

December 17, 2002

Ms. Christie Comanita
Arizona Department of Revenue
Office of Tax Policy and Legal Support
1600 West Monroe
Phoenix, AZ 85007

Re: Proposed TPR on Wastewater Treatment

Dear Christie:

The purpose of this letter is to provide comments on the proposed TPR dealing with TPT/ use taxation on sales/purchases of machinery and equipment used in wastewater treatment. After review by the ATRA Tax Practitioners Committee, we have the following concerns with the proposed ruling.

The first and greatest concern is that the proposed ruling establishes a requirement that the end product be held for sale when claiming the processing machinery and equipment exemption under either ARS § 42-5061 (B)(1) or § 42-5159(B)(1). We would like to point out that this requirement is not found in either statute.

Under the rules of statutory construction, words of a statute are to be given their plain and ordinary meaning. Unlike paragraphs (B)(2) and (B)(3) of § 42-5061, for example, there are no requirements in (B)(1) that the purchases are required to be used for commercial purposes or that the purchaser is required to be engaged in business. It must be presumed that, if the Legislature had intended to put that restriction on the exemption, it could have done so just as it did for several of the other subsection (B) exemptions in §§ 42-5061 and 42-5159. The fact that the Legislature did not so restrict the processing exemption when it clearly did for other exemptions in that subsection militates against the ability of the Department to implement such a restriction.

In addition, the Arizona Court of Appeals has just enunciated the test of exempt manufacturing or processing equipment in its decision in *Arizona Department of Revenue v. Blue Line Distributing, Inc.*, 1 Ca-TX 01-0011 (4/4/02). The test determines whether the operation at issue is commonly understood to be a manufacturing or processing one. There can be no dispute that the purpose of a wastewater treatment plant is a process of cleaning water to make it available as effluent or dried sludge which can be used for golf courses, non-food crops, etc. Even if the end products are not so used, wastewater treatment is still considered processing as the word is commonly understood.

Although the proposed TPR is focused on a government treatment process, it has implications for such processes used in conjunction with manufacturing and electrical generation operations. Further, it has implications on the interpretation of other subsection (B) exemptions.

In the answer to the first question, the statement is made that when machinery and equipment is purchased tax free, the sale of the end products is normally taxable. That is not the case for many of the manufacturers in Arizona since their product becomes a component part of another product or is shipped out of state for final assembly.

Is the Department going to begin interpreting the (B)(6) exemptions for pipes and valves as requiring that the items transported be held for sale? That would be a significant change in policy if that is the direction the Department is going and ATRA would strongly object to such a change. This concern is directly attributable to the answer to the first question in which the Department indicates that machinery and equipment used to perform an ancillary function to facilitate the manufacturing or processing operation or to create byproducts are not deductible under the statute. Under the *Duval* court's rationale and the integrated system theory espoused therein, such machinery and equipment should be exempt. This is a dramatic change of policy that needs serious discussion with the business community.

The second concern is that the proposed TPR has clearly ignored the pollution control aspects of wastewater treatment. Why wouldn't this qualify for the exemptions afforded to taxpayers under §§ 42-5061(B)(19) and 42-5159(B)(19)? Obviously, such a process is government mandated and would meet the requirements of the statutes. Again, the Department's position on the availability of this exemption has further reaching implications for taxpayers beyond the proposed TPR.

Finally, there should be serious concern regarding the public policy aspects of increasing the costs of local government at a time of major economic downturn. The result is that the taxpayer burden is simply shifted from one jurisdiction to another.

We would like to request a meeting with the Department to discuss the ramifications of the proposed ruling after the holidays. We will be in touch with you to schedule such a meeting with the Department's representatives and interested parties.

Sincerely,

Kevin J. McCarthy
President