Douglas A. Ducey
Governor

David Briant
Director

PRIVATE TAXPAYER RULING LR 18-001

March 28, 2018

Thank you for your letter dated April 27, 2016, requesting a private taxpayer ruling ("PTR") on behalf of your client, *** ("***"). Specifically, *** requests a determination on whether the purchase of certain irrigation systems will be exempt from the Arizona transaction privilege tax ("TPT") or use tax. Pursuant to Arizona Revised Statutes (A.R.S.) § 42-2101, the Arizona Department of Revenue ("Department") may issue private taxpayer rulings to taxpayers and potential taxpayers on request.

ISSUE:

Will ***'s purchase of certain components of its irrigation system for use in commercial agricultural production be exempt from the retail TPT and use tax pursuant to the four inch pipe exemption under A.R.S. § 42-5061(B)(6) or the exemption for purchases of new agricultural machinery and equipment under A.R.S. § 42-5061(B)(13).[1]

RULING:

The inline-steel filters, mainline pipes and some sub-mainline pipes qualify for the A.R.S. § 42-5061(B)(6) exemption since they are all larger than four (4) inches in diameter and will all be used to transport water as part of a commercial agricultural irrigation system. In addition, any fittings, seals and any other parts used in operating those pipes are also exempt.

Because the micro irrigation system *** will be installing is recognized by the industry as a drip irrigation system, its components are the same, and its operation is the same as other drip irrigation systems, it qualifies as a drip irrigation system for purposes of this ruling.

In addition to the exemptions under A.R.S. § 42-5061(B)(6), A.R.S. § 42-5061(B)(13) exempts items used for commercial agricultural purposes including drip irrigation lines. A.R.S. §§ 42-5061(C)(7) and 42-5159(C)(7) specifically exclude motors and pumps used in

[1] *** also inquired whether the installation of the irrigation system would be exempt from the prime contracting TPT on the basis that the system is exempt and has independent functional utility pursuant to A.R.S. § 42-5075(B)(7). *** is not the taxpayer performing the installation. Therefore, this issue is not properly before the Department.

irrigation *systems* from any A.R.S. § 42-5061(B) exemption.[2] The statute does not define the term system, and the use of the term 'systems' in A.R.S. §§ 42-5061(C)(7) and 42-5159(C)(7) to make specific exclusions strongly suggests that the word line should have a broader interpretation. The term drip irrigation line in A.R.S. § 42-5061(B)(13) is interpreted to include other components forming part of a drip irrigation system with the exception of motors and pumps. As such, the A.R.S. §§ 42-5061(B)(13) and corresponding 42-5159(B)(13) exemptions include the remaining components forming part of the drip irrigation system.

SUMMARY OF FACTS:

The following is a summary of the relevant facts based on your letter dated April 27, 2016 and subsequent correspondence with the Department dated June 20, 2017 and September 15, 2017:

***, headquartered in Arizona, is in the business of the commercial production of ***. *** has multiple locations in Arizona.[3]

Historically, *** used flood irrigation practices in older ***. However, due to the age of ***'s flood irrigation system, and the inherent inefficiencies with flood irrigation practices, *** is in the process of converting its current flood irrigation to a drip-type irrigation system ("Irrigation System") that sprinkles water around the root zone of each crop. It recently built *** using a micro-sprinkler irrigation system and micro-sprinklers will continue to be used if more *** are built. To install these systems, *** will purchase all new machinery and equipment for the Irrigation System, and will hire contractors to construct the Irrigation System.

<u>The Components of the Irrigation System to be purchased include:</u>

A. In-Line Steel Filters. The Irrigation System pumps water[4] out of a well in the ground (i.e. groundwater) and into an in-line water filter made out of steel pipes.[5] The diameter of

[2] The exemptions related to pumps and motors used as part of an irrigation system are not part of this ruling.
[3] *** also has locations outside Arizona.
[4] The Department assumes the *** will be installing a pump to pump the water from the well. However, *** did not request a determination on whether such a pump would be exempt under Arizona statutes.
[5] See Att. 2 of the ruling request showing images of the in-line filter.

the filters ranges from 8 to 15 inches. The in-line filter cleans physical, chemical, or biological contaminants out of the groundwater.

B. Mainline Pipes. Water flows out of the in-line filter into mainline pipes which then carry water to each separate field in the ***. The pipes are made of polyvinyl chloride ("PVC"), a type of plastic material, and range in diameter from 8 to 15 inches.

C. Sub Mainline Pipes. Water flows from the mainline pipes into sub-mainline pipes which carry water through the middle of a field. These PVC pipes range in diameter from 3 to 10 inches.

D. Lateral Lines. Water flows from the sub-mainline pipes into lateral lines which carry water to each individual tree. Lateral lines are 1¼ inch in diameter.

E. Risers. Water flows from the lateral lines into a "riser," attached to a lateral line at each tree. The riser is a small PVC pipe that is attached to a lateral line underground. It sticks up approximately 18 inches out of the ground. A micro-sprinkler emitter is attached to the top of the riser emitting water around the trees' root zones.

F. Emitters. Drip irrigation systems can use a variety of emitter heads.[6] *** is using micro-sprinkler or low flow sprinkler emitters. The wetted area around each micro-sprinkler will cover the entire trees' root zones. Each tree will have one micro-sprinkler emitter and each tree will receive approximately the same amount of water. The emitters *** will use will emit water at approximately 0.5 to 2.0 gallons per minute but will not flood the area surrounding the trees.[7]

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[6] Examples include *drippers*, where water drips out of a nozzle (either above or below ground); *bubblers*, where water bubbles out of an emitter head above ground; and *micro-sprinkler heads*, where water is sprayed above ground in a circle (or other pattern). The type of emitter head used depends on the type of crop being grown. A drip emitter head would be appropriate for a crop with a small root zone, whereas a bubbler or micro-sprinkler would be more appropriate for a larger crop. Regardless of the type of emitter used, the irrigation system functions the same in that water is delivered directly to the root zone of a crop, the area is not flooded, and all crops receive the same amount of water. See *** ruling request page 3.

[7] Micro-sprinkler emitters can generally emit water from a range of approximately 9 gallons per hour to approximately 5.7 gallons per minute, depending on the model of the micro-sprinkler emitters, and the water pressure. See *** ruling request page 3-4.

G. Valves. The Irrigation System includes two types of valves (field valves and flush valves), installed at different locations on the Irrigation System. Field valves regulate the water pressure, and let any air out of the pipes when necessary. Flush valves drain water out of the Irrigation System to clean the pipes when not in use (i.e. to avoid build-up of algae in the pipes).

H. Seals, Couplings, Fittings, Flanges, and other Adaptors. The Irrigation System is assembled using various types of seals, couplings, fittings, flanges and other adaptors that hold the components of the Irrigation System together and prevent leakage at joints.

Installation and Disassembly of the Irrigation System.

Generally, the installation of the system comprises attaching the components together, burying pipes in underground ditches and stabilizing pipes by bolting to concrete pads.

Disassembly of the system consists of unbolting components from the concrete pad, removing the dirt covering the pipes, and generally disconnecting the pipes and other components from each other.

DISCUSSION & LEGAL ANALYSIS:

Arizona's TPT is a tax on the privilege of conducting certain businesses in Arizona. The TPT is a tax on the *seller*, not on the purchaser. The seller may pass the burden of the tax on to the purchaser; however, the seller is ultimately liable for the tax. All sales that are subject to the TPT are also subject to applicable county excise taxes.

Arizona's use tax is a complimentary tax to the TPT. If a company does not have nexus for Arizona TPT purposes, Arizona's use tax may apply. A.R.S. § 42-5155(A) imposes the use tax on purchases of tangible personal property that are used, stored, or consumed in Arizona. The consumer is liable for the use tax; nevertheless, a vendor may be responsible for collecting and remitting the use tax to the state when the vendor has sufficient nexus with the state or if the vendor otherwise assumes such collection and remission responsibilities.

Whether *** is responsible for the TPT or use tax on the purchases of components for its Irrigation System will depend on whether any specific statutory exemption or deduction is applicable.

Retail Classification

A.R.S. § 42-5061 imposes the state's TPT on the business of selling tangible personal property at retail.[8] All sales of tangible personal property are subject to tax unless specifically deducted or excluded by statute.

A.R.S. § 42-5061(B)(6), and the complimentary use tax provision A.R.S. § 42-5159(B)(6), allow a deduction from the tax base for the sale of "[p]ipes or valves four inches in diameter or larger used to transport … water … including compressor units, regulators, machinery and equipment, fittings, seals and any other part that is used in operating the pipes or valves."[9]

In addition, A.R.S. § 42-5061(B)(13) provides a deduction for sales of "new machinery and equipment consisting of … drip irrigation lines not already exempt under … this subsection and that are used for commercial production of agricultural, horticultural, viticultural and floricultural crops and products in this state."[10] "New machinery or equipment" means machinery or equipment that has never been sold at retail except pursuant to leases or rentals that do not total two years or more. A.R.S. § 42-5061(B)(13)(a). A.R.S. § 42-5159(B)(13) provides a parallel exemption from the use tax. A.R.S. §§ 42-5061(C)(7) and 42-5159(C)(7) specifically provide that the deductions permitted by the statute *do not include* motors and pumps used in drip irrigation *systems.*

The Four Inch Pipe Deduction

It must be determined first whether the components of the Irrigation System are exempt under A.R.S. § 42-5061(B)(6). If that section does not apply or does not cover all the components in question, then A.R.S. § 42-5061(B)(13) must be examined to determine whether the remaining components qualify under that provision.

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[8] See MCTC § -460 for the city privilege tax provisions.

[9] At the city level, MCTC § -465(g) provides a deduction for income-producing capital equipment. MCTC § -110 generally includes definitions of the types of property considered income-producing capital equipment. MCTC § -110(a)(5) includes a deduction (for income-producing capital equipment) for the purchase of pipes or valves four inches (4") in diameter or larger in the same terms as the state provision.

[10] For city privilege tax purposes, MCTC § -110(a)(14) also provides a deduction for certain machinery and equipment used in the production of agricultural crops and a deduction for drip irrigation lines used in commercial agricultural settings. However, that deduction is only available for those cities that elect to include this specific provision in their codes by electing local option A. Those cities include: Buckeye, Casa Grande, Duncan, Fountain Hills, Lake Havasu City, Marana, Maricopa, Parker, Pima, Tucson and Wilcox.

The components of the irrigation system to be installed include the following types of pipes and valves:

- In-Line Steel Filters - 8 to 15 inches in diameter
- Mainline pipes – 8 to 15 inches in diameter
- Sub-mainline pipes – 3 to 10 inches in diameter
- Lateral lines – 1 ¼ inches in diameter
- Risers
- Field and flush valves

The inline-steel filters, mainline pipes and some sub-mainline pipes[11] qualify for the A.R.S. § 42-5061(B)(6)[12] exemption since they are all larger than 4 inches in diameter and will all be used to transport water as part of a commercial agricultural irrigation system. In addition, any fittings, seals and any other part used in operating those pipes are also exempt. Other components used in the installation of the pipes and related parts which are not used in operating the pipes would not be included. For example, the concrete pads used to stabilize the pipes, although a necessary part of the installation of the system, are not needed in the operation of the pipes and would not be exempt.

Deduction for Agricultural Machinery and Equipment

The pipes and other components that do *not* qualify for the deduction under A.R.S. § 42-5061(B)(6) include:

- Sub-mainline pipes – if less than 4 inches in diameter;
- Lateral lines – 1 ¼ inches in diameter;
- Emitters;
- Risers (if less than 4 inches in diameter);
- Field and flush valves less than four inches in diameter or valves not connected to 4 inch or larger pipes;
- Seals, couplings, fittings, flanges, and other adaptors not attached to four inch or larger pipes.

To qualify for the A.R.S. § 42-5061(B)(13) deduction, the above components must be new and be used as part of a drip irrigation in the commercial production of agricultural

[11] Some may not qualify as they range from 3 to 10 inches in diameter.
[12] They would also qualify for the use tax exemption under A.R.S. § 42-5159(B)(6).

products.[13] It is clear that the components will be used in the commercial production of an agricultural product, ***. However, a question arises as to whether the micro sprinkler irrigation *** will use qualifies as drip irrigation. Additionally, the statute does not include a definition of 'line' or the term 'drip irrigation,' so it is unclear whether the statutory provision was intended to cover a micro sprinkler irrigation and whether a drip irrigation 'line' should include only the line itself or should include other items used in operation of the drip irrigation line.

Where a statute expressly defines a term, the legislative definition is binding. *Walker v. City of Scottsdale*, 163 Ariz. 206, 209, 786 P.2d 1057, 1060 (1989). However, where a statute does not expressly define a term, words and phrases are given their ordinary meaning unless it appears from the context or otherwise that a different meaning is intended. *State v. Wise*, 137 Ariz. 468, 470, 671 P.2d 909, 912 (1983); *State v. Korzep*, 165 Ariz. 490, 493, 799 P.2d 831, 834 (1990). If the words do not disclose the legislative intent, we scrutinize the statute as a whole and give it a fair and sensible meaning. *Luchanski v. Congrove,* 193 Ariz. 176, 178, 971 P.2d 636, 638 (1998). In determining the ordinary meaning of a word, we may refer to an established and widely used dictionary. See *State v. Wise*, 137 Ariz. 468, 470, 671 P.2d 909, 911 (1983); *State v. Mahaney*, 193 Ariz. 566, 568, 975 P.2d 156, 158, (1999).

Although the statute does not define the phrase 'drip irrigation,' from the context it appears that the term was intended to be used in the setting of the agricultural, horticultural, viticultural and floricultural industry. The phrase does not have an ordinary meaning outside of those industries, so its ordinary meaning may be gleaned generally from industry use.

The components of a micro irrigation system as described by the United States Department of Agriculture ("USDA") are similar to those described by ***. For example, the USDA describes a micro irrigation system as including emitters, manifolds and lateral lines, main and sublines, filters, valves and pressure regulators.[14] In addition, the USDA in its practice code indicates: "a micro-irrigation system, also known as drip or trickle irrigation, is used to make frequent application of smaller quantities of water on or below the soil surface, as drops, tiny streams or miniature spray through emitters, or applicators placed along a water delivery line."[15] Moreover, the description of other types of irrigation shows that the micro

[13] *** indicates the components will be new.
[14] See generally USDA Natural Resources Conservation Service ("NRCS"), Conservation Practice Standard on Micro Irrigation Systems, Code 441.
[15] Id.

sprinkler system is similar to a drip irrigation system. For example, The US Geological Survey website provides:

> Drip irrigation is one of the more advanced techniques being used today because, for certain crops, it is much more efficient than traditional spray irrigation, where a larger portion of the water is lost to evaporation.[16]
>
> Spray irrigation is a modern and commonly-used system of irrigating, but it also requires machinery...[17] These systems have a long tube fixed at one end to the water source, such as a well.[18] Water flows through the tube and is shot out by a system of spray-guns.[19]
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> …[S]urface irrigation (also known as flood or furrow irrigation)…farmers flow water down small trenches running through their crops… Flood irrigation is not the most efficient irrigation method, but it is cheap and low-tech.[20] On the one hand, less water is lost to evaporation than in spray irrigation, but on the other hand, more water can be lost from runoff at the edges of the fields.[21]

The fact that the statute includes only 'drip irrigation,' suggests that the legislature wanted to limit the A.R.S. § 42-5159(B)(13) deduction to only drip irrigation and not the other types of irrigation. Thus, for example, equipment for flood irrigation or spray irrigation would not be included under that deduction but may qualify for another deduction.[22] This

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[16] https://water.usgs.gov/edu/irdrip.html.
[17] https://water.usgs.gov/edu/irsprayhigh.html.
[18] https://water.usgs.gov/edu/irmethods.html.
[19] *Id.*
[20] https://water.usgs.gov/edu/irfurrow.html.
[21] *Id.*
[22] The other types of irrigation likely qualify for the four inch pipe deduction because they are not targeted to only the plant root area like micro irrigation. For example, spray irrigation normally sprays water over or in the plants' canopy (see https://water.usgs.gov/edu/irsprayhigh.html) and flood irrigation normally floods the crops by the use of large trenches running through the crops (see https://water.usgs.gov/edu/irfurrow.html). Thus, the pipes used by those irrigation systems are likely larger than those used in the micro irrigation system and would likely qualify for the A.R.S. § 42-5061(B)(6) and A.R.S. § 42-5159(B)(6) deductions.

interpretation is supported by the fact that each irrigation system is described by the industry differently and all appear to function differently.[23]

Thus, because the micro irrigation system *** will be installing is also known by the industry as a drip irrigation system, its components are the same, and it operates similarly to other drip irrigation systems, it qualifies as drip irrigation for purposes of this ruling.

While the statutory provision indicates the exemption relates to the drip irrigation 'line,' it must be determined how that term should be interpreted. 'Line' is defined as piping for conveying a fluid (such as steam).[24] Additionally, 'pipe' is defined as a long tube[25] or hollow body for conducting a liquid, gas, or finely divided solid or for structural purposes.[26]

Both A.R.S. § 42-5061(B)(6) and A.R.S. § 42-5061(B)(13) were added to the statutes in 1988 by HB 2001 Ch. 161, Laws 1988 §4, effective July 1, 1989. At the time it was added, the A.R.S. § 42-5061(B)(13) deduction included 'drip irrigation lines not already exempt under paragraph 6…' as it does now. However, A.R.S. § 42-5061(B)(6) only provided a deduction for 'pipes or valves four inches in diameter or larger used to transport oil, natural gas, artificial gas, water or coal slurry.' The A.R.S. § 42-5061(B)(6) deduction at that time did *not* include other parts or components used in conjunction with the qualifying pipes and valves as it does now. That change was made in 1998 when the A.R.S. § 42-5061(B)(6) deduction was amended to include "compressor units, regulators, machinery and equipment, fittings, seals and any other part that is used in operating the pipes or valves."[27] The amendment was retroactive to 1981 and was enacted to reflect the fact that the section, in its original form, was generally interpreted to extend to the parts used in operating the qualifying pipes or valves.[28]

A.R.S. §§ 42-5061(C)(7) and 42-5159(C)(7) specifically provides that the deductions permitted by the statute *do not include* motors and pumps used in drip irrigation *systems*.[29]

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[23] See https://www.nrcs.usda.gov/wps/portal/nrcs/detail/national/programs/?cid=nrcs144p2_027154; Practice Code: 441.
[24] "Line." Merriam-Webster.com. Merriam-Webster, n.d. Web. 20 Nov. 2017.
[25] The Department views the use of the term tube for purposes of the definition as round or circular in shape. i.e. the pipes must be circular.
[26] "Pipe." Merriam-Webster.com. Merriam-Webster, n.d. Web. 20 Nov. 2017.
[27] HB2648 Laws 1998 Ch. 105 §1.
[28] See Senate fact sheet for HB2648 page 1.
[29] This exception was included in the original version of A.R.S. § 42–1310.01, the predecessor to A.R.S. § 42–5061.

The statute does not define the term system, however its ordinary meaning is a 'regularly interacting or interdependent group of items forming a unified whole.'[30] The use of the term 'systems' in A.R.S. §§ 42-5061(C)(7) and 42-5159(C)(7) to specifically exclude motors and pumps used in drip irrigation under A.R.S. § 42-5061(B)(13) which only references 'drip irrigation *lines'* strongly suggests that the word line should have a broader interpretation. If the word 'lines' were strictly interpreted to mean only the lines and no other parts used in operating drip irrigation, this exclusion would be unnecessary.

Because A.R.S. § 42-5061(C)(7) specifically excludes motors and pumps used in irrigation *systems* from any A.R.S. § 42-5061(B) exemption and A.R.S. § 42-5061(B)(6) has traditionally been interpreted to include components that work together with qualifying pipes and valves, the term drip irrigation line in A.R.S. § 42-5061(B)(13) is interpreted to include other parts forming part of a drip irrigation system with the exception of motors and pumps. As such, the A.R.S. §§ 42-5061(B)(13) and corresponding 42-5159(B)(13) exemptions include the following remaining components forming part of the drip irrigation system:

- Those sub-mainline pipes that are less than 4 inches in diameter;
- Lateral lines – 1 ¼ inches in diameter;
- Emitters;
- Risers (less than 4 inches in diameter);
- Field and flush valves less than four inches in diameter;
- Seals, couplings, fittings, flanges, and other adaptors attached to the pipes less than four inches.

Thus, when *** purchases those components, the purchases are exempt from Arizona TPT and corresponding use taxes. Although not mentioned in the request, any motor or pump used as part of the irrigation system is taxable for TPT and use tax purposes.

This response is a private taxpayer ruling and the determinations herein are based solely on the facts provided in your request. Therefore, the conclusions in this private taxpayer ruling do not extend beyond the facts presented in your correspondence. 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 private 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.

[30] "System." Merriam-Webster.com. Merriam-Webster, n.d. Web. 20 Nov. 2017.

The determinations in this private taxpayer ruling are only applicable to the taxpayer requesting the ruling and may not be relied upon, cited nor introduced into evidence in any proceeding by a taxpayer other than the taxpayer who has received the private taxpayer ruling. In addition, this private taxpayer ruling only applies to transactions that occur or tax liabilities that accrue from and after the date the taxpayer receives the ruling.