

## ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 99-6

(This ruling supersedes in part TPR 92-3)

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

### ISSUE:

Taxation of income derived from sending and receiving FAX messages.

*(This ruling supersedes Arizona Transaction Privilege Tax Ruling TPR 92-3 to the extent that TPR 92-3 states that the income from FAX services, which are conducted as a separate line of business by a person that is primarily engaged in business under the transient lodging classification, is taxable under the job printing classification.)*

### APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 42-5064 imposes the transaction privilege tax on the business of providing intrastate telecommunications services. "Intrastate telecommunications services" means transmitting signs, signals, writings, images, sounds, messages, data or other information of any nature by wire, radio waves, light waves or other electromagnetic means if the information transmitted originates and terminates in this state.

A.R.S. § 42-5064(B)(1)(a) provides a deduction from the tax base for sales of intrastate telecommunications services to other persons engaged in businesses classified under the telecommunications classification for use in such business.

### DISCUSSION:

The transaction privilege tax is imposed on the business of transmitting signals, messages or

other information by wire, radio waves, light waves or other electromagnetic means if the information transmitted originates and terminates in this state.

A FAX machine is a device capable of sending or receiving an exact copy of a page of printed or pictorial matter over telephone lines. The document image is converted to digital code which is transmitted to the receiving machine which translates the code it receives back into a visual facsimile of the original document. It is also possible to send computer-based FAX messages. Basically, a computer file is converted to a faxable file format and a special program takes the file and faxes it to the appropriate FAX number.

The process of faxing requires the interactive transmission of signals by both the sending and receiving machines. In a typical FAX session, the sending machine *dials* the telephone number of the receiving machine. The receiving machine *answers* the call and "handshaking" occurs. During the handshake, the FAX devices signal back and forth to set up the FAX call. Handshaking determines, for example, the speed and resolution levels at which faxes will be sent. This occurs before the first page is actually transmitted. "Retraining" is just like handshaking except it takes place between the transmission of each page and then again after the final page is faxed. Depending on the type of equipment involved, the combination of handshaking and retraining accounts for 36 to 65 percent of the overall time it takes to send a three-page FAX. Furthermore, virtually all business-oriented memory FAX machines sold during the 1990s employ the worldwide standard error-correction method. The receiving FAX machine can check each small frame or packet of data for errors and when it detects an error, transmit a message to the sending FAX machine for it to retransmit the frames containing errors.

A person who derives income from sending and/or receiving FAX messages is subject to tax under the telecommunications classification unless the faxing activity is an integral part of some other primary business activity, in which case, the income is taxable under the primary business classification. Whether a person is engaged in more than one line of business is a factual matter that must be determined in each situation.

In *Arizona Rent-A-Car Systems, Inc. v. City of Phoenix*, 182 Ariz. 75, 893 P.2d 75 (App. 1995), the court addressed the application of city tax on refueling charges made by a car rental company. The issue was whether the refueling charge was a sale of gasoline (and exempt from taxation under the city code) or whether it was taxable as an integral part of the car rental transaction.

The court relied on *State Tax Commission v. Holmes & Narver, Inc.*, 113 Ariz. 165, 548 P.2d 1162 (1976), wherein the Supreme Court of Arizona employed a three part test to determine whether design and engineering services were gross receipts of the taxpayer's construction business. The court held that where it can be readily ascertained without substantial difficulty which portion of business is for nontaxable professional service, the amounts in relation to the

company's total taxable business are not inconsequential, and those services cannot be said to be incidental to the contracting business, the professional services are not merged for transaction privilege tax purposes into the taxable contracting business and are not subject to taxation.

The *Arizona Rent-A-Car* court determined that in regard to the second element of the *Holmes* test, the proper focus is not on the dollars, but on the percentage of business represented by those dollars, and no matter how the test is phrased, two percent of the business is not enough to satisfy it. Additionally, the court held that the refueling charge was an integral part of the car rental business.

If a person's primary business activity is not telecommunications, the income derived from faxing activities is, nevertheless, subject to tax under the telecommunications classification if:

It can be readily ascertained without substantial difficulty which portion of the business is derived from faxing services;

The amounts derived from faxing services in relation to the person's total taxable Arizona business are not inconsequential; and

3. The faxing services cannot be said to be incidental to the primary business.

If a person's income from faxing activities is subject to tax under the telecommunications classification, only the income derived from transmissions that originate and terminate in this state is taxable. If a person's faxing income is subject to tax under another classification as an integral part of a primary business, the entire income is taxable without regard to whether the faxes are intrastate or interstate.

The transaction privilege tax does not apply to sales of intrastate telecommunications services to a person who provides FAX services that are subject to tax under the telecommunications classification if the telephone line is a dedicated line for the sole use of the FAX machine. Sales of telecommunications services to a person who provides FAX services which are an integral part of a primary business activity that is subject to tax under a business classification other than telecommunications are taxable.

## RULING:

Income derived from sending or receiving FAX messages is subject to tax under the telecommunications classification unless the income is inseparable from a primary business of the taxpayer. Income derived from FAXing activities will be considered inseparable from the primary business if: (1) the FAXing activities are incidental to the primary business; (2) the income from the FAXing activities is not readily ascertainable; or (3) the income from the FAXing activities is inconsequential compared to the Arizona Taxable Income of the primary business.

If income is subject to tax under the telecommunications classification, only the income derived from transmissions that originate and terminate in this state is taxable. If income is subject to tax under some other classification as an integral part of a primary business, the entire income is taxable without regard to whether the faxes are intrastate or interstate.

Transaction privilege tax does not apply to sales of intrastate telecommunications services to a person who provides FAX services that are subject to tax under the telecommunications classification if the telephone line is a dedicated line for the sole use of the FAX machine. Sales of telecommunications services are taxable when sold to a person who provides FAX services which are an integral part of a primary business activity that is subject to tax under some other classification.

Mark W. Killian, Director

### Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law that are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement that provides interpretation, detail, or supplementary information concerning application of the law. Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.