ARIZONA TRANSACTION PRIVILEGE TAX PROCEDURE

TPP 00-1

Procedure for Factoring Transaction Privilege Tax and Related Taxes

for Retailers and other Non Prime Contractors

(Prime Contractors: See TPP 00-2)

(This procedure and TPP 00-2 supersede Arizona Sales Tax Ruling No. 3-0-84)

ISSUE:

This procedure provides guidance to retailers and other taxpayers that factor their taxes from their gross proceeds of sales or gross income derived from the business, rather than separately stating the taxes. This procedure is inapplicable for persons subject to tax under the prime contracting classification.

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 42-5002 *Exclusions from gross income, receipts or proceeds*, states in pertinent part, that "[f]or purposes of [transaction privilege and affiliated excise tax statutes] the total amount of gross income, gross receipts, or gross proceeds of sales shall be deemed to be the amount received, exclusive of … [t]he taxes imposed by this chapter and chapter 6, article 3 of this title, sales or transaction privilege taxes imposed by municipalities in this state and sales or transaction privilege taxes imposed in this state by Indian tribes, if the Indian tribal tax is imposed with respect to sales by non-Indian or nonaffiliated Indian vendors to nonmembers of the tribe. A person who imposes an added charge to cover the tax levied by this article or which is identified as being imposed to cover transaction privilege tax shall not remit less than the amount so collected to the department."

A.R.S. §§ 42-5061 through 42-5074, 42-5076 and 42-5077 impose transaction privilege tax on sixteen of the seventeen taxable business classifications.

Model City Tax Code Section 250(b) authorizes factoring for purposes of city privilege taxes.

DISCUSSION AND PROCEDURE:

Factoring is a mathematical process that calculates the tax from the seller's receipts, when a tax amount was not separately identified. This method of tax computation is commonly employed when the seller wants the total charge to the purchaser to be a flat amount. Examples of common factoring situations include a vendor at a sporting event that charges a dollar for a soft drink, and an artisan that charges ten dollars for a handcrafted item at an Arts and Crafts Festival. While both sellers have the option of separately charging the tax, it is a convenience to both the seller and the purchaser in such situations to charge a flat amount.

Any seller may opt to factor transaction privilege tax and county excise tax, rather than separately charging the customer for the tax expense. However, an out-of-state seller that is required to collect the Arizona *use* tax is prohibited from factoring this tax by A.R.S. § 42-5165; the use tax must always be separately stated on the purchaser's invoice and in the seller's records, and is not allowed to be factored.

Arizona cities also allow factoring for purposes of computing city privilege taxes, as authorized by Model City Tax Code Section 250(b). Most sellers will have the same amount of taxable receipts from which to factor city privilege tax, state transaction privilege tax, and applicable county excise taxes. Therefore, a relatively easy computation can be used to determine the taxes to be reported to the city, and the taxes to be reported to the state.

Any method of extracting the tax from the seller's receipts is acceptable, as long as the correct amount of tax is determined. The typical factoring method is to divide the gross taxable receipts (the Gross Sales Receipts minus all exempt sales and deductions other than tax), by 1 plus the tax rate(s) expressed as a decimal. The result of this calculation is then multiplied by the tax rate, producing the reportable tax. A decimal factor can also be derived, and used for all similar transactions that have the same tax rate.

Example:

Gross Taxable Receipts $10,000.00

Factor (State 5%; County .7%; City 2%) _____1.077_

Equals Gross Taxable Receipts less the included tax = 9,285.05

Factored Taxes ($10,000.00 – 9,285.05) $ __714.95__ **(A)**

The answer can be checked:

$9,285.05 x 7.7% = Tax $ __714.95__

The separate taxes reportable to the state/county and to the city can be calculated as follows:

State/County = $9,285.05 x 5.7% = $529.25 **(B)** (529.25 ÷ 10,000 = .052925 State/County factor*)

City = $9,285.05 x 2% = $185.70 **(C)** (185.70 ÷ 10,000 = .01857 City factor*)

Total $714.95 (714.95 ÷ 10,000 = .071495 Combined factor*)

These factored taxes are reported on the *Transaction Privilege, Use and Severance Tax Return* (Form TPT-1) as follows:

Gross Sales Receipts are reported on *Page 1, Column 1.*

Deductions are reported on *Page 1, Column 2.*

Factored taxes **(A)** are one of the deductions on *Page 2, Schedule A, Line 1.*

(The total of the itemized deductions (Line 21) is then reported on *Page 1, Column 2*.)

The calculated tax amounts, **(B)** and **(C)**, should equal the tax amounts computed on *Page 1, Column 5*, when Column 3 amounts are multiplied by the tax rates in Column 4.

The above decimal factors* can be used for any similar transaction when the tax rates are the same. Using the previous example, if instead of $10,000.00, the gross taxable receipts amount is $18,150.00, using the previously determined factors* to compute the taxes is simplified:

State/County: $18,150.00 x .052925 = $ 960.59

City: $18,150.00 x .01857 = $ 337.04

Combined: $18,150.00 x .071495 = $1,297.63

Proof: $18,150.00 - 1,297.63 = 16,852.37 x 7.7% = $1,297.63 factored tax

Factoring Tables showing predetermined decimal factors for specific tax rates are available from the department or on the department's website, at the addresses listed at the conclusion of this procedure.

Special Factoring Situations:

The above factoring example is appropriate for taxpayers (other than prime contractors) that have identical amounts of receipts that are subject to both state/county and city taxes. However, rare situations exist where city taxable receipts will be different from state taxable receipts.

The transaction privilege tax statutes contained in Title 42 of the Arizona Revised Statutes govern the determination of a seller's taxable receipts from which the applicable state transaction privilege tax and associated county excise taxes may be factored. Model City Tax Code provisions, which sometimes vary by city, govern the determination of taxable receipts from which the city privilege tax may be factored. Deductions, exemptions, or business classifications contained in Title 42 may differ from those contained in the Model City Tax Code. Therefore, a single transaction may produce different amounts of taxable receipts for city and state purposes.

For sales to which both state/county and city taxes apply, but to different tax bases; algebraic equations may be utilized to determine the correct factored tax amounts. These equations take into account the different tax bases, and that the state and county taxes are allowed as a deduction in computing the city privilege tax, and vice versa. Please contact the department for advice about the development of algebraic equations for difficult taxing scenarios.

Additional note:

For transaction privilege tax and county excise tax purposes, a deduction for a bad debt is allowed for a sale previously reported. Taxpayers using a factoring method to determine a tax amount at the time of initially reporting the tax, must factor out this tax amount before deducting a bad debt expense at a later date. This is necessary in order to adjust the bad debt deduction to the true sales price less the factored tax.

To obtain factoring tables, please contact either of the following department sections, or access the department's website:

Taxpayer Information and Assistance Section

Arizona Department of Revenue
1600 West Monroe
Phoenix, AZ 85007

(602) 255-2060 or (800) 843-7196

Transaction Privilege Tax and Use Tax Audit Section

Arizona Department of Revenue

1600 West Monroe

Phoenix, AZ 85007

(602) 542-4656

Arizona Department of Revenue Website: http://www.azdor.gov

Mark W. Killian, Director

Signed: February 10, 2000

Explanatory Notice

The purpose of a tax procedure is to provide procedural guidance to the general public and to department personnel. A tax procedure is a written statement issued by the department to assist in the implementation of tax laws, administrative rules, and tax rulings by delineating procedures to be followed in order to achieve compliance with the law. Relevant statute, case law, or administrative rules, as well as a subsequent procedure, may modify or negate any or all of the provisions of any tax procedure. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.