ARIZONA SUPREME COURT
ORAL ARGUMENT CASE SUMMARY

SolarCity Corp. v. Ariz. Dep't of Revenue, CV-17-0231-PR

PARTIES:

Petitioner: Arizona Department of Revenue

Respondents/Taxpayers: SolarCity Corp. and Sunrun, Inc.

FACTS:

There are two main methods for generating solar power. The "traditional" method is to generate electricity through a large scale solar plant made up of numerous solar panels installed on vacant land that transmits electricity through the electrical grid to multiple customers. Customers who obtain their solar power in this way pay for their electricity based on the amount of energy delivered from the grid to their electricity meter.

A second system of solar energy generation, the "on-site" method, involves a single solar panel, or a small number of linked solar panels, operated on a single home or business. Electricity generated on-site is not delivered from an outside source through the electricity meter, but instead creates energy from a roof-top solar panel and delivers it directly to the structure on which it is maintained; it often is called a "behind the meter" system because it generates electricity at the structure, rather than being delivered from a utility through the electricity meter on the structure.

An on-site solar panel system is sometimes owned by the owner of the structure to which it is attached. Some on-site systems, however, are owned by a solar company, like Respondents and their competitors, and leased to the building owner.

On-site solar panels cannot store the energy they create. They are designed to provide no more than 125% of the electricity that the home or business can use; any excess electricity is delivered from the structure (i.e., from behind the meter) to the traditional electricity grid. Thus, on-site systems are "grid-tied" because they deliver excess energy to the general electrical system.

Because on-site solar systems are grid-tied, most home/business owners have a "net-metering" agreement with a traditional utility company. Under these agreements, the utility company tracks the amount of electricity that flows from behind the home/business's meter and onto the electrical grid. The home/business owner is then credited with the amount of solar electricity placed onto the grid system; the home/business owner is credited at the retail rate, rather than the wholesale rate a traditional utility company is paid for solar energy.

Traditional solar plants operated by large scale utility companies are subject to valuation and taxation under A.R.S. §§ 42-14151 and 42-14155, which require the Arizona Department of Revenue (the "Department") to value "renewable energy equipment" for tax purposes at 20% of

its depreciated cost. The applicable legislative tax scheme for on-site solar systems is less clear.

In 1997, the Arizona Legislature adopted A.R.S. § 42-11054, which provides methods for appraising "solar energy devices." In 2009, the Legislature amended A.R.S. § 42-11054(C)(2) and it now states:

> Solar energy devices, as defined in § 44-1761, grid-tied photovoltaic systems and any other device or system designed for the production of solar energy primarily for on-site consumption *are considered to have no value and to add no value to the property on which such device or system is installed*.

(Emphasis added). For several years, the Department did not attempt to value or tax any "solar energy devices" under § 42-11054. Thus, Respondents and home/business owners with on-site solar systems were not taxed on the values of those systems.

In 2013, the Department determined that solar power companies that lease on-site solar panel systems to customers, like Respondents, are operating solar systems that constitute taxable "renewable energy equipment," as it is defined in A.R.S. § 42-14155, rather than "solar energy devices" not subject to taxation under A.R.S. § 42-11054(C)(2). The Department concluded that, because these companies owned some of the solar systems they installed on customer's buildings, those panels were "not intended for self-consumption," as contemplated by A.R.S. § 42-11054(C)(2), and, therefore, were "renewable energy equipment" valued at 20% of their depreciated cost under A.R.S. § 42-14155. According to the Department, only when the home/business owner buys the solar system would A.R.S. § 42-11054 apply and provide a zero valuation for the system.

In 2015, the Department valued twenty-one traditional solar energy generation facilities under A.R.S. §§ 42-14151 and 42-14155. Under those same statutes, the Department also valued ten solar energy companies providing on-site solar systems. Respondents asked the Department to reconsider its position and, when it would not, they began an action in tax court, seeking a declaratory judgment that would reject the Department's position.

The tax court did reject the Department's position and held that Respondents' solar systems "are general property to be valued in the usual course by the county assessors" under A.R.S. § 42-13051(A), rather than statewide by the Department. The tax court ruled that A.R.S. § 42-11054(C)(2) could not be interpreted to give a "zero valuation" for tax purposes to Respondents' systems, because to do so would violate the Exemptions Clause of the Arizona Constitution, Ariz. Const. art. 9, § 2(13), and the Uniformity Clause, Ariz. Const. art. 9, § 1.

The court of appeals affirmed in part and reversed in part. According to the court, Respondents "do not sell electricity or control the use of the converted energy and do not receive any benefit from the traditional utility companies for the generation of surplus power." *SolarCity Corp. v. Ariz. Dep't of Revenue*, 242 Ariz. 395, ___ ¶ 24 (App. 2017). Thus, the court of appeals agreed with the tax court that Respondents' systems are not akin to a traditional solar power plant and are therefore not subject to taxation under A.R.S. §§ 42-14151 and 42-14155.

As for the constitutional issues, the court of appeals held the tax court erred in holding that A.R.S. § 42-11054 violates the constitution because it "neither exempts property from taxation,

nor treats similarly-situated property different under the tax law." *Id.* ¶ 28. According to the court, § 42-11054 "does not improperly exempt Taxpayers' solar panels from taxation; therefore, the statute is not unconstitutional." *Id.* ¶ 29.

Because the Arizona Constitution does not provide a specific exemption for solar panels, the Legislature is prohibited from exempting them from taxation under the Exemptions Clause, which provides: "All property in the state not exempt under the laws of the United States or under this constitution or exempt by law under the provisions of this section shall be subject to taxation to be ascertained as provided by law." Ariz. Const. art. 9, § 2(13). The court of appeals held that here, through A.R.S. § 42-11054(C)(2), the Legislature has not exempted Respondents' solar panels from taxation, but rather has "chose[n] to exercise its power of taxation and assign a value of zero to installed grid-tied photovoltaic and solar energy systems." *Id.* ¶ 33.

As for the Uniformity Clause, it provides that once the Legislature has chosen to tax property, then "all taxes shall be uniform upon the same class of property within the territorial limits of the authority levying the tax." Ariz. Const. art. 9, § 1. And, under case law, a legislative taxing scheme will violate the Uniformity Clause if "it applies differently to businesses that (1) are direct competitors, (2) provide similar services, (3) have the same customer base, and (4) use the same equipment type." *SolarCity Corp.*, 242 Ariz. at ___ ¶ 24 (citation omitted).

The court of appeals held that applying A.R.S. § 42-11054 to Respondents' on-site systems does not violate the Uniformity Clause because: Respondents are not direct competitors with traditional utilities; the on-site systems are designed to meet less than all of the customers' needs, while utilities produce large amounts of energy for all utility customers; and the on-site equipment and traditional utility solar equipment provide different services to different customer bases. The court of appeals then remanded for further proceedings.

ISSUES:

1. (a) Is the Department authorized to value Taxpayer's Equipment given that Taxpayers operate grid-tied solar systems that generate electricity that is delivered to customers through the transmission and distribution system; and (b) if not, must county assessors value the Equipment under A.R.S. § 42-13054 because A.R.S. § 42-11054(C)(2) does not apply to the Equipment?

2. If A.R.S. § 42-11054(C)(2) applies to the Equipment, does the statute violate the Exemptions and Uniformity Clauses?

CONSTITUTIONAL AND STATUTORY PROVISIONS:

In relevant part, the **Uniformity Clause, Ariz. Const. art. 9, § 1**, provides:

> The power of taxation shall never be surrendered, suspended or contracted away. Except as provided by § 18 of this article, all taxes shall be uniform upon the same class of property within the territorial limits of the authority levying the tax, and shall be levied and collected for public purposes only."

The **Exemption Clause, Ariz. Const. art. 9, § 2(13)**, provides:

> All property in the state not exempt under the laws of the United States or under this constitution or exempt by law under the provisions of this section shall be subject to taxation to be ascertained as provided by law.

A.R.S. § 42-11054(C)(2) provides:

> Solar energy devices, as defined in § 44-1761, grid-tied photovoltaic systems and any other device or system designed for the production of solar energy primarily for on-site consumption are considered to have no value and to add no value to the property on which such device or system is installed.

A.R.S. § 42-14151(B) provides:

> For the purposes of this article, 'generation of electricity' means the process of taking a source of energy, including coal, natural gas, oil, nuclear fuel or renewable sources and converting the energy into electricity to be delivered to customers through a transmission and distribution system.

In relevant part, **A.R.S. § 42-14155(C)(3)** defines "renewable energy equipment" as:

> electric generation facilities, electric transmission, electric distribution, gas distribution or combination gas and electric transmission and distribution and transmission and distribution cooperative property that is located in this state, that is used or useful for the generation, storage, transmission or distribution of electric power, energy or fuel derived from solar, wind or other nonpetroleum renewable sources not intended for self-consumption, including materials and supplies and construction work in progress.