

**CURRENT DEVELOPMENTS  
2006 CASES AND LEGISLATION**

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### I. TRANSACTION PRIVILEGE (SALES) AND USE TAX

#### A. LEGISLATION

**House Bill 2086 (Ariz. Sess. Laws 2006, Ch. 123).** *Delinquency Dates for Transaction Privilege Tax Payments Standardized.* Before enactment, Arizona statutes treated electronic and paper filers differently. For example, for those who file sales tax returns by mail, a \$25 non-sufficient funds fee was charged to taxpayers who made payments with dishonored checks. However, no similar fee existed for those who filed electronically and whose electronic transactions were dishonored. Moreover, payments were considered delinquent on different dates depending on whether the taxpayer filed paper or electronic returns. This bill eradicates these discrepancies by amending A.R.S. §§ 42-1126, 42-5014 and 42-5018. Specifically, the bill:

- Applies the \$25 non-sufficient funds fee to both paper and electronic filers (previously applied only to checks).
- Clarifies that sales tax payments are delinquent if they are not received on or before the second to the last day of the month. Or if filing by mail they are not postmarked before twenty-fifth day of the month.
- Allows all tax payments to be made by electronic funds transfer.
- Requires taxpayers to timely file returns and timely make payments in order to receive an accounting credit.

**House Bill 2089 (Ariz. Sess. Laws 2006, Ch. 105).** *New Deduction for Postage and Freight Charges Billed to Customers Under the Job Printing Classification.* Arizona levies transaction privilege or sales taxes on certain enumerated businesses. One of those business classifications is job printing, which includes services such as printing, embossing, engraving and copying. For many printing jobs, such as bulk mailers, customers often ask the printer to include postage on the mailings.

Before enactment, and because the tax base for job printing includes all gross receipts of the taxpayer, the taxability of this postage depended on whether the customer paid the Postmaster directly or reimbursed the job printer for postage it purchased in bulk. In the latter case, the job printer was liable for sales tax on the postage reimbursement.

This bill amends A.R.S. § 42-5066 by adding a deduction for the actual amount of postage or freight paid to the USPS or delivery service in order to utilize this deduction.

The taxpayer must separately itemize the postage charges on both its customer invoices and in its own records.

**House Bill 2132 (Ariz. Sess. Laws 2006, Ch. 171).** *New City Sales Tax Exemption for State and County Fairs.* Arizona statute provides a state sales tax exemption for income the Arizona Exposition and State Fair Board retains in conjunction with the state and county fairs. Before enactment, however, this income was not exempt from city sales tax. This bill amends A.R.S. § 42-6004 by providing exempting this income from city sales tax.

**House Bill 2360 (Ariz. Sess. Laws 2006, Ch. 321).** *New Sales and Use Tax Exemptions for Food Prepared Off-Campus But Sold To School Districts For On-Campus Consumption.* Before enactment, Arizona law provided an exemption under the restaurant classification for food provided to a school district if the food was both prepared on campus and served to students for on-campus consumption during school hours. This bill amends A.R.S. §§ 42-5074 and 42-5199 by adding much broader sales and use tax deductions for sales of food to school districts and charter schools. Under this bill, all sales of prepared or unprepared food, drinks, condiments and accessory tangible personal property may be deducted from the taxpayers gross receipts under the restaurant classification, if the food and accessories are served to persons for on-campus consumption during school hours. The bill operates retroactively to January 1, 2000, but refund claims had to be submitted to the Department of Revenue by December 31, 2006.

**House Bill 2429 (Ariz. Sess. Laws 2006, Ch. 333).** *Exemption for Solar Energy Devices for Retailers and Prime Contractors Is No Longer Limited to \$5,000.* Before enactment, Arizona statutes provided transaction privilege tax deductions for both retailers who sell and prime contractors who provide and install solar energy devices. These exemptions, however, were limited to \$5,000 per device or contract. As part of a comprehensive series of tax incentives to encourage solar energy development, this bill amends A.R.S. §§ 42-5061 and 42-5075 by removing the \$5,000 limitations from the sales and use tax exemptions.

**House Bill 2702 (Ariz. Sess. Laws 2006, Ch. 376).** *State TPT Diversion to Rio Nuevo Multi-Purpose District in Tucson to Continue Until 2025.* Currently, the Rio Nuevo Multipurpose Facilities District, which is a downtown redevelopment district in Tucson and includes the convention center as well as plans for new hotels, housing, stores and parking, qualifies as an extended stadium district. Consequently the State can divert 50% of the transaction privilege tax revenues generated by the district or from construction within the district directly back to the district. This bill amends A.R.S. § 42-5031 and extends that diversion from 10 to 40 years, i.e. until 2025. It also establishes a new baseline year to determine the amount of the diversion and eliminates the district's authority to use district funds to acquire land by eminent domain.

**House Bill 2820 (Ariz. Sess. Laws 2006).** *Clarification of Applicability of Sales and Use Tax to Manufactured Homes Under the Prime Contracting Classification.* In the 1990s, considerable confusion existed regarding how to interpret Arizona tax statutes for the sale of manufactured homes. As a result, a series of statutory changes were made that treated the sale of new manufactured, mobile and modular homes as prime contracting (rather than retail sales) at the location where the home is set up. Sales of used homes, however, were not subject to sales tax. This bill clarifies the application of these statutes and amends A.R.S. § 42-5075 in several ways.

- It clarifies that: (1) sales of manufactured homes to another dealership are exempt as sales for resale; (2) sales to people who lease the manufactured buildings are not exempt sales for resale; and (3) proceeds from the alteration or repair of used manufactured buildings are taxable as prime contracting.
- It clarifies the situs of the homes for sales tax purposes in the following ways: (1) homes sold to a specified delivery or set up site in Arizona are taxed at that site; (2) homes sold to an unidentified set-up site are taxed at the dealer's location; (3) homes sold for delivery out-of-state are not taxed.
- It also amends Arizona's use tax statutes at A.R.S. §§ 42-5155 and 42-5156 to provide that manufactured buildings purchased outside the state but set up in Arizona are subject to use tax at 65% of the sales price and that the person hired to set up the home is required to collect and remit the tax to the state.

**House Bill 2871 (Ariz. Sess. Laws 2006, Ch. 351).** *Threshold Tax Liability Levels Required to Trigger June Reporting Requirements Are Raised.* In addition to making the statutory and session law changes related to distributing general revenues in accordance with the 2006-07 budget, this bill amends A.R.S. § 42-5014 with respect to June reporting requirements. Before enactment taxpayers who had annual sales, county excise or telecommunications excise tax liabilities that exceeded \$250,000 had to file and make an estimated tax payment in June of each year. This bill raises the threshold tax liability required to trigger the June reporting requirement from \$250,000 to \$1 million.

**House Bill 2876 (Ariz. Sess. Laws 2006, Ch. 354).** *Certain Transaction Privilege Tax Classifications Are Eliminated.* Named the Omnibus Tax Relief Act, this bill makes several provisions for taxpayer relief. In addition to making changes to Arizona property and income taxes, this bill amends A.R.S. §§ 42-5010, 42-5077, 42-5401 *et seq.* and 42-5201 *et seq.* by

eliminating the membership camping classification, the rental occupancy tax and the severance tax on timber products.

**Senate Bill 1068 (Ariz. Sess. Laws 2006, Ch. 386). *Development and Impact Fees Are Exempt Under Prime Contracting Classification.*** Arizona statutes provide exemptions for numerous activities under the Prime Contracting classification. This bill amends A.R.S. §§ 42-5075 and 42-6004. Under the Prime Contracting classification, it provides a deduction for any portion of a contract price that represents development or impact fees paid to the state or a local government to offset that government's cost of providing infrastructure and public services to the development. It also exempts these fees from municipal taxes. Finally, this bill sets a time limitation on the existing state and municipal deduction/exemption for gross receipts earned on contracts to construct lake facilities in commercial enhancement reuse districts, which will now expire on December 31, 2009. This bill has an effective date of September 1, 2006.

**Senate Bill 1069 (Ariz. Sess. Laws 2006, Ch. 76). *Motor Vehicle Sales to Certain Out-of-State Residents Are Exempt From Sales Tax.*** Called the Tax Corrections Act, this bill primarily makes technical and conforming changes to Arizona tax statutes. With regard to sales tax this bill makes clarifying changes relating to motor vehicles sold to out-of-state residents. Before enactment, the statute required the amount of sales tax paid by an out-of-state resident to this state to be reduced to the amount of use tax the purchaser would pay in his home state, if his or her state of residence taxed at a lower rate. This bill amends A.R.S. § 5061. It clarifies that if the purchaser's home state does not impose an excise tax on the purchase of motor vehicles, no tax will be charged in Arizona, provided that the out-of-state purchaser has obtained the special 90-day non-resident registration required by statute.

**Senate Bill 1367 (Ariz. Sess. Laws 2006, Ch. 222). *New Deduction for Sales of Printed Material to Motion Picture Production Companies for Use in a Film Production Under the Job Printing Classification.*** Last year the Arizona legislature passed a series of tax incentives for movie production companies that film in Arizona and employ a certain threshold number of people in Arizona. In addition to clarifying the income tax credits for movie production companies, this bill amends A.R.S. § 42-5066 and allows a deduction for sales of printing, engraving, copying or embossing under the job printing classification if the product is used directly in a motion picture production. To qualify for the deduction, the motion picture production company must provide the job printer with an exemption certificate.

**Senate Bill 1411 (Ariz. Sess. Laws 2006, Ch. 168). *Portions of Gross Income Derived from Operating Landfills Can be Excluded Under the Prime Contracting Classification.*** State and federal law requires cities to provide a means to dispose of the solid waste generated within their jurisdictions. Most often, cities establish and operate landfills. Landfill operations necessitate the construction, maintenance and operation and closure of "cells," in which garbage is stored and compacted. Landfills also require continuous miscellaneous activities like fencing, land clearing, and litter and soil removal. This bill clarifies which activities with respect to landfill construction and operation constitute contracting, and are thus subject to sales tax under the Prime Contracting classification. It amends A.R.S. § 5075 to provide that actually operating the landfill and creating vehicle access to cells within the facility are not subject to taxation.

However, constructing roads to a landfill and constructing the facility itself may be considered contracting.

**Senate Bill 1433 (Ariz. Sess. Laws 2006, Ch. 371). *New Sales and Use Tax Exemption for Natural Gas Used in Converting Natural Gas to Liquid Natural Gas.*** Historically, natural gas companies and distributors have diverted some of the gas in a pipeline in order to fuel compressors that force the fuel through the pipeline to a destination point. Arizona law exempts natural gas used for this purpose from sales and use tax. Suppliers, however, also divert natural gas to fuel equipment that converts natural gas from a vapor to liquid state, so that the Liquid Natural Gas can be used as fuel in alternative fuel vehicles and other operations. This bill amends A.R.S. §§ 42-5061 and 42-5159 to provide sales and use tax exemptions when gas is diverted for this purpose. The bill was made retroactive to August 1, 2005, but refund claims had to be filed by December 31, 2006.

**House Bill 1506 (Ariz. Sess. Laws 2006, Ch. 225). *Sales and Use Tax Exemption for Donations of Food to Non-Profits That Serve Meals to the Needy.*** The sale of prepared food is taxable in Arizona under the restaurant classification. This bill amends A.R.S. §§ 42-5074 and 42-5159. It provides a deduction from the gross income of the business for restaurants who donate prepared food to non-profit charitable organizations that regularly serve meals to the needy. It also provides a corresponding use tax exemption.

## B. CASES

### Arizona Tax Court

***Arizona Dep't of Revenue v. Discount Copy Supply, Inc., (TX2006-050203) & Arizona Dep't of Revenue v. OFAM Residential & Commercial Painting, LLC (TX2006-050143). Court Finds Corporate Officer and LLC Member Personally Liable For Transaction Privilege Tax.*** A.R.S. § 42-5028 holds any person who fails to remit any additional charge made to cover transaction privilege taxes or who fails to truthfully account for and pay over those amount to the Department personally liable for the those amounts. In 2006 the Tax Court granted summary judgment to the Department of Revenue in two cases where individuals argued that the corporate entity was the "person" liable for the tax, and that they were not liable as individuals. One case involved a member of an LLC. The other involved an corporate officer. While the taxpayers did not file responses to the Department's motion for summary judgment in either case, the Tax Court reasoned that the corporate form is incapable of performing any task. Rather, only the human actor to whom the corporate form delegates the authority and responsibility has that capacity. Thus, that individual may be held liable for payment under A.R.S. § 42-5028.

### Court of Appeals

***DaimlerChrysler Services North America, LLC v. Arizona Department of Revenue, 210 Ariz. 297, 110 P.3d 1031 (App. May 3, 2005). Bad Debt Deduction Under The Arizona Sales Tax Regulations Is Limited To The Dealer That Sold The Automobile And Not The Finance Company That Had Been Assigned The Installment Purchase Contract By The Dealer.*** DaimlerChrysler financed the sale of automobiles by its dealers, including dealers located in Arizona. The dealer would sell a car to a purchaser, with the purchaser making a down payment

and entering into an installment payment contract with the dealer to pay the balance over a period of months. The dealer would assign the installment sale contract to DaimlerChrysler. The assignments at issue in this case were made “without recourse” meaning that DaimlerChrysler assumed all the risk if a purchaser did not pay the full amount agreed upon in the installment sale contract, with the dealer assuming no risk. [In a “recourse” assignment, the dealer would assume the risk of non-payment by the purchaser and be obligated to pay the assignee finance company for any amounts not paid by the purchaser.] DaimlerChrysler would pay the dealer the face amount on the installment payment agreement (net of the down payment) and the dealer would then report and pay sales tax to the state on the full sales price (down payment + face amount of the installment payment contract). As can be expected, a number of purchasers would default on the installment payment contract and stop making payments. At that time the car would be repossessed with the proceeds from the sale of the car at auction going to DaimlerChrysler; which would then apply that amount against the outstanding balance of the installment contract and write off the remainder as a bad debt for both federal income tax purposes and financial reporting purposes.

For Arizona transaction privilege tax purposes, Department of Revenue Regulation R15-5-2011 allows a bad debt deduction if the following three conditions apply: (1) the gross receipts from the transaction on which the bad debt deduction is being taken have been reported as taxable; (2) the debt arose from a debtor/creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money; and (3) All or a part of the debt is worthless. The regulations also provides that a bad debt deduction is to be allowed on conditional or installment sales if: (1) the tax liability is paid on the full sales price of the tangible personal property at the time of sale; or (2) the contract or other financial obligation is sold to a third party as a sale with recourse and principal payments are made by the vendor to the third party, pursuant to the default to the original payor. The regulation provides that such principal payments may be taken as a bad debt deduction if the tax was paid by the vendor on the original sale of the tangible personal property or on the subsequent sale of the financing contract. The regulation does not mention or cover assignments “without recourse.”

DaimlerChrysler in addition to its automobile financing, also engaged in other taxable activities in Arizona and paid state transaction privilege tax on those other activities. DaimlerChrysler filed a refund claim for the bad debts it incurred with respect to the automobile financing transactions. The refund claims were disallowed by the Department and DaimlerChrysler appealed to tax court and then to the court of appeals. DaimlerChrysler argued it was entitled to the bad debt deduction on either of two grounds: (1) Since it had paid sales tax with respect to other transactions, it was entitled to the bad debt deduction in its own right as a taxpayer. Or, (2) as the assignee of the installment sale contract from the dealer, DaimlerChrysler has stepped into the shoes of the dealer and was entitled to claim the bad debt deduction as an assignee under the general principles of the Arizona law of assignment.

The Court of Appeals concluded that DaimlerChrysler, as the purchaser of retail installment sale contracts, was not a retailer or a vendor entitled to take a bad debt deduction; rather, the automobile dealer was the retailer or vendor who was required to pay the transaction privilege tax, and the regulation covering the bad debt deduction only permitted such a deduction by the vendor or the retailer. With respect to the assignment argument, the court held that

DaimlerChrysler, as the assignee of the dealer, was not entitled to the bad debt deduction after buyers defaulted on consumer installment contracts since the dealer was paid in full or the vehicle and suffered no bad debt that the assignee could assert. Additionally, the Court concluded that the bad debt deduction was not available to an assignee under general principles of assignment law; rather, the court stated that tax deductions must be strictly construed against the taxpayer, and as such the general law of assignment would not apply in this situation. In other words, the court concluded that the bad debt regulation superseded the Arizona law of assignment. DaimlerChrysler has requested the Arizona Supreme Court to take review of the court of appeals decision and reverse it.

**Qwest Dex, Inc. v. Arizona Department of Revenue, 210 Ariz.223, 109 P.3d118, 2005 WL 768449 (App. April 5, 2009). *Cost Of Out Of State Printing Services Not Subject To Arizona Use Tax; Only Cost Of Paper Subject To Use Tax.*** Qwest Dex publishes the white pages and yellow pages telephone directories. It purchases the paper that it needs for those directories from out of state paper mills and has the paper shipped to out of state printers for printing of the directories. The taxpayer initially paid the use tax on the purchase price of the paper from the out of state paper mill and on the printing services. The taxpayer then filed a claim for refund for the amount of taxes paid on the cost of the printing services but agreed that the use tax applied to the cost of the paper purchased from the out of state paper mill. The Department audited Qwest Dex and asserted use tax on the cost of the printing services. The Arizona use tax is imposed upon the purchase of tangible personal property from an out of state retailer where that property is brought in to the state and is used, consumed or stored in Arizona. The measure of the use tax is the acquisition cost of the tangible personal property as purchased from the out of state retailer. The use tax does not apply to services. The Tax Court held that the printing services, being services, were not taxable under the retail classification and thus would not be subject to the Arizona use tax. The Court of Appeals agreed, applying what is called the “common understanding test.” Under this test, whether a transaction qualifies as a sale of tangible personal property or the sale of a service is determined by the parties’ common understanding of the particular trade, business or occupation. Using the common understanding test, the court determined that the taxpayer does not owe a use tax on the printing of the directories because printers provide a service. The court observed that the very nature of the term “printing” denotes a service and not a tangible item. The court also cited to several out of state cases that held printers who print specific material on paper for a customer are not engaged in the business of selling tangible personal property, but are instead engaged in a service, reasoning that the paper is of no use to anyone except the customer for whom the printing is done.

The court also noted that the printing service would be taxed in Arizona under the job printing classification of the transaction privilege tax but held that this varying treatment would not change the court’s conclusion as to the use tax. The court reasoned that the job printing classification, unlike the use tax, specifically includes a provision for a tax on printing services while the use tax, in contrast, imposes no specific tax on printing services.