

DECISION OF MUNICIPAL TAX HEARING OFFICER

September 20, 2016

Taxpayer's Representative
Address of Taxpayer's Representative

Taxpayer
MTHO # 904

Dear Representative of Taxpayer:

We have reviewed the evidence and arguments presented by *Taxpayer* for redetermination and the City of Phoenix (City or Tax Collector). The refund period covered was November 2012 through April 2014. Taxpayer's protest, Tax Collector's response and our findings and ruling follow.

Taxpayer's Protest

Taxpayer leases backup generators and compressors used by its customer, an electric utility, to provide power during planned power outages (maintenance) and to blow coal soot out of boilers and other areas essential to the power generation process at an electrical generating station. The leased equipment is therefore directly used in producing electrical power because without the maintenance the generation process would slow down and possibly stop. Taxpayer's claim for refund should therefore be granted.

Tax Collector's Response

The equipment leased by Taxpayer are used by the customer during planned power outages. Exempt income producing equipment includes machinery and equipment used directly in producing electrical power. Because the equipment is used during planned power outages, when electricity is not otherwise being produced, the leased equipment is not directly used in the production of electricity. The City properly denied Taxpayer's claim for refund.

Discussion

Taxpayer leases equipment used by an electric utility during the maintenance of equipment that is used in the production of electricity. The question presented in Taxpayer's claim for refund and protest is whether the lease of equipment used during the maintenance of exempt equipment are exempt under PCC § 14-450(c)(4)(B) as the lease of income-producing capital equipment. Income producing capital equipment includes machinery and equipment used directly in producing electrical power. PCC § 14-110(a)(4).

The code is silent on whether equipment used during the maintenance of exempt equipment is itself exempt. The cases cited by the parties involved equipment used during production and repair and replacement parts for such equipment. The parties have not cited any cases, and we

have not found any, that specifically address equipment used during maintenance. We must therefore determine whether equipment used during maintenance of exempt equipment is itself exempt as income producing capital equipment.

Taxpayer is seeking an exemption from tax. Statutes granting deductions and exemptions from tax should be strictly construed against the deduction or exemption but not so strictly as to defeat the legislative intent and purpose. *Chevron U.S.A. Inc. v. Arizona Department Of Revenue*, 238 Ariz. 519, 363 P.3d 136 (App. 2015). We must examine the nature of the item and its role in the operations. Items essential or necessary to the completion of the finished product are more likely to be exempt. The prominence of an item's role in maintaining a harmonious integrated synchronized system with the indisputably exempt items will also directly correlate with the likelihood that the exemption applies. A court should also consider whether the item physically touches, manipulates or affects the raw materials or work in process. *See, State ex rel. Ariz. Dept. of Revenue v. Capitol Castings, Inc.*, 207 Ariz. 445, 448, 88 P.3d 159 (2004).

Here, the equipment at issue is used during planned power outages when the exempt equipment is in maintenance. Equipment used during maintenance while the exempt equipment is not in operation is not essential to the completion of the finished product. The equipment does not physically touch, manipulate or affect the raw materials or work in process. Such maintenance equipment is at best indirectly related to the operation of a harmonious integrated synchronized system. We therefore hold that the equipment at issue does not qualify as exempt income producing capital equipment under PCC § 14-450(c)(4)(B).

This conclusion is supported by the fact the code specifically includes repair and replacement parts that are acquired to become an integral part of another item of income producing capital equipment. PCC § 14-110(c). Here the maintenance equipment does not become a part of other income producing capital equipment.

Based on the above, the City's denial of Taxpayer's claim for refund is upheld.

Finding of Facts

1. Taxpayer leases generators and compressors to an electric utility (customer).
2. Taxpayer's customer uses the leased equipment during planned power outages when equipment otherwise exempt is being maintained.
3. The leased equipment is not used when the equipment being maintained is operating to produce electricity.
4. Taxpayer paid City privilege tax on its lease of the equipment to its customer.
5. Taxpayer filed a claim for refund of the City taxes paid contending the lease was exempt as lease of income producing capital equipment.
6. The City denied Taxpayer's claim for refund and Taxpayer timely protested.
7. Taxpayer did not submit a reply in support of its protest.

Conclusions of Law

1. PCC § 14-450(a) imposes the City privilege tax on every person engaging or continuing in the business of leasing tangible personal property.
2. PCC § 14-450(c)(4)(B) provides an exemption for leases of income producing capital equipment.
3. PCC § 14-110(a)(4) defines income producing capital equipment as including machinery or equipment used directly in producing electrical power.
4. Statutes granting deductions and exemptions from tax should be strictly construed against the deduction or exemption but not so strictly as to defeat the legislative intent and purpose. *Chevron U.S.A. Inc. v. Arizona Department Of Revenue, supra.*
5. The leased equipment at issue does not play a role in the actual operation of the customer in producing electrical power. *See, State ex rel. Ariz. Dept. of Revenue v. Capitol Castings, Inc., supra.*
6. Taxpayer's lease of the generators and compressors at issue is not the lease of income producing capital equipment and is therefore not exempt from the City privilege tax under PCC § 14-450(c)(4)(B).

Ruling

The protest by Taxpayer of the City's denial of its claim for refund for the period November 2012 through April 2014 is denied.

The City's denial of Taxpayer's claim for refund for the period November 2012 through April 2014 is upheld.

The parties have timely rights of appeal to the Arizona Tax Court pursuant to Model City Tax Code Section -575.

Sincerely,

Hearing Officer

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c: ***Asst. City Attorney***
Municipal Tax Hearing Office