

**ARIZONA DEPARTMENT OF REVENUE
2002 LEGISLATIVE SUMMARY**

The 2002 Legislative Summary provides a brief summary of the tax-related bills that were enacted by the Legislature and approved by the Governor. Also contained in the summarized bills are other bills of general interest and tax-related resolutions filed with the Secretary of State.

The general effective date is **August 22, 2002**.

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INCOME TAX

HB 2088 (income tax subtraction; dividends; repeal) - Chapter 50 RFE

HB 2088 eliminates the corporate income tax subtraction for dividend income received from Arizona corporations. The Department of Revenue is allowed to disclose the names of corporations, the dividends of which qualified for the subtraction, until July 1, 2004. The bill also clarifies that the Department of Revenue shall release confidential information to the Attorney General for the purpose of enforcing the Tobacco Master Tax Settlement.

The bill is effective retroactively to taxable years beginning from and after December 31, 2001.

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HB 2181 (NOW: enterprise; military reuse; tax credits) - Chapter 237 RFE

HB 2181 provides modifications to the enterprise zone program by narrowing definitions, capping the amount of tax credits, increasing reporting requirements and assuring that double credits cannot be taken when a business is in an enterprise zone and another zone.

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Enterprise Zone Premium and Income Tax Credit Changes

- Clarifies and narrows the definitions for the enterprise zone program of retail, retail activities and assigned to retail. The definitions refer to allowable limited retail activity by a manufacturer in an enterprise zone. The definition of zone location also clarifies and limits manufacturers to a single location within a zone. If a business has multiple locations in a zone, each location must qualify.
- Limits the number of qualified employment positions that are eligible for the premium or income tax credits under the enterprise zone program. The qualified business will calculate eligible employees as follows but in no case will the number exceed 200 positions. The calculation for eligible employees is the lesser of:
 - the total number of filled qualified employment positions created or
 - the difference between the average number of full time employees during the current tax year and the average number of full time employees during the immediately preceding tax year.
- Clarifies current procedures for substitution of employees, ensuring that replacement employees meet the original criteria.
- Clarifies that the current requirement for 35% of the net new eligible employees live in the enterprise zone applies to all three years in which a credit is claimed.
- Requires that an eligible business cannot take credits for the second and third year unless they have taken credit for an employee in the first year of employment. An employee must have been employed at least in the last 90 days of the tax year for the position to qualify for the credit. To qualify for the credit, the business must notify the Department of Commerce within six months or earlier if a tax return is due.
- Stipulates requirements for continuing the credits when an ownership change takes place through purchase, reorganization, stock purchase or merger. First year credits

can only be claimed for qualified employment positions that it created and filled after the purchase or reorganization. Second and third year credits can be claimed if the original criteria continues to be met.

- Requires timely reports to the Department of Revenue or the Department of Insurance, as applicable, as well as the Department of Commerce. A failure to submit a timely report disqualifies the taxpayer from the credits.
- Requires increased detailed information on full time employment positions that are eligible for the credit. Also allows the Department of Commerce to make site visits if necessary.
- Clarifies that a credit cannot be taken in an enterprise zone if a credit is taken for the same employee in a military reuse zone or defense-restructuring program.

Enterprise Zone Property Reclassification Changes

- Excludes electric generating plants from the definition of manufacturer for the purpose of reclassification under the enterprise zone program.
- Increases reporting requirements to the Department of Commerce for certification of the property tax reclassification. The Department of Commerce will notify the Department of Revenue or the Department of Insurance, whichever is appropriate, if a business fails to maintain eligibility.
- Requires annual certification for the property reclassification, even though the original certification is for five years. The reclassification is allowed to continue even if the business grows beyond the original size limits for a small business. However, any small businesses originally certified for a ten-year period (prior to 1996), will lose eligibility if size limits are exceeded or the business is no longer independently owned and operated.
- For property that qualifies for reclassification under the enterprise zone program, the reclassification cannot continue under the military reuse zone program.

Miscellaneous Provisions

- Requires that the designation of a military reuse zone must have a runway that is at least 8,000 feet long at the time the military facility was closed.
- Clarifies that a minority and woman owned business must be independently owned and operated.
- Makes technical and conforming changes.
- Contains a Proposition 108 clause requiring two-thirds vote for passage.

The bill is effective retroactively to taxable years beginning from and after December 31, 2001.

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HB 2186 (income tax credit review) - Chapter 238

HB 2186 creates the ten member statutory Joint Legislative Income Tax Credit Review Committee. There are five legislative members appointed from each chamber. The committee is to determine the original purpose of existing tax credits and establish a standard for evaluating and measuring the success or failure of tax credits. The committee must review the individual and corporate income tax credits listed in the bill.

The committee is use the Joint Legislative Budget Committee staff and is permitted to use the staff of the Department of Revenue and Legislative Council for assistance. The committee is to determine whether credits should be amended or repealed and is to report to the President, Speaker and Governor by December 15 of the year that the committee reviews the credit.

The income tax credit review schedule is as follows:

- 2002
 - Recycling Equipment (§ 43-1076)
 - Employment by qualified defense contractor (§ 43-1077 and § 43-1165)
 - Property taxes paid for qualified defense contractor (§ 43-1078 and § 43-1166)
 - Employment in military reuse zone (§ 43-1079 and § 43-1167)
 - Construction cost for qualified environmental technology facility (§ 43-1080 and § 43-1169)
- 2003
 - Research and Development activities (§ 43-1074.01 and § 43-1168)
 - Coal consumed in electric generating power (§ 43-1081 and § 43-1178)
 - Underground storage tank corrective action costs (§ 43-1085 and § 43-1173)
 - Pollution control equipment (§ 43-1170)
- 2004
 - Agriculture pollution control devices (§ 43-1081.01 and § 43-1170.01)
 - Solar energy devices (§ 43-1083)
 - Agriculture water conservation system (§ 43-1084)
- 2005
 - Employment of Temporary Assistance for Needy Families (TANF) recipients (§ 43-1087 and § 43-1175)
 - Contributions to charitable organizations that provide assistance to the working poor (§ 43-1088)
 - Donations of motor vehicles to wheels to work program (§ 43-1090.01 and § 43-1177)
- 2006
 - Family tax credit (§ 43-1073)
 - Private school tuition organization (§ 43-1089)
 - Public school extra curricular activity fee (§ 43-1089.01)
 - Construction materials incorporated into qualifying facilities (§ 43-1089.02)
 - Solar hot water heater plumbing stub outs and electric vehicle recharge outlets installed in houses constructed by taxpayer (§ 43-1176 and § 43-1090)
 - Donation of school site (§ 43-1181)

The bill also provides that any new individual or corporate income tax credit enacted by the legislature shall include a review by the committee in the fifth full calendar year following the date the credit is enacted.

The bill is effective on the general effective date.

HB 2616 (tax credit; increased taxes; prisoners) - Chapter 280 RFE/RFEIR

HB 2616 provides that for taxable years beginning from and after December 31, 2002 a person who is sentenced for at least sixty days of the taxable year to the custody of the federal Bureau of Prisons, the state Department of Corrections or a county jail is not eligible to claim the state income tax credit in mitigation of increases transaction privilege tax and use tax. The credit is in mitigation of the six-tenths of a cent increase in the transaction privilege tax and use tax for education approved by voters at the 2000 general election.

The bill is effective on the general effective date.

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HB 2712 (IRC conformity; revenue sharing) - Chapter 344

HB 2712 conforms Arizona tax statutes to the current United States Internal Revenue Code (IRC) including provisions relating to the Economic Growth and Tax Relief Reconciliation Act of 2001, the Fallen Hero Survivor Benefit Fairness Act of 2001 and portions of the Job Creation and Worker Assistance Act of 2002.

The federal government passed three acts with provisions that have an impact on Arizona tax liability. On June 7, 2001, President Bush signed into law the Economic Growth and Tax Relief Reconciliation Act of 2001, which included significant changes to the estate and generation-skipping transfer tax. Arizona's estate tax revenue is based on the state's share of the maximum credit allowed by the federal estate tax laws. The federal provisions in this Act will phase-out and eventually repeal the federal state death tax credit beginning in tax year 2002.

The second Act is the Fallen Hero Survivor Benefit Fairness Act of 2001, signed into law on June 5, 2001. This act amends the Taxpayer Relief Act of 1997 to extend to survivors of public safety officers killed in the line of duty before December 31, 1996, the same tax benefits available to the survivors of officers killed after such date.

The third act was the Job Creation and Workers Assistance Act of 2002, which was signed into law on March 9, 2002. This act provided for special accelerated depreciation for businesses that purchase equipment between September 11, 2001 through September 11, 2004. This bill provides for immediate conformity of this act, except for the special depreciation, which is phased-in on a delayed basis.

In addition, the bill provides changes to the state's Urban Revenue Sharing (URS) program for 15% to 14.8% for fiscal year 2002-03 and fiscal year 2003-04.

For the purposes of computing income tax, for tax year 2002 the IRC means the IRC in effect on March 9, 2002. The sections of the bill concerning the special depreciation allowance are made retroactive to taxable years beginning from and after December 31, 1999.

[More information on Arizona's treatment of the 30% Bonus Depreciation.](#)

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TRANSACTION PRIVILEGE TAX

HB 2242 (NOW: prime contracting; lawn maintenance; exemption) – Chapter 307

HB 2242 clarifies lawn maintenance services are not prime contracting activities.

The bill clarifies that the gross proceeds of income received from lawn maintenance services are not subject to the prime contracting classification if the contract does not include landscaping activities. It defines lawn maintenance service to include lawn mowing, weeding, repairing sprinkler heads or drip irrigation heads, replacing seasonal flowers and refreshing gravel.

The bill further clarifies that the gross proceeds of income received from landscaping activities are subject to the prime contracting classification and defines landscaping activities. These activities include repairing sprinkler or watering systems and installing gravel or boulders, along with planting and removing trees.

The bill is effective for taxable periods beginning from and after August 31, 2002.

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HB 2300 (direct use tax payments) - Chapter 338

HB 2300 allows businesses that buy at least \$500,000 worth of tangible personal property annually to pay their use taxes directly to the Department of Revenue. The department will administer the program using application forms, use tax direct payment permits and use tax direct payment certificates.

The bill is effective and applies to taxable periods beginning from and after December 31, 2002.

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OTHER TAX

HB 2177 (NOW: tourism and sports authority; revisions) - Chapter 288 E

HB 2177 requires the Tourism and Sports Authority (TSA) to select a site host for the multipurpose facility by September 12, 2002. If the TSA fails to select a site host by this date the TSA must seek voter approval for the continuation of the TSA at the next countywide general election held in the county. The bill also expands the entities allowed to provide the land, infrastructure and parking facilities associated with the multipurpose facility and provides additional monitoring of the TSA's financial activities.

If the electors vote to terminate the TSA and its functions, the necessary statutory changes are contained in the bill in sections 20 through 59. These sections would become effective from and after December 31, 2002. Among the changes would be the repeal of the duty of the department regarding the accounting of revenue collected in connection with a multipurpose facility. These include facility-related transaction privilege taxes in the retail, amusement, restaurant and prime contracting classifications.

The bill contains an emergency clause.

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HB 2313 (jail facilities excise tax; extension) - Chapter 266

HB 2313 authorizes the Maricopa County Board of Supervisors, upon resolution and voter approval, to extend a Jail Facilities Excise Tax (JFET) for a period not to exceed twenty years.

In 1998, the Legislature authorized Maricopa County to levy a JFET tax at a rate of no more than four percent of the transaction privilege tax, subject to the approval of the voters. The duration of the tax was limited to nine years or until \$900 million is collected, whichever occurs first (Laws 1998, Chapter 225). Maricopa County voters approved a 1/5 of a cent JFET construction and operation of new Maricopa County medium and maximum security jail facilities and juvenile detention facilities. The current tax will expire in 2007.

Statute authorizes the county JFET monies to be used to finance and construct new adult and juvenile jail facilities, maintain and operate adult and juvenile jail facilities and fund specified programs to reduce the expense of adult and juvenile jail facilities. HB 2313 authorizes Maricopa County to request voter approval to extend the JFET and reauthorizes the current uses of the tax as well as including the renovation of adult and juvenile jail facilities and implementation of other programs designed to reduce the expense of adult and juvenile jail facilities.

The statute providing for the JFET as added by the bill is repealed on January 1, 2009 if no tax has been levied as of that date.

The bill is effective on the general effective date.

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HCR 2047 (tobacco products tax; health services.) – Secretary of State

HCR 2047 will appear as a proposition on the November 2002 general election ballot. If approved by the voters through referendum, the statutory changes made would impose a tax increase of one and one-half times the tax rate on tobacco products on January 1, 2002. The increase would result in an additional tax of sixty cents per pack of cigarettes. Proceeds from the increased tax would be deposited in the Tobacco Products Tax Fund and distributed to the following accounts in the specified amounts:

- 42% in the Proposition 204 Protection Account.
- 5% in the Health Research Fund.
- 27% in the Medically Needy Account.
- 20% in the Emergency Health Services Account.
- 4% in the Health Care Adjustment Account.
- 2% in the Health Education Account.

The Department of Revenue administers the Health Care Adjustment Account, as well as the collection of the tobacco taxes.

The resolution will become effective if approved by the voters at the November 2002 general election and on proclamation of the Governor.

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SB 1043 (taxation; estates and trusts) - Chapter 130

SB 1043 conforms Arizona estate and trust tax statutes to the Internal Revenue Code (IRC). Currently, Arizona statutes regulating income tax of trust, estates, and beneficiaries of trusts differ from current IRC. Arizona's statute dealing with estate and trust income tax is primarily based on the 1939 IRC. The Revenue Act of 1954 and several other subsequent changes to IRC have created many differences between the federal and state treatment of estate and trust income tax. Provisions for determination of income distribution and distribution deductions, estate and trust income tax exemptions, and distribution of unused carryovers are currently not conformed to federal law.

SB 1043 makes changes to state law to conform to current federal law and current practice.

The bill is effective for tax years beginning from and after December 31, 2002.

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HB 2178 (streamlined sales and use tax) - Chapter 289

HB 2178 adds to Joint Legislative Budget Committee (JLBC) duties, establishes the Tax Reform for Arizona Citizens Committee, establishes the Arizona Fiscal accountability Committee and provides for delegates from Arizona to attend multistate discussions regarding streamlined sales and use taxes.

The JLBC is to analyze the state tax structure, tax burdens on individuals and businesses, and tax incentives for existing and prospective businesses. The JLBC is required to report by October 31, 2002 to various legislative members on the progress of the implementation. The JLBC is also to implement a system of fiscal analysis that applies to those bills introduced in the legislature that involve one or more proposed changes in the tax laws. The analysis is to be based on assumptions that estimate the probable behavioral response of taxpayers, businesses and other citizens.

The fifteen member Tax Reform for Arizona Citizens Committee contains 8 legislative members and seven members representing various groups. The committee is to study and make recommendations on state fiscal policy, economic development strategies, and tax policies of the state and local jurisdictions. It is to develop a comprehensive recommendation concerning the appropriate tax structure of the state and local jurisdictions and a transition strategy to the appropriate tax structure. The Governor's Office of Strategic Planning and Budgeting, the Department of Revenue, JLBC and Legislative Council are to provide technical assistance. The committee is to submit to the Governor, President and Speaker a status report by December 31, 2002 and a final report by September 15, 2003. The session law creating the committee is repealed from and after December 31, 2003.

The fifteen member Arizona Fiscal Accountability Committee contains 8 legislative members and seven members representing various groups. The committee is to study and make recommendations on the expenditure policies of the state and local jurisdictions, explore privatization of services and realigning of services and the elimination or streamlining of duplicative programs at the state level. It is to develop a comprehensive recommendation concerning the appropriate policy adjustments related to the state's expenditures and a strategy for implementation. The Governor's Office of Strategic Planning and Budgeting, the Auditor General, JLBC and Legislative Council are to provide technical assistance. The committee is to submit to the Governor, President and Speaker a status report by December 31, 2002 and a final report by September 15, 2003. The session law creating the committee is repealed from and after December 31, 2003.

Four delegates are appointed to attend multistate discussions regarding streamlines sales and use taxes. The delegate are (1) one House member appointed by the Speaker, (2) one Senate member appointed by the President, (3) the director, a deputy director or an assistant director of the Department of Revenue appointed by the

Governor, and (4) one voting member of the Municipal Tax Code Commission. The delegates are to meet with like delegations from other states to consider whether Arizona should enter into agreement with other states to (1) simplify and modernize administration in order to substantially reduce the burden of tax compliance for sellers and for all types of commerce, (2) establish standards for tax compliance software and service providers, and (3) establish performance standards for multistate sellers. If the delegates determine that the state should enter into an agreement, the delegates are to recommend the preparation of legislation. The session law relating to the participation in multistate discussions is repealed from and after June 30, 2004.

The bill is effective on the general effective date.

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HB 2213 (reviser's technical corrections; 2002) - Chapter 241

HB 2213 corrects defective and conflicting dispositions of statutory text. Sections 25 through 28 of the bill deal with unclaimed property and make reference changes in §44-313 and §44-314 as to the statutory site for the housing trust fund.

The changes to these sections are effective from and after September 30, 2002.

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HB 2243 (contract auditors; contingent fees; prohibition) - Chapter 80

HB 2243 prohibits the state from hiring contract auditors on a contingency fee basis except for auditors hired to enforce unclaimed property provisions. The Department of Revenue contracts with persons on a contingent fee basis for the collection of taxes, interest and penalties already due the state. The department does not currently contract on a contingent fee basis for auditing purposes except for unclaimed property issues. The bill codifies the department's current practices.

The bill is effective on the general effective date.

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HB 2244 (NOW: taxes; administrative procedure) -Chapter 242

HB 2244 provides exceptions to a tax court's authority to dismiss an appeal if the property taxes become delinquent if either of the following occurs:

1. The full year tax for the year is paid on or before December 31 of the tax year.
2. The remaining one-half tax that is unpaid is delinquent after the immediately following May 1 is paid by July 1, including interest due.

The bill is effective on the general effective date.

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HB 2414 (NOW: agency reports; web site posting) - Chapter 116

HB 2414 requires that all state agencies that maintain an agency web site, except the State Compensation Fund, to post on their web site a copy of the annual agency report. The bill prohibits an agency that posts a copy of their annual report on their web site

from distributing copies of the report, with the exception of copies to the Governor, President of the Senate, Speaker of the House of Representatives and Arizona State Library, Archives and Public Records, and pursuant to public records requests.

The agency will send an electronic or printed notification to the recipients that the annual report has been posted on the agency web site. The printed copies of the annual report are to be on twenty-pound bond paper printed with black ink except that the cover and back pages may be of sixty-five pound or less cover paper.

If an agency that has maintained a web site has distributed printed copies of an annual report during the twelve months preceding the bill's effective date, the agency is to notify the director of the Joint Legislative Budget Committee of the savings realized by the posting, printing and distribution requirements contained in the bill. This reporting requirement is repealed on January 1, 2004.

The bill is effective on the general effective date.

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HB 2706 (general appropriations; fiscal year 2002-2003) - Chapter 327

HB 2706 contains the appropriations needed to operate state government for fiscal year 2003-03. Section 57 of the bill provides for 1,042.1 FTE positions and appropriates \$61,140,900 to the Department of Revenue, of which \$58,838,200 is from the state general fund.

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SB 1060 (NOW: budget reconciliation; 2002) - Chapter 321 E

SB 1060 contains provisions that are the fourth and final attempt to balance the FY 2001-02 budget. Section 18 of the bill deals with settlement payments in Ladewig v. State of Arizona. It allocated \$75 million in fiscal year 2002-03 for the purposes of covering the first year payments and costs associated with the case. From this allocation, the Department of Revenue may use up to \$15 million for administration and review of payments. Prior to the administrative expenditure, the department is to present an expenditure plan for Joint Legislative Budget Committee approval that includes an estimate and scope of the entire administrative requirement associated with disbursing payments and costs for the case.

The bill contains an emergency clause.

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SB 1139 (tax corrections act of 2002) - Chapter 326

SB 1139 makes technical, conforming and clarifying changes to the tax statutes.

Electronic Return Preparers

- Establishes a retention period for tax returns and accompanying documents.
- Clarifies that electronic return preparers retain records of transaction privilege tax and use tax returns for six years and other tax return records for four years.

- Provides electronic return preparers who fail to retain tax return records for the specified time periods, have the same penalties as other return preparers.
- Allows the Department of Revenue to require, by administrative rule, electronic return preparers to retain tax return documents for six years and other tax return records for four years.
- Clarifies that electronic return preparers must abide by the regulations set forth in department rules, manuals, rulings or procedures.
- Moves the definitions of electronic return preparer, return preparer and return to another statutory section.

Definitions

- Deletes the definition of claimant and statutory references to claimant.
- Removes, from the definition of report, a holder's report of abandoned property.
- Defines Arizona tax liability due on the taxpayer's estimated tax return as the amount of tax due on the return minus the amount of Arizona income tax withheld and tax credits claimed by the taxpayer.

Miscellaneous

- Removes the requirement that Board of Tax Appeals (BOTA) retain specific records for the property tax assessment and appeals.
- Eliminates reporting of transient personal property (livestock).
- Removes the overlap between confidentiality provisions in current statute (Title 42 and Title 44).
- Clarifies the exchange of information regarding severance tax, jet fuel excise tax or use tax to any county, city or town tax official.
- Clarifies that the Department of Revenue collects and administers, in addition to transaction privilege tax, any affiliated excise taxes including:
 - Use tax.
 - Severance tax.
 - Jet fuel excise and use tax.
 - Rental occupancy tax.
- Authorizes the Department of Revenue to prescribe, by administrative rule, alternative methods for signing, subscribing or verifying any report or statement required to be filed by the department in relation to property tax and unclaimed property.
- Allows the Department of Revenue Director to waive the signature requirement provided that an equivalent method of verification is employed.
- Stipulates that the Department of Revenue will no longer prescribe short form returns for individual taxpayers whose dividend and interest income is less than \$400.
- Corrects internal references regarding personal property.
- Corrects internal references regarding the increased transaction privilege tax from the passage of Proposition 301.
- Provides a conforming change to the utilities classification from the deregulation bill from 1998.

- Removes the transaction privilege tax exemption for semi-trailers manufactured in Arizona that are sold to a person who holds an Interstate Commerce Commission license for use in interstate commerce.
- Clarifies the exchange of confidential information regarding hearings involving tax preparers.
- Changes the date the assessors calculate voluntary contributions from the third Monday in August to the third Friday in September.
- Deletes duplicative statutory language.
- Blends multiple enactments regarding constitutional taxation.

The bill is effective on the general effective date.

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