

ARIZONA DEPARTMENT OF REVENUE

ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 93-28

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

(This ruling supersedes Arizona Sales Tax Ruling 10-15-80 dated August 6, 1980)

ISSUE:

Taxation under the prime contracting classification of maintenance and warranty contracts.

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 42-1310.16 states:

A. The prime contracting classification is comprised of the business of prime contracting and dealership of manufactured buildings.

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B. The tax base for the prime contracting classification is sixty-five per cent of the gross proceeds of sales or gross income derived from the business.

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F. 2. "Contractor" is synonymous with the term "builder" and means a person, firm, partnership, corporation, association or other organization, or a combination of any of them, that undertakes to ... construct, alter, repair, add to, subtract from, improve, move ... any ... building, project, development or improvement.

Arizona Administrative Code (A.A.C.) R15-5-614 states:

In order to distinguish between transactions taxed as a contracting activity rather than a retail one, the following examples are given. The governing factor is whether or not property or material is replaced in the original or existing structure, or if new materials are added.

1. Examples of contracting activities include the installation of a central air conditioning system, the replacement of an air conditioning unit, water heater, electrical wiring, roof, plumbing, landscaping; the installation of a soft water system, remodeling of a kitchen, and the installation of new appliances, wallpaper and other fixtures.

2. Those activities taxed as retail activities consist of repairs in which the materials furnished are not incorporated into the structure. Examples: recharging refrigeration units with Freon, replacement of washers in plumbing.

3. Nontaxable services include carpet cleaning, waxing and polishing, duct cleaning, lawn mowing and garden maintenance.

DISCUSSION:

The question has arisen as to whether prime contractors are subject to transaction privilege tax on the gross proceeds of sales or gross income derived from the sale of warranty and maintenance service contracts.

A contract which provides for the completion of a construction project may also include a warranty contract whereby the prime contractor guarantees the condition of the premises and other covered property. Prime contractors may also contract to provide maintenance services in a transaction which is unrelated to the completion of a construction project.

A contractor may through a warranty and maintenance contract agree to repair items such as light fixtures, walls and wall coverings, and plumbing; to replace heating and air conditioning units and floor covering materials; or to maintain the exterior of the building. However, contractors may also enter into maintenance service contracts which provide for nontaxable services such as carpet cleaning, waxing and polishing, and duct cleaning.

An exemption is provided for the sale of a warranty or service contract under the retail classification. However, this exemption pertains only to the transaction privilege tax on the business of selling tangible personal property at retail. *Tucson Electric Power v. Arizona Department of Revenue*, 170 Ariz. 145, 151, 822 P.2d 498 (App. 1991).

RULING:

The gross proceeds of sales or gross income derived from the sale of warranty contracts and maintenance service contracts which provide for the performance of contracting services are subject to transaction privilege tax under the prime contracting classification.

The gross proceeds of sales or gross income derived from the sale of contracts which provide for the performance of nontaxable services is not subject to transaction privilege tax under the prime contracting classification.

Examples:

1. A prime contractor contracts to construct an apartment building. A warranty contract is included in the contract price. The services to be provided under the warranty contract include replacement of heating and air conditioning units, floor and wall coverings, and electrical wiring as needed. The full contract price is subject to transaction privilege tax under the prime contracting classification.
2. A prime contractor contracts to install elevators in a building. In addition, the contractor enters into a separate contract which provides a warranty for the elevators. Under the warranty contract, the contractor agrees to maintain and repair the elevators as necessary to insure their safe operation. The gross proceeds of the sale of the warranty contract are subject to tax under the prime contracting classification.
3. A prime contractor contracts to provide maintenance services to a customer. The services which will be provided under the contract are limited to janitorial services such as carpet cleaning and waxing and polishing floors. The gross proceeds from the sale of the janitorial services contract are not subject to tax under the prime contracting classification.

Harold Scott, Director
Signed April 16, 1993

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 which are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement which provides interpretation, details or supplementary information concerning the 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 92-1 for more detailed information regarding documents issued by the Department of Revenue.