

Department of Revenue

A.R.S. § 42-102

Director: Gale Garriott

JLBC Analyst: Bob Hull

	FY 2004 Actual	FY 2005 Estimate	FY 2006 Approved
<b>OPERATING BUDGET</b>			
<i>Full Time Equivalent Positions</i>	1,134.0	1,148.0	1,148.0 <sup>1/</sup>
Personal Services	32,257,600	34,027,200	34,654,300
Employee Related Expenditures	8,994,100	10,217,200	11,416,900
Professional and Outside Services	2,421,000	2,033,000	2,042,200
Travel - In State	210,800	344,500	344,500
Travel - Out of State	145,600	258,200	208,200
Other Operating Expenditures	10,624,500	10,782,000	10,749,900
Equipment	811,000	714,700	566,700
<b>OPERATING SUBTOTAL</b>	<b>55,464,600</b>	<b>58,376,800</b>	<b>59,982,700</b>
<b>SPECIAL LINE ITEMS</b>			
Revenue Generating Program	6,571,900	6,788,900	6,989,400
<b>AGENCY TOTAL</b>	<b>62,036,500</b>	<b>65,165,700</b>	<b>66,972,100<sup>2/3/4/</sup></b>
<b>FUND SOURCES</b>			
General Fund	59,858,300	62,846,500	64,582,800
<u>Other Appropriated Funds</u>			
Estate and Unclaimed Property Fund	1,370,700	1,478,900	1,526,000
Liability Setoff Fund	379,300	391,800	393,500
Tobacco Tax and Health Care Fund	428,200	448,500	469,800
SUBTOTAL - Other Appropriated Funds	2,178,200	2,319,200	2,389,300
<b>SUBTOTAL - Appropriated Funds</b>	<b>62,036,500</b>	<b>65,165,700</b>	<b>66,972,100</b>
Other Non-Appropriated Funds	381,300	671,400	671,400
<b>TOTAL - ALL SOURCES</b>	<b>62,417,800</b>	<b>65,837,100</b>	<b>67,643,500</b>

**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.

1/ Includes 103 FTE Positions funded from Special Line Items in FY 2006.

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 \$66,972,100 for FY 2006 is \$6,989,400 from the state General Fund and 103 FTE Positions for the Revenue Generating Program. This program is expected to generate \$53,249,000 for the state General Fund in FY 2006. 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 2006. 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 Department of Revenue shall pay no more than \$368,100 from all funds in FY 2006 for their risk management payment to the Department of Administration. (General Appropriation Act footnote)

<b>PERFORMANCE MEASURES</b>	FY 2003 Actual	FY 2004 Actual	FY 2006 Approved
• Average calendar days to refund income tax	13.5	8.3	8.3
• % of written taxpayer inquiries answered within 30 calendar days of receipt	55	58	65
• % of delinquent accounts collected	10.8	10.0	11.0
• Customer satisfaction rating for taxpayer information section (Scale 1-5).	4.6	4.6	4.6

**Comments:** Average calendar days to refund income tax decreased to 8.3 days in FY 2004 due to an increase in electronic filing. Delinquent accounts collected decreased slightly to 10% in FY 2004, but should improve with the Business Re-Engineering/Integrated Tax System (BRITS).

### ***Operating Budget***

The budget provides \$59,982,700 for the operating budget in FY 2006. This amount consists of:

	<b>FY 2006</b>
General Fund	\$57,593,400
Estate and Unclaimed Property Fund	1,526,000
Liability Setoff Fund	393,500
Tobacco Tax and Health Care Fund	469,800

The approved amount includes an increase of \$1,723,900 in FY 2006 for statewide adjustments. This amount consists of:

General Fund	1,653,800
Estate and Unclaimed Property Fund	47,100
Liability Setoff Fund	1,700
Tobacco Tax and Health Care Fund	21,300

*(Please see the Statewide Adjustments section at the end of this Appropriations Report for details.)*

#### ***Taxpayer Information and Assistance***

The approved amount includes an increase of \$80,000 from the General Fund in FY 2006 for 2 existing vacant Taxpayer Information and Assistance FTE Positions to improve the department's response rate for taxpayer telephone information requests.

#### ***Risk Management***

The approved amount includes \$368,100 in FY 2006 for the Risk Management payment to the Arizona Department of Administration. This amount is unchanged from FY 2005 and consists of:

	359,300
Estate and Unclaimed Property Fund	4,600
Liability Setoff Fund	1,700
Tobacco Tax and Health Care Fund	2,500

The Arizona Department of Administration had proposed an increase of \$855,700 in FY 2006 for DOR's Risk

Management payment to partially reimburse the Arizona Department of Administration Risk Management for \$2 million paid in FY 2004 by Risk Management for plaintiff attorneys' fees in the Ladewig v. State of Arizona settlement. 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. Subsequently, DOR paid \$2 million for plaintiff attorneys' fees in FY 2004, which was reimbursed to DOR by Risk Management. A General Appropriation Act footnote requires that the Department of Revenue shall pay no more in FY 2006 for their Risk Management payment to the Arizona Department of Administration than the approved amount for FY 2005.

#### ***Out-of-State Travel Reduction***

The approved amount includes a decrease of \$(50,000) from the General Fund in FY 2006 for a 25% reduction in the agency's FY 2004 out-of-state travel funding.

#### ***One-Time Costs***

The approved amount includes a decrease of \$(148,000) from the General Fund in FY 2006 for one-time equipment for 14 new tobacco tax enforcement FTE Positions added in FY 2005.

### ***Special Line Items***

#### ***Revenue Generating Program***

The budget provides \$6,989,400 and 103 FTE Positions from the General Fund for the Revenue Generating Program in FY 2006. The approved amount includes an increase of \$200,500 from the General Fund in FY 2006 for statewide adjustments. The Revenue Generating Program is expected to generate \$53,249,000 for the General Fund in FY 2006.

Through March 31, 2005, the Revenue Generating Program was \$(20) million below the 9-month pro-ration of the \$53.2 million General Fund goal in FY 2005. The

Revenue Generating Program was \$(17.8) million below the General Fund goal of \$53.2 million in FY 2004. The Amnesty Program added \$20.5 million in FY 2004 from individuals or businesses already being audited who chose to pay under the Amnesty Program. It is unclear how much of the \$20.5 million would have been collected as part of the Revenue Generating Program without the Amnesty Program. In addition, General Fund revenue in FY 2004 from accounts receivable billings (before the accounts are moved to collections) was \$25.5 million above the FY 2003 amount. These collections could potentially be considered as part of the Revenue Generating Program proceeds. However, the revenues from accounts receivable billings are historically highly variable from year-to-year, and it is unclear how the Revenue Generating Program impacted these receipts.

**Additional Legislation**

**Ladewig Settlement Payments Budget Reconciliation Bill**

The Ladewig Settlement Payments Budget Reconciliation Bill (Laws 2005, Chapter 333) allocates \$58.3 million in FY 2006 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 \$58.3 million includes up to \$1.8 million to be used for department administrative 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 \$1.8 million. Any unused amounts of the \$58.3 million and \$1.8 million are set aside for future Ladewig payments. The bill also reverts any unclaimed Ladewig refunds for FY 2005 and FY 2006 to the General Fund.

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 capped not to exceed \$350 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, 1<sup>st</sup> 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.

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.

Laws 2004, Chapter 285 allocated \$120 million in FY 2005 for the payment of first year Ladewig taxpayer refunds and administrative costs. Of this amount, up to \$3.8 million was for administrative costs. Any unused amount of the \$120 million was set aside for future payments. At the August 2004 JLBC meeting, DOR estimated \$134.7 million for Ladewig costs in FY 2005. The increase was due to corrections from claimant disputes or information provided by taxpayers. DOR pays Ladewig expenses which exceed the allocation from the tax refund account in the General Fund.

The Department of Revenue currently estimates the total cost of the Ladewig Settlement at \$308.5 million. The numbers are not yet final. The \$16.3 million of expenditures in FY 2003 and FY 2004 solely cover administrative costs and attorney fees. Refunds to taxpayers began in FY 2005. The estimated cost is \$134.7 million in FY 2005, \$58.3 million in FY 2006, and \$99.2 million in FY 2007.

**Summary of Ladewig FY 2003 & FY 2004 Expenditures and FY 2005 - FY 2007 Estimates**

	<u>Expenditures</u> <sup>1/</sup>		<u>Estimates</u>		
	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
Allocation	\$15,000,000	\$ 0 <sup>2/</sup>	\$120,000,000 <sup>3/</sup>	\$58,258,900	\$ 0 <sup>4/</sup>
DOR Administration	\$ 8,587,100	\$3,741,600	\$3,000,000 <sup>5/</sup>	\$ 1,758,900	\$ 2,566,300
Plaintiff Attorneys	2,000,000	2,000,000 <sup>6/</sup>	6,000,000	4,900,000	4,900,000
Taxpayer Payments	0	0	125,700,000	51,600,000	91,700,000
Total Expenditures	\$10,587,100	\$5,741,600	\$134,700,000 <sup>7/</sup>	\$58,258,900	\$99,166,300
Ending Balance	\$ 4,412,900	\$671,300 <sup>8/</sup>			

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/ The amount changed to \$134,700,000 after DOR revised their estimate.  
4/ The FY 2007 allocation by the Legislature will be made prior to this fiscal year once final numbers are determined.  
5/ JLBC favorably reviewed \$3,000,000 to fully fund DOR’s estimated administrative costs in FY 2005 at the June 29, 2004 JLBC meeting.  
6/ Reimbursed to DOR by Department of Administration Risk Management.  
7/ DOR estimate reported at the August 17, 2004 JLBC meeting. DOR pays Ladewig expenses which exceed the allocation from the tax refund account in the General Fund.  
8/ The \$671,300 remaining balance reverted to the General Fund.