STATE OF ARIZONA
Department of Revenue

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Governor

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ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 22-XX

(This ruling supersedes and rescinds TPR 95-14)

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Date Proposed: , 2022
Date Final: , 2022
Date Effective: From and after October 1, 2022, and all open periods as of that date.

Issue:

Motor vehicles removed from dealer inventory.

Applicable Law:

Arizona Revised Statutes ("A.R.S.") § 42-5155(A) levies an excise tax on the storage, use, or consumption in this state of tangible personal property purchased from a retailer as a percentage of the sales price.

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

A.R.S. § 42-5159(A)(32) provides that the use tax does not apply to motor vehicles that are removed from inventory by a motor vehicle dealer as defined in section 28-4301 and that are provided to:

(a) Charitable or educational institutions that are exempt from taxation under section 501(c)(3) of the internal revenue code.
(b) Public educational institutions.
(c) State universities or affiliated organizations of a state university if no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

A.R.S. § 42-5157(A) states that the use tax imposed on:

> [M]otor vehicles that are removed from inventory by a motor vehicle dealer as defined in section 28-4301, that are used directly in the conduct of the motor vehicle dealer's primary business and that are returned to the dealer's active sales inventory within one year after the date of the initial removal from inventory shall be levied and imposed on a monthly basis and shall be applied to 1/39 of the value of each new motor vehicle as determined by that manufacturer's suggested retail price and to 1/39 of the value of each used motor vehicle as determined by an industry-wide publication in common use and devoted to listing used car values.

A.R.S. § 42-5157(B) states that:

> [A] service vehicle is not considered to be removed from inventory if the service vehicle is continuously available for sale. The Department shall consider any service vehicle that remains a new motor vehicle as defined in section 28-4301 or that is treated as a new motor vehicle under Title 28, Chapter 10 to be continuously available for sale.

A.R.S. § 42-5151(11) states that "motor vehicles that are removed from inventory" means:

> [A] motor vehicle that has been removed from a motor vehicle dealer's, as defined in section 28-4301, inventory and that is not for sale.

A.R.S. § 28-4301(23) states that "new motor vehicle" means:

> [A] motor vehicle, other than a used motor vehicle, that is held either for:
>
> (a) Sale by the franchisee who first acquired the vehicle from the manufacturer or distributor of the vehicle.

(b) Sale by another franchisee of the same line-make.

A.R.S. § 28-4301(33) states that "used motor vehicle" means:

> [A] motor vehicle that has been sold, bargained, exchanged or given away or the title to the motor vehicle has been transferred from the person who first acquired the vehicle from the manufacturer, or importer, dealer or agent of the manufacturer or importer, and that has been placed in bona fide consumer use. For the purposes of this paragraph, "bona fide consumer use" means actual operation by an owner who acquired a new motor vehicle both:
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> (a) For use in the owner's business or for pleasure or otherwise.
> (b) For which a certificate of title has been issued or that has been registered as provided by law.

A.R.S. § 28-4301(24) states that "motor vehicle dealer" means:

> [A] new motor vehicle dealer, a used motor vehicle dealer, a public consignment auction dealer, a broker or a wholesale motor vehicle auction dealer, excluding a person who comes into possession of a motor vehicle as an incident to the person's regular business and who sells, auctions or exchanges the motor vehicle.

Model City Tax Code ("MCTC") § -610(a) levies a city excise tax on the storage or use in the City of tangible personal property[1]. Under MCTC § -600, "Use (within the City)" means:

> [C]onsumption or exercise of any other right or power over tangible personal property incident to the ownership thereof except the holding for the sale, rental, lease, or license for use of such property in the regular course of business." MCTC § -600.

The MCTC does not have parallel city use tax exemptions to those at the state level for motor vehicles taken out of inventory or otherwise used as service vehicles by a dealer, except that for cities electing Local Option #HH, MCTC § -660(y) provides the following exemption from city use tax:

[1] Note that cities electing Model Option 15 do not impose a city use tax. To see which cities do and do not impose the city use tax, you can visit https://azdor.gov/model-city-tax-code/options-city to review the cities who have elected Model Option 15 to not impose the tax.

[T]angible personal property [including motor vehicles] donated to an organization or entity qualifying as an exempt organization under 26 U.S.C. Section 501(c)(3); if and only if:

(1) The donor is engaged or continuing in a business activity subject to a tax imposed by Article IV [City Privilege Taxes]; and
(2) The donor originally purchased the donated property for resale in the ordinary course of the donor's business; and
(3) The donor obtained from the donee a letter or other evidence satisfactory to the Tax Collector of qualification under 26 U.S.C. Section 501(c)(3) from the Internal Revenue Service or other appropriate federal agency; and
(4) The donor maintains, and provides upon demand, such evidence to the Tax Collector, in a manner similar to other documentation required under Article III.

Discussion:

In accordance with A.R.S. § 42-5155, the Arizona use tax is imposed on the use, storage or consumption in this state of tangible personal property purchased from a retailer as a percentage of the sales price. In addition, tangible personal property which was purchased for resale but subsequently used or consumed by the purchaser is also subject to the use tax.

The exemption under A.R.S. § 42-5159(A)(32), for motor vehicles which are provided to an Internal Revenue Code (I.R.C.) § 501(c)(3) charitable or educational institution, was enacted in 1993. In 1994 this exemption was broadened to include public educational institutions, state universities, or affiliated organizations of a state university if no part of the organization's net earnings inures to the benefit of any private shareholder or individual. These exemptions apply retroactively to taxable periods beginning from and after December 31, 1986.

For purposes of this ruling, an "affiliated organization" is an organization which is associated with a state university and has a working relationship with the university for the purpose of advancement of the objectives of the university and fulfillment of the university's programs. An example of such an organization is a booster club which is associated with a state university for the purpose of supporting its athletic program.

In 1993, the Arizona Legislature passed a separate statutory provision addressing the taxation of motor vehicles removed from active sales inventory by a motor vehicle dealer and used directly in the conduct of the motor vehicle dealer's primary business. Under A.R.S. § 42-5157(A), if such vehicles are returned to the dealer's active sales inventory within one year after the date of the initial removal from inventory, the use tax is levied and imposed on a monthly basis, and is applied to 1/39th of the vehicle's value. The value of a new motor vehicle is determined by the manufacturer's suggested retail price. The value of a used motor vehicle is determined by an industry-wide publication in common use and devoted to listing used car values, such as the Kelly Blue Book.

In 2022, the Arizona Legislature added the statutory provision in A.R.S. § 42-5157(B) which states that a service vehicle is not considered to be removed from inventory if the service vehicle is continuously available for sale, and that the Department shall consider any service vehicle that remains a new motor vehicle as defined in section 28-4301 or that is treated as a new motor vehicle under Title 28, Chapter 10 to be continuously available for sale. The legislature also defined "motor vehicles that are removed from inventory" as meaning a motor vehicle that has been removed from a motor vehicle dealer's, as defined in section 28-4301, inventory and that is not for sale. A.R.S. § 42-5151(11).

Motor vehicle dealers regularly use vehicles from active sales inventory in their daily business operations. Whether such vehicles are subject to use tax depends on the dealer's particular use of each vehicle and whether such vehicle remains continuously available for sale.

"Hard plated" vehicles which must be registered and titled in the dealer's name pursuant to A.R.S. §§ 28-4532 and 28-2354 are subject to the use tax if such vehicles are used in the dealer's business and are not continuously available for sale. Additionally, if a vehicle is "hard plated" but not used in the dealer's business, then the cost of the vehicle is subject to the full amount of the applicable use tax, if such vehicles are not continuously available for sale.

However, transaction privilege or use tax is not due on a vehicle provided to an I.R.C. § 501(c)(3) charitable or educational institution, public educational institution, state university, or a nonprofit affiliated organization of a state university. This exemption is applicable regardless of whether the vehicle is "hard plated," or, in those instances where the vehicle is only provided for temporary use, operated under a temporary registration permit pursuant to A.R.S. § 28-2156.

The cost of a vehicle is not subject to the use tax during applicable periods during which a vehicle qualifies for "dealer plates" under A.R.S. § 28-4533. These vehicles are considered to be subject

to sale and are therefore part of inventory. As such, these vehicles may be furnished for use by the dealer's employees or for use as demonstrators for potential buyers.

The provisions under A.R.S. § 42-5157(A)apply to "hard plated" vehicles removed from a dealer's active sales inventory. A.R.S. § 42-5157(A)does not apply to vehicles qualifying for "dealer plates" because such vehicles are not subject to use tax.

In order for A.R.S. § 42-5157(A)to apply, a dealer's use of a "hard plated" vehicle must be used in the conduct of the dealer's business for a period of one year or less, and the vehicle must not be continuously available for sale. A dealer's use of a "hard plated" vehicle removed from active sales inventory for more than one year is subject to tax under the general use tax statute, A.R.S. § 42-5155. In this case, the tax is levied at the time of initial use and applied to 100 percent of the dealer's cost of the vehicle.

If a dealer is paying tax monthly on its use of a vehicle under A.R.S. § 42-5157(A)and continues such use beyond one year, the provisions of A.R.S. § 42-5155 are applicable. The use tax is levied from the time of initial use and applied to 100 percent of the dealer's cost of the vehicle. At the point in which the dealer realizes its use will exceed a 12 month period, the cost of the vehicle becomes subject to the full amount of the use tax. Since the dealer has been reporting on a monthly basis, the dealer will be allowed to report the net difference between the total amount paid to date and the amount still owing on the full cost. Appropriate documentation should be retained in the books and records of the dealership to substantiate this method of reporting the use tax liability.

Ruling:

Under A.R.S. § 42-5157(A), a motor vehicle removed from a dealer's active sales inventory which is "hard plated" for direct use in the conduct of the dealer's business is subject to use tax imposed monthly on 1/39th of the vehicle's value if returned to the dealer's active sales inventory within one year after the date of initial use. Under A.R.S. § 42-5157(B), a service vehicle is not considered to be removed from inventory if the service vehicle is continuously available for sale. The Department shall consider any service vehicle that remains a new motor vehicle as defined in section 28-4301 or that is treated as a new motor vehicle under Title 28, Chapter 10 to be continuously available for sale.

A dealer's use of a "hard plated" motor vehicle removed from the dealer's active sales inventory and that is not continuously available for sale for more than one year is subject to use tax under

A.R.S. § 42-5155. The tax is levied at the time of initial use and imposed on 100 percent of the dealer's cost of the motor vehicle.

The use tax does not apply to a motor vehicle which a dealer provides to a charitable or educational institution which is exempt from taxation under I.R.C. § 501(c)(3), a public educational institution, a state university, or an affiliated organization of a state university if no part of the organization's net earnings inures to the benefit of any private shareholder or individual. The cost of a vehicle also is not subject to the use tax during applicable periods during which a vehicle qualifies for "dealer plates" under A.R.S. § 28-4533.

For cities who have not elected Model Option 15[2], city use tax applies to any use or exercise of any other right or power over motor vehicles except the holding for the sale, rental, lease, or license for use of such vehicle in the regular course of business. MCTC §§ -600, -610(a). Accordingly, a dealer who removes a motor vehicle from its active sales inventory or uses a vehicle from its active sales inventory as a service vehicle in their business—even if it is continuously available for sale—is subject to city use tax from the date of initial use and the tax is imposed on 100 percent of the dealer's cost of the vehicle.

For cities electing MCTC Local Option #HH, city use tax does not apply to motor vehicles that are removed from inventory by a dealer and donated to a federally-exempt 501(c)(3) nonprofit organization, provided that, per MCTC § -660(y):

(1) The donating dealer is engaged or continuing in a business activity subject to city privilege taxes; and
(2) The donating dealer originally purchased the donated motor vehicle for resale in the ordinary course of the dealer's business; and
(3) The donating dealer obtained from the donee a letter or other evidence satisfactory to the Tax Collector of qualification under 26 U.S.C. Section 501(c)(3) from the Internal Revenue Service or other appropriate federal agency; and
(4) The donating dealer maintains, and provides upon demand, such evidence to the Tax Collector, in a manner similar to other documentation required under Article III of the MCTC.

[2] As noted previously, cities electing Model Option 15 do not impose a city use tax. To see which cities do and do not impose the city use tax, you can visit https://azdor.gov/model-city-tax-code/options-city to review the cities who have elected Model Option 15 to not impose the tax.

Examples:

1. A vehicle from active sales inventory is "hard plated" by a dealer for use as a service vehicle in the dealer's business, but the vehicle remains continuously available for sale even while being used by the dealer as a service vehicle. Under A.R.S. §§ 42-5151(11) and 42-5157(B), because the vehicle remained continuously available for sale, the vehicle is not considered to be removed from inventory and the use tax would not apply to the dealer's use of the vehicle as a service vehicle. However, city use tax would be levied under MCTC § -610(a) if the city has elected to impose a use tax from the date of initial use and imposed on 100 percent of the dealer's cost of the vehicle.

2. A vehicle from active sales inventory is "hard plated" by a dealer for use as a service vehicle in the dealer's business, and is also removed from the dealer's active sales inventory and not continuously available for sale. The dealer returns the vehicle to its active sales inventory within one year from the date of initial use. In this situation, the use tax is levied under A.R.S. § 42-5157(A). The tax is imposed each month the vehicle is so used on $1/39^{th}$ of the vehicle's value. For cities that impose a use tax, city use tax would be levied under MCTC § -610(a) from the date of initial use and imposed on 100 percent of the dealer's cost of the vehicle.

3. Same facts as example 2, except the dealer plans to use the vehicle as a service vehicle, and keep the vehicle removed from its active sales inventory and not continuously available for sale, for more than one year. In this case the use tax is levied under A.R.S. § 42-5155. The tax is levied from the date of initial use and imposed on 100 percent of the dealer's cost of the vehicle. For cities that impose a use tax, city use tax also would be levied under MCTC § -610(a) from the date of initial use and imposed on 100 percent of the dealer's cost of the vehicle.

4. Same facts as example 2, except the dealer continues to use the vehicle as a service vehicle, and kept the vehicle removed from its active inventory and not continuously available for sale, for more than one year. Although the dealer had paid tax monthly under A.R.S. § 42-5157(A), this provision no longer applies. In this situation, the use tax is levied under A.R.S. § 42-5155 from the time of initial use and applied to 100 percent of the dealer's cost of the vehicle. The dealer files Form TPT-2 to reflect the net difference between the tax paid on the vehicle under A.R.S. § 42-5157(A) and the total amount due. For cities that impose a use tax, city use tax would be levied under

MCTC § -610(a) from the date of initial use and imposed on 100 percent of the dealer's cost of the vehicle.

5. A motor vehicle is removed from a dealer's inventory and provided to an athletic booster club which is affiliated with a state university. No part of the booster club's net earnings inure to the benefit of any private shareholder or individual. The use tax does not apply to such a vehicle. For city tax purposes—for cities that have elected MCTC Local Option #HH—if the booster club is a federally-exempt 501(c)(3) nonprofit organization and the dealer otherwise complies with the requirements of MCTC § -660(y), then city use tax also would not apply to such a vehicle. For cities that impose a city use tax but have not elected MCTC Local Option #HH, city use tax would be levied under MCTC § -610(a) from the date the vehicle was removed from the dealer's inventory and imposed on 100 percent of the dealer's cost of the vehicle.

Robert Woods, Director

Signed: , 2022

Explanatory Notice

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