

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

TX 2020-000967

04/10/2023

HONORABLE SARA J. AGNE

CLERK OF THE COURT  
J. Holguin  
Deputy

9W HALO OPCO L P

DOUGLAS S JOHN

v.

ARIZONA DEPARTMENT OF REVENUE

BENJAMIN H UPDIKE

MARK INGLE  
JUDGE AGNE

UNDER ADVISEMENT RULING

The Court held oral argument on February 17, 2023, regarding Plaintiff's Motion for Summary Judgment filed August 17, 2022 ("Plaintiff's Motion"), and the Arizona Department of Revenue's (the "Department") Cross-Motion for Summary Judgment filed October 12, 2022 ("Cross-Motion"), as well as subsequent filings related thereto each of those, including Defendant City of Phoenix's Joinder in the Department's Response to Motion for Summary Judgment and Cross-Motion for Summary Judgment filed February 8, 2023.

The Court has considered the filings and arguments of the Parties, the relevant authorities and applicable law, as well as the entire record of the case, and—considering all facts and reasonable inferences therefrom in the light most favorable to the non-movants, respectively—hereby finds as follows regarding the Motion and Cross-Motion.

Plaintiff 9W Halo Opc, LP dba Angelica Textile Services ("Angelica") rents disinfected, reusable linens to hospitals, outpatient facilities, and long-term care centers in Arizona. (Plaintiff's Statement of Facts filed August 17, 2022 ("PSOF"), at ¶¶1, 42.) Angelica's services include specialized laundry care for the soiled linens. (PSOF ¶4.)

Angelica seeks summary judgment that its purchases of equipment components and parts used in processing contaminated linens are exempt under A.R.S. § 42-5159(B)(1) and Phoenix

SUPERIOR COURT OF ARIZONA  
MARICOPA COUNTY

TX 2020-000967

04/10/2023

City Code §§ 14-110(a)(1) and 14-660(g), so it should be granted full refunds on use taxes paid. (Mot., at 1.) Angelica also seeks summary judgment that its “purchase of chemicals used in a processing operation” is exempt from use tax under A.R.S. § 42-5159(A)(35) and Phoenix City Code §§ 14-110(a)(15) and 14-660(g). (*See* Resp. to Cross-Mot. and Reply filed December 16, 2022, at 2 n.1.) The Department seeks summary judgment that Angelica’s laundry and linen rental operation is not exempt from use taxes, and the City of Phoenix joins that position in full. (Cross-Mot., at 1.)

Summary judgment is appropriate if “there is no genuine dispute as to any material fact and the moving party is entitled to judgment as a matter of law.” Ariz. R. Civ. P. 56(a); *General Motors Corp. v. Maricopa Cty.*, 237 Ariz. 337, 339 ¶7 (App. 2015). Tax exemptions are strictly construed against taxpayers. *Ariz. Elec. Power Coop., Inc., v. Ariz. Dep’t of Revenue*, 242 Ariz. 85, 87 ¶5 (App. 2017).

A.R.S. § 42-5159(B)(1) provides an exemption for: “Machinery, or equipment, used directly in manufacturing, processing, fabricating, job printing, refining or metallurgical operations.”<sup>1</sup> The issue before the Court is whether Angelica’s laundry business is a processing operation entitled to the exemption. The term “processing,” by law includes “those operations commonly understood [to be] within [that term’s] ordinary meaning.” A.R.S. § 42-5159(B)(1).

Angelica contends that it processes and transforms unusable, soiled linens into disinfected linens suitable for use in healthcare facilities. (Mot., at 5.) The Department contends that Angelica is not a processing operation but instead a linen rental business. (Cross-Mot., at 4–5.)

In *Moore v. Farmers Mut. Mfg. & Ginning Co.*, the court recognized the following definition of “process” in the context of cotton ginning:

to subject (especially raw material) to a process of manufacturing, development, preparation for the market, etc; to convert into marketable form, as livestock by slaughtering, grain by milling, cotton by spinning, milk by pasteurizing, fruits and vegetables by sorting and repacking.

51 Ariz. 378, 382 (1938). The Department contends that *Moore* defined “processing” as preparing raw materials and that Angelica’s laundry operation does not prepare raw materials but cleans soiled linens. (Cross-Mot., at 6–7.)

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<sup>1</sup> Phoenix City Code §§ 14-110(a)(1) and 14-660(g) include an identical exemption, *sub nom.* the ‘income-producing capital equipment exemption.’

SUPERIOR COURT OF ARIZONA  
MARICOPA COUNTY

TX 2020-000967

04/10/2023

The Court does not find the technical issue of whether Angelica prepares ‘raw materials’ determinative; neither does it find determinative that Angelica’s regulating or certifying bodies may use the word ‘processing’ to define what it does. Rather, the Court finds *Meredith Corp. v. State Tax Comm’n*, 23 Ariz. App. 152 (1975), and *Ariz. Dep’t of Revenue v. Blue Line Distrib., Inc.*, 202 Ariz. 266 (App. 2002), most helpful in its analysis of the facts at issue.

The question before the court in *Meredith Corp.* was whether a video tape recorder used at a television station was exempt as equipment used in a processing operation. 23 Ariz. App. at 152-53. The court found that although equipment may “process” in some way, the recording, storage, and transmission of a television signal was not a processing operation. *Id.* at 153.

The question before the court in *Blue Line* was whether pizzeria equipment (such as a dough mixer) sold to and used at Little Caesar’s to prepare dough and make pizza was exempt as equipment used in “manufacturing” and “processing.” 202 Ariz. at 266, ¶1. The court held that, “as a matter of law, a restaurant that uses machinery or equipment to make pizza dough from scratch is not commonly understood to be either a ‘manufacturing operation’ or a ‘processing operation.’” *Id.* at 268, ¶10. The court looked at the whole pizzeria business not just the dough-making in isolation to determine it was not a manufacturing or processing operation. *Id.* at 267, ¶9.

At oral argument, counsel for Angelica stated that its customers are paying for the *processing* of soiled linens. But then *Blue Line*’s Little Caesar’s customers would be said to be paying for the dough-mixing—not a finished pizza. *Id.* at 267, ¶9 n.2. The Court does not either find determinative, though, that Angelica is making what the Department views as wholly novel arguments for the exemptions.

Indeed, Angelica’s laundry operations may include some “processing” of the linens as they are cleaned and disinfected, but the Court must look at Angelica’s business as a whole to determine whether it is a “commonly understood” processing operation. A.R.S. § 42-5159(B)(1); *Meredith*, 23 Ariz. App. at 153; *Blue Line*, 202 Ariz. at 267, ¶9. Like the television station in *Meredith Corp.* and the pizzeria in *Blue Line*, a linen rental business that uses equipment to clean and disinfect linens for healthcare facilities is not commonly understood to be a processing operation, but a laundry. *See id.*

Additionally, “[w]hen legislatures create tax exemptions they ‘do so notoriously enough to attract investors, not surreptitiously enough to evade detection for half a century.’” *Carter Oil Co., Inc. v. Ariz. Dep’t of Revenue*, 248 Ariz. 339, 345, ¶19 (App. 2020) (quoting *U.S. v. Wells Fargo Bank*, 485 U.S. 351, 357 (1988)). The exemption at issue here was added in 1989 as A.R.S. § 42-1409(B)(1). 1989 Ariz. Sess. Laws, Ch. 132, § 35. The issue of whether a laundry

SUPERIOR COURT OF ARIZONA  
MARICOPA COUNTY

TX 2020-000967

04/10/2023

qualifies for the exemption is now being raised for the first time more than 30 years later, which is not dispositive, but does further support the Department's position.

**THE COURT FINDS that** Angelica's linen rental business is not a processing operation to garner exemption under A.R.S. § 42-5159(B)(1), and the City of Phoenix Code sections providing for identical exemption, and therefore its purchases of chemicals used in its business are not exempt under A.R.S. § 42-5159(A)(35) and the related City of Phoenix Code sections.

To support its position, Angelica also looked to an Ohio case that found that a linen rental and laundry business "processed" linens. *Van Dyne Crotty Co. v. Limbach*, 558 N.E.2d 44, 48 (Ohio 1990). There, the Supreme Court of Ohio found that the laundry companies processed the linens they rented because "the laundry companies change[d] the state of the articles laundered." *Id.*

The Ohio statutory language differed from the one at issue here. *See id.* (Ohio statute defined "manufacturing" or "processing" as "the transformation or conversion of material or things into a different state or form from that in which they originally existed.") Thus, the Court does not find *Van Dyne* persuasive and need not look to out of state cases given the applicable law stated in *Meredith* and *Blue Line*.

**IT IS ORDERED denying** Plaintiff's Motion for Summary Judgment.

**IT IS FURTHER ORDERED granting** the Department's Cross-Motion for Summary Judgment and Defendant City of Phoenix's Joinder in the same.

**IT IS FURTHER ORDERED** that not later than twenty (20) calendar days after the filing of these Orders by the Clerk of the Superior Court, the Defendants may submit a verified application for awards of costs. If an application is submitted that Plaintiff wishes to oppose, a response must be filed not later than 20 calendar days after service. Defendants are not permitted to file a reply unless requested to do so by the Court.

**IT IS FURTHER ORDERED** that not later than twenty (20) calendar days after the filing of these Orders by the Clerk of the Superior Court, Defendants must also submit a proposed form of judgment. That form of judgment may incorporate by reference from this minute entry ruling but otherwise should be confined to costs being awarded, along with Rule 54(c), Ariz. R. Civ. P., language.