



Are Arizona's Disputes Regarding the Expendables Issue Finally Over?

This month's state and local tax (SALT) column addresses Chevron — the latest, and hopefully the final, Arizona appellate court decision relating to the exclusion from Arizona's retail transaction privilege (sales) tax deductions for expendable materials. The author represented the taxpayer in this case.

Like most states that collect sales or use tax on retail transactions, Arizona offers numerous deductions from its sales and use taxes. For example, businesses such as manufacturers, mining companies, telecommunications companies, electric companies, and others may purchase qualifying machinery and equipment tax free. But, for many years, those businesses had to grapple with the exclusion from Arizona's sales and use tax deductions for "expendable materials."

"Expendable" Was Not Defined Until 1999

For years, Arizona businesses and the Arizona Department of Revenue (Department) disputed the meaning of "expendable." Until 1999, the term "expendable" was not defined in Arizona's sales and use tax statutes. Was something expendable, and thus taxable, if it was used just once, 10 times, for a week, a month, or a year? Or, rather than refer to the number of times something could be used or the length of time it could be used, did "expendable" refer to something that, although used in a qualifying operation, is not absolutely necessary to the operation?

In 1999, the Arizona Legislature added a sentence to the statutory exclusion for expendable materials to clarify that "[f]or the purposes of this paragraph, expendable materials do not include any of the categories of tangible personal property specified in subsection B of this section regardless of the cost or useful life of that property."

Despite the Amendment, the Department Continued Raising the Expendable Issue

Despite the 1999 amendment, when performing audits or reviewing sales or use tax refund requests, the Department often argued that businesses were not entitled to a particular deduction because the items they purchased were used up in the businesses' operations. "Expendable," the Department argued, must still mean something because the term was still used in Arizona's sales and use tax statutes.

Did the Chevron Case Resolve the Expendable Issue?

On December 3, 2015, the Arizona Court of Appeals filed its decision in the Chevron case. The case involved Chevron's sales tax refund request for taxes paid on sales of oils and greases to a customer who used them in its mining, metallurgical, and pollution control operations.

Chevron argued that the oils and greases qualified for Arizona's deductions for machinery and equipment used in mining, metallurgical, and pollution control



by James G. Busby, Jr., CPA

James G. Busby, Jr., CPA, is a state and local tax attorney at The Cavanagh Law Firm. Busby previously worked in the SALT departments at Arthur Andersen and Deloitte & Touche. Before entering private practice, Busby was in charge of all transaction privilege (sales) tax audits at the Arizona Department of Revenue. If you have any questions, please contact the author. He can be reached at (602) 322-4146 or JBusby@CavanaghLaw.com.

activities. The Department argued that the oils and greases were taxable because they are expendable materials used up “in minutes, days or months in mining operations.” The court sided with Chevron.

It determined that, with the 1999 amendment, the legislature “intentionally expanded the scope of the subsection (B) exemptions to include expendable materials ‘regardless of the cost or useful life of the property’ so long as ‘the tangible personal property would otherwise be exempt under the transaction privilege and use tax.”

“In light of the 1999 amendment,” the court explained, “the proper inquiry in this case is not whether the greases and oils are consumed or used up in [the customer’s] operations, but rather whether they qualify for the exemptions set forth in A.R.S. § 42–5061(B)(1), (2), or (18). If the oils and greases qualify as machinery or equipment used directly in [the customer’s] mining and metallurgical activities, they are exempt.”

Hopefully Chevron resolved Arizona’s expendables issue once and for all.

Practice Tip —Tax professionals who work for or consult with businesses that are subject to Arizona sales and use taxes should make sure their companies and clients realize that items that may have been subject to Arizona sales or use tax in the past because they are expendable may not be taxable any more. ■