

2005 LEGISLATION AND CASES

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Income Tax

Legislation

House Bill 2155 (Ariz. Sess. Laws 2005, Chapter 11). *2005 Tax Corrections Act.* This Bill makes technical, conforming and clarifying changes to Arizona tax statutes. With regard to income taxation, it:

- Corrects a bad retroactivity date for enterprise zone credits under A.R.S. § 42-1074 (individual income tax) and A.R.S. § 42-1161 (corporate income tax). In 2004, these statutes were amended to allow taxpayers to claim second or third year credits for taxable year 2002 and third year credits for taxable year 2003 when the first year credit was claimed on an amended (rather than an original) return if a qualified employment position was created prior to January 1, 2002 and certified. The 2004 amendment, however, was meaningless because it was only made retroactive to December 31, 2003. The 2005 Bill changes the retroactivity date to years beginning after December 31, 2001, thereby allowing taxpayers to take advantage of the 2004 amendment.
- This Bill also repeals a defunct statute that allocated a portion of the luxury tax collected on Arizona-produced wine to the Arizona Wine Promotional Fund (the statutes dealing with the Arizona Wine Commission were repealed on January 1, 2005).

House Bill 2156 (Ariz. Sess. Laws 2005, Chapter 12). *Income Tax Credit Review Schedule.* This is the annual Bill that updates the income tax credit review schedule based on the

recommendations of the Joint Legislative Income Tax Credit Review Committee. It removes the income tax credits that were reviewed in 2004 (agricultural pollution equipment, solar energy and agricultural water conservation system credits) and adds these credits to the review schedule in 2009.

Senate Bill 1466 (Ariz. Sess. Laws 2005, Chapter 115). *New National Guard Relief Fund and Tax Checkoff.* This Bill creates the National Guard Relief fund that will assist families of Arizona National Guard members when the Guard member is in combat. The Bill provides for a check-off on Arizona individual income tax forms, where taxpayers can donate to this fund.

House Bill 2059 (Ariz. Sess. Laws 2005, Chapter 148). *Income Tax Credits for Pollution Control Equipment Restricted.* This Bill amends both the Individual and Corporate income tax credits for pollution control equipment. The amendment comes in response to taxpayer attempts to expand the definition of pollution control equipment. For example, taxpayers attempted to claim credits for water retention basins and drainage gutters used for flood, rather than pollution, control. The amendments, restrict the types of property and equipment that qualify for tax credits. To qualify under the amendments, the property or equipment must: (1) reduce pollution that directly results from the taxpayer's operations; (2) not serve dual purposes, such as flood and pollution control; and (3) not be equipment that is included as a standard or an integral part of another property.

Senate Bill 1224 (Ariz. Sess. Laws 2005, Chapter 264). *New Income Tax Credit for National Guard Employees on Active Duty.* This Bill adds an income tax credit for individuals and corporations that employ members of the Arizona National Guard if those employees are placed on active duty during the tax year for a period that exceeds the required training period. The amount of the credit is \$1,000 for each employee placed on active duty and unused credits can be carried forward for up to five years. The credits become effective beginning in taxable year 2006.

Senate Bill 1283 (Ariz. Sess. Laws 2005, Chapter 278). *Requirements Necessary for Businesses to Qualify for Forest Health Tax Incentives are Eased.* In 2004, Arizona passed legislation to promote healthy forests by reducing hazardous fuels on state and federal lands within Arizona. This Bill amends that legislation. The Bill eases the requirements that individuals and businesses must meet to qualify for the tax incentives under A.R.S. §§ 43-1076 and 43-1162. Under the amendments, businesses need only employ three (as opposed to ten) new full-time employees in qualified employment positions in the first year the credit is claimed. The amendment redefines 'full-time employment' as 1,550 hours per year (unless weather conditions or forest closures limit the work year) instead of 1,700 hours per year. It also reduces the percentage of health insurance premiums that the taxpayer must pay for qualified employees. Last year's version required the taxpayer to pay 50% of the premiums. This Bill requires the taxpayer to pay at least 25% in the third year the taxpayer claims a credit, at least 40% in the fourth year, and at least 50% in the fifth year. The final change clarifies that credits can only be recaptured if a business's certification of qualification is revoked or terminated by the DOC and not for some other failure to qualify for or claim credit.

House Bill 2139 (Ariz. Sess. Laws 2005, Chapter 289). *New Corporate Super-weighted Sales Factor Provides Incentive for Capital Investment in Arizona.* This Bill provides an optional apportionment formula for calculating corporate income tax for multistate corporations. This formula is favorable to businesses that have substantial payroll and property in Arizona but make a majority of sales outside the state. It is intended to encourage additional capital investment in Arizona by both corporations moving into the state and corporations with ongoing activities in the state and to create more high tech, knowledge-based jobs in the state.

Currently, multistate corporations calculate corporate income tax using a combination of Arizona property, payroll, and sales, with sales double-weighted. The new option allows corporations to give greater weight (80%) to the sales factor in calculating Arizona tax liability. The 80% sales factor will be phased in over three years, with a 60% sales factor effective in tax year 2007, a 70% sales factor in 2008, and an 80% sales factor in 2009. The optional apportionment formula becomes effective in tax year 2008, but will be retroactive to 2007 if the following two conditions are met:

- At least one corporation announces, on or after June 1, 2005, that it has one or more capital investment projects in Arizona that, individually or collectively, exceed \$1 billion and the corporation reports its activity to the Joint Legislative Budget Committee (JLBC) and the Governor's Office of Strategic Planning and Budgeting (OSPB). The report must contain a description of the project and the project's estimated completion date, cost, and economic impact on the labor force. Intel has already announced that it has planned capital investment projects sufficient to satisfy this condition.
- The corporation reports to JLBC and OSPB by December 15, 2007 that construction has commenced and verifies that project's costs will exceed \$1 billion.

House Bill 2323 (Ariz. Sess. Laws 2005, Chapter 292). *New Tax Credits for Water Conservation Systems.* This Bill adds §§ 43-1090.01 (individual income tax) and 43-1182 (corporate income tax), which provide individual and corporate income tax credits for individuals and builders who install water conservation systems or plumbing stub-outs for water conservation systems in residences. These systems promote water conservation by enabling the homeowner to recapture and store either rainwater or graywater for future use in household gardening, composting, lawn watering, or landscape irrigation. Both credits are available for tax years beginning after December 31, 2006 and ending before January 1, 2012. Taxpayers must get pre-approval for this credit from the DOR and can carry the credit forward for up to five years.

- The individual credit is up to 25% of the cost of installing the system but cannot exceed \$1,000. A husband and wife who file separately can each claim only one-half of the maximum credit. The DOR may not certify more than a total of \$250,000 of individual tax credits per calendar year.
- The corporate credit for builders is for the full cost of installing the plumbing stub outs for a graywater system, but cannot exceed \$200 per house. The

DOR may not certify more than a total of \$500,000 of corporate tax credits per calendar year.

Senate Bill 1027 (Ariz. Sess. Laws 2005, Chapter 303). *Income Tax Exemption for Active Duty Military Compensation.* This Bill exempts all active duty military pay from Arizona income tax. Before this amendment, only pay received during service in a combat zone was exempt from Arizona income tax. Additionally, this Bill exempts individuals, whose only source of income is active duty military pay, from filing requirements unless the taxpayer is claiming a refund. This Bill only applies to the 2006 tax year.

Senate Bill 1335 (Ariz. Sess. Laws 2005, Chapter 316). *New “Angel Investment” Tax Credit for Investments in Small Businesses.* This Bill adds an individual income tax credit for qualified investments in qualified small businesses for tax years beginning after December 31, 2006 and ending December 31, 2014. The Bill is in response to the Governor’s Council on Innovation & Technology’s recommendation for strengthening Arizona’s technology-based, entrepreneurial community. The taxpayer must apply and the Department of Commerce (DOC) must certify that both the investment and the small business qualify. To qualify, the investment must be made after July 1, 2006, must exceed \$25,000, and the investor and its affiliates cannot own more than 30% of the voting power in the small business. The small business must be located in Arizona, have at least two full-time employees who are Arizona residents, cannot have more than \$2 million in assets, and cannot be engaged in a statutorily disqualified business activity. Disqualified activities include: retail, food, and restaurant businesses; real estate investment and development businesses; professional services businesses other than hardware or software services; non-research oriented health care providers; human cloning and embryonic stem cell research companies; financial services businesses; and natural resource extraction businesses. The DOC can also directly certify small businesses that make applications for qualified small business status. These certifications are generally valid for one year.

The credit is 10% of the investment amount for each of the three years following the investment unless the small business is a bioscience company or located in a rural area. A slightly higher percentage is allowed for rural and bioscience businesses (12% for the first two year’s credits and 11% for the third year credit). Thus, over three years the credit amounts to 30-35% of the total investment, depending on the type of business.

The Bill, however, limits the availability of the tax credits by placing restrictions on both the DOC and individual investors. The DOC cannot authorize credits after June 30, 2011. Nor can it authorize credits that exceed \$20 million dollars for all years. Investors are limited to \$250,000 in investments in any given year and total investments in any single business cannot exceed \$2 million for all years.

Senate Bill 1347 (Ariz. Sess. Laws 2005, Chapter 317). *New Tax Incentives for Movie Production.* This Bill provides new corporate and individual income tax incentives to motion picture production companies that: pay a minimum of \$250,000 in production costs; employ a certain percentage of full-time workers in Arizona; and submit an application to the DOC, which must pre-approve the credit. The income tax credit is effective beginning from and after December 31, 2005 through December 31, 2010 and ranges from 10%-20% of the taxpayer’s

production costs depending on the amount of total production costs. Additionally, unclaimed tax credits under this new incentive may be sold or transferred.

Senate Bill 1529 (Ariz. Sess. Laws 2005, Chapter 334). *Internal Revenue Code Conformity Bill--No Bonus Depreciation and Section 179 Expensing; School Tuition and Public School Credits Increased; January 2005 Tsunami Contributions Deductible in 2004.* This is the annual Bill that conforms the Arizona income tax statutes to changes made to the Internal Revenue Code during the past year. The Bill does not provide for full conformity to all changes in the Internal Revenue Code. The following conforming changes are made:

- While the Bill conforms the State income tax statutes to the Working Families Tax Relief Act of 2004 and the American Jobs Creation Act of 2004, including retroactive conformity to the effective dates of the provisions of those federal acts, the Bill continues to exclude three provisions where Arizona did not previously conform to federal changes. As a result, Arizona tax payers must add back the federal bonus depreciation provided in the Job Creation and Worker Assistance Act of 2002 and both the 50% bonus depreciation and the Section 179 expensing in the Jobs and Growth Tax Relief Reconciliation Act of 2003 and then subtract the amount allowable by Arizona when calculating Arizona income tax.
- The Bill also amends A.R.S. § 43-1041 to provide for indexing the standard income tax deduction for inflation based on the average annual change in the Metropolitan Phoenix consumer price index.
- The Bill increases the maximum credit allowed to married couples for:
 - (1) charitable contributions to organizations that assist the working poor from \$200 to \$300 for tax year 2005 and from \$300 to \$400 beginning in tax year 2006;
 - (2) contributions to school tuition organizations from \$625 to \$825 for tax year 2005 and from \$825 to \$1000 beginning in tax year 2006; and
 - (3) fees and contributions made to public schools from \$200 to \$300 in tax year 2005 and from \$300 to \$400 beginning in tax year 2006.
- Additionally, it allows taxpayers who made tsunami relief contributions in January 2005 to claim those contributions on their 2004 tax returns.

Cases

Baker v. Arizona Department of Revenue, 209 Ariz. 561, 105 P.3d 244, 2000 (App. Feb. 3, 2005). Court Of Appeals Upholds Retroactive Limitation Of Alternative Fuel Tax Credits. The court found that the December 2000 retroactive amendment of the Arizona statutes

providing tax credits and other tax incentives for the purchase and conversion of alternative fuel vehicles that limited those benefits did not violate the contract clauses of the Arizona and U.S. Constitutions because the original Act providing for the tax credits and other incentives did not create a contract between the state and the taxpayers. The court stated that the general rule in Arizona is that statutes do not create contractual rights. The court also noted that even if the original April 2000 Act had created a contract, there would be no constitutional violation because the amendments did not substantially impair the taxpayers' rights. The court noted that the taxpayers had conceded that they were "very skeptical" of the original law, finding it "hard to believe such an incentive was available" and that the benefits sounded "a little too good to be true." Additionally, by the time the taxpayers converted their vehicles in November 2000, they had notice from what they had read and heard in the media that the governor and the legislature were going to change the statute to close the loopholes and contain the cost. The court then concluded that the December 2000 law change allowed the taxpayers to recover one hundred percent (100%) of their costs and to keep the profits from selling their vehicles and that they could not reasonably have expected more from a taxpayer-funded program designed to curb air pollution. As a result, the court concluded that the December 2000 amendments did not substantially impair the taxpayers' rights.

Additionally, the court held that even if the December amendment substantially impaired a contract with the taxpayers, it would not offend the Constitution if the adjustment of the rights and responsibilities of the contracting parties was upon reasonable conditions and appropriate to the public purpose, which the court found was the case with the alternative fuel amendment.

TRANSACTION PRIVILEGE TAX (TPT) AND USE TAX

Legislation

House Bill 2155 (Ariz. Sess. Laws 2005, Chapter 11). *Tax Corrections Act.* This Bill makes technical, conforming, and clarifying changes to the Arizona tax statutes. The Bill makes the following changes to TPT and Use taxes:

- The Bill corrects A.R.S. § 42-3251 (tobacco tax levy). Prior to the correction, Arizona statutes contained two nearly-identical provisions. One version required monies collected to be 'deposited with' the state treasurer. The other required that monies be 'paid to' the state treasurer. The former version has been repealed.
- The Bill also corrects § 42-5160 (use tax). Arizona statutes contained two similar provisions for the use tax liability. One provision did not account for a business that pays use tax directly to the DOR. The other provision does. The former provision has been repealed.
- The Bill amends the use tax deduction under A.R.S. § 42-5159(13)(f) for tangible personal property used by 501(c)(3) non-profit organizations that provide services to mentally and physically handicapped persons. The

language of this provision now conforms with the complementary TPT deduction at A.R.S. § 42-5061(A)(29).

- The Bill moves the exemption for gross receipts derived from transporting fertilizer (A.R.S. § 42-5062.01) into the transporting classification statute (A.R.S. § 42-5062).

Senate Bill 1439 (Ariz. Sess. Laws 2005, Chapter 62). *Lodging Sales Tax Application Clarified.* This Bill resulted from industry and DOR confusion over how to tax certain ancillary services that hotels provide to guests. Hotels, for example, arrange amusement activities and transportation services for guests as well as provide telephone, laundry, internet, and fax services. This Bill clarifies which activities are subject to and exempt from TPT taxation under the telecommunications, transportation, transient lodging, and amusement classifications. Most of the Bill's provision became effective Aug. 12, 2005. The specific provisions regarding amusement and transportation services are retroactively effective as of July 1, 1993. However, retroactive refund claims must be filed before January 1, 2006. The Bill adds the following provisions:

- Transportation arranged or provided solely as an ancillary or convenience service to customers or guests is exempt from the transportation classification. Businesses that dispatch vehicles upon customer request and send bills and receive payments are not exempt.
- Telephone, fax or internet services provided to customers for an additional and separately-invoiced charge are subject to the telecommunications classification.
- The following are excluded from gross proceeds under the transient lodging classification: (a) transactions not limited to transients that would not be taxable to persons not subject to TPT; (b) transactions not limited to transients that would not be subject to TPT because of an exemption or deduction under the transporting or amusement classifications; and (c) certain commission payments.
- Arranging an amusement activity for a customer is not taxable under the transient lodging classification. As with transportation services, this exception does not apply to businesses that operate amusements pursuant to customer orders, send billings, and receive payments.

Senate Bill 1185 (Ariz. Sess. Laws 2005, Chapter 196). *New Use Tax Percentage-Based Reporting Method.* Arizona imposes a use tax on the purchaser of tangible personal property that is used, stored, or consumed in the state. Currently, businesses calculate and report use tax liability based on the actual cost of their purchases. This Bill was passed to promote efficiency, simplicity, and flexibility by providing businesses with an alternative. The Bill permits taxpayers to calculate and report use tax liability under a percentage-based, rather than an actual cost, system. Until June 30, 2007, only taxpayers who are currently eligible for direct payment

of use taxes under A.R.S. § 42- 5167 may elect a percentage-based alternative. In other words, the option is limited to taxpayers that purchased more than \$500,000 of tangible personal property for their own use in the preceding tax year. However, the Bill will allow *all* use taxpayers to choose the percentage-based alternative beginning on June 30, 2007. Taxpayers may only elect a percentage-based system if they obtain a letter of authorization from the DOR. This letter will outline standards for calculating the use tax liability and will be valid for four years. The DOR can revoke the letter if it determines that the standards for calculating the taxpayer's liability have become inaccurate due to changes in law, rules, or factual circumstances. Revocations cannot be appealed and are effective the first day of the month beginning 90 days after the taxpayer receives notification. Finally, the DOR can audit taxpayers who receive letters of authorization for transactions listed in the letter. The audit, however, is limited to verifying the accuracy of the calculation based on the terms of the letter.

Senate Bill 1283 (Ariz. Sess. Laws 2005, Chapter 278). *TPT and Use Tax Exemptions for Equipment Used for Forest Health Projects Restricted.* As discussed above in the income tax section, this bill amends the 2004 Forest Health legislation. It amends the TPT and Use tax exemptions as follows:

- **TPT Retail Classification and Use Tax Exemptions:** Under the original legislation, A.R.S. §§ 42-5061(B)(22) (retail classification) and 42-5159(B)(22) (Use Tax) provided exemptions for 'qualifying equipment' purchased for or used in harvesting, transporting, or the initial processing of qualified forest products. This Bill redefines 'qualifying equipment.' That term now includes items such as trailers for hauling forest products but excludes log trucks, chip trucks, ash trucks, and other self-propelled vehicles that require state licensing. In short, trucks used for hauling products are no longer exempt.
- **Prime Contracting Exemption:** The Bill restricts the prime contracting exemption by more narrowly defining several key terms in the exemption. The exemption applies to improvements or developments owned by a 'qualified business.' Businesses qualify by being primarily engaged in a 'qualifying project.' The amendment redefines 'qualifying project' in several ways. First, it defines 'qualifying project' as "harvesting, transporting, or the initial processing of qualifying forest products" (i.e. dead standing and fallen timber, small diameter timber, slash, wood-chips, peelings, brush). Second, it requires that 70% of the project's products be qualifying forest products and that 75% of those products are harvested within the state. These definitions serve to restrict the overall type and number of businesses whose improvements and developments are eligible under the exemption. Moreover, as with the retail classification and use tax exemptions, the prime contractor exemption no longer applies to improvements and developments related to transportation. Rather, it only applies to harvesting and initial processing of forest products.

- Fuel Tax: Beginning from August 31, 2005 and ending December 31, 2010, the Bill reduces the fuel tax for transporting qualifying forest products from the standard rate of 26 cents per gallon to 13 cents per gallon.

Senate Bill 1347 (Ariz. Sess. Laws 2005, Chapter 317). *New TPT and Use Tax Exemptions for Movie Production.* In addition to providing new income tax incentives, this Bill allows for new TPT and Use Tax exemptions for certified movie production companies. To make claim these exemptions, movie production companies must provide proof of certification to the appropriate vendor or contractor at the point of purchase or contract. The Bill provides TPT and Use tax exemptions for:

- machinery, equipment, and tangible personal property purchased and used directly in motion picture production under the retail classification. A.R.S. § 42-5061(B)(23). The same property is exempt from use tax under A.R.S. § 42-5159(B)(23).
- the gross proceeds derived from the rental or lease of lodging space to a certified motion picture production company under the transient lodging classification. A.R.S. § 42-5070(C)(2).
- the sales of catered food and drinks to certified motion picture production companies under the restaurant classification. A.R.S. § 42-5074(B)(10).
- the gross proceeds of sales or gross income received from a construction contract for any building or structure associated with motion picture production in Arizona under the prime contracting classification. A.R.S. § 42-5075(B)(20).

Cases

Qwest Dex, Inc. v. Arizona Department of Revenue, 210 Ariz.223, 109 P.3d118, 2005 WL 768449 (App. April 5, 2009). *Cost Of Out Of State Printing Services Not Subject To Arizona Use Tax; Only Cost Of Paper Subject To Use Tax.* Qwest Dex publishes the white pages and yellow pages telephone directories. It purchases the paper that it needs for those directories from out of state paper mills and has the paper shipped to out of state printers for printing of the directories. The taxpayer initially paid the use tax on the purchase price of the paper from the out of state paper mill and on the printing services. The taxpayer then filed a claim for refund for the amount of taxes paid on the cost of the printing services but agreed that the use tax applied to the cost of the paper purchased from the out of state paper mill. The Department audited Qwest Dex and asserted use tax on the cost of the printing services. The Arizona use tax is imposed upon the purchase of tangible personal property from an out of state retailer where that property is brought in to the state and is used, consumed or stored in Arizona. The measure of the use tax is the acquisition cost of the tangible personal property as purchased from the out of state retailer. The use tax does not apply to services. The Tax Court held that the printing services, being services, were not taxable under the retail classification and thus would not be subject to the Arizona use tax. The Court of Appeals agreed, applying what is called the “common understanding test.” Under this test, whether a transaction qualifies as a sale of

tangible personal property or the sale of a service is determined by the parties' common understanding of the particular trade, business or occupation. Using the common understanding test, the court determined that the taxpayer does not owe a use tax on the printing of the directories because printers provide a service. The court observed that the very nature of the term "printing" denotes a service and not a tangible item. The court also cited to several out of state cases that held printers who print specific material on paper for a customer are not engaged in the business of selling tangible personal property, but are instead engaged in a service, reasoning that the paper is of no use to anyone except the customer for whom the printing is done.

The court also noted that the printing service would be taxed in Arizona under the job printing classification of the transaction privilege tax but held that this varying treatment would not change the court's conclusion as to the use tax. The court reasoned that the job printing classification, unlike the use tax, specifically includes a provision for a tax on printing services while the use tax, in contrast, imposes no specific tax on printing services.

PROPERTY TAX

Legislation

House Bill 2134 (Ariz. Sess. Laws 2005, Chapter 40). *The State Board of Equalization Must Review and Consider All Competent Evidence of Value.* This bill states the obvious in requiring the State Board of Equalization to review and consider all competent evidence, including similar property values, presented as evidence at the time of the Board hearing.

House Bill 2056 (Ariz. Sess. Laws 2005, Chapter 66). *The Definition of "Plant" For Electric Utility Valuation Purposes Excludes Contributions In Aid of Construction ("CIAC").* An example of CIAC is buried electric lines. Electric utilities are required to put in electric distribution lines in a new subdivision but the governmental required installation standard is above ground lines. If the developer wanted underground utility lines instead of above ground lines, the developer would pay the electric utility the difference in cost, with this payment being the developer's "contribution in aid of construction" of the buried electric line. [It should be noted that the current standard in subdivisions calls for buried electric lines.] There has been ongoing litigation between the Department of Revenue and electric utilities over the issue of whether CIAC should be included in "original plant in service" cost, which is the starting point for valuing an electric utility. The utility valuation statute provides that all terms and application of terms are to be interpreted according to the federal energy regulatory commission uniform system of accounts, which provides that CIAC is not to be included in the original cost of the electric plant. The Department of Revenue had taken the position that the FERC provision should not apply but rather the Arizona statutory definition of plant should control. This case is before the Arizona Court of Appeals, awaiting decision.

The legislation resolves the CIAC issue for years beginning in 2005, but leaves unresolved prior years, which are subject to the ongoing litigation. Under the new legislation, CIAC will not be included in the electric utility's original plant in service cost.

House Bill 2252 (Ariz. Sess. Laws 2005, Chapter 131). *Property Tax Administration Changes.* This bill makes a number of administrative changes, including:

- **Refund Interest.** This bill makes a significant change in the errors correction statutes of A.R.S. §42-16252 (Notice of Error) and A.R.S. §42-16254 (Notice of Claim) involving the interest rate on refunds to be made under the error correction statute and changes the refund rate from the legal rate (the legal rate for pre and post judgment interest is ten percent; the interest rate for late property tax payments is sixteen percent) to the interest rate of A.R.S. §42-1123, which is the same as the federal interest rate for refunds (which currently is significantly less than ten percent). It should be noted though that the interest rate charged on any underpayments of property tax determined to be due under the error correction statutes remains at the legal rate. The effect of this change, which was billed as “clarifying” by the Department of Revenue and the county treasurers is to pay refunds with a lower rate of interest than charged for underpayments of property tax.
- **Tax Liens Assigned to State.** Adds new A.R.S. §42-18005, which authorizes the county treasurer or board of supervisors to act as the agent of the state in the collection of property taxes for tax liens that are assigned to the state or any property that is held by the state.
- **Water Company Tax Liens.** Adds a new A.R.S. §42-17153(B), which provides that a tax lien on any property owned by a water utility company centrally valued by the Department of Revenue is a tax lien on all of the company’s property. This change was made to prevent a water company from paying property taxes on its property located in one taxing jurisdiction but not paying taxes on property located in another jurisdiction with the result being that the property tax lien would attach only to the property in the taxing jurisdiction where the taxes had gone unpaid.
- **Tax Lien Foreclosures.** The tax lien foreclosure provisions are changed in two respects. First, A.R.S. §42-18202, which requires a tax lien purchaser to send a notice of intent to file a foreclosure action at least thirty days before filing such an action, is amended to add a new provision, which provides that if a purchaser fails to send such a notice, the purchaser is considered to have substantially failed to comply with the notice provisions and a court may not act on the foreclosure action until the purchaser sends the required notice. Second, A.R.S. §42-18208 is amended. This section provides that if a lien is not foreclosed by the purchaser within ten years from the date the lien was purchased, the lien is void. A new section is added which provides that if a judicial proceeding prohibits the bringing of a tax lien foreclosure action, the ten year period is extended by twelve months following the completion of the judicial proceeding. As an example, if a bankruptcy case had been instituted that somehow prohibited a purchaser from foreclosing on a property tax lien, and if the ten year period would have run while the bankruptcy was pending, the purchaser would have an additional twelve

months from the end of the bankruptcy proceeding to initiate the foreclosure proceedings.

- **Amnesty for Water Companies.** Provides a property tax amnesty for water utility companies that allows the county treasurer to waive the accrued interest on property tax delinquencies for periods before September 30, 1995 if the water utility pays the amount of the property tax for that period and pays any tax, penalty or interest accruing after September 30, 1995, as long as the payment of post September 1995 delinquencies is made on or before December 31, 2005.

Senate Bill 1041 (Ariz. Sess. Laws 2005, Chapter 186). *Property Tax Exemption for Widows, Widowers, and Disabled Persons; Annual Filing Requirement Dropped.* This bill amends A.R.S. §42-11111, which provides a partial property tax exemption for widows, widowers, and disabled persons. Those individuals must annually file an application to claim the exemption. This bill does away with the annual application process and requires that the individual file a one-time only application and also requires the individual to self-report any exemption disqualifying events.

House Bill 2500 (Ariz. Sess. Laws 2005, Chapter 243). *Removal of the Identity of Public Officers From Property Tax Rolls.* County assessors, treasurers and recorders beginning January 1, 2006 will be required, on receipt of a court order, to remove from public access the addresses and phone numbers of certain public officers, such as police officers, judges and parole officers.

House Bill 2441 (Ariz. Sess. Laws 2005, Chapter 276). *Property Tax Exemption for Tribal Housing.* This bill exempts property located off the reservation that is owned and operated by a federally recognized Indian tribe or its tribally designated housing authority if the property is used for the purpose of providing low income rental housing and related facilities for the use of Indians and is not used, held or operated for profit, with no part of the net earnings of the housing authority inuring to the benefit of any private shareholder or individual. The housing must also be designed and constructed, in whole or in part, using federal financial assistance pursuant to the Native American Housing Assistance and Self Determination Act (P.L. 104-330) or using tribal government monies. This new exemption is contained in A.R.S. §42-11131.

House Bill 2771 (Ariz. Sess. Laws 2005, Chapter 302). *Reduction of Business Property Assessment Rate From 25 Percent to 20 Percent Over a Ten Year Period.* Business property currently has an assessment rate of 25 percent, while residential property, both owner occupied and rental, has an assessment rate of 10 percent. The effect of this differential is that business property of the same value will bear a property tax burden 2.5 times greater than the residential property. Given this structure, Arizona has one of the highest business property tax burdens in the country. This legislation will reduce the business property rate from 25 percent to 20 percent over a ten year period, with a .5 percent reduction each year. Beginning in the year 2015 and thereafter, the rate will be 20 percent. It is expected that the business community will approach the legislature this coming year to accelerate the rate decrease.

The reduction of the business property assessment rate would ordinarily result in a shifting of the property tax burden to homeowners. However, the legislature has increased the “homeowners rebate” in order to offset this shift. Thus, homeowners will not be paying additional property taxes as a direct result of the business assessment rate decrease. Rather, the state will absorb that shift.

Senate Bill 1178 (Ariz. Sess. Laws. 2005, Chapter 309). *Property Tax Exemption for Widows, Widowers and Disabled Persons; Income Limits Increased.* This bill increases the income limits for widows, widowers and disabled persons seeking a property tax exemption from \$13,200 to \$25,000 if the individual does not have children under 18 years old living with them and from \$18,840 to \$30,000 if the individual has one or more children living at home.

Cases

4501 Northpoint LP v. Maricopa County, 209 Ariz. 569, 105 P.3d 1188 (App. Feb. 8, 2005). *Rule 68 Offer Of Judgement Was Not An “Adjudication On The Merits” Qualifying The Taxpayer To Receive Attorneys’ Fees.* A.R.S. § 12-348 authorizes an award of attorneys’ fees to the prevailing taxpayer in tax litigation if a taxpayer prevailed in an “adjudication on the merits” of the case. While the case was pending in Tax Court, Maricopa County offered to settle the case based upon a \$12 million value. The taxpayer rejected the offer and the County then tendered to the taxpayer a offer of judgment under Arizona Rules of Civil Procedure, Rule 68. That Rule allowed a party to tender an offer of judgment to the other party to essentially force a settlement of a case. It usually contains two components, one pertains to the merits of the case and the other for attorneys’ fees. In this case, Maricopa County tendered an offer of judgment to the taxpayer to resolve the case based upon a \$12 million full cash value (the original full case value was set at \$13,597,923 for the 2000 tax year) for the property in question and indicated that the County would not pay attorneys’ fees. The taxpayer accepted the offer of judgment component dealing with the \$12 million full cash value but argued that it should nevertheless be entitled to attorneys’ fees (the case had progressed to the stage where trial was eminent and a good deal of preparatory work had been done by the taxpayer). The Tax Court ruled that the taxpayer was not entitled to attorneys’ fees and the Court of Appeals upheld that determination.

In order to be entitled to attorneys’ fees as a prevailing taxpayer in a tax case, including property tax cases, there must be an “adjudication on the merits.” The issue in this case was whether a Rule 68 judgment was “adjudication on the merits.” The Court of Appeals held no, indicating that “adjudication on the merits” means either a determination following a trial in a case or the court’s decision based upon a motion for summary judgment.

Lyons v. State Board of Equalization, 209 Ariz. 497, 104 P.3d 867 (App. Jan. 27, 2005). *Taxpayer Could Bring A Claim Under The Notice Of Claim And Notice Of Error Procedures To Contest An Exemption Denial From A Prior Year.* The property tax error correction statutes, A.R.S. §§ 42-16251 through 16258, provide a mechanism for a taxpayer to file a notice of claim for a refund of property taxes paid in the past as well as for the County to issue a notice of correction of error to correct an error relating to prior year’s property taxes. The requirement is that the particular error must meet the statutory definition of “error.” The Eastside Assembly of God Church owns real property in Tucson and in January 2000, filed an affidavit with a Pima County assessor, Rick Lyons, claiming a property tax exemption for religious property for the 2000 year. The taxpayer stated that an exemption was warranted because later in that year it

planned to use the house on the property as a parsonage. The assessor denied the exemption request because “ownership and usage must be in effect as of the lien date January 1st.” In January 2001, the taxpayer again filed an affidavit for a property tax exemption, this time for the 2001 year on the same basis as for the prior year. The assessor also denied that exemption request (the affidavit filed for 2001 did not indicate whether the house on the property was then being used as a parsonage).

The taxpayer, in August 2002, initiated proceedings under the error corrections statutes by filing two notices of claim asserting that the assessor had erred by denying the request for exemption for 2000 and 2001 because the taxpayer held the property “primarily for religious worship.” The assessor denied the notices of claim on the basis that the error correction statutes were not the appropriate procedure to contest the denial of an exemption claim and also, alternatively, declaring that “the property does not meet the qualifications for property tax exemption.” After initial meetings between the taxpayer and the assessor, which were to no avail, the taxpayer filed an appeal with the State Board of Equalization. The Board decided for the taxpayer holding that its “use of the property complied with the exemptions granted by the state constitution” and therefore granted the property exemption for the 2000 and 2001 years. The assessor appealed to Tax Court and the Tax Court ruled that the State Board of Equalization “has no jurisdiction or authority to hear and decide exemption issues” and that “the error correction procedures are not the proper procedures to appeal the denial of an exemption.” Rather, the Tax Court indicated that the proper method to appeal an exemption claim disallowance was through a 42-204 suit (now A.R.S. § 42-11005), which is a suit brought to contest an illegal tax.

The Court of Appeals reversed the Tax Court and held that a taxpayer could bring a claim under the notice of claim and error procedures to contest an exemption denial and that 42-204 (now 42-11005) was not the exclusive procedure. The court held that the term “error” in the error correction statutes was not limited to factual errors, but extended to discretionary errors such as assessor’s decisions concerning property tax exemptions. It is interesting to note that the taxpayer did not appeal the matter to the Court of Appeals but rather the State Board of Equalization did.

Griffith Energy LLC v. Arizona Department of Revenue, 1 CA-TX04-0007 (App. Jan. 13, 2005) (unpublished decision). *Department Of Revenue’s Adoption Of A Twenty-Five Year Valuation Table For Electric Generation Plants Upheld.* The taxpayer owns a new merchant natural gas-fired, combined cycle electric generation plant in Mohave County, which provides wholesale electricity in Arizona and other states. It started operations in 2001 and the Department of Revenue valued it for the first time on January 1, 2002 for the tax year 2003. The Department followed the methodology set out in A.R.S. § 42-14156 in valuing the Plant. Subsection (A)(3) provides that the valuation of personal property [equipment] used in operating the facility is the cost multiplied by the valuation factors as prescribed by tables adopted by the Department ...”. The Department adopted a twenty-five year valuation table for depreciation of the electric generation equipment, with a ten percent (10%) floor at which depreciation levels out (salvage value). The taxpayer appealed the Department’s valuation to the State Board of Equalization, which upheld the Department’s valuation table and the taxpayer appealed to the Tax Court. The Tax Court concluded that the Department did not act arbitrarily and capriciously in adopting the twenty-five year life table.

The Court of Appeals also concluded that the Department's adoption of the twenty-five year life table was not arbitrary and capricious. The court noted that the legislature directed the Department to adopt tables prescribing appropriate depreciation for valuing personal property used by electric generation facilities, which the Department did. The court also observed that the record reflects the Department's selection of the twenty-five year life span for depreciation was based on a rational basis and after due consideration. Both the Tax Court and Court of Appeals gave substantial deference to the Department's analysis and judgment in adopting a 25 year life.

SFPP, L.P. v. Arizona Department of Revenue, 210 Ariz. 151, 108 P.3d 930, 2005 WL 481336 (App. February 25, 2005). *For Purposes Of Valuing A Pipeline Company, "Original Cost" Means The Original Cost Of Placing The Pipeline In Service And Not The Acquisition Cost To The Current Owner.* Arizona has a statutory method for valuing pipeline companies, with the valuation starting point being "original cost." The issue in this case is whether "original cost" means the original cost of initially placing the pipeline assets in service or the acquisition cost to the current owner where there has been a change in ownership. SFPP owned the pipeline in 1998 and sold its interests in the pipeline to Kinder Morgan. For the 2000 property tax year, the taxpayer filed with the Department the required annual property tax report, in which it listed the original cost of the property as the original cost of placing the pipeline property in service. Based upon this information, the Department initially valued the taxpayer's pipeline at \$121,000,000. The taxpayer also filed a copy of its federal energy regulatory commission (FERC) Form 6 with the Department. That form reported the value of the pipeline, as adjusted to reflect the Kinder Morgan transaction. The Department revalued the pipeline property at \$232,000,000, using its interpretation of original cost as being the original cost to the current owner. The taxpayer appealed to the State Board of Equalization and the State Board affirmed the Department's determination. The taxpayer then appealed to the Arizona Tax Court, which reversed the Board of Equalization and held that original cost meant the original cost of placing the pipeline property in service, which results in the \$121,000,000 value, rather than the \$232,000,000 value. The Department of Revenue appealed to the Court of Appeals, which upheld the Tax Court's determination.

The pipeline valuation statute also has a provision which provides that "all terms and applications of terms shall be interpreted as nearly as possible, under the circumstances, according to the federal energy regulatory commission uniform system of accounts for pipelines in effect on January 1, 1989." The court examined the FERC uniform system of accounts definitions in effect on January 1, 1989 and found that the definition of "original cost" for gas pipelines coincides with the taxpayer's position and the ruling of the Tax Court. However, the uniform system of accounts for oil pipelines does not define "original cost" but defines "cost" in language that is consistent with the Department's position: "cost means the amount of money actually paid for property or services or the current cash value of the consideration given when it is other than money." The taxpayer's pipelines are used for transmission of oil, not gas and the Department thus contended that the definition of "original cost" in the FERC uniform system of accounts for gas pipelines is not applicable and the court should apply the definition of "cost" from the uniform system of accounts for oil pipelines. The taxpayer argued that because the Arizona statute refers the court, for definitional assistance, to the federal energy regulatory commission uniform system of accounts for pipelines in effect on January 1, 1989, the court should apply the only specific definition of "original cost" found in those regulations.

The court reasoned that the Department's argument would lead to a different definition of "original cost" depending on whether the pipeline carried oil or gas. The court noted that there is no reason to believe that the Arizona legislature intended the statutory method of valuing pipelines should produce a different result for gas pipelines compared to oil pipelines. The court thus concluded that the FERC uniform system of accounts for pipelines does not provide the dispositive guidance regarding the intended meaning of "original cost" and the court thus looked to the language used by the legislature, specifically the use of the term "original" in the term "original cost." The court concluded that the use of the term "original" in "original cost" supported the taxpayer's interpretation that original cost means the cost of originally placing the pipeline in service. The court agreed with the taxpayer's position that the pipeline's value was \$121,000,000, which was based upon the cost of originally placing the pipeline in service.

Arizona Department of Revenue v. Salt River Project Agricultural Improvement and Power Dist. and Arizona Public Service, 126 P.3d 1063, 469 Ariz. Adv. Rep. 5, Ariz.App. Div. 1 (Jan. 19, 2006). *Contributions In Aid of Construction Not Included in Valuation Base for Electric Utilities.* The Tax Group represented APS in the valuation for property tax purposes of its transmission and distribution network, and specifically whether contributions in aid of construction (CIAC) are to be included in the valuation base. Utilities are required to provide certain specifically mandated distribution facilities to residences and businesses in Arizona. CIAC are made by property owners for the extra cost of installing additional or unusual distribution items, such as the additional cost of installing electric lines underground rather than above ground. The Department of Revenue argued that those contributions, which are paid by customers and do not become part of APS's tax base are included in the statutory valuation method as part of the "original plant in service cost" of distribution property. The statute at issue, however, requires that all terms and application of terms be made according to the Federal Energy Regulatory Commission "FERC" Uniform System of Accounts. Our group took this issue to the Arizona Tax Court on Summary Judgment arguing that the FERC Uniform System of Accounts excludes CIAC from the accounting for utility systems "cost" reporting and that CIAC must also be excluded from property tax valuation. SRP, represented by Jennings Strauss, was fighting the same issue. The tax court held for the Department of Revenue. On appeal, APS' case was consolidated with SRP's case. The Arizona Court of Appeals recently overruled the Tax Court and held for APS and SRP in a published decision. APS was also awarded statutory attorneys fees, though SRP was not. The fiscal impact of this decision is a multi-million dollar tax savings per year for multiple years to APS.

MISCELLANEOUS

Legislation

House Bill 2133 (Ariz. Sess. Laws 2005, Chapter 39). *Pima County Excise Tax for Hotels Increased.* This Bill amends the current county excise tax on hotels under A.R.S. § 42-6108. The statute only applies to Pima County. The Bill both increases the maximum allowable tax rate from 2% to 6% and strikes the limitation of a flat rate of 1% after December 31, 2012. Prior

to the change, the tax applied to all hotels within the County but when the hotel was located in a municipality that levied a similar tax it was given a credit for that city tax. This Bill changes current law by applying the tax only to hotels located in *unincorporated areas* of Pima County. It also changes the percentage of revenues the county may use for stadium and economic development purposes.

House Bill 2343 (Ariz. Sess. Laws 2005, Chapter 80). *Special Registration Period for Non-resident Vehicle Purchases Extended.* This Bill amends motor vehicle registration statutes for vehicles purchased by non-residents. Formerly, when a non-resident purchased a vehicle in Arizona for use out of state, the registration certificate was valid for thirty days. This Bill extends the validity of a registration certificate from 30 to 90 days. The Bill also amends the existing full and partial TPT exemptions to conform to this change in duration.

Senate Bill 1169 (Ariz. Sess. Laws 2005, Chapter 94). *Beginning in 2007, Luxury Tax on Wine Wholesalers Will be Due When Sold Rather Than When Purchased.* Currently, wine wholesalers pay luxury tax on wine in the month they purchase the product for resale. The tax on beer is levied the same way. Unlike beer, however, wine has a far longer turn-around time. This Bill changes the point at which the luxury tax on wine will be due from wholesalers. Beginning on January 1, 2007, the luxury tax will be due in the month the wholesaler *sells*, rather than purchases, the product. This Bill also amends the alcoholic beverage regulation provisions of A.R.S. § 4-243.01. Currently, Arizona requires beer to be held at the wholesaler's premises for at least 24 hours after delivery. This Bill extends that waiting period to all alcoholic beverages. Finally, the Bill amends § 4-226 by exempting wine used for bona fide religious ceremonies from the alcoholic beverage regulations.

House Bill 2055 (Ariz. Sess. Laws 2005, Chapter 116). *More Protection for Businesses Seeking Municipal TPT Refunds.* Arizona is one of the few states that allows municipalities, within certain limitations, to set their own transaction privilege tax base. Using, though, the structure of the Model City Tax Code. This Bill responds to the difficulty businesses have had in securing refunds for overpaid transaction privilege taxes from some municipalities. Some cities required businesses to provide information regarding each purchaser in order to obtain a refund. Other cities required the taxpayer to issue the refund to the purchaser, even though the tax liability fell on the business. This Bill controls municipal behavior by setting refund and credit provisions in state statute. It requires cities using the Model City Tax Code to compute interest on assessments or refunds based on State TPT rates and calculation methods and clarifies that interest calculation on refunds runs from the date of filing the refund claim to the date of payment. It prohibits cities from refusing to process valid refund claims or requiring taxpayers to refile valid claims. If a tax collector refuses to process a valid claim, the refusal is deemed a denial and the taxpayer may petition for a hearing under the Model City Tax Code or state statute (whichever applies). Additionally, the Bill prohibits cities from requiring that the taxpayer return the refund to the customer regardless of whether the tax collected was separately itemized. The Bill is effective as of September 30, 2005.

Senate Bill 1274 (Ariz. Sess. Laws 2005, Chapter 200). *Municipal Governments Now Required to Make Financial Benefit and Necessity Findings Before Entering Retail Development Tax Incentive Agreements with Businesses.* Arizona cities provide tax incentives to retail businesses in order to entice those businesses to locate within their borders. Moreover,

Arizona cities compete with one another for incoming businesses. This Bill helps ensure that cities do not act arbitrarily when vying for incoming businesses. Effective August 12, 2005, it requires a municipal government to make two findings before entering into a retail development tax incentive agreement with the taxpayer. First, the municipality must anticipate that the revenues derived from the incentive plan will exceed the value of the incentives for the duration of the agreement. If the town cannot make this finding, it cannot enter the agreement. Second, the municipality must find that, absent the agreement, the retail business would locate elsewhere. These findings must be verified by an independent third party and must pass by a majority or two-thirds vote depending on the location and population of the town. Tax incentives given to businesses in redevelopment areas, however, are exempt from the findings requirements.

Senate Bill 1287 (Ariz. Sess. Laws 2005, Chapter 105). *Municipal Governments Can No Longer Make an Economic Development Expenditure or Enter a Development Agreement by Emergency Measure.* In keeping with the concerns outlined under the previous Bill, this Bill amends A.R.S. §§ 9-500.05 and 9-500.11 and prohibits municipalities from making an economic development expenditure (which includes all waivers, deductions, exemptions, and reductions from tax liability) or entering into a development agreement by enacting an emergency measure. Normally, a city ordinance or resolution takes effect 30 days after passage by the council and approval by the mayor. Emergency measures are generally effective immediately after passage and approval. Consequently, no economic development expenditure or development agreement will be effective until at least 30 days after final approval.

House Bill 2365 (Ariz. Sess. Laws 2005, Chapter 248). *Special Joint District for Theme Park & Car Dealers.* This Bill sets the requirements and procedures and allows for the establishment of a joint Theme Park and Vehicle Support Facility District in a city with a population of more than 1 million (Phoenix) or a county with a population between 125,000 and 150,000 (Coconino). The Bill requires any District established to levy a 9% TPT on any business activity within the district. The Bill also authorizes an established District to issue \$1 billion in negotiable revenue bonds.

House Bill 2626 (Ariz. Sess. Laws 2005, Chapter 249). *Military Reuse Zone Tax Incentives Extended and Pre-qualification Requirement for TPT Exemption and Class Six Property Tax Classification Removed.* In the 1990s, Arizona established a tax incentive program to lessen the impact of military base closures. The program creates incentives for aviation and aerospace businesses that create jobs and make capital investments in designated military reuse zones. This Bill extends the termination and renewal terms for military reuse zones from five to ten years and changes some of the requirements that businesses must satisfy to make use of the incentives. The Bill eliminates the requirement that the taxpayer prequalify with the DOC to be eligible for the prime contracting exemption or the class 6 property tax classification. Instead, taxpayers must provide the DOC with information regarding the amount of tax benefits the taxpayer receives during each year in which military reuse incentives are claimed. The Bill also sets an eligibility period of five years for taxpayers who qualify for income tax credits and the class 6 property classification. Currently there are two military reuse zones in Arizona: Williams Gateway Airport and Phoenix/Goodyear Airport.

Senate Bill 1413 (Ariz. Sess. Laws 2005, Chapter 259). *Heavy Equipment Rental Agreements Must Include Surcharge for Property Tax.* Arizona's property tax system

classifies property according to its usage. Commercial and industrial property, including heavy equipment, is generally Class 1 property with a 25% assessment value. This Bill amends Arizona's trade and commerce statutes. Effective August 12, 2005, taxpayers in the business of renting heavy equipment property must include a one and one-half percent surcharge on the gross rental receipts in all rental agreements. The Bill stipulates that the surcharge will be used to pay the personal property tax levied against the heavy equipment. The statute defines 'heavy equipment property' as "rental property of an industry that is described under code 532412 or 532490 of the 2002 North American Industry Classification System." These classifications include equipment leased without operators for construction, mining, or forestry as well as non-consumer machinery, such as manufacturing, metal-working, and telecommunications equipment.

Senate Bill 1238 (Ariz. Sess. Laws 2005, Chapter 311). *Employer Can Elect Not to Withhold Wages in December.* Arizona requires employees to select a percentage of their wages to be withheld each pay period. Each month the employer pays the withholding directly to the state as a credit against the employees' personal income taxes. This Bill adds a provision that allows employers to elect not to impose Arizona withholding in December. It has an effective date of August 31, 2005. To make this election for 2005, employers must notify both the DOR and its employees (so that they can change their withholding percentage accordingly) in writing by October 1, 2005. For subsequent years, the due date for the same notification is July 1.

ADMINISTRATION

Legislation

Senate Bill 1171 (Ariz. Sess. Laws 2005, Chapter 95). *Taxpayers May Audit Themselves Under Managed Audit Agreements With the DOR.* Recognizing that DOR's audit capability is limited by its resources, Arizona has followed the lead of other states in adopting legislation that allows the taxpayer and the DOR to work together to conduct an audit. This Bill allows taxpayers to enter Managed Audit Agreements with the DOR. Under these agreements, the taxpayer actively participates in auditing its own books. Taxpayers may enter agreements to conduct TPT, local excise, and use and luxury tax audits beginning in January 2006 and Corporate Income tax audits beginning in January 2007.

- **Procedures.** The DOR has sole discretion over whether to allow a taxpayer to conduct its own audit and may consider all relevant factors, including compliance history and pending disputes, when making its determination. Under a Managed Audit Agreement, the taxpayer must make and submit written findings to the DOR. The DOR then reviews and accepts or rejects the taxpayer's findings and issues either a deficiency assessment or a refund. The taxpayer's appeal rights under Managed Audit Agreements are the same as under a conventional DOR audit. Managed Audit Agreements may include local excise tax audits at the taxpayer's request. Upon such request, the DOR must notify the relevant cities and towns. If the local jurisdiction refuses to participate in the managed audit, it may not independently audit the taxpayer

for 42 months following the end of the last tax period covered by the Managed Audit Agreement unless a limited exception applies.

- **No Penalties and No Interest.** No penalties will be assessed under a managed audit unless the taxpayer commits fraud or willful tax evasion. No interest will accrue on deficiency assessments or refunds if they are paid within 45 days of the assessment or refund determination.
- **Limited Audits.** Managed Audit Agreements may be limited to certain periods, activities, transactions, geographic areas, or lines of businesses. When audits are completed under limited agreements, the DOR remains free to audit issues not covered by the agreement within the appropriate statute of limitations.