



PRIVATE TAXPAYER RULING LR10-003

Janice K. Brewer
Governor

Gale Garrriott
Director

February 24, 2010

The Department issues this private taxpayer ruling in response to your request of March 12, 2008, as supplemented by your letter of May 16, 2008, submitted on behalf of your client . . . (the "Company"). You request a determination of the applicability of Arizona transaction privilege tax to the Company's business activities of installing and maintaining signage for its customers, who are generally business owners and franchisors in Arizona.

Statement of Facts:

Your March 12 request provides the following excerpted facts:

[The Company] . . . is in the business of manufacturing, installing and maintaining signage throughout Arizona as well as other states. [The Company] manufactures signs at its plants in [other states] to its customers' specifications. The signs are then sent by common carrier to the location where [they] will be installed. Under its contract with its customers [the Company] may be responsible for installation of any lighting and any structural support, footing or base required. [The Company] contracts with subcontractors to complete site preparation and install footings to secure the signs in place as well as for the installation of lighting and related electrical work. After a complete installation, the sign becomes permanently affixed to real property. . . .

After the signs are installed [the Company] generally sells a Lighting Maintenance Program to its customers. Under the Lighting Maintenance Program [the Company] performs the following services. Maintenance Contractors hired by [the Company] perform annual maintenance of contracted elements from April 1 through September 30; however, customers can also request on-call maintenance any time they should have a sign failure.

As part of the annual maintenance, the Maintenance Contractors perform more than just checking to see if the elements are lighting properly. During the annual maintenance contracted elements will be cleaned inside and outside. During the cleaning process the vents and drain holes of the elements will be cleaned and unclogged. All wiring, lamps, and sockets will be inspected and replaced when necessary. All fasteners, screws, anchor bolts, and mounting bolts will be tightened and properly secured. Each element of the sign undergoes a review, then problems are corrected while the defects are reported for documentation along with pictures of the actual work performed. When annual maintenance includes re-lamping, each contracted element receives new lamps to ensure maximum quality and performance.

In addition to the annual maintenance [the Company] also includes on-call maintenance as part of the maintenance agreements. This service includes maintaining the illumination function of the sign, lamps, ballast, sockets, and wiring from the base of the sign through the column and sign head as well as photo cells, times, and other lighting elements. . . .

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Occasionally, as required by contract, [the Company] will ship repair parts or other materials to the owner or lessor of the sign without installing the part. In that situation, the owner or lessor will repair the sign using the part supplied by [the Company]. In all cases this service is only provided customers whose signs were installed by [the Company]. The repair parts may either be sold under a maintenance agreement or separately from a maintenance agreement. The sale of parts is a very small part of [the Company]'s business and is integral to its prime contracting business.

The March 12 request also included a copy of the Company's standard contract for sign installation, which contains the following terms:

[The Company] is in the business of manufacturing identity products and arranging for their delivery and installation. [The Company] is willing to supply such products to ___ and to arrange for the delivery and installation of such products, on the terms and conditions set forth herein.

NOW THEREFORE, the parties hereby agree as follows:

* * * *

7. **Installation Pricing Conditions.** [The Company]'s standard installation pricing is based on the following "Defined Parameters" known to be common at "typical" new locations. All such Defined Parameters are hereby accepted by ___. The Defined Parameters are as follows:

A. The individual installation prices for each product type are based on the complete product package being delivered and installed. Should individual products be ordered, the installation price would be subject to a "travel time" or "trip charge" surcharge.

.....

C. Installation will be invoiced upon completion. This invoice will include any permit cost plus staff time to secure such permit.

D. Pricing doe[s] not include removal of any existing products.

E. When specifications require new footings, pricing assumes normal 3,000 pounds per square foot conditions. Any required breaking of surface asphalt or overcoming underground obstructions such as rock, utility lines, frost, etc., will be billed as an extra charge, subject to prior customer approval.

F. Pricing assumes that building walls are adequate to support the products being installed using standard anchoring methods. Any wall reinforcement or other special anchoring will be billed as an extra charge, subject to prior customer approval.

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- G. Pricing includes making electrical connections at the sign base or at the point of wall attachment assuming an adequate circuit exists at time of installation.
- H. Permits as required will be billed at actual costs. Staff time to secure permits will be billed at actual cost plus 20%. Any special art work or special engineering drawings required to secure permits will be billed at actual cost plus 20%, with actual cost to be documented.
- I. All products, steel columns, and foundation[s have] been engineered to withstand a 35 pounds per square foot windload. Should a higher windload requirement be encountered a price adjustment will be quoted separately.

* * * *

- 10. **Storage Charges/Terminal Billing.** Any inventory (from firm orders by ___) remaining in stock more than six (6) months after the date of its completion shall be subject to a monthly storage charge in the amount of 2% of the actual sales price of such inventory as of the first day of each month as a storage charge. Such storage shall be invoiced to ___ on a monthly basis and shall be due and payable in full thirty (30) days after the date of the invoice. Any products remaining in inventory (produced for a firm order) for a period of twelve (12) months after the date of the Order shall be invoiced to ___ at its actual sales price, with such amount to be due and payable within thirty (30) days after the date of the [Company] invoice.
- 11. **Excess and obsolete inventory.** Raw material lead-times as well as the fast track time frame of the project may cause multiple changes in product demands throughout the term of the agreement and may result in excess raw material, work in process, and finished goods inventory. ___ agrees to pay [the Company] for excess inventory of up to ___. Any inventory that has been rendered obsolete due to changes authorized by ___ will be paid for by ___ within 30 days of obsolescence.
- 12. **Tooling Charges.** All tooling charges incurred by [the Company] in performing its obligations under this Agreement, including molds, screen usage, etc., shall be paid for by ___ at the time such expense is incurred by [the Company]. Any tooling charges relating to non-standard products shall be quoted at the time of the order and shall be subject to the approval of both parties. Any additional new tooling charges or repair charges shall be provided to ___ as the need arises.

Additionally, you also submitted a sample copy of the Company's maintenance agreement, which includes the following language:

On-Call Maintenance

Upon receiving notification from a [client] of the need to restore lighting to a sign, the Sign Supplier will:

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- Confirm that [the] problem does not appear to relate to wiring from [the] sign base through [the] breaker box inside [of the client's] building. If it does, [the client] is responsible for employing an electrician to make repairs.
- If it is determined that [the] lighting problem is in [the] sign or in the wiring from [the] sign to [the] base of the sign, a service crew will be dispatched and necessary repairs made within 72 hours of [the] notification receipt.

ALL LABOR AND REPLACEMENT PARTS COSTS ARE COVERED IN THE MONTHLY/QUARTERLY OR ANNUAL FEE CHARGES.

* * * *

Sign Cleaning & Inspection

The service performed during the cleaning and inspection of a sign will be as follows:

- The sign will be washed inside and outside with an appropriate cleaner and rinsed with cold water until all traces of cleaner are removed. The inside of the sign box will be wiped free from dirt and any foreign matter will be removed. Any oil, grease or water will be removed from the interior of the sign box. Cooling vents will be inspected to assure they are not clogged, and will be cleaned as required.

All drain holes will be checked and unplugged if required.

- All the lamps inside the sign will be cleaned, wiped free of dirt, and any electrical components that are defective will be replaced at this time.
- An inspection will be made to insure the sign is properly secured to its mounting structure. In the case of free-standing signs, the anchor bolt connection at the base will be checked for security. Afterwards, [the] base cover is to be replaced and caulked as before.

Sign Cleaning, Relamping and Inspection

The services performed during the cleaning, relamping and inspection of a sign will be as follows:

* * * *

- All lamps inside the sign will be replaced with new lamps of a type and size required.

Electrical Responsibilities

Electrical responsibilities inside the [client]'s building and to the sign(s) are not part of this maintenance program.

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The Sign Supplier assumes responsibilities for all electrical systems, conduit and wiring inside [the] sign and to the base of [the] sign when pole mounted.

Adequate power to the [client], adequate time clocks, photo electric cells, circuit breaker panels, wiring and conduit inside building and to the sign base or point of wall attachment are the responsibilities of the [client].

Your Issues:

You raise the following issues in your request:

1. Is the Company a taxable prime contractor when it arranges for the installation of the signs?
2. Are the sales of maintenance agreements subject to transaction privilege tax under the prime contracting classification?
3. Are the occasional sales of parts, as required by the installation or maintenance agreement, subject to transaction privilege tax under the prime contracting classification?

Your Positions:

The Company's positions are as follows:

1. The Company is subject to transaction privilege tax under the prime contracting classification on its gross receipts derived from contracting with business owners or franchisors for sign installation in Arizona.
2. The Company is subject to transaction privilege tax under the prime contracting classification on its sales of maintenance agreements that include services such as rewiring the signs and replacing face plates or casings, despite the fact that the maintenance agreement also includes some services that would not be taxable under prime contracting (e.g., cleaning the signs).
3. The Company is subject to transaction privilege tax under the prime contracting classification on its gross receipts from supplying repair parts without installation if the sign for which the Company provides the repair parts was originally installed by the Company.

Applicable Law:

Arizona imposes transaction privilege tax under sixteen tax classifications. For all the classifications, Arizona Revised Statutes ("A.R.S.") § 42-5023 provides:

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For the purpose of proper administration of this article and to prevent evasion of the tax imposed by this article it is presumed that all gross proceeds of sales and gross income derived by a person from business activity classified under a taxable business classification comprise the tax base for the business until the contrary is established.

The prime contracting classification, found at A.R.S. § 42-5075, imposes transaction privilege tax on the business of prime contracting. A prime contractor is

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.

In other words, contracting activities include modifications accomplished through the work of a contractor's employees or through the coordination of work by subcontractors or others. In the prime contracting context, a "modification" is "construction, alteration, repair, addition, subtraction, improvement, movement, wreckage or demolition," pursuant to A.R.S. § 42-5075(O)(5).

The terms "alteration," "repair," and "addition" used in A.R.S. § 42-5075(O)(5) are not defined in statute. As a general rule of construction, courts will consult an established and widely used dictionary to determine the common and ordinary meaning of such undefined words.¹ Consequently, considering the definition of each term is helpful in determining whether the Company's business activities constitute contracting under one or more of these enumerated types of work.

Addition

The verb "add" means:

1. a. To join or unite (a thing to another) so as to increase the number, quantity, or importance. *spec. in Horse-racing (cf. ADDED ppl. a. c).*

* * * *

2. (With object unexpressed) To make an addition to; to increase, augment, enlarge.²

Moreover, the noun "addition" is defined as:

1. a. The action or process of adding; the putting or joining of one thing to another so as to increase it, or the joining together of several things into one amount.³

¹ See, e.g., *United Dairymen of Ariz. v. Rawlings*, 217 Ariz. 592, 596, 177 P.3d 334, 338 (Ct. App. 2008).

² "Add, v." OXFORD ENGLISH DICTIONARY ONLINE [hereinafter OED ONLINE] (2d ed. 1989).

³ "Addition, n." OED Online (2d ed. 1989).

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An addition, then, can refer to an installation or other application of tangible personal property to real property that, upon installation or application, loses its character as tangible personal property and becomes part of (*i.e.*, augmenting or uniting with) the real property. Examples of additions to real property might include house painting; termite and preconstruction pest control treatment; and installation of cabinetry, carpeting, or home security systems.

Alteration

The term “alter” is defined as follows:

1.a. To make (a thing) otherwise or different in some respect; to make some change in character, shape, condition, position, quantity, value, etc. without changing the thing itself for another; to modify, to change the appearance of.⁴

Thus, an alteration, as used in the context of real property, is an activity that causes some physical change to the property without changing the identity of the real property. Examples might include refinishing hardwood floors, sandblasting a building’s façade, or tamping railroad ties.

Repair

The verb repair is defined in the following manner:

2. To restore (a composite thing, structure, etc.) to good condition by renewal or replacement of decayed or damaged parts, or by refixing what has given way; to mend.⁵

Repair, when used as a noun, is defined in the following manner:

1.a. The act of restoring to a sound or unimpaired condition; the process by which this is accomplished; the result attained. Also *pl.*

* * * *

b. spec. Restoration of some material thing or structure by the renewal of decayed or worn out parts, by refixing what has become loose or detached, etc.; the result of this. Also *pl.* (freq. in mod. use). ***upon a repair***, in process of being repaired.⁶

In the context of the prime contracting classification, a repair is a taxable modification if a contractor performs it on an item that constitutes real property. As can be deduced from the definitions provided above, not every activity, by virtue of being “fixing” or “maintaining” an item in a general sense, constitutes “repairing” it for the purposes of performing a modification under the prime contracting classification. Rather, a taxable repair must be an activity that returns the real property or fixture to a usable state from a partial or total state

⁴ “Alter, v.” OED Online (2d ed. 1989).

⁵ “Repair, v.2.” OED Online (2d ed. 1989).

⁶ “Repair, n.2.” OED Online (2d ed. 1989).

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of inoperability or nonfunctionality, thereby restoring the property or fixture. Such activity may involve, but does not require, a transfer of tangible personal property.

Regarding activities that do not rise to the level of repairing or otherwise modifying real property, the gross receipts derived from them may still fall within the scope of a prime contractor's taxable gross receipts "[i]f 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" of prime contracting.⁷

Separate Lines of Business and Company's Sales of Repair Parts

Although the Company does not explicitly address the subject in its ruling request, whether the Company is solely acting as a prime contractor or is also engaged in a separate retail line of business impacts how its sales of repair parts are taxed.

The Arizona Supreme Court has stated that "[i]f 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."⁸ By this reasoning, maintenance or warranty contracts offered by a prime contractor for contracting services are generally subject to tax under the prime contracting classification. In contrast, maintenance or warranty contracts for the performance of nontaxable services would not be subject to tax insofar as the activities are wholly unrelated to contracting activities or otherwise related to the prime contractor's separate retail line of business.

Whether a taxpayer has more than one line of business depends upon evaluating the relevant facts and circumstances pursuant to a three-part test established by the Supreme Court in *State Tax Commission v. Holmes & Narver, Inc.*⁹ The *Holmes & Narver* test provides that whether activities constitute a separate line of business depends on whether: (1) the portions of the separate activities can be readily ascertained without substantial difficulty, (2) the amounts attributable to the activities in relation to the taxpayer's total taxable Arizona business are not inconsequential, and (3) the activities cannot be said to be incidental to the taxpayer's principal business.¹⁰ If the relevant facts and circumstances fail to satisfy the three-prong test, all gross proceeds or gross income would be included as part of the taxpayer's principal business. If the facts and circumstances meet the three prongs, however, the activities would exist as a separate line or lines of business, and taxpayer's gross proceeds or gross income would be subject to tax under the appropriate tax classification for each line of business.

Consequently, the tax treatment of the Company's sales of repair parts without installation depends on whether the Company is engaged in a separate retail line of business in

⁷ *Trico Elec. Coop., Inc. v. State Tax Comm'n*, 79 Ariz. 293, 297, 288 P.2d 782, 784 (1955).

⁸ *Id.*

⁹ 113 Ariz. 165, 548 P.2d 1162 (1976) (en banc).

¹⁰ *Id.* at 169, 548 P.2d at 1166.

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Arizona. If it is, then the repair parts sold without installation will be subject to tax under the retail classification. If, however, the Company is solely engaged in the business of prime contracting, the gross receipts are inseparable from those derived from the primary business of prime contracting and will be subject to tax under the prime contracting classification.

Ruling:

Based on the facts and documentation provided, the Department rules as follows:

1. The Company is subject to transaction privilege tax under the prime contracting classification on its gross receipts derived from sign installation. The installation is contracting activity because it falls within the statutory definition of modification, while the Company is acting as a taxable prime contractor in performing or coordinating such modification activities.¹¹
2. The Company is subject to transaction privilege tax under the prime contracting classification on gross receipts derived from its sales of maintenance agreements. Company performs or coordinates certain activities on behalf of its customers that constitute repairs, alterations, or additions (e.g., on-call maintenance, repairs to defective electrical wiring or other components, repairs to sign mounts). Moreover, the Company does not separately state its gross receipts derived from activities that do not constitute repairs, alterations, or additions. Consequently, the entire amount derived from the sales of such agreements is taxable under the prime contracting classification, pursuant to A.R.S. § 42-5023.
3. If the Company sells parts to customers under the terms of its installation and maintenance agreements with them, the Company is subject to transaction privilege tax under the prime contracting classification on gross receipts derived from sales of repair parts for signs it has installed. If the Company sells repair parts to a customer apart from such agreements, gross receipts from the sale are generally subject to tax under the prime contracting classification, unless the Company maintains a separate retail line of business in Arizona.

This private taxpayer ruling does not extend beyond the facts presented in your letters and enclosed documents of March 12 and May 16, 2008.

This response is a private taxpayer ruling and the determination herein is 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 determination is subject to future change depending on changes in statutes, administrative rules, case law, or notification of a different Department position.

¹¹ *Brink Elec. Co. v. Ariz. Dep't of Revenue*, 184 Ariz. 354, 909 P.2d 421 (Ct. App. 1995)

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The determinations in this private taxpayer ruling are only applicable to the taxpayer requesting the ruling and may not be relied upon, cited, or introduced into evidence in any proceeding by a taxpayer other than the taxpayer who has received the private taxpayer ruling.

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