

# STATE OF ARIZONA

Department of Revenue  
Office of the Director  
(602) 716-6090



Janet Napolitano  
Governor

Gale Garriott  
Director

**CERTIFIED MAIL** [REDACTED]

The Director's Review of the Decision  
of the Hearing Officer Regarding:

[REDACTED]

**UTI No.** [REDACTED]

**ORDER**

**Case No. 200500157-I**

On December 15, 2005 the Hearing Officer issued a decision regarding the protest of [REDACTED] ("Taxpayers"). Taxpayers appealed this decision on January 11, 2006. As the appeal was timely, the Director of the Department of Revenue ("Director") issued a notice of intent to review the decision.

In accordance with the notice given the parties, the Director has reviewed the Hearing Officer's decision and now issues this order.

## STATEMENT OF CASE

Taxpayers filed a request for refund of individual income taxes on October 15, 2003 for tax years 1998 through 2003. The request was based on claimed tax credits for pollution control equipment pursuant to A.R.S. § 43-1081. The Individual Income Tax Audit Section of the Audit Division ("Division") denied Taxpayers' refund request. Taxpayers protested the denial, and the Hearing Officer denied the protest. On appeal, Taxpayer argues that they are entitled to a credit for the construction of storm water retention areas and sewer systems because they constitute pollution control equipment. The Division argues that storm water retention areas and sewer systems do not qualify for the credit because such property is not directly used, constructed or installed for the purpose of meeting or exceeding pollution related requirements of the Environmental Protection Agency or the

Department of Environmental Quality. In addition, the Division argues that various claimed expenses were not substantiated by Taxpayers.

### **FINDINGS OF FACT**

The Director makes the following findings of fact:

1. Taxpayers are engaged in the business of developing commercial real estate in Arizona through [REDACTED].
2. During the years at issue, Taxpayers held a 99% interest in the [REDACTED].
3. The [REDACTED] developed five properties during the years at issue.
4. The [REDACTED] installed certain storm water retention areas and sewers in the developments, including retention walls, gutters, drainage piping, land costs, grading and engineering.
5. The purpose of the installed items was to channel storm water runoff and waste water from the development.
6. The storm water retention areas and the sewer systems serve public health and safety purposes.
7. The primary purpose of the installed items is not pollution control.
8. On October 15, 2003 Taxpayers submitted a request for refund of individual income tax in the amount of \$[REDACTED] plus interest for tax years 1998 through 2003. Taxpayers later amend this amount to \$[REDACTED] and again amended the request in their appeal to the Director to \$[REDACTED].
9. The request for refund results from claimed income tax credits for pollution control equipment pursuant to A.R.S. § 43-1081.
10. The Section denied Taxpayers' refund request.
11. Taxpayers protested the denial.

### **CONCLUSIONS OF LAW**

1. Arizona resident individuals are subject to Arizona income tax on all income received. A.R.S. § 43-102(A)(5).
2. For tax purposes, [REDACTED] is treated as a partnership and is therefore a pass-through entity. The income of the [REDACTED] flows through to and is taxed to the individual members of the [REDACTED].
3. Arizona allows credits against a taxpayer's Arizona income tax liability for pollution control equipment pursuant to A.R.S. § 43-1081.
4. Tax credits are a matter of legislative grace and not a matter of taxpayer right. Tax statutes are construed strictly against a party who claims a credit. *Arizona Department of Revenue v. Raby*, 204 Ariz. 509, 511, 65 P.3d 458 (App. 2002); *Davis v. Arizona Department of Revenue*, 197 Ariz. 527, 4 P.3d 1070 (App. 2000).
5. A cardinal principle of statutory construction is to follow the plain and ordinary meaning of a word. *Dearing v. Arizona Department of Economic Security*, 121 Ariz. 203, 589 P.2d 446 (App. 1978).
6. Statutes are to be given, whenever possible, such an effect that no clause, word or sentence is rendered superfluous, contradictory, void or insignificant. *State v. Deddens*, 112 Ariz. 425, 542 P.2d 1124 (1975).
7. To qualify for the credit provided by A.R.S. § 43-1081, the property must be directly used, constructed or installed in Arizona for the purpose of meeting or exceeding rules or regulations adopted by the United States environmental protection agency, the department of environmental quality or a political subdivision of this state to prevent, control, monitor or reduce air, land or water pollution. A.R.S. § 43-1081.B.
8. Taxpayers' property does not qualify for the credit under A.R.S. § 43-1081.
9. The Division properly denied Taxpayers' credit request.

## **DISCUSSION**

The issue to be decided is whether the Section properly denied Taxpayers' request for refund. Taxpayer's request is based on claimed tax credits for pollution control equipment pursuant to A.R.S. § 43-1081 for expenses related to the installation of sewer systems and

the construction of storm water retention areas on five properties developed by [REDACTED]. In the refund request, Taxpayers list expenses such as retention walls, gutters, drainage piping, land costs, grading and engineering.

A.R.S. § 43-1081, as it existed for the years at issue, provides in pertinent part:

A. A credit is allowed against the taxes imposed by this title for expenses that the taxpayer incurred during the taxable year to purchase real or personal property that is used in the taxpayer's trade or business in this state to control or prevent pollution. The amount of the credit is equal to ten per cent of the purchase price.

B. Property that qualifies for the credit under this section includes that portion of a structure, building, installation, excavation, machine, equipment or device and any attachment or addition to or reconstruction, replacement or improvement of that property *that is directly used, constructed or installed in this state for the purpose of meeting or exceeding rules or regulations adopted by the United States environmental protection agency, the department of environmental quality or a political subdivision of this state to prevent, monitor, control or reduce air, water or land pollution.* The credit allowed pursuant to this section does not apply to the purchase of any personal property that is attached to a motor vehicle. (Emphasis added.)

Credits are a matter of legislative grace and not a matter of taxpayer right. *Keyes v. Chambers*, 209 Or. 640, 307 P.2d 498 (1957)(Credits must be strictly construed against the taxpayer and in favor of the taxing authority); *Davis v. Arizona Department of Revenue*, 197 Ariz. 527, 4 P.3d 1070 (App. 2000)(Tax statutes are construed strictly against a party who claims a credit.) It is also well settled that statutes are to be given, whenever possible, such an effect that no clause, word or sentence is rendered superfluous, contradictory, void or insignificant. *State v. Deddens*, 112 Ariz. 425, 542 P.2d 1124 (1975).

The legislature made a clear statement in A.R.S. § 43-1081.B. that in order to qualify for the credit the property must be directly used, constructed or installed in Arizona for the purpose of meeting or exceeding rules or regulations adopted by the United States environmental protection agency, the department of environmental quality or a political

subdivision of this state to prevent, control, monitor or reduce air, land or water pollution. This legislative requirement must be given meaning.

The storm water retention areas and the sewer systems serve a public health and safety purpose. The storm water retention areas and the sewer systems are not directly used, constructed or installed in Arizona for the purpose of meeting or exceeding rules or regulations adopted by the United States environmental protection agency, the department of environmental quality or a political subdivision of this state to prevent, control, monitor or reduce air, land or water pollution. Therefore, the Director agrees with the Hearing Officer that the Division's denial of Taxpayers' refund request was proper under A.R.S. § 43-1081.

### **ORDER**

The Hearing Officer's decision is affirmed.

This decision is the final order of the Department of Revenue. Taxpayer may contest the final order of the Department in one of two manners. Within 60 days of the receipt of the final order, Taxpayer may file an appeal to the State Board of Tax Appeals, 100 North 15<sup>th</sup> Avenue, Suite 140 Phoenix, AZ 85007 or, if the amount in dispute is greater than five thousand dollars, Taxpayer may bring an action in Tax Court (125 West Washington, Phoenix, Arizona 85003). For appeal forms and other information from the Board of Tax Appeals, call (602) 364-1102. For information from the Tax Court, call (602) 506-3763.

Dated this 8<sup>th</sup> day of January, 2007.

ARIZONA DEPARTMENT OF REVENUE

Gale Garriott  
Director

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Certified original of the foregoing  
mailed to:

[REDACTED]

Copy of the foregoing mailed to:

[REDACTED]

GG:st

cc: Income Tax Appeals Section  
Income Tax Audit Section  
Audit Division