

State of Arizona
House of Representatives
Fifty-second Legislature
First Regular Session
2015

HOUSE BILL 2151

AN ACT

AMENDING SECTIONS 42-1104, 42-1123, 42-2059, 42-2075 AND 42-5069, ARIZONA
REVISED STATUTES; RELATING TO TAX AUDITS.

(TEXT OF BILL BEGINS ON NEXT PAGE)

1 Be it enacted by the Legislature of the State of Arizona:

2 Section 1. Section 42-1104, Arizona Revised Statutes, is amended to
3 read:

4 42-1104. Statutes of limitation; exceptions

5 A. For the taxes to which this article applies, every notice of every
6 additional tax due shall be prepared on forms prescribed by the department
7 and mailed within four years after the report or return is required to be
8 filed or within four years after the report or return is filed, whichever
9 period expires later.

10 B. NOTWITHSTANDING SUBSECTION A OF THIS SECTION, ANY NOTICE OF
11 ADDITIONAL TAX DUE REGARDING INDIVIDUAL INCOME TAX ADJUSTMENTS FOR TAXABLE
12 YEARS BEGINNING FROM AND AFTER DECEMBER 31, 2014 THAT ARE NOT BASED ON
13 FEDERAL INFORMATION MUST BE PREPARED ON FORMS PRESCRIBED BY THE DEPARTMENT
14 AND MAILED WITHIN THREE YEARS AFTER THE REPORT OR RETURN IS REQUIRED TO BE
15 FILED OR WITHIN THREE YEARS AFTER THE REPORT OR RETURN IS FILED, WHICHEVER
16 PERIOD EXPIRES LATER. FOR THE PURPOSES OF THIS SUBSECTION, "BASED ON FEDERAL
17 INFORMATION" MEANS THAT THE ADJUSTMENT IS DETERMINED TO BE NECESSARY BASED ON
18 INFORMATION PROVIDED BY THE INTERNAL REVENUE SERVICE IN AREAS IN WHICH THE
19 ARIZONA AMOUNT IS CONTINGENT ON FEDERAL LAW.

20 ~~B.~~ C. The following are exceptions to the general rules prescribed by
21 this section, and a deficiency assessment may be issued in any of the
22 following cases:

23 1. The department may assess the tax or begin a proceeding in court
24 for the collection of the tax at any time:

25 (a) In the case of a false or fraudulent return with the intent to
26 evade tax.

27 (b) In the case of failure to file a return.

28 2. If a taxpayer omits from gross income, gross receipts, gross
29 proceeds of sales or Arizona adjusted gross income, as defined for purposes
30 of chapter 5 of this title or title 43, an amount ~~which~~ THAT is properly
31 includible and ~~which~~ THAT is in excess of twenty-five ~~per-cent~~ PERCENT of the
32 amount of gross income stated in the return, the tax may be assessed at any
33 time within six years after the return was filed.

34 3. If a taxpayer during a taxable year sells at a gain property used
35 as the taxpayer's principal residence, the statutory period for the
36 assessment of any deficiency attributable to any part of the gain does not
37 expire before the expiration of four years from the date the taxpayer
38 notifies the United States internal revenue service pursuant to the United
39 States internal revenue code.

40 4. If a claim for credit or refund relates to an overpayment on
41 account of the deductibility of a debt as one ~~which~~ THAT became worthless, a
42 loss from worthlessness of a security, an erroneous inclusion of an amount
43 attributable to the recovery of a bad debt, prior tax or delinquency amount
44 due to an adjustment of a bad debt deduction or a loss deduction from
45 worthlessness of a security, the period of limitation is seven years from the

1 date prescribed by law for filing the return for the year with respect to
2 which the claim is made.

3 5. If a taxpayer fails to report a change or correction by the
4 commissioner of internal revenue or other officer of the United States or
5 other competent authority or fails to file an amended return as required by
6 section 43-327, the department may assess any deficiency resulting from such
7 adjustments within four years after the change, correction or amended return
8 is reported to or filed with the United States internal revenue service
9 regardless of any previous examinations by the department.

10 6. If a taxpayer is required to report a change or correction by the
11 commissioner of internal revenue or other officer of the United States or
12 other competent authority or to file an amended return as required by section
13 43-327 and does report the change or files the return, any deficiency
14 resulting from the adjustments may be assessed within six months from the
15 date the notice of amended return is filed with the department by the
16 taxpayer, or within the period provided in subsection A of this section or
17 paragraph 1 or 2 of this subsection, whichever period expires last.

18 7. Except as provided in paragraph 8 of this subsection, if a taxpayer
19 agrees with the United States commissioner of internal revenue for an
20 extension or renewals of the period for proposing and assessing deficiencies
21 in federal income taxes for any year, the period for mailing a notice of a
22 proposed income tax deficiency is four years after the return was filed or
23 six months after the date of the expiration of the agreed period for
24 assessing deficiencies in the federal income tax, whichever period expires
25 later.

26 8. If a taxpayer agrees with the United States commissioner of
27 internal revenue for a limited extension or renewals of the period for
28 proposing and assessing deficiencies in federal income taxes for any year,
29 then, solely with respect to those items specifically enumerated in this
30 agreement, the period for mailing a notice of a proposed income tax
31 deficiency, or claiming a refund, is four years after the return was filed or
32 six months after the date of the expiration of the agreed period for
33 assessing deficiencies in the federal income tax, whichever period expires
34 later.

35 9. If, before the expiration of the time prescribed for the mailing of
36 a notice of a proposed deficiency assessment, the taxpayer consents in
37 writing to an assessment after that time, the assessment may be made at any
38 time before the expiration of the period agreed on. The period agreed on may
39 be extended by subsequent written agreements made before the expiration of
40 the period previously agreed on.

41 ~~E.~~ D. Notwithstanding subsection A of this section and subsection ~~B-~~
42 C, paragraphs 1 and 2 of this section, a taxpayer who has a duty to collect
43 use tax shall not be assessed tax pursuant to chapter 5, article 4 of this
44 title for any retail sales to purchasers who were licensed pursuant to
45 section 42-5005 or registered pursuant to section 42-5154 and who filed use

1 tax returns for the reporting period in which the sale was made, if the
2 reporting period in which the sale was made is more than four years from the
3 notice of proposed deficiency. If, before the expiration of this time
4 limitation, the taxpayer consents in writing to an assessment after that time
5 for the transactions, a subsequent assessment may include any transaction
6 within the agreed extended period. The period agreed to may be extended by
7 subsequent written agreements made before the expiration of the period
8 previously agreed to.

9 Sec. 2. Section 42-1123, Arizona Revised Statutes, is amended to read:

10 42-1123. Interest

11 A. If it is provided by law that interest applies as determined
12 pursuant to this section, the department shall apply interest, compounded
13 annually, in the same manner and at the same times as prescribed by section
14 6621 of the United States internal revenue code, except that the rate of
15 interest for both overpayments and underpayments for all taxpayers is the
16 federal short-term rate, determined pursuant to section 6621(b) of the
17 internal revenue code, plus three percentage points.

18 B. On January 1 of each year the department shall add any interest
19 outstanding as of that date to the principal amount of the tax. For purposes
20 of this section, the amount added to the principal is thereafter considered a
21 part of the principal amount of the tax and accrues interest pursuant to this
22 section.

23 C. If the tax, whether determined by the department or the taxpayer,
24 or any portion of the tax is not paid on or before the date prescribed for
25 its payment, the department shall collect, as a part of the tax, interest on
26 the unpaid amount at the rate determined pursuant to this section from the
27 date prescribed for its payment until it is paid.

28 D. Interest on the amount assessed as a deficiency shall be assessed
29 and paid at the same time as the deficiency at the rate determined pursuant
30 to this section from the date prescribed for the payment of the tax to the
31 date the deficiency is assessed. If any portion of the deficiency is paid
32 before the date it is assessed, interest shall accrue on that portion only to
33 the date paid.

34 E. If the time for filing a return is extended, the department shall
35 collect, as part of such tax, interest on any unpaid balance at the rate
36 determined pursuant to this section from the date on which the payment should
37 have been made if no extension had been granted until the date the tax is
38 paid.

39 F. Except in the case of a jeopardy assessment, collection of which
40 has been stayed by the posting of a bond, if a deficiency or any interest is
41 not paid in full within ten days from the date of notice and demand from the
42 department, the department shall collect as a part of the tax interest on the
43 unpaid tax or interest at the rate determined pursuant to this section from
44 the date of the notice and demand until it is paid.

1 G. If an original return filed with the department shows that the
2 taxpayer is entitled to a refund, interest is not allowed on the amount to be
3 refunded if the refund is paid within sixty days of the last day for filing
4 the return or sixty days from the filing of the return, whichever is later.
5 If the department does not pay the amount of the refund due within sixty days
6 after the date established in this subsection, the department shall pay the
7 interest on the amount at the rate prescribed in this section from the
8 sixty-first day to the issued date of the refund warrant. The department's
9 annual budget shall separately state the amount necessary to satisfy the
10 requirements of this subsection.

11 H. In the case of an amended return, claim for refund or refund
12 determined through audit, interest shall be allowed and paid, with respect to
13 any tax, from the date prescribed for the payment of that tax to the issue
14 date of the refund warrant, but in the case of an original return of tax
15 ~~which~~ THAT is filed after the last date prescribed for filing the return and
16 paying such tax, determined with regard to extensions, no interest may be
17 allowed or paid for any day before the date on which the return is filed or
18 the tax paid, whichever is later. A payment not made incident to a bona fide
19 and orderly discharge of an actual liability or one reasonably assumed to be
20 imposed by law is not an overpayment for the purposes of this subsection and
21 interest is not payable on the payment.

22 I. If a credit or refund of any part of an overpayment would be barred
23 under section 42-1106, subsection A, except for the provisions of section
24 42-1104, subsection ~~B~~ C, paragraph 4, interest shall not be allowed or paid
25 with respect to such part of the overpayment for any period beginning after
26 the expiration of the period of limitation provided in section 42-1106,
27 subsection A for filing a claim for credit or refund of such part of the
28 overpayment and ending at the expiration of six months after the date on
29 which the claim was filed or, if no claim was filed and the overpayment was
30 found by the department, ending at the time the appeal was filed with the
31 board.

32 J. In any judgment of any court rendered for any overpayment, interest
33 shall be allowed at the rate determined pursuant to this section on the
34 amount of the overpayment from the date of the payment or collection to the
35 date of allowance of credit on account of such judgment or to a date
36 determined by the department preceding the date of the refund warrant by not
37 more than thirty days.

38 Sec. 3. Section 42-2059, Arizona Revised Statutes, is amended to read:
39 42-2059. No additional audits or proposed assessments;
40 exceptions

41 A. When the department completes an audit or the findings of a managed
42 audit are accepted by the director or approved on appeal and a deficiency has
43 been completely determined under section 42-1108 or chapter 1, article 6 of
44 this title, the taxpayer's liability for the particular tax for the period

1 subjected to the audit is fixed and determined, and no additional audit may
2 be conducted except under the following circumstances:

3 1. If a taxpayer files a claim for refund under section 42-1251,
4 subsection B or any other provision authorizing a claim for refund. Any
5 departmental audit of the claim is limited to the issues presented on the
6 claim for refund.

7 2. Changes or corrections required to be reported to the department by
8 section 43-327. The department may audit any such reports or any periods for
9 which a report was required notwithstanding this section and may determine a
10 tax deficiency or a refund.

11 3. If the taxpayer failed to disclose material information during the
12 audit, or has falsified books or records or otherwise engaged in an action
13 that prevented the department from conducting an accurate audit, the
14 applicability of this subsection may be part of a subsequent protest and may
15 be contested by the taxpayer pursuant to chapter 1, article 6 of this title.

16 4. If a managed audit is completed under the terms of a limited
17 managed audit agreement, the department may audit the issues not covered by
18 the limited managed audit agreement within the statute of limitations
19 prescribed by section 42-1104.

20 5. FOR INDIVIDUAL INCOME TAX CHANGES OR CORRECTIONS BASED ON FEDERAL
21 INFORMATION AS DEFINED IN SECTION 42-1104, SUBSECTION B, AN AUDIT MAY BE
22 CONDUCTED AFTER AN ASSESSMENT HAS BEEN ISSUED WITHIN THE PERIOD SPECIFIED IN
23 SECTION 42-1104, SUBSECTION B. THE DEPARTMENT'S AUDIT ADJUSTMENTS ARE
24 LIMITED TO CHANGES BASED ON FEDERAL INFORMATION.

25 B. If the department issues a notice of proposed assessment of taxes
26 imposed by chapter 5, article 1 or 4 of this title or title 43, chapter 10,
27 the department may not increase the amount of the proposed assessment except
28 in one or more of the following circumstances:

29 1. The taxpayer has made a material misrepresentation of facts.

30 2. The taxpayer has failed to disclose a material fact to the auditor.

31 3. The department has requested information and the taxpayer fails to
32 provide that information to the department.

33 4. After issuing the notice of proposed assessment but before the
34 assessment becomes final the tax court, court of appeals or supreme court
35 issues a decision, the application of which causes the tax initially proposed
36 to increase.

37 5. THE PROPOSED ASSESSMENT WAS FOR INDIVIDUAL INCOME TAX AND WAS
38 ISSUED WITHIN THE PERIOD REQUIRED IN SECTION 42-1104, SUBSECTION B, AND THE
39 CHANGES ARE BASED ON FEDERAL INFORMATION AS DEFINED IN SECTION 42-1104,
40 SUBSECTION B.

41 C. Subsection B of this section does not apply to changes or
42 corrections that are required to be reported to the department by section
43 43-327.

1 Sec. 4. Section 42-2075, Arizona Revised Statutes, is amended to read:
2 42-2075. Audit duration; definition

3 A. An audit of a taxpayer's return or claim for refund shall not
4 exceed two years from the date of initial audit contact to the issuance of a
5 notice of proposed deficiency assessment or proposed overpayment, except:

6 1. An audit of a fraudulent tax return.
7 2. An audit delayed as the result of the taxpayer's bankruptcy
8 proceeding.

9 3. An audit in which the department has issued a letter to the
10 taxpayer or the taxpayer's representative citing the potential imposition of
11 the penalty described in section 42-1125, subsection C for the taxpayer's
12 failure or refusal to provide information pursuant to the department's
13 written request.

14 4. An audit involving proceedings concerning the enforcement or
15 validity of a subpoena or subpoena duces tecum issued pursuant to section
16 42-1006, subsection C.

17 5. An audit involving a proceeding under section 42-2056.

18 6. An audit where a taxpayer has filed a petition pursuant to section
19 43-1148, but only in relation to the effect of the petition request.

20 7. An audit in which the taxpayer provides a written request to extend
21 the audit beyond the two-year period. A request for extension under this
22 paragraph is not a substitute for a waiver of the statute of limitations
23 pursuant to section 42-1104, subsection ~~B~~-C, paragraph 9. However, a waiver
24 of the statute of limitations is considered to be a written request to extend
25 the audit beyond the two-year period under this paragraph.

26 B. This section applies to audits conducted by the department and to
27 audits conducted by the department and cities and towns pursuant to section
28 42-6002.

29 C. For the purposes of this section, "initial audit contact" means:

30 1. For a field audit, the date of the first meeting between the
31 taxpayer or the taxpayer's representative and a member of the department's
32 audit staff.

33 2. For a desk or office audit or a review conducted pursuant to
34 section 42-1109, the date of the first letter to the taxpayer regarding the
35 audit or review.

36 Sec. 5. Section 42-5069, Arizona Revised Statutes, is amended to read:
37 42-5069. Commercial lease classification; definitions

38 A. The commercial lease classification is comprised of the business of
39 leasing for a consideration the use or occupancy of real property.

40 B. A person who, as a lessor, leases or rents for a consideration
41 under one or more leases or rental agreements the use or occupancy of real
42 property that is used by the lessee for commercial purposes is deemed to be
43 engaged in business and subject to the tax imposed by article 1 of this
44 chapter, but this subsection does not include leases or rentals of real
45 property used for residential or agricultural purposes.

- 1 C. The commercial lease classification does not include:
2 1. Any business activities that are classified under the transient
3 lodging classification.
4 2. Activities engaged in by the Arizona exposition and state fair
5 board or county fair commissions in connection with events sponsored by those
6 entities.
7 3. Leasing real property to a lessee who subleases the property if the
8 lessee is engaged in business classified under the commercial lease
9 classification or the transient lodging classification.
10 4. Leasing real property pursuant to a written lease agreement entered
11 into before December 1, 1967. This exclusion does not apply to the
12 businesses of hotels, guest houses, dude ranches and resorts, rooming houses,
13 apartment houses, office buildings, automobile storage garages, parking lots
14 or tourist camps, or to the extension or renewal of any such written lease
15 agreement.
16 5. Leasing real property between affiliated companies, businesses,
17 persons or reciprocal insurers. For the purposes of this paragraph:
18 (a) "Affiliated companies, businesses, persons or reciprocal insurers"
19 means the lessor holds a controlling interest in the lessee, the lessee holds
20 a controlling interest in the lessor, affiliated persons hold a controlling
21 interest in both the lessor and the lessee, or an unrelated person holds a
22 controlling interest in both the lessor and lessee.
23 (b) "Affiliated persons" means members of an individual's family or
24 persons who have ownership or control of a business entity.
25 (c) "Controlling interest" means direct or indirect ownership of at
26 least eighty ~~per-cent~~ PERCENT of the voting shares of a corporation or of the
27 interests in a company, business or person other than a corporation.
28 (d) "Members of an individual's family" means the individual's spouse
29 and brothers and sisters, whether by whole or half blood, including adopted
30 persons, ancestors and lineal descendants.
31 (e) "Reciprocal insurers" has the same meaning prescribed in section
32 20-762.
33 6. Leasing real property for boarding horses.
34 7. Leasing or renting real property or the right to use real property
35 at exhibition events in this state sponsored, operated or conducted by a
36 nonprofit organization that is exempt from taxation under section 501(c)(3),
37 501(c)(4) or 501(c)(6) of the internal revenue code if the organization is
38 associated with major league baseball teams or a national touring
39 professional golfing association and no part of the organization's net
40 earnings inures to the benefit of any private shareholder or individual.
41 8. Leasing or renting real property or the right to use real property
42 for use as a rodeo featuring primarily farm and ranch animals in this state
43 sponsored, operated or conducted by a nonprofit organization that is exempt
44 from taxation under section 501(c)(3), 501(c)(4), 501(c)(6), 501(c)(7) or

1 501(c)(8) of the internal revenue code and no part of the organization's net
2 earnings inures to the benefit of any private shareholder or individual.

3 9. Leasing or renting dwelling units, lodging facilities or trailer or
4 mobile home spaces if the units, facilities or spaces are intended to serve
5 as the principal or permanent place of residence for the lessee or renter or
6 if the unit, facility or space is leased or rented to a single tenant thirty
7 or more consecutive days.

8 10. Leasing or renting real property and improvements for use primarily
9 for religious worship by a nonprofit organization that is exempt from
10 taxation under section 501(c)(3) of the internal revenue code and no part of
11 the organization's net earnings inures to the benefit of any private
12 shareholder or individual.

13 11. Leasing or renting real property used for agricultural purposes
14 under either of the following circumstances:

15 (a) The lease or rental is between family members, trusts, estates,
16 corporations, partnerships, joint venturers or similar entities, or any
17 combination thereof, if the individuals or at least eighty ~~per cent~~ PERCENT
18 of the beneficiaries, shareholders, partners or joint venturers share a
19 family relationship as parents or ancestors of parents, children or
20 descendants of children, siblings, cousins of the first degree, aunts,
21 uncles, nieces or nephews of the first degree, spouses of any of the listed
22 relatives and listed relatives by the half-blood or by adoption.

23 (b) The lessor leases or rents real property used for agricultural
24 purposes under no more than three leases or rental agreements.

25 12. Leasing, renting or granting the right to use real property to
26 vendors or exhibitors by a trade or industry association that is a qualifying
27 organization pursuant to section 513(d)(3)(C) of the internal revenue code
28 for a period not to exceed twenty-one days in connection with an event that
29 meets all of the following conditions:

30 (a) The majority of such vending or exhibition activities relate to
31 the nature of the trade or business sponsoring the event.

32 (b) The event is held in conjunction with a formal business meeting of
33 the trade or industry association.

34 (c) The event is organized by the persons engaged in the particular
35 trade or industry.

36 13. Leasing, renting or granting the right to use real property for a
37 period not to exceed twenty-one days by a coliseum, civic center, civic
38 plaza, convention center, auditorium or arena owned by this state or any of
39 its political subdivisions.

40 14. Leasing or subleasing real property used by a nursing care
41 institution as defined in section 36-401 that is licensed pursuant to title
42 36, chapter 4.

43 15. Leasing or renting an eligible facility as defined in section
44 28-7701.

1 16. Granting or providing rights to real property that constitute a
2 profit à prendre for the severance of minerals, including all rights to use
3 the surface or subsurface of the property as is necessary or convenient to
4 the right to sever the minerals. This paragraph does not exclude from the
5 commercial lease classification leasehold rights to the real property that
6 are granted in addition to and not included within the right of profit à
7 prendre, but the tax base for the grant of such a leasehold right, if the
8 gross income derived from the grant is not separately stated from the gross
9 income derived from the grant of the profit à prendre, shall not exceed the
10 fair market value of the leasehold rights computed after excluding the value
11 of all rights under the profit à prendre. For the purposes of this
12 paragraph, "profit à prendre" means a right to use the land of another to
13 mine minerals, and carries with it the right of entry and the right to remove
14 and take the minerals from the land and also includes the right to use the
15 surface of the land as is necessary and convenient for exercise of the
16 profit.

17 D. The tax base for the commercial lease classification is the gross
18 proceeds of sales or gross income derived from the business, but
19 reimbursements to the lessor for utility service shall be deducted from the
20 tax base.

21 E. Notwithstanding section 42-1104, subsection ~~B~~ C, paragraph 1,
22 subdivision (b) and paragraph 2, the failure to file tax returns for the
23 commercial lease classification that report gross income derived from any
24 agreement that constitutes, in whole or in part, a grant of a right of profit
25 à prendre for the severance of minerals does not constitute an exception to
26 the general rule for the statute of limitations.

27 F. For the purposes of this section:

28 1. "Leasing" includes renting.

29 2. "Real property" includes any improvements, rights or interest in
30 such property.

31 Sec. 6. Retroactivity

32 This act applies retroactively to taxable years beginning from and
33 after December 31, 2014.