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TAXPAYER INFORMATION RULING LR 21-001

March 22, 2021

By E-mail: dan@garretttax.com

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Dear Mr. Garrett:

Thank you for your letter dated October 21, 2020 and subsequent phone conversation on January 14, 2021, requesting a taxpayer information ruling ("TIR") on behalf of your unnamed client ("taxpayer"). Specifically, you requested a ruling on whether Taxpayer's gross income derived from delivery of food to a business is subject to Arizona's transaction privilege tax ("TPT"). Pursuant to Arizona Revised Statutes ("A.R.S.") § 42-2101, the Arizona Department of Revenue ("Department") may issue taxpayer information rulings to taxpayers and potential taxpayers on request.

ISSUE:

Whether Taxpayer, a bakery, is subject to tax on its sales of baked goods delivered to a business location and, if so, under what tax classification TPT on the sales would be reported and remitted.

TAXPAYER'S POSITION:

The taxpayer's position is that it is a qualified retailer selling tax exempt food such that its sales are generally exempt for state TPT purposes. Furthermore, Taxpayer believes that its sales of baked goods delivered to a business location are exempt from state TPT, despite Arizona Administrative Code ("A.A.C.") R15-5-1806(9), because the administrative rule is incorrect.

RULING:

Food intended for home consumption and sold by a qualifying retailer is generally exempt from TPT for state and county purposes. Because the tax exemption for food is based on food intended for *home* consumption, any food delivered to a business establishment is not eligible for the exemption unless the taxpayer can otherwise demonstrate that the food is intended for home consumption. Home consumption could be demonstrated if the food is purchased by a natural person using a payment method other than a business line of credit or a business credit card.

In this case, despite being a qualified retailer, Taxpayer does not provide any facts that the sales of food delivered to a business establishment are intended for home or personal, non-business related consumption. Accordingly, in cases where a delivery of food is made to a business as the final consumer of the sale rather than for resale purposes, and there is no additional evidence demonstrating that the food is intended for home consumption, the Taxpayer must remit TPT for state and county purposes.

There is no general exemption for the sale of food for home consumption at the municipal level. Consequently, some municipalities impose a privilege tax on food for home consumption. Thus, a bakery's sales are taxable in some cities and towns, regardless of the seller's status or the nature of the food's consumption. The Town of Gilbert currently taxes food for home consumption. Therefore, in addition to state and county taxes, Taxpayer will also be liable for Gilbert privilege tax for its sales of baked goods delivered to a business location.

SUMMARY OF FACTS:

The following are relevant facts provided in the above-referenced letter and phone conversation:

Taxpayer is in the business of baking and selling cakes in Gilbert, Arizona. Customers may purchase cakes in ***** different flavors. The business provides ***** on the cakes. The taxpayer does not provide any facilities for customers to sit and eat on the premises. Customers either take cakes to go or have them delivered. Taxpayer may deliver a cake to a residence or business address. Taxpayer also sells ***** retail items, ***** and birthday themed plates, napkins, cups, candles, and cards.¹ Taxpayer does not sell any beverages in cups, glasses, or open containers.

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, the 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. The Arizona TPT is imposed under sixteen separate business classifications. A.R.S. § 42-6102(A) provides that the state's TPT provisions shall govern the imposition of county excise taxes. Accordingly, all sales subject to TPT are also subject to applicable county excise taxes.

Retail Classification

¹ The non-exhausted list of tangible personal property sold at the bakery are subject to TPT under the retail classification. The taxability on the sale of these items is not in question and is not addressed in this ruling.

A.R.S. § 42-5061 imposes the TPT under the retail classification. The retail classification is comprised of the business of selling tangible personal property at retail. The tax base for the retail classification is the gross proceeds of sales or gross income derived from the business. A.R.S. § 42-5061(V)(4) defines “selling at retail” as “a sale for any purpose *other than for resale* in the regular course of business in the form of tangible personal property” (emphasis added).

A.R.S. § 42-5061(A)(15) provides that the tax does not apply to sales of food, as provided in and subject to the conditions of A.R.S. Title 42, Chapter 5, Article 3. Under this Article, A.R.S. § 42-5102(A)(3) exempts the sale of *food* by a retailer who does not provide or make available any facilities for the consumption of food on the premises.

A.A.C. R15-5-1860 gives further definition to what constitutes a “qualified retailer.” A.A.C. R15-5-1860(12)(b)(iii) defines a qualified retailer as a retailer who sells food and who does not provide any facilities for the consumption of food on the premises. This category may include certain health food stores and certain outlets retailing soda and other similar beverages in bottles or cans, but not cups. A.A.C. R15-5-1860(12)(b)(i)(4) lists bakeries as an example of qualified businesses.

“Food” is defined by A.R.S. § 42-5101 to mean any food item that is *intended for home consumption*, as such intent is defined by rules and regulations adopted by the Department. A.A.C. R15-5-1860(9) provides that “food intended for home consumption” means food, other than food for consumption on the premises, which is usually intended to be consumed at home. That rule further provides that “[u]nless the taxpayer can establish to the contrary, food delivered by a retailer to an office or other business establishment shall not be considered food intended for home consumption.”

A.A.C. R15-5-1860 gives further definition to the term “food.” In accordance with this rule, “food” means items intended for human consumption. Food is deemed to be intended for human consumption when either: (a) its intended or ordinary use is as a food for human consumption or (b) it is an ingredient used in preparing food for human consumption. A.A.C. R15-5-1860(15)(c) provides examples of items that the Department will consider as tax exempt food. These items include bread and flour products, as well as candy and confectionery.

A.A.C. R15-5-1860(9) states that “food intended for home consumption” does not include “food for consumption on the premises.” “Food for consumption on the premises” includes: food served by an attendant; hot prepared foods; sandwiches; and food served with trays, glasses, dishes, or tableware.

Importantly, A.A.C. R15-5-1860(9) provides:

“Food intended for home consumption” means food, other than food for consumption on the premises, which is *usually intended* to be consumed at home.²

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.” See MCTC § -400(a)(1). All Arizona cities follow the MCTC in the imposition of their privilege tax based upon their local ordinances. However, certain options exist, allowing each city to alter or qualify the imposition of its privilege tax.

A.R.S. § 42-6017 addresses the city privilege taxes in relation to the retail classification. It provides that “[e]xcept as provided in this section, section 42-5061 supersedes all city or town ordinances or other local laws insofar as the ordinances or local laws now or hereafter relate to the taxation of business activities classified under section 42-5061.” That section also provides certain exceptions.

One such exception is A.R.S. § 42-6017(C)(1), which provides that a city or town may, notwithstanding A.R.S. § 42-5061(A)(15), levy a transaction privilege tax on the gross proceeds of sales or gross income derived from the business of selling food at retail by the persons described in A.R.S. § 42-5102(A), subject to the conditions of A.R.S. §§ 42-5074, 42-5101 and 42-6015.

MCTC § -462 imposes the city privilege tax on the gross income derived from the business activity of engaging or continuing in the business of selling food for home consumption at retail. While most cities consequently tax food for home consumption, some cities do not. The cities that choose not to tax food for home consumption have adopted a tax rate of zero percent.

DISCUSSION

Taxpayer did not specify the type of business to which it delivers its baked goods or the circumstances under which they will be delivered. For the purposes of this ruling, the Department assumes that the business is not a restaurant or another business that will resell the baked goods. Rather, it is assumed that the business to which the goods are delivered is itself the final customer.

The state exempts food that is sold by a qualifying retailer. See A.R.S. § 42-5061(A)(15). To qualify for this exemption, the items in question must meet three conditions: (1) they must meet the

² (Emphasis added.) In other words, the Rules do not require that the food actually be consumed at someone’s dwelling. Such requirement would be difficult if not impossible to enforce as people often buy food for home consumption but could bring it with them to other social settings, including business locations.

definition of “food,” (2) they must also be classified as “tax exempt food,” and (3) they must be sold by a “qualifying retailer.” A.A.C. R15-5-1860(12)(b)(i)(4) provides that bakeries are an example of a business that might be considered a qualified retailer. If all three of these conditions are not met, the food sold is taxable. If taxable, food would simply be reported under the retail classification for state purposes. The state does not have a separate business code for reporting taxable food.

In the facts provided, Taxpayer does not provide any facilities to consume its cakes on its premises. It does not provide beverages in cups, glasses, or open containers. Taxpayer sells service ware in the form of birthday-themed plates, napkins, and cups. However, if those items are prepackaged and are not provided to the customers to consume the cakes on the property, Taxpayer would still be a qualified retailer. A.A.C. R15-5-1860(12)(b)(iii). Additionally, as mentioned, A.A.C. R15-5-1860(12)(b)(i)(4) provides that bakeries are generally considered to be qualified retailers.

“Food” includes any food item intended for human consumption that is intended for home consumption. See A.R.S. § 42-5101(3). Pursuant to A.A.C. R15-5-1860(7)(b), food is deemed to be intended for human consumption when its intended or ordinary use is as food for human consumption or is an ingredient used in preparing food for human consumption. However, an important qualification to note is that food, as defined by A.R.S. § 42-5101(3), must not only be intended for human consumption, but must also be intended for *home* consumption. A.A.C. R15-5-1860(10) defined “home” as “a natural person’s usual or habitual dwelling place, including rest homes, nursing homes, jails and other such institutions.” A.A.C. R15-5-1860(9) further provides that, “[u]nless the taxpayer can establish to the contrary, food delivered by a retailer to an office or other business establishment shall not be considered food intended for home consumption.”

Consequently, a taxpayer that sells and delivers food that might otherwise qualify as exempt to a business establishment that is the final consumer is subject to Arizona TPT on those sales. Thus, if Taxpayer delivers to an office or other business establishment that does not purchase the food for resale, such sales are subject to state TPT under the retail classification and not under the restaurant classification. Taxpayer must remit TPT on those sales, unless it shows that the food was intended for home consumption by the purchaser. Taxpayer did not present any facts to establish the contrary.³ Taxpayer’s other sales of food intended for home consumption that are delivered to residential addresses are still deductible for TPT purposes.

Taxpayer incorrectly asserts that A.R.S. § 42-5102(A)(3) only contemplates two categories of locations where food can be consumed: on the premises and at home. A.R.S. § 42-5102(A)(3)

³ For example, when an individual uses his or her private credit card and requests for groceries to be delivered to a commercial office building instead of a residential address out of convenience, the sale would nevertheless be considered food for home consumption. Thus, a cake purchased from a bakery by a private individual who requests that it be delivered to an office building instead of a home *could* be considered food for home consumption if the delivery is not for a business or office event.

describes the categories of retailers that are considered qualified retailers. The other categories of retailers listed in that section include vending machines, grocery stores, and street cart vendors.

Taxpayer also asserts,

The Department's rule correctly states that food intended for "home consumption" means food, other than food for consumption on the premises (A.A.C. R15-5-1860(9)). Therefore, if the food is consumed on the vendor's premises it is taxable and if it is not consumed on the vendor's premises it is not taxable.

The Department's rule erroneously creates a third location (a location which is not the vendor's premises and is not the purchaser's home) which is designed to tax food eaten at locations that are not the vendor's premises.

Taxpayer essentially argues that A.A.C. R15-5-1860(9) is incorrect. However, in so doing, Taxpayer incorrectly assumes that the rule attempts to determine where exempt food is *actually* eaten as a qualifier for determining whether such food, when sold, is taxable or exempt. The rule does no such thing.

The rules promulgate guidelines that determine whether food is *intended* to be consumed at home by setting forth parameters of what constitutes food for consumption on the premises. A.A.C. R15-5-1860(8) provides a list of examples, including food served with utensils, food that is served in a condition to be immediately eaten (hot or cold), and beverages sold in open containers. These examples show that what is definitive is *how* the retailer sells exempt food, not the location where it is actually eaten. Taxpayer has presented no additional facts for the Department's further consideration of the issue. Moreover, the Department cannot determine the propriety of A.A.C. R15-5-1860(9) in a letter ruling.

For municipal privilege tax purposes, there is no exemption for the sale of exempt food for home consumption by a retailer. As such, some Arizona cities and towns impose a tax on food for home consumption. Here, Taxpayer's business is located in the Town of Gilbert. Currently, Gilbert taxes food for home consumption. Therefore, taxpayer is liable for municipal privilege tax on its sales of baked goods.

Conclusion

Food intended for home consumption sold by a qualifying retailer is generally exempt from TPT for state and county purposes. Because the tax exemption for food is based on food intended for home consumption, any food delivered to a business establishment as the final consumer of the food is not eligible for the exemption unless home consumption can be demonstrated. Home consumption can be demonstrated if the food is purchased by a natural person using their personal debit or credit,

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cash and not business credit line or debit/credit card. Thus, sales intended for home consumption are exempt from the TPT whereas sales of those items delivered to a business establishment are not exempt unless it can be shown that they were intended for home consumption. In cases where delivery of food is made to a business establishment as the final consumer of the sale and not for resale, and there is no evidence demonstrating an intention that the food is intended for home consumption, the Taxpayer must remit TPT for state and county purposes.

At the city level, unlike at the state and county levels, there is no exemption for the sale of exempt food for home consumption by a retailer and some cities impose a tax on food for home consumption. Thus, selling baked goods at the city level is taxable in some cities. The Town of Gilbert currently taxes food for home consumption. This taxpayer will be responsible for remitting taxes to Gilbert.

This response is a taxpayer information ruling (TIR) and the determination herein is 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 taxpayer information 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.

If the Department is provided with required taxpayer identifying information and taxpayer representative authorization before the proposed publication date (for a published TIR) or date specified by the Department (for an unpublished TIR), the TIR will be binding on the Department with respect to the taxpayer that requested the ruling. In addition, the ruling will apply only to transactions that occur or tax liabilities that accrue from and after the date the taxpayer receives the ruling. The ruling may not be relied upon, cited, or introduced into evidence in any proceeding by a taxpayer other than the taxpayer who has received the taxpayer information ruling. If the required information is not provided by the specified date, the taxpayer information ruling is non-binding for the purpose of abating interest, penalty or tax.

Sincerely,



Ranjana Burke

Tax Attorney III

Taxpayer Services Division

Arizona Department of Revenue