ARIZONA USE TAX RULING

UTR 00-1

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ISSUE:

A purchaser's potential tax liability resulting from a purchase of tangible personal property from an in-state vendor.

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 42-5009(A) enables taxpayers engaged in any transaction privilege tax business classification to establish deductions from the tax base of such business by: (1) marking the transaction invoice to indicate such deduction; and (2) obtaining a completed and executed Arizona Department of Revenue ("Department") transaction privilege tax exemption certificate ("Departmental Certificate").

A.R.S. § 42-5009(B) provides that taxpayers not utilizing a Departmental Certificate may nevertheless establish entitlement to the deductions by presenting facts necessary to support the deduction, but the burden of proof remains on such taxpayers.

Pursuant to A.R.S. § 42-5009(D), if a vendor is entitled to a deduction by complying with A.R.S. § 42-5009(A), the Department may require the purchaser which executed the Departmental Certificate to establish the accuracy and completeness of the certificate information. If the purchaser cannot establish the accuracy and completeness of the Departmental Certificate information, the purchaser is liable in an amount equal to any transaction privilege tax, interest, and penalty which the vendor would have been required to pay if the vendor had not complied with A.R.S. § 42-5009(A) ("5009 Amount"). Payment of the 5009 Amount by the purchaser relieves the purchaser of any use tax liability.

Effective August 6, 1999, pursuant to A.R.S. § 42-5009(E), if a vendor is entitled to a deduction by complying with A.R.S. § 42-5009(B), the Department may require the purchaser to establish

the accuracy and completeness of the information provided to the vendor that entitled the vendor to the deduction. If the purchaser cannot establish the accuracy and completeness of the information, the purchaser is liable for the 5009 Amount. Payment of the 5009 Amount by the purchaser relieves the purchaser of any use tax liability.

A.R.S. § 42-5155(A) imposes a use tax on the storage, use or consumption in this state of tangible personal property purchased from a retailer.

A.R.S. §§ 42-5151(6) and 5151(8) exclude purchases for resale from the definitions of "storage", "use" and "consumption".

A.R.S. § 42-5155(B) imposes the use tax on any purchaser that purchased tangible personal property for resale but subsequently uses or consumes the property.

A.R.S. § 42-5159(A)(1) exempts from use tax the in-state storage, use or consumption of tangible personal property sold in this state if the gross receipts from the sale are included in the measure of the tax imposed by the transaction privilege tax article.

The Tax Court, in *People of Faith Inc. v. Arizona Dep't of Revenue,* 161 Ariz. 514, 779 P.2d 829 (Tax Ct. 1989), aff'd 171 Ariz. 140, 829 P.2d 330 (App. 1992), held that use tax can be imposed upon purchases from in-state vendors under certain circumstances.

DISCUSSION:

The transaction privilege tax is a tax imposed on the privilege of conducting business in the State of Arizona. Although the vendor may pass the burden of the tax on to the purchaser, the vendor is liable to Arizona for the transaction privilege tax.

Arizona also imposes a use tax on the in-state storage, use or consumption of tangible personal property purchased from a retailer. Use tax is a complementary tax to the transaction privilege tax and typically applies only to purchases from out-of-state vendors. Because transaction privilege tax and use tax are complementary taxes, one, but not both, apply to a transaction. The term "retailer" as used in the use tax article is broader than the term "retailer" as used in the transaction privilege tax article, and thus includes entities which, if conducting business in-state, may not be classified under the retail classification.

Under most circumstances, a purchaser is not liable for transaction privilege tax or use tax as a result of the purchase, or in-state use, of tangible personal property purchased from an in-state vendor. In general, the in-state vendor is liable for transaction privilege tax, if any, and the use tax would be inapplicable to the purchaser's in-state use, storage or consumption of the property. However, there are exceptions to this general rule.

In September 1989, the Tax Court published its decision in *People of Faith v. Arizona Dep't of Revenue.* The case involved a taxpayer which, during the period of December 1, 1982 through June 30, 1986, purchased building materials from an in-state vendor under a transaction privilege tax exemption for materials used to construct nursing homes. However, the taxpayer used some of the materials in a non-exempt manner to build a residential complex and garden homes within the state. The issue involved in the case was whether the state could impose a use tax on the in-state use, storage or consumption of tangible personal property purchased from an in-state vendor ("in-state use tax"). The Court examined the language of a 1981 amendment to the predecessor of A.R.S. § 42-5159(A)(1) which currently exempts from use tax tangible personal property sold in this state, "the gross receipts from the sale of which are included in the measure of" the transaction privilege tax article (emphasis added). Prior to the 1981 amendment, the predecessor of A.R.S. § 42-5159(A)(1) exempted from use tax tangible personal property sold in this state, "the gross receipts from the sale of which are required to be included in the measure of" the transaction privilege tax article (emphasis added). The Court examined the legislative intent of the amendment and held that use tax can be imposed on purchases from in-state vendors if, because of some act of the purchaser, the vendor reasonably believed at the time of the transaction that the gross receipts from the sale were exempt from transaction privilege tax.

Prior to the date of the publication of the *People of Faith* decision, the Arizona Legislature enacted the predecessor of A.R.S. § 42-5009 that read the same as the current A.R.S. § 42-5009. (See Laws 1988, Ch. 161) However, the effective date of the act was June 30, 1989. Because the *People of Faith* decision involved the period of December 1, 1982 through June 30, 1986, and because the effective date of the predecessor of A.R.S. § 42-5009 was subsequent to the publication of the decision, the Tax Court in *People of Faith* did not examine the impact of A.R.S. § 42-5009.

As stated above, use tax can be imposed on purchases from in-state vendors if, because of some act of the purchaser, the vendor reasonably believes, at the time of the sale, that the gross receipts from the sale were exempt from transaction privilege tax. However, all persons are presumed to know the law applicable to their business transactions. Thus, a misrepresentation of law will not cause the vendor to *reasonably* believe that the sale is exempt from transaction privilege tax. Therefore, a misrepresentation of law made by a purchaser will not subject the purchaser to in-state use tax liability under *People of Faith*.

An example of a misrepresentation of law is a nonprofit organization's representation to a vendor that none of the nonprofit organization's purchases are subject to transaction privilege tax.

On the other hand, a misrepresentation of fact which, if true, would entitle the vendor to the claimed deduction, can give the vendor reason to believe the sale is exempt from transaction privilege tax. Therefore, such a factual misrepresentation may subject the purchaser to in-state use tax.

An example of a misrepresentation of fact would be a contractor's representation to a vendor that the contractor will use the purchased materials for incorporation into a contracting project [exempt under A.R.S. § 42-5061(A)(27)] although the contractor intends to, and does, use the materials on his/her personal residence.

A.R.S. § 42-5009(A) enables a taxpayer to establish a deduction from the tax base of their transaction privilege tax business by marking the invoice to reflect such a deduction and by obtaining a completed and executed Departmental Certificate. A.R.S. § 42-5009(A)(2) gives the Department the discretion to disregard the Departmental Certificate if the vendor has reason to believe that the information contained within the Departmental Certificate is incomplete or erroneous. Again, because all persons are presumed to know the law applicable to their business transactions, a misrepresentation of law within a Departmental Certificate will give the vendor a reason to believe that the Departmental Certificate is erroneous and thus the Department may disregard the Departmental Certificate. Therefore, a misrepresentation of law by the purchaser will not relieve the vendor of liability for transaction privilege tax, interest and penalties and will therefore not subject the purchaser to the 5009 Amount.

However, a factual misrepresentation within a Departmental Certificate which, if true, would entitle the vendor to the claimed deduction, may not give the vendor reason to believe that the Departmental Certificate is erroneous or incomplete and thus may be reasonably relied upon by the vendor. As a result, A.R.S. § 42-5009(D) would impose an amount on the purchaser that executed the factually inaccurate Departmental Certificate. Unlike the liability discussed in *People of Faith,* the 5009 Amount resulting from a factual misrepresentation is not a use tax. It is an amount based on the tax, interest and penalty that the vendor would have been liable for but for the vendor's reliance on the Departmental Certificate. Because the effective date of A.R.S. § 42-5009 was subsequent to the *People of Faith* decision, the statute will govern for periods on or after June 30, 1989. Thus, a purchaser's factual misrepresentation within a Departmental Certificate which, if true, would entitle the vendor to the claimed deduction, will not subject the purchaser to in-state use tax. Instead, pursuant to A.R.S. § 42-5009(D), the purchaser will be subject to the 5009 Amount.

Misrepresentations of fact can occur without using a Departmental Certificate. A.R.S. § 42-5009(B) provides that a vendor who does not comply with subsection A (by using a Departmental Certificate) may establish entitlement to the deduction by presenting facts necessary to support the entitlement. Under these circumstances, the burden of proving entitlement to the deduction remains on the vendor. However, many transaction privilege tax exemptions are based upon the actual use of tangible personal property by the purchaser or the actual business classification of the purchaser. Facts indicating the purchaser's actual use or actual business are often beyond the control of the vendor. Therefore, the only facts that the vendor can often present to support its claimed deduction are the factual representations of the purchaser. As such, the vendor may *reasonably* rely upon such facts to establish entitlement to the deduction. Thus, prior to August 6, 1999, a purchaser's factual misrepresentation, made in

any manner other than a Departmental Certificate, which if true, would entitle the in-state vendor to the claimed deduction, does not subject the vendor to transaction privilege tax, interest or penalty liability. Instead, pursuant to *People of Faith,* the purchaser is liable for in-state use tax.

Prior to August 6, 1999, § 42-5009 provided two methods under which vendors could establish entitlement to an exemption from the transaction privilege tax. One method was to obtain a certificate from the purchaser providing the information required under the statute. If the vendor obtained a certificate, the purchaser was required to prove that the sale was exempt from tax. If the sale was not exempt, the purchaser was subject to the tax, as well as interest and penalties the vendor would have been required to pay. However, if the vendor did not take a certificate, the vendor could use the facts of the transaction to prove that the sale was exempt from tax. When the vendor was successful in meeting this burden, the purchaser was required to prove the validity of the exemption. If the purchaser could not prove the validity, the statute was silent on what the purchaser was required to pay. The Legislature in 1999 enacted a provision (A.R.S. § 5009(E)) that stipulates that if a purchaser provides incomplete or inaccurate information to a seller in order for a transaction to be deducted from transaction privilege tax, the purchaser becomes liable in an amount equal to any tax, penalty and interest that the vendor would have been required to pay had the purchaser provided accurate information. (See *AZ State Senate Fact sheet for H.B. 2061*, dated February 18, 1999) As such, a purchaser's factual misrepresentation which, if true, would entitle the in-state vendor to the claimed deduction, will subject the purchaser to the 5009 Amount. However, if the vendor has reason to believe the purchaser's factual representation is inaccurate or erroneous, the vendor remains liable for the transaction privilege tax and the purchaser will not be liable for any amount under A.R.S. § 42-5009(E).

Another issue is the interaction between A.R.S. § 42-5155(B), A.R.S. § 42-5009, and *People of Faith*. Pursuant to A.R.S. § 42-5155(B), use tax is imposed on "any purchaser which purchased tangible personal property for resale but subsequently uses or consumes the property." With regard to purchases from in-state vendors, such provision applies only to situations where the in-state vendor who sold the property to the purchaser deducted the gross proceeds of the sale from its tax base. [See A.R.S. § 42-5155(D)]. Any representation of fact by the purchaser that the property was for resale, and thus exempt from transaction privilege tax, may or may not have been accurate at the time of the purchase.

If the purchaser, at the time of the purchase, intended to resell the property in the regular course of its business, then the resale representation does not subject the purchaser to liability for the 5009 Amount because the representation was not "inaccurate" or "incomplete." However, the honest representation by the purchaser that the sale was for resale is "some act on the part of the buyer" which caused the vendor to "reasonably believe, at the time of the sale," that the gross proceeds of the sale were not subject to transaction privilege tax. [See A. R.S. § 42-5061(U)(3)] Thus, A.R.S. § 42-5155(B) and the *People of Faith* decision would authorize the imposition of in-state use tax upon the purchaser.

If the purchaser, at the time of the purchase, did not intend to resell the property in the regular course of its business, and the misrepresentation was made within a Departmental Certificate, then the purchaser is subject to liability for the 5009 Amount. Furthermore, pursuant to *People of Faith,* in-state use tax would also appear applicable because the misrepresentation was "some act on the part of the buyer" which caused the vendor to "reasonably believe, at the time of the sale," that the gross proceeds of the sale were not subject to transaction privilege tax. However, as stated above, because the effective date of A.R.S. § 42-5009 was subsequent to the *People of Faith* decision, the statute will govern for periods on or after such effective date. Thus, on or after June 30, 1989, a purchaser's resale misrepresentation within a Departmental Certificate will not subject the purchaser to in-state use tax. Instead, pursuant to A.R.S. § 42-5009(D), the buyer will be liable for the 5009 Amount. If the purchaser, at the time of the purchase, did not intend to resell the property in the regular course of its business, and the resale misrepresentation was not made within a Departmental Certificate, then the purchaser is liable for in-state use tax pursuant to *People of Faith*.

RULING:

1. A purchaser's factual misrepresentation within a Departmental Certificate which, if true, would entitle the vendor to the claimed transaction privilege tax deduction, will subject the purchaser to the 5009 Amount pursuant to A.R.S. § 42-5009(D).

   2. Prior to August 6, 1999, a purchaser's factual misrepresentation which, if true, would entitle the in-state vendor to the claimed deduction, made in any manner other than a Departmental Certificate, will subject the purchaser to liability for in-state use tax. From and after August 6, 1999, a purchaser's factual misrepresentation which, if true, would entitle the in-state vendor to the claimed deduction, made in any manner other than a Departmental Certificate, will subject the purchaser to the 5009 Amount.

   3. If a purchaser makes a true representation to an in-state vendor that the tangible personal property purchased was for resale, but subsequently stores, uses, or consumes the property in this state, then the purchaser is liable for in-state use tax.

   4. A purchaser's misrepresentation of law to an in-state vendor at any time or in any manner will not subject the purchaser to an in-state use tax or liability for the transaction privilege tax, interest, and penalties that the vendor would had been liable for had it not relied upon the misrepresentation of law.

5. If a purchaser makes a misrepresentation to an in-state vendor within a Departmental Certificate, and the vendor had reason to believe that the Departmental Certificate was inaccurate or incomplete, the Department may disregard the Departmental Certificate. If disregarded, the purchaser will not be liable for any amount under A.R.S. § 42-5009(D).

For more information on a vendor’s use of exemption certificates to document exemptions from transaction privilege tax see Arizona Transaction Privilege Tax Procedure TPP 00-3.

Mark W. Killian, Director
Signed: March 8, 2000

Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law that are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement that provides interpretation, detail, or supplementary information concerning application of the law. Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.