

Department of Revenue

A.R.S. § 42-102

Director: Mark Killian

JLBC Analyst: Bob Hull

	FY 2000 Actual	FY 2001 Estimate	FY 2002 Approved	FY 2003 Approved
PROGRAM BUDGET				
External Services	7,581,900	8,509,400	8,988,200	9,332,200
Processing	7,890,300	7,378,800	8,376,800	8,337,400
Education and Compliance				
<u>Subprograms</u>				
Education/Outreach	405,000	405,700	417,900	432,400
Audit/Assessing	13,032,100	13,573,900	13,972,700	14,421,800
Alternative Fuel Tax Credit SLI	0	494,800	556,200	573,700
<i>Subprogram Subtotal</i>	13,032,100	14,068,700	14,528,900	14,995,500
Collections	7,108,000	7,642,700	8,190,200	8,437,400
Enforcement	533,600	728,900	760,500	790,500
<i>Program Subtotal - Education and Compliance</i>	21,078,700	22,846,000	23,897,500	24,655,800
Agency Support				
<u>Subprograms</u>				
Information Services	9,039,000	8,664,100	9,696,600 ^{1/}	8,813,300 ^{1/}
All Other Agency Support	13,888,400	13,552,000	13,862,100	14,034,400
<i>Program Subtotal - Agency Support</i>	22,927,400	22,216,100	23,558,700	22,847,700
TOTAL APPROPRIATIONS	59,478,300	60,950,300	64,821,200	65,173,100
OPERATING BUDGET				
Full Time Equivalent Positions	1,247.0	1,258.0	1,108.0	1,096.0
Personal Services	32,566,700	33,791,800	34,943,800	36,209,500
Employee Related Expenditures	7,418,500	7,815,500	8,228,900	7,917,400
Professional and Outside Services	2,808,200	2,953,200	3,185,900	3,196,500
Travel - In State	380,000	486,600	486,600	486,600
Travel - Out of State	514,900	675,500	675,500	675,500
Other Operating Expenditures	13,285,200	14,163,800	16,028,900	15,299,000
Equipment	2,504,800	569,100	569,100	668,600
<i>Operating Subtotal</i>	59,478,300	60,455,500	64,118,700	64,453,100
Special Line Items (SLI)	0	494,800 ^{2/}	556,200	573,700
SUBTOTAL	59,478,300	60,950,300	64,674,900	65,026,800
Additional Appropriations -				
Department of Revenue; Confidentiality, Ch. 261	0	0	146,300	146,300
TOTAL APPROPRIATIONS	59,478,300	60,950,300	64,821,200 ^{3/4/5/}	65,173,100 ^{3/4/5/}
FUND SOURCES				
General Fund	57,743,800	59,043,700	62,648,100	62,862,800
<u>Other Appropriated Funds</u>				
Estate and Unclaimed Property Fund	1,110,500	1,154,500	1,407,500	1,508,700
Tobacco Tax and Health Care Fund	311,000	387,200	400,000	410,200
Liability Setoff Fund	313,000	364,900	365,600	391,400
<i>Subtotal - Other Appropriated Funds</i>	1,734,500	1,906,600	2,173,100	2,310,300
TOTAL APPROPRIATIONS	59,478,300	60,950,300	64,821,200	65,173,100

AGENCY DESCRIPTION — *The Department of Revenue (DOR) administers and enforces the collection of personal and corporate income, sales, withholding, luxury and estate taxes. The department administers state property tax laws through the 15 county assessors. The department does not collect transportation related fees and taxes, nor the insurance premium tax.*

PERFORMANCE MEASURES	FY 1999	FY 2000	FY 2001	FY 2002-03
	Est./Actual	Est./Actual	Estimate	Estimate
• Average calendar days to refund income tax	13/13.5	13/19.2	19.3	19.4
• Total tax documents processed (millions)	6.3/5.5	5.6/5.7	5.8	5.8
• % of non-audit revenue to total revenue	96.6/98.6	96.8/97.0	97.1	97.2/97.3
• % of private taxpayer rulings completed within 45 calendar days of receipt	95/86	95/85	90	90
• % that collector contacts taxpayer within 30 calendar days of being assigned a delinquent account	90/72	90/49	65	75/95
• % of delinquent accounts collected	NA	NA	10	20
• % of agency staff turnover	NA/13.2	NA/12	16	16
• Administration as a % of total cost	5.77/NA	5.77/NA	5.77	5.8
• Customer satisfaction rating (Scale 1-8)	NA	NA	NA	6.0

External Services Program — This program provides services to customers outside the department, including property tax oversight, estate tax and unclaimed property administration, econometric analysis, transaction privilege and bingo license processing, and taxpayer dispute resolution. The program is funded from the General Fund and from the Estate and Unclaimed Property Fund.

Unclaimed Property Workload — The approved amount includes an increase of \$230,000 from the Estate and Unclaimed Property Fund in both FY 2002 and FY 2003 above FY 2001 for a projected 20% increase in workload due to caseload growth and reduced holding periods for 6 unclaimed property types, which was enacted by Laws 2000, Chapter 184, effective January 1, 2001.

Equipment — The approved amount includes a FY 2003 Estate and Unclaimed Property Fund increase of \$84,500 for one-time equipment to begin a multi-year project to replace DOR's computer network and personal computers.

Processing Program — This program receives and processes tax forms and electronic tax filings, enters data into computer systems, generates tax refunds and correction notices, and operates the state's debt setoff program. The program is funded from the General Fund and from the Liability Setoff Fund.

Electronic Tax Filing — The approved amount includes a General Fund increase of \$400,000 in both FY 2002 and FY 2003 above FY 2001 for payment of an estimated \$2 vendor transaction fee for 200,000 taxpayers using telefile to file for the \$25 transaction privilege tax credit beginning with FY 2002. This tax credit was included in the recently passed Proposition 301 for low-income taxpayers to offset the 0.6% transaction privilege tax increase for education, which takes effect June 1, 2001.

The approved amount includes a FY 2002 General Fund increase of \$113,000 above FY 2001 and a FY 2003 General Fund increase of \$5,000 above FY 2001 for programming and equipment to implement 2-D bar coding for e-filing of certain tax returns by tax practitioners, so that the department can scan the data instead of doing manual data entry for these returns. The FY 2003 increase is lower due to the elimination of one-time equipment and development costs. The Government Information Technology Agency (GITA) has approved this project.

The approved amount includes a FY 2002 General Fund increase of \$106,000 above FY 2001 to implement a telefile system for filing income tax 140EZ forms. The department expects to also use this same telefile system to process the \$25 income tax credit resulting from the 0.6% transaction privilege tax increase for education. The GITA has approved this project.

- 1/ Before the expenditure of any of the \$339,100 appropriated for computer projects (without an approved project investment justification as of December 1, 2000) in FY 2002, the Joint Legislative Budget Committee Staff shall review the department's plans for expenditure of these monies. Before the expenditure of any of the \$339,100 appropriated for other computer projects in FY 2003, the Joint Legislative Budget Committee Staff shall review the department's plans for the expenditure of these monies. (General Appropriation Act footnote)
- 2/ Laws 2000, Chapter 1, 7th Special Session appropriated \$494,800 and 11 FTE Positions for the review of all income tax returns that claim an alternative fuel tax credit in each year the credits are authorized by law.
- 3/ General Appropriation Act funds are appropriated as a Lump Sum by Agency with Special Line Items.
- 4/ The Department of Revenue may contract with a third party vendor to accept credit card payment for taxes only if there is no cost to the state General Fund for accepting credit card payments. The department shall report to the Joint Legislative Budget Committee by December 31, 2001 on this program. (General Appropriation Act footnote)
- 5/ This amount does not include the triggered appropriation made by Laws 2001, Chapter 235 for the transaction privilege tax database. Triggered appropriations in FY 2002 and FY 2003 depend on the availability of excess revenues. (For more information, refer to the "Transaction Privilege Tax Database" description in Other Issues, and the "Summary of Appropriations Triggered by Revenues" table at the front of this report.)

Equipment — The approved amount includes a FY 2003 Liability Setoff Fund increase of \$15,000 for one-time equipment to begin a multi-year project to replace DOR's computer network and personal computers.

Education and Compliance Program — This program seeks taxpayer compliance with tax laws through taxpayer education and enforcement activities. The program includes the Education/Outreach, Audit/Assessing, Collections, and Enforcement Subprograms, and the Alternative Fuel Tax Credit Special Line Item. The program is funded from the General Fund, from the Estate and Unclaimed Property Fund, and from the Tobacco Tax and Health Care Fund.

Education/Outreach Subprogram — This subprogram supports the agency's tax education seminars and publications for taxpayers and tax practitioners. The subprogram is funded from the General Fund.

Audit/Assessing Subprogram — This subprogram performs audits and related functions for corporate and individual income taxes, sales and luxury taxes, and unclaimed property. The subprogram is funded from the General Fund, from the Estate and Unclaimed Property Fund, and from the Tobacco Tax and Health Care Fund.

Alternative Fuel Tax Credit Special Line Item — Monies in this line item allow the department to review all income tax returns that claim an alternative fuel tax credit in each year the credits are authorized by law. The line item is funded from the General Fund.

Tax Credit Review — The approved amount includes a General Fund increase of \$50,500 in both FY 2002 and FY 2003 above FY 2001, to annualize Personal Services for the 11 FTE Positions and to remove one-time equipment. This Special Line Item is expected to be greatly reduced or eliminated in FY 2004.

Collections Subprogram — This subprogram contacts taxpayers to collect delinquent taxes and returns, and identifies and licenses previously unlicensed businesses. The subprogram is funded from the General Fund.

Enforcement Subprogram — This subprogram enforces tobacco tax laws and works with the Attorney General to prosecute tax cases. The subprogram is funded from the General Fund and from the Tobacco Tax and Health Care Fund.

Agency Support Program — This program supports the department's core functions through the information services, and the all other agency support subprograms. The program is funded from the General Fund.

Information Services Subprogram — This subprogram runs the department's computer and telecommunications

operations, and maintains, microfilms and stores the department's tax records.

Computer Projects — The approved amount includes a General Fund increase of \$339,100 in both FY 2002 and FY 2003 above FY 2001 for other computer projects which had not yet been approved by GITA as of December 1, 2000. A new footnote requires that the JLBC review DOR's expenditure plans for these monies prior to their expenditure, to provide greater legislative oversight of DOR's computerization projects.

Computer Loan — The approved amount includes a FY 2003 General Fund decrease of \$(275,000) below FY 2001 for the department's paying off of their 5-year loan in mid-FY 2003, which was to upgrade their local area computer network and to replace their personal and laptop computers. The department had financed a principal amount of \$2,444,200 for 5 years with debt service payments totaling \$2,749,000, and quarterly debt service payments of \$137,400. The department made \$412,000 of debt service payments from their base budget in FY 1999, before being appropriated \$550,000 for these debt service payments in FY 2000 and in FY 2001. The approved amount continues the \$550,000 appropriation for debt service payments in FY 2002, and then decreases it to \$275,000 in FY 2003. The loan originally would have been paid off after the first quarter of FY 2004. However, the department has used excess vacancy savings to make 3 extra payments ahead of schedule, which leaves only 2 payments totaling \$275,000 to be made in FY 2003.

Mainframe Consolidation — The approved amount includes a FY 2002 General Fund increase of \$632,900 above FY 2001 and a FY 2003 General Fund decrease of \$(164,400) and (12) FTE Positions below FY 2001 due to consolidating DOR's mainframe computer system into the state's central data center. The Arizona Department of Administration (ADOA) will administer the consolidated data center and will allocate their costs to DOR and all other participating agencies. The decreases in FY 2003 are due to anticipated savings from the amount the agency currently expends to maintain their individual system.

All Other Agency Support Subprogram — This subprogram provides internal agency support including accounting, budgeting, purchasing, inventory, human resources, and director's office functions.

Phone Charges — The approved amount includes a General Fund increase of \$156,600 in both FY 2002 and FY 2003 above FY 2001 for an increase in ADOA phone system charges.

Operating Budget Issues

Agencywide FTE Position Decrease — The approved amount includes General Fund decreases of \$(495,700)

and (150) excess FTE Positions in both FY 2002 and FY 2003 from FY 2001 to the department to better align the department's approved number of FTE Positions and Employee Related Expenditures (ERE) dollars with their actual usage. As shown in the following table, the department has had from 163 to 250 excess total FTE Positions, and has had from 165 to 244 excess General Fund FTE Positions, for the past 3 years. During this time, the department has used its budgetary discretion to provide a certain level of customer service, while reallocating their excess Personal Services monies to other budgetary areas, including information technology projects and making early loan payments. The savings comes from eliminating the ERE for these FTE Positions. The department has reallocated the Personal Services for these FTE Positions and is using that money for other items. The approved amount reflects the department's reallocation of Personal Services monies to other line items.

<u>Total FTE Positions</u>			
<u>Fiscal Year</u>	<u>Approved</u>	<u>Actual</u>	<u>Excess</u>
2000	1,247	997	250
1999	1,255	1,085	170
1998	1,255	1,092	163
<u>General Fund FTE Positions</u>			
2000	1,222	978	244
1999	1,237	1,063	174
1998	1,237	1,072	165

Additional Appropriations: Department of Revenue; Confidentiality (Chapter 261) — Establishes a new Federal Refund Offset program, and appropriates \$146,250 from the General Fund in both FY 2002 and FY 2003 to the Department of Revenue to administer the Federal Refund Offset program. Under the Federal Refund Offset program, the state could offset an individual's federal income tax refund against their Arizona individual income tax debts, and thereby recover some of the individual income tax monies owed to the state.

It is estimated that the Federal Refund Offset program would produce increased General Fund revenues of \$1,400,000 in FY 2002, \$1,300,000 in FY 2003, \$790,000 in FY 2004, \$805,000 in FY 2005 and \$850,000 annually beginning in FY 2006. The amount decreases due to 2 factors. First, the Department of Revenue projects an overall net revenue increase of \$1,400,000 in FY 2002, \$1,300,000 in FY 2003, and \$1,000,000 annually as the amounts of individual income tax debts owed the state would decrease and then stabilize at a lower level due to the Federal Refund Offset program. Second, cities would receive 15% of net income tax collections from 2 years prior for urban revenue sharing.

Triggered Appropriations: Conditional Appropriations; Taxation; Revenue Forecasts (Chapter 235) — This act appropriates \$1,685,000 in FY 2002 and \$1,000,000 in FY 2003 from the General Fund for the Transaction Privilege Tax Database if FY 2001 General Fund revenues

exceed the forecast by \$79,708,400. Prior to September 1, 2001, JLBC and OSPB will calculate total FY 2001 revenues and determine if sufficient monies are available to trigger the appropriations. If FY 2001 revenues do not exceed the forecast by the required amount, but FY 2002 General Fund revenues exceed the forecast by \$73,512,300, the act appropriates \$2,685,000 in FY 2003 from the General Fund for the Transaction Privilege Tax Database. Prior to September 1, 2002, JLBC and OSPB will calculate total FY 2002 revenues and determine if sufficient monies are available to trigger the appropriation. *(See the Transaction Privilege Tax Database discussion for more information. For more information on this and other triggered appropriations see the "Summary of Appropriations Triggered by Revenues" table at the front of this report.)*

Additional Legislation: Recording Tax Lien Extensions (Chapter 122) — Requires the Department of Revenue to file a tax lien extension with the appropriate county recorder's office, if the 6-year statute of limitations period is extended. Such an extension might occur through taxpayer agreements or other actions like bankruptcy filings. Chapter 122 is conditionally enacted, effective July 1, 2002 only if the Legislature appropriates monies during the 45th Legislature, 2nd Regular Session to the Department of Revenue for the purpose of recording the notices of tax lien extension.

Other Issues: Transaction Privilege Tax Database — The Department of Revenue has made programming changes to better accommodate their computer files for certain large transaction privilege taxpayers. However, the department reports that their transaction privilege tax computer system will soon reach its capacity, and will need a major overhaul. Laws 2001, Chapter 235, appropriates \$1,685,000 in FY 2002 and \$1,000,000 in FY 2003 from the General Fund for the Transaction Privilege Tax Database. These appropriations are contingent on the availability of excess revenues in FY 2001 and FY 2002. *(See Triggered Appropriations for more detail on the conditions of these appropriations.)*

Credit Cards — Laws 2000, Chapter 311 requires state agencies that accept credit card payments to deduct fees associated with the transaction before depositing the net amount in the appropriate state fund. Chapter 311 also states that the net amount deposited shall be considered as full payment. A new footnote requires that the Department of Revenue may accept credit card payment for taxes only if there is no cost to the state General Fund for accepting credit card payments. The footnote also requires that the department report to the Joint Legislative Budget Committee by December 31, 2001 on this program. This should prevent subjecting the state to an undetermined, but potentially large cost for paying credit card transaction fees.

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