

Director: Gale Garriott

JLBC Analyst: Bob Hull

	FY 2006 Actual	FY 2007 Estimate	FY 2008 Approved	FY 2009 Approved
<b>OPERATING BUDGET</b>				
<i>Full Time Equivalent Positions</i>	1,148.0	1,148.0	1,164.0 <sup>1/</sup>	1,164.0 <sup>1/</sup>
Personal Services	34,177,400	39,936,300	41,127,700	39,936,300
Employee Related Expenditures	11,380,900	14,796,800	15,834,600	14,804,700
Professional and Outside Services	2,505,600	2,599,800	2,618,900	2,599,800
Travel - In State	267,400	410,800	410,800	410,800
Travel - Out of State	84,000	400,500	400,500	400,500
Other Operating Expenditures	10,195,200	10,907,800	12,838,100	10,904,800
Equipment	1,042,300	1,599,200	1,599,200	1,599,200
<b>OPERATING SUBTOTAL</b>	<b>59,652,800</b>	<b>70,651,200</b>	<b>74,829,800</b>	<b>70,656,100</b>
<b>SPECIAL LINE ITEMS</b>				
BRITS Operational Support	0	1,200,000	2,223,700	2,223,700
Health Insurance Premium Tax Credit	0	75,000	30,000 <sup>2/</sup>	30,000 <sup>2/</sup>
Kerr Settlement Administration	345,200	0	0	0
Ch. 279 Legal Arizona Workers Act	0	0	70,000 <sup>3/</sup>	0
Litigation Expenses	0	1,000,000 <sup>4/</sup>	0	0
Revenue Generating Program	6,989,400	0	0	0
Small Towns Revenue Sharing	0	850,000	850,000	0
Unclaimed Property Administration	1,564,500	1,691,300	1,669,200	1,608,600
Unclaimed Property Contract Auditors	0	1,770,000	1,770,000 <sup>5/</sup>	1,770,000 <sup>5/</sup>
<b>AGENCY TOTAL</b>	<b>68,551,900</b>	<b>77,237,500</b>	<b>81,442,700<sup>6/7/</sup></b>	<b>76,288,400<sup>6/7/</sup></b>
<b>FUND SOURCES</b>				
General Fund	66,196,100	71,856,100	76,942,100	71,849,200
<u>Other Appropriated Funds</u>				
Estate and Unclaimed Property Fund	1,564,500	3,461,300	3,439,200	3,378,600
Liability Setoff Fund	316,300	416,800	430,900	413,800
Risk Management Fund	0	1,000,000	0	0
Tobacco Tax and Health Care Fund	475,000	503,300	630,500	646,800
<b>SUBTOTAL - Other Appropriated Funds</b>	<b>2,355,800</b>	<b>5,381,400</b>	<b>4,500,600</b>	<b>4,439,200</b>
<b>SUBTOTAL - Appropriated Funds</b>	<b>68,551,900</b>	<b>77,237,500</b>	<b>81,442,700</b>	<b>76,288,400</b>
Other Non-Appropriated Funds	18,458,700	19,564,300	19,564,300	19,564,300
<b>TOTAL - ALL SOURCES</b>	<b>87,010,600</b>	<b>96,801,800</b>	<b>101,007,000</b>	<b>95,852,700</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 34 FTE Positions funded from Special Line Items in FY 2008 and FY 2009.  
 2/ Laws 2006, Chapter 378 appropriated \$30,000 for administering health insurance premium tax credits.  
 3/ Laws 2007, Chapter 279 appropriated \$70,000 to notify employers of the requirements of the Legal Arizona Workers Act.  
 4/ Laws 2007, Chapter 256 appropriated \$1,000,000 for supplemental funding for litigation expenses.  
 5/ An amount equal to 12.5% of the dollar value of the properties recovered by unclaimed property contract auditors is appropriated from the Estate and Unclaimed Property Fund to pay unclaimed property contract auditor fees in accordance with A.R.S. § 44-313, requiring that administrative expenses be appropriated. This amount is currently estimated at \$1,770,000 in FY 2008 and FY 2009. (General Appropriation Act footnote)  
 6/ General Appropriation Act funds are appropriated as an Operating Lump Sum with Special Line Items by Agency.  
 7/ The department shall provide the department's General Fund revenue enforcement goals for FY 2008 to the Joint Legislative Budget Committee for review by July 31, 2007, and for FY 2009 by July 31, 2008. The department shall provide an annual progress report to the Joint Legislative Budget Committee as to the effectiveness of the department's overall Enforcement and Collections Program for FY 2008 by July 31, 2008 and for FY 2009 by July 31, 2009. The reports shall include a comparison of projected and actual General Fund revenue enforcement collections for FY 2008 and FY 2009 respectively. (General Appropriation Act footnote)

PERFORMANCE MEASURES	FY 2004	FY 2005	FY 2006	FY 2008
	Actual	Actual	Actual	Approved
• Average calendar days to refund income tax Comments: Average calendar days to refund income tax decreased to 5.5 days in FY 2006 due to an increase in electronic filing. DOR estimates 12 days in FY 2008 due to including returns that go to the error resolution section which are not counted now.	8.3	6.3	5.5	12
• % of written taxpayer inquiries answered within 30 calendar days of receipt	58	84	65	65
• Customer satisfaction rating for taxpayer information section (Scale 1-5)	4.6	4.4	4.7	4.7

### Operating Budget

The budget provides \$74,829,800 and 1,130 FTE Positions for the operating budget in FY 2008 and \$70,656,100 and 1,130 FTE Positions in FY 2009. These amounts consist of:

	FY 2008	FY 2009
General Fund	\$73,768,400	\$69,595,500
Liability Setoff Fund	430,900	413,800
Tobacco Tax and Health Care Fund	630,500	646,800

These amounts fund the following adjustments:

#### Statewide Adjustments

The budget provides an increase of \$3,071,300 in FY 2008 and a decrease of \$(1,142,500) in FY 2009 for statewide adjustments including the lease-purchase payment for the Phoenix DOR building. These amounts consist of:

General Fund	3,037,300	(1,135,600)
Liability Setoff Fund	14,100	(3,000)
Tobacco Tax and Health Care Fund	19,900	(3,900)

The \$3,037,300 General Fund increase in FY 2008 includes an increase of \$737,800 for the lease-purchase payment for the Phoenix DOR building. The \$(1,135,600) General Fund decrease in FY 2009 includes a decrease of \$(930,500) for the Phoenix DOR building. *(Please see the Statewide Adjustments section at the end of this Appropriations Report for details. The annualization of these adjustments for FY 2009 will be addressed in the 2008 budget process.)*

#### Revenue Generating Program

The budget provides an increase of \$1,000,000 from the General Fund in FY 2008 and FY 2009 for the revenue generating program, which is estimated to increase General Fund enforcement revenue by more than \$1,000,000 by filling vacant enforcement positions. Enforcement revenue is generated by DOR's audit and collection activities.

#### Tobacco Tax Stamps

The budget provides an increase of \$107,300 from the Tobacco Tax and Health Care Fund in FY 2008 and \$147,400 in FY 2009 for estimated increases in both the quantity and cost of tobacco tax stamps.

### Special Line Items

#### Business Reengineering/Integrated Tax System (BRITS) Operational Support

The budget provides \$2,223,700 and 16 FTE Positions from the General Fund for operational support of BRITS in FY 2008 and FY 2009. These amounts fund the following adjustments:

#### BRITS Operational Support

The budget provides an increase of \$1,378,300 and 16 FTE Positions from the General Fund in FY 2008 and FY 2009 for ongoing BRITS operational support of the implemented BRITS systems.

#### One-Time Equipment

The budget provides a decrease of \$(354,600) from the General Fund in FY 2008 and FY 2009 for BRITS one-time equipment. *(Please see Additional Legislation for additional information.)*

Monies in this line item are used for annual server and printer replacement costs, increased BRITS data storage requirements, and information technology personnel to operate and maintain the BRITS system.

#### Health Insurance Premium Tax Credit

The budget provides \$30,000 from the General Fund for the Health Insurance Premium Tax Credit in FY 2008 and FY 2009 as authorized in Laws 2006, Chapter 378. These amounts fund the following adjustments:

#### One-Time Costs

The budget provides a decrease of \$(45,000) in FY 2008 and FY 2009 for one-time costs associated with administering health insurance premium tax credits. Chapter 378 appropriated \$75,000 from the General Fund in FY 2007, and \$30,000 in each of the fiscal years 2008

through 2011, for DOR to administer health insurance premium tax credits.

Monies in this line item are used to administer health insurance premium tax credits. As a result of the appropriation in Chapter 378, this funding does not appear in the FY 2008 General Appropriation Act.

#### ***Kerr Settlement Administration***

The budget provides no funding from the General Fund for Kerr Settlement Administration in FY 2008 and FY 2009. This amount is unchanged from FY 2007.

Monies in this line item were a one-time supplemental appropriation for FY 2006 to be used for administration of the Kerr v. State of Arizona lawsuit. (Please see *Kerr Settlement Payments below for additional information.*)

#### ***Legal Arizona Workers Act***

The Legal Arizona Workers Act (Laws 2007, Chapter 279) appropriates \$70,000 from the General Fund for the Legal Arizona Workers Act in FY 2008 and no funding in FY 2009. Monies in this line item are to provide employers with notice of the new requirements of the Legal Arizona Workers Act by October 1, 2007.

#### ***Litigation Expenses***

The Supplemental Appropriation Bill (Laws 2007, Chapter 256) provides \$1,000,000 from the Risk Management Fund in FY 2007 for supplemental funding for litigation expenses. The appropriation is exempt from lapsing.

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

The budget provides no funding from the General Fund for the Revenue Generating Program special line in FY 2008 and FY 2009. This amount is unchanged from FY 2007. However, the operating budget does include an increase of \$1,000,000 in FY 2008 and FY 2009 for the revenue generating program. (Please see *Operating Budget for additional information.*)

This funding was transferred in FY 2007 to the operating budget, since DOR was not separately tracking and reporting the increased revenues produced by the Revenue Generating Program, as had been required by footnotes in previous years. The standard reporting footnote was changed beginning in FY 2007 to correspond with the transfer of funding to the operating budget.

#### ***Small Towns Revenue Sharing***

The budget provides \$850,000 from the General Fund for Small Towns Revenue Sharing in FY 2008 as one-time funding and no funding in FY 2009. The \$850,000 level is unchanged from FY 2007. Monies in this line item are for distribution to towns with a population of 1,500 or less, including \$221,340 to Jerome, \$199,970 to Winkleman, \$130,160 to Duncan, \$115,020 to Hayden, \$109,730 to Patagonia, and \$73,780 to Fredonia.

#### ***Unclaimed Property Administration***

The budget provides \$1,669,200 and 18 FTE Positions from the Estate and Unclaimed Property Fund for Unclaimed Property Administration in FY 2008 and \$1,608,600 and 18 FTE Positions in FY 2009. These amounts fund the following adjustments:

##### **Statewide Adjustments**

The budget provides an increase of \$50,400 from the Estate and Unclaimed Property Fund in FY 2008 and a decrease of \$(10,200) in FY 2009 for statewide adjustments including the lease-purchase payment for the Phoenix DOR building.

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

The budget provides a decrease of \$(72,500) from the Estate and Unclaimed Property Fund in FY 2008 and FY 2009 for one-time equipment costs for an electronic document imaging and management system.

Monies in this line item are used for the administrative costs of handling, publicizing and selling of unclaimed or abandoned property. Abandoned property can include bank accounts, safe deposit boxes, stock certificates, utility deposits, life insurance policies and unclaimed victim restitution monies. Property is typically considered abandoned after 5 years. (Please see the *Unclaimed Property narrative in Additional Legislation for additional information.*)

#### ***Unclaimed Property Contract Auditors***

The budget provides \$1,770,000 from the Estate and Unclaimed Property Fund to pay unclaimed property contract auditor fees in FY 2008 and FY 2009. This amount is unchanged from FY 2007.

Monies in this line item are used to pay contract auditors, who mainly audit large financial and insurance companies headquartered out of state. The actual appropriation is 12.5% of the dollar value of the properties recovered by unclaimed property contract auditors. The amount displayed is the amount that DOR paid unclaimed property contract auditors in FY 2005. A standard footnote specifies that 12.5% of the dollar value of the properties recovered by unclaimed property contract auditors is the amount appropriated.

### ***Additional Legislation***

#### ***Business Reengineering/Integrated Tax System (BRITS) Contract Extensions or Modifications***

The Budget Procedures Budget Reconciliation Bill (Laws 2007, Chapter 259), as session law, continues to require that before executing any BRITS contract extensions or modifications that increase the contractor's share of gain-sharing proceeds from state revenues during FY 2008, DOR shall submit the proposed changes for Joint Legislative Budget Committee review, retroactive to June

30, 2007. Contract extensions have allowed DOR to use additional General Fund resources on this project without a legislative appropriation.

BRITS is the computer system being implemented by DOR to integrate their separate tax systems, improve enforcement, and ultimately increase revenues to the state. The system was implemented in FY 2003. The original contract called for BRITS to be completed in FY 2007. However, DOR had problems with the transaction privilege tax conversion to BRITS in January 2004, which delayed the BRITS conversions of corporate income tax from September 2004 to September 2006, and of individual income tax from September 2006 to December 2007.

The overall cost of the original BRITS contract was approximately \$133,700,000, including \$122,700,000 for the base contract and \$11,000,000 for estimated interest. DOR currently estimates a total cost of \$153,700,000, including \$122,700,000 for the base contract, \$7,000,000 for estimated interest, and \$24,000,000 for the BRITS contract extensions. The decrease from \$11,000,000 to \$7,000,000 for estimated interest is due to the contractor having to finance less BRITS costs, since BRITS revenues now exceed projections. The \$153,700,000 total cost does not include the cost to implement document imaging and customer relationship management. DOR has postponed the evaluation and development of their document imaging and customer relationship management needs until after the implementation of individual income tax.

Since the Joint Legislative Budget Committee had expressed concerns regarding BRITS cost and time overruns, as evidenced by the contract extensions, the Government Information Technology Agency (GITA) and the Information Technology Authorization Committee (ITAC) have become more involved with monitoring various aspects of the BRITS project. ITAC is GITA's oversight committee, which reviews and approves information technology projects with development costs over \$1,000,000. GITA and DOR began issuing joint monthly BRITS progress reports beginning with January 2007. ITAC has reviewed DOR's requests for the \$14,857,200 BRITS contract extension to finish converting individual income tax and the \$2,200,000 BRITS contract extension to continue operation of the BRITS data center.

The cost of BRITS is being financed by the contractor who, in turn, is paid from the increased revenues generated by BRITS. Payments are made to the contractor based on 85% of tax enforcement revenues above an established baseline amount. These payments are not dependent on the enforcement revenue being directly related to the BRITS project. Enforcement revenue represents collections received through the tax audit and collection processes. DOR reported that, through April 2007, BRITS revenues totaled \$272,685,400, which was \$138,861,300

(or 104%) above the \$133,824,100 originally estimated for this time in the project.

The Joint Legislative Budget Committee had asked that an outside panel be convened to evaluate the amount of enforcement revenue which has been credited to the BRITS project using the baseline methodology. As input to the outside panel, the JLBC Staff subsequently developed a summary of the issue and asked DOR to review the summary. JLBC Staff found that BRITS has had a positive impact on increasing enforcement revenue, but it is difficult to determine how much of an effect it had compared to other factors not related to BRITS. DOR generally agreed with the JLBC Staff findings, but commented that "under any sound calculation method, BRITS will clearly generate enough revenues to pay for the project over the ten-year contract period."

The outside panel felt that the JLBC Staff analysis was a fair assessment. The panel believed that the methodology had to balance some level of precision with ease of administration, and that the BRITS project would continue to produce benefits to Arizona.

#### ***Unclaimed Property***

The General Revenues Budget Reconciliation Bill (Laws 2007, Chapter 260), as permanent law, permits the department to liquidate securities in the Unclaimed Property Fund immediately and changes the abandonment period for dividends and corporate bond instruments to 3 years. Chapter 260, as session law, requires that all proceeds from the sales of securities in FY 2008 be deposited into the General Fund instead of the statutory split between the General Fund, Department of Housing, and Department of Racing. This is estimated to generate increased revenue of \$45,000,000 to the General Fund in FY 2008.

#### ***Additional Information***

##### ***Kerr Settlement Payments***

DOR was allocated \$15,000,000 in FY 2007 for payments and costs associated with the case of Kerr v. State of Arizona. The settlement was for an expanded group of federal employees who had challenged the state's taxing their retirement system contributions, while not taxing Arizona's employees' contributions to the State Retirement System for the years 1985-1990. The settlement requires that DOR complete the taxpayer refunds by August 4, 2007. DOR began paying Kerr taxpayer refunds in October 2006, and had paid \$12,334,800 through April 2007 for taxpayer refunds and plaintiff's lawyers. Any unused amounts of the \$15,000,000 appropriation revert to the General Fund.

##### ***Ladewig Settlement Payments***

DOR was allocated \$94,800,100 in FY 2007 for payments and costs associated with the case of Ladewig v. State of

Arizona. FY 2007 is the final year for paying refunds to taxpayers. Any unused amounts of the \$94,800,100 in FY 2007 for Ladewig payments and costs revert 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 \$350,000,000 over 5 years.

The Department of Revenue estimates the total cost of the Ladewig Settlement at \$302,700,000, as shown in the following table. The numbers are not yet final.

	<b>Expenditures <sup>1/</sup> FY 2003 - FY 2006</b>	<b>Estimate FY 2007</b>	<b>Total</b>
DOR Administration	\$ 15.3	\$ 1.0 <sup>2/</sup>	\$ 16.3
Attorney Fees	15.4 <sup>3/</sup>	5.0	20.4
Taxpayer Payments	<u>177.2 <sup>4/</sup></u>	<u>88.8</u>	<u>266.0</u>
<b>Total</b>	<b>\$207.9</b>	<b>\$94.8 <sup>5/</sup></b>	<b>\$302.7</b>

<sup>1/</sup> In addition, DOR reports operating budget expenditures of \$134,900 in FY 2002 for Ladewig administration.  
<sup>2/</sup> JLBC favorably reviewed \$974,600 to fully fund DOR's estimated administrative costs in FY 2007 at the June 14, 2006 JLBC meeting. \$25,400 was unallocated in DOR's plan.  
<sup>3/</sup> \$2,000,000 was reimbursed in FY 2004 to DOR by Department of Administration Risk Management.  
<sup>4/</sup> Refunds to taxpayers began in FY 2005. Includes unclaimed taxpayer payments totaling \$21,292,100 in FY 2005 and \$12,568,900 in FY 2006, which were transferred to the General Fund.  
<sup>5/</sup> Any unused amounts revert to the General Fund.

Any unclaimed Ladewig refunds are transferred to the General Fund. Unclaimed taxpayer payments totaling \$21,300,000 in FY 2005 and \$8,900,000 in FY 2006 were transferred to the General Fund.