BEFORE THE STATE BOARD OF TAX APPEALS
STATE OF ARIZONA
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WILMINGTON TRUST COMPANY and WILLIAM J. WADE, as Owner Trustee and Cotrustee, Appellant, vs. ARIZONA DEPARTMENT OF REVENUE, Appellee.	Docket No. 1706-97-S NOTICE OF DECISION: FINDINGS OF FACT AND CONCLUSIONS OF LAW

The State Board of Tax Appeals, having considered all evidence and arguments presented, and having taken the matter under advisement, finds and concludes as follows:

FINDINGS OF FACT

Wilmington Trust Company and William J. Wade, in their capacities as owner trustee and cotrustee (collectively, "Appellant"), hold title to Unit Four of the Irvington Generating Station ("Unit Four"), which is an electric power plant operated by Tucson Electric Power Company ("TEP"). Unit Four generates electricity by burning coal.

TEP originally owned Unit Four, which burned oil and gas to produce electricity. Between 1982 and 1987, TEP converted Unit Four to burn coal. TEP financed the conversion through the sale of bonds issued by the Industrial Development Authority of Pima County (the "IDA").

In 1987, TEP decided to refinance the conversion through a sale-leaseback transaction. TEP solicited investors for the refinancing, and the Ford Motor Credit Company ("Ford") was the successful bidder. To facilitate the refinancing and preserve certain bond and tax advantages, Ford did not purchase and leaseback Unit Four directly. Instead, Ford formed a revocable trust entity with itself as the sole settlor and sole beneficiary, and Appellant as the trustee. Appellant purchased Unit Four from TEP for the total consideration of approximately $152 million. Appellant borrowed $121.4 million from the IDA. This amount was used to redeem the bonds. The remaining amount was paid directly to TEP.

The actual transfer of Unit Four and the specific assets included in the transfer to Appellant was accomplished through two documents. Under the first document, TEP sold and conveyed certain property described in an attachment and an interest in certain common property located at the Irvington Plant. Under the second document, TEP granted Appellant certain common easements and leased certain water rights. TEP, in turn, agreed to "lease" Unit Four back from Appellant under a lease agreement. TEP was responsible for payment of taxes, insurance, and repair expenses during the term of the transaction. TEP reported all assets, other than the land, to the Arizona Department of Revenue (the "Department") as personal property for property tax purposes and claimed depreciation of the property for federal and Arizona income tax purposes under the accelerated cost system.

The Department determined Appellant was liable for transaction privilege tax on the lease of Unit Four to TEP under the commercial lease classification. A.R.S. § 42-5069 (formerly A.R.S. § 42-1310.09). The Department issued an assessment, including late filing and late payment penalties and interest, against Appellant for the period October 1990 through September 1993. After unsuccessfully protesting the assessment to the Department, Appellant now timely appeals to this Board.[1]

DISCUSSION

The primary issue before the Board is whether Appellant's lease to TEP is subject to transaction privilege tax under the commercial lease classification, which provides in pertinent part:

> A. The commercial lease classification is comprised of the business of leasing for a consideration the use or occupancy of real property.
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> B. A person who, as a lessor, leases or rents for a consideration under one or more leases or rental agreements the use or occupancy of real property that is used by the lessee for commercial purposes is deemed to be engaged in business and subject to the tax imposed by this article, but this subsection does not include leases or rentals of real property used for residential or agricultural purposes.

A.R.S. § 42-5069.

[1] The parties acknowledge that this appeal is identical to an appeal filed with the Board involving the audit period August 1985 through September 1990 in which the Board upheld the Department's assessment. *Wilmington Trust Co. v. Arizona Dep't of Rev.*, No. 1259-94-S (BTA June 18, 1996). Appellant appealed the Board's decision to the Arizona Tax Court, which granted the Department's motion for summary judgement in its minute entry (No. TX 96-00414) dated June 29, 1998.

Appellant argues that it is not taxable because it is not engaged in the business of leasing for a consideration the use or occupancy of real property. Appellant bears the burden of proof. *See State Tax Comm'n v. Kieckhefer*, 67 Ariz. 102, 191 P.2d 729 (1948); A.A.C. R16-3-118.

First, Appellant contends that it is not engaged in business. Business is defined in A.R.S. § 42-5001(1) (formerly A.R.S. § 42-1301(1)) to include "all activities or acts, personal or corporate, engaged in or caused to be engaged in with the object of gain, benefit or advantage, either directly or indirectly, *but not casual activities or sales*." Appellant argues that its activities are casual *but for* the language of A.R.S. § 42-5069(B). According to Appellant, the language in subsection (B) creates an unconstitutional irrebuttable presumption. "[A]n irrebuttable presumption attempts by legislative fiat to enact into existence a fact that does not exist in actuality, and cannot be upheld." *Hecla Mining Co. v. Arizona Dep't of Rev.*, 130 Ariz. 83, 634 P.2d 10 (Ct. App. 1981).

The Board may not declare a statute unconstitutional, but it may consider the constitutionality of a statute as it applies to Appellant. *Valley Vendors Corp. v. City of Phoenix*, 126 Ariz. 491, 616 P.2d 951 (Ct. App. 1980). In this case, the pertinent statute does not attempt to enact into existence a fact that does not exist in actuality. To facilitate the refinancing and preserve certain bond and tax advantages, Appellant was formed to purchase Unit Four and lease it back to TEP. It engages in these activities with the object of "gain, benefit or advantage." A.R.S. § 42-5001(1). Therefore, Appellant is engaged in business.

Appellant next argues that the transaction at issue is not a lease, but merely a nontaxable refinancing mechanism. The Board disagrees. Appellant characterized the transaction as a lease for federal income tax purposes. Further, the pertinent document is identified as a "Lease Agreement." It names Appellant as the lessor and TEP as the lessee and is replete with references to the "lease," "lessor" and "lessee." That the transaction was structured as a sales-leaseback is irrelevant because the Board has found such a transaction to be a taxable lease. *Honeywell Bull, Inc.; CRA, Inc. v. Arizona Dep't of Rev.*, No. 646-89-S (BTA Jan. 23., 1990).

Appellant argues that , even If the Board determines that the transaction is a lease, it is a lease of personal property,[2] not real property. The Department concedes that items of personal property may

[2] Tangible personal property is defined as "personal property which may be seen, weighed, measured, felt, or touched or is in any other manner perceptible to the senses." A.R.S. § 42-5001(16).

exist within a structure. However, the nature of the property indicates that the lease at issue is of the facility as a whole and not of each individual item comprising Unit Four. Appellant points to a provision of the lease that indicates that the parties intend that the facilities be considered personal property. Although, Appellant and TEP may agree on how the property at issue will be treated as between themselves, this determination is irrelevant for transaction privilege tax purposes. Appellant cannot bind the Department to a contract to which it was not a party.[3] *See Higgins v. Smith*, 60 S. Ct. 355 (1940).

For purposes of the commercial lease classification, "real property" is defined to include "any improvements, rights or interest in such property." A.R.S. § 42-5069(E)(2). The term is typically defined as "land" and generally whatever is erected or growing upon or affixed to land. Black's Law Dictionary 1096 (5th ed. 1979). The property at issue falls within these broad definitions.

In conclusion, the Board finds that the evidence indicates Appellant's lease to TEP is subject to transaction privilege tax under A.R.S. § 42-5069.[4] Further, the late filing and late payment penalties at issue may not be abated because the facts of the case do not show reasonable cause existed in this instance. A.R.S. § 42-1125(A) and (D) (formerly A.R.S. § 42-136(A) and (D). The interest imposed represents a reasonable interest rate on the tax due and owing and is made part of the tax by statute; therefore, it may not be abated. *See* A.R.S. § 42-1123(B) (formerly A.R.S. § 42-134(B)); *see also Biles v. Robey*, 43 Ariz. 276, 30 P.2d 841 (1934).

CONCLUSIONS OF LAW

1. Appellant has failed to prove that its lease to TEP is not subject to transaction privilege tax under A.R.S. § 42-5069. *State Tax Comm'n v. Kieckhefer*, 67 Ariz. 102, 191 P.2d 729 (1948); A.A.C. R16-3-118.

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[3] Because the Board has determined that the property at issue is not personal property, it is not necessary to consider whether it is, as Appellant argues, exempt as personal property used directly in the production and transmission of electrical power. ARS § 42-5061(B)(4).

[4] Appellant did not adequately address a final issue involving the classification of two vehicles as personal property and, therefore, did not meet the burden of proof concerning this issue. *Kieckhefer*, 67 Ariz. 102 (1948); A.A.C. R16-3-118.

2. Appellant has failed to demonstrate that its failure to timely file returns and pay transaction privilege tax was due to reasonable cause; therefore, the penalties may not be abated. A.R.S. § 42-1125(A) and (D).

3. Because the interest imposed represents a reasonable interest rate on the tax due and owing and is made part of the tax by statute, it may not be abated. *See* A.R.S. § 42-1123(B); *see also Biles v. Robey*, 43 Ariz. 276, 30 P.2d 841 (1934).

ORDER

THEREFORE, IT IS HEREBY ORDERED that the appeal is denied, and the final order of the Department is affirmed.

This decision becomes final upon the expiration of thirty (30) days from receipt, unless either the State or the taxpayer brings an action in superior court as provided in A.R.S. § 42-1254 (formerly A.R.S. § 42-124).

DATED this 23rd day of February, 1999.

STATE BOARD OF TAX APPEALS

Stephen P. Linzer, Chairman

SPL:ALW
CERTIFIED

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