

ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 95-13

(Supersedes and Rescinds G 91-8)

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

ISSUE:

Taxation of drop shipments/third-party sales.

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 42-1310.01 levies the transaction privilege tax on the business of selling tangible personal property at retail.

A.R.S. § 42-1310.01.A.14 provides an exemption for:

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.

A.R.S. § 42-1310.01.A.24 provides an exemption for:

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.

A.R.S. § 42-1310.01.A.37 provides an exemption for:

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

A.R.S. § 42-1310.01.P.3 defines "selling at retail" as a sale for any purpose other than for resale in the regular course of business.

A.R.S. § 42-1316 outlines the requirements for exemption certificates.

A.R.S. § 42-1328 outlines the requirements to document a sale for resale.

A.R.S. § 42-1407 requires every retailer, before selling any tangible personal property for storage, use or consumption within Arizona to register with the Department of Revenue.

A.R.S. § 42-1408 levies the Arizona use tax upon the purchaser of tangible personal property purchased from an out-of-state vendor and brought into Arizona for use, storage or consumption.

Arizona Administrative Code (A.A.C.) rule R15-5-170 discusses interstate and foreign transactions.

A.A.C. R15-5-175 discusses sales to nonresidents temporarily within the state. A.A.C. R15-5-175.A specifically provides that:

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.

A.A.C. R15-5-2214 discusses the procedure for establishing the right to a deduction by use of a certificate or other documentation.

DISCUSSION:

A drop shipment is a shipment of tangible personal property from a seller directly to the purchaser's customer, at the direction of the purchaser. These sales are also known as third-party sales.

Example:

Clark, a manufacturer, sells property to Bravo. Bravo sells the goods to Able. Clark ships the goods directly to Able. (For the purposes of this ruling, Clark is considered the **primary seller**, Bravo is considered the **secondary seller**, and Able is the **final purchaser**.)

A third-party drop shipment is an arm's length transaction. If the seller bills the "purchaser's" customer directly, there are only two parties to the sale, and as such this transaction would

generally not be considered a third-party drop shipment. The transaction privilege and use tax implications of such a transaction hinge upon the Arizona tax nexus of the secondary seller and the location of the final purchaser. (Regardless of Arizona tax nexus, the primary seller will always be exempt from the transaction privilege tax or use tax collection if the secondary seller provides a valid "resale" certificate. The resale of the tangible personal property by the secondary seller is integral to third-party sales transactions.) The drop shipment must be examined as two separate transactions: (1) the sale from the seller to the purchaser; and, (2) the sale from the purchaser to the purchaser's customer.

The transaction privilege tax is imposed on the business of selling tangible personal property at retail. If a company does not have nexus for Arizona transaction privilege tax purposes, Arizona use tax may apply. Arizona's use tax is imposed on the storage, use or consumption within Arizona on purchases from a retailer.

An out-of-state retailer making sales of tangible personal property to Arizona purchasers is required to register with the department to collect and remit Arizona use tax. If the retailer is not registered to collect the use tax, the retailer's customer must report and remit the use tax to the Department of Revenue on Form TPT-1; or, if not licensed, under cover letter.

Arizona statutes provide numerous exemptions which the taxpayer should examine to determine if a transaction is exempt from transaction privilege or use tax. The four most relevant exemptions from transaction privilege and/or use tax for drop shipments are as follows:

- (1) sales for resale;
- (2) sales in interstate commerce;
- (3) sales to nonresidents; and,
- (4) sales in foreign commerce.

Sales for Resale

A.R.S. § 42-1310.01.P.3. provides that selling at retail is a sale for any purpose other than for resale in the regular course of business. The burden of proving that a sale was not a sale at retail (a sale for resale) is on the seller unless the seller receives from the purchaser a certificate as described by A.R.S. § 42-1328. The certificate must contain the following information:

- The name and address of the purchaser.
- A statement that the property was purchased for resale in the ordinary course of

business.

- The transaction privilege tax license number of the purchaser. If the purchaser has a tax license number from a state other than Arizona, that license number may be used on the certificate.
- Certification that the person executing the certificate is authorized to do so on behalf of the purchaser.

Other states' exemption certificates may be used provided all the requirements of A.R.S. § 42-1328 are met. If the purchaser does not have a transaction privilege tax license number, the purchaser shall indicate the reason on the certificate.

Sales in Interstate Commerce

A.R.S. §§ 42-1310.01.A.24 and 42-1409.A.3 provide that transaction privilege and use tax, respectively, do not apply to sales in interstate or foreign commerce if prohibited from being taxed by the Constitution of the United States or the constitution of this state. A.A.C. R15-5-170, addressing sales made in interstate and foreign commerce, requires that the following conditions must be met for interstate sales to be exempt:

1. The order must be received from a customer outside of Arizona; and
2. The merchandise must be shipped or delivered to the customer outside of Arizona for use outside of Arizona.

This rule also specifies the records necessary to substantiate the exemption.

Sales to Nonresidents

A.R.S. § 42-1310.01.A.14 provides an exemption for sales to nonresidents of this state. A nonresident's purchase of tangible personal property is exempt if the property is for use outside Arizona **and** the vendor ships or delivers the property out of this state. For purposes of this exemption, a nonresident is an individual who is not a resident for Arizona income tax purposes or an entity which has no business location or business nexus in Arizona.

A.A.C. R15-5-175 delineates the documentation necessary to substantiate an exempt sale to a nonresident. The vendor must obtain from the purchaser either an exemption certificate **or** a written statement that the purchaser is not a resident of Arizona and that the property will be used outside of Arizona.

Sales in Foreign Commerce

A.R.S. § 42-1310.01.A.37 provides an exemption for sales of tangible personal property shipped or delivered directly to a destination outside the United States for use in that foreign country. Unlike the exemption for sales in interstate or foreign commerce, there is no requirement that the purchaser be a nonresident or that the order must be received from outside of Arizona. However, the property must be shipped or delivered by the vendor to a destination outside of the United States.

Establishing an Exemption

A.R.S. § 42-1316.A outlines the requirements to establish these and other exemptions from the transaction privilege tax. The invoice must be marked to indicate that the gross proceeds of sales or gross income derived from the transaction were deducted from the tax base. The vendor must also obtain a certificate executed by the purchaser indicating the name and address of the purchaser; the precise nature of the business of the purchaser; the purpose for which the purchase was made; the necessary facts to establish the appropriate deduction; the tax license number of the purchaser to the extent the deduction depends on the purchaser conducting business under the transaction privilege tax statutes; and, a certification that the person executing the certificate is authorized to do so on behalf of the purchaser. A.R.S. § 42-1316.C authorizes the department to prescribe a certificate which can be used to establish exempt transactions. *ADOR Form 5000* has been adopted by the Department of Revenue for this purpose.

If a vendor accepts the certificate adopted by the department and it is completed pursuant to the statutory requirements, the vendor will be relieved of liability and the department may require the purchaser to establish the accuracy and completeness of the claimed exemption. A vendor may accept a certificate other than that adopted by the department as long as the certificate contains the delineated information. However, if a vendor accepts a certificate other than the one issued by the department, the burden of proof remains with the vendor as to the validity of the claimed exemption.

The department's *ADOR Form 5000* meets the requirements of both A.R.S. §§ 42-1316 and 42-1328. Additionally, A.A.C. R15-5-2214 and *Transaction Privilege Tax Procedure TPP 92-1* discuss the requirements for documenting exempt sales. As noted above for sales to nonresidents, a **statement** from the purchaser may satisfy the requirements of the rule.

RULING:

Any of the three parties involved in a third-party drop shipment or third-party sale may be subject to transaction privilege or use tax. However, the primary seller will always be exempt from Arizona taxes, either the transaction privilege tax or use tax collection requirements, as long as the secondary seller provides a valid resale certificate. The taxability of the subsequent

sale by the secondary seller is determined by the Arizona tax nexus of the secondary seller and by the location of the final purchaser.

The following examples serve as a general guide to be used in determining the transaction privilege and use tax implications of a third-party drop shipment transaction. However, the law as it applies to the specific facts will determine the actual tax implications of any transaction.

Example One: Out-of-state primary seller

Out-of-state secondary seller

Property drop shipped to Arizona final purchaser

The Arizona transaction privilege tax and use tax statutes do not impose tax collection requirements on an out-of-state seller which drop ships tangible personal property into Arizona at the request of an out-of-state purchaser who resells the property to an Arizona customer. The shipment of goods into Arizona by the primary seller will not cause the primary seller to be liable for any tax which may be due on a transaction between a secondary seller and the final purchaser.

Therefore, the primary seller is not required to obtain an exemption certificate from the purchaser or the purchaser's customer. Although the seller is not required to obtain an Arizona exemption certificate, the department suggests that the seller obtain an exemption certificate from the purchaser to document an exempt sale for resale. The requirements to document an exempt sale for resale are outlined above.

The sale from the secondary seller to the Arizona final purchaser is subject to taxation. Unless the secondary seller has nexus for transaction privilege tax purposes, the purchase is subject to Arizona use tax. As discussed above, the secondary seller must collect and remit the use tax to the department. If the secondary seller does not charge and collect the use tax from the Arizona final purchaser, the final purchaser is liable to remit the use tax directly to the department unless otherwise exempt.

Example Two: Out-of-state primary seller

Arizona secondary seller

Property drop shipped to Arizona final purchaser

The sale from the primary seller to the secondary seller is not a sale at retail because the sale is for resale. The primary seller should obtain an exemption certificate from the secondary seller to document an exempt sale for resale. The requirements to document an exempt sale

for resale are outlined above.

The secondary seller's sale to a customer located in Arizona is subject to transaction privilege tax unless a statutory exemption applies to the transaction.

Example Three: Out-of-state primary seller OR Arizona primary seller

Arizona secondary seller

Property drop shipped to out-of-state final purchaser

The sale from the primary seller to the secondary seller is not a sale at retail because the sale is for resale. The primary seller should obtain an exemption certificate from the secondary seller to document an exempt sale for resale. The requirements to document an exempt sale for resale are outlined above.

The sale from the Arizona secondary seller to the out-of-state final purchaser is subject to transaction privilege tax unless the sale is statutorily exempt. The sale may be an exempt sale in interstate commerce, an exempt sale to a nonresident, or an exempt sale in foreign commerce. If the sale is exempt, the purchaser should obtain a certificate or statement which documents the applicable statutory requirements as discussed above. If these qualifications are not met, the gross proceeds of the sale are taxable under the retail classification.

Example Four: Arizona primary seller

Out-of-state secondary seller

Property drop shipped to Arizona final purchaser

The sale from the primary seller to the secondary seller is not a sale at retail because the sale is for resale. The primary seller should obtain an exemption certificate from the secondary seller to document an exempt sale for resale. The requirements to document an exempt sale for resale are outlined above.

The sale from the out-of-state secondary seller to the Arizona final purchaser is subject to taxation. Unless the out-of-state secondary seller has nexus for transaction privilege tax purposes, the purchase is subject to Arizona use tax. As discussed above, the purchaser or the purchaser's customer must collect and/or remit the use tax to the department.

Example Five: Arizona primary seller

Out-of-state secondary seller

Property drop shipped to out-of-state final purchaser

The sale from the primary seller to the secondary seller is not a sale at retail because the sale is for resale. The primary seller should obtain an exemption certificate from the secondary seller to document an exempt sale for resale. The requirements to document an exempt sale for resale are outlined above.

The transaction between the out-of-state secondary seller and the out-of-state final purchaser does not have Arizona transaction privilege or use tax consequences for either party.

Harold Scott, Director
Signed August 3, 1995

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 which are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement which 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 92-1 for more detailed information regarding documents issued by the Department of Revenue.