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DEPARTMENT OF LAW  
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Phoenix, Arizona 85007

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ATTORNEY GENERAL

March 21, 1977

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Mr. Neal G. Trasente, Director  
Department of Revenue  
State Capitol, West Wing  
Phoenix, Arizona 85007

Re: Tax Liabilities of Agencies of the State of Arizona

Re: 77-68 (R76-427)

Dear Neal:

You have requested research from the Office of the Attorney General in order to give guidance to the Department of Revenue with regard to the question of whether or not the Department of Revenue can impose certain taxes upon the property of and/or transactions involving agencies of the State of Arizona.

To begin with, your inquiry centers upon the three basic categories of taxes which are authorized under the Arizona Constitution and implementing statutes. These categories are ad valorem property taxes, income taxes and excise taxes. Property taxes are authorized under Article 9, § 2 of the Arizona Constitution, and the income and excise tax categories are authorized under Article 9, § 12 thereof.

With regard to the first category (i.e., property taxes), Article 9, § 2 of the Arizona Constitution specifically provides:

There shall be exempt from taxation all federal, state, county and municipal property.

This provision has been uniformly construed by the courts of Arizona as creating an absolute bar against subjecting state, county or municipal property to direct ad valorem property taxation. City of Phoenix v. Elias, 64 Ariz. 95, 166 P.2d 589 (1946); Arizona Land & Stock Co. v. Markus, 37 Ariz. 530, 296 P. 251 (1931); Clark v. City of Tucson, 1 Ariz.App. 431, 403 P.2d 936 (1965). See also A.R.S. § 42-271(1). Cf. Ariz. Atty. Gen. Ops. 68-1, 59-144. Therefore, as to ad valorem property taxation, the Department of Revenue is without the power to impose such taxes upon property which is owned by the state, counties or municipalities.

Mr. Neal G. Trasente  
March 21, 1977  
Page Two

The second category of taxes (i.e., income taxes) are authorized under the broad provisions of Article 9, § 12 of the Arizona Constitution. Title 43 of the Arizona Revised Statutes contains the general legislative authority for the imposition of income taxes upon taxpayers. However, A.R.S. § 43-101(e) defines "taxpayer" as:

. . . any person subject to a tax imposed by this title, but in no case shall it include the United States, the state, counties, cities, villages, school districts, or other political subdivisions or units of the state or federal government.

Thus, as was true with regard to ad valorem property taxes, the state, counties, municipalities or other units of the state government are exempt from the imposition of state income taxes. And, given the definition of "taxpayer" quoted above, this conclusion would hold true without regard to whether or not the income arose from a governmental or proprietary activity.

The final category of taxes to be considered herein are the excise taxes. The two most prominent taxes in this category are the transaction privilege ("sales") tax imposed under A.R.S. §§ 42-1301 et seq. and the use tax imposed under A.R.S. §§ 42-1401 et seq.

In this category, a different result obtains. To begin with, it has been specifically held that municipal corporations within this state are subject to the state transaction privilege tax with regard to gross receipts from their proprietary activities. City of Phoenix v. Moore, 57 Ariz. 350, 113 P.2d 935 (1941); City of Phoenix v. State of Arizona, 53 Ariz. 28, 85 P.2d 56 (1938). See also A.R.S. § 42-1301(9) defining "person" for purposes of the tax imposed by A.R.S. § 42-1308 as including municipal corporations. The State of Arizona, however, is not subject to transaction privilege taxation by its inferior political subdivisions. City of Tempe v. Arizona Board of Regents, 11 Ariz.App. 24, 461 P.2d 503 (1969).

With regard to the question of whether or not the Department of Revenue could impose the transaction privilege tax upon other state agencies, such a result clearly is not permissible under the transaction privilege tax act. The tax is imposed upon the privilege of engaging in business rather than upon engaging in the operation of state government.

Mr. Neal G. Trasente  
March 21, 1977  
Page Three

Moreover, A.R.S. § 42-1301(9) does not include the term "State of Arizona" in its definition of "person" for purposes of A.R.S. § 42-1308. In view of the fact that the Legislature specifically included municipal corporations within the definition of "person" in A.R.S. § 42-1301(9), the application of the doctrine of statutory construction expressio unius est exclusio alterius ("the expression of one thing is the exclusion of another") would support the conclusion that the Legislature intended that other governmental bodies such as the state, the counties and school districts, were to be excluded from direct taxation under A.R.S. § 42-1309. This conclusion is further strengthened when the provisions of A.R.S. § 42-1301(9) are construed in pari materia with A.R.S. § 42-1401(4), discussed infra, since the latter statute specifically names the state, counties, cities and districts or political subdivisions thereof as being "persons" for purposes of use taxation.

Although the State of Arizona, as a vendee, may, by contract assume the economic burdens of its vendor's transaction privilege tax, it does not follow that it, as a vendor of goods or services, is subject to taxation. The long-standing, unchallenged and uninterrupted administrative practice that has heretofore been followed by the State Tax Commission and its successor agency, the Department of Revenue, of refraining from attempting to impose the transaction privilege tax upon state agencies would carry great persuasive weight should the matter ever come before a court. Long v. Dick, 87 Ariz. 25, 347 P.2d 581 (1959).

Therefore, the Department of Revenue should not impose or attempt to impose the transaction privilege tax (and the related education excise tax and special excise tax for education taxes under A.R.S. §§ 42-1361 et seq. and 42-1371 et seq.) upon state agencies.

The last tax to be considered is the use tax. The use tax provisions under A.R.S. §§ 42-1401 et seq. impose an excise tax upon the storage use or consumption of tangible personal property. The tax is imposed directly upon the person who stores, uses or consumes the property. A.R.S. § 42-1408. A.R.S. § 42-1401(4) defines a "person" as including:

. . . this state, any county, city, municipality, district or other political subdivision or agency thereof.

Mr. Neal G. Trasente  
March 21, 1977  
Page Four

A.R.S. § 42-1409 provides for numerous specific exemptions from the use tax, but the only state entities that are presently entitled to exemption are hospitals operated by the state or any political subdivision of the state with regard to their purchases of tangible personal property outside of the State of Arizona. A.R.S. § 42-1409(A)(10).

Since the state and its political subdivisions are not exempted from the use tax (save as stated in A.R.S. § 42-1409(A)(10)) but are, through the definition of "person" in A.R.S. § 42-1401(4), explicitly declared by the Legislature to be subject to the tax, it is clear that the Department of Revenue has the power, authority and duty to impose the use tax upon state agencies. See Ariz. Atty. Gen. Ops. 63-32 (state educational institutions are subject to use taxes) and 62-31 (sales to Maricopa County Hospital are not exempt under A.R.S. § 42-1321).

This result is not inconsistent with the conclusions reached with regard to the transaction privilege tax. The use tax was enacted to complement, as much as possible, the transaction privilege tax and thereby serve as an incentive for Arizona purchasers of tangible personal property to "shop locally" rather than in other states to avoid the economic burdens of local vendors' taxes being shifted to them as a component of the contract price. See Message of Governor Ernest W. McFarland to the Second Special Session of the 22nd Legislature, Nov. 29, 1955, 1956 Session Laws of Arizona, pp. 455-457. This rationale applies with equal force to both private purchasers and the State of Arizona as a purchaser, for local businesses stand to benefit greatly from the monies expended by the State of Arizona for tangible personal property used in the conduct of governmental operations. It should be noted, however, that should the Legislature so desire, it could specifically create an exemption from use taxation for property stored, used or consumed by the state.

Please advise if you require additional information.

Sincerely,

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