

ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 01-2

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:

The application of the transaction privilege tax to the sale and/or delivery of water.

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 42-5061 imposes the transaction privilege tax on the business of selling tangible personal property at retail.

A.R.S. § 42-5062 imposes the transaction privilege tax on the business of transporting for hire persons, freight or property by motor vehicle, railroads or aircraft from one point to another point in this state.

A.R.S. § 42-5063 levies the transaction privilege tax on the business of producing and furnishing or furnishing to consumers natural or artificial gas and water.

A.R.S. § 42-5302 levies a tax on the business of operating a "municipal water delivery system".

Arizona Administrative Code (A.A.C.) R15-5-1860(9) provides that "food intended for home consumption" means food, other than food for consumption on the premises, which is usually intended to be consumed at home. Unless a taxpayer can establish to the contrary, food delivered by a retailer to an office or other business establishment shall not be considered food intended for home consumption.

A.A.C. R15-5-2106 provides that the gross receipts from sales of bottled gases and bottled water are subject to tax under the retail classification.

Article XIII, § 7, of the Arizona Constitution provides that irrigation, power, electrical, agricultural improvement, drainage, and flood control districts, and tax levying public improvement districts are political subdivisions of the state.

The U.S. Constitution prohibits a state from imposing a tax if the legal incidence of the tax falls directly on the federal government.

DISCUSSION:

The Arizona transaction privilege tax is a tax imposed on the privilege of conducting business in the State of Arizona. This tax is levied on the seller, not the purchaser. The seller may pass the burden of the tax on to the purchaser; however, the seller is ultimately liable to Arizona for the tax. The Arizona transaction privilege tax is imposed under 17 separate business classifications including selling tangible personal property at retail, transporting for hire and the business of providing utilities to consumers.

The sale or delivery of water is subject to transaction privilege tax unless specifically exempted by statute. Depending on the circumstances surrounding the sale or delivery of water such transactions may or may not be subject to tax under the retail classification, the utilities classification or the transportation classification.

Retail Classification

A.R.S. § 42-5061 imposes the transaction privilege tax on the business of selling tangible personal property at retail. A.R.S. § 42-5061(V)(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. § 42-5061(A)(15) provides that the tax does not apply to sales of food, as provided in and subject to the conditions of Article 3. Under this article, A.R.S. § 42-5102(A)(3) exempts the sale of food by a qualifying retailer who sells food and does not provide or make available any facilities for the consumption of food on the premises. "Food" is defined by A.R.S. § 42-5101 to mean any food item intended for human consumption which is intended for home consumption as defined by rules and regulations adopted by the department.

The department has issued A.A.C. R15-5-1860 that gives further definition to the term "food". In accordance with this rule, "food" means items intended for human consumption. Food is deemed to be intended for human consumption when its intended or ordinary use is as a food for human consumption or is an ingredient used in preparing food for human consumption. A.A.C. R15-5-1860(15)(c) includes ice cubes and bottled water including carbonated and mineral water as tax exempt food under the retail classification.

Bottled water, however, that is delivered by a retailer to an office or other business establishment is not considered food for home consumption and is therefore subject to tax under the retail classification.

Utilities Classification

A.R.S. § 42-5063 levies the transaction privilege tax on the business of producing and furnishing or furnishing to consumers electricity, natural or artificial gas and water. However, in accordance with A.R.S. § 42-5063(B)(1) the utilities classification does not include sales of

electricity, gas or water to a person for resale. The tax base for the utilities classification is the gross proceeds of sales or gross income derived from the business.

A.R.S. § 42-5063(D)(7) defines "utility business" as including a person engaged in the business of producing and furnishing or furnishing to consumers water. Water haulers, private entities, cooperatives or cities and towns are all in the business of producing and furnishing or furnishing to consumers water. Arizona Transaction Privilege Tax Ruling TPR 93-20 discusses the taxation of utility cooperatives that provide water and the additional Municipal Water Delivery System Tax.

A water hauler is taxable under the utilities classification on sales to consumers if the water hauler is extracting and delivering water from a well or the water hauler is purchasing the water for resale. A water hauler is not subject to the additional Municipal Water Delivery System Tax.

Note: A.A.C. R15-5-2106 Utilities Classification, specifically provides that the gross receipts from sales of bottled gases and bottled water are subject to tax under the retail classification.

Transporting Classification

The tax is imposed on the transporting classification in accordance with A.R.S. § 42-5062. The transporting classification is comprised of the business of transporting for hire persons, freight or property by motor vehicle, railroads or aircraft from one point to another point in this state. The tax base is the gross proceeds of sales or gross income derived from the business. All transporting for hire from one point to another point in this state is subject to tax unless specifically exempted by statute.

A water hauler would be subject to tax under the transportation classification when a consumer purchases water from a third party and only contracts with the hauler to haul the water to the consumer.

However, A.R.S. § 42-5062(A)(1) provides that the transporting classification does not include transporting by motor carriers subject to a fee prescribed in Title 28, Chapter 16, Article 4 or by light motor vehicles subject to a fee under Title 28, Chapter 15, Article 4.

Arizona Transaction Privilege Tax Ruling TPR 97-4 provides detailed information regarding this exemption. This ruling explains that transporting by motor vehicles which have a declared gross weight of 12,001 pounds or greater on which the motor carrier tax or motor carrier fee has been paid, is not subject to transaction privilege tax. Effective January 1, 1998, transporting by vehicles which have a declared gross weight of 12,000 pounds or less which are subject to the annual light motor vehicle fee is also exempt.

Therefore, water haulers that contract to only haul water that is purchased by a consumer directly from a water company are not subject to tax under the transportation classification if the motor carrier fee or the light motor vehicle fee is paid on the transporting vehicle.

Governmental and Proprietary Functions

The sale or delivery of water by the United States government, any state governmental entity, such as an agricultural improvement district or an irrigation district, or an authorized agent thereof, that is acting in fulfillment of its *governmental* function is not subject to transaction privilege tax. See *Salt River Project Agricultural Improvement and Power District v. City of Phoenix*, 129 Ariz. 398, 631 P.2d 553 (App. 1981).

A governmental function is generally recognized as one undertaken because of a duty imposed on the entity for the welfare or protection of its citizens or a function that is fundamentally inherent in or encompassed within the nature of government. *Flowing Wells Irrigation District v. City of Tucson*, 176 Ariz. 623, 624, 863 P.2d 915 (Tax 1993), citing *Copper Country Mobile Home v. City of Globe*, 131 Ariz. 329, 333, 641 P.2d 243, 247 (App. 1982); *Book-Cellar, Inc. v. City of Phoenix*, 150 Ariz. 42, 44, 721 P.2d 1169, 1171 (App. 1986).

Proprietary activities of a government, however, are taxable. A proprietary function is "more a commercial activity which directly competes with other commercial activities...." *Flowing Wells Irrigation District v. City of Tucson*, 176 Ariz. 624, 863 P.2d 915 (Tax 1993), citing *Book-Cellar, Inc. v. City of Phoenix*, 150 Ariz. at 44, 721 P.2d at 1171 (App. 1986).

If the sale or delivery of water by any federal or any state governmental entity is in fulfillment of its governmental purpose and not a proprietary activity, the transaction privilege tax does not apply.

RULING:

1. The sale of bottled water for home consumption by a qualified vendor is exempt from tax under the retail classification.
2. The business of producing and furnishing or furnishing water to consumers is subject to tax under the utilities classification. Cooperatives and municipalities are in the business of producing and furnishing or furnishing water to consumers. If water haulers or other private entities own the water they deliver or provide, they, too, are in the business of producing and furnishing or furnishing water to consumers and are taxable under the utilities classification.
3. If a consumer purchases water from a third party and contracts separately with the water hauler to haul that water to the consumer, the water hauler is engaged in a transporting business activity. The transportation classification provides an exclusion from tax under the transportation classification if the motor carrier fee or the light motor vehicle fee is paid on the transporting vehicle.
4. The sale or delivery of water by the United States government, any state governmental

entity, such as an agricultural improvement district or irrigation district, or an authorized agent thereof, that is acting in fulfillment of a governmental function is not subject to taxation.

Mark W. Killian, Director

Signed: August 20, 2001

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.