



ARIZONA TRANSACTION PRIVILEGE TAX RULING TPR 06-1

Janet Napolitano
Governor

Effective Date: January 1, 2007

Gale Garriott
Director

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ISSUE:

Taxation of charges for goods, services or activities customarily provided in the course of the business of operating a transient lodging facility.

APPLICABLE STATUTES AND RULES:

Arizona Revised Statutes (A.R.S.) § 42-5008(A) levies a transaction privilege tax measured by the amount or volume of business transacted by persons on account of their business activities.

A.R.S. § 42-5001(1) defines "business" as "all activities or acts, personal or corporate, engaged in or caused to be engaged in with the object of gain, benefit or advantage, either directly or indirectly, but not casual activities or sales."

A.R.S. § 42-5001(4) defines "gross income" as "the gross receipts of a taxpayer derived from trade, business, commerce or sales and the value proceeding or accruing from the sale of tangible personal property or service, or both, and without any deduction on account of losses."

A.R.S. § 42-5023 states that "[f]or the purpose of proper administration of this article and to prevent evasion of the tax imposed by this article it is presumed that all gross proceeds of sales and gross income derived by a person from business activity classified under a taxable business classification comprise the tax base for the business until the contrary is established."

A.R.S. § 42-5061 imposes the transaction privilege tax under the retail classification. The retail classification is comprised of the business of selling tangible personal property at retail.

A.R.S. § 42-5061(A)(6) states that the tax imposed on the retail classification does not apply to the gross proceeds of sales or gross income from business activity that is properly included in any other business classification.

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A.R.S. § 42-5062 imposes the transaction privilege tax under the transporting classification. 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 in this state.

A.R.S. § 42-5064 imposes the transaction privilege tax under the telecommunications classification. The telecommunications classification is comprised of the business of providing intrastate telecommunications services.

A.R.S. § 42-5069 imposes the transaction privilege tax under the commercial lease classification. The commercial lease classification is comprised of the business of leasing for a consideration the use or occupancy of real property.

A.R.S. § 42-5070 imposes the transaction privilege tax under the transient lodging classification. The transient lodging classification is comprised of the business of operating, for occupancy by transients, a hotel or motel, including an inn, tourist home or house, dude ranch, resort, campground, studio or bachelor hotel, lodging house, rooming house, apartment house, dormitory, public or private club, mobile home or house trailer at a fixed location or other similar structure, and also including a space, lot or slab which is occupied or intended or designed for occupancy by transients in a mobile home or house trailer furnished by them for such occupancy.

A.R.S. § 42-5071 imposes the transaction privilege tax under the personal property rental classification. The personal property rental classification is comprised of the business of leasing or renting tangible personal property for a consideration.

A.R.S. § 42-5073 imposes the transaction privilege tax under the amusement classification. A.R.S. § 42-5073 states the following:

The amusement classification is comprised of the business of operating or conducting theaters, movies, operas, shows of any type or nature, exhibitions, concerts, carnivals, circuses, amusement parks, menageries, fairs, races, contests, games, billiard or pool parlors, bowling alleys, public dances, dance halls, boxing and wrestling matches, skating rinks, tennis courts, except as provided in subsection B of this section, video games, pinball machines, sports events or any other business charging admission or user fees for exhibition, amusement or entertainment, including the operation or sponsorship of events by a tourism and sports authority under title 5, chapter 8. For purposes of this section, admission or user fees include, but are not limited to, any revenues derived from any form of contractual agreement for rights to or use of premium or special seating facilities or arrangements.

A.R.S. § 42-5074 imposes the transaction privilege tax under the restaurant classification. The restaurant classification is comprised of the business of operating restaurants, dining

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cars, dining rooms, lunchrooms, lunch stands, soda fountains, catering services or similar establishments where articles of food or drink are sold for consumption on or off the premises.

A.R.S. § 42-5155 levies and imposes an excise tax on the storage, use or consumption in this state of tangible personal property purchased from a retailer or utility business as a percentage of the sales price.

A.R.S. § 42-5252 imposes a telecommunications service excise tax on every provider of wire and wireless service.

A.R.S. § 42-5251(4) defines a “provider” as a “public service corporation offering telephone or telecommunications services pursuant to title 40, which provides exchange access services.”

Arizona Administrative Code (A.A.C.) R15-5-1002 states the following:

- A. If a transient lodging facility is engaged in the business of providing lodging and engages in the business of providing meals, the gross receipts from lodging shall be separately stated and reported from the gross receipts from restaurant activities.
- B. Gross receipts from the providing of meals or room service shall be subject to tax under the restaurant classification.
- C. Gross receipts from the sale of tangible personal property by transient lodging facilities such as from magazine stands, gift shops, or in-room food or beverage bars shall be subject to tax under the retail classification.

A.A.C. R15-5-1708 states the following:

- A. A restaurant's gross receipts from gratuities that are separately stated on the check or bill are not included in the restaurant's tax base if:
 1. The exact amount charged on a check for gratuities is segregated on the seller's records for the account of the employees actually providing the services; and
 2. The amounts so segregated are distributed directly to the employees providing the services for which the charges were made.
- B. If a restaurant cannot specifically segregate the charges for gratuities or if any portion of the amounts charged for gratuities is not distributed to the employees involved, the total gross receipts from the gratuities are included in the tax base under the restaurant classification.

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A.A.C. R15-5-2004 states that a person who engages in more than one type of business under each license shall maintain books and records so that the gross proceeds of sales or gross income of each taxable business classification is shown separately. Failure to maintain appropriate books and records shall result in the imposition of the tax at the highest tax rate on gross proceeds of sales or gross income applicable to a classification under which the taxpayer is doing business.

APPLICABLE CASE LAW:

The Arizona Supreme Court has stated that “[i]f activities are incidental in the sense that they are inseparable from the principal business and interwoven in the operation thereof to the extent that they are in effect an essential part of the major business, they cannot be taxed as a separate business.” Trico Electric Coop., Inc. v. State Tax Comm’n, 79 Ariz. 293, 297, 288 P.2d 782, 784 (1955).

In addition, the Arizona Supreme Court has held that,

[w]here it can be readily ascertained without substantial difficulty which portion of the business is for non-taxable professional services . . . , the amounts in relation to the company’s total taxable Arizona business are not inconsequential, and those services cannot be said to be incidental to the . . . business, the professional services are not merged for tax purposes into the taxable . . . business and are not subject to taxation.

State Tax Comm’n v. Holmes & Narver, Inc., 113 Ariz. 165, 169, 548 P.2d 1162, 1166 (1976).

In Walden Books Co. v. Ariz. Dep’t of Revenue, 198 Ariz. 584, 588, 12 P.3d 809, 813 (App. 2000), the Arizona Court of Appeals acknowledged the soundness of the Arizona Supreme Court’s holding in Holmes & Narver, but made clear that the test outlined by the Holmes & Narver Court is inapplicable in determining the taxability of goods, services and activities that are subject to a specific exclusion, exemption or deduction.

The Arizona Court of Appeals stated that the “practicality, efficiency and convenience of administrative enforcement is taken into consideration by courts when interpreting tax statutes.” Valencia Energy Co. v. Ariz. Dep’t of Revenue, 189 Ariz. 79, 82, 938 P.2d 474, 477 (App. 1996) (vacated in part, 191 Ariz. 565, 959 P.2d 1256 (1998)).

The Valencia Court further held that a taxpayer that supplied coal to an electric power plant could not reduce the amount of taxable gross proceeds by an amount attributable to its transportation and handling services, due to its failure to keep separate sales records; that a hypothetical separate retail price for coal could be constructed from taxpayer’s purchase records did not satisfy the statutory bookkeeping requirement. Valencia, 189 Ariz. at 82-83, 938 P.2d at 477-478.

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DISCUSSION:

Unlike the sales tax imposed by most states, Arizona imposes a transaction privilege tax on the privilege of conducting business in the State of Arizona. The tax is levied on the business, rather than the consumer. The business may pass the economic burden of the tax on to the consumer, but the business is ultimately liable to Arizona for the tax.

The Arizona transaction privilege tax is imposed under numerous business classifications, including the transient lodging, retail, transporting, telecommunications, commercial lease, personal property rental, amusement and restaurant classifications. In addition, county excise taxes “piggyback” the imposition of the state’s transaction privilege tax. Sales that are subject to Arizona’s transaction privilege tax are also subject to applicable county excise taxes.

A.R.S. § 42-5070 imposes the transaction privilege tax under the transient lodging classification. The transient lodging classification is comprised of the business of operating, for occupancy by transients, a hotel or motel, including an inn, tourist home or house, dude ranch, resort, campground, studio or bachelor hotel, lodging house, rooming house, apartment house, dormitory, public or private club, mobile home or house trailer at a fixed location or other similar structure, and also including a space, lot or slab which is occupied or intended or designed for occupancy by transients in a mobile home or house trailer furnished by them for such occupancy. A.R.S. § 42-5070 focuses on providing facilities for occupancy by transients.

A.R.S. § 42-5070(F) defines a “transient” as “any person who either at the person's own expense or at the expense of another obtains lodging space or the use of lodging space on a daily or weekly basis, or on any other basis for less than thirty consecutive days.”

A.R.S. § 42-5070(C) states that the tax base for the transient lodging classification is the gross proceeds of sales or gross income derived from the business. A.R.S. § 42-5001(1), in turn, defines “business” as “all activities or acts, personal or corporate, engaged in or caused to be engaged in with the object of gain, benefit or advantage, either directly or indirectly, but not casual activities or sales.” A.R.S. § 42-5023 states that it is presumed that all gross proceeds of sales and gross income derived by a person from business activity classified under a taxable business classification comprise the tax base for the business until the contrary is established. Therefore, the gross proceeds of sales or gross income derived from all activities or acts engaged in by a transient lodging facility with the object of gain, benefit or advantage, either directly or indirectly, may be subject to transaction privilege tax under the transient lodging classification.

In addition to the rental of rooms, transient lodging facilities routinely provide a variety of goods, services and activities that may be subject to transaction privilege tax under one or more of the various business classifications. Examples of such goods, services and activities include laundry and dry cleaning services, pay-per-view movies, golf courses, golf lessons, spa services, gift shops, restaurants and room service. Given the number of goods, services and activities that may be provided by a transient lodging facility, there has been some

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confusion regarding whether such goods, services and activities are subject to tax under the transient lodging classification or whether charges for the same constitute a separate line of business subject to tax, or exempt from tax, under one or more of the various business classifications.

Case law has shown that a taxpayer may provide goods, services or activities that constitute separate lines of business. The case law was decided for past periods and determinations were based on facts that had already taken place. Some of the criteria considered in the case law could not be determined until after the event had occurred. Where there are a myriad of services and activities occurring on a daily basis, this historical perspective is not conducive to providing clear and consistent guidance regarding the taxation of future transactions. A clear and consistent interpretation of the tax statutes allows a transient lodging business to correctly determine the amount of their tax liability at the time of the transaction and allows for administration of the tax more efficiently.

Legislation was enacted to clarify how goods, services and activities are taxable to businesses operating under the transient lodging classification. It provided specific statutory exclusions under the transient lodging classification. If a statute or related rule provides for a specific exclusion, exemption or deduction, or otherwise specifies how certain goods, services or activities should be treated for tax purposes, a separate line of business analysis is inapplicable. Therefore, while the Arizona Supreme Court's holding in Holmes & Narver is still good law, the test outlined by the Court is inapplicable in determining the taxability of goods, services and activities that are the subject of a specific exclusion, exemption or deduction. See Walden Books Co. v. Ariz. Dep't of Revenue, 198 Ariz. 584, 588, 12 P.3d 809, 813 (App. 2000). However, if goods, services or activities are the subject of a specific exclusion, exemption or deduction, but fail to meet the requirements of such exclusion, exemption or deduction, such goods, services or activities are subject to tax under the transient lodging classification and a separate line of business analysis will not be applied.

If goods, services or activities are not the subject of a specific exclusion, exemption or deduction, a separate line of business analysis still applies. See Trico Electric Coop., Inc. v. State Tax Comm'n, 79 Ariz. 293, 288 P.2d 782 (1955). In an effort to clearly and consistently impose Arizona's transaction privilege tax to the income derived by hotels, motels and other lodging facilities in the state, the Department has applied a separate line of business analysis to those goods, services and activities routinely provided by the transient lodging industry in addition to the rental of rooms. The result of this analysis appears in the "Arizona Tax Matrix for Hotel/Motel Lodging Industry" ("Matrix") attached to this ruling and incorporated by reference. The separate line of business analysis focused on whether such goods, services or activities routinely provided by the transient lodging industry are open to the public. Arizona imposes the transaction privilege tax under the transient lodging classification on lodging facilities that provide occupancy for transients. Therefore, whether particular goods, services or activities are incidental to, inseparable from and interwoven in the operation of the transient lodging business depends on whether such goods, services or activities are limited to transients. Exclusions under the transient lodging classification further bolster this focus as

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they also depend on whether such goods, services or activities are open to the public. Finally, case law is consistent with this focus. Therefore, if a transient lodging facility provides goods, services or activities that are not open to the public and not specifically addressed by statute or related rule, such goods, services or activities are subject to tax under the transient lodging classification.

Although A.R.S. § 42-5070(C) states that the tax base for the transient lodging classification is the gross proceeds of sales or gross income derived from the business, A.R.S. § 42-5070(C)(1) states that the tax base does not include the following:

[g]ross proceeds of sales or gross income derived from business activity that is properly included in another business classification under this article and that is taxable to the person engaged in that business classification, but the gross proceeds of sales or gross income to be deducted shall not exceed the consideration paid to the person conducting the activity.

A.R.S. § 42-5070(D) states the following:

For the purposes of this section, the tax base for the transient lodging classification does not include gross proceeds of sales or gross income derived from:

1. Transactions or activities that are not limited to transients and that would not be taxable if engaged in by a person not subject to tax under this article.
2. Transactions or activities that are not limited to transients and that would not be taxable if engaged in by a person subject to taxation under section 42-5062 or 42-5073 due to an exclusion, exemption or deduction.
3. Commissions paid to a person that is engaged in transient lodging business subject to taxation under this section by a person providing services or property to the customers of the person engaging in the transient lodging business.

A.R.S. § 42-5073(B)(4) states that the tax base for the amusement classification is the gross proceeds of sales or gross income derived from the business, except that the following shall be deducted from the tax base:

The gross proceeds of sales or gross income derived from sales to persons engaged in the business of transient lodging classified under § 42-5070, if all of the following apply:

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- (a) The persons who are engaged in the transient lodging business sell the amusement to another person for consideration.
- (b) The consideration received by the transient lodging business is equal to or greater than the amount to be deducted under this subsection.
- (c) The transient lodging business has provided an exemption certificate to the person engaging in business under this section.

A.R.S. § 42-5064 imposes the transaction privilege tax under the telecommunications classification. The telecommunications classification is comprised of the business of providing intrastate telecommunications services. Transient lodging facilities routinely provide telecommunication services that are limited to transients. However, A.R.S. § 42-5064(C) provides that a transient lodging business that is subject to tax under A.R.S. § 42-5070 and that provides telephone, fax or internet access services to its customers at an additional charge, which is separately stated on the customer invoice, is considered to be engaged in business subject to taxation under the telecommunications classification for the purposes of taxing the gross proceeds of sales or gross income derived from providing those services.

A.R.S. § 42-5252 levies a tax on every “provider” for each activated wire and wireless service account for the purpose of financing emergency telephone communication services. A “provider” is defined by A.R.S. § 42-5251(4) as “a public service corporation offering telephone or telecommunications services pursuant to title 40, which provides exchange access services.” Although revenue received from local telephone charges and long distance intrastate telephone charges, if separately stated on the folio, is taxable to a lodging facility under the telecommunications classification, the lodging facility is not a “provider” for purposes of the telecommunications service excise taxes imposed by A.R.S. § 42-5252. Therefore, the telecommunications service excise taxes are not levied on such lodging facility. In addition, the exemption provided by A.R.S. § 42-5061(B)(3) for sales of certain telecommunications equipment is not available to a lodging facility that provides telephone or internet services.

EXAMPLES:

While other exclusions, exemptions or deductions may be relevant, following is a discussion of some of the most common exclusions, exemptions and deductions followed by related examples.

A.R.S. § 42-5070(C)(1)

A.R.S. § 42-5070(C)(1) states the following:

the tax base does not include gross proceeds of sales or gross income derived from business activity that is properly included in another business classification under this article and that is taxable to the person engaged in that business

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classification, but the gross proceeds of sales or gross income to be deducted shall not exceed the consideration paid to the person conducting the activity.

Therefore, the gross proceeds of sales or gross income to be deducted by a lodging facility may not exceed the consideration paid to the third party provider and the business activity must be taxable to the third party provider.

Example 1:

Hotel A arranges for a golf outing for one of its guests. The golf course is neither owned nor operated by Hotel A. Upon check-out, a charge of \$110 appears on the guest's folio. This charge represents a \$100 greens fee collected by the hotel on behalf of the golf course and a \$10 mark-up by Hotel A. The \$100 charge for greens fees is subject to tax under A.R.S. § 42-5073. However, the \$100 charge is taxable to the person engaged in business under the amusement classification, which is the golf course. The \$10 mark-up charge is taxable to Hotel A under the transient lodging classification. When Hotel A reports its gross receipts, it reports \$110 as gross receipts and \$100 as a deduction.

Example 2:

Hotel B purchases 25 golf packages from a local golf course for \$100 each. Hotel B provides the golf course with an exemption certificate for the entire purchase, which totals \$2,500. Hotel B then resells 10 of the golf packages to guests of the hotel for \$75 each, and resells 10 of the golf packages to guests of the hotel for \$200 each. The remaining 5 golf packages are given to Hotel B's guests and employees free of charge.

A.R.S. § 42-5073(B)(4) allows the local golf course to deduct from its gross proceeds the price of the golf packages sold to Hotel B if (i) Hotel B resells such packages, (ii) for an amount equal to or greater than what Hotel B paid for the golf packages and (iii) Hotel B provides an exemption certificate to the local golf course.

The local golf course must mark its invoice and indicate that the gross receipts from the sale of golf packages to Hotel B were deducted from the local golf course's tax base. The local golf course must also obtain a complete and properly executed exemption certificate from Hotel B at the time of the transaction. If the local golf course accepts the exemption certificate from Hotel B in good faith, with the reasonable expectation that Hotel B will be selling the packages for \$100 or more, the local golf course will not be liable for any tax on the transaction. See A.R.S. § 42-5009. If, however, the local golf course is aware that 15 of the golf packages will be sold or given away by Hotel B for less

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than the amount paid by Hotel B, the local golf course cannot in good faith accept the exemption certificate and is subject to tax on the sale of those packages.

Assuming Hotel B presents the local golf course with an exemption certificate indicating that all 25 packages are to be sold at an amount equal to or greater than Hotel B's purchase price, Hotel B is responsible for remitting an amount equal to the tax the local golf course should have paid on the transaction had the local golf course known the number of packages Hotel B intended to sell for an amount less than \$100. In this example, Hotel B must remit the amount of tax that results from applying the amusement tax rate to the \$1,500 paid to the local golf course for the 15 golf packages (15 golf packages purchased for \$100 each and sold for or given away for less than \$100). See A.R.S. § 42-5009. Hotel B must remit the amount of tax that results from applying the amusement tax rate to the \$2,000 paid to Hotel B by its guests (10 golf packages sold to Hotel B's guests for \$200 each). See A.R.S. § 42-5070(C)(1).

A.R.S. § 42-5070(D)(1)

A.R.S. § 42-5070(D)(1) states that the tax base for the transient lodging classification does not include gross proceeds of sales or gross income derived from “[t]ransactions or activities that are not limited to transients and that would not be taxable if engaged in by a person not subject to tax under this article.” In other words, such transactions or activities must be open and available to the general public. In order for a transaction or activity to be deemed “open to the public,” it must be the hotel's or motel's policy and practice to provide the same to the general public. A hotel's or motel's practice may not be established by evidence of providing a service or activity on an occasional basis or in an isolated example. The Department will look beyond the form of the alleged policy or practice to its substance.

Examples of transactions or activities that would not be taxable if engaged in by a taxpayer other than a transient lodging facility include pet grooming, babysitting, laundry services, salon services, self-parking, long distance interstate telephone charges, high speed internet access, shipping and mailing charges and secretarial services.

Example 3:

Hotel C offers spa services to its guests and to members of the general public. Therefore, its spa services are not limited to transients. In addition, spa services are not subject to tax if performed by a business that is not subject to tax under the transient lodging classification. Thus, charges by Hotel C for spa services performed for guests and for members of the general public are not subject to tax.

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Example 4:

Hotel C also offers laundry services. However, its laundry services are offered only to guests of the hotel. Therefore, its laundry services are limited to transients. Laundry services are not subject to tax if performed by a business that is not subject to tax under the transient lodging classification. However, because Hotel C's laundry services are not open to the general public, charges by Hotel C for laundry services performed for guests are subject to tax under the transient lodging classification.

A.R.S. § 42-5070(D)(2)

A.R.S. § 42-5070(D)(2) states that the tax base for the transient lodging classification does not include gross proceeds of sales or gross income derived from “[t]ransactions or activities that are not limited to transients and that would not be taxable if engaged in by a person subject to taxation under section 42-5062 or 42-5073 due to an exclusion, exemption or deduction.”

Examples of transactions or activities that would not be taxable if engaged in by a taxpayer subject to tax under the transporting or amusement classifications due to an exclusion, exemption or deduction include “[t]ransporting for hire persons, freight or property 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” as provided by A.R.S. § 42-5062(A)(1), golf or tennis lessons, or membership fees granting the right to use a recreational facility for 28 days or more.

Example 5:

Hotel D offers a shuttle service to and from its location and the local airport for \$20. This shuttle service is available to hotel guests and to members of the general public. Charges for the same shuttle service would not be taxable if performed by a business subject to tax under the transporting classification but exempt from tax due to the exemption provided by A.R.S. § 42-5062(A)(1). Thus, charges by Hotel D for the shuttle service performed for guests and members of the general public are not subject to tax if Hotel D meets the requirements of A.R.S. § 42-5062(A)(1). This exemption states that the transporting classification does not include “[t]ransporting for hire persons, freight or property 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.”

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A.R.S. § 42-5070(D)(3)

A.R.S. § 42-5070(D)(3) excludes “[c]ommissions paid to a person that is engaged in transient lodging business subject to taxation under this section by a person providing services or property to the customers of the person engaging in the transient lodging business.”

Example 6:

Hotel E provides information to its guests about a horseback riding trip through the desert provided by Company X, an unrelated third party provider. Hotel E neither arranges the trip, nor do charges for the trip appear on the hotel folio. Hotel E receives a commission from Company X for each horseback riding trip later arranged by a guest. The commission received by Hotel E from Company X is not subject to tax.

A.R.S. § 42-5070(D)(3) excludes commissions paid only to persons engaged in a transient lodging business.

Example 7:

Hotel F is a full-service destination resort. Golf Course X owns and manages a golf course on Hotel F’s property. Golf Course X receives a commission from Golf Course Y, another area golf course, for either referring golfers to Golf Course Y or arranging for tee times for golfers at Golf Course Y. A.R.S. § 42-5070(D)(3) does not exempt such commissions. Golf Course X is not a business subject to tax under the transient lodging classification. Therefore, A.R.S. § 42-5070(D)(3) is inapplicable and does not exempt such commissions.

Packages

A hotel or motel may provide a package to its guests for a lump sum price. This price includes goods, services or activities in addition to the rental of a room. The hotel or motel folio presented to the guest at check-out may state the lump sum amount for the package and any applicable tax for the guest’s convenience. However, the books and records maintained by the hotel or motel must separately state each item and the applicable tax. As stated in A.A.C. R15-5-2004, “[f]ailure to maintain appropriate books and records shall result in the imposition of the tax at the highest tax rate on gross proceeds of sales or gross income applicable to a classification under which the taxpayer is doing business.”

The cost of a “destination services” package provided by a third party may appear on a guest’s folio. Generally, the charge for such a package is merely a “pass-through transaction.” A “pass-through transaction” is defined as a transaction where goods or services are provided to a guest by a third party and the charges are itemized separately on the folio merely for the guest’s convenience. A “pass-through” transaction is not limited to “destination

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services.” The hotel collects the charges and remits the entire amount to the third party, without mark-up by the hotel. The hotel must maintain proof that an unrelated third party provided goods or services to the guest and that the revenue was purely pass-through in nature. The hotel is merely acting as an agent of the third party provider. The appearance of the third party provider’s name on the hotel folio with no mark-up by the hotel is sufficient proof that an unrelated third party provided goods or services to the guest.

Example 8:

Hotel G offers a weekend summer package for its guests for \$500. This price includes the rental of a hotel room for two nights, a spa treatment, one round of golf at a local golf course, and dinner in Hotel G’s restaurant.

The hotel folio presented to the guest at check-out states the total amount for the package and applicable tax. However, the hotel folio retained by Hotel G for its records, separately states each item and the applicable tax for each item. The rental of the hotel room for two nights is equal to \$200. This amount is subject to tax under the transient lodging classification. The spa treatment is provided at the hotel spa, which is open to the general public, and is equal to \$100. This amount is exempt from tax under A.R.S. § 42-5070(D)(1). The round of golf at a local golf course is equal to \$125 and represents the cost of greens fees. However, Hotel G marks-up such round of golf \$25 for a total of \$150. Hotel G remits \$125 to the local golf course and retains \$25 for itself. The local golf course is subject to tax under the amusement classification on \$125. Hotel G is subject to tax on \$25 under the transient lodging classification. Finally, the \$50 restaurant charge is subject to tax under the restaurant classification.

RULING:

Transient lodging facilities routinely provide a variety of goods, services and activities in addition to the rental of rooms. Examples of such goods, services and activities include laundry and dry cleaning services, pay-per-view movies, golf courses, golf lessons, spa services, gift shops, restaurants and room service.

Arizona case law has shown that a taxpayer may provide goods, services or activities that constitute a separate line of business. However, goods, services or activities that are incidental or integral to the rental of a room cannot be taxed as a separate line of business. This line of cases did not provide a useful guide for Arizona’s transient lodging businesses. Therefore, legislation was enacted to clarify how goods, services and activities are taxable to businesses operating under the transient lodging classification by providing specific statutory exclusions under the transient lodging classification.

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Although the Arizona Supreme Court's holding in Holmes & Narver is still good law, the test outlined by the Court is inapplicable in determining the taxability of goods, services and activities that are the subject of a specific exclusion, exemption or deduction. See Walden Books Co. v. Ariz. Dep't of Revenue, 198 Ariz. 584, 588, 12 P.3d 809, 813 (App. 2000). If a statute or related rule provides for a specific exclusion, exemption or deduction from the transient lodging tax base, or otherwise specifies how certain goods, services or activities should be treated for tax purposes, a separate line of business analysis is inapplicable. However, if goods, services or activities are the subject of a specific exclusion, exemption or deduction, but fail to meet the requirements of such exclusion, exemption or deduction, such goods, services or activities are subject to tax under the transient lodging classification and a separate line of business analysis will not be applied.

If goods, services or activities are not the subject of a specific exclusion, exemption or deduction, a separate line of business analysis still applies. See Trico Electric Coop., Inc. v. State Tax Comm'n, 79 Ariz. 293, 288 P.2d 782 (1955). In an effort to clearly and consistently impose Arizona's transaction privilege tax to income derived by hotels, motels and other lodging facilities in the state, the Department has applied a separate line of business analysis to those goods, services and activities routinely provided by the transient lodging industry in addition to the rental of rooms. The separate line of business analysis focused on whether such goods, services or activities routinely provided by the transient lodging industry are open to the public. Therefore, if a transient lodging facility provides goods, services or activities that are not open to the public and not specifically addressed by statute or related rule, such goods, services or activities are subject to tax under the transient lodging classification.

The purpose of this ruling and the guidance provided in [the Matrix¹](#) attached to this ruling and incorporated by reference, is to clarify when revenue is taxable to a hotel or motel (or other transient lodging facility) and the appropriate business classification for such revenue. Although the legislation discussed in the ruling may be retroactive, this Matrix is prospective. The Matrix is intended to be a guide for the transient lodging industry for those goods, services or activities that may be provided in addition to the rental of rooms. The principles discussed in this ruling should also guide the transient lodging industry for items that may arise in the future. This ruling and the accompanying matrix applies to persons engaged in business under the transient lodging classification. Neither this ruling nor the Matrix applies to, or may be used by, any taxpayer not engaged in the transient lodging business.

The Matrix provides a detailed list of goods, services and activities that are either separable from the principal business of a lodging facility and therefore taxable as a separate line of business, or inseparable and interwoven in the operation thereof to the extent that they are in effect an essential part of the lodging facility's business and therefore not taxable as a separate line of business. The Matrix provides a safe harbor for taxpayers engaged in the business of transient lodging. If a taxpayer chooses not to follow the Matrix, for whatever

¹ The term "guest" as used in the Matrix is limited to a person, who either at the person's own expense or at the expense of another, rents a room at a lodging facility. For purposes of this definition, the term "room" includes a banquet room, meeting room or lodging room.

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reason, neither the taxpayer nor the Department will be precluded from raising any valid arguments regarding the taxation of the taxpayer's business activities.

Please see the attached Matrix for a detailed list of goods, services and activities that may be taxable under the transient lodging or other business classification. The Matrix includes many items not specifically discussed in this ruling. This ruling does not discuss the taxation of goods, services or activities by Arizona cities. It is anticipated that the cities will issue a separate ruling. However, the Matrix identifies whether revenue is taxable to a hotel or motel (or other transient lodging facility) by the cities and the appropriate business classification for such revenue. For a detailed discussion of the cities' tax treatment of such revenue, see the guideline issued by the Unified Audit Committee.

EFFECTIVE DATE:

The effective date of this ruling is January 1, 2007.

Gale Garriott, Director

Signed: September 14, 2006

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.