

THE SUPERIOR COURT OF THE STATE OF ARIZONA
IN THE ARIZONA TAX COURT

TX 2016-001218

09/04/2018

HONORABLE CHRISTOPHER WHITTEN

CLERK OF THE COURT
T. Cooley
Deputy

CARTER OIL COMPANY INC

BRIAN W LACORTE

v.

ARIZONA DEPARTMENT OF REVENUE

SCOT G TEASDALE

JUDGE WHITTEN

MINUTE ENTRY

The Court has considered Defendant's Motion for Summary Judgment, filed April 30, 2018, Plaintiff Carter Oil's response, filed June 25, 2018, and Defendant's reply, filed July 16, 2018. The Court benefited from oral argument on the motion on August 28, 2018.

This case asks the Court to determine whether dyed diesel fuel qualifies as machinery, or equipment, used directly in mining operations, and therefore exempt from tax under A.R.S. §42-5061. The paraphernalia which falls within this category has, especially over the past few years, seemingly expanded.

The Department argues that "[t]he Legislature has not seen fit to adopt a broad consumables exemption for manufacturing and mining, and one should not be adopted judicially by erroneously construing fuel as 'machinery' or 'equipment.'" That ship, however, seems to have sailed.

Fourteen years ago, in *State ex rel. Arizona Dept. of Revenue v. Capitol Castings*, 207 Ariz. 445, 451 (2004), the court listed factors for determining whether the equipment exemption applies. One of those factors was how integral a role an item plays in an "integrated synchronized system." The court went on to indicate that it was applying a "more expansive definition of machinery or equipment" by applying "flexible and commonly used definitions of those terms." *Id.* at 450-51. Using this test, the court found silica sand was "equipment."

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Although A.R.S. §42-5061(C) facially excludes "expendable materials," three years ago the Court of Appeals, in *Chevron U.S.A. Inc. v. Arizona Dept. of Revenue*, 238 Ariz. 519 (App. 2015) held that the legislature, in its 1999 revision to the statute, had "intentionally expanded the scope of the subsection (B) exemptions to include expendable materials 'regardless of the cost or the useful life of the property' so long as the tangible personal property would otherwise be exempt under the transaction privilege and use tax." *Chevron*, 238 Ariz. at 521-22. It therefore found oils and greases used to lubricate machinery to be "equipment." In order to "further, not frustrate, the policy of encouraging investment and spurring economic development," the *Chevron* court effectively revised the balancing test; being part of an integrated, synchronized system was sufficient. After *Chevron*, an item, whether or not consumable, that has an "integral role" in the process is exempt. *Id.* at 523 ¶ 21.

Even more recently, in *Empire Southwest, LLC v. Arizona Dept. of Revenue*, -- Ariz. --, 2018 WL 2356129 (App. May 24, 2018), the Court of Appeals held that a truck delivering diesel fuel to exempt machinery, so as to permit that machinery to function, is itself exempt. Logically, this holding seems to control the present case. If the fuel truck is part of an integrated system, and thus exempt only because it carries the diesel fuel that the machinery needs, then how could the fuel it carries be less so.

The application of the exemption to this case might be problematic. The Court cannot find among Hansen's records, documentation to allow Carter to deduct from its transaction privilege tax obligation the full value of the dyed diesel fuel it sold. At some point, however, accommodation to economic reality will be necessary. The appellate courts have emphasized the importance of the TPT deductions for mining equipment, which since *Empire Southwest* have included dyed diesel fuel. Motor vehicle fuels are fungible liquids typically sold in bulk. It hardly seems reasonable to insist, as a condition for utilizing the transaction privilege tax exemption, that buyers maintain separate fuel tanks for exempt and non-exempt equipment, plus potentially additional tanks for vehicles whose status is uncertain. This, however, is a problem for another day.

ACCORDINGLY, Defendant's Motion for Summary Judgment is denied.