

Changes to Arizona's Sales Tax Deduction for Manufacturers

by James G. Busby Jr.



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In this article, Busby explains how Arizona's sales tax deduction for purchases of electricity and gas by qualifying manufacturers is changing and when the changes will take effect.

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Arizona provides a deduction from its state and county transaction privilege (sales) taxes¹ for utility companies' gross income from sales of electricity and natural gas to customers who are "principally engaged" in manufacturing or smelting operations² and use at least 51 percent of the electricity and gas in those operations.³

Differing Interpretations of the Deduction Led to Amendments

Ever since the deduction took effect on August 1, 2014, the Arizona Department of Revenue interpreted it in a manner that resulted in some large, well-known companies not qualifying for it — even though virtually everyone in the business community felt that those companies should qualify.

Accordingly, Republican Gov. Doug Ducey's staff worked with the Arizona Chamber of Commerce and DOR

¹Arizona municipalities may, but are not required to, provide a corresponding exemption or deduction. See A.R.S. section 42-6012(A). To date, no Arizona municipality provides a corresponding exemption or deduction.

²Because there are just a couple of smelters in Arizona, this article focuses on manufacturers.

³A.R.S. section 42-5063(C)(6).

officials to come up with language to amend the statutory terms of the deduction during the 2016 legislative session. The resulting changes were enacted as HB 2676.

Changes Required by HB 2676

Manufacturing was defined in the 2014 version of the deduction to mean "the performance as a business of an integrated series of operations that places tangible personal property in a form, composition or character different from that in which it was acquired and transforms it into a different product with a distinctive name, character or use. Manufacturing does not include processing, fabricating, job printing, mining, generating electricity or operating a restaurant."⁴

Because the DOR felt that some companies did not qualify for the deduction given the exclusion for processing and fabricating, HB 2676 struck those words from the exclusion. However, the bill added that publishing and packaging are excluded from the definition of manufacturing.⁵

The bill also eliminated the requirement that manufacturers must use at least 51 percent of the electricity in manufacturing operations to qualify for the deduction.⁶

Finally, HB 2676 eliminated the requirement that a utility business's customer must be "principally engaged" in manufacturing to qualify for the deduction and, in its place, provided that only sales to "qualified manufacturing" businesses qualify for the deduction.

To be a qualified manufacturing business, a business must satisfy at least one of the following:

- manufacture products in Arizona of which at least 51 percent will be exported out of state for final sale;
- derive at least 51 percent of its income from the sale of products manufactured by the business;
- use at least 51 percent of its square footage in Arizona for manufacturing or activities directly regarding manufacturing;
- employ at least 51 percent of its Arizona workforce in manufacturing or activities directly regarding manufacturing; or

⁴A.R.S. section 42-5063(C)(6)(b).

⁵Laws 2016, Ch. 374, section 2.

⁶*Id.*

- use at least 51 percent of the value of its assets capitalized in Arizona for manufacturing or activities directly regarding manufacturing.⁷

All changes in HB 2676 are effective on January 1, 2017.

Additional Changes to the Deduction

Two additional bills enacted during the 2016 session also change the deduction. The changes implemented by SB 1505, HB 2025, and HB 2676 all have different effective dates.

SB 1505 provides that, effective August 6, 2016, proceeds from gas transportation services provided to qualifying manufacturers are included in the deduction.⁸ Before that time, those proceeds are excluded from the deduction.⁹ The definition of gas transportation services did not change; it still means “the services of transporting natural gas to a

natural gas customer or to a natural gas distribution facility if the natural gas was purchased from a supplier other than the utility.”¹⁰

HB 2025 provides that, effective September 1, 2016, the deduction applies to proceeds from sales of both natural gas and liquefied petroleum gas, commonly referred to as propane.¹¹

Practice Tip

Some businesses clearly qualify for this deduction but do not realize it is available. For others, it may not be as obvious, but they too may fall under the relatively broad language used to define manufacturing for purposes of the deduction. Either way, they would probably appreciate it if you brought this potential tax savings opportunity to their attention and helped them determine whether it applies. ■

⁷*Id.*

⁸Laws 2016, Ch. 357, section 1.

⁹A.R.S. section 42-5063(C)(6)(a).

¹⁰Laws 2016, Ch. 374, section 2.

¹¹Laws 2016, Ch. 359, section 1.