



Douglas A. Ducey
Governor

David Raber
Director

PRIVATE TAXPAYER RULING LR15-003

April 29, 2015

The Department issues this private taxpayer ruling in response to your letters (“Request”) requesting a ruling on behalf of *** (“Company”). Specifically, you request a ruling on whether purchases made by Company are exempt from tax as an instrumentality of the Federal Government. Because Company is not the taxpayer in regard to purchases because Arizona the seller is subject to the transaction privilege tax, this taxpayer information ruling is limited to Arizona use tax implications because the use tax is imposed on the purchaser. However, the use tax statutory provisions addressed in this ruling are identical to corresponding transaction privilege tax statutory provisions. Pursuant to Arizona Revised Statutes (“A.R.S.”) § 42-2101, the Department may issue private taxpayer rulings to taxpayers and potential taxpayers on request.

ISSUE:

Whether purchases made by Company are subject to use tax or exempt as an instrumentality of the Federal Government.

RULING:

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

Purchases made by Company are subject to use tax, unless otherwise exempt, as it is not considered an instrumentality of the Federal Government.

FACTS ASSERTED BY COMPANY:

The following are facts excerpted from the letters dated January 3, 2014:

Company is a nonprofit scientific organization that has been recognized by the Internal Revenue Service as exempt from federal corporate income tax under Internal Revenue Code (I.R.C.) Section 501(c)(3). Company has entered into a cooperative agreement with [Agency], which is an independent U.S. government agency responsible for promoting ... through research programs and education projects. Under the cooperative agreement, Company manages and operates the [Location 1], [Location 2], and [Location3]. [Location 1] is a Federally Funded Research and Development Center for the purpose of ... research. [Agency] maintains oversight of [Location 1] and Company through review, reports, and continued attendance in governing meetings. [Location 1] employs a separate committee for self-evaluation and a review of Company’s activities.

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In October 2012, Company received a cooperative agreement to manage the final design, construction and operation of [Location 3]. In total, the Company's Tucson office manages and operates [Location 1] and [Location 2] as well as manages the design, development and construction of Location 3 to be built The Company's Tucson office performs the procurement functions for [Location 1], [Location 2], and [Location 3]. Some buying for the [Locations are] done from the Tucson office and when buying is done by the [out of state] office for shipment of the items to [outside the United States], the items purchased are shipped to Tucson for delivery because the Tucson office performs all of the international shipments.... Under the terms of the various Company cooperative agreements, legal title to personal property acquired by Company using [Agency] funds vests in the Federal Government.

The [Agency] reviews Company's management midway through the cooperative agreement and conducts periodic and ad hoc reviews of Company. A full review is conducted prior to a new cooperative agreement being entered into between Company and the [Agency]. The Cooperative Agreement Financial & Administrative Terms and Conditions (CA-FATC) states, "Awardees are reminded that the governing cost principles cited in Article 12 limit the allowability of taxes to those the organization is required to pay. Awardees must avail themselves of any tax exemptions for which any activities supported by Federal funds may qualify, including any applicable exemptions from state or local sales and use taxes on the purchase of goods and services made with [Agency] award funds."

Company provided letters from September 28, 1960 and October 25, 1960 from the State Tax Commission of Arizona granting Company status as an instrumentality of the Federal Government and therefore exempt from state taxation.

DISCUSSION & LEGAL ANALYSIS:

A.R.S. § 42-5155(A) imposes Arizona's 5.6% use tax on purchases of tangible personal property from an out-of-state retailer, job printer, or utility business that are used, stored, or consumed in Arizona. A.R.S. § 42-5159 provides specific exemptions from the use tax. In general, there is no statutory exemption from use tax for 501(c)(3) non-profit organizations.

The Supremacy Clause (Article VI) of the U.S. Constitution prevents states from levying taxes directly on the federal government, but does not prevent the imposition of a tax that indirectly burdens the U.S. Government. "Tax immunity is appropriate in only one circumstance: when the levy falls on the United States itself, or on an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned." *United States v. New Mexico*, 455 U.S. 720, 735, 102 S. Ct. 1373, 1383 (1982). Therefore, the imposition of the transaction privilege tax upon a retailer selling to a branch or agency

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of the federal government, or a prime contractor performing a contract for the federal government, has been upheld by the courts regardless of the fact that the federal government may bear the economic burden of the tax. *Arizona State Tax Commission v. Garrett Corp.*, 79 Ariz. 389, 291 P.2d 208 (1955); *U.S. v. New Mexico et al.*, 455 U.S. at 720.

In *United States v. New Mexico*, the state of New Mexico imposed a tax on several federal contractors “[f]or the privilege of engaging in business, an excise tax equal to four per cent [4%] of gross receipts is imposed on any person engaging in business in New Mexico.” N.M.Stat. Ann. § 72-16A-4 (Supp.1975). In effect, the gross receipts tax operates as a tax on the sale of goods and services.” *U. S. v. New Mexico*, 455 U.S. at 727, 102 S .Ct. at 1379. The United States sought a declaratory judgment that the amount paid under the various contracts were not subject to the state tax. *Id.* at 727-8. The contracts provided that title to the tangible personal property passed directly from the vendor to the federal government, the government bore the risk of loss, the government had control over the disposition of the property and the contractor’s property management procedures, and the contractors paid the creditors with drafts drawn on a special bank account in which the government deposited funds. *Id.* at 720.

The United States Supreme Court held that the various companies were not instrumentalities of the Federal Government and the companies were subject to New Mexico’s taxes. *Id.* at 740. As the Supreme Court noted, federal tax immunity from state tax is extremely limited. *Id.* at 735. The Court stated, “tax immunity is appropriate...when...an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned.” *Id.* “[A] finding of constitutional tax immunity requires something more than the invocation of traditional agency notions: to resist the State’s taxing power, a private taxpayer must actually ‘stand in the Government’s shoes.’” *Id.* at 736. Further, immunity may not be conferred simply because the tax has an effect on the United States, or even because the Federal Government shoulders the entire economic burden of the levy. *New Mexico*, 455 U.S. at 734.

Case law on whether an entity is an instrumentality of the Federal Government has changed significantly since Company received exemption letters from the Arizona State Tax Commission in 1960. “[A] narrow approach to governmental tax immunity accords with competing constitutional imperatives, by *giving full range to each sovereign’s taxing authority.*” *New Mexico*, 455 U.S. at 735-36 (emphasis added). Also, Immunity is not granted because the burden falls on a contractor providing service to the federal government and that government funds will ultimately be used to pay the tax. Arizona’s use tax is a tax on the purchaser. Company does make purchases which are paid by funds procured through a government cooperative agreement. This is not a tax on the Federal Government, it is a tax on Company and therefore are not immune to taxation.

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The Company must be so closely connected to the Federal Government that it is not seen as a separate entity. The Company is a separate, identifiable, entity. Company's website shows that is a nonprofit consortium of other institutions that furthers astronomical research and anyone visiting the site could easily separate Company from the Federal Government. Further, the [Agency] refers to Company as an 'external structure' (a structure not part of the Federal Government) in its memorandum to Congress on its budget. *United States v. New Mexico* case dealt with contractors operating the Los Alamos laboratories (nuclear weapons laboratories) and it is difficult to conceive of activities that could be more uniquely confined to Federal Government responsibility.

As stated in *U.S. v. New Mexico*, typical agency relationship does not make Company an instrumentality of the Federal Government. Company's articles of incorporation make no mention of supporting astronomical research through arrangements with the Agency 1 or other governmental organizations. [Location 1's] website states, "[Locattion 1] is the national center for ... in the United States and is operated by [Company] under cooperative agreement with [Agency]." This makes clear that it is an agency agreement through a cooperative agreement and not so closely related that Company and the Government are viewed as the same entity.

Company points to the fact that it is monitored by the Government as to why is should be considered an instrumentality of the Federal Government. This monitoring includes performing work for a third party, ownership of property obtained, and the Government oversees the business. *New Mexico* involved contract terms of all property passing to the Government, the Government would bear the risk of loss of the property, and Government control of property management procedures. *Id.* at 724-25. The Company would have to be viewed as an arm of the Federal Government and based on the finding in *New Mexico*, these monitoring activities do not rise to the level of an instrumentality.

The Federal Government is not claiming, at this point, that Company is an instrumentality of the Federal Government. Even if the Federal Government made this allegation, it does not necessarily then automatically make Company an instrumentality. See *New Mexico*, 455 U.S. at 720.

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 dated January 3, 2014. 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.

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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 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.

Lrulings/15-003-D