

## PRIVATE TAXPAYER RULING LR99-006

June 28, 1999

The following private taxpayer ruling is in response to your initial letter of March 17, 1999 and follow-up letter of April 14, 1999. Your letter requests a determination regarding a process to alter residual solids from a wastewater treatment facility into a chemically balanced fertilizer. You wish to know whether the chemicals purchased by the ... ("the District") are exempt from transaction privilege tax as chemicals which cause a change in a manufacturing process.

Following is a restatement of the facts presented in your letters. After the facts portion of this letter, your position will be presented. Next, applicable statutes are given followed by a discussion. Finally, a conclusion is reached.

### FACTS

The District manages all matters pertaining to the .... Two activities conducted by the District are (1) wastewater treatment and (2) producing a balanced organic fertilizer from wastewater residual solids. The activity at issue herein is the fertilizer production.

The fertilizer is a chemically balanced fertilizer produced by mixing certain chemicals with dried biosolids from the wastewater treatment facility. This new process is referred to as the ... process. Before the ... process was developed, wastewater from the sewage disposal system was dried (de-watered) which produced biosolids or sludge. The biosolids were then disposed of by landfill or land application.

The ... process involves mixing anhydrous ammonia and phosphoric acid ("the Chemicals") with the dried biosolids. In the ... process, the de-watered solids ("the Organics") are pumped, under pressure, into an enclosed pipe reactor. The Chemicals are injected at several points in the reactor and mixed with the Organics. The Chemicals can be mixed at different ratios (Chemicals to solids) to produce an end-product with different fertilizing characteristics. The primary purpose served by the Chemicals is to add and bind nutrients to the organic material. Bacteria are not necessarily destroyed by the Chemicals. The resulting slurry is then pumped into a pug mill and mixed before being transferred to a thermal rotary dryer. The thermal dryer destroys bacteria.

A more technical explanation of the reaction between the Chemicals and the Organics is as follows: Adding the Chemicals at particular times, in a certain order and in a particular quantity causes the Organics to hold on to the nutrients and form chemical bonds. The ... process

changes the molecular structure of and chelates the Chemicals so the end-product is a slow release, enriched, organic fertilizer. The ... end-product is mono-ammonia phosphate. Traditional chemical fertilizers are produced by blending nitrogen, phosphorous and potassium without the addition of any organic components. The addition of anhydrous ammonia and phosphoric acid to the Organics in the ... process greatly increases the value of the end-product fertilizer. Without the addition of the Chemicals and the ... process, the waste stream from the treatment plant would be a semi-dried sludge of little or no value.

The District purchases the Chemicals used in the ... process from Arizona suppliers. Currently, the suppliers are passing on to the District the transaction privilege tax applicable to these purchases. The District believes its future purchases of Chemicals should be exempt from tax because the Chemicals are "used in a manufacturing process which cause or permit a chemical change to occur...." The District also wishes to obtain a refund of transaction privilege tax it has paid to its suppliers (as per the applicable statute of limitations).

## YOUR POSITION

In its March 16, 1999 letter, the District explains the rationale underlying its contention that the purchase of Chemicals for the ... process should be exempt from transaction privilege tax. The District believes that the chemicals, anhydrous ammonia and phosphoric acid, are chemicals used in a manufacturing process which cause or permit a chemical change to occur and should be exempt from tax pursuant to A.R.S. § 42-5061(A)(40) (1999) (formerly codified at A. R.S. § 42-1310.01(A)(40) (1998)).

In support of its contention, the District notes that the ... process converts residual wastewater plant solids into a balanced organic fertilizer through an exothermic reaction. The District states:

The residual organic matter is transformed through a chemical reaction by the addition of anhydrous ammonia and phosphoric acid. The addition of these chemicals causes an exothermic reaction, producing heat to kill harmful bacteria and viruses. The chemicals also change the molecular structure of the biosolids and chelate the added plant nutrients, resulting in an enriched slow release organic fertilizer.

The District believes that the conversion of residual solids into fertilizer is a manufacturing process. The District cites A.R.S. § 42-1310.01(A)(40) to support its position. Applying the aforementioned statute to the ... process, the District argues as follows:

Sales of liquid, solid or gaseous chemicals (Anhydrous ammonia and phosphoric acid) used in processing wastewater solids (sludge) involves direct contact with the sludge causing or permitting a chemical or physical change (exothermic

reaction) to occur in the sludge and causing bacteria and viruses to be killed as part of the production process. In addition, the chemicals bind with added plant nutrients resulting in an enriched slow release organic fertilizer.

Finally, the District notes: "The state's definition of a 'manufacturer' means a person who is principally engaged in the fabrication, production or manufacture of products, wares or articles for use from raw or prepared materials, imparting to those materials new forms, qualities, properties and combinations."

## APPLICABLE STATUTORY PROVISIONS

A.R.S. § 42-5061(A)(40) states in pertinent part:

A. 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. The tax imposed on the retail classification does not apply to the gross proceeds of sales or gross income from:

....

40. Sales of liquid, solid or gaseous chemicals used in manufacturing, processing, [or] fabricating ... if using or consuming the chemicals, alone or as part of an integrated system of chemicals, involves direct contact with the materials from which the product is produced for the purpose of causing or permitting a chemical or physical change to occur in the materials as part of the production process....

A similar exemption is available under the use tax statutes. A.R.S. § 42-5159(A)(35).

A.R.S. § 42-5061(V)(2) states in pertinent part:

V. For purposes of subsection K of this section:

....

2. "Manufacturer" means a person who is principally engaged in the fabrication, production or manufacture of products, wares or articles for use from raw or prepared materials, imparting to those materials new forms, qualities, properties and combinations.

It should be noted that the definition of "manufacturer" in A.R.S. § 42-5061(V)(2) is specifically applicable only to subsection K of A.R.S. § 42-5061. Therefore, as defined, the term does not

necessarily apply to A.R.S. §§ 42-5061(A)(40) or 42-5159(A)(35).

Unless the Legislature clearly expresses an intent to give a term a special meaning, words used in statutes are to be given their plain and ordinary meaning. See State v. Korzep, 165 Ariz. 490, 493, 799 P.2d 831, 834 (1990).

In determining the ordinary meaning of a word, courts may refer to an established and widely used dictionary. State v. Mahaney, 975 P.2d 156, 158, ¶12 (Ariz. Ct. App. 1999) (citing State v. Wise, 137 Ariz. 468, 470 n.3, 671 P.2d 909, 911 n.3 (1983)).

Arizona's transaction privilege tax is imposed on the amount or volume of business conducted by persons (vendors or sellers) in the state. A.R.S. § 42-5008(A); Arizona Administrative Code (A.A.C.) R15-5-2002. The vendor is responsible for paying the tax. A.A.C. R15-5-2002. However, the vendor may pass the economic burden of the tax on to the purchaser. A.A.C. R15-5-2210(A).

A.R.S. § 42-2101(G) states in part: "The department may issue a private taxpayer ruling addressing a taxpayer's ongoing business activities, except that the ruling applies only to transactions that occur or tax liabilities that accrue from and after the date the taxpayer receives the ruling."

A.R.S. § 42-1118 provides for the issuance of a credit or refund when any amount of tax, penalty or interest has been paid in excess of the amount actually due. The provision enumerates the different forms in which a refund may be issued. In addition, the statute specifically delineates what is to be included in a refund request.

## DISCUSSION

Arizona imposes a transaction privilege tax which differs from the sales tax imposed by most states. The Arizona transaction privilege tax is imposed on the privilege of conducting business in the State of Arizona. This tax is levied on the **vendor** (seller), not the purchaser. The vendor may pass the burden of the tax on to the purchaser. However, the vendor is the taxpayer and is ultimately liable to Arizona for the tax.

The transaction privilege tax is imposed on 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. All retail sales are subject to tax unless specifically exempted by statute. In certain cases, an exemption is available for the retail sale of chemicals. Sales of chemicals used in manufacturing are exempt from tax "if using or consuming the chemicals ... involves direct contact with the materials from which the product

is produced for the purpose of causing or permitting a chemical or physical change to occur in the materials as part of the production process." A.R.S. § 42-5061(A)(40).

The terms "manufacturing," "processing" and "fabricating" are not particularly defined by the Legislature for purposes of A.R.S. §§ 42-5061(A)(40) or 42-5159(A)(35). Therefore, one must look "to an established and widely used dictionary" for a definition of the words. One dictionary defines manufacturing as follows: "to make by hand or, esp., by machinery, often on a large scale and with division of labor ... to work (wood, steel, etc.) into usable form...." Webster's New World Dictionary of the American Language 864 (David B. Guralnik ed., Second College ed., Simon and Schuster 1984) (hereinafter Webster's). A second definition of manufacturing may be found in the Administrative Code. A.A.C. R15-5-120(A), in part, defines manufacturing as "the performance as a business of an integrated series of operations which place tangible personal property in a form, composition, or character different from that in which it was acquired and transforms it into a different product with a distinctive name, character, or use." Processing means "to prepare by or subject to a special process or method...." Webster's at 1133. Fabricating means "to make, build, construct, etc., esp. by assembling parts; manufacture...." Webster's at 500.

Combining the language of A.R.S. § 42-5061(A)(40) with the ... process as described in your letters, we see that the Chemicals used in the ... process, in fact, are used or consumed as part of an integrated system of chemicals involving direct contact with the biosolids for the purpose of causing or permitting a chemical or physical change to occur in the biosolids as part of the fertilizer production process. The ... system is a process or involves manufacturing as those terms are used in A.R.S. § 42-5061(A)(40).

Due to the prospective constraints imposed by A.R.S. § 42-2101(G), the question of refunds cannot be addressed in this Private Taxpayer Ruling. An information letter explaining refunds will be provided to you under separate cover.

## CONCLUSION

The ... process constitutes manufacturing or processing pursuant to A.R.S. § 42-5061(A)(40). Therefore, the purchase of Chemicals for use in the ... process is not subject to tax.

The conclusions in this private taxpayer ruling do not extend beyond the facts as presented in the request for a private taxpayer ruling dated March 17, 1999 and the follow-up letter of April 14, 1999.

This response is a private taxpayer ruling and the determinations herein are based solely on the facts provided in your request. The determinations in this taxpayer ruling are the present position of the department and are valid for a period of four years from the date of issuance except as set out herein.

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 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.