

5. The System collects wastewater and sewage from the houses in the developments and other buildings and transports the sewage to the Utilities or to a third party treatment facility.
6. The System includes sewer lines and lift stations used to transport the wastewater and sewage.
7. Two of the Communities transport their wastewater and sewage to a third party treatment facility.
8. For two of the Communities the developer built each a wastewater treatment facility (Facility or Type 2 property).
9. The two Facilities were constructed to meet the wastewater and sewage disposal needs of the two Communities.
10. To construct the plant the developer needed permits from Arizona Department of Environmental Quality (ADEQ) and Maricopa County Environmental Services (MCES).
11. The Facilities treat and clean sewage by removing solid material, separating clean water from sludge using a bacterial process, filtering and disinfecting the water.
12. Water is removed from the sludge by centrifuge.
13. The sludge is taken to a landfill.
14. The clean effluent is then distributed to recharge wells to recharge the ground water and to put into lakes and water golf courses.
15. The water leaving the Facility is clean enough to be put into the groundwater.
16. The system to distribute the effluent is Type 3 property.
17. A part of the treatment process produces noxious odors.
18. The odors and other gases are removed using an odor scrubber.
19. The scrubber prevents the odor and other gases from being released into the atmosphere.

20. The Communities also have storm water management systems to collect and manage rain water (Type 4 property).
21. Storm water management includes keeping water and sediment on the property and channeling the water to retention areas and golf course lakes.
22. Type 4 property includes drains, gutters and retention areas.
23. Costs for the storm water management system include excavating, grading, staking, hauling off excess dirt and removing trees.
24. Plans for the drainage plans had to be reviewed and approved by ADEQ and the Flood Control District of Maricopa County.
25. The purpose of the storm water management system was to channel storm water runoff and waste water from the properties.
26. The storm water retention areas and the sewer systems serve public health, flood control and safety purposes.
27. The primary purpose of the installed items is not pollution control.
28. Taxpayers filed claims for refund for tax years 1998 through 2004.
29. Taxpayers submitted numerous amended claims for refund and alternative claims for refund.
30. Some of the amended claims for refund were filed after the claim for refund statute of limitations had expired.
31. The claims for refund claimed a credit for pollution control equipment provided in A.R.S. §§ 43-1081 and 43-1170.¹
32. Taxpayers claimed the pollution control credit for the wastewater and sewage collection system, the treatment facility, the effluent distribution system and the storm water management system.

¹ A.R.S. § 43-1081 applies to individuals and A.R.S. § 43-1170 applies to corporations. The relevant text of the two statutes are identical.

33. The Section denied Taxpayers' claims for refund stating that the properties were not pollution control equipment under A.R.S. §§ 43-1081 and 43-1170.
34. The Section also denied as untimely Taxpayers' amended claims filed after the statute of limitations expired and that exceeded earlier claims for refund.
35. Taxpayers provided schedules showing their claimed expenses but did not provide invoices or other documents substantiating the claimed expenses.
36. The Section denied Taxpayers' refund requests.
37. Taxpayers protested the denial.

CONCLUSIONS OF LAW

1. Arizona allows credits against a taxpayer's Arizona income tax liability for pollution control equipment pursuant to A.R.S. §§ 43-1081 and 43-1170.
2. Tax credits are a matter of legislative grace and not a matter of taxpayer right.
3. Tax statutes are construed strictly against a party who claims a credit. *Arizona Department of Revenue v. Raby*, 204 Ariz. 509, 511, 65 P.3d 458 (App. 2002); *Davis v. Arizona Department of Revenue*, 197 Ariz. 527, 4 P.3d 1070 (App. 2000).
4. The burden is on the taxpayer to show he is entitled to a deduction or exemption from tax. See *Ebasco Servs., Inc. v. Ariz. State Tax Comm'n*, 105 Ariz. 94, 99, 459 P.2d 719, 724 (1969).
5. A cardinal principle of statutory construction is to follow the plain and ordinary meaning of a word. *Dearing v. Arizona Department of Economic Security*, 121 Ariz. 203, 589 P.2d 446 (App. 1978).
6. Statutes are to be given, whenever possible, such an effect that no clause, word or sentence is rendered superfluous, contradictory, void or insignificant. *State v. Deddens*, 112 Ariz. 425, 542 P.2d 1124 (1975).

7. Terms in a statute must be defined in a way that avoids absurdity and fulfills legislature's purpose. *Mail Boxes v. Industrial Com'n of Arizona*, 181 Ariz. 119, 888 P.2d 777 (1995).
8. To qualify for the credit provided by A.R.S. §§ 43-1081 and 43-1170, the property must be directly used, constructed or installed in Arizona for the purpose of meeting or exceeding rules or regulations adopted by the United States environmental protection agency, the department of environmental quality or a political subdivision of this state to prevent, control, monitor or reduce air, land or water pollution. A.R.S. §§ 43-1081(B) and 43-1170(B).
9. Other than the equipment used to contain and remove noxious odors and other gases created during the treatment process, Taxpayers' property does not qualify for the credit under A.R.S. §§ 43-1081 and 43-1170. Decision of Director of Revenue, Case No. 200500075-C.
10. The period within which a claim for refund may be filed is the period within which the Department may make an assessment under section 42-1104. A.R.S. § 42-1106(A).
11. Failure to begin an action for refund or credit within the time specified in A.R.S. § 42-1106(A) is a bar against the recovery of taxes by the taxpayer. A.R.S. § 42-1106(D).
12. Each claim for refund must provide the amount of refund requested. A.R.S. § 42-1118(E).
13. Taxpayers' amended claims for refund filed after the statute of limitations expired and that exceeded earlier claims for refund are barred by A.R.S. § 42-1106(D).
14. Equipment used to contain and remove noxious odors and other gases created during the treatment process constitute pollution control equipment under A.R.S. §§ 43-1081 and 43-1170.

15. Taxpayers failed to substantiate the costs of the equipment used in containing and removing noxious odors and other gases created during the treatment process.
16. Taxpayers have not established their entitlement to a credit for the equipment used in containing and removing noxious odors and other gases created during the treatment process.
17. The Section properly denied Taxpayers' refund requests.

DISCUSSION

The issue to be decided is whether the Section properly denied Taxpayers' requests for refund. Taxpayers' requests are based on claimed tax credits for pollution control equipment pursuant to A.R.S. §§ 43-1081 and 43-1170 for expenses related to the installation of sewer systems, sewage treatment facilities, effluent distribution systems and the construction of storm water retention areas on properties owned by Taxpayers.

A.R.S. §§ 43-1081 and 43-1170 provide in pertinent part:

A. A credit is allowed against the taxes imposed by this title for expenses that the taxpayer incurred during the taxable year to purchase real or personal property that is used in the taxpayer's trade or business in this state to control or prevent pollution. The amount of the credit is equal to ten per cent of the purchase price.

B. Property that qualifies for the credit under this section includes that portion of a structure, building, installation, excavation, machine, equipment or device and any attachment or addition to or reconstruction, replacement or improvement of that property *that is directly used, constructed or installed in this state for the purpose of meeting or exceeding rules or regulations adopted by the United States environmental protection agency, the department of environmental quality or a political subdivision of this state to prevent, monitor, control or reduce air, water or land pollution.*

Credits are a matter of legislative grace and not a matter of taxpayer right. *Keyes v. Chambers*, 209 Or. 640, 307 P.2d 498 (1957) (Credits must be strictly construed against the taxpayer and in favor of the taxing authority); *Davis v. Arizona*

Department of Revenue, supra (Tax statutes are construed strictly against a party who claims a credit.) It is also well settled that statutes are to be given, whenever possible, such an effect that no clause, word or sentence is rendered superfluous, contradictory, void or insignificant. *State v. Deddens, supra*.

The legislature made a clear statement in A.R.S. § 43-1170(B) that in order to qualify for the credit the property must be directly used, constructed or installed in Arizona for the purpose of meeting or exceeding rules or regulations adopted by the United States environmental protection agency, the department of environmental quality or a political subdivision of this state to prevent, control, monitor or reduce air, land or water pollution.

This legislative requirement must be given meaning. The storm water retention areas and the system for collecting and treating sewage and distributing the effluent serve public health, flood control and safety purposes. These systems are not directly used, constructed or installed in Arizona for the purpose of meeting or exceeding rules or regulations adopted by the United States environmental protection agency, the department of environmental quality or a political subdivision of this state to prevent, control, monitor or reduce air, land or water pollution within the meaning of A.R.S. §§ 43-1081 and 43-1170.

Taxpayers argue in their reply that if taxpayers let the sewage run into the streets, they would be polluting. Under Taxpayers' argument any container (even a garbage can) used to enclose any undesirable materials would qualify for the credit. Such an absurd result could not have been intended by the legislature. Therefore, the Section's denial of Taxpayers' refund requests was proper under A.R.S. §§ 43-1081 and 43-1170. Decision of Director of Revenue, Case No. 200500075-C.

Taxpayers also filed amended claims for refund that were submitted after the refund statute of limitations had expired. The amended claims increased the amount of

refund requested. Because the amended claims were filed after the limitation period had expired, they were untimely.

One component of Taxpayers' sewage treatment facilities arguably qualifies for the credit. The process of treating the sewage creates certain noxious odors and gases that Taxpayers are required to control. That is pollution created by Taxpayers in their sewage treatment activity. However, the Section disallowed the claims for that equipment because Taxpayers did not adequately substantiate the costs associated with the equipment used in controlling the noxious odors and other gases. The burden is on Taxpayers to show they are entitled to the credit. By not adequately substantiating the costs associated with the equipment, Taxpayers failed to meet their burden. Therefore the Section's denial of Taxpayers' refund requests regarding the equipment used in controlling the noxious odors and other gases was proper.

The Section's denial of Taxpayers' claims for refund for tax years 1998 through 2004 is upheld.

DATED this 15th day of June, 2010.

ARIZONA DEPARTMENT OF REVENUE
HEARING OFFICE

[REDACTED]
Hearing Officer

Original of the foregoing sent by
certified mail to:

[REDACTED]

Copy of the foregoing delivered to:

Arizona Department of Revenue
Individual Income Tax Audit Section