SUPREME COURT OF ARIZONA

State ex rel. Ariz. Dep't of Revenue v. Capitol Castings, Inc., 207 Ariz. 445

88 P.3d 159 (2004) · No. CV-03-0250-PR · Decided April 21, 2004

SUMMARY

The Supreme Court of Arizona interpreted the machinery-or-equipment use-tax exemption under A.R.S. § 42-5159(B)(1), including the effect of a 1999 legislative amendment concerning expendable materials. Applying functional and integrated-system tests, the court held that silica sand, chemical binders, exothermic sleeves, mold cores, mold wash, and hot topping qualified for the exemption, while cement and lime used for pollution control did not. The court remanded the exemption issue concerning refractory materials.

CASE DETAILS

COURT	Supreme Court of Arizona
WRITING FOR THE COURT	Justice Berch; Chief Justice Charles E. Jones; Vice Chief Justice Ruth V. McGregor; Justice Michael D. Ryan; Justice Andrew D. Hurwitz
JURISDICTION	Arizona
DECIDED	April 21, 2004
DOCKET	CV-03-0250-PR
DISPOSITION	reversed_and_remanded
PROCEDURAL POSTURE	The Arizona Supreme Court granted Capitol Castings' petition for review of a court of appeals decision concerning the use-tax exemption for machinery or equipment used directly in manufacturing operations.
STANDARD OF REVIEW	De novo review of statutory interpretation.
PRECEDENTIAL VALUE	Published, en banc opinion of the Supreme Court of Arizona; precedential.
PARTIES	State of Arizona, ex rel. Arizona Department of Revenue v. Capitol Castings, Inc.

TOPICS

sales and use tax · statutory interpretation · legislative intent · tax court procedure · state and local tax

PRACTICE AREAS

state and local taxation · tax litigation · statutory interpretation

QUESTIONS PRESENTED

1. Whether the 1999 amendment to A.R.S. § 42-5159(C)(1) altered the interpretation of the machinery-or-equipment exemption in A.R.S. § 42-5159(B)(1).
2. What functional standards govern whether materials qualify as machinery or equipment used directly in manufacturing operations.
3. Whether silica sand, chemical binders, exothermic sleeves, mold cores, mold wash, hot topping, cement, and lime qualified for the use-tax exemption.
4. Whether coxy sand and cerwool blankets qualified for the use-tax exemption.

HOLDINGS

1. The 1999 amendment was intended to overrule Capitol I and reinstate the broader functional approach reflected in Duval Sierrita for determining whether property qualifies as machinery or equipment under A.R.S. § 42-5159(B)(1).
2. A court must use flexible, commonly understood industry definitions and examine the item's function, necessity, integration into the manufacturing process, and nexus to converting raw materials into finished products.
3. Silica sand, chemical binders, exothermic sleeves, mold cores, mold wash, and hot topping qualify for the use-tax exemption.
4. Cement and lime used to detoxify dust from the arc furnaces do not qualify for the use-tax exemption.
5. The record was insufficient to determine whether coxy sand and cerwool blankets qualified for the exemption; the issue was remanded to the tax court.

KEY QUOTATIONS

> *"Thus, in analyzing whether an item is exempt from use tax under § 42-5159(B)(1), a court should consider a number of factors to determine whether the item qualifies as "[m]achinery, or equipment, used directly in manufacturing... operations.""* (164-165)

> *"Items essential or necessary to the completion of the finished product are more likely to be exempt."* (165)

> *"We conclude that the silica sand, chemical binders, exothermic sleeves, mold cores, mold wash, and hot topping qualify for the exemption because they were used directly in and were an integral part of a qualifying process under A.R.S. § 42-5159(B)(1)."* (166)

FACTUAL BACKGROUND

Capitol Castings manufactured grinding balls and custom-cast items by pouring molten metals and alloys into molds. Its molding process used silica sand, chemical binders, exothermic sleeves, mold cores, mold wash, and hot topping; some materials were consumed or rendered unusable during each casting. Capitol also used cement and lime to detoxify furnace dust and refractory materials, including coxy sand and cerwool blankets, to protect machinery from extreme heat. The Arizona Department of Revenue challenged the use-tax exemption for these materials.

PROCEDURAL HISTORY

The tax court ruled on the exemption status of materials used by Capitol Castings in its foundry. The court of appeals issued two published opinions, ultimately concluding that the materials did not qualify as machinery or equipment. The Supreme Court of Arizona vacated the court of appeals opinion, reversed the tax court's decision, resolved the exemption status of several items, and remanded for further proceedings concerning refractory materials.

DISPOSITION

reversed_and_remanded

REMAND INSTRUCTIONS

The case was remanded to the tax court to enter judgment concerning the items resolved by the Supreme Court and to determine, under the functional and integrated-process tests, whether the coxy sand and cerwool blankets qualify for exemption.

CASES CITED

- Arizona Department of Revenue v. Capitol Castings, Inc., 193 Ariz. 89, 970 P.2d 443 (App. 1998)
- State ex rel. Arizona Department of Revenue v. Capitol Castings, Inc., 205 Ariz. 258, 69 P.3d 29 (App. 2003)
- Duval Sierrita Corp. v. Arizona Department of Revenue, 116 Ariz. 200, 568 P.2d 1098 (App. 1977)
- Arizona Department of Revenue v. Blue Line Distributing, Inc., 202 Ariz. 266, 43 P.3d 214 (App. 2002)
- Cyprus Sierrita Corp., 177 Ariz. 301, 867 P.2d 871 (Tax 1994)
- Bilke v. State, 206 Ariz. 462, 80 P.3d 269 (2003)
- Canon School District No. 50 v. W.E.S. Construction Co., 177 Ariz. 526, 869 P.2d 500 (1994)
- People's Choice TV Corp. v. City of Tucson, 202 Ariz. 401, 46 P.3d 412 (2002)
- Arizona Tax Commission v. Dairy & Consumers Co-op. Association, 70 Ariz. 7, 215 P.2d 235 (1950)
- Tucson Transit Authority, Inc. v. Nelson, 107 Ariz. 246, 485 P.2d 816 (1971)

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