arizona's transaction privilege tax ("TPT"). Pursuant to Arizona Revised Statutes (A.R.S.) § 42-2101, the Arizona Department of Revenue ("Department") may issue private taxpayer rulings to taxpayers and potential taxpayers on request.

ISSUE:

1. Whether the Taxpayer's gross receipts derived from the full-service video production line of business is subject to Arizona TPT?
2. Whether the Taxpayer's gross receipts derived from the marketing services line of business is subject to Arizona TPT?
3. Whether the Taxpayer's gross receipts derived from the graphics design line of business subject to Arizona TPT?

RULING:

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

1. Taxpayer's full-service video production business constitutes a *service business* and gross revenue from business activities would not be subject to Arizona state and city TPT under the retail classification provided any sale or transfer of tangible personal property meets the inconsequentiality elements outlined in Arizona Administrative Code (A.A.C.) R15-5-104(C). The customized video given to a client at the end of a video production project qualifies as an inconsequential sale or transfer of tangible personal property of the services provided. However, any sales of photography from the sale of stock images or photographs is subject to TPT under the retail classification.
2. Taxpayer's marketing services constitutes a *service business* and gross revenue from business activities would not be subject to Arizona state and city TPT under the retail classification provided any sale or transfer of tangible personal property meets the inconsequentiality elements outlined in A.C.C. R15-5-104(C). The marketing plans and marketing materials provided to clients qualify as an inconsequential sale or transfer of tangible personal property of the services provided.

3. Taxpayer's graphic design services constitutes a *service business* and gross revenue from business activities would not be subject to Arizona state and city TPT under the retail classification provided any sale or transfer of tangible personal property meets the inconsequentiality elements outlined in A.A.C. R15-5-104(C). The electronic transfer of the designs qualifies as an inconsequential sale or transfer of tangible personal property of the service provided. However, Taxpayer's gross receipts derived job printing is subject to Arizona state and city TPT under the job printing classification when Taxpayer designs graphics and prints the final deliverables for their clients.

SUMMARY OF FACTS:

The following are facts excerpted from your letter dated April 12, 2018.

. . . .

*** is a full-services video production company that provides all stages of the production process including creative planning, pre-production, and post-production. The company also provides graphic design and marketing services, but these services constitute an insignificant portion of their gross revenue.

Services provided within the production process include scriptwriting, story boarding, idea development, budgeting, locating scouting, videography, directing, sound design, voiceovers, creating motion graphics, and video editing. Additional contract labor is hired as needed to meet the needs of each project. The company owns its own production equipment and charges a daily fee for using the equipment while on set. The video provided at the end of the project is a custom service for each client with a single copy made available to them electronically. Clients are billed for the unique combination of services required for each project. The video itself, is an inconsequential element with the total array of services provided by the production company. The charge for the video itself is not separately stated on the invoices and it is not transferred to the client in a form that is subject to retail sale. In addition, the video itself represents less than 15% of the costs incurred by *** in providing services to its customers.

Examples of invoices to customers provide as an attachment to this letter show that voice over services, engineering, studio, directing, set design, translation services, editing, scheduling, filming, and script development comprise the majority of services billed to customers.

. . . .

Marketing services include creating social media marketing plans and marketing materials which are provided directly to each client based on the sales agreement.

Graphic Design services are a small portion of the business and include designing stickers, business cards, posters, etc. for individual clients. The graphic is typically delivered electronically to the client who then uses it to print their own materials. On occasion, the company prints the final deliverables – the cards, poster, etc. for their clients.

You provided additional facts in your September 26, 2018 e-mail correspondence:

Marketing services for when I help to create a marketing message, plan, and design for marketing campaigns, including design and message for them to use on flyers, business cards, postcards but I do not print or provide the printed materials for this. I only assist in design and marketing message.

[T]he charge for stock video or pictures is a charge to recoup the cost I obtained for purchasing these royalty free images on their behalf to use in the video. For instance, a training video I did needed example pictures or video of a bulldozer so I needed to purchase the license to use the already generated image from a stock photo/video site to use in the video. I then invoice my client for the costs.

DISCUSSION & LEGAL ANALYSIS:

Arizona imposes a TPT on the privilege of conducting business in the State of Arizona. The authority to levy the TPT tax is found in A.R.S. § 42-5008. The TPT tax is a tax on the seller, not the purchaser. The seller may pass the burden of the tax on to the purchaser; however, the seller is ultimately liable for the tax. All sales that are subject to the TPT are also subject to applicable county excise taxes.

Retail Classification

A.R.S. § 42-5061 imposes the TPT under the retail classification. 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. All sales of tangible personal property are subject to TPT under the retail classification unless specifically exempted or excluded by statute. A.R.S. § 42-5001(17) defines "tangible personal property" as personal property which may be seen, weighed, measured, felt or touched or is in any other manner perceptible to the senses.

A.R.S. § 42-5061(A)(1) exempts “[p]rofessional or personal service occupations or businesses which involve sales or transfers of tangible personal property only as inconsequential elements.” The Department discusses the nature of professional and personal service occupations and businesses in *Arizona Transaction Privilege Tax Ruling* TPR 90-2 (Aug. 1, 1990). Professional and personal service occupations are those where the professional is able to engage in the occupation by virtue of a state sanctioned or state issued license to engage in that occupation (e.g., lawyers, doctors, cosmeticians, barbers). A service business is one whose dominant purpose is to provide a service rather than to fabricate and sell the goods fabricated.¹ Examples of service businesses include vehicle maintenance garages, pest control, lawn maintenance and other like services.

The A.R.S. § 42-5061(A)(1) exemption generally covers those inconsequential sales or transfers of tangible personal property used by an occupation or business in the actual operation thereof or to facilitate the service provided (e.g., shampoo used by a hair stylist to wash a customer’s hair). Assuming such sales and transfers meet the inconsequentiality test provided under A.A.C. R15-5-104(C), they may be exempt from TPT under A.R.S. § 42-5061(A)(1).

A.A.C. R15-5-104(C) provides that sales of tangible personal property shall be considered inconsequential elements of the service if:

1. The purchase price of the tangible personal property to the person rendering the services represents less than 15% of the charge, billing, or statement rendered to the purchaser in connection with the transaction;
2. At the time of the sale, the tangible personal property transferred is not in a form which is subject to retail sale; and
3. The charge for the tangible personal property is not separately stated on the invoice.

A.R.S. § 42 5061(A)(2) provides a deduction for services rendered in addition to selling tangible personal property at retail. A.A.C. R15-5-105 states 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. See A.R.S. § 42 5061(F). For instance, automotive repairs generally entail service in conjunction with the sale of auto parts.

Videography

A.A.C. R15-5-150(A)(3) defines “photography” as “the process of taking and supplying images to customers, using film, video, or another data storage medium.” Thus, the gross income derived from all sales of photography, whether transmitted in hard copy form or by digital methods, is subject to the TPT imposed under the retail classification unless,

¹ Additionally, Arizona case law provides that under the dominant purpose test, “if the dominant purpose of the transaction is a service, then the transaction is not taxable.” See *generally Qwest Dex, Inc. v. Arizona Department of Revenue*, 109 P.3d 121,123 (Ariz. Ct. App. 2005).

pursuant to A.C.C. R15-5-150(B) , “under A.C.C. R15-5-104(C), the sale of such photography is considered an inconsequential element of nontaxable activities that are associated with the sale.” A.C.C. R15-5-150(B) provides that “[e]xamples of nontaxable activities that are associated with the sale of photography include research; script consulting; director, crew, and equipment charges; preproduction or post production charges; location scouting fees; and music charges.”

Pursuant to A.R.S. § 42-5061(A)(1), Taxpayer could exclude gross receipts derived from its full-service video production line of business if: 1) the business constitutes either a professional or personal service occupation or a service business and 2) the sale or transfer of the tangible personal property meets the inconsequentiality test provided in A.A.C. R15-5-104(C). Based on the information received, it appears the full-service video production business constitutes a *service business* under A.R.S. § 42-5061(A)(1). Additionally, the videos provided to clients at the end of a project appear to meet the inconsequentiality test provided in A.A.C. R15-5-104(C). The service of creating or developing the customized video (rather than the video itself) is the dominant purpose of the transaction and the video was developed for the first time based on the specific client’s unique needs and specification. The “final product” is a customized production by your business for a specific client on a video and the video is not separately stated on the invoice.

However, the sale of “stock” images, on the other hand, is not exempt from retail TPT. Stock images or videos is not based on the specifications or needs of an individual client. Such stock images or videos is tangible personal property that is generally marketable and may be used by any client or customer. Additionally, the sale of stock images do not meet the inconsequentiality test because they are separately stated on the Taxpayer’s invoices.

Marketing

Pursuant to A.R.S. § 42-5061(A)(1), Taxpayer could exclude gross receipts derived from its marketing line of business if: 1) the business constitutes either a professional or personal service occupation or a service business and (2) the sale or transfer of the tangible personal property meets the inconsequentiality elements provided in A.A.C. R15-5-104(C). Taxpayer provides marketing services such as creating a marketing message, plan, and design for marketing campaigns. Thus, it appears the marketing line of business constitutes a *service business* under A.R.S. § 42-5061(A)(1). The dominant purpose of the transaction is the service of creating a customized marketing plan. A.R.S. § 42-5061(A)(1) exemption generally covers those inconsequential sales or transfers of tangible personal property used by an occupation or business in the actual operation thereof or to facilitate the service provided. The marketing plans and marketing materials provided to the client appear to meet the inconsequentiality test provided in A.A.C. R15-5-104(C).

Graphic Design

Pursuant to A.R.S. § 42-5061(A)(1), Taxpayer could exclude gross receipts derived from its graphic design service if: 1) the business constitutes either a professional or personal service occupation or a service business and (2) the sale or transfer of the tangible personal property meets the inconsequentiality elements provided in A.A.C. R15-5-104(C). Based on the information received, it appears the graphic design line of business constitutes a *service business* under A.R.S. § 42-5061(A)(1). The dominant purpose of the transaction is the service of creating graphic designs based on ideas from the client. The electronic transfer of tangible personal property necessary to convey each graphic design is an inconsequential element of Taxpayer's service occupation or business and meets the inconsequentiality test provided in A.A.C. R15-5-104(C).

Job Printing Classification

A.R.S. § 42-5066 imposes TPT upon persons engaging in the business of job printing, engraving, embossing, and copying. Unless specifically exempted by statute, all income derived from job printing, engraving, embossing and copying is subject. The tax base for the job printing classification is the gross proceeds of sales or the gross income derived from the business without deduction on account of the cost of labor, materials or subcontract work.

A "printer," as defined in A.A.C. R15-5-1101(4), is "a person that copies or reproduces textual or pictorial material by any means, process, or method of job printing, engraving, embossing, or copying, but that does not distribute the copied or reproduced material on the person's own behalf." A "printing," under A.A.C. R15-5-1101(5), is "a finished product in physical or electronic form produced by a printer through job printing, engraving, embossing, or copying and that is held for sale by the printer."

A.R.S. § 42-5001 defines "gross income" as the "gross receipts" of a taxpayer, which is further defined in pertinent part as "the total amount of the sale, lease or rental price ... including any services that are a part of the sales ... without any deduction from the amount on account of the cost of the property sold, materials used, labor or service performed, interest paid, losses or any other expense." "Sale" is defined as any transfer of title or possession, or both, exchange, barter, lease or rental, conditional or otherwise, of tangible personal property for a consideration.

A printer is engaged in various activities necessary to produce the final printed product. These activities may include pre-press services such as graphic design, typesetting, layout and color separation in addition to the actual printing of the item. A printer may also perform post-press activities such as stuffing envelopes, sorting, affixing postage and mailing. The tax base for printed matter includes all charges for materials used, pre-press activities, printing activities and post-press activities.

A.R.S. § 42-5066(B)(4) provides a deduction from the tax base of the job printing classification for gross income derived from “[s]ales of postage and freight except that the amount deducted shall not exceed the actual postage and freight expense that is paid to the United States postal service or a commercial delivery service and that is separately itemized by the taxpayer on the customer's invoice and in the taxpayer's records.”

Thus, Taxpayer's business activities of printing specialized items such as printed stickers, business cards, and posters for clients would be taxable under the job printing classification pursuant to A.R.S. § 42-5066. Taxpayer's gross proceeds of sales or gross income derived from job printing sales are subject to TPT. A deduction may be taken for the actual postage and freight expense that is paid to the United States postal service or a commercial delivery service and that is separately itemized by the Taxpayer on the customer's invoice and in the Taxpayer's records.

City Taxes

It is important to note, the imposition of city privilege taxes is separate and distinct from the state's TPT and accompanying county excise taxes. As with the state's TPT, city privilege taxes are imposed on the vendor for the privilege of engaging in business in the city. The Model City Tax Code (“MCTC”) was created in order to impose and administer city privilege taxes. Similar to Arizona's TPT, city privilege taxes are imposed “upon persons on account of their business activities”. See MCTC § 400(a)(1). All Arizona cities follow the MCTC in their imposition of their privilege tax based upon their local ordinances. However, certain options exist, allowing each city to alter or qualify the imposition of its privilege tax. The MCTC can be found online at www.modelcitytaxcode.az.gov/.

MCTC § -460(c)(5) provides a similar exemption for professional service businesses as at the state level. Thus, the services provided by Taxpayer as outlined above would also be exempt from tax for city tax purposes.

Similar to state statute, MCTC § -425 provides similar language for the job printing classification. Thus, the sale of printed graphic designs such as stickers, posters, business cards, etc. is subject to city privilege tax under the job printing classification.

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 correspondence. 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.