

STATE OF ARIZONA

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



Janet Napolitano
Governor

J. Elliott Hibbs
Director

CERTIFIED MAIL

The Director's Review of the Decision)
of the Administrative Law Judge Regarding:)
[TAXPAYER])
ID No. [REDACTED])
_____)

ORDER

Case No. 200300086S

On October 20, 2003, the Administrative Law Judge issued a decision regarding the protest of [REDACTED] ("Taxpayer"). The Taxpayer appealed this decision on November 18, 2003. 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 Administrative Law Judge's decision and now issues this order.

STATEMENT OF CASE

Taxpayer, while protesting an audit assessment, requested a refund, with interest, of state retail transaction privilege taxes that it had paid to the Department of Revenue ("Department") on sales of electricity generators. Taxpayer contends those sales were exempt from transaction privilege taxes pursuant to A.R.S. § 42-5061(B)(4) as "Machinery, equipment or transmissions lines used directly in producing or transmitting electrical power, but not including distribution.". The Transaction Privilege and Use Tax Section ("Section") of the Audit Division denied Taxpayer's claim for refund. The protest of the audit assessment is not at issue in this Appeal.

FINDINGS OF FACT

The Director adopts from the findings of fact in the decision of the Administrative Law Judge and makes additional findings of fact based on the record as set forth below:

1. Taxpayer is a retailer of home improvement products. As a portion of its business operations, Taxpayer sells electric generators for household and farm use. The largest generator Taxpayer sells has a capacity of 7000 watts.
2. Taxpayer is not an electric utility engaging in the business of producing or transmitting electricity for sale.
3. Taxpayer included the receipts from the sale of the generators in its taxable base for Arizona transaction privilege tax purposes.
4. Taxpayer submitted two claims for refund of transaction privilege taxes it paid on the sales of the generators. The first was submitted in September 2002 in the amount of \$ [REDACTED] plus interest for the period June 2000 to July 2002. On December 5, 2002, Taxpayer submitted a second claim for refund in the amount of \$ [REDACTED] plus interest for the period October 1998 through May 2000.
5. It was Taxpayer's position that its sales of generators were exempt from the transaction privilege tax under the retail and rental of tangible personal property classifications as machinery, equipment or transmissions lines used directly in producing or transmitting electrical power, but not including distribution.
6. The Section denied both claims for refund. Taxpayer timely protested the denials.
7. Taxpayer conceded at the hearing before the Office of Administrative Hearings that the claim for refund for the month of October, 1998 in the amount of \$ [REDACTED] was barred by the applicable statute of limitations. The claim for refund for that month is not before the Director.
8. The combined refund request at issue for the period November 1998 through July 31, 2002 is in the amount of \$ [REDACTED], plus interest.

CONCLUSIONS OF LAW

The Director makes the following conclusions of law:

1. A.R.S. § 42-5061 imposes the transaction privilege tax on the business of selling tangible personal property at retail. The tax base is the gross proceeds of sales or gross income derived from the business.
2. Taxpayer's income from the sale of the generators was gross proceeds of sales or gross income derived from its retail sales business.
3. Taxpayer collected the economic burden of its transaction privilege tax on the sale of the generators from its customers.
4. A.R.S. § 42-5061(B)(4) provides a deduction from the retail tax base for machinery, equipment or transmissions lines used directly in producing or transmitting electrical power, but not including distribution. Transformers and control equipment used at distribution sites constitute equipment used in producing or transmitting electrical power.
5. Exemptions from tax are to be narrowly construed. *Kitchell Contractors v. City of Phoenix*, 151 Ariz. 139, 144, 726 P.2d 236 (App. 1986).
6. A taxpayer requesting a refund has the burden of showing that the gross income in question is not taxable. *State Tax Comm'n v. Graybar Electric Co.*, 86 Ariz. 283,344 P.2d 1008 (1959).
7. Arizona courts will apply the rules of construction if a plain meaning interpretation would lead to an absurd result or a result at odds with the legislature's intent. See *Resolution Trust Corp. v. Western Technologies, Inc.*, 179 Ariz. 195, 201, 877 P.2d 294, 300 (App. 1994).
8. A statute must be read so as to give it a fair and sensible meaning and meaning must be given to each statutory clause and the effects and consequences as well as the spirit and purpose of the law must be considered. *Tittle v. State*, 169 Ariz. 8, 9, 816 P.2d 267, 268 (App. 1991).

9. The exemption provided by A.R.S. § 42-5061(B)(4) is intended for sales made to electric utility companies because their sales of the electricity produced are in turn subject to the transaction privilege tax. *Duval Sierrita Corp. v. Arizona Department of Revenue*, 116 Ariz. 200, 204, 568 P.2d 1098, 1102 (App. 1977). The exemption was thus not intended to apply to sales made for household and farm use.
10. In rare situations, the Department may be estopped from assessing a tax that is legally owed by a taxpayer. *Valencia Energy Co. v. Arizona Dep't of Revenue*, 191 Ariz. 565, 576, 578-79, 959 P.2d 1256, 1267, 1269-70 (1998). This appeal involves a refund claim, and the specific circumstances enumerated by the Court in *Valencia* for estoppel to apply do not exist here.

DISCUSSION

Taxpayer is engaged in a taxable retail business activity and sells electric generators for household and farm use. Taxpayer argues that a small electric generator nevertheless is an item of machinery or equipment used directly in the production of electricity. In making this argument, Taxpayer focuses on a small portion of the exemption and not the language of the entire exemption.

The Section argues that the exemption was intended for sales of electrical generating and transmission equipment sold to electric utilities. The Section's interpretation is more consistent with the intent of the legislature to provide the deduction since the end product of the generating activity is subject to the tax. *Duval Sierrita Corp. v. Arizona Department of Revenue, supra*.

This interpretation is further supported by a consideration of the language of the entire exemption. The language of the entire provision allows a deduction for equipment used to produce and transmit electrical power other than distribution and discusses the deductibility of transformers and control equipment used at transmission substations. These are the basic activities performed by electric utilities engaged in the business of producing, transmitting and distributing electrical power to customers. It indicates that the focus of the

legislature in enacting the deduction was not for personal use generators. Taxpayer's arguments fail to take the entire statutory provision into account.

The legislative history surrounding the original enactment of the deduction further supports the Section's position. The deduction was first enacted by Laws 1968, Ch. 2. As initially drafted, the deduction applied to "Electric Power Companies." This raised a concern that the deduction might not apply to other organizations that produced and sold electricity such as the City of Mesa, Salt River Project and other improvement districts and power authorities. The deduction was thereafter changed in the final version of the bill to apply to "Electric, power production and transmission." There was no indication that removing the term "Electric Power Companies" was intended to extend the deduction to the sale of personal use generators.

Taxpayer argues that the plain language of the statute allows a deduction for a generator since it produces electricity. It does not matter to whom the generator is sold since the statute does not contain any limitation. However, Arizona courts will apply the rules of construction if a plain meaning interpretation would lead to an absurd result or a result at odds with the legislature's intent. *Resolution Trust Corp. v. Western Technologies, Inc., supra*. A statute must be read so as to give it a fair and sensible meaning and the effects and consequences as well as the spirit and purpose of the law must be considered. *Tittle v. State, supra*.

Taxpayer's interpretation would lead to a result clearly not intended by the legislature. For example, under Taxpayer's interpretation the deduction would apply not only to personal use generators, but also to the sale of all alternators for cars and trucks. Arguably, under Taxpayer's interpretation the deduction could apply to the sale of batteries. Exemptions from tax are to be narrowly construed. *Kitchell Contractors v. City of Phoenix, supra*. There is nothing in the record to indicate that the legislature intended such an expansive deduction as urged by Taxpayer.

Finally, Taxpayer urges the Department to follow in this case a twenty year old letter (January 7, 1983) to another taxpayer. Taxpayer maintains that the letter applies to its own

situation since that letter relates to a question about sales of electrical generators. However, it is not possible to determine from the record whether the factual situation of the third party was the same or similar to Taxpayer's factual situation or whether the letter represents the Department's current position on that issue. In any event, the letter does not prevent the Department from denying Taxpayer's claim for refund in this case. *Valencia Energy Co. v. Arizona Dep't of Revenue, supra.*

ORDER

The Administrative Law Judge's decision is affirmed.

This decision is the final order of the Department of Revenue. The Taxpayer may contest the final order of the Department in one of two manners. The Taxpayer may file an appeal to the State Board of Tax Appeals, 100 North 15th Avenue, Suite 140, Phoenix, AZ 85007 or may bring an action in Tax Court (125 West Washington, Phoenix, Arizona 85003) within sixty (60) days of the receipt of this order. 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 19th day of April, 2004.

ARIZONA DEPARTMENT OF REVENUE

J. Elliott Hibbs
Director

Certified original of the foregoing
mailed to:

[REDACTED]

Copy of the foregoing mailed to:

[REDACTED]

[REDACTED]
Case No. 200300086S
Page 7

cc: Transaction Privilege and Use Tax Section
Office of Administrative Hearings
Transaction Privilege Tax Appeals