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## PRIVATE TAXPAYER RULING LR08-004

June 24, 2008

This private taxpayer ruling is in response to your April 25, 2007 letter requesting a private taxpayer ruling, as updated on August 6, 2007, in which you request the Arizona Department of Revenue ("Department"), to rule on behalf of your client, . . . ("Taxpayer"), on the application of Arizona transaction privilege tax to the Taxpayer's clean up and remediation activities of fire and smoke damage, water damage, and mold, in addition to the residential and commercial cleaning activities.

Pursuant to Arizona Revised Statutes (A.R.S.) § 42-2101, the Department may issue private taxpayer rulings to taxpayers and potential taxpayers on request.

### **Statement of Facts**

Your April 25, 2007 request for a private taxpayer ruling, as supplemented by the August 6, 2007 correspondence, provides in part the following information:

Fire and Smoke Clean Up. [Taxpayer] provides residential and commercial cleaning and deodorization services for buildings that have suffered a fire or smoke loss. This involves physically cleaning the soot from both the structure and its contents. The deodorization process is either by ozone treatment, which involves setting up an ozone generating machine and running for 12 - 30 hours, or by fogging an odor neutralizing treatment into the building. If any contents need to be packed out to another location for cleaning, [Taxpayer] typically performs this work. In some cases, specialized cleaning may be necessary, (e.g., electronics, artwork, musical instruments), and these cleaning services are usually contracted by [Taxpayer's] customer. [Taxpayer] will also subcontract duct cleaning and dry cleaning for their customers when necessary. [Taxpayer] only directly provides cleaning and deodorizing services for fire and soot clean up jobs. Ancillary moving services are provided as needed at their customer's request.

Water Damage Clean Up. [Taxpayer] provides residential and commercial cleaning and drying services for buildings that have suffered water damage due to a pipe break, roof leak, toilet overflow, or other sources of water entering the structure from outside. This involves extracting all standing water with vacuums, and setting up drying equipment such as fans and

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dehydrators. In some cases, [Taxpayer] will remove building materials to facilitate drying. Materials typically removed are carpet, carpet padding, carpet tack strips, baseboards and molding, wet drywall and insulation, cabinet toe kicks and cabinetry. [Taxpayer] does not repair or reinstall any of these materials.

Mold Clean Up. [Taxpayer] provides residential and commercial cleaning services for buildings that have developed mold as a result of water damage not remediated in a timely manner. This involves setting up a temporary plastic containment barrier so that the removal and clean up of the mold does not spread it to other areas within the structure. Air scrubbing machines and filtered vacuums are also used in the removal/containment of the mold. In some cases, [Taxpayer] will remove any and all porous building materials to get rid of the mold. Materials typically removed are carpet, carpet padding, carpet tack strips, baseboards and molding, drywall and insulation, cabinet toe kicks, cabinetry, and countertops. [Taxpayer] does not repair or reinstall any of these materials.

Standard Cleaning Services. [Taxpayer] . . . provides standard residential and commercial cleaning services. This involves carpet cleaning, tile and grout cleaning and upholstery cleaning. [Taxpayer] will subcontract duct cleaning for their customers when necessary.

### Issue

Is Taxpayer subject to transaction privilege tax under the prime contracting classification?

### Your Position

Taxpayer advocates the conclusion that its primary business activities are not subject to transaction privilege tax under the prime contracting classification.

### Discussion

Arizona's transaction privilege tax differs from the sales tax imposed by most states. Arizona transaction privilege tax is a tax imposed on the privilege of conducting business in the State of Arizona. This tax is levied on the vendor, not the purchaser. The vendor may pass the burden of the tax on to the purchaser. However, the vendor is ultimately liable to Arizona for the tax. The Arizona transaction privilege tax is imposed under 16 separate business classifications, including for example, the *prime contracting classification*, the *transporting classification* and the *retail classification*.

Some service businesses are not subject to Arizona transaction privilege tax. Under the retail classification, Arizona Revised Statutes provides that the gross proceeds of sales or

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the gross income from professional or personal service occupations or businesses that involve sales or transfers of tangible personal property only as inconsequential elements are not subject to transaction privilege tax. A.R.S. § 42-5061(A)(1).

Arizona Administrative Code (A.A.C.) R15-5-105 provides that “[a] charge in connection with a retail sale is taxable unless the charge for service is shown separately on the sales invoice and records.”

Examples of nontaxable services include carpet cleaning, waxing and polishing, duct cleaning, lawn mowing and garden maintenance. A.A.C. R15-5-614(3).

The business of altering or improving any real property, structure, project, development or improvement is subject to Arizona transaction privilege tax under the prime contracting classification. A.R.S. § 42-5075(A).

A.R.S. § 42-5075(N)(8) defines a “prime contractor” as “a contractor who supervises, performs or coordinates the modification of any building, highway, road, railroad, excavation, manufactured building or other structure, project, development or improvement including the contracting, if any, with any subcontractors or specialty contractors and who is responsible for the completion of the contract.”

A.R.S. § 42-5075(N)(5) defines “modification” as “construction, alteration, repair, addition, subtraction, improvement, movement, wreckage or demolition.”

A.A.C. R15-5-613(A) provides that the sale and installation of all floor covering which is affixed to real property is subject to transaction privilege tax under the prime contracting classification.

A.R.S. § 42-5062(A)(1) provides that the transporting classification does not include transporting for hire persons, freight or property by motor carriers subject to a fee prescribed in Title 28, Chapter 16, Article 4 or by light motor vehicles subject to a fee under Title 28, Chapter 15, Article 4.

Not all activities of a corporation are necessarily taxable based on the fact that one of the activities engaged in is that of contracting. *Ebasco Services Incorporated v. Arizona State Tax Commission*, 105 Ariz. 94, 459 P.2d 719 (1969).

A person’s activities may be such as to constitute more than one business and the taxpayer is obligated to pay the appropriate tax on each. If activities are incidental in the sense that they are inseparable from the principal business and interwoven in the operation thereof to the extent that they are in effect an essential part of the major business, they cannot be taxed as a separate business. *Trico Electric Cooperative, Inc. v. State Tax Commission*, 79 Ariz. 293, 288 P.2d 782 (1955).

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The Arizona Supreme Court specifically addressed the exclusion of “design and engineering services” from a prime contractor’s taxable receipts in *State Tax Commission v. Holmes & Narver, Inc.*, 113 Ariz. 165, 548 P.2d 1162 (1976). In *Holmes & Narver*, the State argued that design and engineering services were gross receipts of the taxpayer's construction business. The Arizona Supreme Court disagreed with the State Tax Commission, and in doing so articulated a three-part test.

The court held that: (1) because it could be readily ascertained what part of the receipts was for design and engineering and what part was for construction; (2) because the design and engineering receipts were not inconsequential compared to the total amount of the project; and (3) because the design and engineering services were not incidental to the contracting business, the design and engineering receipts were not part of the contracting business for tax purposes.

In its holding, the Arizona Supreme Court stated that “[t]he tax is on the contracting business, not merely on the form of a series of contracts performed in the pursuance of that business. Here that business is two-fold: design and engineering, and construction. . . . [W]e merely conclude that design and engineering services are not contracting which is the business which is the subject of the tax.”

**Conclusion and Ruling**

The Department rules that Taxpayer is subject to transaction privilege tax under the following transaction privilege tax business classifications for the following activities:

Activity	Business Classification
Removal or pulling back of carpeting	Prime contracting classification
Removal or pulling back of carpet padding	Prime contracting classification
Removal or pulling back of carpet tack strips	Prime contracting classification
Removal or pulling back of flooring	Prime contracting classification
Removal or pulling back of baseboards	Prime contracting classification
Removal or pulling back of molding	Prime contracting classification
Removal of drywall	Prime contracting classification
Removal of insulation	Prime contracting classification
Removal or pulling back of cabinet toe kicks	Prime contracting classification
Removal of cabinetry	Prime contracting classification
Removal of countertops	Prime contracting classification
Wall ventilation	Prime contracting classification
Removal of building materials	Prime contracting classification

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Activity	Business Classification
Exploratory cut in ceiling or wall	Prime contracting classification
Transporting property from job site to remote or other location within Arizona	Prime contracting classification unless separate line of business under the transporting classification <sup>1</sup>
Sale of tangible personal property not inconsequential pursuant to A.A.C. R15-5-104	Prime contracting classification unless separate line of business under the retail classification
Clean up and remediation	Prime contracting classification unless separate line of business then not taxable

When Taxpayer's clean up and remediation activities for fire and smoke damage, water damage, and mold, or the residential and commercial cleaning activities are incidental to prime contracting activities, all gross proceeds or gross income from the clean up and remediation or cleaning and contracting activities are subject to transaction privilege tax under the prime contracting classification. A.R.S. § 42-5075(A); *Holmes & Narver*.

It is possible for a taxpayer to be engaged in more than one line of business. The clean up and remediation gross proceeds would not be included in the prime contracting tax base if the gross proceeds were from a separate line of business not otherwise subject to transaction privilege tax as provided by the three-part test in *Holmes & Narver*. The determination of whether or not Taxpayer engages in more than one line of business activity depends on the facts and circumstances surrounding Taxpayer's business, and is so fact intensive the Department is unable to rule on that issue. Pursuant to Arizona General Tax Procedure GTP 07-1, the Department does not issue private taxpayer rulings if the problem or question involves a fact intensive issue.

The conclusions in this private taxpayer ruling do not extend beyond the facts presented in your correspondence dated April 25, 2007 and August 6, 2007, respectively.

**This response is a private taxpayer ruling and the determinations herein are based solely on the facts provided in your request. 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**

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<sup>1</sup> Transporting for hire by vehicles that have a declared gross vehicle weight of 12,000 pounds or less and that are subject to the annual light motor vehicle fee is not subject to transaction privilege tax. Transporting for hire by motor vehicles that have a declared gross vehicle weight of 12,001 pounds or greater, and on which the motor carrier tax or motor carrier fee has been paid, is not subject to the transaction privilege tax. A.R.S. § 42-5062(A)(1). See Arizona Transaction Privilege Tax Ruling TPR 97-4.

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**determination is subject to future change depending on changes in statutes, administrative rules, case law or notification of a different Department position.**

**The determinations in this private taxpayer ruling are applicable only to the taxpayer requesting the ruling and may not be relied upon, cited nor introduced into evidence in any proceeding by a taxpayer other than the taxpayer who has received the private taxpayer ruling.**

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