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PRIVATE TAXPAYER RULING LR19-005

June 11, 2019

Thank you for your letter requesting a private taxpayer ruling on behalf of your client, *** ("Taxpayer"). Specifically, you requested a ruling regarding whether the transfer for consideration of non-transplantable human tissue for medical research and education is subject to Arizona's transaction privilege tax ("TPT"). Pursuant to Arizona Revised Statutes (A.R.S.) § 42-2101, the Arizona Department of Revenue ("Department") may issue private taxpayer rulings to taxpayers and potential taxpayers on request.

ISSUE:

Whether the transfer for a consideration of non-transplantable human tissue for research purposes is subject to Arizona's TPT.

RULING:

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

Consideration received for the transfer of human tissue for medical research and educational purposes is not prohibited by the National Organ Transplant Act ("NOTA") or the Arizona Anatomical Gift Act ("AAGA"), which only prohibit the transfer of human tissue for consideration when used for transplant or therapy purposes. Taxpayer's transfer of human tissue is classified as a sale of tangible personal property per A.R.S. § 42-5001(14). As such, and for the following reasons, Taxpayer's gross receipts for the transfer of non-transplantable human tissue for medical research and educational purposes are subject to TPT unless a specific deduction or exemption applies:

- Taxpayer does not qualify for the A.R.S. § 42-5061(A)(1) professional or personal service deduction because Taxpayer is not a professional or personal service occupation. Moreover, Taxpayer is not a service business because Taxpayer's dominant purpose is to provide human tissue rather than a service.
- Additionally, Taxpayer's processing activities performed on human tissue are in preparation of a sale, or to bring the human tissue to market, and they do not qualify

for a deduction under A.R.S. § 42-5061(A)(2) as services rendered in addition to a retail sale.

However, Taxpayer's transportation costs may qualify for the A.R.S. § 42-5061(A)(2) deduction if they are separately stated and reflective of Taxpayer's actual costs.

SUMMARY OF FACTS:

The following are facts excerpted from your letter dated June 15, 2016, and follow up correspondence from January 25, 2019 and February 13, 2019.

. . . .

Founded in ***, Taxpayer is a non-transplantable human tissue bank that provides services associated with the processing, storage, preparation and transportation of tissue specimen to clients for medical research and training purposes. Taxpayer's customers include medical facilities, hospitals, universities, academic medical centers, medical training organizations and medical device manufacturers, amongst others. Taxpayer receives donated human bodies shortly after the time of death in order to provide the medical community with either complete, intact cadavers, or portions of human tissue according to its customers' specific needs associated with their training and research requirements.¹ Taxpayer makes no payments to a donor's estate or their family for the donated remains. Highly skilled experts are used to remove parts in such a way as to preserve the integrity and usefulness of those bodies and requested tissue for specific training and research purposes.² Any tissues that are not recovered for a qualified use are cremated and either disposed of or returned to next of kin upon request.³

... [T]he National Organ Transplant Act ("NOTA") of 1984 bans the sale of human organs and tissue for transplant, but allows tissue banks to charge fees for tissue and services associated with procuring and preparing tissue. In

¹ Donated cadavers are transported to Taxpayer by third party unaffiliated transport providers.

² Experts work for a third party company wholly owned by Taxpayer. Experts are not regulated by the state and Taxpayer does not require any specific degrees or certificates. However, Taxpayer typically hires candidates who have training and education in science, biology or medicine.

³ In some rare instances, a cadaver is received by Taxpayer before the necessary information is received to accept the donation. During the donation process, Taxpayer collects medical information used to determine acceptance. If that information is received after the donor is brought into Taxpayer's facility, the estate of the donor is requested to arrange for pickup of the cadaver to be taken to a funeral home or transport company.

addition, 42 U.S. Code § 274e(a) states that “It shall be unlawful for any person to knowingly acquire, receive, or otherwise transfer any human organ for valuable consideration for use in human transplantation if the transfer affects interstate commerce.” Further, the federal Public Health Service Act prohibits the sale of human fetal tissue as stated in 42 U.S. Code § 289g-2(a), “It shall be unlawful for any person to knowingly acquire, receive, or otherwise transfer any human fetal tissue for valuable consideration if the transfer affects interstate commerce.” Additionally, the Uniform Anatomical Gift Act (adopted by Arizona through A.R.S. § 36-854), governs both tissue for transplantation into living patients as well as the making of anatomical gifts for the advancement of science. Section 16 of the Uniform Anatomical Gift Act (2006) states that “A person may charge a reasonable amount for the removal, processing, preservation, quality control, storage, transportation, implantation, or disposal of a part.”

...Taxpayer charges fees to its customers in order to recover the costs associated with acquisition, storage, preservation, preparation and distribution of the tissue.⁴ Cost-plus pricing, rather than supply-demand metrics, establish service charges invoiced to the Taxpayer’s customers.⁵ There are no charges for human tissue. Taxpayer is properly following the various longstanding nationwide legal and social norms which provide that there can be no sale of a human body or vital body parts. The Arizona legislature has seen fit to also address this topic in A.R.S. § 36-854, which, like the Uniform Anatomical Gift Act above, states:

- a. Except as otherwise provided in subsection B, a person who for valuable consideration knowingly purchases or sells a part for transplantation or therapy, if removal of a part from an individual is intended to occur after the individual’s death, is guilty of a class 3 felony.

⁴ Human tissue storage and preservation include suturing, wrapping tissue, freezing and embalming. The human tissue is prepared as ordered and customers are able to make special requests. For example, a customer could request a shoulder socket cut in a certain unique way, or only a certain portion of the bone.

⁵ The cost-plus pricing is based on the actual cost related to the third-party transportation costs for acquiring the donated cadavers and the actual costs of the highly skilled experts who will prepare the human tissue for storage and transportation. Taxpayer has established the cost with their associated vendors such that the price to those organizations purchasing the human tissue is a known price and not a wildly fluctuating price.

- b. This section does not prevent a person from charging a reasonable amount for the removal, processing, preservation, quality control, storage, transportation, implantation or disposal of a part.

The fees which Taxpayer lists and charges are an aggregate reflection of the services it provides related to its tissue removal, processing, preservation, storage, transportation and disposal and are allowable under Arizona statutes.

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DISCUSSION & LEGAL ANALYSIS:

TPT Generally

Arizona imposes the TPT on the privilege of conducting business in the State of Arizona. The authority to levy the TPT is found in A.R.S. § 42-5008. The tax is levied on the seller, rather than the customer. However, the seller may legally pass the economic burden of the tax onto its customers. The Arizona TPT is imposed under sixteen separate business classifications. A.R.S. § 42-5023 states that 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 can be established.”

A.R.S. § 42-5061 imposes the TPT under the retail classification. The retail classification is comprised of 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. A.R.S. § 42-5001(4) defines gross income to mean “the gross receipts of a taxpayer derived from trade, business, commerce or sales.” A.R.S. § 42-5001(7) defines gross receipts to include the “total amount of the sale..., including any services that are a part of the sales...without any deduction from the amount on account of the cost of the property sold, materials used, labor or service performed, interest paid, losses or any other expense.” A.R.S. § 42-5001(14) defines "sale", in part, as any transfer of title or possession, or both, in any manner or by any means, including consignment transactions and auctions, of tangible personal property for a consideration. All sales of tangible personal property are subject to TPT under the retail classification unless specifically exempted or excluded by statute. And A.R.S. § 42-5001(13) defines any person engaged in a business classified under the retail classification as a retailer. A.R.S. § 42-5001(17) defines "tangible personal property" as personal property which may be seen, weighed, measured, felt or touched or is in any other

manner perceptible to the senses. A.R.S. § 42-5001(13) defines a retailer as any person engaged in a business of making a sale, or a transfer of title, of tangible personal property.

Transfer of Human Tissue

Arizona legislation has allowed anatomical gifts for medical research and education purposes from as early as 1954.⁶ In 1970, Arizona adopted and codified provisions of the Uniform Anatomical Gift Act as the Arizona Anatomical Gift Act (“AAGA”), which are currently found in A.R.S. §§ 36-841 to 36-848.⁷ The AAGA statutes allow a donation of a human body for transplant and therapy purposes, and specifically allow certain persons to make anatomical gifts during life and following death. A.R.S. § 36-850 allows anatomical gifts to be received by: organ procurement organizations; qualified medical, research or educational organizations; or tissue banks.

In 1996, AAGA was revised to incorporate NOTA, which limited the manner in which the transfer of human tissue for transplantation or therapy purposes, in exchange for consideration, could be characterized.⁸ A.R.S. § 36-854(A) states that “a person who for valuable consideration knowingly purchases or sells a part *for transplantation or therapy*...is guilty of a class 3 felony” (emphasis added). The statute allows a person to charge “a reasonable amount for removal, processing, preservation, quality control, storage, transportation, implantation or disposal of a part.”

As detailed above, Arizona has addressed the transfer of human tissue since 1954, and for purposes of the transfer of human tissue for *medical or educational* purposes, has never required the characterization of consideration be limited to charges for specified services, as it does for transplantation purposes.⁹ Accordingly, there is no limitation under Arizona law preventing the characterization of a transfer of human tissue for consideration as a sale of tangible personal property.

⁶ Laws 1954, Ch. 6 (SB 42), 21st Reg. Sess.

⁷ Laws 1970, Ch. 147 (SB 36), 2d Reg. Sess.

⁸ Laws 1996, Ch. 333E (SB 2315), 2d Reg. Sess. SB 2315 revised AAGA to restrict the transfer of human tissue for transplantation or therapy purposes in exchange for consideration, but allowed a reasonable payment for the services required to prepare and transfer the human tissue.

⁹ There is no restriction on a transfer of donated human tissue, so long as the transferor and transferee adhere to all laws (similar to federal regulations). A.R.S. § 16-841 defines a decedent to include, “subject to restrictions imposed by any other law, a fetus.”

Taxpayer's Transfers of Human Tissue Specimens Constitute a Sale.

Taxpayer is a tissue bank qualified to receive anatomical donations or gifts of human tissue. Each donor completes the Taxpayer's *** agreement and acknowledges the "gift is made voluntarily without obligation" or compensation."¹⁰ Additionally, the donor acknowledges that Taxpayer shall have the right to "any recovered organs, tissues or parts of the body [to] be used indefinitely into the future for medical research, scientific use or student or physician education and surgical training."¹¹ (emphasis added). After removal of the desired tissue, Taxpayer may cremate the remaining tissue and return it to next of kin.¹² Tissue used for medical research, scientific use or education is not returned to the decedent's next of kin, but is cremated, or incinerated, and properly disposed of.¹³

A gift is defined as "a voluntary conveyance...or transfer of goods, from one person to another, made gratuitously, and not upon any consideration of blood or money."¹⁴ A transfer is defined as "[a] conveyance of property or title from one person to another."¹⁵ Generally, a gift is not subject to TPT. For TPT purposes, a sale means "any transfer of title or possession or both, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatever...of tangible personal property or other activities taxable under this chapter, for a consideration."¹⁶ Furthermore, Arizona defines gross income to include "the gross receipts of a taxpayer derived from trade, business, commerce or sales."

Taxpayer receives a gift or donation of a human body, which gives them title and the right to prepare the human body for transfer to their customers. The transfer to Taxpayer's customers is not a gift, but quite the opposite: it is a transfer or conveyance of title consummated with signed contract, an invoice and consideration paid by Taxpayer's customer. The transfer of title in the human tissue to Taxpayer's customer grants a limited and conditional license ** for use ***...and use thereof shall be limited the right to use *** for research and development or educational purposes,"¹⁷ as well as the right to transfer the human tissue to another recipient so long as it is done in a manner consistent with applicable

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¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ "Gift," *Black's Law Dictionary* (7d ed. 1999).

¹⁵ "Transfer," *Id.*

¹⁶ A.R.S. § 42-5001(14).

¹⁷ Taxpayer's customers covenant and agree that they "shall handle Tissue obtained under this Agreement with universal precautions, as mandated by the Occupational Safety and Health Administration Blood Borne Pathogens Final Standard; shall not use Tissue as a therapy; and shall not use Tissue for transplantation."

federal, state and local laws and with Taxpayer's consent.¹⁸ However, such restrictions upon Taxpayer's use of the tissue do not alter the nature of the transfer of title, and human tissue unambiguously falls within definition tangible personal property as pertinent to TPT under Title 42. The courts have held that "[w]hen a statutory scheme expressly defines certain terms, we are bound by those definitions in construing a statute within that scheme."¹⁹

Given these facts and circumstances, the transfer of human tissue by Taxpayer constitutes a sale as defined by A.R.S. § 42-5001(14), and Taxpayer's gross receipts derived from the transfer of human tissue are subject to TPT under the retail classification, barring any specific exclusions or deductions that may apply.

Professional or Personal Service Occupations and Service Businesses

A.R.S. § 42-5061(A)(1) exempts "[p]rofessional or personal service occupations or businesses which involve sales or transfers of tangible personal property only as inconsequential elements." The Department discusses the nature of professional and personal service occupations and businesses in *Arizona Transaction Privilege Tax Ruling* TPR 90-2 (Aug. 1, 1990). Professional and personal service occupations "are those wherein the professional is able to engage in the occupation by virtue of a state sanctioned or state issued license to engage in that occupation" (e.g., lawyers, doctors, cosmeticians, barbers), and the services are geared toward the particular needs of the customer with the final product or service meeting those specific needs. A service business is one that is commonly understood—and whose dominant purpose is to provide a service rather than to process and sell the goods processed.²⁰ The exemption provided in A.R.S. § 42-5061(A)(1) generally covers those inconsequential sales or transfers of tangible personal property used by an occupation or business in the actual operation thereof or to facilitate the service provided (e.g., shampoo used by a hair stylist to wash a customer's hair).

Taxpayer's Employees are Not Engaged in a Professional and Personal Service Occupation.

AAGA requires a tissue bank be licensed by the Arizona Department of Health Services as a procurement organization.²¹ However, the employees performing the tissue extraction

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¹⁹ *State v. Wilson*, 200 Ariz. 390, 397, 26 P.3d 1161, 1168 (Ct. App. 2001), as corrected (June 18, 2001) (citing to *Herman v. City of Tucson*, 197 Ariz. 430, 434, 4 P.3d 973, 977 (Ct. App. 1999)).

²⁰ *Qwest Dex, Inc. v. Ariz. Dep't of Revenue*, 210 Ariz. 223, 226, 109 P.3d 118, 121 (Ct. App. 2005).

²¹ A.R.S. § 36-851.01(F)(5) provides that a procurement organization that recovers anatomical gifts for research or education only and that is affiliated with a hospital pursuant to Title 36 (Public Health and Safety), Chapter 4 (Health Care Institutions) is not required to be licensed pursuant to A.R.S. §§ 36-851.01, 36-851.02, and 36-851.03.

and preparation are not required to be licensed by either A.R.S. Title 32 (Professions and Occupations) or Title 36 (Public Health and Safety). Professional and personal service occupations generally require a formal licensing by a professional body of those performing the service.²²

By way of example, a mortician who processes and prepares a human body for burial is engaged in a professional or personal service occupation. Although the mortician is engaged in activities that are, in many ways, similar to those engaged in by Taxpayer, there are some key distinctions between a mortician and Taxpayer that results in different treatment under A.R.S. § 42-5061(A)(1):

- A mortician may take possession of the body, but never takes title to the body—such title remains with the decedent’s estate. Contrastingly, Taxpayer *is* granted title to the human body.
- In addition, while there may be a transfer of tangible personal property, e.g., embalming fluid, etc., these are inconsequential to the purpose of a mortician’s transaction in preparing the body for burial. Taxpayer’s transfer of human tissue to its customers, however, constitutes the very essence of the transaction.

Taxpayer is Not Engaged in a Service Business.

A service business analysis looks to the dominant purpose and common understanding of a business’s transactions. For instance: is the dominant purpose to provide the service (*i.e.*, service business), or is it to provide tangible personal property (*i.e.*, retail business)? The organizations that purchase from Taxpayer may themselves receive directly donated human tissue, as anatomical donations may be made to hospitals, medical schools and universities, or procurement organizations for research or education purposes.²³ These same organizations likely hire their own personnel who possess the skills required to extract and prepare the human tissue as required.

The common understanding test looks to the “parties’ common understanding of the particular trade, business, or occupation.” In *Qwest Dex, Inc. v. Arizona Department of Revenue*, our Court of Appeals cites to *Dun & Bradstreet, Inc. v. City of New York*,²⁴ in which New York State’s Supreme Court applied the common understanding test to hold that sales

²² “Services which require a formal certification by a professional body, such as legal, medical, accounting, etc. are called professional services.” “Professional services,” Black’s Law Dictionary Free (2d ed. 2019).

²³ A.R.S. § 36-850(A).

²⁴ 276 N.Y. 198, 11 N.E.2d 728 (N.Y. 1937).

of books containing credit ratings were service transactions, not sales of tangible personal property. The court stated that “[t]he paper is a mere incident; the skilled service is that which is required.”²⁵ It appears that the common understanding between the Taxpayer and its customers is that Taxpayer, a tissue bank, will provide the necessary human tissue needed for education and scientific experiments. The human tissue is not simply a mere incident to the services that Taxpayer performs, but is, as stated above, the essence or object of the transaction for Taxpayer’s customers.

Together, the dominant purpose and common understanding tests indicate that Taxpayer is providing the sale of human tissue rather than a service. The human tissue is not a mere incident of the transaction, but rather, is the basis upon which the transaction is performed. Taxpayer’s customers come to Taxpayer for human tissue: without it, there is no basis for the transactions.

Consequently, Taxpayer’s dominant purpose is to provide human tissue to their customers for use in medical or educational purposes, and not for the skills required in the removal, processing, preservation, storage or transportation of the human tissue.

Services Rendered in Addition to Retail Sales

A.R.S. § 42-5061(A)(2) excludes from TPT services rendered in addition to selling tangible personal property at retail. Nontaxable services must be distinct from the activities of processing and generally include one or more of the following: (1) repair labor; (2) installation labor; or (3) instruction and training.²⁶ Typically, for the exemption to apply, the services rendered are performed separately from the actual processing of the tangible personal property. Arizona Administrative Code R15-5-126 states that the cost of labor employed in processing tangible personal property may not be deducted from the gross receipts derived from the sale of such property.

In *Moore v. Farmers Mutual Manufacturing & Ginning Co.*,²⁷ the Arizona Supreme Court analyzed a company’s cotton ginning process, in which from raw cotton the seed is separate from the fiber to make cotton a useful marketable product.²⁸ The Court, in looking to the definition of “processing” in the *Webster’s New International Dictionary*, found it consists of tangible personal property being operated on, and the nature of which includes such activities

²⁵ *Id.* (citing to *Dun & Bradstreet*).

²⁶ See *Arizona Transaction Privilege Tax Ruling* TPR 93-31 (May 10, 1993), explaining that the three categories “are not intended to be an exclusive list.”

²⁷ 51 Ariz. 378, 383, 77 P.2d 209, 211 (1938).

²⁸ *Id.*, 51 Ariz. at 381, 77 P.2d at 211.

as “compounding, packing preserving, [or] processing.”²⁹ The Court found the ginning activities could be summed up in the phrase “‘preparing for the market...’ [or] preparing for the sale.”³⁰ Thus, the costs of preparing tangible personal property for market or sale are subject to TPT. The Court concluded that the cotton ginning process was clearly a processing procedure, akin to a manufacturing process, and was done so in preparation for sale.³¹

Taxpayer’s Activities Constitute Processing.

Taxpayer’s activities of acquisition, storage, preservation, preparation and distribution costs, invoiced as “service fees,” are similar to the ginning process analyzed in *Moore* in that raw material—an unprocessed human body—is prepared for transfer as human tissue specimens to Taxpayer’s clients. This processing activity is not a service rendered in addition to a retail sale, as contemplated by A.R.S. § 42-5061(A)(2). Rather, like any business bringing tangible personal property to market, these are necessary activities for preparing and processing the tangible personal property into a desired marketable form. As a result, invoiced charges related to preparation of human tissue, whether referred to as service fees or otherwise, are subject to TPT.

Returning to the example of the mortician, a mortician (or funeral home) may take possession of a human body but does not take title, which remains with the decedent’s estate. Furthermore, the mortician’s processing of the human body is not in preparation for a sale, but rather, is in anticipation of burial. This is opposite of Taxpayer’s situation, wherein a *** transfers title in the human body to Taxpayer “indefinitely into the future for medical research, scientific use or student or physical education and surgical training.”³² And while a mortician and Taxpayer may both “process” a human body, the mortician is doing so in preparation for a funeral service, while Taxpayer is doing so in preparation for a sale—or, as *Moore* stated, in preparation for market.

Taxpayer’s Shipping or Transportation Charges May be Deductible.

A.R.S. § 42-5061(A)(2) allows a deduction for a retailer’s freight charge for shipping merchandise to a customer, if the charge reflects the actual cost of transporting and is separately stated on the invoice and clearly reflected in the books and records of the

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.* at 382-83, 211-12.

³² *Donation Authorization*, at 1.

company. Unlike freight charges, flat fee shipping and/or handling charges are those that are added to the purchase price at a flat rate. These charges have no relation to the size or weight of the package, or the distance the package will travel. Because of these aspects, flat fee shipping or handling charges are not considered to be the costs for a service provided by the retailer, and therefore, are not excludable from the tax base. The receipts from Arizona customers for flat fee shipping or handling charges are subject to either the TPT or the use tax, regardless of whether or not they are separately stated on the invoice.

Shipping costs, if a reflection of the actual cost and separately stated from the handling costs, are not subject to TPT.

This ruling does not address other possible deductions or exemptions available to Taxpayer in making sales to the medical community and medical device manufacturers.

This response is a private taxpayer ruling and the determinations herein are based solely on the facts provided in the Request. Therefore, the conclusions in this private taxpayer ruling do not extend beyond the facts presented in your correspondence. 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 private 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.

The determinations in this private taxpayer ruling are only applicable 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. In addition, this private taxpayer ruling only applies to transactions that occur or tax liabilities that accrue from and after the date the taxpayer receives the ruling.