

## PRIVATE TAXPAYER RULING LR00-001

February 7, 2000

The following private taxpayer ruling is in response to your letter of November 10, 1999. Your letter requests a determination regarding sales of inkpads which will be used to stamp size information onto manufactured garments.

Following is a restatement of the facts presented in your letter. After the facts portion of this letter, your position will be presented. Next, applicable statutes are given followed by a discussion. Finally, a conclusion is reached.

### FACTS

The following facts were stated in your letter:

[Taxpayer] is a manufacturer of disposable medical garments including hospital gowns. Since 1996, [Taxpayer] has purchased inkpads from an office supply company located in Arizona for use in the manufacturing process. The ink on the inkpads is transferred via a hand stamp to a tag on the hospital gown. The inked tag is used to identify the size of the hospital gown.

In a telephone conversation, you indicated that the [Taxpayer's] manufacturing facility is located in Arizona.

### YOUR POSITION

Citing Arizona Revised Statute (A.R.S.) § 42-5159(A)(4), [Taxpayer] ("Manufacturer") argues "[t]here is a use tax exemption for tangible personal property that directly enters into and becomes an ingredient or component part of any manufactured, fabricated, or processed article, substance, or commodity for sale in the regular course of business." Additionally, the Manufacturer references two rules from the Arizona Administrative Code (A.A.C.) which state "sales of articles to be incorporated into a fabricated or manufactured product are considered to be sales for resale and are therefore exempt." A.A.C. R15-5-122 and A.A.C. 15-5-2321. The Manufacturer's argument concludes, "[t]he exemption applies to the purchase of the inkpads because the ink becomes a part of the finished product."

### APPLICABLE STATUTORY PROVISIONS

#### Retail Sales within Arizona

According to A.R.S. § 42-5061, *Retail classification*, the transaction privilege tax is imposed on 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. All retail sales are subject to tax unless specifically exempted by statute.

"Selling at retail" is defined as "a sale for any purpose other than for resale in the regular course of business...." A.R.S. § 42-5061(U)(3).

"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." A.A.C. R15-5-101(A), *Sales for Resale or Lease*.

A.A.C. R15-5-122, *Articles Incorporated into a Manufactured Product* states:

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.

"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." A.A.C. R15-5-123, *Sale of Tools and Supplies to Businesses*.

## Use Tax

A.R.S. § 42-5155, *Levy of tax; tax rate; purchaser's liability*, imposes a use tax on the storage, use or consumption of tangible personal property. The use tax is calculated as a percentage of the sales price. Every person storing, using or consuming in Arizona tangible personal property purchased from a retailer is liable for the tax. Additionally, the use tax applies to a purchaser who initially purchased an item for resale but subsequently uses or consumes the property. One's liability for the use tax is not extinguished until the tax has been paid to the state. However, the purchaser is relieved from liability for the use tax if the purchaser can produce a receipt from either (1) a retailer who maintains a place of business within Arizona; or (2) a retailer who is authorized by the Arizona Department of Revenue to collect the use tax.

A.R.S. § 42-5159, *Exemptions*, provides a list of items exempt from the use tax. Paragraph (A) (4) indicates that the use tax

does not apply to the storage, use or consumption in this state of the following

described tangible personal property:

....

[T]angible personal property which directly enters into and becomes an ingredient or component part of any manufactured, fabricated or processed article, substance or commodity for sale in the regular course of business.

A.A.C. R15-5-2321, *Exemptions -- Articles to be Incorporated into a Manufactured Product* states: "Purchases of articles which become an integral part of a manufactured product are not subject to the Use Tax. They are considered purchases for resale."

## DISCUSSION

Arizona imposes a transaction privilege tax which differs from the sales tax imposed by most states. The Arizona transaction privilege tax is imposed on the privilege of conducting business in the State of Arizona. A.R.S. § 42-5008. This tax is levied on the **vendor** (seller), not the purchaser. The vendor may pass the burden of the tax on to the purchaser. A.A.C. R15-5-2210 (A). However, the vendor is the taxpayer and is ultimately liable to Arizona for the tax. A.A.C. R15-5-2002.

The transaction privilege tax is imposed on sales made by vendors located within Arizona, while the use tax is levied on purchases from out-of-state vendors. A.R.S. § 42-5151; A.A.C. R15-5-2306(A). Purchases made from vendors not maintaining a place of business in Arizona by customers in Arizona are subject to the use tax. A.R.S. § 42-5151; A.A.C. R15-5-2308.

Sales of articles that will be incorporated into a manufactured product are exempt from tax. A.R.S. § 42-5159(A)(4); A.A.C. R15-5-122(A); A.A.C. R15-5-2321. Such sales are considered to be sales for resale. A.A.C. R15-5-122(A); A.A.C. R15-5-2321. However, please note, for the exemption to apply, the materials must actually become a part of the finished product. A.A.C. R15-5-122(B). Supplies consumed in the manufacturing process do not qualify for the exemption. *Id.* Additionally, sales of tools and supplies to be used in the operation of a business are subject to tax. A.A.C. R15-5-123.

The Manufacturer purchases ink to hand-stamp size information on the hospital gowns it manufactures. When purchased, the ink has saturated and is contained in an inkpad. The typical inkpad is enclosed in a metal or plastic container. Presumably, the ink cannot be purchased without the inkpad and the inkpad's container. Therefore, for purposes of this Private Taxpayer Ruling, the inkpad and the inkpad's container will be viewed as the container of the ink. The terms "ink" and "inkpad" will be used interchangeably throughout this Private

## Taxpayer Ruling.

A hand-held stamp is used to transfer the ink from the inkpad onto the gown label. The hand-held stamp is a tool used in the operation of the Manufacturer's business. A.A.C. R15-5-123. The ink, however, once transferred onto the gown label, is incorporated into the gown, a manufactured product. A.R.S. § 42-5159(A)(4); A.A.C. R15-5-122.

If the Manufacturer, an Arizona-based company, purchases inkpads from vendors within Arizona, the statutes and rules governing the transaction privilege tax apply. However, if the Manufacturer purchases inkpads from vendors located outside Arizona, the statutes and rules governing the use tax apply. Sales of inkpads that will be used to stamp size information on gown labels will be considered to be sales for resale. Id. Sales of tangible personal property for resale are not subject to transaction privilege tax. A.R.S. § 42-5061; A.A.C. R15-5-101; A.A.C. R15-5-122. Sales of tangible personal property which becomes an integral part of a manufactured product or which directly enters into and becomes an ingredient of a manufactured article are not subject to the use tax. A.R.S. § 42-5159(A)(4); A.A.C. R15-5-2321.

## CONCLUSION AND RULING

On the basis of the information provided, we rule that the sale or purchase of inkpads used by [Taxpayer] in the stamping of sizes on gown labels are not subject to transaction privilege or use taxes.

The conclusions in this private taxpayer ruling do not extend beyond the facts as presented in the request for a private taxpayer ruling dated November 10, 1999.

This response is a private taxpayer ruling and the determinations herein are based solely on the facts provided in your request. The determinations in this taxpayer ruling are the present position of the department. The determinations are subject to change should the facts prove to be different on audit. If it is determined that undisclosed facts were substantial or material to the department's making of an accurate determination, this taxpayer ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law or notification of a different department position.