TX 2004-000723 03/15/2006

HONORABLE MARK W. ARMSTRONG

CLERK OF THE COURT
L. Slaughter
Deputy

FILED:____________________

JAMES M. AND PATSY L. CHAMBERLAIN JAMES G. BUSBY, JR.

v.

ARIZONA DEPARTMENT OF REVENUE LISA A. NEUVILLE

UNDER ADVISEMENT RULING

This matter was taken under advisement after oral argument held January 23, 2006. The Court has considered the Plaintiffs' Motion for Summary Judgment, Defendant's Cross-Motion for Summary Judgment and arguments of counsel.

I. THE ISSUE

The parties agree that James M. and Patsy L. Chamberlain ("the Taxpayers") are entitled to an Arizona income tax credit for five percent of the cost of the materials that the Taxpayers used to construct three commercial facilities. However, the parties dispute the amount of the credit that is due to the Taxpayers. The Court must decide: Whether earthwork and paving, fencing, curbing, landscaping, termite control chemicals, lime slurry, offsite improvements, guard shacks, gravel and truck scales are part of the "building or structure" and thus part of the "qualifying facility" as that term is used in A.R.S. § 43-1082(E)(4). If such items are part of the building or structure, then Taxpayers are entitled to the remainder of the credit that they claim.

II. FACTUAL BACKGROUND

The Taxpayers are member-owners of Chamberlain Development, L.L.C., a pass-through entity that constructed three commercial facilities between January 1994 and December 1999. The Facilities are located at: 1007 E. University Drive in Tempe, Arizona (the "Celwave Facility"); 1600 N. Desert Drive in Tempe, Arizona (the "Three-Five Facility"); and 690 S. 91st Avenue in Tolleson, Arizona (the "Atrium Facility"). A manufacturing company operates out of each Facility.

The Taxpayers filed original Arizona income tax returns for years 1995 through 1998

without claiming a credit for construction of the Facilities. Subsequently, they filed a refund claim for those years, seeking a credit pursuant to A.R.S. § 43-1082. The Arizona Department of Revenue ("the Department") granted the claim in part and denied it in part. The Department increased the allowed refund claim based on additional information from the Taxpayers. In total, the Department has allowed and credited the Taxpayers $497,895 in tax, together with applicable interest.

The Hearing Officer granted the Taxpayers' protest in part, increasing the allowable credit by $822, and denied the protest as to the remainder. The Director affirmed the Hearing Officer's decision. This appeal followed. The total amount remaining at issue is $55,695 in tax plus applicable interest.

III. ARGUMENTS OF THE PARTIES

- James M. and Patsy L. Chamberlains' Arguments -

I. THE DEPARTMENT'S INTERPRETATION OF THE CREDIT IS INCONSISTENT WITH THE PLAIN MEANING OF THE STATUTE AND THE LEGISLATURE'S INTENT AND WOULD LEAD TO AN ABSURD RESULT.

As the Arizona Supreme Court has stated, "it is especially important in tax cases to begin with the words of the operative statute." *See Arizona State Tax Commission v. Staggs Realty Corp.*, 85 Ariz. 294, 297, 337 P.2d 281, 283 (1959). When the language of a statute is "clear and unambiguous, the plain meaning" applies unless such an interpretation would result in an absurd result or a result at odds with the legislature's intent. *See Resolution Trust Corp. v. Western Technologies, Inc.*, 179 Ariz. 195, 201, 877 P.2d 294, 300 (App. 1994). Here the operative statute allows a credit for 5% of the cost of materials used to construct a "qualifying facility." *See* A.R.S. § 43-1082(A). In relevant part, the state legislature defined "qualifying facility" as a "new building or structure . . . predominantly used for manufacturing" or other qualifying activities. *See* A.R.S. § 43-1082(E)(4).

The plain meaning of the term "building" is "a structure with walls and a roof, e.g. a house or factory."[1] The plain meaning of the term "structure" is "a building, bridge, framework, or other object that has been put together from many different parts."[2] Thus, the term "structure" is, by definition, broader than the term "building." Therefore, the Legislature clearly meant to include more items within the definition of "qualifying facility" by defining the term to include "building or structure" than if it had simply defined the term as a "building" used in manufacturing or other qualifying activities. *See, e.g., Citadel Care Center v. Ariz. Dep't of*

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[1] *See Encarta World English Dictionary*, North American Edition (2005), available online at: http://encarta.msn.com/encnet/features/dictionary/dictionaryhome.aspx.

[2] *Id.*

Revenue, 200 Ariz. 286, 290, 25 P.3d 1158, 1162 (App. 2001) (statutes should be interpreted to give meaning to every word, phrase, clause and sentence so that no part of the statute is rendered void, inert, redundant or trivial). Here, while the disputed earthwork and paving, fencing, curbing, landscaping, exterminating, soil stabilizers, offsite improvements, guard shacks, gravel and truck scales may not all be part of the buildings that were constructed, they certainly were part of the structures that the Taxpayers constructed and, as such, were part of the "qualifying facility" as that term is used in A.R.S. § 43-1082(E)(4).

In addition to the plain meaning of the statute, the legislative intent of the statute supports Taxpayers' interpretation of the statute. The credit was intended to be a dollar-for-dollar credit for sales tax paid on construction materials. Prime contractors are subject to sales tax on their gross proceeds, less a standard 35% deduction intended to approximate the value of labor that they provide in addition to construction materials. *See, e.g., Knoell Bros. Const., Inc. v. Ariz. Dep't. of Revenue*, 132 Ariz. 169, 170-71, 644 P.2d 905, 906-7 (App. 1982). Thus, after taking a deduction intended to approximate the value of labor, prime contractors are subject to tax on the value of all construction materials that they use to construct buildings and other structures. Because the credit is intended to be a dollar-for-dollar credit for sales tax paid on all construction materials and prime contractors are subject to sales tax on construction materials used to construct buildings and other structures, the state legislature obviously intended the credit to apply both to sales tax paid on materials used to construct buildings and on to sales tax paid on materials used to construct other structures.

On the other hand, the Department's argument that the phrase "qualifying facility" is limited to the building itself is contrary to the plain language of the statute, at odds with the legislature's intent, and would lead to an absurd result. For example, one of the requirements of the credit not at issue here is that cost of constructing a qualifying facility must exceed $5 million. *See* A.R.S. § 43-1082(E)(4). If only the cost of constructing the building itself is properly included within the calculation of the $5 million threshold for "qualifying facilit[ies]," then all construction costs not directly related to the cost of constructing the building must be factored out of the total cost of construction to arrive at the cost constructing the "qualifying facility."

However, the Department does not require Taxpayers to factor out various general costs of construction from the total cost of constructing a facility to arrive at the costs strictly related to constructing the building itself in order to satisfy the $5 million threshold. For example, the Department commonly allows the following general costs of construction when calculating the $5 million threshold: general conditions, erosion control, site excavation, site grading, dust control, sewer lines, potable water lines, fire lines, drainage systems, driveways, sidewalks, curbing, striping, landscaping, exterminating, fencing, traffic controls, cosmetic walls, retaining walls, irrigation, hand rails, guard rails, backflow valve assemblies, parking shelters, signage, outdoor storage areas, security booths, soil testing, soil treatment, offsite improvements, staking, as well as the portion of supervision, overhead, profit, sales tax, insurance, engineering and architectural fees not related to the building itself.

If the Department disallowed general costs of construction like these, taxpayers would be forced to conduct burdensome and expensive cost-segregation studies in order to demonstrate that they qualify for the credit. When interpreting a statute, "legislative intent is controlling" and a "pragmatic construction is required if a technical construction would lead to an absurdity." *State v. Weible*, 142 Ariz. 113, 118, 688 P. 2d 1005, 1010 (1984). Thus, in this case, the credit should be interpreted to apply not only to the cost of materials used to construct buildings but also to the cost of materials used to construct related structures.

II. THE DEPARTMENT'S INTERPRETATION OF THE CREDIT IS INCONSISTENT WITH FEDERAL AND STATE INCOME TAX LAWS.

The Department argues that the credit should not apply to the cost of materials used for earthwork and paving, fencing, curbing, landscaping, exterminating, soil stabilizers, offsite improvements, guard shacks, gravel and truck scales. That is inconsistent with federal and state income tax laws that require taxpayers to include all of these costs when calculating the taxpayers' basis for the facilities. *See* Treasury Regulation § 1.263A-1 and A.R.S. § 43-1001(3). It is inconsistent and incorrect for the Department to suggest that the Taxpayers (a) have to capitalize these costs as part of the cost of the facilities and then depreciate them over time (rather than accelerate their deduction and thereby reduce their current tax liability by expensing these costs as they are incurred) for purposes of calculating their tax liability but (b) may not include these costs when calculating the amount of the credit that they are entitled to.

III. THE DEPARTMENT'S INTERPRETATION OF THE CREDIT IS INCONSISTENT WITH ARIZONA'S PROPERTY TAX LAWS.

For property tax purposes, both the Department and Uniform Standards of Professional Appraisal Practice consider the disputed items and other components of the buildings or structures to be inseparable units of real property.[3] This results in higher real property values and, therefore, higher property taxes. The principle of inseparability also supports the Taxpayers' argument that the facilities they constructed are inseparable from the disputed items. The Department cannot have it both ways. It cannot receive higher property values and, therefore, more property taxes by considering the disputed items and buildings or structures as units and then separate the disputed items from the buildings or structures to avoid granting state income tax credits.

[3] *See* the Department's definitions of "Real Property" and "Annexation" on pages 2.7 and 2.15 of the Department's Personal Property Tax Manual and Uniform Standards of Professional Appraisal Practice, Standards Rule 1-2(e)(ii).

IV. THE DEPARTMENT'S INTERPRETATION OF THE CREDIT IS INCONSISTENT WITH STATE AND LOCAL ZONING AND ENVIRONMENTAL LAWS.

The Department argues that only costs related to the construction of a building itself, not the cost of any non-building components like earthwork and paving, fencing, curbing, landscaping, exterminating, soil stabilizers, offsite improvements, guard shacks, gravel and truck scales, should be included in calculating the amount of the credit due to the Taxpayers. However, state and local environmental laws and zoning ordinances require many of the disputed non-building improvements before building permits are issued and/or inspections may be completed and certificates of occupancy granted. For example, the City of Phoenix requires developers to comply with a strict development review approval process. As a part of the city's development review process, developers must demonstrate compliance with applicable standards concerning things such as: (a) grading and drainage, (b) storm drain design, (c) floodplains, (d) streets and sidewalks, (e) street classifications, (f) driveway standards, (g) uniform standard details for public works construction, (h) landscape standards and guidelines, (i) American Nursery Association standards, (j) low water using plants, (k) city water conservation ordinances, (l) shielding and filtering outdoor lighting, (m) zoning ordinances, (n) the Phoenix Construction Code, (o) the Phoenix Fire Code, (p) subdivision ordinances, (q) American Society of Irrigation Consultants' minimum standards for landscape irrigation, and (r) the Phoenix Active Management Area's low water using plants list. *See City of Phoenix Zoning Ordinances, § 507(H).* Similarly, the Arizona Department of Environmental Quality requires developers to comply with strict design, installation and testing requirements before building or expanding a sewage collection system. *See, e.g., A.A.C. R18-9-E301(D)*

Obviously, the cost of compliance with these and a myriad of other laws, ordinances and regulations is significant and results in substantial expenses for non-building components like many of the disputed items. Clearly the Department's interpretation of the credit is inconsistent with state and local environmental and zoning laws because the cost of constructing a building is not limited just to the direct cost of the materials used to construct the building. Rather, the cost of constructing a building includes the cost of constructing both the building and related non-building structures, many of which are required by state or local environmental or zoning laws.

V. THE DEPARTMENT'S INTERPRETATION OF THE CREDIT IS INCONSISTENT WITH ARIZONA CASE LAW.

In *Duvall Sierrita,* the Court of Appeals interpreted the scope of the term "manufacturing" for purposes of an exemption from Arizona's transaction privilege tax. In doing so, the Court established broad boundaries for the term, stating:

> the boundaries of the exempt operation must be drawn taking into consideration the entire operation as it is 'commonly understood' which operation must, of

> necessity, include those items which are essential to its operation and which make it an integrated system.

Duval Sierrita Corporation v. Arizona Department of Revenue, 116 Ariz. 200, 206, 568 P.2d 1098, 1104 (App. 1977).

Likewise, in this case involving the interpretation of a tax credit, the boundaries of the credit should be drawn taking into consideration the commonly understood definitions of the applicable terms. The term "structure" is commonly understood to be broader than the term "building" and, therefore, includes items that may not necessarily be components of a building like the disputed items: earthwork and paving, fencing, curbing, landscaping, exterminating, soil stabilizers, offsite improvements, guard shacks, gravel and truck scales.

In its recent *Capitol Castings* decision, the Arizona Supreme Court affirmed *Duval Sierrita's* broad, "flexible approach" to identifying the boundaries of the exemption at issue. *Arizona Department of Revenue v. Capitol Castings*, 424 Ariz. Adv. Rep. 8, 19-20, 88 P.3d 159, 164 (2004). The Court stated that, to determine whether one qualifies for an exemption:

> First, a court must apply flexible and commonly used definitions of machinery and equipment within the relevant industry. . . .
> . . .
> Throughout its analysis, a court must bear in mind that the goal of the exemption – promoting economic development – must not be frustrated by too narrow an application of [the manufacturing exemption].

Id. at 19-20, 164-65.

VI. THE DEPARTMENT MISCHARACTERIZED ONE OF THE TAXPAYERS' PRIMARY ARGUMENTS.

The Department claims that "[t]he Taxpayers admit that the materials at issue in this case were not incorporated into or permanently affixed to the facilities . . .." That is incorrect. Rather, the Taxpayers believe that the term "building" is distinguishable from the term "structure" and argue that, "while the disputed guard shacks, fencing, truck scales and materials used in: earthwork, paving, curbing, landscaping and exterminating may not all be part of the buildings that they constructed, they certainly were part of the structures that the Taxpayers constructed and, as such, were part of the "qualifying facility" as that term is used in A.R.S. § 43-1082(E)(4)." As explained above: (1) the statutory language clearly provides that a "qualifying facility" can be either a "building" or a "structure," (2) because the plain meaning of the term "structure," is broader than the term "building," it can include both a building and related non-building components like the disputed items and (3) in this case, the "qualifying facilitie[s]" are "structure[s]" that include both buildings and related non-building components comprised of the disputed items.

VII. THE DISPUTED ITEMS ARE "CONSTRUCTION MATERIALS" AS THAT TERM IS USED IN THE LANGUAGE OF THE SUBJECT CREDIT.

While the Department admits that the Taxpayer used lime slurry and chemicals to control termites to treat the ground that its facilities were constructed on, the Department argues that such items were not "construction materials" as that term is defined in the statutory language of the credit. Similarly, because gravel and other components of the landscaping at Taxpayers' facilities were "laid upon or attached to the ground," the Department argues that they do not qualify as "construction materials." Likewise, while the Department admits that the remaining items in dispute are "improvements to the real property involved in the project," it argues that they are not "construction materials" because "they are not attached or incorporated into the actual facility."

"Construction materials" are "tangible personal property incorporated into and permanently affixed to the taxpayer's qualifying facility . . ." See A.R.S. § 43-1082(E)(1). The subject materials are, indisputably, tangible personal property. As noted above, the Department admits that the subject materials were incorporated into or permanently affixed to the real property involved in the subject projects. Thus, once again, the issue is whether the "qualifying facility[ies]" are just the three buildings, as the Department argues, or all three of the "structure[s]" that the Taxpayer constructed, which include the buildings and the related non-building components comprising the disputed items as the Taxpayers urge.

VIII. THE CREDIT WAS INTENDED TO BE A CREDIT FOR SALES TAX PAID ON CONSTRUCTION MATERIALS.

Seeking to distance itself from the terms of its own internal memorandum to the contrary, the Department argues that the credit was not intended to be a credit for sales tax paid on construction materials. In support of this argument, the Department posits that "a prime contractor's tax base includes income from materials and work to construct things other than buildings or structures, such as roads, excavations, and improvements." However, both the broad, commonly understood definition of "structure" and the definitions used in the prime contracting classification of Arizona's sales tax include roads, excavations and other improvements as "structures." *See* dictionary definition of "structure" (quoted above) and A.R.S. § 42-5075(G)(2) ("Contractor"… means any person…that undertakes to…construct…any building, highway, road, railroad, excavation, manufactured building or other structure ...")

While the Department is correct that legislative intent was more clearly expressed in the language of the proposed credit (granting a credit for "the amount of transaction privilege taxes paid on construction materials") than in the language of the credit as it exists today (for "five percent of the purchase price of the materials"), it offers no affirmative support for its argument that the credit was not intended to be a credit for sales tax paid on construction materials. Rather, the language of the proposed credit was modified due to "some technical problems with

the legislation, particularly concerning the construction materials…" *See* February 21, 1994 Minutes of [Senate] Committee on Finance. The Department's Deputy Director subsequently explained at the House Ways and Means Committee hearing on March 24, 1994 that:

> On the transaction privilege tax, the reason why the Department had problems with what the bill intended to do is because the transaction privilege tax on materials is not paid. It is purchased and then it is incorporated and then it is part of the contract. So, there is not the ability to separate taxes paid on materials because they are not taxed at that point.

See March 22, 1994, testimony of Leigh Cheatham, then Deputy Director of the Arizona Department of Revenue, before the House Ways and Means Committee.

While it is understandable that the Department would like to distance itself from the terms of its own internal memorandum to the contrary, it offers no affirmative support for its present argument that the credit was not intended to be a credit for sales tax paid on construction materials. Rather, the record shows that the credit was intended to be a credit for sales tax paid on construction materials and that the language of the proposed credit had to be modified due to the "technical problem" that contractors do not pay sales tax on construction materials when they purchase them. *See* A.R.S. § 42-5061(A)(27) and the testimony cited above.

In sum, while the Legislature's intent was more clearly expressed in the language of the proposed credit (granting a credit for "the amount of transaction privilege taxes paid on construction materials") than in the language of the credit as it exists today, (for "five percent of the purchase price of the materials"), both the legislative record and the Department's contemporaneously prepared internal memorandum demonstrate that the credit was intended to be a credit for sales tax paid on construction materials. Because the credit was intended to be a credit for sales tax paid on all construction materials and prime contractors are subject to sales tax on construction materials used to construct buildings and other structures, the Legislature obviously intended the credit to apply both to materials used to construct buildings and to materials used to construct other structures like the subject structures, which include both buildings and related non-building components comprised of the disputed items.

- Arizona Department of Revenue's Arguments -

The Department granted most of the Taxpayers' request for an income tax credit under A.R.S. § 43-1082. It denied that portion of the Taxpayers' claim relating to earthwork and paving, fencing, curbing, landscaping, exterminating, soil stabilizers, offsite improvements, a guard booth and shack, gravel, and truck scales. The Taxpayers contend that the credit applies to these costs because they were part of the overall construction project. The Department, however, interprets the statutory language as limiting the credit to the purchase price of materials actually incorporated into and permanently affixed to the qualifying facility.

I. THE CLEAR AND UNAMBIGUOUS STATUTORY LANGUAGE DOES NOT EXTEND THE CREDIT TO ALL CONSTRUCTION MATERIALS USED IN THE PROJECT.

"The cardinal rule of statutory construction 'is to ascertain the meaning of the statute and intent of the legislature.'" *Walgreen Arizona Drug Co. v. Ariz. Dep't of Revenue,* 209 Ariz. 71, 73, 97 P.3d 896, 898 (App. 2004). The legislative intent evidenced by the language of a statute is conclusive absent a clear and express intent to the contrary. *Ariz. Dep't of Revenue v. Superior Court*, 189 Ariz. 49, 52, 938 P.2d 98, 101 (App. 1997).

A.R.S. § 43-1082 provides a credit as follows:

> A. A credit is allowed against the tax imposed by this title for new construction materials incorporated into a qualifying facility located entirely within this state, construction of which is begun on or after January 1, 1994 and completed on or before December 31, 1999. The credit shall be computed as five per cent of the purchase price of the materials. The credit shall be claimed in the taxable year in which the qualified facility receives a certificate of occupancy.
>
> E. 1 "Construction materials" means tangible personal property incorporated into and permanently affixed to the taxpayer's qualifying facility other than materials exempt from taxation pursuant to § 42-5061 or 42-5159, subsection B.
>
> E. 3 "Purchase Price" means either the direct cost of materials purchased by the taxpayer from a supplier for incorporation into the qualifying facility, or the direct cost of materials paid by the contractor for incorporation into the taxpayer's qualifying facility.
>
> E. 4. "Qualifying facility" means a new building or structure, or expansion of an existing building or structure, located entirely within this state, predominantly used for manufacturing fabricating, mining, refining, metallurgical operations, direct broadcast satellite television or data transmission services or research and development as described in § 43-1168, and which has a total cost of construction in excess of five million dollars.

The Taxpayers admit that the materials at issue in this case were not incorporated into or permanently affixed to the facilities that cost Chamberlain Development more than five million dollars to build. They argue, however, that the credit should be interpreted to apply to both the material incorporated into the facility and also the cost of materials used to construct related "structures" such as sidewalks, curbs, fences, and sprinklers. The statute, however, only applies

to construction materials incorporated into and permanently affixed to the qualifying facility, which the Legislature specifically defined as "a building or structure . . . which has a total cost of construction in excess of five million dollars." A.R.S. § 43-1082(E).

The statutory definition of a qualifying facility is very limited. The Legislature did not define the qualifying facility as all buildings and structures that are part of a construction project. Rather, the Legislature used the singular to limit the credit to a specific building or structure that costs in excess of five million dollars to construct. A.R.S. § 43-1082(E)(4). The Taxpayers consistently attempt to rewrite this limitation by changing the statutory language to "building[s] or structure[s]." The words "a building or structure" does not mean a building and all related structures.

The Taxpayers assert that the word "structure" is broader than the term "building." They define a "structure" as "a building, bridge, framework, or other object that has been put together from many different parts." The statutory language permits the qualifying facility to be something other than a building. For example, the qualifying facility could be a satellite transmission tower used to broadcast satellite television transmissions. A qualifying facility might also be a framework used in a mining operation. In this case, however, Chamberlain Development built manufacturing plants, which are buildings. Thus, the qualifying facility in this case is a building rather than a structure.

Moreover, the Legislature did not define "construction materials" as all materials used to construct a qualifying facility. Rather, the definition limits the credit to tangible personal property actually "incorporated into and permanently affixed" to the qualifying facility. A.R.S. § 43-1082(E)(1). Thus, the definition does not include expendable materials used in the construction process or materials that are not permanently affixed to the facility.

The materials at issue in this case do not satisfy the statute's definition of construction materials. For example, the Taxpayers included the costs for termite control chemicals and lime slurry. These are materials applied to treat the ground itself. Similarly, the Taxpayers include the costs for gravel and various landscaping materials, which are laid upon or attached to the ground. The remaining costs, for items including curbing materials, earthwork and paving, unspecified off-site improvements, guard booth and shack materials, fencing, and truck scales, are improvements to the real property involved in the project, but are not attached or incorporated into the actual facility. While some of these things may be structures in and by themselves, such as a guard booth or a fence, they are not materials incorporated into the building or structure that costs in excess of five million dollars to construct.

The Taxpayers assert that the legislative intent was to create a dollar-for-dollar credit for "sales" tax paid on the construction materials. The Legislature knows how to draft such credits. *See* A.R.S. § 42-5015 (creating a refundable credit for "fifty percent of the transaction privilege and use taxes imposed by this chapter.") In this case, the House amended the Senate bill and changed the credit from "the amount of the transaction privilege taxes paid on construction

materials" to "five per cent of the purchase price of the materials." The "purchase price" is defined as the actual cost of the materials from the supplier. A.R.S. § 43-1082(E)(3). Thus, while the credit may ease the economic burden of the transaction privilege tax, it is not a dollar-for-dollar credit.

Moreover, the scope of the transaction privilege tax is far broader than the construction materials subject to the credit. For example, the Legislature defined contracting under the prime contracting classification of the transaction privilege tax as work involving any "building, highway, road, railroad, excavation, manufactured building or other structure, project, development or improvement." A.R.S. § 42-5075(K)(2). Therefore, a prime contractor's tax base includes income from materials and work to construct things other than building or structures, such as roads, excavations, and improvements. The Legislature, however, chose to limit the income tax credit to just construction materials attached to and incorporated into the qualifying building or structure that costs over five million dollars to construct. Because the Legislature defined the income tax credit far more narrowly than the tax base for the prime contracting classification, the statutory language does not support the Taxpayers' assertion that the credit should be interpreted to apply to all materials subject to transaction privilege tax.

The statutory language limits the credit to five percent of the purchase price of construction materials incorporated into and permanently affixed to a qualifying building or structure that costs more than five million dollars to construct. The materials at issue were not incorporated into and permanently affixed to the building that Chamberlain Development constructed. Rather, they were used to treat or improve the real property. The statutory language and legislative history does not support the Taxpayers' argument that the Legislature intended to apply the credit to materials used in the surrounding or nearby improvements to a project. Therefore, the credit does not apply to the materials at issue in this case.

II. OTHER RULES OF STATUTORY CONSTRUCTION SUPPORT THE DEPARTMENT'S DENIAL OF THE SMALL PORTION OF THE TAXPAYERS' REFUND CLAIM AT ISSUE IN THIS CASE.

First, tax deductions, subtractions, exemptions, and credits are strictly construed against exemption from tax. *Ariz. Dep't of Revenue v. Raby,* 204 Ariz. 509, 511-12, 65 P.3d 458, 460-61 (App. 2003). Exemptions "must exist, if at all, within a specific statutory grant." *New Cornelia Co-op. Mercantile Co. v. Arizona State Tax Comm'n*, 23 Ariz. App. 324, 327, 533 P.2d 84, 87 (1975). Second, courts generally afford great weight to an agency's interpretation of a statute that it enforces. *Davis v. Ariz. Dep't of Revenue,* 197 Ariz. 527, 530, 4 P.3d 1070, 1073 (App. 2000).

The Taxpayers cite federal laws concerning depreciation. They rely on definitions of "real property" in the Personal Property Tax Manual and Uniform Standards of Professional Appraisal Practice. They also argue that this credit should be interpreted based on state and local zoning and environmental laws. The Taxpayers do not provide any reference to the adoption of

any of those laws in the income tax credit. Other statutes should not be looked to define terms in a tax credit without some evidence of a legislative intent that it should do so. *See Avondale v. Deere Credit, Inc.,* 191 Ariz. 307, 311, 955 P.2d 544, 548 (App. 1998).

The Taxpayers assert that the credit statute should be interpreted broadly. They argue that the commonly understood definitions of the applicable terms should apply. The applicable statutory term is "construction materials," which the Legislature defined as tangible personal property incorporated into and permanently affixed to the taxpayer's qualifying facility. A.R.S. § 43-1082(E)(1). The Taxpayers do not provide anything to demonstrate a common understanding that personal property incorporated into a facility would include items such as earthwork, off-site improvements, or truck scales. Moreover, where a statute expressly defines a term, the legislative definition is binding on the court in all cases based upon that statute. *Walker v. City of Scottsdale,* 163 Ariz. 206, 209, 786 P.2d 1057, 1060 (App. 1989).

The Taxpayers also assert that the goal of promoting economic development should be taken into consideration. The Department has already approved a credit of nearly $500,000 in tax alone. The Taxpayers fail to demonstrate that disallowing the small portion of their claim for items outside the scope of the statutory definition would frustrate the Legislature's intent.

The Taxpayers argue that they would have to conduct burdensome and expensive cost-segregation studies in order to demonstrate that they qualify for the credit as the Department interprets it. The Taxpayers, however, focus on the five million dollar threshold for the qualifying facility. First, the threshold applies to "costs of construction" not "construction materials." The statute does not define "costs of construction" but it must include more than just the materials incorporated into the facility. Second, there is no evidence that the Department generally allows items such as driveways, sidewalks, curbing, striping, landscaping, exterminating, fencing, security booths, or off-site improvements, as costs of constructing the facility. Third, because the Legislature passed the statute before the construction commenced, the Taxpayers should have known to keep detailed records separately listing the construction materials' purchase price from the start rather than separating them out after the fact. Fourth, there is no evidence that the Taxpayers experienced an unreasonable burden or expense in this case. The Department was able to determine the costs that qualified for the credit and those that did not qualify, based on the Taxpayers' documentation.

IV. THE COURT'S FINDINGS AND CONCLUSIONS

As advocated by the Taxpayers and recently restated by the Supreme Court in *Arizona Department of Revenue v. Capitol Castings, Inc.*, 207 Ariz. 445, 447, 88 P.3d 159 (2004), the standard for the Court when interpreting tax statutes is to strive to "discern and give effect to legislative intent." *People's Choice TV Corp. v. City of Tucson*, 202 Ariz. 401, 403, P7, 46 P.3d 412, 414 (2002). The Court also must "construe the statute as a whole, and consider its context, language, subject matter, historical background, effects and consequences, [as well as] its spirit

and purpose." Id. (quoting *State ex rel. Ariz. Dep't of Revenue v. Phoenix Lodge No. 708, Loyal Order of Moose, Inc.*, 187 Ariz. 242, 247, 928 P.2d 666, 671 (App. 1996)).

In tax cases, the Court liberally construes statutes imposing taxes in favor of taxpayers and against the government, *Ariz. Tax Comm'n v. Dairy & Consumers Co-op Ass'n*, 70 Ariz. 7, 18, 215 P.2d 235, 242-43 (1950), but strictly construes tax credits, exemptions, and refunds because they violate the policy that all taxpayers should share the common burden of taxation. *See Tucson Transit Auth., Inc. v. Nelson*, 107 Ariz. 246, 252, 485 P.2d 816, 822 (1971); *Davis v. Arizona Dept. of Revenue*, 197 Ariz. 527, 529-30, 4 P.3d 1070, 1072-73 (Ariz. App. Div. 1 2000); *71 Am. Jur. 2d State and Local Taxation* §§ 232, 233 (2001). Nevertheless, an exemption should "not be so strictly construed as to defeat or destroy the [legislative] intent and purpose." *W.E. Shipley, Annotation, Items or Materials Exempt from Use Tax as Used in Manufacturing, Processing, or the Like*, 30 A.L.R.2d 1439, 1442 {88 P.3d 162} (1953).

Taxpayers argue that the Legislature intended for the term "structure" as used in A.R.S. § 43-1082(E)(4) to define "qualifying facility" to be defined broader than the term "building." Therefore they argue, by definition, and pursuant to rules of statutory construction, the Legislature clearly meant to include more items within the definition of "qualifying facility" by defining the term to include "building[s] or structure[s]" than if it had simply defined the term as a "building" used in manufacturing or other qualifying activities. However, the Court considers the Taxpayers' interpretation too broad.

Based on the Court's review of A.R.S. § 43-1082(E)(4), considering the plain and ordinary meaning of the words along with the legislative background, the Court agrees with ADOR that the statute limits the credit to the cost of materials incorporated into a specific building or structure that costs in excess of five million dollars to construct. A.R.S. § 43-1082(E)(4). Therefore, items such as earthwork and paving, fencing, curbing, landscaping, offsite improvements, guard shacks, gravel and truck scales are not included since they are actually incorporated into the "qualifying facility."

On the other hand, the Court finds that two of the items claimed by Taxpayers do qualify for the credit. Those two items are the termite control chemicals and the lime slurry to the extent the Taxpayers applied them under the "qualifying facility." The Court considers these materials to have been an integral part of the construction of the "qualifying facility," and finds that they were incorporated into and permanently affixed to the "qualifying facility."

IT IS THEREFORE ORDERED granting in part and denying in part Taxpayers' Motion for Summary Judgment to the extent set forth above.

IT IS FURTHER ORDERED granting in part and denying in part the Department's Cross-Motion for Summary Judgment to the extent set forth above.