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## ARIZONA TRANSACTION PRIVILEGE TAX RULING TPR 20-2

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### **ISSUE:**

If the retail and personal property leasing or rental sourcing provisions contained in Arizona Revised Statutes (A.R.S.) § 42-5040 are inconsistent with sourcing provisions found in the Model City Tax Code (MCTC), which provisions should govern?<sup>1</sup>

### **APPLICABLE LAW:**

ARIZ. CONST. Art. XIII, § 2 provides that “[a]ny city containing, now or hereafter, a population of more than three thousand five hundred may frame a charter for its own government consistent with, and subject to, the Constitution and the laws of the state.”

A.R.S. § 42-6002(B) provides that “[t]he procedures for levy, collection and enforcement of payment of transaction privilege and affiliated excise taxes . . . levied by a city or town shall be in the same manner as authorized by chapter 5 of this title.” A.R.S. § 42-6002(A) further provides that, “[u]nless the context otherwise requires, chapter 1 and chapter 5, article 1 of this title govern the administration of the municipal privilege taxes levied by a city or town.”

*For retail sales of tangible personal property (TPP):*

A.R.S. § 42-5040(A) provides that, except as provided in A.R.S. § 42-5075, retail sales are sourced:

- To a seller’s business location if the seller receives an order at a business location in this state pursuant to A.R.S. § 42-5040(B); or
- To the purchaser’s location in this state if a seller receives an order at a business location outside this state or to the purchaser’s billing address if there is no delivery address (*i.e.*, no in-state purchaser’s location identified to the seller), except in the case of materials sold tax-exempt that are used toward maintenance, repair, replacement, or alteration (MRRRA) projects under A.R.S. § 42-5008.01.

MCTC § -465(b) exempts out-of-city sales from municipal retail privilege tax. MCTC § -100 defines an out-of-city sale as:

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<sup>1</sup> This document does not address nexus concerns. Sourcing necessarily presumes that the taxpayer has already sufficient nexus with Arizona for the imposition of TPT under the standard four-part *Complete Auto* test. See *South Dakota v. Wayfair, Inc.*, \_\_\_ U.S. \_\_\_, 138 S. Ct. 2080, 2091 (2018) (citing *Complete Auto Transit v. Brady*, 430 U.S. 274, 279 (1977)).

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the sale of tangible personal property and job printing if all of the following occur:

- (1) transference of title and possession occur without the [c]ity; and
- (2) the stock from which such personal property was taken was not within the corporate limits of the [c]ity; and
- (3) the order is received at a permanent business location of the seller located outside the [c]ity; which location is used for the substantial and regular conduct of such business sales activity. In no event shall the place of business of the buyer be determinative of the situs of the receipt of the order.

The definition further clarifies that “[f]or the purpose of this definition it does not matter that all other indicia of business occur within the [c]ity, including, but not limited to, accounting, invoicing, payments, centralized purchasing, and supply to out-of-[c]ity storehouses and out-of-[c]ity retail branch outlets from a primary storehouse within the [c]ity.”

MCTC § -100.1(e) provides that “[r]etail sales by brokers acting for another person shall be deemed to have occurred at the regular business location of the broker, in a manner similar to that used to determine ‘out-of-city sales’; provided, however, that an auctioneer is deemed to be engaged in business at the site of each auction.”

#### *For leases and rentals of TPP:*

A.R.S. § 42-5034(A)(11) provides that, to determine the location of a business in A.R.S. Title 42, Chapter 5, a taxpayer engaged in activities subject to tax under the personal property rental classification will be deemed to be engaged in business “at the location where the business therein enumerated [is] located or conducted.”

A.R.S. § 42-5040(C) provides that “[t]he gross receipts from leasing or renting tangible personal property shall be sourced . . . [t]o the lessor’s business location if the lessor has a business location in this state” or “[t]o the lessee’s address if the lessor does not have a business location in this state or, if there is no lessee’s address, to the lessee’s billing address.” The lessor’s gross receipts are taxable when such property is “shipped, delivered or otherwise brought into this state for use in this state.” A.R.S. § 42-5040(D)(1) provides that “lessee’s address” refers to the “residential address of an individual lessee” or the lessee’s “primary business address” otherwise. A.R.S. § 42-5040(D)(2) defines “lessor’s business location” as “the business address that appears on the lessor’s transaction privilege tax license.”

Arizona Administrative Code (A.A.C.) R15-5-1503(E) provides that leased or rented TPP will be exempt from tax “if the property is removed from the state and used exclusively outside of the state” on a non-intermittent basis. R15-5-1503(G) further specifies that “[f]or leasing or renting activity related to a motor vehicle, the Department shall examine whether the motor vehicle is licensed, registered, or primarily used in Arizona.”

MCTC § -450(a) levies a tax on TPP rented, leased, or licensed for use that is “semi-permanently or permanently installed within the [c]ity” as provided in regulation. MCTC Reg. -450.4(a) provides that an item will be considered “permanently or semi-permanently installed” in a city or town if it is to remain located in such city or town for greater than 180 consecutive days under a rental, lease, or license agreement.

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MCTC § -450(b) provides, “A lease transaction involving a motor vehicle for a minimum period of twenty-four (24) months shall be considered to have occurred at the location of the motor vehicle dealership, rather than the location of the place of business of the lessor, even if the lessor’s interest in the lease and its proceeds are sold, transferred, or otherwise assigned to the lease financing institution; provided further that the city or town where such motor vehicle dealership is located levies a privilege tax or an equivalent excise tax upon the transaction.”

#### **DISCUSSION:**

In 2012, Governor Brewer convened a TPT Simplification Task Force (Task Force) to review and simplify the state and local transaction privilege tax (TPT) system. A.R.S. § 42-5040 (formerly A.R.S. § 42-5039) was introduced to implement the Task Force’s recommendations for the unified sourcing of state and local taxes for retail sales and leases and rentals of TPP “for both state and local taxes.”<sup>2</sup>

This goal was echoed in the final legislative fact sheet produced for H.B. 2111, the original TPT simplification bill passed in 2013, which summarized the recommendation by stating, “The Arizona State Legislature should act to ensure Arizona is well-positioned to benefit from the taxation of online retail and remote sales by passing legislation clarifying that taxable transactions are sourced at the destination for both state and local taxes.”<sup>3</sup> The fact sheet then described the applicable provision as “modif[ying] provisions regarding sourcing of certain transactions involving tangible personal property.”<sup>4</sup>

Nevertheless, for various categories of retail sales, leases, or rentals, specific preexisting provisions contained in the MCTC conflict with A.R.S. § 42-5040’s sourcing provisions.<sup>5</sup>

1. *Although sourcing provisions are likely administrative in nature, no context exists to warrant variance from A.R.S. § 42-5040.*

For city privilege taxes, there is a clear demarcation line drawn in statute between matters of levy, collection, and enforcement, on the one hand, and administrative matters on the other:

For the former category comprising levy, collection, and enforcement, A.R.S. § 42-6002(B) would require that the procedures found in A.R.S. Title 42, Chapter 5 supersede any contradictory or varying provisions found elsewhere, including the MCTC.

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<sup>2</sup> See Transaction Privilege Tax Simplification Task Force, Final Report 21 (Dec. 13, 2012), available at [http://www.arizonatax.org/sites/default/files/publications/position\\_papers/tpt\\_report.pdf](http://www.arizonatax.org/sites/default/files/publications/position_papers/tpt_report.pdf) (“Through the Task Force process, ADOR and the League have been drafting legislative language that would be the basis for such legislation.”).

<sup>3</sup> See H. Summ. (as Transmitted to Governor) (June 13, 2013), available at <https://apps.azleg.gov/BillStatus/GetDocumentPdf/222021>.

<sup>4</sup> *Id.*

<sup>5</sup> As of the date of this ruling’s issuance, examples include: retail sales made by an out-of-city or out-of-state seller; retail sales made by a broker (MCTC Reg. -100.1(e)); “semi-permanent or permanently installed” property leased, rented, or licensed for use that remains for 180 days or more in one location (MCTC § -450(a)); and motor vehicle leases that are either permanently removed from the state for use exclusively outside the state or that have lease terms of 24 months or more (MCTC § -450(b)).

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- For the administration of city privilege taxes, however, A.R.S. § 42-6002(A) provides that Chapters 1 and 5 govern “[u]nless the context otherwise requires.”

For administrative provisions, then, the statute requires that one review the MCTC’s provisions and, if necessary and *based on the context*, follow the MCTC’s guidance over that found in chapters 1 and 5 of A.R.S. Title 42 to arrive at the proper result. Looking to the plain meanings of the undefined terms used, provisions considered to be “administrative” could be characterized as those that are ministerial in nature, insofar as they “relat[e] to the running of a business, organization, etc.”<sup>6</sup> On the other hand:

- A “levy” procedure is one which “impose[s] (a tax, fee, or fine)”;
- A “collection” procedure deals with “the action or process of collecting someone or something”; and
- An “enforcement” procedure is one “compelling observance of or compliance with a law, rule, or obligation.”<sup>7</sup>

The sourcing provisions found in A.R.S. § 42-5040 allow the taxing authority to designate a situs or location from which the appropriate taxing provisions and tax rates can be assigned for municipal taxing purposes. In other words, they are used by the department to *administer* the city tax. They are not to govern the scope of the tax’s levy or imposition, dictate the method of or timing for collection, or to enforce reporting or payment obligations.<sup>8</sup>

Upon concluding that the sourcing provisions are administrative in nature, the next step is determining whether the context dictates that they supersede conflicting sourcing provisions found in the MCTC or other local laws. No such context can be found: the MCTC provisions merely address subsets that fall within the general categories of taxable transactions covered by A.R.S. § 42-5040. That is, they deal with discrete types of retail sales, leases, and rentals that A.R.S. § 42-5040 already encompasses.

There are instances, however, in which the context of administrative provisions *does* warrant looking beyond A.R.S. Title 42, Chapters 1 and 5: that is when there is a need to address taxes on specific subjects of taxation—be they business activities or forms of property—that are not addressed by state statute. These include, for example, municipal speculative builder tax<sup>9</sup> and city taxes on advertising,<sup>10</sup> timbering,<sup>11</sup> and wastewater removal services.<sup>12</sup>

2. *To the extent that the MCTC is inconsistent with A.R.S. § 42-5040, the state’s sourcing provisions will prevail because they involve a matter of statewide concern not solely limited to any one city or town.*

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<sup>6</sup> See “Administrative,” OXFORD DICTIONARY OF ENGLISH (3d ed. 2010).

<sup>7</sup> See “Levy,” “Collection,” “Enforcement,” *id.*

<sup>8</sup> Indeed, even the heading of A.R.S. Title 42, Chapter 5, Article 1, in which A.R.S. § 42-5040 is found, is titled “General *Administrative* Provisions” (emphasis added).

<sup>9</sup> MCTC § -416.

<sup>10</sup> MCTC § -405.

<sup>11</sup> MCTC § -430.

<sup>12</sup> MCTC § -485.

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Pursuant to Article XIII, § 2 of the Arizona Constitution, Arizona’s “charter” or “home rule” cities may derive power from ordinances contained in their own city charters separate and apart from those powers conferred by the state legislature on matters confined to purely municipal affairs.<sup>13</sup> A charter serves as “effectively, a local constitution.”<sup>14</sup> If a city or town lacks a charter, it operates under the general laws of the state.<sup>15</sup>

However, regardless of the source of a city’s authority,

where the legislature has enacted specific statutes addressing a subject of statewide concern, those statutes are binding upon municipalities. While the latter may enact ordinances which provide stringent requirements, they may not enact provisions which conflict with such statutes.<sup>16</sup>

In fact, the Arizona Supreme Court has recently held that “a generally applicable state statute on [a] subject controls over a conflicting municipal ordinance.”<sup>17</sup> This result is true, even when a home rule city has adopted ordinances pursuant to its charter powers:

Where the legislature has enacted a law affecting municipal affairs, but which is also of state concern, the law takes precedence over any municipal action taken under the home rule charter. But where the legislative act deals with a strictly local municipal concern, it can have no application to a city which has adopted a home rule charter. Whether or not an act of the legislature pertains to a matter of local or statewide concern becomes a question for the courts when a conflict of authority arises.<sup>18</sup>

The language of A.R.S. § 42-5040 speaks broadly to sourcing “retail sales of tangible personal property” and “gross receipts from leasing or renting tangible personal property.” A.R.S. § 42-5040(A), (C). There is no language in the statute to qualify or restrict the application of these provisions.

Choosing the correct sourcing methodology for a transaction involves determinations that implicate more than one city. For example, assuming that a business’s address used on its TPT license differs from the business location that originates a lease, multiple jurisdictions are implicated in determining where to source the lease for TPT purposes. By its nature, it is more than a “strictly local municipal concern” because it impacts political subdivisions that fall outside the political boundaries of any one municipality. This is true by the very nature of sourcing, as it involves a determination of which local jurisdictions’ laws or ordinances apply in lieu of the laws and ordinances of others.

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<sup>13</sup> *Strode v. Sullivan*, 72 Ariz. 360, 364 (1951).

<sup>14</sup> *City of Tucson v. State*, 229 Ariz. 172, 178 (2012).

<sup>15</sup> See ARIZ. CONST. art. XIII, § 5; A.R.S. § 9-101 *et seq.*

<sup>16</sup> *City of Tucson v. Fleischman*, 152 Ariz. 269, 272 (App. 1986).

<sup>17</sup> *State ex rel. Brnovich v. City of Tucson*, 242 Ariz. 588, 591 (2017).

<sup>18</sup> *City of Tucson v. Walker*, 60 Ariz. 232, 239 (1943).

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Unlike state TPT, municipalities explicitly tax licensing for use of TPP.<sup>19</sup> Nevertheless, what cities and towns consider licenses for use *may* fall within the scope of leasing and rental activity subject to state TPT, which is governed by both statute and case law.<sup>20</sup>

#### **RULING:**

A.R.S. § 42-5040 reflects general administrative laws on sourcing retail sales, leases, and rentals of TPP. Consequently, the state provisions found in A.R.S. § 42-5040 are binding upon municipalities. They supersede inconsistent city provisions, regardless of the source of power (*i.e.*, charter power or state law) upon which a city or town relied when it adopted such inconsistent provisions.

As the state supreme court has explained, when interpreting taxation statutes, the objective “is to effectuate the legislature’s intent. The best indicator of that intent is the statute’s plain language, which we read in context with other statutes relating to the same subject or having the same general purpose.”<sup>21</sup> Whenever possible, provisions from multiple statutes should be read in harmony to “avoid interpretations that result in contradictory provisions.”<sup>22</sup>

Regarding any potential inconsistency in the application of A.R.S. § 42-5040 to sourcing for city privilege tax purposes, no municipality will apply the provisions contained in this Ruling to assess or penalize a taxpayer for complying with then-existing MCTC sourcing provisions to retail sale, lease, or rental transactions in any tax period falling before the issuance of this Ruling.

#### *Sourcing Retail Sales of TPP:*

When sourcing retail sales transactions subject to state and local privilege taxes, a retailer is deemed to have received all of the necessary information to accept a purchaser’s order at the location where the retailer receives all such information.<sup>23</sup> A retailer’s brick-and-mortar storefront in Arizona is deemed to be the business location for sourcing purposes if the retailer receives all the requisite order information at that location without considering additional locations at which activities distinct from order acceptance (*e.g.*, payment processing, order fulfillment) occur.

Except for the category of TPP referenced below, a retail sale is sourced for state, county, and municipal privilege tax purposes according to the following priority:

1. The seller’s Arizona business location, if the seller receives all of the information necessary to accept the order by or on behalf of the seller at that location; or

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<sup>19</sup> MCTC § -450.

<sup>20</sup> See A.R.S. § 42-5071; *State Tax Comm’n v. Peck*, 106 Ariz. 394 (1970) (en banc); *City of Phoenix v. Bentley-Dille Gradall Rentals, Inc.*, 136 Ariz. 289 (App. 1983); *Energy Squared, Inc. v. Ariz. Dep’t of Revenue*, 203 Ariz. 507 (App. 2002); *Jones Outdoor Advertising, Inc. v. Ariz. Dep’t of Revenue*, 238 Ariz. 1 (App. 2015).

<sup>21</sup> *SolarCity Corp. v. Ariz. Dep’t of Revenue*, 243 Ariz. 477, 480 (2018) (internal citations omitted).

<sup>22</sup> *Premier Physicians Grp., PLLC v. Navarro*, 240 Ariz. 193, 195 (2016).

<sup>23</sup> The elements necessary for a seller to accept an order may depend on the particular types of sales transactions at issue. See, *e.g.*, *Restatement (Second) of Contracts* § 24 (1981) (“An offer is the manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to that bargain is invited and will conclude it.”).

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2. The Arizona purchaser's delivery address as specified in the order, if the seller receives the order at a location outside this state; or
3. The purchaser's Arizona billing address, if the seller lacks the purchaser's delivery address.

If the purchaser at one location provides order information that the seller receives at a *different* location, the location where the seller receives such information is considered the business location for sourcing purposes. This principle applies, regardless of whether the purchaser uses a means furnished by the seller (*e.g.*, in-store kiosk or terminal) to place the order.

There is a statutory exception provided for sales of materials originally sold tax-exempt that are subsequently used toward MRRRA projects. Amounts remitted for these materials are sourced to the project location, pursuant to A.R.S. § 42-5008.01.<sup>24</sup>

#### *Sourcing Leases and Rentals of TPP:*

As with all TPT license holders, Arizona lessors are obliged to specify and update each and every business location on their licenses.<sup>25</sup> The location to which leases and rentals are sourced is determined by the *proper* location specified on the lessor's TPT license: that is, the business location at which the leasing or rental activity at issue is conducted.<sup>26</sup> By statute, rentals and leases of TPP are sourced for state, county, and municipal privilege tax purposes in the following order:

- The address of the lessor's Arizona business location according to the methodology below; or
- The lessee's Arizona address, if the lessor has this information; or
- The lessee's Arizona billing address.

Determining whether one or multiple Arizona business locations exists for the lessor and how lease and rental transactions should be sourced are according to the following priority:

1. If the lessor has *one* business location in Arizona, then all taxable leases and rentals are sourced to this location.<sup>27</sup>
2. If the lessor has *multiple* business locations in Arizona (including circumstances in which the lessor is unable to identify a single business location in the state), the lessor should source a taxable lease or rental to the location where it conducts the leasing or rental activity.<sup>28</sup> If the lessee did not enter the lease or rental at any of the lessor's business locations in Arizona, however, the lease or rental is sourced to the lessee's Arizona address or billing address, pursuant to part (2) or (3) of the prioritization described above.<sup>29</sup>

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<sup>24</sup> Note that in Arizona, sales of manufactured buildings are not considered retail sales of TPP for state, county, and city purposes and fall outside the scope of this ruling.

<sup>25</sup> A.R.S. § 42-5005(H)-(J); A.A.C. R15-5-2204.

<sup>26</sup> See A.R.S. §§ 42-5034(A)(11), 42-5040(D)(2).

<sup>27</sup> See A.R.S. § 42-5040(C)(1).

<sup>28</sup> See A.R.S. § 42-5034(A)(11).

<sup>29</sup> A.R.S. § 42-5040(C)(2).

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3. If the lessor has *no* Arizona business locations, then a taxable lease or rental is sourced to the lessee's address or billing address, pursuant to part (2) or (3) of the prioritization described above.<sup>30</sup>

A rental or lease of TPP—including motor vehicles—that is initially sourced to an Arizona location will cease to be sourced to Arizona from the time it is permanently removed from the state for use exclusively outside the state. Similarly, a rental or lease of TPP will be sourced to an Arizona address upon its relocation to Arizona for use within the state.

Regarding subjects of taxation outside the scope of state statute, local sourcing provisions may continue to vary from those found in A.R.S. § 42-5040. In such cases, taxpayers should rely on the provision found within the applicable municipality's adoption of MCTC.

*Grant Nulle*

Grant Nulle (Oct 6, 2020 11:07 PDT)

Signed: Grant Nulle, Deputy Director

Date: Oct 6, 2020

#### 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.

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<sup>30</sup> *Id.*