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SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

TX 2012-000382 03/10/2015

HONORABLE CHRISTOPHER WHITTEN

CLERK OF THE COURT
A. Quintana
Deputy

LUCENT TECHNOLOGIES INC PAUL J MOONEY

v.

ARIZONA DEPARTMENT OF REVENUE SCOT G TEASDALE

UNDER ADVISEMENT RULING

The Court has considered Plaintiff's Motion for Summary Judgment filed September 11, 2014, and Defendant's Cross-Motion for Summary Judgment filed November 21, 2014, both of which are now fully briefed. The Court benefited from Oral Argument on the motions on February 6, 2015.

While the Department's cross-motion was filed after the deadline set by the Court, the issues are going to have to be faced in any event, the parties have extensively briefed them, and there seems to be no reason to postpone consideration of them.

As usual, the Court begins by examining the statutory language. A.R.S. § 42-5061(B)(3) states:

> The gross proceeds of sales or gross income derived from sales of the following categories of tangible personal property shall be deducted from the tax base:… Tangible personal property sold to persons engaged in business classified under the telecommunications classification and consisting of central office switching equipment, switchboards, private branch exchange equipment, microwave radio

equipment and carrier equipment including optical fiber, coaxial cable and other transmission media that are components of carrier systems.

The parties concur that the relevant category is "central office switching equipment," but differ on how broadly that is to be defined. Plaintiff asserts that the term includes every component necessary to have a central office switching system; the Department would limit it to little more than the physical switch itself.

The Department's attempt to distinguish *Arizona Dept. of Revenue v. Capitol Castings, Inc.*, 207 Ariz. 445, 449 (2004), and *Duval Sierrita Corp. v. Arizona Dept. of Revenue*, 116 Ariz. 200, 204 (App. 1977), is unpersuasive. The use of the term "used directly" in subsections (B)(1) and (B)(2) acts as a limitation of the scope of the deduction for machinery and equipment provided for in those subsections. Without such limiting language in subsection (B)(3), the scope of the deduction should if anything be broader.

The Court can find no support for giving the deduction for central office switching equipment a narrower interpretation. But the Court cannot endorse the position of Plaintiff's expert Mr. Mroz that "the market determines what is integral or essential to the operation of the switch." It is entirely possible that the market will insist on features that make the switching equipment more desirable but do not perform any role in its operation; providing such features might be a business necessity for the manufacturer, but does not make them part of the central office switching equipment.

Nor can the Court endorse the opinion of Mr. Richy that the term "switching equipment" includes literally everything from one telephone to another. Had the legislature intended such a near-universal exclusion of the entire telephone infrastructure, it would have said so.

Finally, Plaintiff's suggestion that "components of carrier systems" at the end of the subsection extends "central office switching equipment" goes against the last antecedent rule. This rule in Arizona provides that, unless the context otherwise demands or a contrary intent by the legislature is indicated, a qualifying word or phrase is taken as applying only to the antecedent immediately preceding and not to prior ones. *Phoenix Control Systems, Inc. v. Ins. Co. of N. America*, 165 Ariz. 31, 34 (1990). Grammatically, for the list of subcategories that follows "including" to apply to all the antecedents, it would have to be preceded by a comma. *See Pawn 1^St^, L.L.C. v. City of Phoenix*, 231 Ariz. 309, 312 ¶ 18 (App. 2013) (discussing "comma exception"). Neither the context nor evident legislative intent requires that the last antecedent rule be disregarded, so the list that follows "including" applies only to carrier equipment, a category of no importance in this case. It is therefore necessary to examine each of the disputed items.

To start with the software, a switching system must be capable of switching calls as they come into the system, with whatever demands on the system they contain. Software to accommodate these calls is part of the system. However, software to add additional functions to those of incoming calls is not part of switching, and is not exempted. The software is not customized simply because different features of it are activated for any given customer.

The hardware enclosing the switching electronics is plainly part of the equipment. Even were there not federal regulations governing the allowable amount of electromagnetic radiation emitted by the equipment, requiring shielding, it would be impractical to leave the electronics exposed to the environment and the possibility of accidental contact. Labeling is also plainly part of the equipment, directing repairers to the appropriate parts. Cables, to the extent that they are either wholly internal or custom-designed for the specific equipment, are also part of the equipment, but ordinary cables connecting the switching equipment to the outside system are not.

Whether Lucent's installation revenue is subject to the tax for prime contracting depends on the version of A.R.S. § 42-5075(B)(7) that applies. Under the current version, it is not: bolting a piece of machinery to the floor so that it will remain in place does not make its installation permanent and therefore a taxable event. However, under the prior version, "it is sufficient if the item is intended to remain where affixed until worn out, until the purpose to which the realty is devoted is accomplished or until the item is superseded by another item more suitable to the purpose." *Brink Elec. Const. Co. v. Arizona Dept. of Revenue*, 184 Ariz. 354, 361 (App. 1995) (quoting *Brink Elec. Const v. State of S. Dakota Dept. of Revenue*, 472 N.W.2d 493, 500 (S.Dak. 1991); emphasis omitted). Plainly, it is envisioned that the switching equipment, while it may be moveable, is envisioned to remain in the installed location until replaced.

Plaintiff's Motion for Summary Judgment is granted in part and denied in part, as specified above. Defendant's Cross-Motion for Summary Judgment is also granted in part and denied in part, as specified above. The Court leaves it to the parties to apply its ruling to the actual figures; should they be unable to reach agreement, they may return for further proceedings.

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