

## Department of Revenue

|                                             | FY 2015<br>ACTUAL | FY 2016<br>ESTIMATE | FY 2017<br>APPROVED               |
|---------------------------------------------|-------------------|---------------------|-----------------------------------|
| <b>OPERATING BUDGET</b>                     |                   |                     |                                   |
| <i>Full Time Equivalent Positions</i>       | 880.8             | 880.8               | 880.8 <sup>1/</sup>               |
| Personal Services                           | 30,453,400        | 28,451,200          | 28,451,200                        |
| Employee Related Expenditures               | 13,545,900        | 12,503,000          | 12,163,200                        |
| Professional and Outside Services           | 6,292,000         | 9,575,400           | 9,570,100                         |
| Travel - In State                           | 236,200           | 291,000             | 291,000                           |
| Travel - Out of State                       | 122,500           | 116,000             | 116,000                           |
| Other Operating Expenditures                | 9,262,700         | 10,691,700          | 10,734,000                        |
| Equipment                                   | 2,772,900         | 2,071,300           | 2,071,300                         |
| <b>OPERATING SUBTOTAL</b>                   | <b>62,685,600</b> | <b>63,699,600</b>   | <b>63,396,800</b>                 |
| <b>SPECIAL LINE ITEMS</b>                   |                   |                     |                                   |
| BRITS Operational Support                   | 6,014,400         | 7,538,900           | 7,497,500                         |
| Income Tax Fraud Prevention                 | 0                 | 3,150,000           | 3,150,000 <sup>2/3/</sup>         |
| TPT Information Technology                  | 0                 | 1,230,700           | 0                                 |
| TPT Simplification                          | 1,000,000         | 990,600             | 970,400                           |
| Unclaimed Property Administration and Audit | 1,070,500         | 1,218,500           | 1,218,500 <sup>4/</sup>           |
| Veterans' Income Tax Settlements            | 0                 | 0                   | 2,000,000 <sup>5/</sup>           |
| <b>AGENCY TOTAL</b>                         | <b>70,770,500</b> | <b>77,828,300</b>   | <b>78,233,200</b> <sup>6/7/</sup> |
| <b>FUND SOURCES</b>                         |                   |                     |                                   |
| General Fund                                | 45,637,600        | 30,343,900          | 31,998,300                        |
| <u>Other Appropriated Funds</u>             |                   |                     |                                   |
| Department of Revenue Administrative Fund   | 24,215,700        | 46,407,500          | 45,158,700                        |
| Liability Setoff Program Revolving Fund     | 378,600           | 398,000             | 397,900                           |
| Tobacco Tax and Health Care Fund            | 538,600           | 678,900             | 678,300                           |
| <b>SUBTOTAL - Other Appropriated Funds</b>  | <b>25,132,900</b> | <b>47,484,400</b>   | <b>46,234,900</b>                 |
| <b>SUBTOTAL - Appropriated Funds</b>        | <b>70,770,500</b> | <b>77,828,300</b>   | <b>78,233,200</b>                 |
| Other Non-Appropriated Funds                | 4,011,200         | 3,017,100           | 3,017,100                         |
| <b>TOTAL - ALL SOURCES</b>                  | <b>74,781,700</b> | <b>80,845,400</b>   | <b>81,250,300</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.

<sup>1/</sup> Includes 70 GF FTE Positions funded from Special Line Items in FY 2017.

<sup>2/</sup> The department may not transfer any monies to or from the Income Tax Fraud Prevention line item without prior review by the Joint Legislative Budget Committee. (General Appropriation Act footnote)

<sup>3/</sup> On or before November 1, 2016, the department shall report the results of private fraud prevention investigation services during FY 2016 to the Joint Legislative Budget Committee. The report shall include the total number of fraudulent returns prevented and the total dollar amount of fraudulent returns prevented during FY 2016. (General Appropriation Act footnote)

<sup>4/</sup> If the total value of properties retained by unclaimed property contract auditors exceeds \$1,218,500, the excess amount is transferred from the state General Fund to the DOR Administrative Fund, established by A.R.S. § 42-1116.01, and appropriated to the department for contract auditor fees. (General Appropriation Act footnote)

<sup>5/</sup> Laws 2016, Chapter 125 appropriated \$2,000,000 from the General Fund for veterans' income tax settlement payments.

<sup>6/</sup> The department shall report the department's General Fund revenue enforcement goals for FY 2017 to the Joint Legislative Budget Committee on or before September 30, 2016. 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 2017 on or before September 30, 2017. The reports shall include a comparison of projected and actual General Fund revenue enforcement collections for FY 2017, including the amount of projected and actual enforcement collections for all tax types. (General Appropriation Act footnote)

<sup>7/</sup> General Appropriation Act funds are appropriated as an Operating Lump Sum with Special Line Items by Agency.

## Operating Budget

The budget includes \$63,396,800 and 810.8 FTE Positions in FY 2017 for the operating budget. These amounts consist of:

|                                         | <b>FY 2017</b> |
|-----------------------------------------|----------------|
| General Fund                            | \$23,871,800   |
| DOR Administrative Fund                 | 38,448,800     |
| Liability Setoff Program Revolving Fund | 397,900        |
| Tobacco Tax and Health Care Fund        | 678,300        |

These amounts fund the following adjustments:

### One-Time Named Claimants Funding

The budget includes a decrease of \$(5,323.09) from the General Fund in FY 2017 for the elimination of one-time funding of prior year unpaid claims. *(Please see the Named Claimants discussion in ADOA Other Issues.)*

### Statewide Adjustments

The budget includes a decrease of \$(297,500) in FY 2017 for statewide adjustments. This amount consists of:

|                                         |           |
|-----------------------------------------|-----------|
| General Fund                            | (280,600) |
| DOR Administrative Fund                 | (16,200)  |
| Liability Setoff Program Revolving Fund | (100)     |
| Tobacco Tax and Health Care Fund        | (600)     |

*(Please see the Agency Detail and Allocations Section.)*

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

The budget includes \$7,497,500 and 51 FTE Positions in FY 2017 for operational support of BRITS. These amounts consist of:

|                         |           |
|-------------------------|-----------|
| General Fund            | 2,006,100 |
| DOR Administrative Fund | 5,491,400 |

These amounts fund the following adjustments:

### Statewide Adjustments

The budget includes a decrease of \$(41,400) in FY 2017 for statewide adjustments. This amount consists of:

|                         |          |
|-------------------------|----------|
| General Fund            | (39,500) |
| DOR Administrative Fund | (1,900)  |

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. BRITS is the

state's computer system for collecting and processing tax data.

## Income Tax Fraud Prevention

The budget includes \$3,150,000 from the General Fund in FY 2017 for Income Tax Fraud Prevention. This amount is unchanged from FY 2016.

This funding initially appeared in the FY 2016 operating budget. The FY 2016 amount was transferred to this line item for ease of comparison. *(Please see the FY 2016 Appropriations Report for more information.)*

These monies are used to contract with a vendor to provide fraud prevention investigation services, make programming changes to the Taxpayer Accounting System (TAS), and provide audit and investigative support.

## TPT Information Technology

The budget includes no funding from the DOR Administrative Fund in FY 2017 for programming changes to TAS. This amount funds the following adjustments:

### Remove One-Time Funding

The budget includes a decrease of \$(1,230,700) from the DOR Administrative Fund in FY 2017 for the elimination of one-time funding for temporary Information Technology (IT) staff to make programming changes in TAS for Transaction Privilege Tax (TPT) simplification.

As part of the TPT simplification, Laws 2013, Chapter 255 and Laws 2014, Chapter 263 require DOR to operate a statewide electronic TPT filing system to receive TPT payments. This electronic system will make DOR the single source for taxpayers to apply for licenses, file returns, and make payments for all state, county and municipal TPT and sales taxes.

This system was initially scheduled to be available in January 2015, but has been delayed due to extensive programming changes needed to establish the system. DOR expects the system to be fully available and to become the single source for TPT filing and reporting in Fall 2016.

Monies in this line item were used to hire temporary IT staff to make programming changes in TAS, which will allow DOR to complete the electronic TPT filing system.

### **TPT Simplification**

The budget includes \$970,400 and 19 FTE Positions from the General Fund in FY 2017 for TPT Simplification responsibilities. These amounts fund the following adjustments:

#### **Statewide Adjustments**

The budget includes a decrease of \$(20,200) from the General Fund in FY 2017 for statewide adjustments.

While this funding was initially included in the operating budget in FY 2015, the FY 2016 monies were appropriated in a separate line item. The FY 2015 amounts are displayed as a part of this line item for ease of comparison. *(Please see the FY 2015 Appropriations Report for more information.)*

Laws 2013, Chapter 255 and Laws 2014, Chapter 263 created a unified TPT audit and collections system under the auspices of DOR. As a result, DOR will assume the responsibility for the audit and collection of TPT taxes from all municipalities including the 14 "Non-Program" cities which currently administer their own TPT taxes. These monies will allow DOR to fund the additional staffing associated with the new TPT oversight responsibilities.

### **Unclaimed Property Administration and Audit**

The budget includes \$1,218,500 from the DOR Administrative Fund in FY 2017 for Unclaimed Property Administration and Audit. This amount is unchanged from FY 2016.

Monies in this line item are used for the administrative costs of unclaimed or abandoned property. Contract auditors retain 10.25% to 12.5% of the value of properties they recover. This amount is currently estimated at \$1,218,500.

Laws 2016, Chapter 239 requires DOR to establish procedures to monitor the performance of contract auditors and issue a Request for Information by January 1, 2017 to explore the feasibility of audit contracts that are not contingent on the recovery of unclaimed property.

### **Veterans' Income Tax Settlements**

The FY 2017 Revenue Budget Reconciliation Bill (BRB) (Laws 2016, Chapter 125) appropriates \$2,000,000 from the General Fund in FY 2017 for Veterans' Income Tax Settlements. This amount will be deposited into the newly created Veterans' Income Tax Settlement Fund,

which allows DOR to grant settlement payments to refund incorrectly withheld income taxes.

The FY 2017 Revenue BRB creates the Veterans' Income Tax Settlement Fund and allows DOR to distribute settlement payments to Native American veterans for state individual income tax incorrectly withheld from military pay between September 1, 1993 and December 31, 2005. Members of an Indian tribe who are domiciled on an Indian reservation are not subject to state income tax, and military service men and women do not relinquish their domicile status while on assignment out of state.

Additionally, 5% of the fund balance at the beginning of each fiscal year can be used by both DOR and the Department of Veterans' Services for costs to administer the program. On or before October 1 of each year during CY 2017, CY 2018, and CY 2019, DOR shall report to the Legislature on the amount of withholdings subject to payments and the number of veterans affected. Any remaining monies in the fund on June 30, 2019 will revert to the General Fund.

### **Other Issues**

### **FY 2016 Supplemental**

The budget includes an FY 2016 supplemental appropriation of \$5,323.09 from the General Fund for unpaid claims.

### **Additional Legislation**

#### **Income Tax Credit Reporting Requirement**

The FY 2017 Revenue BRB permanently requires the Department of Revenue to report to the Directors of the Joint Legislative Budget Committee and the Governor's Office of Strategic Planning and Budgeting on the amount of individual income tax credits and corporate income tax credits claimed for a given fiscal year within 3 months of the end of that fiscal year. This report was previously included as a footnote in the FY 2016 General Appropriation Act (Laws 2015, Chapter 8), and only included individual income tax credits.

#### **DOR Local Cost Sharing**

The FY 2017 Revenue BRB continues the legislative intent statement that local fees authorized by A.R.S. § 42-5041B, do not exceed \$20,755,385 and are to be allocated between cities and towns, counties, the Maricopa Association of Governments and the Pima Association of Governments based on the prorated share of all revenues

distributed to them (excluding Highway User Revenue Fund allocations.)

**Tax Amnesty**

The FY 2017 Revenue BRB establishes a tax amnesty program which requires DOR to waive all penalties and interest payments for tax liabilities for tax years 2013 and before if the unpaid taxes are not under audit. Taxpayers may choose to pay off tax liabilities at once in FY 2017 or over 3 years from FY 2017 to FY 2019.

**Luxury Tax Revenue Allocation**

The FY 2017 Revenue BRB retroactively extends the allocation of luxury tax revenues to the Corrections Fund to July 1, 2015. Pursuant to A.R.S. § 42-3104, a portion of alcohol and tobacco revenues are deposited in the Corrections Fund. In FY 2015, the Corrections Fund received \$30.7 million from alcohol and tobacco tax revenues. The majority of Corrections Fund monies go to the Arizona Department of Corrections to offset General Fund prison spending. Without this statutory change, the luxury tax revenues that will be allocated to the Corrections Fund would have instead been distributed to the General Fund.

**Tobacco Tax Stamps**

The FY 2017 Revenue BRB amends the discount rate on the purchase of tobacco tax stamps from 96.0% of the face value of the stamps to 96.48%, grants an administrative allowance of 3.52 cents on tobacco tax stamps with a \$0 tax rate, grants an administrative allowance of 3.52 cents for tobacco tax stamps sold on tribal lands with a tax rate greater than \$0 if the tax payment is not precollected, and specifies that rebates on precollected payments for tax stamps sold on tribal lands shall be equal to the full face value of the stamps.

**Tobacco Tax/Master Settlement Agreement**

The budget continues to transfer \$436,500 from the Traditional Medicaid Services line item in AHCCCS in FY 2017 for DOR staff to help enforce the provisions of the Master Settlement Agreement. These monies are provided in a footnote in the AHCCCS budget. This transfer funds 6 FTE Positions to perform luxury tax enforcement and audit duties. The FTE Position increase is not reflected in DOR's appropriation total. *(Please see the AHCCCS section for more information regarding these transfers.)*

**Private TPT Collectors**

The FY 2016 Revenue BRB (Laws 2015, Chapter 10) allows DOR to hire contracted collectors to collect TPT accounts receivable in FY 2016 and FY 2017. The department may

use up to \$2.0 million of revenues collected by the contractors to pay for services rendered. DOR has decided not to hire contracted collectors. The FY 2016 budget assumed the contracted collectors would generate \$32.6 million in General Fund revenues in FY 2016 and \$13.0 million in General Fund revenues in FY 2017 (net of fees). The budgeted revenue projections have been reduced accordingly to account for this lack of revenue.

**APF - Enterprise Tax System Replacement Assessment**

The budget includes a fund transfer from the Liability Setoff Revolving Fund to the Automation Projects Fund in FY 2017 for vendor services to assess the replacement of DOR's tax system. *(Please see the Department of Administration - Automation Projects Fund section for details regarding this information technology project.)*