



Arizona's Broad Application of its Sales Tax on Rentals of Tangible Personal Property

In this month's state and local tax (SALT) column, Busby identifies two key differences between the tax base for Arizona's sales tax on retail sales and its sales tax on rentals of tangible personal property. He explains how Arizona taxing authorities have acted on these differences to impose sales tax on the gross receipts of many service businesses — including many that most people would not consider to be in the business of renting tangible personal property.

Most states do not impose broad sales taxes on services. Likewise, Arizona's Legislature only specifically identified a handful of services, such as telecommunications services, pipeline operations, and some construction contracting services, that should be subject to Arizona sales tax.

However, partly because of two key differences between Arizona's sales tax on retail sales versus its sales tax on rentals of tangible personal property, many service businesses have been surprised to find that the Arizona Department of Revenue (Department) believes their gross receipts are subject to the state's sales tax on rentals of tangible personal property.

The Taxation of Services Rendered in Addition to Selling vs. Renting Tangible Personal Property

The Legislature clearly excluded services rendered, in addition to selling tangible personal property at retail, from the scope of Arizona's tax on retail sales. Unfortunately, it did not provide a specific corresponding exclusion from Arizona's tax on proceeds from renting tangible personal property.

To its credit, in one of its rules, the Department put persons engaged in the business of renting tangible personal property on notice that they may be subject to tax on a variety of services, including "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."

The Taxation of Inconsequential Transfers of Tangible Personal Property

While there is an exclusion from Arizona's sales tax on persons engaged in the business of selling tangible personal property for "professional or personal service occupations or businesses that involve transfers of tangible personal property only as inconsequential elements," there is not a specific, comparable statutory exclusion from Arizona's sales tax on persons engaged in the business of renting tangible personal property.

Worse yet, even though the Department never issued an administrative rule or transaction privilege tax ruling to alert otherwise nontaxable service businesses that their gross receipts may be subject to Arizona's sales tax on proceeds from



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renting tangible personal property if any portion of their business involves letting their customers use something that the Department considers tangible personal property, the Department is now taking that position.

For example, the Department's director has ruled that companies that provide their customers with online access to a database containing articles and notes that their research analysts wrote are subject to Arizona's sales tax on rentals of tangible personal property. Likewise, the Department issued private taxpayer rulings indicating that online computer back-up service businesses and cloud storage businesses are subject to Arizona's sales tax on rentals of tangible personal property. The Department even ruled that a company that permitted its customers to use its online "software tools" to create websites that the company hosted was subject to Arizona's sales tax as if it had rented tangible personal property to them.

The Department's Expansive View of Tangible Personal Property

Like many other states, Arizona defines tangible personal property as "personal property which may be seen, weighed, measured, felt or touched or is in any other manner perceptible to the senses." Despite the definition's emphasis on things that are perceptible to human senses, the Department applies an extremely broad interpretation that encompasses many forms of intellectual property that most people would not ordinarily consider as tangible personal property.

As a result, service businesses are often surprised not only by the key statutory differences described above, but also to learn that the Department believes that their business involves rentals of tangible personal property in the first place — such as the online research database, online computer back-up, cloud storage and online website building and hosting businesses referred to above. ■