

Director: Elliott Hibbs

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	FY 2003 Actual	FY 2004 Estimate	FY 2005 Approved
OPERATING BUDGET			
<i>Full Time Equivalent Positions</i>	1,145.1	1,134.0	1,148.0 ^{1/}
Personal Services	32,275,800	32,256,800	33,706,800
Employee Related Expenditures	7,916,200	9,783,000	9,967,600
Professional and Outside Services	1,899,300	2,119,100	2,119,100
Travel - In State	192,200	258,600	308,600
Travel - Out of State	157,500	250,200	270,200
Other Operating Expenditures	11,539,000	11,082,500	10,860,300
Equipment	847,900	455,000	603,000
OPERATING SUBTOTAL	54,827,900	56,205,200	57,835,600
SPECIAL LINE ITEMS			
Alternative Fuel Tax Credit	384,200	0	0
Revenue Generating Program	3,275,800	6,571,900	6,703,100
AGENCY TOTAL	58,487,900	62,777,100	64,538,700^{2/3/4/}
FUND SOURCES			
General Fund	56,365,700	60,507,700	62,219,500
<u>Other Appropriated Funds</u>			
Estate and Unclaimed Property Fund	1,349,500	1,448,200	1,478,900
Liability Setoff Fund	371,100	385,800	391,800
Tobacco Tax and Health Care Fund	401,600	435,400	448,500
SUBTOTAL - Other Appropriated Funds	2,122,200	2,269,400	2,319,200
SUBTOTAL - Appropriated Funds	58,487,900	62,777,100	64,538,700
Other Non-Appropriated Funds	833,400	689,800	689,800
TOTAL - ALL SOURCES	59,321,300	63,466,900	65,228,500

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 2003	FY 2003	FY 2004	FY 2005
	Appropriation	Actual	Appropriation	Appropriation
• Average calendar days to refund income tax	19.4	13.5	14	13
• % of non-audit revenue to total revenue	97.3	95.6	95.8	95.9
• % of written taxpayer inquiries answered within 30 calendar days of receipt	--	55	70	70
• % that collector contacts taxpayer within 30 calendar days of being assigned a delinquent account	95	43	51	51
• % of delinquent accounts collected	20	10.8	10	11
• % of agency staff turnover	16	11.4	12	11
• Administration as a % of total cost	5.8	6.5	6.4	6.4

^{1/} Includes 153 FTE Positions funded from Special Line Items in FY 2005.

^{2/} General Appropriation Act funds are appropriated as an Operating Lump Sum with Special Line Items by Agency.

^{3/} Included in the total appropriation of \$64,538,700 for FY 2005 is \$6,703,100 from the state General Fund and 153 FTE Positions for the Revenue Generating Program. This program is expected to generate \$53,249,000 for the state General Fund in FY 2005. The department shall provide quarterly progress reports to the Joint Legislative Budget Committee as to the effectiveness of the Revenue Generating Program and the department's overall Enforcement and Collections Program. The reports shall include a comparison of projected and actual revenue enforcement collections for FY 2005. The reports are due within 30 days after the end of each calendar quarter. (General Appropriation Act footnote, as adjusted for statewide allocations.)

^{4/} The appropriations in this section do not include funding for a North Phoenix office. (General Appropriation Act footnote)

PERFORMANCE MEASURES (Cont'd)	FY 2003	FY 2003	FY 2004	FY 2005
	Appropriation	Actual	Appropriation	Appropriation
• Customer satisfaction rating for taxpayer information section (Scale 1-5).	6.0	4.6	4.6	4.6

Comments: The agency reports that they must manually collect data to report on collectors contacting taxpayers within 30 calendar days and on delinquent accounts collected, which makes the results somewhat variable. The agency expects to be able to measure both of these items more easily and accurately in the future using their Business Reengineering/Integrated Tax System (BRITS) computer project. The average calendar days to refund income tax continued to benefit from electronic filing and 2D bar coding, despite the use of fewer temporary employees to process returns.

Operating Budget

The budget provides \$57,835,600 for the operating budget in FY 2005. This amount consists of:

General Fund	\$55,516,400
Estate and Unclaimed Property Fund	1,478,900
Liability Setoff Fund	391,800
Tobacco Tax and Health Care Fund	448,500

This amount includes an increase for statewide salary and other adjustments. *(Please see the Statewide Adjustments section at the end of this Appropriations Report for details.)*

Lease Costs

The budget includes a decrease of \$(242,100) for lease costs. This amount includes a decrease of \$(241,300) from the General Fund, an increase of \$2,200 from the Estate and Unclaimed Property Fund, and a decrease of \$(3,000) from the Liability Setoff Fund.

The General Fund amount includes a reduction of \$(199,400) for North Phoenix Office rent. A General Appropriation Act footnote states that the department's appropriations do not include funding for a North Phoenix office.

Tobacco Tax Enforcement

The budget includes a General Fund increase of \$900,000 and 14 FTE Positions for Tobacco Tax Enforcement. The 14 FTE Positions are expected to generate between \$1,724,400 to \$1,874,400 revenue in FY 2005. This increased revenue would be split 13.56% to the General Fund, 1.69% to the Corrections Fund, and 84.75% to the Tobacco Tax and Health Care Fund (including 50.85% to the Proposition 303 Tobacco Products Tax Fund and 33.9% to the Proposition 200 Tobacco Tax and Healthcare Fund).

Special Line Items

Alternative Fuel Tax Credit

The budget provides no funding from the General Fund for the Alternative Fuel Tax Credit in FY 2005. Funding for this line item was eliminated in FY 2004 due to the substantial completion of the program.

Revenue Generating Program

The budget provides \$6,703,100 from the General Fund for the Revenue Generating Program in FY 2005. This amount includes:

- An increase for statewide salary and other adjustments.
- A General Fund decrease of \$(15,000) for one-time training costs in the Revenue Generating Program.

The Revenue Generating Program includes 153 FTE Positions and is expected to generate \$53,249,000 for the General Fund in FY 2005. A General Appropriation Act footnote requires that the department provide quarterly progress reports to the Joint Legislative Budget Committee regarding the effectiveness of the program, including a comparison of projected and actual revenue enforcement collections for FY 2005.

Additional Legislation

Ladewig Settlement; Budget Reconciliation

The Ladewig Settlement Budget Reconciliation Bill (Laws 2004, Chapter 285) allocates \$120 million in FY 2005 to the department for payments and costs associated with the case of Ladewig v. State of Arizona, with any unused amount to be held in reserve for future payments. The \$120 million includes up to \$3,753,300 for department administration costs and review of payments. The department is required to present an expenditure plan for review by the Joint Legislative Budget Committee that includes an estimate and scope of the entire administrative requirement associated with disbursing payments and costs for this case, before expending any of the \$120 million.

Based on the 2001 Arizona Supreme Court decision in the Ladewig v. State of Arizona case, the state is required to refund individual income taxes paid on non-Arizona dividends earned for the years 1986 through 1989. Payments and related costs associated with this case were originally expected to total approximately \$348 million over 5 years.

Laws 2002, Chapter 321 provided a \$75 million "set-aside" for the FY 2003 payments and costs associated with the Ladewig case. Laws 2003, 1st Special Session, Chapter 2 reduced this allocation for FY 2003 to \$15 million. These remaining monies were to pay administrative costs associated with the settlement.

Summary of Ladewig FY 2002 & FY 2003 Expenditures ^{1/} and FY 2005 – FY 2007 Estimates

	<u>Expenditures</u>		FY 2005	<u>Estimates</u>	
	FY 2003	FY 2004 (10 Mo.)		FY 2006	FY 2007
Allocation	\$15,000,000	\$ 0 ^{2/}	\$120,000,000	\$ 0 ^{6/}	\$ 0 ^{6/}
DOR Administration	\$ 8,587,100	\$3,074,100	\$2,955,400	\$ 1,786,600	\$ 2,566,300
Plaintiff Attorneys	2,000,000	2,000,000 ^{3/}	5,707,000	4,853,300	4,853,300
Taxpayer Payments	0	0	116,310,900	58,245,200	85,945,000
Total Expenditures	\$10,587,100	\$5,074,100 ^{3/}	\$124,973,300 ^{4/}	\$64,885,100	\$93,364,600
Ending Balance	\$ 4,412,900	\$1,338,800 ^{5/}			

^{1/} In addition, DOR reports operating budget expenditures of \$134,600 in FY 2002 for Ladewig administration.

^{2/} Governor vetoed the allocation of up to \$7,300,000 for Ladewig administrative costs in FY 2004.

^{3/} Reimbursed to DOR by Department of Administration Risk Management.

^{4/} If DOR's Ladewig expenses exceed \$120 million in FY 2005, the department expects to make those payments above \$120 million from the tax refund account in the General Fund.

^{5/} Any remaining balance would revert to the General Fund.

^{6/} FY 2006 and FY 2007 allocations by the Legislature will be made prior to these fiscal years once final numbers are determined.

Laws 2003, Chapter 263 as transmitted to the Governor allocated \$75 million for Ladewig for FY 2004. Of this amount, up to \$7.3 million was for administrative costs, and the remainder would be set aside for future taxpayer refunds. The Governor line-item vetoed the FY 2004 set-aside in order to provide an additional \$75 million in the General Fund balance.

The Department of Revenue estimates the total cost of the Ladewig Settlement at \$302 million plus 10% interest on plaintiff attorneys' fees from the date awarded until they are paid. The numbers are not yet final. The FY 2003 and FY 2004 expenses solely cover administrative costs. Refunds to taxpayers will begin in FY 2005. The anticipated cost is \$125 million in FY 2005, \$65 million in FY 2006, and \$93 million in FY 2007.

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