

**THE RETAIL CLASSIFICATION**

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**STEPTOE & JOHNSON LLP**

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## 1. ***THE RETAIL CLASSIFICATION STATUTE AND EXEMPTIONS – A.R.S. § 42-5061.***

### **SALES TAX RATE:**

State 5.6% (5% prior to June 1, 2001)

County varies

City varies

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. The tax imposed on the retail classification pursuant to this section does not apply to the gross proceeds of sales or gross income from:

### [MISCELLANEOUS DEDUCTIONS]

1. Professional or personal service occupations or businesses which involve sales or transfers of tangible personal property only as inconsequential elements.

2. Services rendered in addition to selling tangible personal property at retail.

3. Sales of warranty or service contracts. The storage, use or consumption of tangible personal property provided under the conditions of such contracts is subject to tax under section 42-1408.01.

4. Sales of tangible personal property by any nonprofit organization organized and operated exclusively for charitable purposes and recognized by the department and the United States internal revenue service as such a nonprofit organization for charitable purposes.

5. Sales to persons engaged in business classified under the restaurant classification of articles used by human beings for food, drink or condiment, whether simple, mixed or compounded.
6. Business activity by a person which is properly included in any other business classification by that person which is taxable under this article.
7. The sale of stocks and bonds.
8. Drugs and medical oxygen on the prescription of a member of the medical, dental or veterinarian profession who is licensed by law to administer such substances.
9. Prosthetic appliances as defined in section 23-501 prescribed or recommended by a health professional licensed pursuant to title 32, chapter 7, 8, 11, 13, 14, 15, 16, 17 or 29.
10. Insulin, insulin syringes and glucose test strips.
11. Prescription eyeglasses or contact lenses.
12. Hearing aids as defined in section 36-1901.
13. Durable medical equipment which as a federal health care financing administration common procedure code, is designated reimbursable by Medicare, is prescribed by a person who is licensed under title 32, chapter 7, 8, 13, 14, 15, 17 or 29, can withstand repeated use, is primarily and customarily used to serve a medical purpose, is generally not useful to a person in the absence of illness or injury and is appropriate for use in the home.
14. Sales to nonresidents of this state for use outside this state if the vendor ships or delivers the tangible personal property out of this state.
15. Food, as provided in and subject to the conditions of article 1.1 of this chapter and section 42-5074.
16. Items purchased with United States department of agriculture food coupons issued under the food stamp act of 1977 (P.L. 95-113; 91 Stat. 958) or food instruments issued under section 17 of the child nutrition act (P.L. 95-627; 92 Stat. 3603; and P.L. 99-661, section 4302).
17. Textbooks by any bookstore that are required by any state university or community college.
18. Food and drink to a person who is engaged in business which is classified under the restaurant classification and which provides such food and drink without monetary charge to its employees for their own consumption on the premises during the employees' hours of employment.
19. Articles of food, drink or condiment and accessory tangible personal property to a school district if such articles and accessory tangible personal property are to be prepared and served to persons for consumption on the premises of a public school within the district during school hours.
20. Lottery tickets or shares pursuant to title 5, chapter 5, article 1.

21. The sale of precious metal bullion and monetized bullion to the ultimate consumer, but the sale of coins or other forms of money for manufacturer into jewelry or works of art is subject to the tax. In this paragraph:

(a) "Monetized bullion" means coins and other forms of money which are manufactured from gold, silver or other metals and which have been or are used as a medium of exchange in this or another state, the United States or a foreign nation.

(b) "Precious metal bullion" means precious metal, including gold, silver, platinum, rhodium and palladium, which has been smelted or refined so that its value depends on its contents and not on its form.

22. Motor vehicle fuel and use fuel which are subject to a tax imposed under title 28, chapter 9, article 1 or 2, sales of use fuel to a holder of a valid single trip use fuel tax permit issued under section 28-1559, sales of aviation fuel which are subject to the tax imposed under section 28-1765.01 and sales of jet fuel which are subject to the tax imposed under article 8 of this chapter.

23. Tangible personal property sold to a person engaged in the business of leasing or renting such property under the personal property rental classification if such property is to be leased or rented by such person.

24. Tangible personal property sold in interstate or foreign commerce if prohibited from being so taxed by the Constitution of the United States or the constitution of this state.

25. Tangible personal property sold to:

(a) A qualifying hospital as defined in section 42-5001.

(b) A qualifying health care organization as defined in section 42-5001 if the tangible personal property is used by the organization solely to provide health and medical related educational and charitable services.

(c) A qualifying health care organization as defined in section 42-5001 if the organization is dedicated to providing educational, therapeutic, rehabilitative and family medical education training for the blind, visually impaired and multi-handicapped children from the time of birth to age twenty-one.

(d) A qualifying community health care center as defined in section 42-5001.

(e) A nonprofit charitable organization that has qualified under section 501(c)(3) of the internal revenue code and that regularly serves meals to the needy and indigent on a continuing basis at no cost.

(f) For taxable periods beginning from and after June 30, 2001, a nonprofit charitable organization that has qualified under section 501(c)(3) of the internal revenue code and that provides residential apartment housing for low income persons over sixty-two years of age in a facility that qualifies for a federal housing subsidy, if the tangible personal property is used by the organization solely to provide residential apartment housing for low income persons over sixty-two years of age in a facility that qualifies for a federal housing subsidy.

26. Magazines or other periodicals or other publications by this state to encourage tourist travel.

27. Tangible personal property sold to a person that is subject to tax under this article by reason of being engaged in business classified under the prime contracting classification under § 42-5075, or to a subcontractor working under the control of a prime contractor that is subject to tax under article 1 of this chapter, if the property so sold is any of the following:

- (a) Incorporated or fabricated by the person into any real property, structure, project, development or improvement as part of the business.
- (b) Used in environmental response or remediation activities under § 42-5075, subsection B, paragraph 6.
- (c) Incorporated or fabricated by the person into any lake facility development in a commercial enhancement reuse district under conditions prescribed for the deduction allowed by § 42-5075, subsection B, paragraph 8.

28. The sale of a motor vehicle to:

(a) A nonresident of this state if the purchaser's state of residence does not allow a corresponding use tax exemption to the tax imposed by this article and if the nonresident has secured a special thirty-day nonresident registration of the vehicle by applying according to section 28-302.

(b) An enrolled member of an Indian tribe who resides on the Indian reservation established for that tribe.

29. Tangible personal property purchased or leased in this state by a nonprofit charitable organization that has qualified under section 501(c)(3) of the United States internal revenue code and that engages in and uses such property exclusively for training, job placement or rehabilitation programs or testing for mentally or physically handicapped persons.

30. Sales of tangible personal property by a nonprofit organization that is exempt from taxation under section 501(c)(3), 501(c)(4), or 501(c)(6) of the internal revenue code if the organization is associated with a major league baseball team or a national touring professional golfing association and no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

31. Sales of commodities, as defined by title 7 United States Code section 2, that are consigned for resale in a warehouse in this state in or from which the commodity is deliverable on a contract for future delivery subject to the rules of a commodity market regulated by the United States commodity futures trading commission.

32. Sales of tangible personal property by a nonprofit organization that is exempt from taxation under § 501(c)(3), 501(c)(4), or 501(c)(6), 501(c)(7) or 501(c)(8) of the internal revenue code if the organization sponsors or operates a rodeo featuring primarily farm and ranch animals and no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

33. Sales of seeds, seedlings, roots, bulbs, cuttings and other propagative material to persons who use those items to commercially produce agricultural, horticultural, viticultural or floricultural crops in this state.

34. Machinery, equipment, technology or related supplies that are only useful to assist a person who is physically disabled as defined in section 46-191, has a developmental

disability as defined in section 36-551 or has a head injury as defined in section 41-3201, to be more independent and functional.

35. Sales of tangible personal property that is shipped or delivered directly to a destination outside the United States for use in that foreign country.

36. Sales of natural gas or liquefied petroleum gas used to propel a motor vehicle.

37. Paper machine clothing such as forming fabrics and dryer felts, sold to a paper manufacturer and directly used or consumed in paper manufacturing.

38. Coal, petroleum, coke, natural gas, virgin fuel oil and electricity sold to an environmental technology manufacturer, producer or processor as defined in section 41-1514-02, and directly used or consumed in the generation or provision of on-site power or energy solely for environmental technology manufacturing, producing or processing or environmental protection. This paragraph shall apply for fifteen full consecutive calendar or fiscal years from the date the first paper manufacturing machine is placed in service. In the case of an environmental technology manufacturer, producer or processor who does not manufacture paper, the time period shall begin with the date the first manufacturing, processing or production equipment is placed in service.

39. Sales of liquid, solid or gaseous chemicals used in manufacturing, processing, fabricating, mining, refining, metallurgical operations research and development and, beginning on January 1, 1999, printing, if using or consuming the chemicals, alone or as part of an integrated system of chemicals, involves direct contact with the materials from which the product is produced for the purpose of causing or permitting a chemical or physical change to occur in the materials as part of the production process. This paragraph does not include chemicals that are used or consumed in activities such as packaging, storage or transportation but does not affect any deduction for such chemicals that is otherwise provided by this section.

40. Through December 31, 1994, personal property liquidation transactions, conducted by a personal property liquidator. From and after December 31, 1994, personal property liquidation transactions shall be taxable under this section provided that nothing in this subsection shall be construed to authorize the taxation of casual activities or transactions under this chapter. In this paragraph:

(a) "Personal property liquidation transaction" means a sale of personal property made by a personal property liquidator acting solely on behalf of the owner of the personal property sold at the dwelling of the owner or upon the death of any owner, on behalf of the surviving spouse, if any, any devisee or heir or the personal representative of the estate of the deceased, if one has been appointed.

(b) "Personal property liquidator" means a person who is retained to conduct a sale in a personal property liquidation transaction.

41. Sales of food, drink and condiment for consumption within the premises of any prison, jail or other institution under the jurisdiction of the state department of corrections, the department of public safety, the department of juvenile corrections or a county sheriff.

42. A motor vehicle and any repair and replacement parts and tangible personal property becoming a part of such motor vehicle, sold to a licensed motor carrier or a lightweight motor vehicle operator subject to tax under title 28, chapter 16, article 4, who is engaged in the business of leasing or renting such property.

43. Livestock and poultry feed, salts, vitamins and other additives for livestock or poultry consumption that are sold to persons who are engaged in producing livestock, poultry, or livestock or poultry products, or who are engaged in feeding livestock or poultry commercially. For purposes of this paragraph, "poultry" includes ratites.

44. Sales of implants used as growth promotants and injectable medicines, not already exempt under paragraph 8 of this subsection, for livestock or poultry owned by or in possession of persons who are engaged in producing livestock, poultry, or livestock or poultry commercially. For purposes of this paragraph, "poultry" includes ratites.

45. Sales of motor vehicles at auction to nonresidents of this state for use outside this state if the vehicles are shipped or delivered out of this state, regardless of where title to the motor vehicles passes or its free on board point.

46. Tangible personal property sold to a person engaged in business and subject to tax under the transient lodging classification if the tangible personal property is a personal hygiene item which is furnished to and intended to be consumed by the transient during his occupancy.

47. Sales of alternative fuel, as defined in § 1-215, to a use oil fuel burner who has received a permit to burn used oil or used oil fuel under § 49-426 or 49-480.

48. Sales of materials that are purchased by or for publicly funded libraries including school district libraries, charter school libraries, community college libraries, state university libraries, or federal state, county or municipal libraries for use by the public as follows:

(a) Printed or photographic materials, beginning August 7, 1985.

(b) Electronic or digital media materials, beginning July 17, 1994.

49. Tangible personal property sold to a commercial airline consisting of food, beverages and condiments and accessories used for serving the food and beverages, if those items are to be provided without additional charge to passengers for consumption in flight. For purposes of this paragraph, "commercial airline" means a person holding a federal certificate of public convenience and necessity or foreign air carrier permit for air transportation to transport persons, property or United States mail in intrastate, interstate or foreign commerce.

50. Sales of new alternative fuel vehicles, as defined in § 43-1086, and equipment that is installed in a conventional motor vehicle to convert the vehicle to operate on an alternative fuel, as defined in § 43-1086.

51. Sales of any spirituous, vinous or malt liquor by a person that is licensed in this state as a wholesaler by the department of liquor licenses and control pursuant to title 4, chapter 2, article 1.

52. Sales of tangible personal property to be incorporated or installed as a part of environmental response or remediation activities under § 42-5075, subsection B, paragraph 6.

53. Sales of tangible personal property by nonprofit organization that is exempt from taxation under § 501(c)(6) of the internal revenue code if the organization produces, organizes or promotes cultural or civic related festivals or events and not part of the organization's net earnings inures to the benefit of any private shareholder or individual.

## [THE MACHINERY AND EQUIPMENT EXEMPTIONS]

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:

1. Machinery, or equipment, used directly in manufacturing, processing, fabricating, job printing, refining or metallurgical operations. The terms “manufacturing”, “processing”, “fabricating”, “job printing”, refining” and “metallurgical” as used in this paragraph refer to and include those operations commonly understood within their ordinary meaning. “Metallurgical operations” includes leaching, milling, precipitating, smelting and refining.

2. Mining machinery, or equipment, used directly in the process of extracting ores or minerals from the earth for commercial purposes, including equipment required to prepare the materials for extraction and handling, loading or transporting such extracted material to the surface. “Mining” includes underground, surface and open pit operations for extracting ores and minerals.

3. Tangible personal property, sold to persons engaged in business classified under the telecommunications classification, consisting of central office switching equipment, switchboards, private branch exchange equipment, microwave radio equipment and carrier equipment including optical fiber, coaxial cable and other transmission media which are components of carrier systems.

4. Machinery, equipment or transmission lines used directly in producing or transmitting electrical power, but not including distribution. Transformers and control equipment used at transmission substation sites constitute equipment used in producing or transmitting electrical power.

5. Neat animals, horses, asses, sheep, ratites, swine or goats used or to be used as breeding or production stock, including sales of breedings or ownership shares in such animals used for breeding or production.

6. Pipes or valves four inches in diameter or larger used to transport oil, natural gas, artificial gas, water or coal slurry, including compressor units, regulators, machinery and equipment, fittings, seals and any other part that is used in operating the pipes or valves.

7. Aircraft, navigational and communication instruments and other accessories and related equipment sold to:

(a) A person holding a federal certificate of public convenience and necessity or foreign air carrier permit for air transportation for use as or in conjunction with or becoming a part of aircraft to be used to transport persons, property or United States mail in intrastate, interstate or foreign commerce.

(b) Any foreign government for use by such government outside of this state.

(c) Persons who are not residents of this state and who will not use such property in this state other than in removing such property from this state. This subdivision also applies to corporations that are not incorporated in this state, regardless of maintaining a place of business in this state, if the principal corporate office is located outside this state and the property will not be used in this state other than in removing the property from this state.

8. Machinery, tools, equipment and related supplies used or consumed directly in repairing, remodeling or maintaining aircraft, aircraft engines or aircraft component parts by or on behalf of a certificated or licensed carrier of persons or property.

9. Railroad rolling stock, rails, ties and signal control equipment used directly to transport persons or property in intrastate or interstate transportation for hire.

10. Machinery or equipment used directly to drill for oil or gas or used directly in the process of extracting oil or gas from the earth for commercial purposes.

11. Buses or other urban mass transit vehicles which are used directly to transport persons or property for hire or pursuant to a governmentally adopted and controlled urban mass transportation program and which are sold to bus companies holding a federal certificate of convenience and necessity or operated by a city, town or other governmental entity or by any person contracting with such governmental entity as part of a governmentally adopted and controlled program to provide urban mass transportation.

12. Groundwater measuring devices required under § 45-604.

13. New machinery and equipment consisting of tractors, tractor-drawn implements, self-powered implements, machinery and equipment that are necessary for extracting milk, and for cooling milk and livestock, and drip irrigation lines not already exempt under paragraph 6 of this subsection used for commercial production of agricultural, horticultural, viticultural and floricultural crops and products in this state. In this paragraph:

(a) “New machinery and equipment” means machinery and equipment which has never been sold at retail except pursuant to leases or rentals which do not total two years or more.

(b) “Self-powered implements” includes machinery and equipment that is electric-powered.

14. Machinery or equipment used in research and development. In this paragraph, “research and development” means basic and applied research in the sciences and engineering, and designing, developing or testing prototypes, processes or new products, including research and development of computer software that is embedded in or an integral part of the prototype or new product or that is required for machinery or equipment otherwise exempt under this section to function effectively. Research and development do not include manufacturing quality control, routine consumer product testing, market research, sales promotion, sales service, research in social sciences or psychology, computer software research that is not included in the definition of research and development, or other nontechnological activities or technical services.

15. Machinery and equipment that are purchased by or on behalf of the owners of a soundstage complex and primarily used for motion picture, multimedia or interactive video production in the complex. This paragraph applies only if the initial construction of the soundstage complex begins after June 30, 1996 and before January 1, 2002 and the machinery and equipment are purchased before the expiration of five years after the start of initial construction. For purposes of this paragraph:

(a) “Motion picture, multimedia or interactive video production” includes products for theatrical and television release, educational presentations, electronic retailing, documentaries, music videos, industrial films, CD-ROM, video game production, commercial advertising and television episode production and other genres that are introduced through developing technology.

(b) “Soundstage complex” means a facility of multiple stages including production offices, construction shops and related areas, prop and costume shops, storage areas, parking for production vehicles and areas that are leased to businesses that complement the production needs and orientation of the overall facility.

16. Tangible personal property that is used by either of the following to receive, store, convert, produce, generate, decode, encode, control or transmit telecommunications information:

(a) Any direct broadcast satellite television or data transmission service that operates pursuant to 47 Code of Federal Regulations Parts 25 and 100.

(b) Any satellite television or data transmission facility, if both of the following conditions are met:

(i) Over two-thirds of the transmissions, measured in megabytes, transmitted by the facility during the test period were transmitted to or on behalf of one or more direct broadcast satellite television or data transmission services that operate pursuant to 47 Code of Federal Regulations Parts 25 and 100.

(ii) Over two-thirds of the transmissions, measured in megabytes, transmitted by or on behalf of those direct broadcast television or data transmission services during the test period were transmitted by the facility to or on behalf of those services.

For purposes of subdivision (b) of this paragraph, “test period” means the three hundred sixty-five day period beginning on the later of the date on which the tangible personal property is purchased or the date on which the direct broadcast satellite television or data transmission service first transmits information to its customers.

17. Clean rooms that are used for manufacturing, processing, fabrication or research and development, as defined in paragraph 14 of this subsection, of semiconductor products. For purposes of this paragraph, “clean room” means all property that comprises or creates an environment where humidity, temperature, particulate matter and contamination are precisely controlled within specified parameters, without regard to whether the property is actually contained within that environment or whether any of the property is affixed to or incorporated into real property. Clean room:

(a) Includes the integrated systems, fixtures, piping, movable partitions, lighting and all property that is necessary or adapted to reduce contamination or to control airflow, temperature, humidity, chemical purity or other environmental conditions or manufacturing tolerances, as well as the production machinery and equipment operating in conjunction with the clean room environment.

(b) Does not include the building or other permanent, non-removable component of the building that houses the clean room environment.

18. Machinery and equipment used directly in the feeding of poultry, the environmental control of housing for poultry, the movement of eggs within a production and packaging facility or the sorting or cooling of eggs. This exemption does not apply to vehicles used for transporting eggs.

19. Machinery or equipment employed in connection with manufacturing, processing, fabricating, job printing, refining, mining, metallurgical operations, telecommunications, producing or transmitting electricity or research and development that is used

directly to meet or exceed rules or regulations adopted by the federal energy regulatory commission, the United States environmental protection agency, the Arizona department of environmental quality or a political subdivision of this state to prevent, monitor, control or reduce land, water or air pollution.

20. Machinery and equipment sold to a person engaged in the commercial production of livestock, livestock products or agricultural, horticultural, viticultural or floricultural crops or products in this state and that is used directly and primarily to prevent, monitor, control or reduce air, water or land pollution.

21. Machinery or equipment that enables a television station to originate and broadcast or to receive and broadcast digital television signals and that was purchase to facilitate in compliance with the telecommunications act of 1996 (p.l. 104-104; 110 stat. 56; 47 United States Code § 336) and the federal communications commission order issued April 21, 1997, 47 code of federal regulations part 73. This paragraph does not exempt any of the following:

(a) Repair or replacement parts purchased for the machinery or equipment described in this paragraph.

(b) Machinery or equipment purchased to replace machinery or equipment for which an exemption was previously claimed and taken under this paragraph.

(c) Any machinery or equipment purchased after the television station has ceased analog broadcasting, or purchased after November 1, 2009, whichever occurs first.

C. The deductions provided by subsection B of this section do not include sales of:

1. Expendable materials. For 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.

D. In computing the tax base, gross proceeds of sales or gross income from retail sales of automobiles does not include any amount attributable to federal excise taxes imposed by 26 United States Code section 4001.

E. In addition to the deductions from the tax base prescribed by subsection A of this section, there shall be deducted from the tax base the gross proceeds of sales or gross income

derived from sales of machinery, equipment, materials and other tangible personal property used directly and predominantly to construct a qualified environmental technology manufacturing, producing or processing facility as described in section 41-1514.02. This subsection applies for ten full consecutive calendar or fiscal years after the start of initial construction.

F. In computing the tax base, gross proceeds of sales or gross income from retail sales of heavy trucks and trailers does not include any amount attributable to federal excise taxes imposed by 26 United States Code section 4051.

G. In computing the tax base, gross proceeds of sales or gross income from the sale of use fuel, as defined in section 28-1551, does not include any amount attributable to federal excise taxes imposed by 26 United States Code section 4091.

H. 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.

I. If a person is engaged in the business of selling tangible personal property at both wholesale and retail, the tax under this section applies only to the gross proceeds of the sales made other than at wholesale if the person's books are kept so as to show separately the gross proceeds of sales of each class, and if the books are not so kept, the tax under this section applies to the gross proceeds of every sale so made.

J. A person who engages in manufacturing, baling, crating, boxing, barreling, canning, bottling, sacking, preserving, processing or otherwise preparing for sale or commercial use any livestock, agricultural or horticultural product or any other product, article, substance or commodity and who sells the product of such business at retail in this state is deemed, as to such sales, to be engaged in business classified under the retail classification. This subsection does not apply to businesses classified under the:

1. Transporting classification.
2. Utility classification.
3. Telecommunications classification.
4. Pipeline classification.
5. Private car line classification.
6. Publication classification.
7. Job printing classification.
8. Prime contracting classification.
9. Owner builder sales classification.
10. Restaurant classification.

K. The gross proceeds of sales or gross income derived from the following shall be deducted from the tax base for the retail classification:

1. Sales made directly to the United States government or its departments or agencies by a manufacturer, modifier, assembler or repairer.

2. Sales made directly to a manufacturer, modifier, assembler or repairer if such sales are of any ingredient or component part of products sold directly to the United States government or its departments or agencies by the manufacturer, modifier, assembler or repairer.

3. Overhead materials or other tangible personal property that is used in performing a contract between the United States government and a manufacturer, modifier, assembler or repairer, including property used in performing a subcontract with a government contractor who is a manufacturer, modifier, assembler or repairer, to which title passes to the government under the terms of the contract or subcontract.

4. Sales of overhead materials or other tangible personal property to a manufacturer, modifier, assembler or repairer will be exempt under paragraph 3 of this subsection.

L. There shall be deducted from the tax base fifty per cent of the gross proceeds or gross income from any sale of tangible personal property made directly to the United States government or its departments or agencies, which is not deducted under subsection K of this section.

M. The department shall require every person claiming a deduction provided by subsection K or L of this section to file on forms prescribed by the department at such times as the department directs a sworn statement disclosing the name of the purchaser and the exact amount of sales on which the exclusion or deduction is claimed.

N. In computing the tax base, gross proceeds of sales or gross income does not include:

1. A manufacturer's cash rebate on the sales price of a motor vehicle if the buyer assigns the buyer's right in the rebate to the retailer.

2. The waste tire disposal fee imposed pursuant to section 44-1302.

O. There shall be deducted from the tax base the amount received from sales of solar energy devices, but the deduction shall not exceed five thousand dollars for each solar energy device. Before deducting any amount under this subsection, the retailer shall register with the department as a solar energy retailer. By registering, the retailer acknowledges that it will make its books and records relating to sales of solar energy devices available to the department for examination.

P. In computing the tax base in the case of the sale or transfer of wireless telecommunication equipment as an inducement to a customer to enter into or continue a contract for telecommunication services that are taxable under § 42-5064, gross proceeds of sales or gross income does not include any sales commissions or other compensation received by the retailer as a result of the customer entering into or continuing a contract for the telecommunications service.

Q. For the purpose of this section, a sale of wireless telecommunication equipment to a person who holds the equipment for sale or transfer to a customer as an inducement to enter into or continue a contract for telecommunication services that are taxable under § 42-5064 is considered to be a sale for resale in the regular course of business.

R. Retail sales of prepaid calling cards or prepaid authorization numbers for telecommunications services, including sales of reauthorization of a prepaid card or authorization number, are subject to tax under this section.

S. For the purposes of this section, the diversion of gas from a pipeline by a person engaged in the business of operating a natural or artificial gas pipeline, for the sole purpose of fueling compressor equipment to pressurize the pipeline, is not a sale of the gas to the operator of the pipeline.

T. If a seller is entitled to a deduction pursuant to subsection B, paragraph 16, subdivision (b) of this section, the department may require the purchaser to establish that the requirements of subsection B, paragraph 16, subdivision (b) of this section have been satisfied. If the purchaser cannot establish that the requirements of subsection B, paragraph 16, subdivision (b) of this section have been satisfied, the purchaser is liable in an amount equal tax, penalty and interest which the seller would have been required to pay under article 1 of this chapter if the seller had not made a deduction pursuant to subsection B, paragraph 16, subdivision (b) of this section. Payment of the amount under this subsection exempts the purchaser from liability for any tax imposed under article 4 of this chapter related to the tangible personal property purchased. The amount shall be treated as transaction privilege tax to the purchaser and as tax revenues collected from the seller to designate the distribution base pursuant to § 42-5029.

U. For the purposes of this section:

1. "Aircraft" includes:

(a) An airplane flight simulator that is approved by the federal aviation administration for use as a phase II or higher flight simulator under appendix H, 14 Code of Federal Regulations part 121.

(b) Tangible personal property that is permanently affixed or attached as a component part of an aircraft that is owned or operated by a certificated or licensed carrier of persons or property.

2. "Other accessories and related equipment" includes aircraft accessories and equipment such as ground service equipment that physically contact aircraft at some point during the overall carrier operation.

3. "Selling at retail" means a sale for any purpose other than for resale in the regular course of business in the form of tangible personal property, but transfer of possession, lease and rental as used in the definition of sale mean only such transactions as are found on investigation to be in lieu of sales as defined without the words lease or rental.

V. For purposes of subsection K of this section:

1. "Assembler" means a person who unites or combines products, wares or articles of manufacture so as to produce a change in form or substance without changing or altering the component parts.

2. "Manufacturer" means a person who is principally engaged in the fabrication, production or manufacture of products, wares or articles for use from raw or prepared materials, imparting to those materials new forms, qualities, properties and combinations.

3. "Modifier" means a person who reworks, changes or adds to products, wares or articles of manufacture.

4. "Overhead materials" means tangible personal property, the gross proceeds of sales or gross income derived from which would otherwise be included in the retail classification, and which are used or consumed in the performance of a contract, the cost of which is charged to an overhead expense account and allocated to various contracts based upon generally accepted accounting principles and consistent with government contract accounting standards.

5. "Repairer" means a person who restores or renews products, wares or articles of manufacture.

6. "Subcontract" means an agreement between a contractor and any person who is not an employee of the contractor for furnishing of supplies or services that, in whole or in part, are necessary to the performance of one or more government contracts, or under which any portion of the contractor's obligation under one or more government contracts is performed, undertaken or assumed and that includes provisions causing title to overhead materials or other tangible personal property used in the performance of the subcontract to pass to the government or that includes provisions incorporating such title passing clauses in a government contract into the subcontract.

## **2. STATUTORY DEFINITIONS -- A.R.S. § 42-5001**

In this article, unless the context otherwise requires:

1. "Business" includes all activities or acts, personal or corporate, engaged in or caused to be engaged in with the object of gain, benefit or advantage, either directly or indirectly, but not casual activities or sales.

2. "Distribution base" means the portion of the revenues derived from the tax levied by this article and chapters 8.1, 9.2 and 11 of this title designated for distribution to counties, municipalities and other purposes according to § 42-5029, subsection D.

3. "Engaging," when used with reference to engaging or continuing in business, includes the exercise of corporate or franchise powers.

4. "Gross income: means the gross receipts of a taxpayer derived from trade, business, commerce or sales and the value proceeding or accruing from the sale of tangible personal property or service, or both, and without any deduction on account of losses.

5. "Gross proceeds of sales" means the value proceeding or accruing from the sale of tangible personal property without any deduction on account of the cost of property sold, expense of any kind or losses, but cash discounts allowed and take on sales are not included as gross income.

6. "Gross income" and "gross proceeds of sale" do not include goods, wares or merchandise, or value thereof, returned by customers if the sale price is refunded either in cash or by credit, nor the value of merchandise traded in on the purchase of new merchandise when the trade-in allowance is deducted from the sales price of the new merchandise before completion of the sale.

7. "Gross receipts" means the total amount of the sale, lease or rental price, as the case may be, of the retail sales of retailers, including any services that are a part of the sales, valued in money, whether received in money or otherwise, including all receipts, cash, credits and property of every kind or nature, and any amount for which credit is allowed by the seller to the purchaser 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 another expense. Gross receipts do not include cash discounts allowed and taken or the sale price of property returned by customers if the full sale price is refunded either in cash or by credit.

8. "Person" or "company" includes an individual, firm, partnership, joint venture, association, corporation, estate or trust, this state, any county, city, town, district other than a school district, or other political subdivision and any other group or combination acting as a unit, and the plural as well as the singular number.

9. “Qualifying community health center” means an entity that is recognized as nonprofit under 501(c)(3) of the United States internal revenue code, that is a community-based primary care clinic that has a community-based board of directors and that is either:

- (a) The sole provider of primary care in the community;
- (b) A non-hospital affiliated clinic that is located in a federally designated medically underserved area in this state.

10. “Qualifying health care organization” means any entity that is recognized as nonprofit under section 501(c) of the United States internal revenue code and that uses at least eighty per cent of all monies that it receives from all sources each year only for health and medical related educational and charitable services, as documented by annual financial audits prepared by an independent certified public accountant, performed according to generally accepted accounting standards and filed annually with the department.

11. “Qualifying hospital” means:

(a) A licensed hospital which is organized and operated exclusively for charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(b) A licensed nursing care institution or a licensed residential care institution or a residential care facility operated in conjunction with a licensed nursing care institution or a licensed kidney dialysis center, which provides medical services, nursing services or health related services and is not used or held for profit.

(c) A hospital, nursing care institution or residential care institution which is operated by the federal government, this state or a political subdivision of this state.

12. “Retailer” includes every person engaged in the business classified under the retail classification pursuant to § 42-5061 and, when in the opinion of the department it is necessary for the efficient administration of this article, includes dealers, distributors, supervisors, employers and salesmen, representatives, peddlers or canvassers as the agents of the dealers, distributors, supervisors or employers under whom they operate or from whom they obtain the tangible personal property sold by them, whether in making sales on their own behalf or on behalf of the dealers, distributors, supervisors or employers.

13. “Sale” means any transfer of title or possession, or both, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatever, including consignment transactions and auctions, of tangible personal property or other activities taxable under this chapter, for a consideration, and includes:

(a) Any transaction by which the possession of property is transferred but the seller retains the title as security for the payment of the price.

(b) Fabricating tangible personal property for consumers who furnish either directly or indirectly the materials used in the fabrication work.

(c) Furnishing, preparing or serving for a consideration any tangible personal property consumed on the premises of the person furnishing, preparing or serving the tangible personal property.

14. “Solar daylighting” means a device that is specifically designed to capture and redirect the visible portion of the solar beam, while controlling the infrared portion, for use in illuminating interior building spaces in lieu of artificial lighting.

15. “Solar energy device” means a system or series of mechanisms designed primarily to provide heating, to provide cooling, to produce electrical power, to produce mechanical power, to provide solar daylighting or to provide any combination of the foregoing by means of collecting and transferring solar generated energy into such uses either by active or passive means, including wind generator systems that produce electricity. Solar energy systems may also have the capability of storing solar energy for future use. Passive systems shall clearly be designed as a solar energy device, such as trombe wall, and not merely as a part of a normal structure, such as a window.

16. “Tangible personal property” means personal property which may be seen, weighed, measured, felt or touched or is in any other manner perceptible to the senses.

17. “Tax year” or “taxable year” means either the calendar year or the taxpayer’s fiscal year, if permission is obtained from the department to use a fiscal year as the tax period instead of the calendar year.

18. “Taxpayer” means any person who is liable for any tax which is imposed by this article.

19. “Wholesaler” or “jobber” means any person who sells tangible personal property for resale and not for consumption by the purchaser.

**3. THE DEPARTMENT’S REGULATIONS UNDER THE RETAIL CLASSIFICATION.**

***R15-5-101. Sales for Resale or Lease.***

A. Gross receipts from the sales of tangible personal property to be resold by the purchaser in the ordinary course of business are not taxable under the retail classification.

B. Gross receipts from the sales of tangible personal property to be leased out by a person in the business of leasing such personal property are not taxable under the retail classification.

1. Gross receipts from the sale of tangible personal property to a lessor of real property are taxable if the tangible personal property is incorporated into, or leased in conjunction with, the real property; and

2. The rental of the tangible personal property is not separately stated as part of the real property lease transaction.

C. Gross receipts from the sale of repair or replacement parts for tangible personal property which is to be leased out by a person engaged in the business of leasing such tangible personal property are not taxable under the retail classification.

D. The seller may establish the deduction for a sale for resale or lease by obtaining documentation from the purchaser pursuant to statutory provisions and to R15-5-2214.

***R15-5-102. Casual Sales.***

Gross receipts from a casual sale, as defined in R15-5-2001, are not taxable under the retail classification. R15-5-2001 defines casual sales as “casual sale” means an occasional transaction of an isolated nature made by a person who is not engaged in the business of selling, within or without the state, the same type of character of property as that which is sold.

***R15-5-103. Sale of Business Enterprises.***

Gross receipts from the sale of a business as a going concern shall not be taxable if the sale is for the business as an operating enterprise.

***R15-5-104. Service Businesses.***

A. Gross receipts from the sales of tangible personal property to a person engaged in a professional or professional service occupation or business are taxable if the tangible personal property is used or consumed in the performance of the service or is sold only as an inconsequential element of the nontaxable service provided.

B. Gross receipts from the sale of tangible personal property, by a person engaged in a professional or personal service occupation or business, shall not be taxable if the property is sold only as an inconsequential element of the nontaxable service provided.

C. 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.

D. A person engaged in both a retail business and a service business shall keep records of purchases of tangible personal property sufficient to establish whether the property was resold as a taxable retail sale.

***R15-5-105. Services in Connection with Retail Sales.***

A charge in connection with a retail sale is taxable unless the charge for service is shown separately on the sales invoice and records.

***R15-5-106. Finance Charges in Connection with Retail Sales.***

Gross receipts from finance, carrying charges, or interest charges incurred in connection with a retail sale of tangible personal property shall not be taxable if:

1. The charges are separately stated as part of the sales transaction; and

2. The charges result from the sale of such property on credit or under an installment contract.

**R15-5-107.      *Reserved.***

**R15-5-108.      *Reserved.***

**R15-5-109.      *Reserved.***

**R15-5-110.      *Lease-purchase Agreements.***

A.      Gross income derived from the leasing of tangible personal property under a lease-purchase agreement shall be taxable under the personal property rental classification.

B.      Payments received after the conversion from a lease to a purchase are taxable under the retail classification.

C.      Gross receipts from the sale of tangible personal property shall include conversion charges paid or incurred at the time the lease is converted to a purchase.

**R15-5-111.      *Consignment Sales.***

A.      The following definitions apply for purposes of this rule:

1.      “Consignee” is the party which is in the business of selling tangible personal property belonging to a “consignor.”

2.      “Consignor” is the party with the legal right to contract the services of the consignee to sell tangible personal property on behalf of the consignor.

B.      Gross receipts from consignment sales are subject to tax under the retail classification.

C.      A consignee shall obtain a transaction privilege tax license prior to engaging in the business of making consignment sales.

**R15-5-112.      *Sales by Auctioneers.***

A.      Gross receipts from the sales of tangible personal property by an auctioneer are subject to tax under the retail classification.

B.      An auctioneer shall obtain a transaction privilege tax license prior to conducting an auction.

**R-15-5-113.      *Sales by Trustees, Receivers, and Assignees.***

A.      Gross receipts from the sale of tangible personal property by a trustee, receiver, or assignee shall be taxable if the sale of the property in the hands of the owner would have been taxable.

B.      Gross receipts from the sale of tangible personal property by a trustee, receiver, or assignee shall not be taxable if the sale of the property in the hand of the owner would have been exempt.

**R15-5-114.      *Reserved.***

**R15-5-115.      *Reserved.***

**R15-5-116.      *Reserved.***

**R15-5-117.      *Reserved.***

**R15-5-118.      *Reserved.***

**R15-5-119.      *Reserved.***

**R15-5-120.      *Exempt Sales of Machinery or Equipment.***

A.      Machinery or equipment used in manufacturing or processing includes machinery or equipment that constitutes the entire primary manufacturing or processing operation from the initial stage where actual processing begins through the completion of the finished end product, processing, finishing, or packaging of articles of commerce. Manufacturing is the performance as a business of an integrated series of operations which place tangible personal property in a form, composition, or character different from that in which it was acquired and transforms it into a different product with a distinctive name, character, or use.

B.      Gross receipts from the sale of repair or replacement parts for exempt machinery or equipment are not subject to the tax under the retail classification. Repair or replacement parts are defined as those individual component and constituent items which, together, comprise exempt machinery or equipment.

C.      In establishing the exempt sale of machinery or equipment, the seller shall keep adequate documentation, pursuant to statutory requirements and as delineated in R15-5-2214, for the statutorily required period of time.

**R-15-5-121.      *Sales of Fuel Used in Manufacturing.***

The sale of fuel used or consumed in a manufacturing process is taxable. The fuel is not considered to be incorporated into the manufactured product.

**R-15-5-122.      *Articles Incorporated into a Manufactured Product.***

A.      Sales of articles to be incorporated into a fabricated or manufactured product are considered to be sales for resale and, therefore, exempt. For example, the sale of wood to a furniture manufacturer is a sale for resale.

B.      In order for the exemption to apply, the materials must actually become a part of the finished product. Supplies which are consumed in the manufacturing process do not qualify.

**R-15-5-123.      *Sales of Tools and Supplies to Businesses.***

The sale of tools, supplies, and other articles to be used or consumed by persons in the operation of their businesses, and not for resale, are taxable as retail sales.

**R15-5-124.      *Reserved.***

**R15-5-125.      *Reserved.***

**R15-5-126.      *Manufacturing Labor.***

The cost of labor employed in manufacturing, processing, or fabricating tangible personal property shall not be allowed as a deduction from the gross receipts derived from a sale of such property.

***R15-5-127. Sales of Fuel.***

A. For purposes of this rule, “use fuel” means fuel other than motor vehicle fuel, as defined in A.R.S. § 28-101(28). Diesel fuel is a use fuel. Gasoline is a motor vehicle fuel.

B. Gross receipts from the sale of use fuel are taxable under the retail classification if the use fuel is not used to propel vehicles on the streets, roads, and highways of this state.

C. Retail sales of jet fuel are taxable under the jet fuel excise and use tax classification.

***R15-5-128. Electric Power Transmission and Distribution.***

A. Gross receipts from the sale of machinery, equipment, or transmission lines for direct use in a transmission system are deductible from the tax base. Gross receipts from the sale of machinery, equipment, or lines for use in a distribution system are taxable.

B. Machinery and equipment used to facilitate the production of voltage up to and including 34,500 volts shall be considered part of a distribution system.

1. Gross receipts from the sale of such equipment are subject to transaction privilege tax.

2. If tangible personal property was purchased as exempt, subsequent nonexempt use shall subject the gross purchase price to use tax according to statutory provisions.

C. Machinery and equipment used to facilitate the production of voltage above 34,500 volts shall be categorized as part of a transmission or distribution system based on the following definitions.

1. “Transmission system” means:

(a) All land, conversion structures, and equipment employed at a primary source of supply to change the voltage or frequency of electricity for the purpose of its more efficient or convenient transmission;

(b) All land, structures, lines, switching and conversion stations, high tensions apparatus and their control and protective equipment between a generating or receiving point and the entrance to a distribution center or wholesale point; and

(c) All lines and equipment whose primary purpose is to augment, integrate, or tie together the sources of power supply.

2. “Distribution system” means all land, structures, conversion equipment, lines, line transformers, and other facilities employed between the primary source of supply and of delivery to customers, which are not includible in a transmission system whether or not such land, structures, and facilities are operated as part of a transmission system or as part of a distribution

system. Stations which change electricity from transmission to distribution voltage shall be classified as distribution stations.

3. "Primary source of supply" means a generating station or point of receipt in the case of purchased power.

4. Dual-use equipment shall be designated as follows:

- (a) If poles or towers support both transmission and distribution conductors, the poles, towers, anchors, guys, and rights-of-way shall be classified as a transmission system. The conductors, crossarms, braces, grounds, tiewire, insulators, and other similar tangible personal property shall be classified as transmission or distribution facilities, according to the purpose for which they are used.
- (b) If underground conduit contains both transmission and distribution conductors, the underground conduit and the right-of-way shall be classified as a distribution system. The conductors shall be classified as transmission or distribution facilities according to the purpose for which they are used.
- (c) Based on statutory provisions, transformers and control equipment utilized operationally at transmission substation sites are considered to be a part of a transmission system and, therefore, are exempt from transaction privilege and use tax.

D. Machinery, equipment, or transmission lines for direct use in a transmission system are only those which are recorded as being part of a transmission system in accordance with the definitions in subsection (C).

1. Gross receipts from the sale of such equipment are exempt from the tax.

2. If such machinery and equipment is removed from inventory to be used as part of a distribution system, the purchase price is subject to use tax.

***R15-5-129. Discounts, Refunds, and Coupon Redemption.***

A. Cash discounts allowed the purchaser for timely payment are permissible as deductions from the sale price.

B. Refunds in cash or credit given on returned merchandise are considered to be a reduction of sales.

C. When coupons issued by a manufacturer are redeemed by a retailer the amounts refunded to the purchaser are not permissible as deductions from the selling price of articles sold by the retailer. In these cases, the gross selling price is taxable.

D. Coupons issued by a retailer and later redeemed by the retailer as a discount on the price of merchandise sold by him are considered a reduction of the selling price. In such cases the net selling price is subject to tax.

***R15-5-130. Reserved.***

***R15-5-131. Lay-away Sales.***

Gross receipts from lay-away agreements shall be taxable when title or possession transfers to the purchaser or at the time receipts from the transaction are determined to be nonrefundable, whichever occurs first.

***R15-5-132. Retail Sales with Trade-ins.***

A. When a retailer accepts tangible personal property as a trade-in for part or full payment on the sale of tangible personal property, the dollar amount of the payment represented by the trade-in is deductible from the retailer's gross receipts from that sale.

B. A trade-in deduction shall be limited to the amount of the retailer's gross receipts on that sale.

C. When the property traded in is subsequently sold at retail, the gross receipts from the transaction are taxable.

***R15-5-133. Delivery Charges in Connection with Retail Sales.***

A. A charge by a retailer for delivery from the retailer's location to the purchaser's location, if separately stated on the sales invoice, is not taxable.

B. When the freight cost is incurred any time prior to the time of the retail sale, such cost is part of the gross sale and, therefore, subject to the tax.

***R15-5-134. Sales of Containers, Bottles, and Labels.***

A. The sale of containers and bottles is considered a sale for resale only when the purchaser is to transfer the containers with their contents in future sales.

B. In cases where the containers are not subsequently sold as part of the merchandise, such sales are deemed to be taxable retail sales.

C. The sale of labels to a purchaser who affixes them to nonreturnable containers to be resold is considered to be a sale for resale and is not taxable.

D. In cases where the containers are returnable and a new label is to be affixed, each time the container is refilled, the sale of the labels is also considered to be a sale for resale.

E. The sale of analysis tags or other labels to be attached to containers of feed and sold along as part of the article is a sale for resale.

F. However, the sale of items such as price tags, shipping tags, and advertising matter used in connection with the subsequent sale is taxable as a retail sale.

***R15-5-135. Sales of Restaurant Accessories.***

A. Gross receipts from the sale of disposable containers, paper napkins, and other similar food accessories to persons engaged in the restaurant business, which are transferred by the restaurant in the ordinary course of business to facilitate the consumption of the food, drink, or condiment provided, shall be considered gross receipts from sales for resale.

B. Gross receipts from the sale of matchbooks, advertisement fliers, and other similar tangible personal property to persons engaged in the restaurant business that are transferred by the restaurant for the convenience, operation, or benefit of the restaurant business are taxable.

***R15-5-136. Returnable Containers.***

A. Gross receipts from deposits on sales of returnable containers which contain taxable food shall be taxable.

B. Deposit refunds paid to purchasers on the return of such containers shall be deductible from the retailer's tax base in the month refunded.

C. Gross receipts from deposits received on returnable containers which contain non-taxable food shall not be taxable. Therefore refunds paid on such deposits shall not reduce the tax base.

***R15-5-137. Warranty or Service Contracts.***

A. For purposes of this rule, a "warranty or service provision" means a manufacturer's or vendor's warranty provision which automatically, and for no extra charge, applies to the tangible personal property when purchased.

B. Gross receipts from the sale of warranty or service contracts shall not be taxable if such contracts are sold as a distinct and separate item and the charge for the warranty or service contract is stated separately on the sales invoice.

C. A warranty or service provision shall not be considered a warranty or service contract under A.R.S. § 42-1310.01(A). An exclusion from gross receipts shall not be allowed for a warranty or service provision on the sale of tangible personal property when such property cannot be sold without the acceptance of the warranty or service provision.

***R15-5-138. Tangible Personal Property Used in Conjunction with Warranty or Service Contracts.***

A. For purposes of this rule, "covered" tangible personal property is that property which is included in the charge for the warranty or service contract holder is not additionally charged for such property.

B. Tangible personal property sold in conjunction with the servicing of a warranty or service contract, but not covered by such a contract, is a sale of tangible personal property and, as such, shall be subject to tax under the retail classification, unless statutorily exempt.

C. Tangible personal property which is covered under a warranty or service contract, and used in the servicing of such a contract, is subject to use tax unless transaction privilege tax was paid when the tangible personal property was acquired or unless otherwise statutorily exempt.

***R15-5-139. Reserved.***

***R15-5-140. Reserved.***

***R15-5-141. Reserved.***

***R15-5-142. Reserved.***

**R15-5-143. Reserved.**

**R15-5-144. Reserved.**

**R15-5-145. Reserved.**

**R15-5-146. Reserved.**

**R15-5-147. Reserved.**

**R15-5-148. Reserved.**

**R15-5-149. Reserved.**

**R15-5-150. Photography.**

A. The following definitions apply for purposes of this rule:

1. "Photographer" means a person who engages in the business of photography.
2. "Photography" means the operation of taking, developing, processing, or printing pictures, prints, or images on or from film, video, or other similar media.

B. Gross receipts derived from sales of photography by a photographer are taxable under the retail classification.

C. Developing of films and making of prints of pictures taken by others are taxable. Developing and printing for drugstores and other retailers are sales for resale.

**R15-5-151. Artists.**

A. Gross receipts from the sale of paintings, drawings, etchings, sculptures, craftwork, other artwork or reproductions of such items to final consumers shall be taxable under the retail classification if the person is making regular sales of these items.

B. Gross receipts from the sale of paints, canvasses, frames, sculpture ingredients, and other items which will become an integral part of the finished product shall not be taxable if sold to a creating artist who is regularly engaged in the business of creating and selling paintings, drawings, etchings, sculptures, craftwork, other artwork, or reproductions of such items. Sales of brushes, easels, tools, and similar items to be consumed by the creating artist shall be taxable.

C. Gross receipts from the sale by the creating artist of a painting, drawing, etching, sculpture, or a piece of craftwork that is not a reproduction of an original work shall not be taxable if:

1. The sale is a casual sale pursuant to the definition in R15-5-1812; or
2. The sale is of commissioned artwork by an individual artist. For purposes of this rule, "commissioned artwork" is a custom, one-of-a-kind art creation made by the individual artist pursuant to the particular requirements of a specific purchaser.

**R15-5-152. Reserved.**

**R15-5-153. Four-inch Pipes or Valves.**

Gross receipts from the sale of pipes, valves, or fire hydrants with an inside diameter of four inches or more are deductible from the tax base if the pipes, valves, or fire hydrants are to be used to transport oil, natural gas, artificial gas, water, or coal slurry.

***R15-5-154. Data Processing Equipment and Software.***

A. Income from services rendered in whole or in part in connection with the sale of data processing equipment is exempt including income from charges imposed for professional and technological services such as analysis, design, support engineering services, classroom instruction and data conversion services.

B. Income from the multiple use of data processing equipment where no single customer has exclusive use of the equipment for a fixed period of time, or where the customer does not exclusively control all manual operations necessary to operate the equipment is nontaxable service income.

C. Except as provided in subsection (D), the gross receipts derived from the sale of electronic data processing programs are taxable.

D. The gross receipts derived from charges imposed for the original creation of an electronic data processing program or the modification of a canned electronic data processing program for the specific use of an individual customer are nontaxable service activities.

E. When income is received from both the sale of tangible personal property and exempt services, the charges for each shall be separately stated on billings and invoices or otherwise clearly reflected in the books and records of the taxpayer. If not so separately stated, the gross income from such transactions is taxable.

***R15-5-155. Reserved.***

***R15-5-156. Sales of Prescription Drugs and Prosthetic Appliances.***

A. For purposes of this rule, the following definitions apply:

1. “Drugs on a prescription” means those substances which can only be dispensed on the direction of a member of the medical, dental, or veterinary profession, who is licensed by law to administer such drugs, and which cannot be purchased without such authorization. A legend drug is considered a drug on a prescription.

2. “Hearing aid” means any wearable device designed for aiding or compensating for defective human hearing including parts, attachments, accessories, and earmolds.

3. A “legend drug” is a drug which bears the statement *CAUTION: FEDERAL LAW PROHIBITS DISPENSING WITHOUT PRESCRIPTION.*

4. “Nonprescription drugs” means a substance which can be purchased without a prescription even though recommended by a member of the medical, dental, or veterinarian profession.

5. “Prescription drugs” are drugs on a prescription.

6. “Prescription eyeglasses” includes frames and component parts if purchased for use with prescription lenses.

7. “Prosthetic appliance” means an artificial device which fully or partially replaces a part or function of the human body or increases the acuity of a sense organ.

B. Gross receipts from sales of the following items are deductible from the tax base:

1. Drugs on a prescription.
2. Medical oxygen, pursuant to statute.
3. Insulin, insulin syringes, and glucose strips whether or not prescribed.
4. Prosthetic appliances prescribed or recommended by a statutorily authorized individual.
5. Durable medical equipment, pursuant to statute.
6. Prescription eyeglasses and contact lenses.
7. Hearing aids. Batteries and cords do not qualify as exempt.

C. Unless otherwise stated, the sale of component and repair parts for any property included in this rule is not taxable.

D. If a prescription or recommendation is required to purchase the tangible personal property, the required prescription or recommendation shall be in writing and shall be maintained as part of the vendor’s records.

E. Gross receipts from the sale of nonprescription drugs and other medical supplies to doctors, dentists, or veterinarians are taxable unless otherwise exempt.

1. Gross receipts from the sale of nonprescription drugs and other medical supplies to doctors, dentists, and veterinarians are not taxable if the tangible personal property qualifies as a sale for resale and the doctor, dentist, or veterinarian is a retailer in the business of reselling such property.

2. Gross receipts from the sale of prescription drugs, for use in the course of treating patients, are not taxable if the prescription drugs are sold to a doctor, dentist, or veterinarian who is licensed by law to administer prescription drugs.

3. Gross receipts from the sale of prescription drugs are not taxable if the prescription drugs are sold to an organization where the prescription drugs are used in the course of treating patients and are administered under the direction of a doctor, dentist, or veterinarian who is licensed by law to administer such drugs.

***R15-5-157. Membership Fees.***

A. Membership, admission, or other fees charged by a limited-access retail business shall be considered part of the taxable gross income of the business activity.

B. For purposes of this rule, “a limited-access retail business” means a business which does not sell to the general public but which charges a membership fee or a membership due in order to obtain access to the business or to obtain discounts or preferential treatment in the purchase or rental of tangible personal property from or through the business.

C. Gross income shall not include separately billed amounts paid to secure ownership interests or rights in the business which can be transferred or assigned.

***R15-5-158. Reserved.***

***R15-5-159. Reserved.***

***R15-5-160. Reserved.***

***R15-5-161. Reserved.***

***R15-5-162. Reserved.***

***R15-5-163. Reserved.***

***R15-5-164. Reserved.***

***R15-5-165. Reserved.***

***R15-5-166. Reserved.***

***R15-5-167. Reserved.***

***R15-5-168. Reserved.***

***R15-5-169. Reserved.***

***R15-5-170. Interstate and Foreign Transactions.***

A. Gross receipts from sales of tangible personal property made in interstate or foreign commerce are deductible from the tax base if all of the following apply:

1. The order is received from a location outside of Arizona; and
2. The retailer ships or delivers the tangible personal property to a location outside of Arizona for use outside of Arizona.

B. In meeting the above requirements, if delivery is made by the retailer to a common carrier for transportation to a location outside Arizona, the common carrier is deemed to be the agent of the retailer for purposes of this rule regardless of who is responsible for payment of the freight charges.

C. Suitable records shall be kept to substantiate the deduction for a sale made in interstate commerce. As such, records shall identify the tangible personal property sold and the delivery destination. The following records may be sufficient to substantiate the exemption:

1. Suitable records for substantiating the receipt of an order from out-of-state may include purchase orders, letters, or written memoranda on the receipt of orders placed by telephone.
2. Suitable records for substantiating out-of-state shipments include:

- (a) Internal delivery orders supported by receipts of expenses incurred in delivering the property and signed on the delivery date by the person who delivers the property;
- (b) Common carrier's receipt or bill of lading;
- (c) Parcel post receipt;
- (d) Export declaration;
- (e) Receipt from a licensed broker; or
- (f) Proof of export or import signed by a customs officer.

***R15-5-171. Sales to a Common Carrier.***

Gross receipts from sales made to a common carrier, engaged in interstate business, for delivery by the common carrier to a location outside of Arizona and for use outside of Arizona shall not be taxable if the order is received from a location outside of Arizona and the Arizona retailer prepays the freight charge.

***R15-5-172. Sales by Florists.***

A. Gross receipts from sales made by florists are taxable. Delivery and relay or transmittal charges, when separately stated, are deductible from the tax base.

B. Orders received by an Arizona florist from an out-of-state customer for delivery within Arizona are taxable.

C. When the florist conducts transactions through a delivery association, the following shall apply:

1. Gross receipts from sales made by an Arizona florist, where the order is subsequently transmitted to another florist for filling and delivery, whether inside or outside of Arizona, are taxable.

2. Gross receipts from sales by Arizona florists who deliver from a transmitted order of another florist, whether the ordering florist is inside or outside of Arizona, are not taxable.

***R15-5-173. Sales of Property Subsequently Taken Out-of-State.***

Gross receipts from sales of tangible personal property by Arizona vendors made to purchasers who subsequently take the property out-of-state do not qualify as exempt unless otherwise specifically exempted by statute.

***R15-5-174. Sales to Non-U.S. Citizens.***

Gross receipts from sales to non-U.S. citizens are subject to the tax unless otherwise exempt.

***R15-5-175. Sales to Nonresidents Temporarily Within this State.***

A. For purposes of this rule, "nonresident" means:

- 1. An individual who is not a resident for Arizona income tax purposes; or
- 2. An entity which has no business location or business nexus in Arizona.

B. Gross receipts from the sale of tangible personal property to a nonresident of Arizona who is temporarily within this state are exempt from the tax if:

1. The vendor ships or delivers the tangible personal property out of this state by common carrier, United States mail, or the vendor's own conveyance; and

2. The tangible personal property is not used in Arizona.

C. To substantiate the exemption for a sale to a nonresident temporarily within the state, the vendor shall obtain a completed exemption certificate or a written statement from such a buyer certifying that the buyer is not a resident of Arizona and that the property purchased is for use outside of Arizona.

1. Such a statement or certificate shall be maintained as part of the records of the vendor for the required statutory period.

2. The vendor may use the exemption certificate prescribed by the Department.

D. Suitable records, as delineated in R15-5-170, shall be kept by the vendor to establish out-of-state shipments.

***R15-5-176. Aircraft, Instruments, and Related Accessories.***

A. Gross receipts from the sale of airplanes, navigational and communication instruments, other accessories, and related equipment are deductible from the tax base if such property:

1. Is not used in this state except to remove such property from this state; and

2. Is sold to persons who are not residents of this state.

B. "Persons who are not residents of this state" means:

1. An individual who is not a resident for Arizona income tax purposes;

2. An entity, other than a corporation, which has no business location or business nexus in Arizona; or

3. A corporation which is not incorporated in Arizona and whose principal corporate office is not located in Arizona even though it may have a branch office in Arizona.

C. To substantiate the exemption for a sale to a nonresident, the vendor shall obtain a completed exemption certificate or a written statement from such a buyer certifying that the buyer is not a resident of Arizona and that the property purchased is for use outside of Arizona:

1. Such a statement or certificate shall be maintained as part of the records of the vendor for the required statutory period.

2. The vendor may use the exemption certificate prescribed by the Department.

***R15-5-177. Reserved.***

***R15-5-178. Reserved.***

***R15-5-179. Reserved.***

***R15-5-180. Sales by Businesses in Federal Areas.***

Gross receipts from sales by businesses which are not operated by or as an agency of the Federal Government, located on military bases or other federal areas, are taxable.

***R15-5-181. Governmental Organizations.***

A. Gross receipts from the sale of tangible personal property to the state or its political subdivisions are taxable unless otherwise exempt. Gross receipts from the sale of tangible personal property to the Federal Government or its departments and agencies are taxable at the rate prescribed by statute, unless otherwise exempt.

B. Gross receipts from the sale of tangible personal property by the state or its political subdivisions, when acting in a proprietary capacity, are taxable unless otherwise exempt.

C. Gross receipts from the sale of tangible personal property by the Federal Government are not taxable.

***R15-5-182. Nonprofit Organizations.***

A. Gross receipts from the sale of tangible personal property to nonprofit churches, schools, and other nonprofit organizations are taxable unless otherwise exempt.

B. Gross receipts from the sale of tangible personal property by a charitable nonprofit organization, recognized as such for income tax purposes by the Internal Revenue service and the Department, are not taxable.

C. If an organization wishes to obtain tax-exempt status by being recognized by the Department as a nonprofit charitable organization, it shall submit a letter to the Department requesting tax-exempt status and shall include a copy of its Internal Revenue Service recognition as such an organization.

D. For purposes of the statutory exemption and this rule, the Internal Revenue Service recognition of a charitable nonprofit organization is defined in Internal Revenue Code § 501(c)(3).

***R15-5-183. Exempt Sales to Health Organizations.***

A. Gross receipts from the sale of tangible personal property to qualifying hospitals, qualifying health care organizations, rehabilitation programs for mentally or physically handicapped persons, and qualifying community health centers are exempt from tax if such purchases are exempt from tax pursuant to statutory provisions.

B. The Department may, upon review of the written request and any other information requested by the Department to make a proper determination, provide an Exemption Letter to organization meeting the statutory criteria. The Exemption Letter shall be valid for a period of 12 months from the first day of the month following the issue date of the Exemption Letter unless the organization's tax exempt status changes prior to the end of the 12-month period, or the organization misrepresented or omitted material information in its exemption request.

C. Qualifying hospitals, qualifying health care organizations, rehabilitation programs for mentally or physically handicapped persons, and qualifying community health centers shall

annual submit to the Department a written request for an Exemption Letter. The request shall be submitted at least 30 days prior to the first day of the exemption period. For purposes of this rule, “exemption period” means the 12-month period beginning on the first day of the month following the issue date of the Exemption Letter or the 12-month period requested by the organization.

1. Qualifying hospitals shall attach to their annual exemption request a copy of their current license issued by the Department of Health Services.

2. Qualifying health care organizations shall attach to their exemption request letter the statutorily required annual financial audit and a copy of their Internal Revenue Code 501(c) recognition unless the Department has previously received a copy of this recognition.

3. Rehabilitation programs for mentally or physically handicapped persons shall attach to their exemption request a copy of their Internal Revenue Code 501(c)(3) recognition unless the Department has previously received a copy of this recognition.

4. Qualifying community health centers shall attach to their exemption request documentation supporting the statutory criteria and a copy of their Internal Revenue Code 501(c)(3) recognition unless the Department has previously received a copy of this recognition.