

PRIVATE TAXPAYER RULING LR94-021

December 29, 1994

The following private taxpayer ruling is in response to your request that the department rule that... is not subject to transaction privilege tax on services performed under contract to....

Statement of Facts:

The following is a restatement of the facts as presented in your letter. ...has a contract with ... to administer and manage many of their Demand Side Management (DSM) electric conservation programs. ...bills ... for services rendered under the contract. ...offers their residential, commercial and industrial customers free energy conservation related services. ...performs the following services for ... under the contract:

1. Design and development of DSM conservation programs. This includes conducting market research; designing cost effective programs; developing collateral material to promote the programs; developing and writing program procedures and work plans; establishing a computer tracking system to track details of each program; developing marketing and communication plans.
2. Residential energy surveys, which include the identification of electric energy saving opportunities through use of calculation formulas which predict the energy savings, measure cost, and payback. Your staff recommends and encourages customers to implement these identified energy conservation practices and measures. You also provide follow up services, including providing the names of licensed contractors who will arrange for the purchase and installation of recommended improvements. A typical residential energy survey will take place at the customer's site and last from 2 to 3 hours.
3. Commercial and industrial energy surveys, which are similar to the residential energy surveys but utilize a more thorough and complicated analysis.
4. Planting of shade trees to reduce air conditioning energy consumption. You solicit participation and identify customers who wish to receive shade trees, either at no cost or adopt a shade tree for \$5.00/tree, up to three trees per household. In the case where the \$5.00/tree is collected, this is considered to be a tax deductible adoption fee because all fees collected are donated to the Future Farmers of America, Kingman High School Chapter. For all shade trees planted, ... pays a professional licensed landscaper directly for the purchase and planting of the shade trees for their electric customers.
5. Arrange for financing through ... special lowÄinterest loan program. Actual processing of the loan is administered through a bank under agreement with You assist this program by distributing financing program literature to customers and delivering loan applications to the bank.

6. Arranging for ESCO's services is a service provided to commercial and industrial customers. Your staff identifies energy conservation opportunities and recommends other third party Energy Service Companies (ESCO's) which provide financing, implementation and project management for the installation of cost effective energy conservation measures. You do not enter into the contract between the customers and the ESCO's, you simply provide the service of connecting customers who desire energy conservation measures with ESCO's who perform the services.

7. Complete new construction design reviews for developers, builders or contractors who are building new residential or commercial properties within ... electric service territories.

8. Install free low cost electric hot water conservation materials. In two residential programs, low income and residential energy survey, your staff will install, at no cost to the customer, the following low cost conservation materials: electric water heater tank insulation; pipe insulation; low flow showerheads; faucet aerators. You bill ... for the materials you acquire on a monthly basis. Your charges to ... for conservation materials are greater than the purchase price to cover costs of inventory ordering, storage and overall inventory management. The end-users of the materials are ...' customers who do not pay for any of the materials.

Recap of Your Position:

Your company provides a service to ... which is not subject to Arizona's transaction privilege tax. Your company is subject to use tax on the materials which are used in the residential program where you provide and install the electric hot water conservation materials.

Applicable Statutory Provisions:

Arizona Revised Statutes (A.R.S.) 42-1310.01 imposes the transaction privilege tax on the business of selling tangible personal property at retail.

A.R.S. 42-1310.01.P.3 defines "selling at retail" as a sale for any purpose other than for resale in the regular course of business. All sales of tangible personal property are subject to tax unless specifically exempted by statute.

A.R.S. 42-1310.01.A.1 provides an exemption from transaction privilege tax for the gross proceeds of sales or the gross profits from professional or personal service occupations or businesses which involve sales or transfers of personal property only as inconsequential elements.

A.R.S. 42-1310.16 levies the transaction privilege tax on the business of prime contracting. Prime contracting includes altering, repairing, adding to or subtracting from real property. The tax base for the prime contracting classification is 65 percent of the gross proceeds of sales or gross income derived from the business.

A.R.S. 42-1310.16.F.6.A defines "prime contractor" as a contractor who supervises, performs or coordinates the construction, alteration, repair, addition, subtraction, improvement, movement, wreckage or demolition of any building, highway, road, railroad excavation or other structure, project, development or improvement including the contracting, if any, with any subcontractors or specialty contractors and is responsible for the completion of the contract.

A.R.S. 42-1408.A provides that Arizona's use tax is levied on the storage, use or consumption in this state of tangible personal property purchased from a retailer, as a percentage of the purchase price.

Discussion:

Transaction privilege tax is imposed on the business of making sales at retail. However, the law provides an exemption from the tax for professional services or personal service occupations which involve sales or transfers of tangible personal property only as inconsequential elements. The transfer of items of tangible personal property shall be considered to be inconsequential and, therefore, not subject to transaction privilege tax, when:

1. The cost of the tangible personal property to the professional represents less than 15 percent of the charge to the consumer of the service; and
2. The tangible personal property is not in a form which is typically subject to retail sale; and
3. The charge for the tangible personal property (even if otherwise "inconsequential") is not separately stated on the invoice.

However, a person who performs personal or professional services and who makes retail sales of tangible personal property is subject to tax on the retail sales if the charge for the sale of the tangible personal property is separately stated from the sale of the personal or professional service. Transaction privilege tax is also imposed on the business of prime contracting. In order to be a taxable prime contractor on a project, the contractor must be responsible for the completion of the contract. Occasionally it can be difficult to determine whether a person is a retailer or a contractor. This is true because a business may be involved in various activities which fall under one or more transaction privilege tax classifications. In that event, an analysis of the individual activity is required in order to make a determination of the tax status of the transaction.

The rules under the prime contracting classification provide guidance in distinguishing between which transactions are taxed as a contracting activity rather than a retail sale. Arizona Administrative Code (A.A.C.) rule R15-5-614 states that the governing factor is whether or not property or material is replaced in the original or existing structure, or if new materials are added.

The rule also provides examples of activities which are considered to be contracting activities rather than retail activities.

An example of a contracting activity is the installation of new appliances, wallpaper, and other fixtures.

An example of a retail sale is the replacement of washers in plumbing.

In order to be taxable under the prime contracting classification it is not necessary for the individual to be a licensed contractor as defined in the statutes governing the Registrar of Contractors.

Conclusion and Ruling:

On the basis of the information provided, we rule that the income from the following activities is not subject to Arizona's transaction privilege tax under the retail classification:

1. The design and development of DSM conservation programs;
2. Residential energy surveys and follow up services;
3. Commercial and industrial energy surveys;
4. The shade tree program where you identify customers who wish to receive shade trees;
5. Arranging for financing by distributing financing program literature to customers and delivering loan applications to the bank;
6. Arranging for ESCO's services; and
7. Completing new construction design reviews for developers, builders or contractors who are building new residential or commercial properties within ... electric service territories. The sale of the low cost conservation materials to ..., such as electric water heater tank insulation; pipe insulation; low flow showerheads; faucet aerators and any other items, is subject to Arizona's transaction privilege tax under the retail classification.

The conclusion in this private taxpayer ruling does not extend beyond the facts as presented in the request for a private taxpayer ruling and related documents dated November 11, 1994. This response is a private taxpayer ruling and the determination herein is based solely on the facts provided in your request. The determination in this taxpayer ruling is the present position of the department and is valid for a period of four years from the date of issuance except as set out herein. This determination is 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.