STATE OF ARIZONA
Department of Revenue

Douglas A. Ducey
Governor

Robert Woods
Director

PRIVATE TAXPAYER RULING LR 21-003

May 27, 2021

Thank you for your letter dated September 2, 2020, requesting a private taxpayer ruling ("PTR") on behalf of your client *** ("Taxpayer"). Specifically, you requested a determination of whether income derived from providing information on a spreadsheet based on specific tailored parameters is subject to taxation pursuant to the Arizona transaction privilege tax ("TPT") statutes.

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:

Whether the gross income derived from providing a temporary or non-perpetual right to use digital information and data, which has been compiled and sent automatically and where the customer has full use and control of the information and data received during the agreed upon term, is subject to TPT.

TAXPAYER'S POSITION(S):

Taxpayer has not articulated any particular position, other than providing a statement that they do not provide their customers with online access to Taxpayer's data repository (*i.e.,* server(s)), nor are customers given the ability to manually run search queries for desired information and data. Finally, Taxpayer does not provide nor grant customers the ability to control, access, or otherwise use any software in order to obtain the information and data.

RULING:

The Department rules that Taxpayer's gross income derived from providing a temporary or non-perpetual use of digital information and data, over which the customer has exclusive use and control, is subject to TPT under the personal property rental classification.

SUMMARY OF FACTS:

The following facts are paraphrased from your ruling request dated September 21, 2020, as supplemented by additional information provided December 18, 2020, January 8, 2021, January 19, 2021, February 1, 2021, March 4, 2021, March 15, 2021, and April 5, 2021:

Taxpayer, headquartered outside of Arizona with home-based sales employees residing in Arizona, is an information and analytics company that offers information and data to ***. This information and data is marketed as ***.[1] *** is the name used to identify and market the product (*i.e.,* the spreadsheet containing the information and data sent to the customer) and is not the name of the software used to compile, store, and deliver the information and data to the customer. *** stands alone and is not offered in connection with any additional services or solutions.[2]

*** comprises primarily of public information and data *** that is compiled and continually updated by Taxpayer. The public information and data is obtained from multiple sources either by purchasing the information and data from its original source or through "web scraping" methods.[3] Original sourced data refers to *** data collected by ***.[4] The information and data include, but is not limited to, *** address and contact information, ***, among other key data (collectively referred to as "Data").[5] The public Data is compiled by Taxpayer's proprietary software into a centralized repository hosted on Taxpayer's servers located in ***.

*** is sold non-exclusively to customers on a subscription basis and priced based in part on the amount of Data requested and frequency of file transfers.[6] Customers may request specific Data which currently is not in Taxpayer's repository. However, when the new Data is acquired and added to the repository, it is made available to all of Taxpayer's customers. A customer signs a Statement of Work ("SOW") that contains the "general or overarching legal aspects governing payment terms,

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[1] Letter from ***, to Ariz. Dep't of Revenue Tax Research & Analysis (Sept. 21, 2020) (on file with author).
[2] *Id.*
[3] Web scraping is defined as:

> [A] term for various methods used to collect information from across the Internet. Generally, this is done with software that simulates human Web surfing to collect specified bits of information from different websites. Those who use web scraping programs may be looking to collect certain data to sell to other users, or to use for promotional purposes on a website.
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> Web scraping is also called Web data extraction, screen scraping or Web harvesting.

What is Web Scraping? - Definition from Techopedia, TECHOPEDIA, https://www.techopedia.com/definition/5212/web-scraping [http://web.archive.org/save/https://www.techopedia.com/definition/5212/web-scraping].
[4] Email from ***, to *** Ariz. Dep't of Revenue Tax Research & Analysis (Apr. 5, 2021) (on file with author).
[5] *Id.*
[6] "Non-exclusive" is defined to mean that the same data is sold to multiple customers. *See* Email from ***, to *** Ariz. Dep't of Revenue Tax Research & Analysis (Feb. 1, 2021) (on file with author).

termination rights, non-disclosure, warranty/indemnity, assignment, etc."[7] Specifically, the SOW outlines the parameters by which the Data will be sorted, compiled, and delivered to the customer. For example, Data could be compiled on ***, but one client may filter results by ***, whereas another client may accept Data no matter ***.

Once the parameters, or "filters," are established, the licensing agreement provides that Data will be extracted from the repository and securely transferred to the customer in a spreadsheet format. This process is completed automatically through the use of Taxpayer's software. And because Taxpayer continually adds new Data to the repository or updates existing Data to keep it current, after the initial delivery, the customer's Data is updated on a recurring basis (the frequency is established in the SOW). Although software is utilized by Taxpayer to automatically compile and send the Data, Taxpayer's customers are not provided access to the software at any point. Rather, the agreement only grants Taxpayer the right to use the Data during the subscription period as provided in the Master License and Service Agreement:

> V. Project Order '"Use" (Data):
>
> . . . Client may use, copy, analyze and/or modify the Data for Its business purposes, including but not limited to, transferring, distributing, reselling, disclosing, renting or otherwise make available the Data to Client's subsidiaries, affiliates, parent, customers, contractors, representatives, agents, or entities with whom [redacted] contracts involve the transferring, distributing, reselling, disclosure or renting of Data in addition to [redacted] claims information and without executing a Third Party Use Agreement.
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> VI. License Type and License Term:
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> The Data shall be provided to Client under a non-exclusive, and limited use license (License Type). The License Term for the Use of the Data is three (3) year(s). This license shall automatically renew year to year thereafter, unless notice of intent to terminate is given by the terminating party at least 60 days prior to the automatic renewal date.

[7] Email from ***, to*** Ariz. Dep't of Revenue Tax Research & Analysis (Jan. 8, 2021) (on file with author).

> Client understands that the Data cannot be shared with any third party (as defined herein) unless said Third Party has executed a Third Party Use Agreement with Client and Vendor, except as may otherwise be provided for in this Project Order.

After the agreement is terminated, by either party, all Data sent to the customer over the course of the agreement's term must be deleted by the customer or any subsidiary, affiliate, parent, customer, contractor, representative, agent, or entity with whom the customer has shared the Data.[8] The deletion of the Data is a contractual obligation and the customer must, upon request, provide proof of deletion.[9]

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, 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. 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.

Data as Tangible Personal Property

For the purposes of Arizona's transaction privilege and use taxes, tangible personal property is much more than physical goods that a person can hold, touch, or feel. As defined in A.R.S. § 42-5001(21), it is property "which may be seen, weighed, measured, felt or touched or is in any other manner perceptible to the senses." Consistent with this broad definition, there is longstanding precedent in case law for applying this broad definition of tangible personal property to subjects other than physical goods, such as electricity, electronic delivery of software, and music played from a jukebox.[10] The Arizona Supreme Court's decision in *State v. Jones* addressed the scope of the taxation of tangible personal property.[11] In *State v. Jones*, the Arizona Supreme Court held when a person inserts a coin into a jukebox and listens to a phonograph record, he is purchasing tangible personal property.[12] The court stated, the playing of the record is perceptible to the sense of hearing and,

[8] Email, *supra* note 6.
[9] Email from ***, to*** Ariz. Dep't of Revenue Tax Research & Analysis (Mar. 15, 2021) (on file with author).
[10] *State Tax Comm'n v. Marcus J. Lawrence Mem'l Hosp*., 108 Ariz. 198 (1972) (en banc) (finding that electricity and gas are tangible personal property); *State v. Jones*, 60 Ariz. 412 (1943) (finding that playing a record is perceptible to the senses and fulfills the statute's definition of tangible personal property).
[11] *Jones*, 60 Ariz. at 413.
[12] *Id.*

hence, constitutes what the statute terms tangible personal property.[13] The current definition is not substantively different from that considered by the *Jones* court in 1943. Even the supreme court of another state, in a use tax opinion, noted the broad scope of Arizona's definition.[14]

Therefore, whether delivered electronically or in a physical format, all rentals or sales of Data are considered to be rentals or sales of tangible personal property subject to tax under the personal property rental classification or retail classification.[15] The medium employed in the delivery of the item does not affect its taxable status.

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 deducted by statute.

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.[16] Therefore, all charges associated with the rental of tangible personal property are taxable unless a separate statutory exclusion or deduction applies.

The *State Tax Commission v. Peck* Court set out guidelines for determining whether a particular activity is considered a personal property rental.[17] It resolved the question of whether the facts presented before it constituted a rental by looking at the dictionary definition of the word "rent," which was defined as "(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."[18]
The court determined that:

[13] *Id.*
[14] *Ramco, Inc. v. Director*, 248 N.W.2d 122, 124 (Iowa 1976).
[15] Although ample Arizona case law suggests that digital data is tangible personal property for TPT purposes, Arizona courts have not specifically addressed this issue. However, other states have found that a sale of computer-organized data constitute a sale of tangible personal property. *See, e.g., Miami Citizens Nat'l Bank & Tr. Co. v. Lindley*, 364 N.E.2d 25 (Ohio 1977).
[16] Ariz. Admin. Code ("A.A.C.") R15-5-1502(D) (2020).
[17] *State Tax Comm'n v. Peck*, 106 Ariz. 394 (1970).
[18] *Id.* at 396.

> 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.[19]

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, or the renting party's ability to operate or use rented property on its own.[20]

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City Tax

It is important to note that the imposition of city privilege taxes is separate and distinct from the state's TPT and accompanying county excise taxes. As with the state's TPT, city privilege taxes are imposed on the vendor for the privilege of engaging in business in the city. The Model City Tax Code ("MCTC") was created in order to impose and administer city privilege taxes. Similar to Arizona's TPT, city privilege taxes are imposed "upon persons on account of their business activities."[21] All Arizona cities 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.

Rental, leasing, and licensing for use of tangible personal property

Similar to A.R.S. § 42-5071, MCTC § -450 imposes the city privilege tax on the rental, leasing and licensing for use of tangible personal property. However, separately stated charges for direct customer services and "delivery, installation, repair, and/or maintenance" are not taxable for city purposes.[22] MCTC Reg. § -450.5 provides additional guidance that delivery and installation charges are exempt when the provisions of MCTC Reg. § -100.2 have been met.

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[19] *Id.*
[20] *City of Phoenix v. Bentley-Dille Gradall Rentals, Inc.*, 136 Ariz. 289, 292 (App. 1983).
[21] MCTC § -400(a)(1).
[22] MCTC § -450.

Discussion

Taxpayer is in the business of collecting Data from the public domain and providing the Data to customers on a recurring basis, subject to termination by either party. When a customer initially contracts with Taxpayer, a contract is signed between the parties indicating the terms of the agreement. These terms include filters or parameters specifying acceptable Data, frequency of Data updates, cost, payment, and the length of time the customer will have control of the Data. After the original delivery of the *** product, the Data is updated by Taxpayer on a recurring basis to provide newly acquired Data matching the customer's criteria or make changes to previously-provided Data. Although the file, and the Data it contains, are to be used exclusively by that customer, the Data held in the repository is provided to any customer who has paid for Data with matching parameters.[23] This arrangement continues until the agreement is terminated by either party. Following the agreement's termination, the customer is contractually required to delete all Data received through ***. Taxpayer may require a proof of deletion, and noncompliance by the customer would constitute a breach of contract.

As noted above, tangible personal property is defined for purposes of state TPT as "personal property that may be seen, weighed, measured, felt or touched or that is in any other manner perceptible to the senses."[24]

A rental of tangible personal property is subject to TPT under the personal property rental classification. A rental of tangible personal property is taxable when the lessee "enjoy[s] possession or control of the [tangible personal property].[25] In determining whether a transaction is taxable (*i.e.,* a lease of tangible personal property) or whether it is a nontaxable service, the Arizona Court of Appeals has most recently applied both the "dominant purpose" and the "common understanding" tests.[26]

The dominant purpose test provides that a transaction is determined to be "all taxable or all nontaxable by identifying the dominant purpose of the transaction."[27] Reviewing the facts makes it clear that the primary objective of the parties is that, for a consideration, Taxpayer will provide a

[23] This is analogous to a remotely accessed software program wherein each customer pays for certain features (some may pay for all while others may be more selective). However, each customer has exclusive use of the login and the software features for which the customer has paid.
[24] A.R.S. § 42-5001(21).
[25] *Jones Outdoor Advert., Inc. v. Ariz. Dep't of Revenue*, 238 Ariz. 1, 3 (App. 2015).
[26] *Val-Pak E. Valley, Inc. v. Ariz. Dep't of Revenue*, 229 Ariz. 164 (App. 2012).
[27] *Id.* at 167 (generally citing to *Qwest Dex, Inc. v. Ariz. Dep't of Revenue,* 210 Ariz. 223, 226-27 (App. 2005)).

customer with unrestricted access to Data for the term of the agreement. In other words, the Data is the dominant purpose of the test.

However, while the Court of Appeals acknowledged that the dominant purpose test is "a recognized method of deciding taxability," it also acknowledged that the test has been "harshly criticized by courts and commentators because it often leads to inconsistent results."[28] Thus, the court also applied a second "common understanding" test together with the dominant purpose test to determine whether the taxpayer was engaged in a nontaxable business activity.

The common understanding test provides that, in determining whether Taxpayer is engaged in a taxable business activity or a nontaxable service, the inquiry should center on whether the business activity is primarily renting tangible personal property or rendering services, as these activities are *commonly understood*.[29] Simply put, the court found that a taxpayer is more likely to be understood as having engaged in a nontaxable service if a transfer of tangible personal property during the transaction is merely incidental to the services or skills provided.[30]

Taxpayer's business activity involves granting customers the right to full "possession or control" of Data (*i.e.,* tangible personal property), pending termination by either party. Although the Data is initially sourced from public sources, Taxpayer either paid or mined for the Data, and whatever the source, Taxpayer exercises ownership over the Data housed in the repository. Upon termination of the arrangement, customers no longer have a legal right to exercise any use or control over the Data received from Taxpayer and it must be deleted (deleting the Data is analogous to the lessee returning tangible personal property when the lease/rental expires). Any owner of tangible personal property (*i.e.,* the lessor) who, for a consideration, temporarily loans personal property to another (*i.e.,* the lessee) for that person's exclusive use and enjoyment during the agreed upon term, is commonly understood to be engaged in the business of leasing or renting tangible personal property, a business activity which is taxable in Arizona.

Furthermore, in applying the simple version of the common understanding test, the customers' receipt of the Data is not a byproduct or a "mere incident" of providing nontaxable services. Rather,

[28] *Val-Pak*, 229 Ariz. at 167.
[29] *Id.* at 168 (citing WALTER HELLERSTEIN, STATE TAXATION ¶ 12.08 (3d ed. 2011).
[30] *Qwest Dex,* 210 Ariz. at 228 (citing *Dun & Bradstreet, Inc. v. City of New York*, 11 N.E.2d 728 (N.Y. 1937)).

it is the primary object of the transaction.[31] Without the Data, it is unlikely that Taxpayer's customers would sign a contract or pay the fees that they do for the Data.[32]

It should be noted that the contract's use of the term "limited use license" is contractual language that has no bearing on whether the agreement ultimately constitutes a taxable lease or rental.[33] Taxpayer delivers "non-exclusive Data"—an industry term meaning that the same Data will be provided to multiple customers—to the client,[34] whereupon the customer then has possession or control of the received Data (the contract provides that the customer may "use, copy, analyze and/or modify the Data").[35] The agreement's term is a set period, after which time the agreement automatically renews annually unless terminated by either party before the automatic renewal date. If the agreement is terminated, the client and all affiliates with whom the Data was shared are required to delete all Data in their possession.

Accordingly, Taxpayer is engaged in the business of renting tangible personal property and the gross income derived from renting Data is presumed subject to TPT, unless otherwise exempted or deducted.

If applicable, Taxpayer may take state, county, and city tax deductions on the gross income derived from the renting Data to ***, or any other deduction that may ultimately apply under the personal property rental classification.

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.

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[31] The primary purpose is the same as the dominant purpose and is ultimately why *Val-Pak* applied both tests, as they go hand-in-hand.

[32] Although it may require extensive labor and/or skill to acquire the data (*e.g.*, sourcing and purchasing the data or through web scraping), and even though a customer may request specific data, this data is provided to any customer who requests it. Moreover, the data—*i.e.*, the tangible personal property—is not a random or incidental result of the labor. This is the primary purpose of building out Taxpayer's repository.

[33] *State Tax Comm'n v. Peck*, 106 Ariz. 394, 396 (1970) (stating "[n]or do we believe that the mere attachment of a label such as 'license', borrowed from other areas of law, can be dispositive of the tax question before us").

[34] Email from ***, to *** Arizona Department of Revenue (Feb 1, 2021 10:04 MST) (on file with author).

[35] Master Licensing & Service Agreement (Oct. 4, 2006) (on file with author).

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 and after the date the taxpayer receives the ruling.