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Governor

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Director

PRIVATE TAXPAYER RULING LR 21-002

April 19, 2021

Thank you for your letter dated December 23, 2020, requesting a private taxpayer ruling (“PTR”) on behalf of your client, *** (“Taxpayer”). Specifically, you requested a determination on sourcing long-term vehicle leases for the purposes of state and local privilege taxes (hereinafter collectively “TPT”), where the state and city sourcing provisions appear to conflict.

Pursuant to Arizona Revised Statutes (“A.R.S.”) § 42-2101, the Arizona Department of Revenue (“Department”) may issue private taxpayer rulings to taxpayers and potential taxpayers on request.

ISSUE:

Are municipal privilege taxes imposed on long-term leases of motor-vehicles sourced according to Model City Tax Code (“MCTC”) § -450(a) or A.R.S. § 42-5040(C), where provisions contained in the two codes conflict?

TAXPAYER’S POSITION(S):

Taxpayer seeks to confirm the Department’s position with respect to sourcing long-term motor vehicle leases. That is, based on *Arizona Transaction Privilege Tax Ruling* TPR 20-2 (Oct. 6, 2020), should long-term motor vehicle leases be sourced to the vehicle’s garaging address for state, county, and municipal privilege tax purposes.

RULING:

The Department rules as follows:

Because the MCTC sourcing provisions for a long-term motor vehicle lease conflicts with the state statutory sourcing provisions, Taxpayer should follow A.R.S. § 42-5040(C) for sourcing municipal privilege taxes due on a lessor’s gross receipts derived from the lease. If a lessor has no Arizona business address, TPT on the lessor’s gross receipts derived from taxable leases—including municipal privilege tax—is sourced to the lessee’s Arizona shipping address, not to the dealership location

where the original lease was signed. If the lessor changes on a particular long-term motor vehicle lease from one tax period to the next, the sourcing for taxes due on the lease may likewise change.

SUMMARY OF FACTS:

The following facts summarize the information provided in your December 23, 2020 ruling request, as supplemented by additional clarification provided on January 14, 2021:

Taxpayer, located in ***, is engaged in the business of long-term motor vehicle leasing (leases for 24 months or longer). Taxpayer's TPT license lists the primary business address in *** and Taxpayer does not have a business location in Arizona. Taxpayer files TPT returns under the personal property rental classification—business code 047 for state and county taxes and business code 214 for municipal tax purposes.¹

Taxpayer purchases motor vehicles and accompanying lease rights from motor vehicle dealers ("dealer") licensed with the Arizona Department of Transportation. The Arizona dealer has already entered into a long-term motor vehicle lease with a lessee who may reside in Arizona or outside of Arizona. However, all leases relevant to this ruling are executed in Arizona between an Arizona motor vehicle dealer and lessees take possession of the leased motor vehicles at the dealers' respective Arizona business locations.² The vehicle leases under consideration in this ruling are those registered in Arizona for primary use in the state.

DISCUSSION AND LEGAL ANALYSIS:

Arizona's TPT differs from the sales tax imposed by most states. It is a tax on the privilege of conducting business in the State of Arizona. Differing from a true sales tax, the TPT is levied on income derived by the seller, who is legally allowed to pass the economic expense of the tax on to the purchaser. However, the seller is ultimately liable to Arizona for the tax. At the state and county levels, TPT is imposed under sixteen separate business classifications. A.R.S. § 42-6103 provides that the state's TPT provisions shall govern the imposition of county excise taxes. All sales subject to TPT are also subject to applicable county excise taxes.

¹ Letter from ***, to Tax Policy, Arizona Department of Revenue (December 23, 2020) (on file with author).

² *Id.*

Personal Property Rental Classification

A.R.S. § 42-5071 imposes TPT on the business of leasing or renting tangible personal property for a consideration. The personal property rental classification is comprised of businesses that lease or rent tangible personal property. All income received by a lessor of tangible personal property is subject to TPT unless specifically exempted or deductible by statute.

The tax base is the gross proceeds of sales or gross income derived from the business. Gross income from the rental of tangible personal property further “includes charges for installation, labor, insurance, maintenance, repairs, pick-up, delivery, assembly, set-up, personal property taxes, and penalty fees,” even if such charges are billed as separate items. See Arizona Administrative Code (“A.A.C.”) R15-5-1502(D).³ Therefore, all charges associated with a rental of tangible personal property are taxable unless a separate statutory exclusion or deduction applies.

A.A.C. R15-5-1503(D) provides that gross receipts from leasing or renting tangible personal property are not taxable if the property is shipped or delivered outside of the state and intended, at the inception of the lease, for use exclusively outside of the state. Furthermore, A.A.C. R15-5-1503(G) states that for motor vehicle leasing the Department shall examine whether the motor vehicle is licensed, registered, or primarily used in Arizona.

The Arizona Supreme Court, in *State Tax Commission v. Peck*, 106 Ariz. 394 (1970), set forth guidelines for determining whether a particular activity is considered a lease or rental of personal property. It resolved the question by first looking to the dictionary definition of the word rent, which means “(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.”

The court determined that:

When customers use the equipment on the premises of the plaintiffs...such customers have an exclusive use of the equipment for a fixed period of time and for payment of a fixed amount of money...the customers themselves exclusively control 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.⁴

³ A.A.C. Title 15 may be viewed online at https://apps.azsos.gov/public_services/Title_15/15-05.pdf.

⁴ *Peck*, at 396.

As may be gleaned from *Peck*, actual possession of the property by its transfer to the customer is not essential for a finding of control. Control may be found through exclusive use.

Sourcing

A.R.S. § 42-5040(C) states that gross receipts from leasing or renting tangible personal property shall be sourced as follows:

1. To the lessor's business location if the lessor has a business location in this state.
2. To the lessee's address if the lessor does not have a business location in this state or, if there is no lessee's address, to the lessee's billing address. The gross receipts are taxable when the property is shipped, delivered or otherwise brought into this state for use in this state.

A "lessee's address" is the residential address of an individual lessee and the primary business address of any other lessee.⁵ A "lessor's business location" is the business address that appears on the lessor's TPT license.⁶

Municipal Tax

It is important to note that the imposition of privilege taxes levied by Arizona cities and towns is separate and distinct from the state's TPT and accompanying county excise taxes. As with the state's TPT, municipal privilege taxes are imposed on the vendor for the privilege of engaging in business in the city or town. The MCTC provides provisions for the administration and enforcement of these local privilege taxes. Similar to Arizona's TPT, municipal privilege taxes are imposed "upon persons on account of their business activities."⁷ All Arizona cities and towns have adopted the MCTC in the imposition of their privilege taxes based upon their local ordinances. However, certain options exist, allowing each city to alter or qualify the imposition of its privilege tax.

⁵ A.R.S. § 42-5040(D)(1).

⁶ A.R.S. § 42-5040(D)(2).

⁷ MCTC § -400(a)(1) (available at <https://azdor.gov/model-city-tax-code/model-city-tax-code>).

Rental, Leasing, and Licensing for Use of Tangible Personal Property

MCTC § -450 imposes municipal privilege tax on the rental, leasing, and licensing for use of tangible personal property. MCTC § -450(b) provides that leases on motor vehicles for terms of greater than twenty-four months should be sourced to the location of the motor vehicle dealership and not to the location of the lessor's place of business.

Conflicting Sourcing Provisions

TPR 20-2 ruled that when there is a conflict between state and MCTC sourcing provisions, the state sourcing statutes should be applied for administration of the city privilege tax. As a basis for the ruling, TPR 20-2 addresses first that sourcing statutes are likely administrative in nature and no context exists to warrant variance from the state sourcing statute. Secondly, citing to the Arizona Supreme Court's ruling in *State ex rel. Brnovich v. City of Tucson*, 242 Ariz. 588, 591 (2017), TPR 20-2 ruled that state statutes generally control over a conflicting municipal ordinance, and that "[t]o the extent that the MCTC is inconsistent with A.R.S. § 42-5040, the state's sourcing provisions will prevail because they involve a matter of statewide concern not solely limited to any one city or town."

Conflict in Sourcing Provisions between the ARS and MCTC

Specifically, a conflict arises in sourcing long-term vehicle leases of twenty-four months or greater. The state's sourcing statute in A.R.S. § 42-5040(C) provides that the rental of tangible personal property is sourced to the lessor's business location in Arizona and to the lessee's shipping address if the lessor has no Arizona business location. By contrast, MCTC § -450(b) provides a special sourcing provision in relation to long-term (24 months or greater) motor vehicle leases requiring sourcing to the location of the motor vehicle dealership, rather than the location of the place of business of the lessor. This is true even when the original lessor—the dealership—sells, transfers, or otherwise assigns the lease to a lease financing institution ("finance company").

Under A.R.S. § 42-5040(C), the lease is sourced to the location of the motor vehicle dealership. When the dealership sells the interest in the lease to a finance company, the lease would then be sourced to the Arizona location of that business. If the finance company has no Arizona address, the lease is sourced to lessee's shipping address when the lease is transferred to the finance company. If both A.R.S. § 42-5040(C) and MCTC § -450(b) are used for sourcing a single lease, a finance company with no Arizona business location would be required to source the state and county TPT to the lessee's shipping address and municipal tax to the location of the original dealership. Thus, a conflict exists.

Administrative Nature of Sourcing Provisions

TPR 20-2 provides that sourcing statutes appear to be administrative in nature, and A.R.S. § 42-6002(A) provides that A.R.S. Title 42, Chapter 1 (Administration) and Chapter 5 (Transaction Privilege and Affiliated Excise Taxes) are to govern the administration of the municipal privilege taxes unless the statutory context requires otherwise.

Black's Law Dictionary defines "context" to mean "[t]he surrounding text of a word or passage, used to determine the meaning of that word or passage."⁸ TPR 20-2 rules that the context in MCTC allowing deviation from state statutes are those in which the municipal privilege tax is imposed on activities the state does not tax (*i.e.*, speculative building, advertising, timbering, and wastewater removal services).

State Sourcing Provisions Prevail

Leasing and renting tangible personal property is taxable under A.R.S. Title 42, Chapter 5. Thus, to the extent that the MCTC sourcing provisions are inconsistent with those found in state statute, the state sourcing provisions prevail. A.R.S. § 42-5040(C) provides that taxes on personal property rentals and leases are sourced to the lessor's Arizona business address (generally the address on the TPT license). If the lessor does not have an Arizona business address, the tax should be sourced to the lessee's Arizona shipping address. If the lessor does not know the lessee's Arizona shipping address, the tax should be sourced to the billing address.⁹ MCTC § -450(b) sources long-term motor vehicle leases (greater than 24 months) to the dealership's location where the lease is signed, irrespective of the location of the lessor or subsequent lessor.

MCTC § -450(b) is inconsistent with A.R.S. § 42-5040(C), and in accordance with TPR 20-2, A.R.S. § 42-5040(C) should be followed in sourcing long-term vehicle leases.

It must be noted that leased motor vehicles permanently removed to a location outside of Arizona to be used exclusively outside of Arizona are not subject to TPT at any level and are not at issue in

⁸ *Context*, BLACK'S LAW DICTIONARY (10th ed. 2014).

⁹ Please note, sourcing to the lessee's billing address is a recent update to A.R.S. § 42-5040(C) and was intended to aid in sourcing the rental of digital goods where a shipping address may be not be known.

this ruling.¹⁰ In satisfying this provision, the Department shall look to the location of the registration and licensing of the motor vehicle.¹¹

This response is a private taxpayer ruling and the determinations herein are 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 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.

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

¹⁰ TPR 20-02, pg. 2 (2020).

¹¹ A.A.C. R15-5-1503(G).