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Governor

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Director

TAXPAYER INFORMATION RULING LR10-006

March 5, 2010

The Department issues this taxpayer information ruling in response to the ruling request dated July 24, 2009 on behalf of your unnamed client ("Company"), and the additional information and documentation provided on October 15, 2009. You request the Department to rule as to the applicability of Arizona transaction privilege tax to income derived from Company's provision of vehicle-installed breathalyzer devices for stated fees to persons convicted of a DUI offense. These devices prevent the driver's vehicle from starting if alcohol is detected by the breathalyzer device.

Statement of Facts:

The following facts are excerpted from your letter dated July 24, 2009:

When an Arizona court convicts a driver of a DUI or DWI, it frequently mandates that the driver participate in a monitoring and reporting program with the Arizona Motor Vehicle Division ("MVD") to make sure that the driver has not operated his or her vehicle after consuming an alcoholic beverage. Likewise, the state sometimes requires participation in a monitoring and reporting program in exchange for allowing a convicted driver to obtain a restricted use driver's license. The Service Provider is a local service company that provides this monitoring and reporting service as a middleman between the MVD and the driver. In order to do so, the Service Provider has been approved and certified by the MVD.

To provide its service, the Service Provider uses state-approved monitoring equipment that it installs on the driver's vehicle. The monitoring unit is a hand-held portable device (about the size of a mobile telephone) with a coiled cord connecting it to a small relay module that generally fits under the car's dashboard. The relay module is wired into the vehicle's ignition system with a tamper seal to prevent the driver from tampering with it. When a driver decides to operate the vehicle, he or she must turn the key in the car's ignition. At that time, the monitoring device requests a breath test before the ignition will start. The driver must breathe into the hand-held device, which measures the driver's blood alcohol concentration and records the data onto the device's memory. If the device measures a blood alcohol concentration below a preset level, the driver may start the vehicle's ignition. However, if the blood alcohol concentration exceeds the preset level, the relay module prevents the driver from starting the vehicle and records the incident into the device's memory. The device also requests additional breath tests at random intervals as the driver continues operating the vehicle.

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The driver must return to the Service Provider's location on a regularly scheduled basis for data retrieval and monitoring. Generally, the frequency of such monitoring sessions is established by the MVD or a court order. Additionally, if the driver triggers a program violation, the system will instruct him or her to return to the Service Provider's location immediately for an unscheduled monitoring session. If a driver does not appear for a monitoring session, the monitoring device may trigger a lock-out mode making it impossible to start the vehicle. In that case, the driver must tow the vehicle to the Service Provider's location.

During a monitoring session, the Service Provider retrieves the data stored in the device's memory. Once the data has been downloaded, the Service Provider analyzes the data and prepares a report for submission to the MVD as to the driver's compliance or non-compliance with the program. The Service Provider will also inspect and service the device and schedule the next mandatory monitoring session.

To provide this service to its customers, the Service Provider enters into a Service Agreement with those customers, which states that it charges a monitoring fee "for scheduled monitoring based on the minimum number of monitoring days, including retrieval of events log information, and regular periodic reporting to the Administering Authorities." ... Under the terms of the agreement, the Service Provider does not sell or lease the equipment to the drivers; it only offers the monitoring service. The only equipment charges that a driver could incur would be if he or she damaged or lost the monitoring equipment. The Service Provider does not charge any fee for installation of the device on the driver's vehicle (although it does charge a fee for removal or early termination of the service agreement).
(footnote omitted)

The following is excerpted from Exhibit A, which was provided with June 24th request:

1. IGNITION INTERLOCK SYSTEM ["IID"] :

The System is owned by, and shall remain the sole and exclusive property of the Service Provider. The Client shall not, directly or indirectly, encumber or otherwise impair the Service Provider's title to the System.

Upon termination of this Agreement the Client shall return to have the System removed from the Vehicle within 3 days after the date of termination. The cost for the removal of the device is \$75.00 due the date of removal. In the event that the Client does not comply with this provision, the Service Provider shall have the right if authorized by the administering authorities to recover possession of the System from the Vehicle wherever it is located without such entry being deemed a trespass. The Client appoints the Service Provider as his/her lawful agent for such purpose, with full authority to gain access and entry to the Vehicle, and remove the System from the Vehicle, by whatever means required. SERVICE CENTER has

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the right to recover its property and may take whatever means necessary to do same, including entry into vehicle, taking possession of the vehicle or other legal recourses. It is expressly acknowledged and agreed that the Service Provider shall not be liable for any loss or damage occasioned thereby, and the Client hereby undertakes to indemnify and save harmless the Service Provider from and against any liability arising therefrom.

2. TERM OF AGREEMENT:

This Agreement will continue for a period of ___ months and shall continue month-to-month thereafter until it is scheduled by a Court Order for termination. Once the **IID** is installed, SERVICE CENTER can only remove the device with a court order or approval from installing agency.

3. PAYMENTS:

The Client agrees to pay the Service Provider for all fees and charges arising under this Agreement as detailed on the fee schedule published by the Service Provider, which Fees are fixed for the Term of this Agreement. Fees and charges payable include:

Installation Charge: This charge covers installation and training to familiarize the Client with its use and function. The Installation Charge of \$0.00 does not include charges to recover possession of the System in the event the System is not returned pursuant to the terms of this Agreement. Any changes to or additions of vehicles during the Term of this Agreement shall result in additional charges. The administrative fee is \$___. This charge covers training to familiarize the Client with its use and function.

Monitor Fee: This charge is for scheduled monitoring based on the minimum number of monitoring days, including retrieval of event information, and regular periodic reporting to the Administering Authorities. The monthly fee is \$ _____. Monitoring more frequently than specified in the Fee Schedule may result in an Early Service Fee.

Loss Protection Plan: This charge limits the Client's responsibility, subject to the provisions of Section 9, for any damage to or loss of the System to a maximum of \$100.00 per occurrence.

Early Termination Fee: If this Agreement is terminated pursuant to Section 7, the Early Contract Termination fee will be a charge of \$150.00 plus a \$75.00 removal fee and represents a genuine and reasonable pre-estimate of damages likely to be suffered by the Service Provider.

Taxes: The Client is responsible for all taxes assessable on charges payable by the Client.

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Enforcement Costs: The Client will pay all charges, costs and expenses incurred by or on behalf of the Service Provider in collecting or attempting to collect fees due under this Agreement or otherwise taking steps to enforce this Agreement, including the recovery of the System and any Collection and/or attorney fees.

All payments are to be made by the Client in the form of cash, Visa, Mastercard, certified check, or bank or postal money order. The Monitor Fee through to the next scheduled monitor date, together with applicable Taxes, is due and payable in full at each scheduled monitor date. Payment for any other charges, including applicable Taxes thereon, is due in full in advance at the time the costs are incurred. The Client acknowledges that the Service Provider is under no obligation to perform any services until payment for such services, together with any outstanding payment if applicable, is made.

The Client further acknowledges that if the System is not serviced as required, it will enter a permanent lockout state and the Vehicle will not start, and that a Lock-out fee of \$75.00 will be assessed.

In the event of a Program Violation the Vehicle must be returned for early inspection and reporting. If not, the System will prevent the vehicle from being started and the Vehicle will have to be towed to the Designated Service Center at the Client's expense.

The Client's obligation to pay Monitor Fees, together with any other amounts payable during the Term hereof, shall continue in full force and effect, notwithstanding termination of this Agreement, until the System has been returned to the Service Provider in good condition subject only to reasonable wear and tear.

4. MONITOR APPOINTMENTS:

The Client shall return the Vehicle to the Designated Service Center, which the Service Provider may reasonably change from time to time, for regularly for scheduled monitoring as confirmed with the Client each time the System is monitored. In the event of a Program Violation, an Early Recall will be announced via the lights and tones of the System, which obligates the Client to return the Vehicle to the Designated Service Center for unscheduled monitoring within the number of days prescribed by the System.

Upon payment by the Client, the Service Provider will do the following in accordance with Program requirements:

- inspect and service the System;
- retrieve stored information from the System's events log;
- prepare a report for the Administering Authorities as to the Client's compliance or non-compliance with the Program; and
- establish the next Monitor Date.

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5. SERVICE PROVIDER'S RESPONSIBILITY:

The Service Provider agrees to install and service the System in a good and workmanlike manner. The Service Provider (including its employees and agents) shall not be responsible for any loss or damage to the Vehicle or its contents during installation or removal of the System. The liability of the Service Provider shall be limited to repair or replacement of defective components. Such replacement shall be done during normal business hours at the Designated Service Center. In no event shall the Service Provider (including its employees and agents) be liable for any consequential loss or damage to the person or property of the Client or anyone else.

Without limiting the generality of the foregoing, the Client understands that the Service Provider does not warrant the ability of the Client or other permitted users of the Vehicle to operate the Vehicle safely with the System.

Operation of the Vehicle is the sole responsibility of the Client. The Client also understands that the Service Provider does not warrant the ability of the System to prevent the Client or any other user of the Vehicle from starting and/or operating the Vehicle in violation of the Program or Federal, State or local laws while in an alcohol impaired condition. THE CLIENT SHALL NOT ATTEMPT TO START OR OPERATE THE VEHICLE AFTER CONSUMING BEVERAGE ALCOHOL.

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7. EARLY TERMINATION:

This Agreement may be terminated by Client at any time prior to the end of the Term upon notice to the Service Provider. This agreement shall terminate immediately if the Service Provider receives notification from the Administering Authorities that the Client's participation in the Program has been revoked, suspended, canceled or otherwise terminated. In addition to the above, this Agreement may be terminated by the Service Provider, at any time prior to the end of the Term, upon notice to the Client, in the following circumstances:

- a) Failure by Client to pay any fees or other charges arising under this Agreement when due;
- b) Failure by Client to return Vehicle to the Designated Service Center after any scheduled monitor date;
- c) Damage to or loss of the System caused by a willful act or omission on the part of the Client or a permitted user of the Vehicle;
- d) Any evidence of tampering with or attempting to circumvent the System;
- e) Any sale, lease, assignment or transfer of title, or other transfer of legal or equitable ownership or possession of the Vehicle by the Client or registered owner without the Service Provider's prior consent, and any actual or threatened seizure, impoundment, repossession or permanent dispossession by the Client of the Vehicle;

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f) Any other material breach of this Agreement by the Client.

In the event of a normal or early termination of this Agreement, the Client shall not be entitled to any refund of prepaid fees or other charges and the Early Termination Fee shall become immediately due and payable, if applicable. All terminations, whether initiated by the Client, the Service Provider, or the Administering Authorities will be reported to the Administering Authorities. The Client acknowledges that early termination of this agreement may result in a loss of driving privilege and/or probation violation.

...

9. LOSS PROTECTION PLAN:

The Client acknowledges financial responsibility for any damage to or loss of the System, however caused, provided that upon payment of the Loss Protection Plan fee, the Client's financial responsibility for damage to or loss of the System shall be limited to a maximum of \$100.00. Service Provider reserves the right to terminate the Loss Protection Plan if the Client has two (2) or more claims under the plan. Notwithstanding the foregoing, purchase of the Loss Protection Plan shall not limit the Client's financial responsibility for damage to or loss of the System caused by a willful act or omission on the part of the Client or other permitted users of the Vehicle. The Client must present a copy of the police report, along with any other evidence of loss, and pay the applicable liability limit within 72 hours of loss. If the Client declines the Loss Protection Plan the Client is responsible for any loss or damage to the unit to a maximum cost for a complete loss as detailed on section 10.

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The following is excerpted from EXHIBIT D, the "State of Arizona Participant / Client Handbook" that was provided on October 15, 2009. This section (on page six) details the training provided to the client by the ignition interlock device installer:

What training will I receive?

While your [ignition interlock device] is being installed you will begin your training by viewing a video, which explains the function and use of the [ignition interlock device]. After viewing the video you will be given this Handbook and a test. Not to worry ... it's open book! You'll simply read the Handbook and answer the question as you go along. Your handbook is your best friend. To understand and comprehend the information in the handbook is to understand the operating procedures and regulations of the problem.

You are encouraged to write down any questions you have in the "NOTES" section of the handbook so you can review them with your technician later. When you are finished reading your handbook and completing your test, your technician will go over the test with you and answer any questions you may have.

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You and your technician will review the Training Checklist to ensure your understanding of the operation of the [ignition interlock device] and other important information about the [] Program.

After your questions have been answered you will be instructed on how to properly give a breath test and then demonstrate your ability to pass five (5) consecutive breath tests prior to leaving the service center.

Remember, you (the Client) and anyone also who will be using the vehicle must be trained on an [ignition interlock device] and understand its purpose and function. Also, you are ultimately responsible for all activity that is recorded in the device, regardless of who was driving the vehicle.

Issue:

Is Company's income derived from various charges contained in contractual agreements to provide ignition interlock devices to clients, subject to transaction privilege tax under the personal property rental classification?

Your Position:

Your position is stated in your taxpayer information ruling request as follows:

The Company's activities under the Service Agreement with its customers, in which the Company monitors information collected by hand-held blood alcohol concentration tracking devices and reports that information to the MVD, constitutes a non-taxable service activity and not a rental of tangible personal property. As a result, the Company is not subject to transaction privilege tax on its gross receipts from providing this service.

Discussion

Arizona's transaction privilege tax differs from the sales tax imposed by most states. The transaction privilege tax is imposed on the privilege of conducting business in the State of Arizona. Differing from a true sales tax, the transaction privilege tax is levied on income derived by the *seller* or *lessor*, who is legally allowed to pass the economic expense of the tax on to the purchaser. However, the seller or lessor is ultimately liable to Arizona for the tax.

A.R.S. § 42-5071 *Personal property rental classification*, imposes the transaction privilege tax on businesses that lease or rent tangible personal property for a consideration. The tax base for this classification is the gross proceeds of sales or gross income derived from the business. All leases of tangible personal property in Arizona are subject to tax under the personal property rental classification unless specifically exempted by statute.

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For a person convicted of a DUI offense by an Arizona court, the court may require the use of an ignition interlock device on that person's vehicle, which prevents the person from operating the vehicle if he or she is under the influence of alcohol. In Arizona, ignition interlock devices are required to be calibrated such that recognition of alcohol concentrations of 0.03 grams or more in a driver's breath sample shall disable the ignition of the motor vehicle, preventing the impaired driver from operating the vehicle.

The Arizona Department of Transportation's Motor Vehicle Division ("MVD") provides the convicted driver a letter detailing the requirement for an ignition interlock device to be installed on that person's vehicle, which includes a listing of several interlock ignition device providers from which to choose. The providers may only install ignition interlock devices that have been approved by the MVD.

Once installed, the ignition interlock device is in the sole possession of the convicted driver and is used to enable operation of the driver's vehicle. The installer provides the manufacturer's handbook to the client, which provides complete instructions and detailed information on the correct use and care of the ignition interlock devices. Arizona Administrative Code (A.A.C.) R17-5-704 (in pertinent part) details the responsibilities of the installer of the ignition interlock device to ensure that the client ("participant") understands the use and operation of the device:

R17-5-704. Division-certified Installer Responsibilities

An authorized installer certified by the Division to install a certified ignition interlock device shall:

6. Provide to every participant, and make available for every person operating a motor vehicle equipped with the certified ignition interlock device, a copy of the manufacturer's written instructions for the following:
 - a. Operating a motor vehicle equipped with the certified ignition interlock device;
 - b. Cleaning and caring for the certified ignition interlock device; and
 - c. Identifying and addressing vehicle malfunctions or repairs that may affect the certified ignition interlock device;
7. Ensure that each participant receives an operator's manual and is further instructed regarding all of the following:
 - a. How to use the system;
 - b. How to obtain service for the system;
 - c. How to find answers to any additional questions;
 - d. How the alcohol retest feature works;
 - e. How drinking alcohol before a test may result in a reading of sensitive or fail;
 - f. How the handset of the device shall not be removed, except by an installer-certified service representative;
 - g. How missing an appointment for a regularly scheduled accuracy check will cause the certified ignition interlock device to enter into a lock-out condition that will emit a unique cue, either auditory, visual, or both, to warn the driver

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- that after 72 hours the vehicle will not start. It shall be the responsibility of each participant to have the car towed to the service center if a lock-out condition occurs;
- h. How noncompliance with a regularly scheduled accuracy check shall result in suspension of the participant's driver license until proof of compliance is submitted to the Division under A.R.S. § 28-1463; and the duration of the participant's certified ignition interlock device requirement shall be extended under A.R.S. § 28-1464 and A.A.C. R17-4-408;
 - i. What the penalties are for tampering with, circumventing, or misusing the system;
 - j. What will happen after failing a start-up breath alcohol test; and
 - k. What will happen after failing a rolling retest.
8. Ensure that each participant demonstrates:
- a. A properly delivered alveolar breath sample; and
 - b. An understanding of how the abort test feature works.

...

The client must periodically return to the installer's service center to have the device tested, to assure that no tampering has been performed on the device, and that it remains calibrated and completely functional. The installer must provide a report of these specifications to MVD. The installer will also upload electronic information from the device that can indicate if an ignition interlock device has experienced an interruption in service or has been disconnected. Infractions of the correct use of an ignition interlock device are reported to the MVD.

Company (the ignition interlock device "service provider") charges monthly "monitoring fees," as well as various other fees for resetting, un-locking, repairing (due to tampering), and removal / reinstallation of the ignition interlock devices. Other fees apply to a missed scheduled appointment, the replacement of a stolen or destroyed device, and the "early termination of the lease."

In *State Tax Comm'n v. Peck*, 106 Ariz. 394, 476 P.2d 849 (1970), the Arizona Supreme Court found that the use of coin operated laundry equipment and car washing equipment were taxable rentals of tangible personal property. As the legislature had not defined "renting" and "leasing" as used in the statute at issue, the court found that the ordinary meaning of the words would provide guidance. In reaching its conclusion that the businesses at issue reasonably fell under the personal property rental classification, the court stated:

Webster's Third International Dictionary defines the verb 'to rent' as '(1) to take and hold under an agreement to pay rent,' or '(2) to obtain the possession and use of a place or article for rent.' There is no question that when customers use the equipment on the premises of the plaintiffs herein, such customers have an exclusive use of the equipment for a fixed period of time and for payment of a fixed amount of money. It is also true that the customers themselves exclusively control

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all manual operations necessary to run the machines. In our view such exclusive use and control comes within the meaning of the term 'renting' as used in the statute.

It is clear that Company's clients gain complete exclusive use and control of the ignition interlock devices for the purpose of enabling their vehicles to drive. Merely because the vehicle must be taken to the ignition interlock device installer's service center for periodic testing does not mean that the client's use and control of the device has been negated.

In *City of Phoenix v. Bentley-Dille Gradall Rentals, Inc.*, 136 Ariz. App. 289, 665 P.2d 1011 (1983), the Court of Appeals addressed the use of "gradalls" at a construction site, and whether this constituted a taxable lease or rental of tangible personal property or was a prime contracting activity. A "gradall" is described in the court's opinion as a "highly sophisticated piece of equipment which can do a variety of excavation jobs as well as rip up concrete, remove trees and do some sloping." (*Bentley-Dille* at 1012) Bentley-Dille provided employee operators for the gradalls, and these machines were in the possession of Bentley-Dille employees at all times.

In *Bentley-Dille*, the Arizona Court of Appeals acknowledged the Arizona Supreme Court's holding in *State Tax Commission v. Peck*, and stated "the principal characteristic of a rental or lease is the giving up of possession to the lessee so that he, as opposed to the lessor, exercises control over and uses the leased or rented property." If control is not relinquished, the activity is not considered a rental for purposes of taxation under the personal property rental classification. The court found that Bentley-Dille did not give up possession and control of the gradalls and therefore this activity was not the renting of tangible personal property. Your ruling request describes the court's holding as "treat[ing] the transaction as a service." Whether this was a "service" was not discussed; the court found the activity to be taxable as contracting.

In contrast to the taxpayer's control over the gradalls in *Bentley-Dille*, Company does relinquish possession and control of the ignition interlock devices to its clients, who use the devices to enable operation of their vehicles.

More recently, the Arizona Court of Appeals determined that a customer's use of a tanning bed on the premises of a tanning salon was not a lease of tangible personal property for a consideration. In *Energy Squared, Inc. v. Ariz. Dep't of Revenue*, 203 Ariz. 507, 56 P.3d 686 (App. 2002), the court discussed that the scope and application of taxation under the personal property rental classification "hinges on the degree of control over the property in question that is ceded to its putative 'lessee' or 'renter'" (*Energy Squared* at 689.) Because its patrons' use of the tanning equipment was controlled by the tanning salon's employees, who limited the use based on various specific factors partly governed by federal regulations and strict procedures, the court found that the nature of the tanning salon's activities was the provision of a service.

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Because Company does cede control over the ignition interlock devices to its clients who use and control the ignition interlock devices to operate and drive their vehicles, there is no analogy to the tanning salon businesses at issue in *Energy Squared*. While the contractual agreement and rules contained in the Arizona Administrative Code¹ require periodic accuracy and compliance checks and reports to the MVD, these activities do not constitute services provided to Company's clients.

Company charges specific monthly fees and possible additional charges and penalties based on the customer's misuse of the ignition interlock devices. A.A.C. R15-5-1502(D) provides that the "[g]ross income from the rental of tangible personal property includes charges for installation, labor, insurance, maintenance, repairs, pick-up, delivery, assembly, set-up, personal property taxes, and penalty fees even if these charges are billed as separate items, unless a specific statutory exemption, exclusion, or deduction applies."

Conclusion and Ruling

Company is subject to transaction privilege tax under the personal property rental classification on the income derived from the lease or rental of ignition interlock devices.

Company's gross income derived from engaging in business under the personal property rental classification (as clarified by A.A.C. R15-5-1502) is subject to transaction privilege tax, and includes all income derived from fees, costs and charges described in the "service agreement" enclosed with the July 24, 2009 request for a taxpayer information ruling, in addition to the "fee schedule" attached as Exhibit A in the subsequent letter dated October 15, 2009.

The conclusions in this taxpayer information ruling do not extend beyond the facts presented in the correspondences dated July 24, 2009 and October 15, 2009.

This response is a taxpayer information ruling (TIR) 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 information 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.

If the Department is provided with required taxpayer identifying information and taxpayer representative authorization before the proposed publication date (for a published TIR) or date specified by the Department (for an unpublished TIR), the

¹ See, e.g. A.A.C. rule R17-5-610.

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TIR will be binding on the Department with respect to the taxpayer that requested the ruling. In addition, the ruling will apply only to transactions that occur or tax liabilities that accrue from and after the date the taxpayer receives the ruling. The ruling may not be relied upon, cited, or introduced into evidence in any proceeding by a taxpayer other than the taxpayer who has received the taxpayer information ruling. If the required information is not provided by the specified date, the taxpayer information ruling is non-binding for the purpose of abating interest, penalty or tax.

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