Michael K. Jeanes, Clerk of Court
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02/17/2016 8:00 AM

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

TX 2014-000458 02/12/2016

CLERK OF THE COURT
HONORABLE CHRISTOPHER WHITTEN H. Bell
Deputy

ARIZONA ELECTRIC POWER COOPERATIVE INC DANIEL T GARRETT

v.

ARIZONA DEPARTMENT OF REVENUE MACAEN MAHONEY

MINUTE ENTRY

Courtroom 201-OCH

10:25 a.m. This is the time set for Oral Argument re: Cross-Motion for Summary Judgment. Plaintiff is represented by counsel, Daniel T. Garrett. Defendant is represented by counsel, Macaen Mahoney.

A record of the proceedings is made by audio and/or videotape in lieu of a court reporter.

Oral argument is presented.

Based upon matters presented to the Court,

IT IS ORDERED taking this matter under advisement.

10:52 a.m. Matter concludes.

LATER:

The Court has considered Defendant's Motion for Summary Judgment, filed September 28, 2015, and Plaintiff's Cross-Motion for Summary Judgment and Response to Defendant's Motion for Summary Judgment, filed October 30, 2015, both of which are fully briefed. The Court benefited from oral argument on the motions on February 12, 2016.

From August 2003 through June 2010, Plaintiff purchased natural gas and coal from vendors who were not subject to the Arizona Transaction Privilege tax. Accordingly, Plaintiff paid Arizona use tax on the coal and natural gas. Plaintiff filed an Arizona use tax refund claim with the Arizona Department of Revenue ("ADOR") in September 2007 and requested a refund of $4,199,440.88 for the periods of August 2003 through July 2007. Plaintiff filed a second refund claim with ADOR in July 2011, requesting a refund of $3,089,540.09 in use taxes it paid related to its purchase of natural gas and coal from June 2007 through June 2010. The Department denied both refund claims.

This case presents two main issues: (1) Whether Plaintiff's purchases coal and natural gas are outside the scope of the Arizona use tax as nontaxable purchases for resale, and (2), if such purchases are within the scope of the tax, whether such purchases are exempt from tax pursuant to A.R.S. § 42-5159(A)(4).

"[T]he general rule [is] that laws exempting property from taxation are to be strictly construed, the presumption being against such an exemption. At the same time, … exemptions should not be so strictly construed as to defeat or destroy the legislative intent and purpose." *Chevron U.S.A. Inc. v. Arizona Dept. of Revenue*, 363 P.3d 136, 137-38 ¶ 6 (App. 2015) (internal citations and some punctuation omitted). Plaintiff has pointed the Court to no stated legislative intent to exempt fuels used in generating electricity. To the contrary, A.R.S. § 42-5061 (35) excludes from the complementary Transaction Privilege Tax proceeds from "sales of natural gas or liquefied petroleum gas used to propel a motor vehicle." The natural gas functions in a car just as it does in a power generating facility: it is burned and its released energy powers the motor. That the legislature specifically excluded one use indicates an intent not to exclude other uses. Thus, strict construction is appropriate.

Coal and natural gas are tangible personal property. Under Arizona law, electricity is also tangible personal property. *State Tax Comm. v. Marcus J. Lawrence Memorial Hospital*, 108 Ariz. 198, 199 (1972). This opinion, however, does not go as far as Plaintiff urges and make all forms of energy tangible personal property. *Marcus J. Lawrence* cited the statutory definition of tangible personal property as "personal property which may be seen, weighed, measured, felt, touched, or is in any other manner perceptible to the senses." *Id.* (citing what is now A.R.S. § 42-5001(17)). This cannot be taken to the literal extreme Plaintiff urges; if it were, then all of the known matter and energy in the universe is "tangible," because we know, and can know, of its existence only by detecting it through our senses or by measuring it. Unfortunately, the Supreme Court did not identify what about electricity makes it tangible; indeed, it quickly went on to cite an amendment to the relevant statute changing "tangible personal property" to "all personal property" as the basis of its holding. *Id.* If "tangible personal property" already encompassed everything in the universe, it is hard to see what "all" could have added.

In order to be tangible personal property, the object must be personal property. Plaintiff cites no case law finding energy in any form other than electrical current to be personal property. Moreover, the energy Plaintiff claims to "own" as part of its fossil fuels is not electrical energy. The energy incorporated into the coal and natural gas is potential energy, released as heat, which turns water into steam, which rotates a turbine within a magnetic field to induce an electrical current. The Court takes judicial notice of the Law of Conservation of Energy. However, ownership of a packet of potential energy does not confer upon Plaintiff a proportionate share of the energy in the universe in perpetuity. The energy emitted by the fuel is entirely consumed in creating the steam that turns (and overcomes the friction of) the turbine. It does not convert itself into electricity.

The use tax exemption described in A.R.S. § 42-5159(A)(4) exists only if the object is "an ingredient or component part of" the electricity. In Plaintiff's examples, the chemical elements present in the petroleum and the sand, while rearranged, remain intact in the finished plastic and glass. The heat energy released from the fossil fuel does not remain in the electricity. The Second Law of Thermodynamics, of which the Court also takes judicial notice, makes the equal or greater input of energy in some form essential to the production of electrical energy. It does not make the input energy part of the electricity.

Plaintiff's citation of A.R.S. § 42-14151(B) is inapposite. First, by its terms its definition applies only to property tax valuation. Second, it does not exclude generators of electricity from property tax, it merely places them within the category of utilities, alongside water and sewer systems. The latter two enjoy no exemption from tax by virtue of their utility status; neither does Plaintiff.

Accordingly, Defendant's Motion for Summary Judgment, filed September 28, 2015, is GRANTED, and Plaintiff's Cross-Motion for Summary Judgment, filed October 30, 2015 is DENIED.