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PRIVATE TAXPAYER RULING LR08-001

January 23, 2008

The Department issues this private taxpayer ruling in response to your letter of April 16, 2007, requesting a ruling on behalf of your client . . . ("the Company").

Statement of Facts:

The following facts are excerpted from your April 16 letter:

The Company is a large multistate retailer of products and services. It operates more than 880 stores in the United States and Canada as well as Internet and catalog divisions.

In order to provide its broad range of products and services, the Company uses many products and supplies in its stores[,] including but not limited to: supplies used to perform services or maintain merchandise for sale, signs, brochures, display racks, cleaning and restroom supplies, office supplies, training materials, employee uniforms, business forms and holiday decorations. Rather than store large quantities of such products and supplies at each store, the Company maintains a series of regional distribution centers ("DCs"), one of which is located in Arizona.

The Company's Arizona DC stores products and supplies like those referenced above until they are shipped to the Company's stores in various states to be used in such stores. The number fluctuates from time to time as new stores are constructed and the mixture of stores serviced by the Arizona DC changes, but roughly 11% of the products and supplies stored in the Company's Arizona DC are ultimately used in Arizona. The remaining products and supplies are used in other states. The company does not modify or otherwise use these products and supplies in its Arizona DC or elsewhere after purchasing them until they are sent to the Company's stores in various states and used or consumed therein. When necessary, the Company may remove items from their original supplier packaging and repackage them in smaller quantities for distribution purposes. The decision to purchase and store supplies in DC[]s occurs within Arizona. The decision to send supplies to stores, including the types and quantities[,] occurs both within and outside of Arizona.

Your Issues:

As stated in your request, you ask whether the Company is subject to Arizona use tax on the cost of products and supplies stored in its Arizona DC for subsequent use solely outside the state. If the Company is not subject to use tax, you further ask what documentation the Company should provide to registered suppliers to support the exemption claim.

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Your Position:

You cite to the Arizona Revised Statutes (“A.R.S.”) § 42-5151 definition of “storage” for use tax purposes to support your position that the Company is not subject to state use tax on the cost of property temporarily stored in Arizona and subsequently used outside the state. You also cite to *Salt River Project Agricultural Improvement and Power District v. City of Tempe*, 147 Ariz. 144, 708 P.2d 1335 (Ct. App. 1985), involving a definition of storage” in Tempe’s municipal tax code that was nearly identical to the state’s, as further support for the conclusion that products and supplies stored in one jurisdiction that are ultimately used in another jurisdiction fall outside the scope of storage activity that is subject to the former jurisdiction’s use tax.

Conclusions and Ruling:

A.R.S. § 42-5155(A) imposes Arizona use tax on “the storage, use or consumption in this state of tangible personal property purchased from a retailer or utility business, as a percentage of the sales price.” A.R.S. § 42-5155(E) further provides that use tax liability falls upon the person who stores, uses, or consumes tangible personal property in this state, and that the liability is not extinguished until the tax has been paid.

“Storage,” as used in the A.R.S. § 42-5155(A) levy statute, is defined as “keeping or retaining tangible personal property purchased from a retailer for any purpose *except* sale in the regular course of business or *subsequent use solely outside this state.*” A.R.S. § 42-5151(18) (emphasis added). Arizona Administrative Code (“A.A.C.”) R15-5-2304(B) explains that tangible personal property brought into Arizona is presumed to be subject to use tax, and that the burden of proof that the purchase is not subject to use tax falls upon the purchaser.

While the plain language of A.R.S. § 42-5155 leaves unambiguous the point that tangible personal property currently located in Arizona and purchased from a retailer but to be used solely outside the state is not subject to Arizona use tax, a question remains as to how a taxpayer may meet its burden of proof to show that the property was purchased for such nontaxable subsequent use.

Although there is no statute or administrative rule that explicitly governs the documentation requirements for this situation, the circumstances are very similar to those found in an exempt sale of tangible personal property made in interstate or foreign commerce under the A.R.S. § 42-5061 retail classification for transaction privilege tax. To satisfy this retail exemption, A.A.C. R15-5-170(A) explains that a retail business needs to demonstrate that the order was received from a location outside of Arizona and that it subsequently ships or delivers the tangible personal property to a location outside of Arizona for use outside of Arizona. Regarding documentation requirements for such exempt interstate and foreign transactions, A.A.C. R15-5-170(C) provides:

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Suitable records shall be kept to substantiate the deduction for a sale made in interstate commerce. As such, records shall identify the tangible personal property sold and the delivery destination. The following records may be sufficient to substantiate the exemption:

1. Suitable records for substantiating the receipt of an order from out-of-state may include purchase orders, letters, or written memoranda on the receipt of orders placed by telephone.
2. Suitable records for substantiating out-of-state shipments include:
 - a. Internal delivery orders supported by receipts of expenses incurred in delivering the property and signed on the delivery date by the person who delivers the property;
 - b. Common carrier's receipt or bill of lading;
 - c. Parcel post receipt;
 - d. Export declaration;
 - e. Receipt from a licensed broker; or
 - f. Proof of export or import signed by a customs officer.

Nearly identical documentation provisions are also found in A.A.C. R15-5-1102(D), which addresses the interstate or foreign commerce exemption for sales of printing under the A.R.S. § 42-5066 job printing classification for transaction privilege tax.

Given the parameters of nontaxable temporary storage set forth by the A.R.S. § 42-5151(18) storage definition, the A.A.C. R15-5-170(C)(1) requirement for substantiating that an order is received from outside the state is clearly inapplicable. Nevertheless, the examples of suitable records for substantiating out-of-state shipments provided in A.A.C. R15-5-170(C)(2) are useful in answering the question raised in this private taxpayer ruling.

Given the warehousing function of the Company's Arizona DC as described in its April 16 request, the Company should be capable of meeting its burden of proof for documenting shipments out of state through tracking, at the DC level, the shipment of products and supplies from the Arizona DC to destinations outside the state for use solely outside the state. In considering the specific examples provided in the administrative rule, the Company may find the first three described in A.A.C. R15-5-170(C)(2)(a)-(c) particularly applicable to its operations.

The Company's April 16 ruling request states that, at times, the Company "may remove items from their original supplier packaging and repackage them in smaller quantities for distribution purposes." If the Company is merely taking items that are bundled together for shipping purposes, removing the bundling packaging, and retaining some items for future use in Arizona while shipping others outside the state, then the portion of the order that is not used in Arizona may be exempt from use tax. Nevertheless, the Company may

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encounter problems with separately accounting for the portion of products or supplies that is stored for use within Arizona—and, thus, subject to Arizona use tax—and the portion that is to be subsequently used solely outside of Arizona.*

To address this problem, Laws 2005, Ch. 196, § 1 enacted A.R.S. § 42-5168, which provides a means for the Department to authorize certain taxpayers to use a percentage based reporting method for use tax. The method provides a more flexible means for taxpayers and the Department to arrive at standards that taxpayers can use to calculate their use tax liabilities, by taking into consideration such factors as dollar amount, the type of tangible personal property at issue, the purposes for which the property are used, and “other standards that are appropriate to the taxpayer’s operations.” See A.R.S. § 42-5168(B).

Based on the above conclusions, the Department rules that the Company is not liable for Arizona use tax on tangible personal property it purchased from outside the state and temporarily stores in Arizona before subsequently shipping or delivering the property outside the state for use solely outside the state. The Company may rely upon documentation described in A.A.C. R15-5-170(C)(2) to substantiate the shipment or delivery of the property. To the extent that it may assist the Company in calculating its use tax liability, it may, under A.R.S. § 42-5168, request that the Department issue it a letter of authorization to use a percentage based reporting method.

This private taxpayer ruling does not extend beyond the facts presented in your correspondence of April 16, 2007.

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.

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.

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* This ruling does not cover a scenario in which the Company receives a bulk quantity of an item in Arizona and repackages it (e.g., taking a bulk container of cleaning solvent and repackaging it into smaller bottles) such that some of the repackaged item is subsequently shipped outside the state and the remainder is used in Arizona. Under such circumstances, the Company’s activities may constitute use subjecting it Arizona use tax on the entire purchase price of the item.