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ARIZONA TAX RESEARCH ASSOCIATION

ATRA SUPPORTS SB1334

Protecting Arizona's Machinery & Equipment Exemption

During the 1996 legislative session, the Legislature enacted legislation to reverse a court decision that would have done immeasurable harm to economic development in Arizona. The passage SB1280 was critical following the ruling in 1995 by the Arizona Court of Appeals in *Brink Electric Construction Co. v. Arizona Department of Revenue*, which at the time, changed the longstanding policy of the Arizona Department of Revenue (ADOR) regarding the tax treatment of the installation of exempt machinery and equipment (M&E) that did not become permanently attached to real property. Despite an existing ADOR regulation that required M&E become permanently attached, the Court of Appeals dismissed the permanent attachment test and concluded it was taxable contracting as long as the M&E remains "until the purpose to which the realty is devoted is accomplished."

Left unchanged, Arizona would have been the only state in the country that exempted the purchase of M&E from the retail sales tax only to turn around and tax the installation costs of those items in new facilities through the contracting tax. Considering the significant costs associated with the installation of M&E for capital intensive manufacturers, this tax would have become a major impediment to economic growth in Arizona. In its final form, SB1280 exempted from the prime contracting tax the costs associated with installing, assembling, repairing or maintaining M&E that is also exempt from the TPT retail class that does not become "permanently attached" to the real estate.

The passage of SB1280 in 1996, which was clearly intended to return to a pre-*Brink* status in law, capped a long and pronounced battle between taxpayers until 2012 when ADOR advanced a TPT ruling under prime contracting that reflected the holding of *Brink Electric*, completely ignoring the Legislature's actions under SB1280 in 1996 to overturn that decision. In the proposed ruling, ADOR stated that simply bolting down exempt M&E into a concrete base was considered permanently attached and therefore subject to TPT under the prime contracting class.

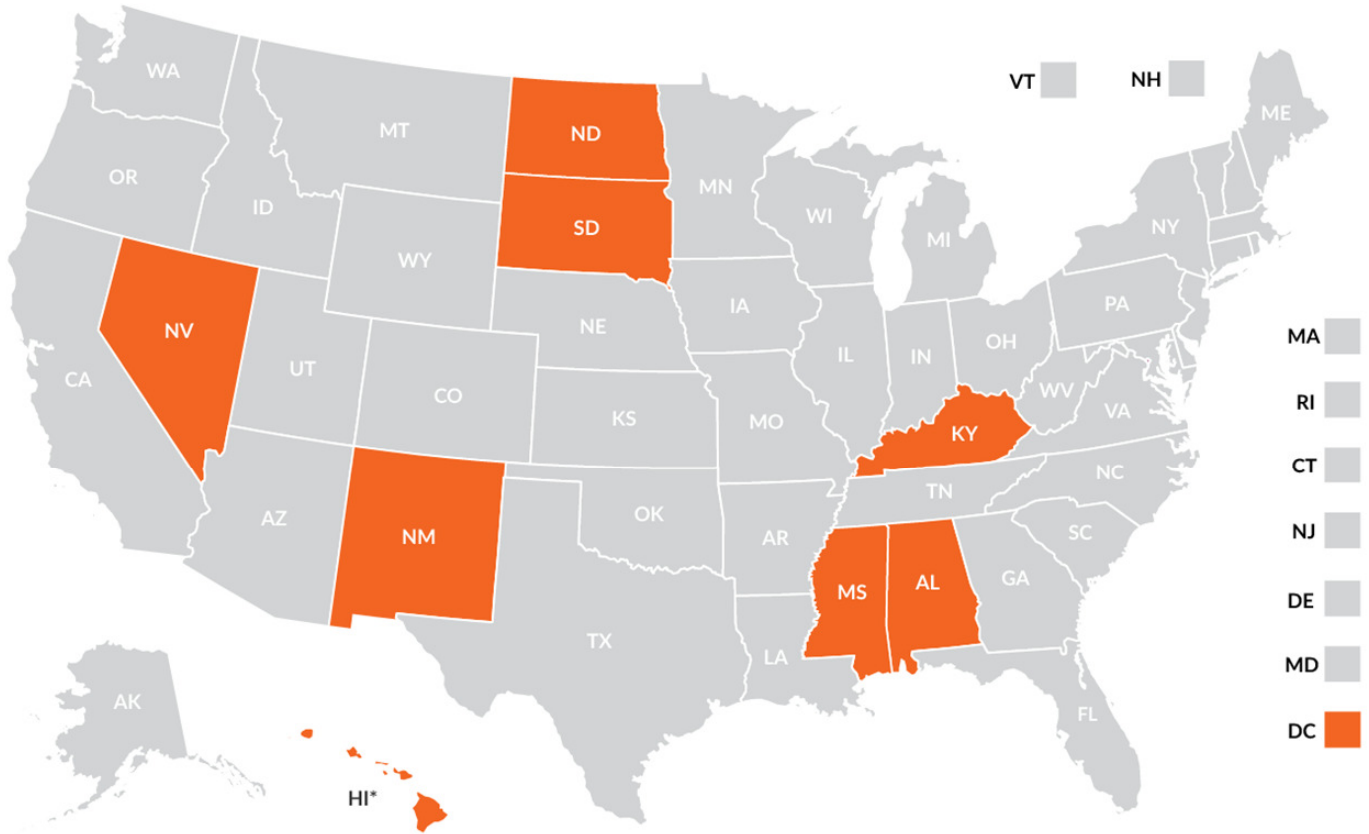
The most recent attempt to provide clarity regarding the tax treatment on the installation of exempt M&E was HB2535 in 2013. HB2535 established that the labor for the installation of exempt machinery and equipment was deductible if the equipment had "independent functional utility." The new independent functional utility test was a joint effort between ATRA and ADOR to clearly establish that the exemption was not lost if the labor was associated with assembling the M&E or stabilizing it through bolting or burying it. The Legislature's support for protecting the M&E exemption was reflected in the unanimous support for HB2535.

Regrettably, private letter rulings from ADOR are again attempting to narrow the exemption. Those rulings are in direct conflict with the 2013 law – denying the labor exemption for equipment being attached to real property for purposes of stabilization.

SB1334 is an attempt to reverse ADORs latest effort to change the longstanding treatment of the installation of exempt M&E under the prime contracting class. SB1334 removes the requirement that connections to real property be "nonpermanent" in order to maintain the legislative intent of past legislative enactments that sought to preserve the M&E exemption.

Does Your State Tax Manufacturing Machinery?

Sales Taxes on Manufacturing Machinery, 2019



Note: DE, MT, NH, and OR have no sales tax. Alaska has a local option sales tax.
*Hawaii taxes both manufacturing machinery and manufacturing raw materials.
Source: Tax Foundation; Commerce Clearing House; state statutes.

- Taxes Manufacturing Machinery
- Does Not Tax Manufacturing Machinery