



Janice K. Brewer  
Governor

David Raber  
Acting Director

## TAXPAYER INFORMATION RULING LR13-012

November 25, 2013

This taxpayer information ruling is in response to your written request dated March 15, 2013, and the additional information provided in your letter dated April 26, 2013 on behalf of your unidentified affiliated clients (“Taxpayers M, P and S”), regarding the application of transaction privilege tax to mining and retail activities. Pursuant to Arizona Revised Statutes (“A.R.S.”) § 42-2101, the Department may issue a taxpayer information ruling to a representative of an unidentified taxpayer.

### ISSUES:

1. Does a company have to be engaged in the actual extraction of nonmetalliferous mineral products from beneath or at the surface of the earth in order to be subject to transaction privilege tax under the mining classification?
2. Is a company engaged in purchasing raw silica sand mined in Arizona from an affiliated company and processing the sand into a nonmetalliferous mineral product called “[X]. sand,” subject to transaction privilege tax under the mining classification or the retail classification?

### RULING:

The Department rules as follows:

Under the mining classification provided by A.R.S. § 42-5072, there is no requirement that a business must mine or extract the nonmetalliferous mineral product from the earth in order to be subject to tax under the mining classification. A business that produces for sale, profit or commercial use any nonmetalliferous mineral product that has been mined, quarried or otherwise extracted within the boundaries of this state, is subject to transaction privilege tax under the mining classification.

A company that processes raw silica sand mined within Arizona into [X] sand, is producing for sale, profit or commercial use a nonmetalliferous mineral product and is subject to the transaction privilege tax imposed under the mining classification. The mining classification includes the business of producing for sale, profit or commercial use any nonmetalliferous mineral product that has been mined, quarried or otherwise extracted in Arizona. A.R.S. § 42-5072.

## TAXPAYER INFORMATION RULING LR13-012

November 25, 2013

Page 2

### TAXPAYER POSITION:

The following position is presented in your March 13, 2013 letter:

Taxpayers M, P and S are single member limited liability companies (“LLCs”) owned by the same entity. Taxpayer M mines sand under an agreement with an unrelated third party owner of the mining property. Taxpayer M then sells the sand in an arm’s length transaction to Taxpayer P. ... Taxpayer P processes and refines the sand into another marketable product called “[X] sand”. ... The sale transactions between these entities are at arm’s length, and these entities were not created for the purpose of avoidance of the Arizona TPT.

Your position is that Taxpayer M is engaged in business under the mining classification; the income from its sales is subject to tax under the mining classification. Taxpayer P is engaged in business under the retail classification, its sales to Taxpayer S are tax exempt sales for resale. Taxpayer S is also engaged in business under the retail classification.

### DISCUSSION AND LEGAL ANALYSIS:

A.R.S. § 42-5072(A) provides that the mining classification is comprised of the “business of mining, quarrying or producing for sale, profit or commercial use any nonmetalliferous mineral product that has been mined, quarried or otherwise extracted within the boundaries of this state ...” (emphasis added). By its express terms, the classification includes more than merely mining. The tax base for the mining classification is the gross proceeds of sales or gross income derived from the business.

Moreover, A.R.S. § 42-5072(D) speaks to the taxability of persons engaged in business under the mining classification who derive income from service or manufacturing charges, including those who derive all of their income from these activities that do not involve the extraction of the nonmetalliferous mineral products from beneath or at the surface of the earth:

In the case of a person engaged in business classified under the mining classification all or part of whose income is derived from service or manufacturing charges instead of from sales of the products manufactured or handled, the tax base includes the gross income of the person derived from the service or manufacturing charge.

In a case involving a virtually identical statute that imposed transaction privilege tax on the mining of mineral products, the taxpayer argued that the sale of a portion of copper cathodes that was copper mined *by a third party* was not subject to the transaction privilege tax under the mining classification because the taxpayer did not *mine* that copper. See *State Tax Comm. v. Ranchers Exploration and Dev. Corp.*, 22 Ariz.App. 480, 528 P.2d 866 (1974). The court disagreed, and stated in its discussion:

The pertinent portions of [A.R.S. §] 42-1310(2)(a)] specifically provide that the tax imposed

## TAXPAYER INFORMATION RULING LR13-012

November 25, 2013

Page 3

shall be levied and collected at an amount equal to one percent of the 'gross income from the business' upon every person engaging in the business of 'mining . . . or producing for sale, profit or commercial use, any . . . copper . . . or other mineral product, compound or combination of mineral products . . . for sale, profit or commercial use.' Thus, the tax is upon more than mining. It is upon producing any copper or other mineral product. In this instance appellee is producing and selling copper cathodes, deriving its gross income from the sale of this product.

*Id.* at 482, 528P.2d at 868

Just like the statute at issue in *Ranchers*, A.R.S. § 42-5072 imposes the transaction privilege tax on the business of mining, quarrying or producing for sale, profit or commercial use any nonmetalliferous mineral product that has been mined, quarried or otherwise extracted within the boundaries of this state. A.R.S. § 42-5072(G) defines "nonmetalliferous mineral product" as "oil, natural gas, limestone, sand, gravel or any other nonmetalliferous mineral product, compound or combination of nonmetalliferous mineral products."

Arizona courts have found distinctions between activities taxable under the mining classification and the exempt manufacturing of articles from mineral products<sup>1</sup> that are entirely disassociated from the activities taxable under the mining classification. In *State Tax Commission v. Wallapai Brick & Clay Products, Inc.*, 85 Ariz. 23, 330 P.2d 988 (Ariz. 1958), the Arizona Supreme Court found that a mining business that both removed clay and fabricated bricks was subject to transaction privilege tax on the gross income from the sale of the bricks – the "first marketable product." In *Arizona Department of Revenue v. Magma Copper Co.* 138 Ariz. 322, 674 P2d 876 (Ariz. 1983), the Arizona Supreme Court held that a mining business that mined copper and "electrolytically refined" the copper to produce 99.96 pure copper, was not subject to tax on the further fabrication of the copper into a six square inch bar that was further drawn through a series of rolling mills.

...

Taxpayer M mines the round grain sand and sells 100% of it to Taxpayer P. Taxpayer P processes the sand and ensures that it meets [X] Standards for use as [X] sand. Taxpayer P does not perform any manufacturing or fabrication activities to the sand.

Taxpayer M is engaged in mining a nonmetalliferous mineral product. Taxpayer P is engaged in producing for sale, profit or commercial use a nonmetalliferous mineral product . Both Taxpayers

---

1 There are no court cases that address the current mining statute (A.R.S. § 42-5072) regarding nonmetalliferous mineral products. However, the statutory language at issue is identical to the prior statute (A.R.S. § 42-1310) which imposed transaction privilege tax on both mineral products and nonmetalliferous mineral products, and which was addressed in several court cases.

## TAXPAYER INFORMATION RULING LR13-012

November 25, 2013

Page 4

M and P are subject to transaction privilege tax under the mining classification. Taxpayers are free to use whatever form of business they choose, but in choosing a form they must accept its advantages and disadvantages. *Higgins v. Smith*, 308 U.S. 473 (1940).

**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.**

Lrulings/13-012-D