

Are Arizona's Disputes Over the Expendables Issue Finally Over?

by James G. Busby Jr.



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In this edition of SALT From My Saddle, Busby addresses *Chevron* — the latest and ideally final Arizona appellate court decision regarding the exclusion from Arizona's retail transaction privilege tax deductions for expendable materials.

The author represented the taxpayer in this case.

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Like most states that collect sales or use tax on retail transactions, Arizona offers numerous deductions from its retail transaction privilege (sales) and use taxes. For example, businesses such as manufacturers, mining companies, telecommunications companies, electric companies, and others may purchase qualifying machinery and equipment tax free.¹ But for many years, those businesses had to grapple with the exclusion from Arizona's sales and use tax deductions for "expendable materials."²

'Expendable' Not Defined Until 1999

For years, Arizona businesses and the Department of Revenue disputed the meaning of expendable.³ Until 1999

the term "expendable" was not defined in Arizona's sales and use tax statutes. Was something expendable, and thus taxable, if it was used just once, 10 times, for a week, a month, or a year? Or, rather than refer to the number of times something could be used or the length of time it could be used, did "expendable" refer to something that, although used in a qualifying operation, is not absolutely necessary to the operation?

In 1999 the Legislature added a sentence to the statutory exclusion for expendable materials to clarify that "for the purposes of this paragraph, expendable materials do not include any of the categories of tangible personal property specified in subsection B of this section regardless of the cost or useful life of that property."⁴

Despite the 1999 amendment, when performing audits or reviewing sales or use tax refund requests, the DOR often argued that businesses were not entitled to a particular deduction because the items they purchased were used up in the businesses' operations. "Expendable," the department argued, must still mean something because the term was still used in Arizona's sales and use tax statutes.

Did *Chevron* Resolve the Expendable Issue?

On December 3, 2015, the Arizona Court of Appeals filed its *Chevron* decision. The case involved Chevron's refund request for taxes paid on sales of oils and greases to a customer who used them in its mining, metallurgical, and pollution control operations.⁵

Chevron argued that the oils and greases qualified for Arizona's deductions for machinery and equipment used in mining, metallurgical, and pollution control activities. The DOR argued that the oils and greases were taxable because they are expendable materials used up "in minutes, days or months in mining operations."⁶ The court sided with Chevron.

It determined that with the 1999 amendment, the Legislature "intentionally expanded the scope of the subsection (B) exemptions to include expendable materials 'regardless

¹A.R.S. sections 42-5061(B) and 42-5159(B).

²A.R.S. sections 42-5061(C)(1) and 42-5159(C)(1).

³In *Capital Castings Inc. v. Ariz. Dep't of Rev.*, 207 Ariz. 445, 88 P.3d 159 (2004), beginning at paragraph 14, the Arizona Supreme Court summarized some of the legislative and judicial history of Arizona's expendables exclusion.

⁴Laws 1999, Ch. 153, section 2.

⁵*Chevron U.S.A. Inc. v. Ariz. Dep't of Rev.*, 2015 WL7770679.

⁶*Id.*

of the cost or useful life of the property' so long as 'the tangible personal property would otherwise be exempt under the transaction privilege and use tax.'"⁷

"In light of the 1999 amendment," the court said, "the proper inquiry in this case is not whether the greases and oils are consumed or used up in [the customer's] operations, but rather whether they qualify for the exemptions set forth in A.R.S. section 42-5061(B)(1), (2), or (18). If the oils and greases qualify as machinery or equipment used directly in [the customer's] mining and metallurgical activities, they are exempt."⁸

Hopefully *Chevron* resolved Arizona's expendables issue once and for all.

Practice Tip: Tax professionals who work for or consult with businesses that are subject to Arizona sales and use taxes should make sure their companies and clients realize that items that may have been subject to Arizona sales or use tax in the past because they are expendable may not be taxable anymore. ☆

⁷*Id.*

⁸*Id.*

IN THE WORKS

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Martin Eisenstein and David Bertoni examine state efforts to expand nexus, which they argue at times is likely unconstitutional.

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German loss recapture rules compatible with EU law (*Tax Notes International*)

Tom O'Shea examines the Court of Justice of the European Union's recent decision in *Timac Agro Deutschland*, C-388/14, in which German loss recapture rules were held not to violate the freedom of establishment principle contained in article 49 of the Treaty on the Functioning of the European Union.

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Jeffrey Owens talks to Nina Olson, U.S. National Taxpayer Advocate, and Philip Baker QC, with Field Court Tax Chambers in Gray's Inn in London, about taxpayer rights in an age of transparency.

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Frank J. Jones explores how the code affects investment planning, including asset allocation, asset location, and asset reallocation.

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Clifford Meyer discusses how giving an IRA through a charitable remainder unitrust is often more advantageous than simple bequeathment of an IRA.