

ARIZONA DEPARTMENT OF REVENUE



THE REVENUE IMPACT  
OF ARIZONA'S TAX  
EXPENDITURES  
FY 1997/98

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PREPARED FOR: THE GOVERNOR & THE LEGISLATURE  
BY: THE OFFICE OF ECONOMIC RESEARCH & ANALYSIS

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The following report on Arizona's Tax Expenditures was prepared for the Governor and the Legislature in compliance with A.R.S. §42-105.

The 1998 report provides a broad range of information. The report contains sections for all taxes imposed by the state. The preliminary report, released November 15, 1998, did not have information on tax expenditures from the Individual Income Tax. The individual income tax information included in this final report was made available through the 1996 Individual Income Tax Simulation Model.

If you have any questions or comments regarding this report, please contact the Office of Economic Research and Analysis at the Arizona Department of Revenue at 542-3062.



## TABLE OF CONTENTS

INTRODUCTION .....	Page 1
AIRCRAFT LICENSE TAX EXPENDITURES.....	Page 3
AVIATION FUEL TAX EXPENDITURES.....	Page 9
BINGO TAX EXPENDITURES.....	Page 13
BOXING TAX EXPENDITURES.....	Page 19
CORPORATE INCOME TAX EXPENDITURES.....	Page 23
ESTATE TAX EXPENDITURES.....	Page 35
FIDUCIARY INCOME TAX EXPENDITURES.....	Page 39
FLIGHT PROPERTY TAX EXPENDITURES.....	Page 49
IN-LIEU PROPERTY TAX EXPENDITURES.....	Page 53
INDIVIDUAL INCOME TAX EXPENDITURES.....	Page 57
INSURANCE PREMIUM TAX EXPENDITURES.....	Page 73
JET FUEL EXCISE AND USE TAX EXPENDITURES.....	Page 81
LUXURY TAX EXPENDITURES.....	Page 85
MOTOR CARRIER FEE EXPENDITURES.....	Page 91
MOTOR VEHICLE FUEL TAX EXPENDITURES.....	Page 97
PARI-MUTUEL TAX EXPENDITURES.....	Page 101

PRIVATE CAR PROPERTY TAX EXPENDITURES.....	Page 105
PROPERTY TAX EXPENDITURES.....	Page 109
SEVERANCE TAX EXPENDITURES.....	Page 117
TRANSACTION PRIVILEGE AND USE TAX EXPENDITURES.....	Page 121
UNDERGROUND STORAGE TANK TAX EXPENDITURES.....	Page 145
UNEMPLOYMENT INSURANCE TAX EXPENDITURES.....	Page 149
USE FUEL TAX EXPENDITURES.....	Page 157
VEHICLE LICENSE TAX EXPENDITURES.....	Page 161
WATERCRAFT LICENSE TAX EXPENDITURES.....	Page 167
WORKMEN'S COMPENSATION PREMIUM LIEU TAX EXPENDITURES.....	Page 173

# THE 1998 ARIZONA TAX EXPENDITURE REPORT

## INTRODUCTION

The Arizona Tax Expenditure Report is a study prepared for the Governor and the Legislature by the Arizona Department of Revenue's Office of Economic Research and Analysis. The report is prepared in compliance with A.R.S. §42-105.

Tax expenditures are provisions within the law (exemptions, exclusions, deductions and credits) that are designed to encourage certain kinds of activity or to aid taxpayers in certain categories. Such provisions, when enacted into law, result in a loss of tax revenues, thereby reducing the amount of revenues available for state (as well as local) programs. In effect, the fiscal impact of implementing a tax expenditure would be similar to a direct expenditure of state funds. This report provides a list of tax expenditures, plus, whenever possible, details the approximate costs of exempting certain types of income, goods, services or property from their respective tax statutes.

The purpose of this report is to provide a better understanding of the costs associated with the existing set of tax exemptions, exclusions, deductions and credits. There are sections on every tax imposed in Arizona. In each section, provisions dealing with that specific tax type are analyzed. The analysis includes a detailed explanation of the provision as well as the approximate cost of that provision, if possible. Sections pertaining to tax types not administered

by the Arizona Department of Revenue were reviewed by the agency administering the tax. Any figures presented in these sections were provided by that agency.

## ASSUMPTIONS

This report is not intended in any way to determine the desirability of the tax expenditures currently established in law. The Legislature and the Governor determine the taxation environment that they wish to create in Arizona and formulate law to create this taxation policy. All tax expenditures were conscious public policy decisions at the time of enactment. For example, since 1990, public policy decisions were made to relieve the individual income tax burden on persons age 65 and over in Arizona. To that end, the amount of the age 65 and over exemption was increased in 1992 to \$1,750 from \$1,500 and increased again for tax year 93 to \$2,100. In tax year 1995, 1996 and 1997, the age 65 and over exemption remained at \$2,100.

The costs associated with the specific provisions shown in this report are the estimated impact of that provision based upon the information available for the stated fiscal year. *There is no consideration of decreased demand as a result of higher taxes.* For example, if taxes on a certain type of liquor were increased to \$3 per gallon, the

calculations presented assume that the same demand exists under the \$3 per gallon tax as exists when the tax is 84¢ per gallon. This constant demand would not exist in the "real" world, but the tools are not available to the Department of Revenue to estimate the elasticity of demand. Therefore, the estimated costs should be used only as a guide and not as an exact representation of what would occur in later years.

Finally, the summary page(s) at the end of each section provides a total value of the tax expenditure. *This total value is only a general guide and should not be used in isolation from the rest of the expenditure amounts.* In fact, the expenditures for any particular tax cannot generally be added to reach a total. The presence or absence of one expenditure for a tax type can directly affect the value of another expenditure for that same tax type.

# **AIRCRAFT LICENSE TAX EXPENDITURES**



# AIRCRAFT LICENSE TAX EXPENDITURES<sup>1</sup>

A license tax is imposed on aircraft operating in this state at the rate of 0.5% of the average fair market value of the particular make, model and year of the aircraft, but not less than \$20. The proceeds from this tax are deposited into the state aviation fund.

## AIRCRAFT LICENSE TAX EXEMPTIONS

Certain aircraft are exempt from this license tax, as set out in A.R.S. §28-8322. *Aircraft operated by an airline company and regularly scheduled for the primary purpose of carrying persons or property for hire in interstate, intrastate, or international transportation* are exempt from this tax. Calculating the tax value of this tax expenditure would require knowing the average fair market value of every aircraft carrying persons or property for hire that stops at an airport in this state. Therefore, the tax value of this tax expenditure is not quantifiable.

A.R.S. §28-8326 provides an exemption for *aircraft owned by a nonresident who bases his/her aircraft in Arizona for a period not greater than 90 consecutive days or 90 days in any one calendar year, provided that such aircraft are not engaged in any intrastate commercial activity.* The tax value of this tax expenditure is not quantifiable because the average fair market value of all nonresident-owned aircraft falling into this category is unknown.

*Aircraft owned and operated exclusively in the public service by the federal government, by the state or by any political subdivision thereof, or by the civil air patrol* is exempt from the vehicle license tax (A.R.S. §28-8323). Although the average fair market value of aircraft owned by the federal government and operated in Arizona is unknown, it is known that there were 101 aircraft owned by the Arizona Department of Transportation, the Arizona Department of Public Safety, various Arizona counties and cities, and the civil air patrol in Fiscal Year 1997/98. The average fair market value of each aircraft is \$128,500 which equates to a tax value of \$64,892 for this tax expenditure.

A.R.S. §28-8383B also exempts *aircraft owned and held by a bona fide aircraft dealer solely for the purposes of sale, as long as these aircraft are registered within ten days of the dealer's purchase date.* There were 166 aircraft of this type registered by bona fide aircraft dealers in Arizona in Fiscal Year 1997/98. The tax value of these aircraft was \$532,030.

## PREFERENTIAL TAX RATES

There are preferential aircraft license tax rates granted to certain types of aircraft in A.R.S. §28-8336. The license tax rate for a *nonresident who bases his aircraft in Arizona for more than 90 days but less than 210 days in a given calendar year, provided that the aircraft is not engaged in any intrastate commercial activity,* is equal to 0.1% of the average fair market

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<sup>1</sup>Any figures presented for Aircraft License Tax Expenditures were provided by the Arizona Department of Transportation.

value of the particular make, model, and year of aircraft (A.R.S. §28-8336). This tax rate is 20% of the tax rate imposed on resident-owned aircraft. The total aircraft license tax paid by nonresidents falling into this category in Fiscal Year 1997/98 was \$7,719. Multiplying this figure by four yields the foregone tax collections allowed by this preferential rate, or \$30,876.

*Aircraft in storage or being repaired* is charged a license tax of \$20 (A.R.S. §28-8337). There are 442 aircraft which have been granted this license tax rate with a fair market value of \$442,952,903. The tax value of this preferential license tax is \$2,205,925, which is the total fair market value multiplied by 0.5% less \$20 per aircraft.

The annual license tax for a *salvage aircraft that is in storage or that is being restored* is \$5 (A.R.S. §28-8338). There are 50 aircraft which were registered under this provision. Assuming no market value for salvage aircraft, the tax value of this tax expenditure is the difference between the \$20 minimum

license tax imposed on all other aircraft and the \$5 minimum license tax imposed on these tax, or \$750.

A.R.S. §28-8339 allows a \$20 license tax for an *antique, classic, warbird, glider, experimental, homebuilt, or balloon aircraft*. There are 1,364 aircraft registered in Arizona under this provision, with a total market value of \$6,811,570. The tax value of this tax expenditure is the total market value multiplied by 0.5% less the \$20 license tax paid per aircraft, or \$6,778.

*Maintenance aircraft owned by a nonresident* (A.R.S. §28-8341) and *manufacturer's aircraft* (A.R.S. §28-8340) are required to pay an aircraft license tax of \$20. There are no nonresident-owned maintenance aircraft and 14 manufacturer's aircraft registered in Arizona, for a total market value of \$2,214,100. The tax value of this tax expenditure can be calculated by multiplying the total market value by 0.5% and subtracting the \$20 per aircraft tax paid, or \$10,790.

## SUMMARY OF AIRCRAFT LICENSE TAX EXPENDITURES

	<u>Revenue Gain</u>
<b>AIRCRAFT LICENSE TAX EXEMPTIONS:</b>	
Aircraft operated for the primary purpose of carrying persons or property for hire .....	NIA *
Nonresident-owned aircraft in the state for less than 90 days.....	NIA
Aircraft owned by a government or by the civil air patrol .....	\$65,000
Aircraft owned by an aircraft dealer for sale.....	532,000
 <b>PREFERENTIAL TAX RATES</b>	
Preferential rate for nonresidents with aircraft in the state from 90 to 210 days .....	\$31,000
Preferential rate for aircraft in storage or being repaired .....	2,206,000
Preferential rate for salvage aircraft in storage or being repaired .....	800
Preferential rate for antique, classic, warbird, etc., aircraft.....	7,000
Preferential rate for maintenance aircraft .....	0
Preferential rate for manufacturer's aircraft.....	11,000
 <b>TOTAL QUANTIFIABLE AIRCRAFT LICENSE TAX EXPENDITURES<sup>2</sup></b>	
.....	<b>\$2,852,800</b>

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\*No Information Available

<sup>2</sup>These tax expenditures represent foregone revenues to the state aviation fund.



# **AVIATION FUEL TAX EXPENDITURES**



## AVIATION FUEL TAX EXPENDITURES<sup>3</sup>

An aviation fuel tax is imposed on every distributor for each gallon of aviation fuel possessed, refined, manufactured, produced, blended or compounded in this state by the distributor or imported by the distributor, whether in the original package or container in which it was imported or otherwise. Beginning January 1, 1998, all suppliers are required to pay tax on all aviation fuel. In order to qualify for exemptions on certain types of aviation fuel, the taxpayer must file for a refund. The fuel tax rate is 5¢ per gallon.

Exemptions from the aviation fuel tax are set out in A.R.S. §28-1519. *Aviation fuel moving in interstate or foreign commerce, not destined or diverted to a point within this state* is exempt from aviation fuel tax. This information is not required to be reported; therefore, the tax value of this expenditure is unknown.

Also exempt from aviation fuel tax is *aviation fuel sold to the United States armed forces for use in ships or aircraft, or for use without this state* (A.R.S. §28-1519). The amount of aviation fuel

purchased by the United States armed forces is not reported and the tax value is unknown.

Although not listed as an exemption, a taxpayer may request a refund for *aviation fuel for use in applying seeds, fertilizer or pesticides* (A.R.S. §28-1520A). If such fuel were subject to taxation in Fiscal Year 1997/98, an additional \$4,300 in aviation fuel tax would have been received.

*Aviation fuel which is exported* from the state is exempt from aviation fuel tax (A.R.S. §28-1520A). The taxpayer must apply for a refund. If such fuel were subject to taxation in Fiscal Year 1997/98, an additional \$6,050 in aviation fuel tax would have been received.

Also not listed as an exemption, a taxpayer may request a refund for *losses of fuel due to fire, theft or other accident* (A.R.S. §28-1520A). No requests for refunds were made in Fiscal Year 1997/98.

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<sup>3</sup>Any figures presented for Aviation Fuel Tax Expenditures were provided by the Arizona Department of Transportation.

<b>SUMMARY OF AVIATION FUEL TAX EXPENDITURES</b>
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	<u>Revenue Gain</u>
Aviation fuel moving in interstate or foreign commerce.....	NIA *
Aviation fuel sold to the United States armed forces.....	NIA
Aviation fuel for use in applying seeds, fertilizer or pesticides.....	\$4,000
Exported aviation fuel .....	6,000
Aviation fuel lost due to fire, theft or other accident .....	0
 <b>TOTAL QUANTIFIABLE AVIATION FUEL TAX EXPENDITURES<sup>4</sup></b>	
.....	<b>\$10,000</b>

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\* No Information Available.

<sup>4</sup>The tax expenditures represent foregone revenues to the state aviation fund.

# **BINGO TAX EXPENDITURES**



## BINGO TAX EXPENDITURES

The tax on state licensed bingo operations is based on a multi-tiered licensing structure. There are three classes of bingo licenses, each of which has a different tax rate. Each class' tax rate is based on bingo receipts. All bingo tax collections are deposited into the general fund.

Class A licensees, whose gross receipts do not exceed \$15,600 per year, are taxed at 2.5% of their *adjusted gross receipts* (A.R.S. §5-414). Adjusted gross receipts equals gross receipts less the amount paid for prizes. Therefore, prize money is exempt from taxation for this class of bingo licensees. In FY 1997/98, \$2,249,940 was subtracted from gross receipts by this group of taxpayers. Determination of the tax value of this subtraction, however, is not a simple matter. If prize money were not allowed as a subtraction from gross receipts, it is unlikely that this group would have a 2.5% tax rate. However, if a 2.5% tax rate is not used, a more appropriate tax rate must be selected.

The tax value of the prize money subtraction for Class A taxpayers is calculated in two ways. Option 1 is to multiply the subtraction amount by 2.5%, the Class A tax rate. This results in potential collections of \$56,249. Option 2 is to multiply the subtraction amount by the average effective tax rate of the Class A licensees, calculated by dividing Class A tax collections by Class A total gross receipts. This rate for the Class A licensees is 0.30%. (This method is based on the premise that the Class A tax rate would not be 2.5% if the subtraction

were not allowed.) Multiplying the prize money subtraction amount by 0.30% results in potential collections of \$6,750.

Class B and Class C licensees are taxed on their gross receipts. Class B licensees, whose gross receipts do not exceed \$300,000, are taxed at 1.5% of their gross receipts. Class C licensees, whose gross receipts exceed \$300,000 annually, are taxed at 2.0% of their gross receipts. This is a preferential rate structure because different tax rates are imposed on similar taxpayers (all involved in the business of bingo) based on some criteria set in Arizona statutes. This preferential rate structure allows taxpayers with lower gross receipts to be taxed at a lower tax rate. Measuring the tax value of allowing a preferred tax rate for bingo is difficult because the lowest-income taxpayers (those whose receipts do not exceed \$15,600 annually) have a tax rate higher than the highest-income taxpayers. Normally, this type of calculation would simply involve applying the highest tax rate to all taxpayers to find the revenues that might have been received.

Therefore, the tax value of allowing preferential tax rates is also calculated in two ways. Option 1 determines the additional tax that would be received if all classes of licensee were taxed at the highest rate. For this option, the Class A tax rate is considered to be the effective tax rate of 0.30%, as explained above, making the highest tax rate among the three classes 2.0%. If Class A and Class B were taxed at 2.0%, additional general fund revenues would total \$136,778. (The calculation for Class A involves

substituting 2.0% as the effective tax rate.) The problem with this method of determining the tax value of preferential tax rates is that it assumes (1) there is a possibility of a legislative change which would raise the bingo tax to a uniform rate that is the highest tax rate currently being imposed and (2) small bingo operations would not be affected by an increase in the tax rate (the same level of bingo activities would occur irrespective of the tax rate).

Option 2 looks at preferential rates slightly differently. This option assumes that if a uniform tax rate were to be imposed to tax all licensees identically, the new rate would be revenue neutral, resulting instead in a burden shift. The

effective tax rate on all bingo activities, determined by dividing total tax collections into gross receipts, is 1.66%. If this rate is applied to all classes of bingo licensees, total tax collections remain the same, but, as can be seen below, the amount of tax paid by class of licensee shifts.

<b>Class</b>	<b>Original Tax Collections*</b>	<b>New Tax Collections</b>	<b>Difference</b>
A	\$7,872	\$42,754	\$34,882
B	\$303,343	\$336,724	\$33,381
C	\$407,541	\$339,278	(\$68,263)
Total	\$718,756	\$718,756	

\*This amount reflects collections for tax only, and does not include penalty and interest.

<b>SUMMARY OF BINGO TAX EXPENDITURES</b>
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	<u>Revenue Gain</u>
<b>Subtraction from Gross Receipts for Class A Licensees</b>	
Option 1.....	\$56,000
Option 2.....	7,000
 <b>Preferential Tax Rates for Class A and Class B Licensees</b>	
Option 1.....	\$137,000
Option 2.....	0
 <b>TOTAL QUANTIFIABLE BINGO TAX EXPENDITURES<sup>5</sup></b>	
.....	<b>\$7,000 - \$193,000</b>

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<sup>5</sup>These tax expenditures represent foregone revenues to the state general fund.



# **BOXING TAX EXPENDITURES**



## BOXING TAX EXPENDITURES<sup>6</sup>

Any person who promotes a boxing contest in Arizona must pay to the Department of Racing (collecting for the state Boxing Commission) a 4% tax on the gross receipts of such match or exhibition, after deduction of city, state and federal taxes (A.R.S. §5-104.02A). Gross receipts are defined as receipts from the face value of tickets sold. Tickets issued as complimentary by the promoter of a boxing match are exempt

from taxation, as long as the number of complimentary tickets does not exceed 2% of total number of tickets issued or 75 tickets, whichever is greater. During FY 1998, 16 boxing contests were held and, at each, 75 complimentary tickets were issued.

Had the value of these tickets been taxable, an additional \$1,000 in boxing taxes would have been received.

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<sup>6</sup>Any figures presented for Boxing Tax Expenditures were provided by the Arizona Boxing Commission.

**SUMMARY OF BOXING TAX EXPENDITURES**

	<u>Revenue Gain</u>
Complimentary tickets issued .....	\$1,000
<b>TOTAL QUANTIFIABLE BOXING TAX EXPENDITURES<sup>7</sup></b>	
.....	<b>\$1,000</b>

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<sup>7</sup>These tax expenditures represent foregone revenues to the state general fund.

# **CORPORATE INCOME TAX EXPENDITURES**



# CORPORATE INCOME TAX EXPENDITURES

The Department of Revenue collected over \$528 million in net corporate income taxes during Fiscal Year 1997/98. Net income tax (corporate, individual and fiduciary) collections are deposited into the general fund after 15.8% of net income tax collections received two years prior is disbursed to cities and towns. In other words, 15.8% of net individual plus corporate plus fiduciary income tax received in Fiscal Year 1997/98 will be distributed to incorporated cities/towns in Fiscal Year 1999/00. When reviewing the tax value of the corporate tax expenditures, therefore, the assumption can be made that 84.2% of the tax value is general fund revenue, although the remaining 15.8% is not actually disbursed for two years in the future.

Arizona corporate income tax filers begin their calculations with federal taxable income. Therefore, any subtractions available federally in the calculation of federal taxable income are allowed under Arizona law by conforming to the Internal Revenue Code definition of federal taxable income. From federal taxable income, certain exemptions and subtractions are allowed in reaching Arizona taxable income. Finally, after the calculation of Arizona tax liability, corporations may take advantage of certain credits to reduce tax liability.

Most of the corporate tax expenditures are not quantifiable. The tax value of the federal subtractions in the calculation of federal taxable income cannot be determined because these are for corporate income from all states, not just

Arizona income. The tax value of Arizona's subtractions from federal taxable income cannot be calculated because subtractions are deducted from federal taxable income prior to apportionment of income to Arizona. Therefore, it cannot be determined what percent of the subtractions is used in the calculation of Arizona tax. The remaining subtractions and tax credits are only quantifiable to the extent that data exists.

## SUBTRACTIONS ALLOWED IN THE CALCULATION OF FEDERAL TAXABLE INCOME

The starting point for the calculation of Arizona corporate tax liability is federal taxable income, as calculated on the federal corporate income tax returns. The Arizona legislature must approve legislation annually to conform to the definition of federal taxable income as of January of the current year. In conforming to the definition of federal taxable income, Arizona accepts the subtractions from gross income allowed by the federal government. These subtractions include:

- *Compensation of officers.*
- *Salaries and wages.*
- *Incidental repairs that do not add to the value of the property or appreciably prolong its life.*
- *Debts that became worthless in whole or in part during the tax year.*
- *Expenses of renting or leasing a vehicle.*

- *Contributions or gifts actually paid within the tax year to charitable and governmental organizations and any unused contributions carried over from prior years, except the total amount claimed may not be more than 10% of taxable income.*
- *Depreciation, plus the part of the cost (up to \$10,000) that the corporation elected to expense for certain tangible property placed in service during the tax year.*
- *Certain percentage depletion rates applicable to natural deposits.*
- *Contributions to pensions, profit-sharing or other funded deferred compensation plans.*
- *Contributions to employee benefit programs not elsewhere claimed.*
- *Amortization of certain bond premiums, research and experimental expenditures, qualified reforestation and reforestation costs, business start-up expenditures, organizational expenditures for a corporation, etc.*

It is not possible to estimate the tax value of these subtractions. While the Department of Revenue does receive information from the Internal Revenue Service on corporations with an Arizona address, information on corporations headquartered outside of Arizona but operating within the state is not available. Even if it were available, multi-state corporations would include income and deductions from all states in which they operate in the calculation of federal taxable income, making it useless for Arizona tax expenditure calculation purposes.

## EXEMPT ORGANIZATIONS

Certain organizations are exempt from corporate income tax according to Arizona law. The organizations specifically set out in statute as exempt are:

- *The United States, the state, counties, municipalities, school districts or other political subdivisions or units of this state or the federal government (A.R.S. §43-104.23).*
- *Labor, agricultural or horticultural organizations, other than cooperative organizations (A.R.S. §43-1201.01).*
- *Qualifying fraternal beneficiary societies, orders or organizations (A.R.S. §43-1201.02).*
- *Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit (A.R.S. §43-1201.03).*
- *Qualifying corporations organized and operated exclusively for religious, charitable, scientific, literary or educational purposes or for the prevention of cruelty to children or animals (A.R.S. §43-1201.04).*
- *Nonprofit business leagues, chambers of commerce, real estate boards or boards of trade, no part of the net earnings of which inures to the benefit of any private shareholder or individual (A.R.S. §43-1201.05).*
- *Nonprofit qualifying civic leagues or organizations operated exclusively for the promotion of social welfare, or local organizations of employees (A.R.S. §43-1201.06).*
- *Clubs organized and operated exclusively for pleasure, recreation and other non-profit making purposes (A.R.S. §43-1201.07).*

- *Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom and turning over the entire amount of such income, less expenses, to an organization which itself is exempt from the tax imposed by this title (A.R.S. §43-1201.08).*
- *Voluntary employee's beneficiary organizations providing for the payment of life, sick, accident or other benefits to the members of such organizations or their dependents, providing certain requirements are met (A.R.S. §43-1201.09).*
- *Teachers' or public employees' retirement fund organizations of a purely local character, provided certain requirements are met (A.R.S. §43-1201.10).*
- *Religious or apostolic organizations or corporations, if such organizations or corporations have a common treasury or community treasury, even if such corporations or organizations engage in business for the common benefit of the members, but only if the members thereof include, at the time of filing their returns, in their Arizona gross income their pro rata shares, whether distributed or not, of the net income of the organizations or corporations for such year (A.R.S. §43-1201.11).*
- *Voluntary employees' beneficiary organizations providing for the payment of life, sick, accident or other benefits to the members of such organization, their dependents or their designated beneficiaries, provided certain requirements are met (A.R.S. §43-1201.12).*
- *Corporations classified as diversified management companies under §5 of the Federal Investment Company Act of 1940 and registered*

*as provided in that act (A.R.S. §43-1201.13).*

- *Insurance companies paying to the state tax upon premium income derived from sources within this state (A.R.S. §43-1201.14).*
- *Mutual ditch, irrigation or water companies or similar nonprofit organizations if 85% or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses (A.R.S. §43-1201.15).*
- *Workers' compensation pools established pursuant to §23-961.01 (A.R.S. §43-1201.16).*
- *A small business corporation which makes an election for a taxable year pursuant to subtitle A, chapter 1, subchapter S of the Internal Revenue Code is not subject to corporate taxes for such year but only to the extent such corporation is not subject to federal income taxes (A.R.S. §43-1126).*

Three of these organizations - religious or apostolic organizations, insurance companies and Subchapter S corporations - are exempt from corporate tax but their income does not escape taxation. In the case of the religious or apostolic corporations and the Subchapter S corporations, the income is taxed at the individual income tax level. Insurance companies are required to pay insurance premium tax rather than corporate income tax.

It is not possible to calculate the corporate tax which would be collected if all exempt organizations were subject to corporate taxation. That calculation would require completion of federal and state tax forms by the exempt organizations.



## ARIZONA SUBTRACTIONS FROM FEDERAL TAXABLE INCOME

Arizona statute sets out certain amounts which can be subtracted from federal taxable income to reach adjusted income attributable to Arizona. The tax value of these subtractions, as mentioned in the opening paragraphs of this section, cannot be determined because these are subtracted from federal taxable income prior to apportionment of income to Arizona. It is impossible to isolate those subtractions attributable to Arizona only.

- *Annuity income included pursuant to §72 of the Internal Revenue Code if the first payment with respect to such annuity was received prior to 12/31/78 (A.R.S. §43-1122.01).*
- *The excess of a partner's share of income required to be included under §702(a)(8) of the Internal Revenue Code over the income required to be included under chapter 14, article 2 of Title 43 (A.R.S. §43-1122.01).*
- *The excess of a partner's share of partnership losses determined pursuant to chapter 14, article 2 of Title 43 over the losses allowable under §702(a)(8) of the Internal Revenue Code (A.R.S. §43-1122.01).*
- *The amount by which the adjusted basis of all property which is held for the production of income and which is sold or otherwise disposed of during the taxable year other than depreciable property used in a trade or business, computed pursuant to Title 43 and the income tax act of 1954, as amended, exceeds the adjusted basis of such property computed pursuant to the Internal Revenue Code (A.R.S. §43-1122.01).*
- *The amount allowed by A.R.S. §43-1024 for amortization by a qualified defense contractor certified by the Department of Commerce under §41-1508, of a capital investment for private commercial activities (A.R.S. §43-1122.01).*
- *Gain included on the sale or other disposition of a capital investment that a qualified defense contractor has elected to amortize pursuant to A.R.S. §43-1024 (A.R.S. §43-1122.01).*
- *The amount allowed by §43-1025 for contributions during the taxable year of agricultural crops to charitable organizations (A.R.S. §43-1122.01).*
- *The portion of any wages or salaries paid or incurred by the taxpayer for the taxable year that is equal to the amount of the federal work opportunity credit, the empowerment zone employment credit, the credit for employer paid social security taxes on employee cash tips, and the Indian employment credit that the taxpayer received under §§45A, 45B, 51(a) and 1396 of the IRC (A.R.S. §43-1122.01).*
- *Dividend income received from Arizona corporations (A.R.S. §43-1122.02).*
- *Arizona capital loss carryover in an amount not to exceed \$1,000 from tax years beginning prior to 1/1/88 (A.R.S. §43-1122.03).*
- *Expenses and interest relating to tax-exempt income disallowed pursuant to §265 of the Internal Revenue Code (A.R.S. §43-1122.04).*
- *Dividends received from another corporation owned or controlled directly or indirectly by a recipient corporation (A.R.S. §43-1122.05).*
- *Interest income received on obligations of the U.S (A.R.S. §43-1122.06).*

- *Dividend income from foreign corporations*(A.R.S. §43-1122.07).
- *State income tax refunds received which were included as income in computing federal taxable income* (A.R.S. §43-1122.09).
- *Expense recapture included in income pursuant to §617 of the Internal Revenue Code for mine exploration expenses* (A.R.S. §43-1122.10).
- *Deferred exploration expenses allowed by A.R.S. §43-1127* (A.R.S. §43-1122.11).
- *Exploration expenses related to the exploration of oil, gas or geothermal resources*(A.R.S. §43-1122.12).
- *Amortization of pollution control devices*(A.R.S. §43-1122.13).
- *Amortization of the cost of child care facilities*(A.R.S. §43-1122.14).
- *Income from a domestic international sales corporation required to be included in the income of its shareholders pursuant to §995 of the Internal Revenue Code* (A.R.S. §43-1122.15).
- *The amount authorized by A.R.S. §43-1128.01 for the taxable year for purchases of alternative fuel vehicles* (A.R.S. §43-1122.16).
- *The income of an insurance company that is exempt under A.R.S. §43-1201 to the extent that it is included in computing Arizona gross income on a consolidated return* (A.R.S. §43-1122.17).
- *The amount of contributions by the taxpayer during the taxable year to individual medical savings accounts pursuant to A.R.S. §43-1028* (A.R.S. §43-1122.18) *to the extent not already deducted in computing federal taxable income.*
- *The amount by which capital loss carryover allowable per A.R.S. §43-*

1130.01 F *exceeds the capital loss carryover allowable per section 13410(b)(5) of the internal revenue code.*

## ARIZONA NET OPERATING LOSSES

All corporate taxpayers are allowed to subtract from their Arizona taxable income the amount of *unused net operating losses attributable to Arizona* for the last five years (A.R.S. §43-1122.08). Corporations claimed Arizona-based net operating losses totaling \$7.624 billion for tax year 1996. In many cases these losses exceeded taxable income, meaning that the amount claimed is greater than the amount actually used to offset taxable income. To calculate the tax value of this \$7.624 billion, the loss was multiplied by 9% for those businesses with positive taxable income. For those with negative taxable income, that portion of loss that was larger than the taxable income was multiplied by 9%.<sup>8</sup> The result of these calculations was a maximum tax value of \$138,425,900.

Approximately 25% of the 50,900 corporations in Arizona (filing Arizona corporate income tax returns) had net operating losses in 1996. The table below shows the number of corporations by size of net operating loss and by positive or negative taxable income.

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<sup>8</sup>For example, if the net operating loss was \$10,000 and the negative taxable income was \$9,000, adding back the loss would result in a positive taxable income of \$1,000. The tax rate was applied against the \$1,000 to arrive at the taxable value of the operating loss.

1996 --Size of NOL	# with Liability	# w/o Liability	Total
\$1 to \$99	144	253	397
\$100 to \$999	489	1,032	1,521
\$1,000 to \$9,999	1,261	3,078	4,339
\$10,000 to \$49,999	885	2,795	3,680
\$50,000 to \$99,999	180	845	1,025
\$100,000 to \$499,999	198	1,063	1,261
\$500,000 to \$999,999	26	216	242
Over \$1,000,000	38	455	493
<b>Total</b>	<b>3,221</b>	<b>9,737</b>	<b>12,958</b>
\$ Value	\$252,365,988	\$7,371,885,421	\$7,624,251,409

## COMMERCIAL TAX CREDITS

A tax credit directly reduces a corporation's tax liability, as opposed to a subtraction which reduces taxable income. The tax credits which currently exist in Arizona corporate tax law are nonrefundable credits; therefore, any credit amount greater than a firm's tax liability will not be refunded. A corporation receives a credit for expenditures in the following areas:

- for increased employment in enterprise zones (A.R.S. §43-1161).
- for investment or employment in qualified property on the grounds of an Arizona correctional facility (A.R.S. §43-1162).
- for the purchase of recycling equipment (A.R.S. §43-1164).
- for employment by a qualified defense contractor (A.R.S. §43-1165).
- for property taxes paid by a qualified defense contractor (A.R.S. §43-1166).
- for increased employment in military reuse zones (A.R.S. §43-1167).
- for research and development expenses (A.R.S. §43-1168).
- for expenses incurred in constructing a qualified environmental technology

*manufacturing, producing or processing facility* (A.R.S. §43-1169).

- for expenses incurred to purchase property used to control or prevent pollution (A.R.S. §43-1170).
- for construction materials incorporated into a qualifying facility (A.R.S. §43-1171).
- for an agricultural water conservation system (A.R.S. §43-1172).
- for corrective action costs for underground storage tanks (A.R.S. §43-1173).
- for alternative fuel vehicles and equipment (A.R.S. §43-1174).
- for employment of TANF recipients (A.R.S. §43-1175).
- for solar hot water heater plumbing stub outs and electric vehicle recharge outlets installed (A.R.S. §43-1176).
- for wages paid by an employer to students (in grade 12 and under) enrolled in the summer school and jobs program established by the Department of Economic Security (Chapter 236, First Regular Session, 1995)

Prior to discussing the cost of the corporate income tax credits, it is important to mention two points. First, corporate tax information for a given tax year changes over time. Late returns are

filed, corporations are audited, amended returns are filed, retroactive legislation is enacted, etc. Therefore, any figures stated here will probably change next year and figures cited in previous years will probably not match what is said here. Second, information cannot be revealed about certain credits claimed without breaching confidentiality. If fewer than four firms claim a credit or if one firm claims more than 90% of the total credit amount claimed or if providing statistics on one credit would

result in information being divulged about other credits (which is confidential), then that information cannot legally be released.

In tax year 1996, **135** corporations filed for **\$20,433,472** in commercial tax credits. Eleven types of credits were claimed, as summarized on the table below. Asterisks indicate instances in which release of information would breach confidentiality laws.

TYPE OF CREDIT	1993		1994		1995		1996	
	#	\$ USED	#	\$ USED	#	\$ USED	#	\$ USED
Enterprise Zone	17	\$1,453,899	21	\$791,101	21	\$1,776,264	22	\$2,215,647
Corrections								
Dependent Day Care	7	\$18,311	5	6,839		No longer available		No longer available
Recycling Equipment			**	**	5	14,851	4	11,167
Defense Restructuring	**	**	**	**	**	**	4	\$4,544,146
Military Reuse							**	**
Research & Development	21	301,091	77	2,197,471	70	5,233,254	82	7,475,059
Environmental Technology	**	**	4	2,329,787	6	15,821,497	5	2,552,462
Construction Materials			**	**	6	4,849,737	9	990,729
Agricultural Water			5	8,321	**	**	**	**
Underground Storage Tanks			**	**			**	**
Alternative Fuel Vehicles			**	**	**	**	**	**
Pollution Control					15	2,367,936	18	2,601,850
Summer School & Jobs					**	**		
<b>Total</b>	<b>48</b>	<b>\$2,029,683</b>	<b>120</b>	<b>\$5,911,203</b>	<b>136</b>	<b>\$31,415,432</b>	<b>152</b>	<b>\$20,433,472</b>

## SUMMARY OF CORPORATE INCOME TAX EXPENDITURES

	<u>Revenue Gain</u>
<b>Subtractions Allowed in Calculation of Federal Taxable Income:</b>	
Compensation of Officers .....	NIA *
Salaries and wages .....	NIA
Incidental repairs adding no value to property .....	NIA
Debts becoming worthless during the tax year .....	NIA
Expenses of renting or leasing a vehicle .....	NIA
Charitable or governmental organization contributions.....	NIA
Depreciation .....	NIA
Certain percentage depletion rates applicable to natural deposits.....	NIA
Pension, profit-sharing, etc. contributions .....	NIA
Contributions to employee benefit programs.....	NIA
Amortization of certain items.....	NIA
 <b>Exempt Organizations:</b>	
Political subdivisions or units of the state or federal government .....	NIA
Labor, agricultural or horticultural organizations .....	NIA
Qualifying fraternal beneficiary societies.....	NIA
Cemetery companies not for profit.....	NIA
Qualifying religious, charitable, scientific, etc., corporations.....	NIA
Nonprofit business leagues .....	NIA
Nonprofit qualifying civic leagues.....	NIA
Clubs organized for pleasure, recreation or other nonprofit purposes .....	NIA
Corporations organized to hold title to property for exempt organization.....	NIA
Voluntary employee's beneficiary organizations.....	NIA
Teachers' or public employees' retirement fund organization .....	NIA
Religious or apostolic organizations which pass through income .....	NIA
Voluntary employee's beneficiary organizations with a twist .....	NIA
Diversified management companies .....	NIA
Insurance companies subject to the insurance premium tax .....	NIA
Mutual ditch, irrigation or water companies.....	NIA
Subchapter S corporations.....	NIA
 <b>Arizona Subtractions from Federal Taxable Income:</b>	
Annuity income included pursuant to §72 of the IRC.....	NIA
Excess of a partner's share of income under §702(a)(8) of IRC .....	NIA
Excess of a partner's share of partnership losses .....	NIA
Excess of adjusted basis of property held for income production.....	NIA

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\* No Information Available.

Amortization by a qualified defense contractor of a capital investment for private commercial activities.....	NIA *
Gain on amortized capital investment by a qualified defense contractor.....	NIA
Dividend income received from Arizona corporations.....	NIA
Arizona capital loss carryover not to exceed \$1,000 prior to 1/1/88 .....	NIA
Expenses/interest relating to tax-exempt income disallowed per IRC.....	NIA
Dividends received from controlled corporation .....	NIA
Interest income received on obligations of the U.S.....	NIA
Dividend income from foreign corporations.....	NIA
Income tax refunds from states other than Arizona included as income in computing federal taxable income.....	NIA
Expense recapture for mine exploration expenses.....	NIA
Deferred exploration expenses allowed by §43-1127 .....	NIA
Exploration expenses related to oil, gas or geothermal exploration .....	NIA
Amortization of pollution control devices .....	NIA
Amortization of the cost of child care facilities.....	NIA
Income from domestic international sales corporation .....	NIA

**Net Operating Losses**..... \$138,426,000

**Commercial Tax Credits:**

Enterprise zone employment.....	\$2,216,000
Investment or employment at Arizona correctional facility.....	0
Purchase of recycling equipment .....	11,000
Employment by qualified defense contractor.....	4,544,000
Property taxes paid by qualified defense contractor.....	0
Increased employment in military reuse zones .....	?? <sup>10</sup>
Research and development expenses .....	7,475,000
Environmental technology manufacturing facility construction .....	2,553,000
Construction materials .....	991,000
Agricultural water conservation.....	?? <sup>10</sup>
Underground Storage Tanks.....	?? <sup>10</sup>
Alternative Fuel Vehicles.....	?? <sup>9</sup>
Pollution Control .....	2,602,000
<b>Total Commercial Tax Credits</b> .....	<b>\$20,434,000</b>

**TOTAL QUANTIFIABLE CORPORATE INCOME TAX**

**EXPENDITURES<sup>10</sup>**

.....**\$158,860,000**

\* No Information Available.

<sup>9</sup>These question marks ("??") indicate that release of this information would result in a violation of Arizona confidentiality laws.

<sup>10</sup>These expenditures represent foregone revenues to the state general fund and to the urban revenue sharing fund, which is distributed to incorporated cities and towns.



# **ESTATE TAX EXPENDITURES**



## ESTATE TAX EXPENDITURES

The Arizona estate tax is a tax on the transfer of property or interest in property that takes effect upon the owner's death. The estate tax is an amount equal to the federal credit for state death taxes. Estate taxes are deposited into the general fund.

If the decedent owned realty or tangible personal property located in another state, the Arizona tax is reduced by *the smaller of the amount of death tax paid to the other state or the federal credit times the percentage of total real or tangible personal property located in another state.*

Information on this reduction is unavailable for the current year. However, the average percentage of total collections allowed as a deduction over the past three years is approximately 1.68%. Total collections in Fiscal Year 1997/98 was \$62,902,974, and an estimated deduction for this year would be roughly 1.68% of this total, or \$1,055,028. This deduction is a dollar-for-dollar reduction in the estate tax liability.

**SUMMARY OF ESTATE TAX EXPENDITURES**

	<u>Revenue Gain</u>
Deduction from federal credit for state death taxes .....	\$1,055,000
<b>TOTAL QUANTIFIABLE ESTATE TAX EXPENDITURES<sup>11</sup></b>	
.....	<b>\$1,055,000</b>

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<sup>11</sup>These expenditures represent foregone revenues to the state general fund.

# **FIDUCIARY INCOME TAX EXPENDITURES**



# FIDUCIARY INCOME TAX EXPENDITURES

Fiduciary income tax is the income tax on estates or trusts, based on the residence of the fiduciaries or beneficiaries. For estates, all income received by the estate after the death of the taxpayer is reported on a fiduciary income tax return. Upon creation of a trust, the trust becomes a taxable entity and income to the trust must be reported on a fiduciary income tax return.

Net income tax (corporate, individual and fiduciary) collections are deposited into the general fund after 15.8% of net income tax collections received two years prior is disbursed to cities and towns. In other words, 15.8% of net individual plus corporate plus fiduciary income tax received in Fiscal Year 1997/98 will be distributed to incorporated cities/towns in Fiscal Year 1999/2000. When reviewing the tax value of the fiduciary tax expenditures, therefore, the assumption can be made that 84.2% of the tax value is general fund revenue, although the remaining 15.8% is not actually disbursed for two years in the future.

Calculation of fiduciary income tax begins with federal taxable income from the federal form 1041 (U.S. Fiduciary Income Tax Return). Therefore, any subtractions allowed in the calculation of federal taxable income are allowed under Arizona law by the act of conforming to the Internal Revenue Code definition of federal taxable income. From federal taxable income, certain subtractions and exemptions are allowed to reach Arizona taxable income. After calculation of Arizona tax liability, a credit for taxes

paid to other states or countries is allowed.

## SUBTRACTIONS ALLOWED IN THE CALCULATION OF FEDERAL TAXABLE INCOME

The starting point for the calculation of Arizona fiduciary income tax liability is federal taxable income, as calculated on the federal form 1041 (U.S. Fiduciary Income Tax Return). The Arizona legislature must choose to approve legislation annually to conform to the definition of federal taxable income as of January of the current year. In conforming to the definition of federal taxable income, Arizona accepts the subtractions from gross income allowed by the federal government. These subtractions include:

- *Deduction for interest paid by the estate or trust on amounts borrowed by the estate or trust or on debt acquired by the estate or trust. This includes any investment interest (subject to limitations), qualified residence interest and any interest payable on any unpaid portion of the estate tax attributable to the value of a reversionary or remainder interest in property.*
- *Deductible taxes, including state and local income or real property tax and generation-skipping transfer tax imposed on income distributions.*
- *Deductible fees paid to the fiduciary for administering the estate or trust during the tax year.*

- *Charitable contributions less tax-exempt income allocable to charitable contributions.*
- *Deductible attorney, accountant, and return preparation fees paid by the estate or trust.*
- *Other deductions, such as amortizable bond premiums, casualty and theft losses, net operating loss deduction and fiduciary's share of amortization, depreciation and depletion not claimed elsewhere.*
- *Miscellaneous itemized deductions in excess of 2% AGI.*
- *Income Distribution Deduction.*
- *Estate tax paid.*
- *\$600 exemption for estates. \$300 exemption for trusts in which all income must be distributed currently. \$100 exemption for all other trusts unless the trust is filing for the final year (in which case no exemption is allowed).*

It is not possible to calculate the tax value of these subtractions. Information from the Internal Revenue Service would be required to determine the value and this information is not readily available.

## ARIZONA SUBTRACTIONS FROM FEDERAL TAXABLE INCOME

Arizona statute sets out certain amounts which can be subtracted from federal taxable income to reach adjusted gross income attributable to Arizona.

- *Interest received on U.S. obligations.* Interest income received on obligations of the United States (less any interest on indebtedness, or other related expenses, and deducted in arriving at Arizona gross income) which were incurred or continued to

purchase or carry such obligation can be subtracted (A.R.S. §43-1332.1).

- *Federal income from other fiduciaries.* When the estate or trust is the beneficiary of another estate or trust, the beneficiary's share of the trust or estate income recognized under the Internal Revenue Code may be subtracted (A.R.S. §43-1332.1).

- *Arizona estate tax deduction.* The apportionate share of the Arizona estate tax that related to the income of the estate and which was included in federal taxable income may be subtracted from federal taxable income (A.R.S. §43-1332.5).

- *Arizona distribution to beneficiaries.* The income of the estate or trust which is to be distributed or credited during the year to any legatee, heir or beneficiary is allowed as a subtraction from federal taxable income (A.R.S. §43-1332.3 & .4).

- *Medical savings accounts.* In the case of a trust that is established as a medical savings account pursuant to A.R.S. §43-1028, income earned by the trust, to the extent that the income is included in the trust's Arizona gross income (A.R.S. §43-1332.5).

Other Subtractions. The remaining subtractions are entered in aggregate on the line "Other Subtractions from federal taxable income." The following is a list of "Other Subtractions":

- *Benefits, annuities and pensions in an amount totaling not more than \$2500 received from: U.S. government service retirement and disability fund, retired or retainer pay of the U.S. uniformed services, the U.S. foreign service retirement and disability system, any other retirement*

*system or plan established by federal law, the state retirement system, the state retirement plan, the corrections officer retirement plan, the public safety personnel retirement system, the elected officials' retirement plan, an optional retirement program established by the AZ board of regents under A.R.S. §15-1628, or a retirement plan established for employees of a county, city or town in this state. (A.R.S. §43-1332.1)*

- The amount of any distributions from an individual retirement account as provided for in §408 of the IRC or from a qualified retirement plan of a self-employed individual as provided for in §401 of the IRC to the extent that total adjustments made pursuant to this paragraph in all tax years do not exceed the total of all contributions made by the taxpayer to such plans prior to 12/31/75, which were included in computing Arizona taxable income. (A.R.S. §43-1332.1)*
- The amount of income on an installment receivable which is recognized pursuant to the IRC and which has already been recognized on the death of the taxpayer for purposes of this title for tax years ending before 1/1/90. (A.R.S. §43-1332.1)*
- The amount of any income tax refunds which were received from states other than Arizona and which were included as income. (A.R.S. §43-1332.1)*
- Annuity income included pursuant to §72 of the IRC if the first payment with respect to such annuity was received prior to 12/31/78. (A.R.S. §43-1332.1)*
- The excess of a partner's share of income required to be included under §702(a)(8) of the IRC over the income required to be included under chapter*

*14, article 2 of title 43. (A.R.S. §43-1332.1)*

- The excess of a partner's share of partnership losses determined pursuant to chapter 14, article 2 of title 43 over the losses allowable under §702(a)(8) of the IRC. (A.R.S. §43-1332.1)*
- The amount by which the adjusted basis of all property which is held for the production of income and which is sold or otherwise disposed of during the taxable year other than depreciable property used in a trade or business, computed pursuant to title 43 and the income tax act of 1954, as amended, exceeds the adjusted basis of such property computed pursuant to the IRC. (A.R.S. §43-1332.1)*
- The amount allowed by §43-1024 for amortization, by a qualified defense contractor certified by the department of commerce under §41-1508, of a capital investment for private commercial activities. (A.R.S. §43-1332.1)*
- The amount of gain included on the sale or other disposition of a capital investment that a qualified defense contractor has elected to amortize pursuant to §43-1024. (§43-1332.1)*
- The amount allowed by A.R.S. §43-1025 for contributions of agricultural crops to charitable organizations (A.R.S. §43-1332.1).*
- The amount of winnings less than \$5000 in a single taxable year from any of the state lotteries established and operated pursuant to title 5, chapter 5, article 1, except that all such winnings before 3/22/83, including periodic distributions from such winnings made after 3/22/83, may be subtracted. (A.R.S. §43-1332.1)*

- *The amount of mining exploration expenses determined pursuant to §617 of the IRC which have been deferred in a taxable year ending before 1/1/90 and for which a subtraction has not been previously made. (A.R.S. §43-1332.1)*
- *The amount included pursuant to §86 of the IRC, relating to taxation of social security and railroad retirement benefits. (A.R.S. §43-1332.1)*
- *To the extent not already excluded from Arizona gross income under §112 of the IRC, compensation received for active service as a member of the armed forces of the U.S. for any month during any part of which the member served in a combat zone. (A.R.S. §43-1332.1)*
- *The amount of nonreimbursed medical and hospital costs, adoption counseling, legal and agency fees and other nonrecurring costs of adoption not to exceed three thousand dollars (A.R.S. §43-1332.1).*
- *The amount authorized by A.R.S. §43-1026 for the purchases of and equipment relating to, alternative fuel vehicles (A.R.S. §43-1332.1).*
- *The amount authorized by A.R.S. §43-1027 for the purchases of, and nonoptional equipment directly related to the operation of, qualified wood stoves, wood fireplaces or gas fired fireplaces (A.R.S. §43-1332.1).*
- *With respect to individual medical savings accounts established pursuant to A.R.S. §43-1028, the account holder may subtract the amount of contributions made by the employer, to the extent that these contributions are included in the taxpayer's federal adjusted gross income, and the amount deposited by the taxpayer in the account during the year. The employer may subtract the amount of*

*contributions made to an employee's account to the extent that the contributions are not deductible under the internal revenue code (A.R.S. §43-1332.1).*

- *The amount by which an operating loss carryover or capital loss carryover, allowable pursuant to A.R.S. §43-1029 F, exceeds the net operating loss carryover or capital loss carryover allowable pursuant to section 1341(b)(5) of the internal revenue code (A.R.S. §43-1332.1).*

The values associated with the total subtractions were found in the 1996 Arizona Fiduciary Income Tax Abstract. Average tax rates were applied to this total value to reach the tax value of the subtraction. The total amount of subtractions on Fiduciary tax returns for estates for tax year 1996 was \$53.44 million. Fiduciary returns for trusts showed a total subtraction amount of \$608.192 million for tax year 1996. Using an effective tax rate of 1.6% of **gross income** for estates and trusts results in a tax value of these subtractions of \$10.586 million.

## **EXEMPTIONS FROM ARIZONA ADJUSTED GROSS INCOME**

Estates and trusts are allowed exemptions from Arizona adjusted gross income (A.R.S. §43-1332.A2). Estates are allowed *\$1,000 exemptions*; trusts are allowed *\$100 exemptions*. The total amount of exemptions claimed by estates and trusts in 1996 was \$7.91 million. However, a large portion of these exemptions were claimed by filers with negative adjusted gross income. Exemptions claimed by taxpayers with positive taxable income were \$2.05 million. Using an average tax rate of

4.6% (tax rates based on Arizona **taxable income**) for estates and trusts, the exemptions had a tax value of \$0.094 million. This excludes returns with negative adjusted gross income.

## PREFERENTIAL TAX RATES

Fiduciary income tax for tax year 1996 was calculated according to a graduated tax rate schedule as presented below:

at least	but less than	
\$0	\$10,000	3.0% of the amount
10,000	25,000	\$300, plus 3.5% of the excess over \$10,000
25,000	50,000	\$825, plus 4.2% of the excess over \$25,000
50,000	150,000	\$1,875, plus 5.2% of the excess over \$50,000
150,000	and over	\$7,075, plus 5.6% of the excess over \$150,000

Lower taxable incomes are taxed at a lower level, or, in other words, are treated preferentially. If all taxpayers were treated identically, the same tax rate would be applied regardless of the level of taxable income. A question arises, however, as to what tax rate should be applied to determine the revenue impact of treating all taxpayers identically. One argument may be that since the highest tax rate is 5.6%, determining the impact of taxing all income at 5.6% would seem appropriate. Using this reasoning, an additional \$3.3 million would have been collected from fiduciary income tax if a flat 5.6% tax rate had been used. However, no taxpayer is currently taxed solely at 5.6%; only that income greater than \$150,000 is taxed at 5.6%. Therefore, everyone would experience a tax increase.

If a flat tax rate were applied to fiduciary income, the logical tax rate applied would be the effective tax rate of all fiduciary taxpayers. Applying an effective tax rate

to all taxpayers will result in the same fiduciary tax collections as with the graduated tax rate structure, but the burden of the tax will change. In this example, an effective tax rate of 4.6% of taxable income for estates and trusts was used, excluding the negative income bracket.

As can be seen from the table below, changing the graduated tax rates to a single tax rate (equal to the current effective tax rate for all taxpayers) results in taxpayers with lower taxable incomes paying more tax and taxpayers with higher taxable incomes paying less tax. In the \$0.01 to \$1,999 FAGI bracket, the total tax paid under the current tax schedule is \$95,697; changing to one tax rate equal to the current effective tax rate increases this group's tax liability by \$50,166 or a 52.42% increase. For FAGIs of \$2,000 to \$99,999, the tax burden would increase because the new effective tax rate is greater than the current effective tax rate for these groups.

<u>Federal Adjusted Gross Income</u>	<u>Original Tax Collections</u>	<u>New Tax Collections</u>	<u>Difference</u>	<u>% Change</u>
\$0.01-1,999	\$95,697	\$145,863	\$50,166	52.42%
\$2,000-3,999	\$160,203	\$238,683	\$78,480	48.99%
\$4,000-5,999	\$170,695	\$259,985	\$89,290	52.31%
\$6,000-7,999	\$174,091	\$265,471	\$91,380	52.49%
\$8,000-9,999	\$161,409	\$247,288	\$85,879	53.21%
\$10,000-11,999	\$169,646	\$256,125	\$86,479	50.98%
\$12,000-13,999	\$188,195	\$259,938	\$71,743	38.12%
\$14,000-15,999	\$183,367	\$266,694	\$83,327	45.44%
\$16,000-17,999	\$171,569	\$245,937	\$74,368	43.35%
\$18,000-19,999	\$167,747	\$238,180	\$70,433	41.99%
\$20,000-24,999	\$370,080	\$516,595	\$146,515	39.59%
\$25,000-29,999	\$328,678	\$447,745	\$119,067	36.23%
\$30,000-39,999	\$631,247	\$816,131	\$184,884	29.29%
\$40,000-49,999	\$534,185	\$663,352	\$129,167	24.18%
\$50,000-74,999	\$929,739	\$1,060,838	\$131,099	14.10%
\$75,000-99,999	\$769,945	\$812,290	\$42,345	5.50%
\$100,000-199,999	\$1,585,696	\$1,563,101	(\$22,595)	-1.42%
\$200,000-499,999	\$1,633,083	\$1,459,880	(\$173,203)	-
\$500,000-999,999	\$1,538,488	\$1,311,505	(\$226,983)	-
\$1,000,000 and	\$4,892,429	\$3,780,590	(\$1,111,839)	-22.73%
<b>Total</b>	<b>\$14,856,189</b>	<b>\$14,856,189</b>	<b>\$0</b>	<b>0</b>

### CREDITS

Once fiduciary tax liability is calculated, one credit is allowed to be subtracted from the tax liability. If the estate or trust is considered to be a resident of Arizona and also a resident of another state or

country, the estate or trust will be allowed a tax credit against the Arizona income tax liability for *taxes paid to the other state or country*. In 1996, \$0.72 million was claimed as credit for taxes paid to other states or countries. This is a direct reduction of tax liability.

## SUMMARY OF FIDUCIARY INCOME TAX EXPENDITURES

	<u>Revenue Gain</u>
<b>Arizona Subtractions in Calculation of Federal Taxable Income:</b>	
Deduction for interest paid.....	NIA *
Deductible taxes.....	NIA
Deductible fiduciary fees.....	NIA
Charitable contributions.....	NIA
Deductible attorney, accountant fees.....	NIA
Other miscellaneous deductions.....	NIA
Miscellaneous itemized deductions in excess of 2% AGI .....	NIA
Income distribution deduction.....	NIA
Estate tax paid .....	NIA
\$600/\$300/\$100 estate/trust exemption .....	NIA
 <b>Subtractions from Federal Taxable Income:</b>	
Interest received on U.S. obligation	
Federal income from other fiduciaries	
Arizona estate tax deduction	
Arizona distribution to beneficiaries	
Other subtractions:	
U.S./state pensions not over \$2500	
Certain IRA distributions or 401Ks	
Installment income recognized pursuant to IRC	
Income tax refunds from other states	
Annuity income included pursuant to §72 of the IRC	
Excess of a partner's share of income	
Excess of a partner's share of losses	
Excess of adjusted basis of property held for income production	
Amortization by a qualified defense contractor	
Gain on sale of capital investment by qualified defense contractor	
Lottery winnings, up to \$5,000	
Mining exploration expenses	
Social security and railroad retirement benefits	
Active military pay	
Total Subtractions from Federal Taxable Income .....	<b>\$10,586,000</b>
 <b>\$1,000/\$100 exemptions for estates/trusts.....</b>	 <b>\$94,000</b>
 <b>Preferential tax rates (raising average tax rate to 5.6% for all taxpayers)</b>	 <b>\$3,300,000</b>
 <b>Credit for taxes paid to other states or countries.....</b>	 <b>\$720,000</b>

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\* No Information Available.

**TOTAL QUANTIFIABLE FIDUCIARY INCOME TAX  
EXPENDITURES<sup>12</sup>**

.....\$14,700,000

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<sup>12</sup>These expenditures represent foregone revenues to the state general fund and to the urban revenue sharing fund, which is distributed to incorporated cities and towns.

# **FLIGHT PROPERTY TAX EXPENDITURES**



# FLIGHT PROPERTY TAX EXPENDITURES

The airline companies in Arizona pay a tax on the flight property within the state. The taxable value, or net assessed value, of the flight property is determined by multiplying the full cash value of the property by an assessment ratio. The tax rate that is applied to the net assessed value is equal to the statewide average tax rate, which is \$12.70 in 1997.

## EXEMPTIONS

*If an airline operating in Arizona has a system wide average passenger capacity of less than 56 seats or a system wide average payload capacity of less than 18,000 pounds, this small airline's taxable value is determined by 30% of its original cost less depreciation multiplied by the assessment ratio (A.R.S. §42-704). Had the taxable value been 100%, the state would have raised \$1,198,000 more in FY98.*

## PREFERENTIAL ASSESSMENT RATIO

Arizona statutes set out the assessment ratios to be used in determining the net assessed values of the various classes of property. These assessment ratios range from 27% to 1%. For flight property, the *assessment ratio is equal to the ratio which the total net assessed valuation of all taxable property in classes 1 (mines and timber), 2 (utilities) and 3 (commercial and industrial) and personal property in class 4 (agricultural and vacant land) bears to the total full cash value of such property* (A.R.S. §42-705A). For tax year 1997, the assessment ratio used for flight property was 23%. This is considered to be a preferential assessment ratio because it is an average of the assessment ratios in several other classes of property. If flight property had an assessment ratio equal to the highest assessment ratio imposed, 27%, tax collections would have increased by \$2,719,319.

<b>SUMMARY OF FLIGHT PROPERTY TAX EXPENDITURES</b>
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	<u>Revenue Gain</u>
<b>EXEMPTION</b>	
Tax value at 30% for small airplanes.....	\$1,198,000
<b>PREFERENTIAL ASSESSMENT RATIOS:</b>	
Preferential assessment ratio at 27%.....	\$2,719,000
<b>.....TOTAL QUANTIFIABLE FLIGHT PROPERTY TAX EXPENDITURES<sup>13</sup></b>	
<b>.....</b>	<b>\$3,917,000</b>

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<sup>13</sup>These expenditures represent foregone revenues to the state aviation fund.

# **IN LIEU PROPERTY TAX EXPENDITURES**



## IN LIEU PROPERTY TAX EXPENDITURES

Irrigation districts, power districts, electrical districts or agricultural improvement districts directly engaged in the sale of electric power or energy other than for irrigation purposes may elect to make voluntary contributions to Arizona and the political subdivisions thereof for property taxes. These districts are not legally liable for property taxes imposed by the state and the political subdivisions, so these voluntary contributions are known as in lieu property taxes. (However, according to A.R.S. §9-432B, water may not be transported from remote municipal property by a city, town or political subdivision, unless voluntary contributions have been paid.)

The Department of Revenue determines the full cash value of the district electing to make in lieu property tax payments. The county assessor of each county where district electric facilities are located computes the gross contribution to be made. The district may subtract certain amounts from this gross contribution figure. A subtraction is allowed for the contribution related to that portion of the electric system related to pumping water

(A.R.S. §48-242C1). A deduction of \$10,000 is allowed from the gross contribution (A.R.S. §48-242C2). Certain taxes or assessments paid to any political subdivision during the preceding calendar year may be deducted from the gross contribution (A.R.S. §48-242C3). The annual average of the total water costs devoted to municipal use during the last three calendar years is also deductible from the gross contribution (A.R.S. §48-242C4).

The effect of these deductions from the gross contribution amount is that the district in question pays a certain percentage of the gross contribution. The primary contributor, Salt River Project, paid 84.44% of the tax that would have been levied in Fiscal Year 1998 had they been legally bound to pay property tax. Given the repeal of the state rate, the dollar expenditure previously appeared in this report is no longer applicable. However, because the exemptions filter through to the tax base at the local level, descriptions of the exemptions remain.



# **INDIVIDUAL INCOME TAX EXPENDITURES**



For tax year 1996 filed in calendar year 1997, the Arizona Department of Revenue collected nearly \$1.5 billion in resident individual income taxes, before credits. Against the same tax year, the state allowed exemptions, deductions, exclusions, credits and preferential rates worth as much as \$1.7 billion in tax liability. This report details the value of each of these exemptions, deductions, exclusions, credits and preferential rates to Arizonans.

The figures presented in this report were determined using the Individual Income Tax Simulation Model, containing a 1996 database. This Model contains 36,087 resident returns, selected using stratified sampling techniques. The information on the back of Arizona Individual Income Tax Form 140 and on Schedule A was data-entered for the sample returns, making the detailed information presented below available. **Please remember these figures are for tax year 1996.** All of the tax expenditures discussed in this report refer to tax law in existence in 1996, filed in 1997.

Examination of the detail presented in this section reveals that summing the tax value of certain tax expenditures individually does not produce the total value of removing all of those same tax expenditures at one time. (The sum of the parts is less than the whole.) Disallowing exemptions, subtractions or deductions can have the effect of changing the tax rate applied to a portion of a taxpayer's taxable income. For example, the taxpayer may have had taxable income of \$40,000 prior to the removal of the tax exemption device, resulting in a tax rate of 4.2% on part of this income. Removal of deductions may

result in pushing the taxpayer's taxable income to \$55,000, resulting in a tax rate of 5.2% on part of this income. Removal of all exemptions, subtractions and deductions may make taxable income high enough to hit the 5.6% tax rate. Therefore, adding back large pieces of income that were previously untaxed can push the taxpayer into two or three higher tax brackets.

In other areas of this report, you may notice that adding the impacts of individual deductions together results in a **larger** impact than what the figure for removal of the entire section indicates. (The sum of the parts is greater than the whole.) For example, if the components of the Taxes Paid Deduction on the Schedule A were added together, the total would be \$98 million. However, removal of the entire Taxes Paid Deduction section results in a value of \$95 million. In this case, removal of individual pieces may lower the Schedule A total and may or may not push the taxpayer into a higher tax bracket. Removal of the entire section, however, may push the Schedule A total below the standard deduction level. If this happens, the standard deduction amount is substituted for the Schedule A amount. Therefore, there is a constant deduction level (equal to the standard deduction) below which the taxpayer will not fall, regardless of how much of the Schedule A is removed. This constant deduction level serves to buffer the impact of losing the Schedule A deductions and could potentially keep the taxpayer from moving into a higher tax bracket.

Net income tax (corporate, individual and fiduciary) collections are deposited in the general fund after 15.8% of net income

tax collections received two years prior is disbursed to cities and towns. In other words, 15.8% of net individual plus corporate plus fiduciary income tax received in Fiscal Year 1997/98 will be distributed to incorporated cities/towns in Fiscal Year 1999/00. When reviewing the tax value of the individual income tax expenditures, therefore, the assumption can be made that 84.2% of the tax value is general fund revenue, although the remaining 15.8% is not actually disbursed for two years in the future.

## **SUBTRACTIONS ALLOWED IN THE CALCULATION OF FEDERAL ADJUSTED GROSS INCOME**

The starting point for the calculation of Arizona individual income tax liability is federal adjusted gross income, as calculated on the federal form 1040, 1040A and 1040EZ U.S. Individual Income Tax returns. The Arizona legislature must approve legislation annually to conform to the definition of federal adjusted gross income as of January of the current year. In conforming to the definition of federal adjusted gross income, Arizona accepts the subtractions from gross income allowed by the federal government. These subtractions include:

- *Welfare benefits.*
- *Disability retirement payments and other benefits paid by the Department of Veterans' Affairs.*
- *Workers' compensation benefits, insurance, damages, etc., for injury or sickness.*
- *Child support.*
- *Money or property that was inherited, willed to you or received as a gift.*

- *Dividends on veterans' life insurance.*
- *Life insurance proceeds received because of a person's death.*
- *Amounts you received from insurance because you lost the use of your home due to fire or other casualty to the extent the amounts were more than the cost of your normal expenses while living in your home.*
- *Certain amounts received as a scholarship grant.*
- *Cancellation of certain student loans if, under the terms of the loan, the student performs certain professional services for any of a broad class of employers.*
- *Interest earned on series EE U.S. savings bonds issued after 1989 for filers with qualified higher education expenses.*
- *Up to \$62,500 (\$125,000 if married) in capital gains from the sale of a personal residence if over 55.*
- *Soil and water conservation expenses, up to 25% of gross farming income.*
- *Individual Retirement Account contributions for individuals with qualifying incomes.*
- *One-half of self-employment tax paid.*
- *Up to 50% of self-employed health insurance payments.*
- *Keogh payments or simplified employee pension payments if you are self-employed.*
- *Penalty on early withdrawal of savings.*
- *Alimony paid.*

It is only possible to estimate the tax value of those subtractions that appear on the front of the federal 1040 tax return as subtractions to gross income.

<u>SUBTRACTION</u>	1996 (Millions)
Individual Retirement Account for qualifying individuals	\$4.57
One-half of self-employment tax	5.21
Self-employed health insurance deduction	1.14
Keogh retirement plan and self-employed SEP deduction	6.41
Penalty on early withdrawal of savings	0.07
Alimony paid	<u>2.74</u>
TOTAL VALUE OF SUBTRACTIONS	\$20.57

## EXEMPTIONS

Like the federal government, Arizona grants exemptions for taxpayers meeting certain conditions. For 1996, the federal government allowed \$2,550 for personal and dependent exemptions. In Arizona, the amount of exemption varies according to type.

### Personal Exemption

The *personal exemption* is the most broad-based of all exemptions: every taxpayer (and spouse) is eligible for one (A.R.S. §43-1043). Single taxpayers and those who are married but filing separately were allowed exemptions of \$2,100 for tax year 1996. Married couples filing jointly and unmarried head of household taxpayers were allowed \$4,200 exemptions. The higher personal exemption allowed unmarried head of household filers is a preferential personal

exemption amount, double the amount normally allowed for one person.

### Age 65 or Older Exemption

Taxpayers *age 65 or older* were eligible for an *additional exemption* equal to \$2,100 for primary filer and for eligible spouse in 1996 (A.R.S. §43-1023B).

### Dependent Exemption

Arizona taxpayers may claim a *dependent exemption* for children and certain other relatives for whom they provide more than 50% support (A.R.S. §43-1023D). The dependent exemption was \$2,300 in 1996.

### Blind Exemption

Taxpayers who have corrected vision of no better than 20/200 or have a field of vision no wider than 20 degrees are eligible for a *blind exemption* (A.R.S. §43-1023A1). The exemption amount was \$1,500 in 1996.

<u>TYPE OF EXEMPTION</u>	1996 (Millions)
Personal Exemption	\$147.44
Preferential Personal Exemption for Unmarried Head of Household filers	7.49
Age 65 Or Older Exemption	19.14
Dependent Exemption	68.67
Blind Exemption	<u>0.30</u>
TOTAL VALUE OF EXEMPTIONS	\$248.63

## ARIZONA SUBTRACTIONS FROM INCOME

Arizona taxpayers can subtract certain amounts from their gross income. The largest subtraction in 1996 was for Social Security or Railroad Retirement benefits included on the federal Form 1040 (A.R.S. §43-1022.18). Arizona also allowed these amounts to be subtracted: the first \$2,500 of a federal or Arizona state or local retirement annuity (A.R.S. §43-1022.2), the first \$5,000 in Arizona lottery winnings (A.R.S. §43-1022.16), interest on US obligations (A.R.S. §43-1022.6), which cannot be taxed by states per federal law, and Agricultural crops contributed to Arizona charitable organizations (A.R.S. §43-1022.14). In addition, there were a myriad of "other subtractions" including, but not limited to:

- *A beneficiary's share of trust or estate income recognized pursuant to the internal revenue code (A.R.S. §43-1022.3).*
- *The amount of any distributions from an individual retirement account as provided for in §408 of the internal revenue code or from a qualified retirement plan of a self-employed individual (A.R.S. §43-1022.4).*
- *The amount of income on an installment receivable which is recognizable pursuant to the internal revenue code and which has already been recognized on the death of the taxpayer for purposes of this title for tax years ending before 1/90 (A.R.S. §43-1022.5).*
- *The amount of any income tax refunds which were received from states other than Arizona and which were included as income (A.R.S. §43-1022.7).*
- *Annuity income included in income pursuant to §72 of the internal revenue code if the first payment with respect to such annuity was received prior to 12/31/78 (A.R.S. §43-1022.8).*
- *The excess of a partner's share of income required to be included under §702(a)(8) of the internal revenue code over the income required to be included under Chapter 14, article 2 of title 43 (A.R.S. §43-1022.9).*
- *The excess of a partner's share of partnership losses determined pursuant to chapter 14, article 2 of title 43 over the losses allowable under §702(a)(8) of the internal revenue code (A.R.S. §43-1022.10).*
- *The amount by which the adjusted basis of all property which is held for the production of income and which is sold or otherwise disposed of during the taxable year other than depreciable property used in a trade or business, computed pursuant to title 43 and the income tax act of 1954, as amended, exceeds the adjusted basis of such property computed pursuant to the internal revenue code (A.R.S. §43-1022.11).*
- *The amount of exploration expenses determined pursuant to §617 of the internal revenue code which have been deferred in a taxable year ending before 1/90 and for which a subtraction has not been previously made (A.R.S. §43-1022.17).*
- *To the extent not already excluded from Arizona gross income under §112 of the internal revenue code, compensation received for active service as a member of the armed forces of the U.S. for any month during any part of which the member served in a combat zone (A.R.S. §43-1022.19).*

<u>TYPE OF ARIZONA SUBTRACTION</u>	1996 (Millions)
Interest on US Obligations	\$16.34
Exclusion for Federal, Arizona State or Local Pensions	8.28
Exempt Arizona State Lottery Winnings	0.25
Social Security or Railroad Retirement Benefits included on federal Form 1040	31.80
Agricultural Crop Contributions	0.37
Income Tax Refund from Other States	0.44
Other Subtractions	<u>6.41</u>
<b>TOTAL VALUE OF ARIZONA SUBTRACTIONS</b>	<b>\$64.78</b>

## DEDUCTIONS

All taxpayers in Arizona could deduct the part of their income used to pay for certain expenses, such as taxes or medical bills, in 1996 by either listing (itemizing) the deductions or taking the standard deduction. Arizona allowed the same itemized deductions as the federal government, with three exceptions. Medical deductions are more generous in Arizona than at the federal level, gambling losses are adjusted to take the lottery subtraction into consideration, and a property tax adjustment is made to offset a property tax credit claimed. These adjustments are explained more fully below.

### Standard Deduction

In 1996, the *standard deduction* was \$3,600 for single and married filing separate filers and \$7,200 for married filing joint and unmarried head of household filers (A.R.S. §43-1041). The higher standard deduction amount allowed for unmarried head of household filers is a preferential deduction amount, double the amount normally allowed one person (A.R.S. §43-1041A2).

### Itemized Deductions (Schedule A):

The provisions allowed on the Schedule A are mentioned in statute at A.R.S. §43-1042 and described below. When calculating the impact of disallowing portions of the Schedule A and the entire Schedule A, the standard deduction replaced the Schedule A total if the Schedule A total dropped below the amount allowed for the standard deduction. In other words, if the Schedule A total dropped below \$3,600 or \$7,200 (the standard deduction amounts based on filing status as described in the previous paragraph) the standard deduction amount was used.

### Medical Deduction

The *medical deduction* on the federal Schedule A equaled any medical expenses greater than 7.5% of the taxpayer's Federal Adjusted Gross Income. This deduction was adjusted on the Arizona return to allow medical expenses incurred during the tax year. The value of the 1996 medical deductions was \$43.1 million.

### Taxes Paid Deduction

*Deductions allowed for taxes* included state and local income taxes, real estate taxes and other taxes, including personal property taxes.

<u>TYPE OF TAX DEDUCTION</u>	1996 (Millions)
State and Local Income Taxes	\$65.14
Real Estate Taxes	24.89
Other Taxes	<u>8.03</u>
VALUE OF TAXES PAID DEDUCTION	\$94.86

### Interest Expense Deduction

The *interest expense deduction* is the largest of all the itemized deductions. Deductible interest includes home

mortgage interest, points paid on the purchase of a home and some investment interest.

<u>TYPE OF INTEREST EXPENSE DEDUCTION</u>	1996 (Millions)
Home Mortgage Interest and points	\$123.02
Deductible Points	0.85
Deductible Investment Interest	<u>9.85</u>
VALUE OF INTEREST EXPENSE DEDUCTION	\$133.43

### Charitable Contribution Deduction

*Deductions were allowed for contributions made to religious, charitable, educational, scientific or*

*literary organizations.* The contributions could be cash, property or out-of-pocket expenses incurred while doing volunteer work.

<u>TYPE OF CHARITABLE CONTRIBUTION DEDUCTION</u>	1996 (Millions)
Cash Contribution	\$32.36
Contributions Other Than Cash	9.49
Carryover from Prior Year	<u>2.27</u>
VALUE OF CHARITABLE CONTRIBUTION DEDUCTION	\$44.12

### Casualty and Theft Losses

*Losses on non-business property arising from theft, vandalism, fire, storm, and car, boat and other accidents or similar causes* are deductible. Money kept in a financial institution that was lost because of insolvency or bankruptcy of the institution was also deductible in some cases. However, only those losses that exceeded 10% of Federal Adjusted Gross Income were deductible. The value of this type of deduction was \$0.08 million.

This deduction includes *unreimbursed job expenses, tax return preparation fees, safe deposit box rental, certain legal and accounting fees, etc.*, which exceed 2% of Federal Adjusted Gross Income. The value of this deduction in 1996 was \$16.86 million.

### Job Expenses and Most Other Miscellaneous Deductions

#### Other Miscellaneous Deductions

These fully deductible miscellaneous deductions include *gambling losses to the extent of gambling winnings, federal estate tax on income in respect of a decedent, amortizable bond premiums on bonds acquired before 10/23/86, etc.*

Any gambling losses taken on the federal Schedule A were adjusted for Arizona to offset the subtraction for Arizona lottery winnings. Without this adjustment, a double deduction could have been allowed for gambling losses associated with the Arizona lottery. An adjustment

is also made to the Arizona itemized deductions for the amount of property taxes included on the federal Schedule A for those qualified defense contractors who claimed a credit. This deduction category was worth \$4.30 million in 1996.

<u>TYPE OF DEDUCTION</u>	1996 (Millions)
<b>Standard Deduction</b>	<b>\$127.25</b>
<b>Preferential Standard Deduction for Unmarried Head of Household filers</b>	<b>\$9.53</b>
<b>Itemized Deductions:</b>	
Medical & Dental Expenses	\$43.11
Taxes Paid	94.86
Interest Expense	133.43
Charitable Contributions	44.12
Casualty or Theft Losses	0.08
Job Expenses & Most Other Miscellaneous Deductions	16.86
Other Miscellaneous Deductions	4.30
<b>Value of All Itemized Deductions</b>	<b>\$228.94</b>
<b>VALUE OF STANDARD &amp; ITEMIZED DEDUCTIONS</b>	<b>\$500.25</b>

## PREFERENTIAL TAX RATES

Individual income tax for single and married filing separate filers is calculated

according to a graduated tax rate schedule as presented below (double this for married filing joint and unmarried head of household filers):

<u>at least</u>	<u>but less than</u>	
\$0	\$10,000	3.0% of the amount
10,000	25,000	\$300, plus 3.5% of the excess over \$10,000
25,000	50,000	\$825, plus 4.2% of the excess over \$25,000
50,000	150,000	\$1,875, plus 5.2% of the excess over \$50,000
150,000	and over	\$7,075, plus 5.6% of the excess over \$150,000

Lower taxable incomes are taxed at a lower level, or, in other words, are treated preferentially. If all taxpayers were treated identically, the same tax rate would be applied regardless of the level of taxable income. A question arises, however, as to what tax rate should be applied to determine the revenue impact of treating all taxpayers identically. *One argument may be that since the highest*

*tax rate is 5.6%, determining the impact of taxing all income at 5.6% would be appropriate.* Using this reasoning, an additional \$715.57 million would have been collected from individual income tax if a flat 5.6% tax rate had been used.

However, no taxpayer is currently taxed solely at 5.6%; only that income greater than \$150,000 is taxed at this rate. *If a*

flat tax rate were applied to individual income, the logical tax rate applied would be the effective tax rate of all individual income taxpayers. Dividing total tax liability on individual income tax returns by the total Arizona taxable income for individual income returns results in an effective tax rate of 3.79%. Applying this tax rate to all taxpayers will

result in the same individual income tax collections as with the graduated tax rate structure, but the burden of the tax will change. As can be seen from the table below, taxpayers with lower Federal Adjusted Gross Incomes will pay more tax and taxpayers with higher Federal Adjusted Gross Incomes will pay less tax.

<u>Federal Adjusted Gross Income</u>	<u>Original Tax Collections</u>	<u>New Tax Collections</u>	<u>Difference</u>
Negative	\$60,861	\$63,267	\$2,406
\$0-\$10,000	\$3,350,220	\$4,793,453	\$1,443,233
\$10,000-\$20,000	\$45,963,663	\$58,284,492	\$12,320,829
\$20,000-\$30,000	\$98,298,133	\$119,130,192	\$20,832,059
\$30,000-\$50,000	\$227,995,104	\$268,539,502	\$40,544,398
\$50,000-\$75,000	\$270,583,004	\$307,339,143	\$36,756,139
\$75,000-\$100,000	\$162,446,318	\$174,895,057	\$12,448,739
\$100,000-\$500,000	\$409,268,330	\$366,789,830	(\$42,478,500)
\$500,000+	\$279,181,011	\$195,564,195	(\$83,616,816)
<b>Total</b>	<b>\$1,497,146,644</b>	<b>\$1,495,399,131</b>	<b>(\$1,747,513)</b>

## CREDITS

A tax credit differs from an exemption, subtraction or deduction, in that it directly reduces tax liability, not taxable income. A \$100 deduction, for example, would reduce tax liability by, at most, \$5.60 (\$100 times the maximum tax rate of 5.6%). On the other hand a \$100 credit reduces tax liability by the full \$100.

### Family Tax Credit

Effective tax year 1995, single and married filing separately filers with a Federal Adjusted Gross Income (FAGI) of \$10,000 or less, and married filing jointly and head of household filers with an FAGI of \$20,000 or less, may claim the family tax credit (A.R.S. §43-1073). The amount of the credit is set at \$30 per person in the household, and is capped at \$120 for married filing jointly and head

of household filers, and \$60 for single and married filing separately filers.

### Property Tax Credit

In 1977, the Legislature instituted the property tax credit program in order to provide *tax relief to the state's low-income elderly*. Under this program, full-year residents age 65 or older with a household income of less than \$5,500 are eligible for credits ranging from \$56 to \$502 (A.R.S. §43-1072). The property tax credit is refundable, meaning that those eligible for the credit receive money even if they had no income tax liability.

### Other Credits

Other credits are filed on a separate Schedule CR. In many instances, the credit claimed exceeds the tax liability on the return. Since these credits are non-refundable, the unused portion of the

credit is superfluous. For this reason, in order to generate the true expenditure associated with credits, each credit claim must be reviewed.

### **Credit for Taxes Paid to Other States or Countries**

In the past, the majority of the credits claimed on the Schedule CR, in terms of dollars and volume, were for *taxes paid to other states or countries* (A.R.S. §43-1071).

### **Defense Contracting Credit**

Defense contracting credits are provided to *qualified defense contractors for net increases in full-time employment positions under the United States Department of Defense contracts and for net increases in private commercial full-time employment within Arizona by a qualified defense contractor* (A.R.S. §43-1077). An income tax credit is also *allowed equal to a portion of the amount paid as property taxes during the taxable year by a qualified defense contractor on property that is classified as Class 3* (A.R.S. §43-1078).

### **Enterprise Zone Credits**

Enterprise zone credits are income tax *credits provided for businesses located in an enterprise zone established under Arizona law who have a net increase in employment of qualified employees* (A.R.S. §43-1074). A maximum of \$1,000 per each net new employee can be claimed in the first or partial year of employment. In the second year of continuous employment, a maximum of \$1,500 per net new employee can be claimed. The limit in the third year of continuous employment is \$2,500 per net new employee.

### **Environmental Technology Credit**

An income tax credit is provided for *expenses incurred in constructing a qualified environmental technology manufacturing, producing or processing facility* (A.R.S. §43-1080). The amount of the credit is equal to 10% of the amount spent during the taxable year to construct the facility.

### **Military Reuse Zone Credit**

The military reuse zone credit is a tax credit for *net increases in employment by the taxpayer of full-time employees working in a military reuse zone who are primarily engaged in manufacturing, assembling or fabricating aviation or aerospace products* (A.R.S. §43-1079). The amount of the credit is determined by a dollar amount allowed for net new employee positions other than dislocated military base employees and by a dollar amount allowed for net new dislocated military base employee positions.

### **Recycling Equipment Credit**

The recycling equipment credit is an income tax credit *for businesses or individuals who acquire and place in service recycling equipment in the state* (A.R.S. §43-1076). This credit is equal to 10% of the installed cost of the recycling equipment but not to exceed the lesser of 25% of the tax liability for that tax year or \$5,000.

### **Summer School and Jobs Credit**

Establishes a credit for income taxes *for hiring high school students for summer jobs if the student also attends summer school* (First Regular Session 1995, Chapter 236). This provision is only effective for the summer of 1996. The credit is equal to one half of the wages paid to the student.

### **Agricultural Water Conservation System Credit**

A credit is allowed against income taxes imposed *for expenses that the taxpayer incurred to purchase and install an agricultural water conservation system in the state* (A.R.S. §43-1084). The amount of this credit is equal to 75% of the qualifying expenses incurred during the taxable year.

### **Alternative Fuel Vehicles and Equipment Credit**

An income tax credit is provided for *one or more new alternative fuel vehicles purchased for use in this state, for expenses incurred for converting one or more conventional vehicles to operate on alternative fuel, or purchase of an alternative fuel delivery system* (A.R.S. §43-1086). This credit is equal to \$1,000 per purchase or conversion.

### **Underground Storage Tanks Credit**

A credit is allowed against income taxes imposed *for expenses incurred for corrective actions taken with respect to the release of a regulated substance from an underground storage tank* (A.R.S. §43-1085). The amount of this credit is

equal to 10% of the total amount spent to take the required corrective action.

### **Solar Energy Devices Credit**

A credit is allowed against income taxes imposed *for installing a solar energy device* (A.R.S. §43-1083). This credit is equal to 25% of the cost of the device but may not exceed \$1,000.

### **Pollution Control Equipment Credit**

An income tax credit is provided *for expenses incurred to purchase real or personal property used in a trade or business to control or prevent pollution* (A.R.S. §43-1081). The amount of this credit is equal to 10% of the purchase price.

### **Construction Materials Credit**

An income tax credit is provided for *new construction materials incorporated into a qualifying facility located entirely within this state, construction of which is begun on or after January 1, 1994 and completed on or before December 31, 1999* (A.R.S. §43-1082). The credit is equal to 5% of the purchase price of the materials and is claimed in the taxable year in which the facility receives a certificate of occupancy.

<u>TYPE OF CREDIT</u>	1996 <u>(Millions)</u>
Family Tax Credit	\$6.63
Property Tax Credit	5.83
Other Tax Credits:	
Credit for Taxes Paid to Other States	40.57
Defense Contracting Credit	0
Enterprise Zone Credit	0.30
Environmental Technology Credit	0
Military Reuse Zone Credit	?? <sup>14</sup>
Recycling Equipment Credit	??

<sup>14</sup> These question marks ("??") indicate that release of this information would result in violation of Arizona confidentiality laws. Fewer than six taxpayers claimed this credit.

Summer School and Jobs Credit

??

<u>TYPE OF CREDIT</u>	1996 <u>(Millions)</u>
Agricultural Water Conservation System Credit	\$0.71
Alternative Fuel Vehicles and Equipment Credit	0.02
Underground Storage Tanks Credit	0
Solar Energy Devices Credit	0.52
Pollution Control Equipment Credit	?? <sup>15</sup>
Construction Materials Credit	??
Total Other Credits	<u>42.13</u> <sup>16</sup>
VALUE OF CREDITS	\$54.59

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<sup>15</sup> These question marks ("??") indicate that release of this information would result in violation of Arizona confidentiality laws. Fewer than six taxpayers claimed this credit

<sup>16</sup> Total Other Credits includes those credits claimed that cannot be released due to confidentiality laws.

## INDIVIDUAL INCOME TAX EXPENDITURES

1996

### FEDERAL SUBTRACTIONS FROM INCOME:

Individual Retirement Account for qualifying individuals .....	\$4,571,000
One-half of Self-Employment tax .....	5,212,000
Self-Employed Health Insurance Deduction .....	1,144,000
Keogh Retirement Plan and Self-Employed SEP Deduction.....	6,414,000
Penalty on Early Withdrawal of Savings .....	66,000
Alimony Paid .....	<u>2,741,000</u>
<b>Total Value of Federal Subtractions from Income .....</b>	<b>\$20,572,000</b>

### EXEMPTIONS:

Personal Exemptions.....	\$147,442,000
Preferential Personal Exemption for Unmarried Head of Household.....	7,489,000
Age 65 or Over Exemptions.....	19,135,000
Dependent Exemptions .....	68,665,000
Blind Exemptions.....	<u>301,000</u>
<b>Total Value of Exemptions.....</b>	<b>\$248,631,000</b>

### SUBTRACTIONS FROM INCOME:

Interest on US Obligations.....	\$16,337,000
Exclusion for Federal, Arizona State or Local Pensions.....	8,282,000
Exempt Arizona State Lottery Winnings.....	252,000
Social Security or Railroad Retirement Benefits included on federal Form 1040.....	31,800,000
Agricultural Crops.....	370,000
Income Tax Refund from Other States .....	438,000
Other Subtractions.....	<u>6,412,000</u>
<b>Total Value of Subtractions .....</b>	<b>\$64,781,000</b>

### DEDUCTIONS:

Standard Deduction.....	\$127,254,000
Preferential Standard Deduction for Unmarried Head of Household .....	9,534,000
Itemized Deductions:	
Medical & Dental Expenses.....	43,105,000
Taxes Paid:	
State and Local Income Taxes.....	65,138,000
Real Estate Taxes.....	24,891,000
Other Taxes.....	<u>8,029,000</u>
Total Value of Taxes Paid Deduction.....	\$94,857,000
Interest Expense:	
Home Mortgage Interest .....	123,024,000
Deductible Points.....	848,000
Deductible Investment Interest .....	<u>9,850,000</u>

1996

Total Value of Interest Expense .....	\$133,432,000
Charitable Contributions:	
Cash Contribution.....	32,358,000
Contributions Other Than Cash.....	9,493,000
Carryover From Prior Year .....	2,267,000
Total Value of Charitable Contributions .....	\$44,123,000
Casualty & Theft Losses .....	83,000
Job Expenses and Most Other Miscellaneous Deductions.....	16,855,000
Other Miscellaneous Deductions .....	4,296,000
Total Value of Itemized Deductions .....	\$228,936,000
<b>Total Value of Deductions.....</b>	<b>\$500,249,000</b>
<b>PREFERENTIAL TAX RATES.....</b>	<b>\$0 - \$715,568,000</b>

**CREDITS:**

Family Tax Credit .....	\$6,626,000
Property Tax Credit.....	5,830,000
Other Credits:	
Credit for Taxes Paid to Other States or Countries .....	\$40,571,000
Defense Contracting Credit.....	0
Enterprise Zone Credit .....	303,000
Environmental Technology Credit .....	0
Military Reuse Zone Credit.....	?? <sup>17</sup>
Recycling Equipment Credit .....	??
Summer School and Jobs Credit .....	??
Agricultural Water Conservation System Credit .....	708,000
Alternative Fuel Vehicles and Equipment Credit .....	24,000
Underground Storage Tanks Credit.....	0
Solar Energy Devices Credit .....	520,000
Pollution Control Equipment Credit .....	??
Construction Materials Credit .....	??
Total Other Credits.....	\$42,134,000 <sup>18</sup>
<b>Value of Credits.....</b>	<b>\$54,590,000</b>

**VALUE OF INDIVIDUAL INCOME TAX EXPENDITURES<sup>19</sup>**

..... **\$949,152,000 - \$1,664,720,000**

<sup>17</sup> These question marks ("??") indicate that release of this information would result in violation of Arizona confidentiality laws. Fewer than six taxpayers claimed this credit.

<sup>18</sup> Total Other Credits includes those credits claimed that cannot be released due to confidentiality laws.

<sup>19</sup> These expenditures represent foregone revenues to the state general fund and to the urban revenue sharing fund, which is distributed to incorporated cities and towns.



# **INSURANCE PREMIUM TAX EXPENDITURES**



# INSURANCE PREMIUM TAX EXPENDITURES<sup>20</sup>

Each insurer in the state is required to file a report with the Arizona Department of Insurance annually, showing total direct premium income (A.R.S. §20-224). Total direct premium income does not include "*applicable cancellations, returned premiums, the amount of reduction in or refund of premiums allowed to industrial life policyholders for payment of premiums direct to an office of the insurer, all policy dividends, refunds, savings coupons and other similar returns paid or credited to policyholders within this state and not reapplied as premiums for new, additional or extended insurance.*" Direct premium income also excludes "*considerations received on annuity contracts,*" as well as the "*unabsorbed portion of any premium deposit.*" No information is available on the value of these exclusions from direct premium income, because this information is not required to be reported to the Department of Insurance. However, there is data available for "*considerations received on annuity contracts.*" Insurance companies have reported \$746.3 million in these considerations which, if taxed at a two percent rate, would have resulted in \$14.9 million in revenues to the state.

Insurers which are assessed by the Life and Disability Insurance Guaranty Fund or the Property and Casualty Insurance Guaranty Fund are permitted to offset their premium tax liabilities "*in the*

*amount of 20% of the assessment for the year of assessment and 20% of the assessment in each of the succeeding four years*" [A.R.S. §20-674(B) and §20-692(B)]. Insurers were able to offset their calendar year 1997 insurance tax liabilities by an aggregate of \$27.5 million. This had a dual effect on General Fund revenues. First, General Fund revenues accompanying tax returns were reduced by \$27.5 million. Second, insurance premium tax installment payments in the subsequent calendar year are reduced. Insurers "*which paid or [were] required to pay a tax of \$2,000 or more on net premiums received during the preceding calendar year must file [installment payments and reports] on or before the 15th day of each month from March through August.*" Installment payments are "*equal to 15% of the [premium taxes] paid or required to be paid during the preceding calendar year.*" Because four installment payments based on 1997 tax liability are required in Fiscal Year 1998 (from March through June 1998), and two installment payments based on 1996 tax liability were required in Fiscal Year 1998 (July and August 1997), the effects of the Guaranty Fund Credits on Fiscal Year 1998 installment tax payments are \$24.8 million, as follows:

$$(4 * 0.15 * \$27.5 \text{ million}) + (2 * 0.15 * \$27.6 \text{ million}) = \$24.8 \text{ million}$$

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<sup>20</sup>Any figures presented for Insurance Premium Tax Expenditures were provided by the Department of Insurance.

The benefit from increased installment tax revenue would be realized only once. Increasing installment tax revenues directly decreases the amount of tax paid with tax returns (or directly increases the amount refunded to insurers for overpayments of tax). Thus, the benefit of eliminating the tax credit would essentially have been limited to the amount by which credits would have been decreased, or \$27.5 million in Fiscal Year 1998. The effect of eliminating tax credits would be mitigated by retaliatory tax, described later.

Surplus line brokers are not required to collect and remit insurance premium tax on "*...reinsurance, ocean marine and foreign trade insurance, insurance on subjects located, resident or to be performed wholly outside this state, insurance on vehicles or aircraft owned and principally garaged outside this state, or insurance on property or operations of railroads engaged in interstate commerce*" [A.R.S. §20-420(A)]. No information is available on the value of these exemptions.

Insurers are required to pay a 2.2% tax on fire insurance premiums "*...except that the tax on fire insurance premiums on property located in [qualified locations including] incorporated cities or towns which procure the services of private fire companies...*" is 0.66% [A.R.S. §20-224(B)]. Eighty-five percent of fire insurance premium taxes are deposited into the Insurance Premium Tax Clearing Account Fund for apportionment to fire districts and municipalities for the retirement plans of firefighters [A.R.S. §§20-224(C), 9-951, 9-952, 9-972]. The remaining 15% of fire insurance premium taxes are deposited into the General Fund (A.R.S. §20-227). In calendar year 1997,

insurers wrote \$14.0 million of taxable fire insurance premium for risks in *qualified* locations resulting in \$92,400 in insurance premium tax paid for those risks. If risks in qualified locations were subject to the 2.2% tax, insurers would have paid \$308,000 in Fiscal Year 1998, a difference of \$215,600. The portion of the difference allocable to the General Fund (15%) would have been \$32,300. The effect of the tax rate difference may be mitigated by retaliatory tax, described later.

Hospital, medical, dental and optometric service corporations are considered to be nonprofit institutions, thus, they are exempt from insurance premium taxes "*...except on premiums received to effect or maintain its subscription contracts other than coverage concerning which the corporation's relationship is as administrative or fiscal agent for national, state or municipal government or any political subdivision body thereof...*", or any premiums charged thereto (A.R.S. §20-837). The total of exempted net premiums in calendar year 1997 was \$201.5 million. If the State were able to apply the 2% tax rate which would apply without the exemption, the State would have collected \$4.0 million in Fiscal Year 1998.

Life and health insurance premiums paid by the Federal Employee Health Benefits (FEHB) Fund are exempt from taxation by the states [5 U.S.C. §§ 8714 & 8909(f)]. In calendar year 1997, FEHB premiums collected for life and health coverage procured by the FEHB Fund to provide life and health coverage for Federal employees in Arizona totaled \$211.2 million. If Arizona were able to tax those premiums at a 2% rate, the state

would have collected \$4.2 million in Fiscal Year 1998.

*"Payments received by health care services organizations from the United States secretary of health and human services pursuant to a contract issued pursuant to 40 United States Code §1395mm(g) are not taxable."* [A.R.S. §20-1060(C)]. No information is available on this exemption.

Premiums written by the Federal Crop Insurance Corporation (FCIC) to *"...insure, or provide reinsurance for insurers of, producers of agricultural commodities grown in the United States..."* (7 U.S.C. §1508), are exempt from state insurance premium taxation (7 U.S.C. §1511). In calendar year 1997, insurers collected \$5.1 million in insurance premiums written to the FCIC which, if taxable, would have resulted in an additional \$102,000 being collected by the state in Fiscal Year 1998.

In 1993, the Legislature enacted Laws 1993, Chapter 231 (A.R.S. §§ 20-2301 et seq.) to ensure the availability of small group health insurance in Arizona. Part of this legislation [A.R.S. § 20-2304(E)] reduces the premium tax rate applied to small group health insurance policies written by accountable health plans.

*... [B]eginning July 1, 1996, accountable health plans shall pay a premium tax of one per cent of the net premiums received for health benefits plans issued to small employers. Beginning July 1, 1997, accountable health plans are exempt from the premium taxes that are required by § 20-224, subsection B, § 20-837, 20-1010 and 20-1060, for the net premiums received for health benefits plans issued to small employers...*

Between January 1 and June 30, 1997, aggregate net premiums received for health benefits plans issued to small employers was \$130.6 million. Had the tax rate on these premiums remained at two percent (instead of decreasing to one percent), an additional \$1.3 million would have been deposited to the General Fund in Fiscal Year 1998. Between July 1 and December 31, 1997, aggregate net premiums received for health benefit plans issued to small employers was \$144.9 million. Had the tax rate on these premiums remained at 2% (instead of becoming exempt from taxation), an additional \$2.9 million would have been deposited to the General Fund in Fiscal Year 1998.

A.R.S. §20-230 allows the Department of Insurance to charge foreign and alien insurers the same taxes, fees, fines, penalties, licenses, deposits and other obligations that the laws of their state or country will impose upon Arizona insurers doing business in their state or country. This *retaliatory tax*, as it is commonly known, guarantees that insurers headquartered in state "X," pay the same rates of taxes and fees in Arizona as Arizona-based insurers pay in state "X." Therefore, while domestic insurers may pay the tax rates mentioned above, foreign or alien insurers will pay the tax rates above plus the retaliatory tax if the combination of taxes and fees paid in the home state would be greater than the taxes and fees levied by Arizona. This is common practice among most states. Because the amount of retaliatory tax paid by foreign and alien insurers relies on the tax rates, fees and assessments charged by the insurers' states of domicile, it is impossible to calculate the exact effect Arizona would realize if the

above-described qualification and exemption of insurance premium taxes were not in place. Therefore, the estimates provided do not include

consideration for the possible effect of retaliation.

## SUMMARY OF INSURANCE PREMIUM TAX EXPENDITURES

	<u>Revenue Gain</u>
<b>SUBTRACTIONS FROM TOTAL PREMIUM INCOME:</b>	
Applicable cancellations .....	NIA *
Returned premiums.....	NIA
Reduction or refund for direct payment of industrial life insurance.....	NIA
Policy dividends.....	NIA
Refunds .....	NIA
Savings coupons.....	NIA
Other similar returns paid or credited to policyholders not reapplied as premiums .....	NIA
Considerations received on annuity contracts.....	\$14,926,000
Unabsorbed portion of any premium deposit .....	NIA
<b>TOTAL SUBTRACTIONS FROM PREMIUM INCOME .....</b>	<b>\$14,926,000</b>
 <b>INSURANCE GUARANTY FUND CREDITS.....</b>	 <b>\$27,534,000</b>
 <b>EXEMPTIONS FOR SURPLUS LINE INSURANCE:</b>	
Reinsurance.....	NIA
Ocean marine and foreign trade insurance.....	NIA
Insurance on subjects located, resident or to be wholly performed outside the state.....	NIA
Insurance on vehicles or aircraft owned and principally garaged outside the state.....	NIA
Insurance on property or operations of railroads engaged in interstate commerce .....	NIA
<b>TOTAL EXEMPTIONS FOR SURPLUS LINE INSURANCE.....</b>	<b>NIA</b>
 <b>PREFERENTIAL RATE ON QUALIFIED FIRE INSURANCE .....</b>	 <b>\$216,000</b>
 <b>GOVERNMENT PROGRAM EXEMPTIONS:</b>	
Hospital, medical, dental and optometric service corporation premiums paid by federal, state and municipal governments.....	\$4,030,000
Health care services organization premiums received from the U.S. Secretary of Health and Human Services.....	NIA
Life and health insurance premiums paid by FEHB Fund .....	4,224,000
Premiums written by the FCIC.....	103,000
Accountable Health Plan Group Health Insurance to Small Employers.....	4,203,000
<b>TOTAL GOVERNMENT PROGRAM EXEMPTIONS.....</b>	<b>\$12,560,000</b>

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\* NIA No information available.

**TOTAL QUANTIFIABLE INSURANCE PREMIUM TAX  
EXPENDITURES<sup>21</sup>**

..... **\$55,236,000**

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<sup>21</sup>These expenditures represent foregone revenues to the state general fund.



# **JET FUEL EXCISE AND USE TAX EXPENDITURES**



# JET FUEL EXCISE AND USE TAX EXPENDITURES

Arizona imposes a tax of 3.05¢ per gallon on the first ten million gallons of jet fuel sold. Jet fuel is defined as being expressly manufactured and blended for operating jet or turbine powered aircraft. The jet fuel use tax rate is also 3.05¢ per gallon and is levied on the first ten million gallons of jet fuel stored, used or consumed. The use tax applies to purchasers who originally purchased jet fuel for resale but instead used or consumed the jet fuel and on which excise tax has not been paid. The excise tax does not apply to the sale or use of jet fuel that has already been taxed by another state unless the tax imposed by another state is less than Arizona's tax rate. The difference between Arizona's rate and the rate of the other state is what will be levied and collected.

## PREFERENTIAL JET FUEL TAX RATES

Amounts of jet fuel sold over ten million gallons are not subject to the excise or

use tax. Fiscal Year 1993/94 was the last year that amounts over ten million gallons were taxed. In that year, 179,413,000 gallons were taxed at the over ten million gallon tax rate of 1.05¢ per gallon. Using the same growth rate that has been experienced with jet fuel of less than ten million gallons, an additional \$7.9 million would have been collected in Fiscal Year 1997/98 if sales of jet fuel over ten million gallons were taxed at 3.05¢ per gallon.

## JET FUEL TAX EXEMPTIONS

Jet fuel sold to *commercial airlines and used on flights that originate in Arizona and whose first outbound destination is outside of the United States* is exempt from the jet fuel excise tax (A.R.S. §42-1574). Information is not available on this tax exemption.

**SUMMARY OF JET FUEL EXCISE AND USE TAX EXPENDITURES**

	<u>Revenue Gain</u>
<b>PREFERENTIAL TAX RATES:</b>	
Jet fuel over 10 million gallons.....	<b>\$7,900,000</b>
<b>EXEMPTIONS:</b>	
International flights which originated within the state.....	NIA *
<b>TOTAL QUANTIFIABLE JET FUEL EXCISE AND USE TAX EXPENDITURES<sup>22</sup></b>	
.....	<b>\$7,900,000</b>

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\* No Information Available.

<sup>22</sup>These expenditures represent foregone revenues to the state general fund, counties and incorporated cities and towns.

# **LUXURY TAX EXPENDITURES**



# LUXURY TAX EXPENDITURES

Luxury tax collected by the Arizona Department of Revenue totaled \$210,899,000 for Fiscal Year 1997/98. The potential for additional luxury tax collections would have been \$373,892,000 with the elimination of exemptions currently allowed, and with the adoption of a standard liquor tax rate. Repeal of exemptions currently in place would have resulted in an additional \$8.1 million. The remaining \$365.8 million would be the result of standardizing the liquor tax rate to \$3.00 per gallon in exchange for the current rates.

## ITEM TAXED AT A PREFERENTIAL RATE

Current Arizona law (A.R.S. §42-1204A) provides for liquor to be *taxed at three different rates*: spirituous liquor at \$3.00 per gallon; malt liquor or cider at \$0.16 per gallon; and, vinous liquor with an alcohol content of less than or equal to 24% by volume at \$0.84 per gallon<sup>23</sup>. By applying the standard \$3.00 per gallon rate across all liquor types, the resulting revenues would have been:

	<u>FY 97/98</u>
<u>Vinous</u>	
At \$3/gallon	\$28,190,000
Actual	<u>\$7,893,000</u>
Difference	\$20,297,000
<u>Malt</u>	
At \$3/gallon	\$364,938,000
Actual	<u>\$19,463,000</u>
Difference	\$345,475,00
<b>Total</b>	<b>\$365,772,000</b>

<sup>23</sup>Vinous tax is also assessed on vinous liquor with an alcohol content of greater than 24%; however the department has received no tax collections for this liquor type.

This analysis ignores any decrease in demand due to increased prices, a probable result of raising all liquor taxes to \$3.00 per gallon.

An alternative to equalizing liquor prices but not raising all liquor taxes to the highest rate would be to determine the effective tax rate for all liquor and use this rate for taxation. This is accomplished by determining gallons sold for each type of liquor and dividing the total tax collections by this figure. The result is the effective tax rate, \$0.34 per gallon. Applying this tax rate to all types of liquor will result in the same amount of tax collections; however, there will be a tax burden shift. Spirituous and vinous liquor are taxed at a lower rate under this scenario, and malt liquor is taxed at a higher rate. Therefore, the proportion of total taxes paid by each type of liquor shifts away from spirituous and vinous and towards malt.

Type	Original Tax Collections	New Tax Collections	Difference
Spirituous	\$18,788,000	\$2,104,800	(\$16,683,200)
Vinous	\$7,893,000	\$3,157,900	(\$4,735,100)
Malt	\$19,463,400	\$40,881,700	\$21,418,300
<b>Total</b>	<b>\$46,144,400</b>	<b>\$46,144,400</b>	<b>\$0</b>

## EXEMPTIONS FOR TOBACCO PRODUCTS

Several exemptions from luxury tax on tobacco products are allowed. *Tobacco powder or tobacco products used exclusively for agricultural or horticultural purposes and unfit for human consumption* are exempt from taxation (A.R.S. §42-1204A). Since this

figure is exempt from taxation, the Arizona Department of Revenue does not require this figure to be reported. Therefore, no tax value of this tax expenditure is available.

A.R.S. §42-1207C allows *discounts on cigarette stamps*. The luxury tax on cigarettes is in the form of a stamp affixed to the cigarette package which is obtained from the Department of Revenue at the following rates:

1. 96% of face value of stamp for first \$36,000 worth of stamps.
2. 97% of face value of stamp for second \$36,000 worth of stamps.
3. 98% of face value of stamp for additional stamps up to \$165,000 in any month by a distributor. In addition, if the distributor purchases more than \$165,000 worth of stamps, then the effective rate for all stamps purchased, including the first \$72,000, will be 98% of face value.

If all stamps were purchased at face value, revenue would have increased by \$3,488,000 in Fiscal Year 1997/98.

*A distributor may return unused tobacco product stamps for a refund* (A.R.S. §42-1210A). Luxury tax is *refunded if the cigarettes become unfit for sale due to breakage or spoilage* (A.R.S. §42-1210B). Most often, staleness is the reason for refund. If the state considered this to be a hazard of doing business and disallowed such refunds, an additional \$4,569,000 in Fiscal Year 1997/98 in luxury revenues would have resulted.

If proof is provided that *cigarettes for which the stamps were purchased were*

*exported from the state*, luxury tax may be refunded (A.R.S. §42-1210B). No information is available on the value of this exemption.

## EXEMPTIONS FOR LIQUOR

Several exemptions for liquor are identified in statute. *Liquids containing less than 1/2% alcohol by volume* are exempt from luxury tax (A.R.S. §42-1201A). Since no tax is due on these items, reporting to the Department of Revenue is not required, resulting in no available information on potential luxury tax collections.

In accordance with A.R.S. §42-1201B., taxable liquors *shall not include those which contain medicines unsuitable for beverage purposes*. No information is available on liquor in medicine which is unsuitable for beverage purposes.

Luxury tax is refunded if (1) proof is provided that *the liquor for which the stamps were purchased was exported from the state* and (2) if *the liquor becomes unfit for sale due to breakage or spoilage* (A.R.S. §42-1210B). No information is available on liquor for which stamps were purchased and were then exported from the state. Liquor unfit for sale due to breakage or spoilage includes beer or wine which has exceeded its shelf life of three to six months and containers damaged in such a way that the product's quality is uncertain. Documents reporting destruction under this provision indicated \$63,000 in tax revenue lost in Fiscal Year 1997/98.

<b>SUMMARY OF LUXURY TAX EXPENDITURES</b>
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	<u>Revenue Gain</u>
<b>PREFERENTIAL TAX RATES ON LIQUOR:</b> .....	<b>\$365,772,000</b>
 <b>TOBACCO PRODUCT EXEMPTIONS AND REFUNDS:</b>	
Tobacco powder or products used exclusively for agricultural or horticultural purposes & unfit for human consumption .....	NIA*
Discounts.....	\$3,488,000
Breakage or spoilage refunds.....	4,569,000
Exported from state after cigarette stamps purchased.....	NIA
<b>TOTAL TOBACCO PRODUCT EXEMPTIONS AND REFUNDS .....</b>	<b>\$8,057,000</b>
 <b>LIQUOR EXEMPTIONS AND REFUNDS:</b>	
Liquids containing less than 1/2% alcohol by volume.....	NIA
Liquor contained in medicines, unsuitable for beverage purposes .....	NIA
Liquor exported from state after stamps were purchased.....	NIA
Breakage or spoilage refunds.....	\$63,000
<b>TOTAL LIQUOR EXEMPTIONS AND REFUNDS.....</b>	<b>\$63,000</b>
 <b>TOTAL QUANTIFIABLE LUXURY TAX EXPENDITURES<sup>24</sup></b>	
.....	<b>\$373,892,000</b>

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\* No Information Available.

<sup>24</sup>These expenditures represent foregone revenues to the state general fund and the corrections fund.



# **MOTOR CARRIER FEE EXPENDITURES**



# MOTOR CARRIER FEE EXPENDITURES<sup>25</sup>

Motor carrier fees were effective on October 1, 1997, replacing the motor carrier tax. Motor carriers are responsible for the following fees: motor carrier fee, gross weight fee, highway use fee, and title and registration fee. Receipts from these fees go into the highway user fund and distributed to the state highway fund, counties, and cities/towns.

## PREFERENTIAL VEHICLE FEE RATES

### Motor Vehicle Fee

The basic motor carrier fee is set at amounts ranging from \$64.00 to \$800.00, dependent upon vehicle weight (A.R.S. §28-5854). The vehicle weight for this schedule ranges from 12,001 pounds to 80,000 pounds. The fees are flat amounts based on gross vehicle weight. Lightweight motor vehicles, with a *declared gross weight of 12,000 or fewer pounds*, pay a flat rate of \$64.00 per vehicle (A.R.S. §28-5492). Lighter vehicles are granted preferential fee amounts. The value of this expenditure is currently unavailable.

A reduced *motor carrier fee of 7/10 of the full rate* is applied against motor vehicles (A.R.S. §28-5855) that pre qualified for the reduced motor carrier fee with the department and travel under the following conditions: 45% or more of the mileage reported is either (1) without a load; (2) with equipment which makes a motor vehicle ready for the road, (3) with restraining equipment which makes the

load safe, (4) with equipment normally carried with the motor vehicle and used for load or unloading, (5) with empty containers being returned to the point of shipment, or (6) with commodities or goods being returned to the point of shipment as a result of damage or consignee returns. The value of this expenditure is unavailable.

A reduced *motor carrier tax rate of 7/10 of the full rate* is applied against motor vehicles if the vehicle begins and ends a qualifying trip at the same point without having added to its load any items other than those listed in the previous paragraph and at the midway point of a qualifying trip, the load is less than 45% of the full load capacity of the vehicle (A.R.S. §28-5856). The tax value of this information is not available.

A reduced *motor carrier tax rate of 7/10 of the full rate* applies to motor vehicles or lightweight motor vehicles if the vehicle is used only for transporting agricultural products (A.R.S. §28-5857). Agricultural products are crops, livestock or supplies used or produced in farming operations or products, crops or livestock in their unmanufactured or unprocessed states. The value of this expenditure is unavailable.

### Gross Weight Fee

The gross weight fee is set at amounts ranging from \$7.50 to \$918.00, dependent upon vehicle weight (A.R.S. §28-5433). The vehicle weight for this schedule ranges from up to 8,000 pounds

<sup>25</sup>Figures presented for Motor Carrier Tax Expenditures were provided by the Department of Transportation.

to 80,000 pounds. Vehicles in excess of 80,000 are subject to special permits. A \$4.00 commercial registration fee is added to the gross weight fee for each registered vehicle. The fees are flat amounts based on the gross vehicle weight. Therefore, lighter vehicles are granted preferential fee amounts. However, the value of this expenditure is currently unavailable.

If a motor vehicle is used for *seasonal agricultural work*, the annual fee will be reduced by 1/12th for each month the vehicle is not in use. The reduced fee is for a period of at least 90 days but less than a full year (A.R.S. §28-5436). The value of this expenditure is currently unavailable.

If a privately owned school bus is temporarily operated for purposes other than transportation of children to and from school, the owner must *pay 1/10th of the annual gross weight fee* (A.R.S. §28-5432). The value of this expenditure is currently unavailable.

### Highway Use Fee

The highway use fee is set at amounts ranging from \$50.00 to \$469.00, depending upon vehicle weight and age. Vehicle weight for this schedule ranges from up to 8,000 pounds to 80,000 pounds. Vehicles in excess of 80,000 pounds are subject to special permits. If the model year of the vehicle is 1978 or older, the use fee schedule is lower, ranging from \$50.00 to \$405.00 (A.R.S. §28-5471). The values of these expenditures are currently unavailable.

## **EXEMPTIONS FROM VEHICLE FEES**

*Motor vehicles, trailers or semitrailers owned and operated by religious*

*institutions and used exclusively for the transportation of property produced and distributed for charitable purposes* are exempt from the gross weight fee (A.R.S. §28-5432.C1) and the motor vehicle fee (A.R.S. §28-5851.4). No information is available for this tax exemption.

*Motor vehicles, trailers or semitrailers owned and operated by nonprofit schools which are recognized as being tax exempt by the federal or state government* are exempt from the gross weight fee (A.R.S. §28-5432.C1) and the motor vehicle fee (A.R.S. §28-5851.4) if used exclusively for transportation of pupils in connection with school curriculum, training of pupils or transportation of property for charitable purposes without compensation. No information is available on the tax value of this exemption.

*A nonprofit organization which can present a form approved by the director of the division of emergency management* may have its motor vehicles, trailers and semitrailers exempted from the gross weight fee (A.R.S. §28-5432.C3) and the motor vehicle fee (A.R.S. §28-5851.4). No information is available on this tax exemption.

*A vehicle owned and operated by a foreign government, a consul or any other official representative of a foreign government, by the United States, by a state or political subdivision of a state or by an Indian tribal government* is exempt from the gross weight fee (A.R.S. §28-5432.C4) and the motor vehicle fee (A.R.S. §28-5851.4). No information is available on this tax exemption.

Gross weight fee (A.R.S. §28-5432.C2) and motor vehicle fee (A.R.S. §28-

5851.4) are not applicable to *school buses*. No information is available on this tax exemption.

A *farm vehicle that is issued a farm vehicle license plate* is exempt from highway use fees (A.R.S. §28-5473.D). No information is available on this tax exemption.

<b>SUMMARY OF MOTOR CARRIER TAX EXPENDITURES</b>
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Revenue Gain

**PREFERENTIAL FEE RATES:**

**Motor Vehicle Fee**

Same motor vehicle fees for all vehicles.....	NIA *
Reduced motor carrier fee for lighter loads.....	NIA
Reduced motor carrier fee for trips starting and ending at the same point with a lighter load midway.....	NIA
Reduced motor carrier fee for agricultural loads.....	NIA

**Gross Weight Fee**

Same gross weight fees for all vehicles .....	NIA
Reduced gross weight fee for seasonal agricultural vehicles.....	NIA
Reduced gross weight fee for privately owned school busses .....	NIA

**Highway Use Fee**

Same use fees for all vehicles .....	NIA
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**VEHICLE FEE EXEMPTIONS:**

Motor carriers owned by religious institutions and used for charitable purposes.....	NIA
Motor carriers owned by nonprofit schools .....	NIA
Motor carriers owned by nonprofit organizations with a division of emergency maintenance form .....	NIA
Motor carriers owned by governments.....	NIA
School buses.....	NIA
Farm vehicles.....	NIA

**TOTAL QUANTIFIABLE MOTOR CARRIER FEE  
EXPENDITURES<sup>26</sup>**

.....	NIA
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\* No Information Available.

<sup>26</sup>These expenditures represent foregone revenues to the state highway fund, counties and incorporated cities/towns.

# **MOTOR VEHICLE FUEL TAX EXPENDITURES**



# MOTOR VEHICLE FUEL TAX EXPENDITURES<sup>27</sup>

There is a tax of 18¢ per gallon on each gallon of motor vehicle fuel possessed, refined, manufactured, produced, blended or compounded by the supplier or imported by the supplier, whether in the original package or container in which it was imported or otherwise. Beginning January 1, 1998, all suppliers are required to pay tax on all fuel received. In order to qualify for an exemption, the taxpayer must file for a refund. The proceeds of this tax are distributed to the state highway fund, counties, incorporated cities and towns, the off-highway vehicle recreation fund and the state lake improvement fund.

## EXEMPTIONS FROM THE MOTOR VEHICLE FUEL TAX

*Motor vehicle fuel moving in interstate or foreign commerce, not destined or diverted to a point within this state is exempt from the motor vehicle fuel tax (A.R.S. §28-5610.A5). No information is available on this tax expenditure.*

*Motor vehicle fuel sold to the United States armed forces for use in ships or aircraft, or for use without this state, is exempt from the motor vehicle fuel tax*

(A.R.S. §28-5610.A6). There is no information available on this tax expenditure.

*A person who purchases and uses motor vehicle fuel other than in motor vehicles upon the highways of Arizona, and other than in watercraft upon the waterways in Arizona, and other than in motor vehicles operating on a transportation facility or toll road shall be repaid the motor vehicle fuel tax paid (A.R.S. §28-5610.A1-2). In Fiscal Year 1997/98, \$992,000 in motor vehicle fuel tax was repaid based on this exemption.*

*Motor vehicle fuel purchased for export is exempt from motor vehicle fuel tax (A.R.S. §28-5610.A1-2). Requests for credits against import liability in the amount of \$486,000 were received in Fiscal Year 1997/98.*

Anyone who purchases motor vehicle fuel and *loses such fuel due to fire, theft or other accident* may request a refund for the tax paid on this fuel (A.R.S. §28-5611.A4). No refunds for this reason were requested for Fiscal Year 1997/98.

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<sup>27</sup>Any figures presented for Motor Vehicle Fuel Tax Expenditures were provided by the Arizona Department of Transportation.

<b>SUMMARY OF MOTOR VEHICLE FUEL TAX EXPENDITURES</b>
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	<u>Revenue Gain</u>
Motor vehicle fuel moving in interstate or foreign commerce.....	NIA*
Motor vehicle fuel sold to the United States armed forces.....	NIA
Motor vehicle fuel used other than in motor vehicles on the highways, other than in watercraft and other than on a transportation facility or toll road.....	\$992,000
Motor vehicle fuel purchased for export .....	486,000
Motor vehicle fuel lost due to fire, theft or other accident.....	0
 <b>TOTAL QUANTIFIABLE MOTOR VEHICLE FUEL TAX EXPENDITURES<sup>28</sup></b>	
.....	<b>\$1,478,000</b>

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\* No Information Available.

<sup>28</sup>The tax expenditures represent foregone revenues to the off-highway vehicle recreation fund, the state lake improvement fund, the state highway fund, counties and incorporated cities and towns.

# **PARI-MUTUEL TAX EXPENDITURES**



# PARI-MUTUEL TAX EXPENDITURES<sup>29</sup>

## HORSE OR HARNESS RACING PREFERENTIAL RATES

For horse or harness races, the state receives 2% of the gross amount of the first \$1 million handled on live races in pari-mutuel pools and 5% of the gross amount exceeding \$1 million (A.R.S. §5-111D). If the state received 5% of all proceeds, the state would have received an additional \$256,000 in Fiscal Year 1997/98. From the state share of the horse or harness racing revenues, the general fund received no revenues in Fiscal Year 1997/98.

## EXEMPTIONS FROM THE PARI-MUTUEL TAX

Moneys handled in a pari-mutuel pool for wagering on simulcasts of out-of-state horse or harness races are exempt from the state tax, as described above (A.R.S. §5-111D). The state share of the pari-mutuel tax was reduced by \$2,464,000 in Fiscal Year 1997/98 due to this exemption.

*Any county fair racing association may have one racing meeting each year (A.R.S. §5-111E). All such racing meetings are exempt from the state tax described above. If county fair racing meetings were not exempt from the tax, the state would have received an*

additional \$204,000 in pari-mutuel revenues in Fiscal Year 1997/98.

*Moneys from charity racing days are also exempt from the state tax (A.R.S. §5-111F). Taxation of these events would have raised an additional \$90,000 in Fiscal Year 1997/98 in pari-mutuel revenues.*

The percentage paid to the state for dog racing and for horse or harness racing shall be reduced by 1% of the total amount wagered in connection with all racing meetings in counties with a population of 500,000 or more and by 2% in all other counties for those *permittees who make capital improvements to existing race tracks* (A.R.S. §5-111.02A and §5-111.03A). The state share of the pari-mutuel tax was reduced by \$1,305,000 due to this reduction in the percentage in Fiscal Year 1997/98.

The percentage decrease in pari-mutuel wagering between the base year and the previous fiscal year determines a permittee's eligibility for a hardship tax credit. The state share of the pari-mutuel tax for dog racing and for horse or harness racing was reduced by the amount equal to the amount of the hardship tax credit (A.R.S. §5-111I). The state share of the pari-mutuel tax was reduced by \$883,000 in hardship tax credits in Fiscal Year 1997/98.

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<sup>29</sup>Any figures presented for Pari-mutuel Tax Expenditures were provided by the Arizona Department of Racing.

<b>SUMMARY OF PARI-MUTUEL TAX EXPENDITURES</b>
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	<u>Revenue Gain</u>
<b>PREFERENTIAL TAX RATES FOR HORSE OR HARNESS</b>	
<b>RACING</b> .....	\$256,000
 <b>PARI-MUTUEL TAX EXEMPTIONS:</b>	
Reduction in pari-mutuel tax on simulcast out-of-state races.....	\$2,464,000
County fair racing association meetings .....	204,000
Charity racing days.....	90,000
Reduction in pari-mutuel tax for capital improvements to race tracks .....	1,305,000
Reduction in pari-mutuel tax for hardship tax credit .....	883,000
 <b>TOTAL QUANTIFIABLE PARI-MUTUEL TAX EXPENDITURES<sup>30</sup></b>	
.....	<b>\$5,202,000</b>

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<sup>30</sup>These expenditures represent foregone revenues to the breeders award fund, the county fairs' racing betterment fund, county fairs' livestock agriculture promotion fund, the coliseum and exposition center fund, the county fair racing fund, the stallion award fund, for administration of county fair racing betterment retirement fund and breeders award fund, agriculture consulting and training fund, and the state general fund.

# **PRIVATE CAR PROPERTY TAX EXPENDITURES**



## PRIVATE CAR PROPERTY TAX EXPENDITURES

Businesses that operate, furnish or lease railroad cars to be used for transporting or accommodating persons or freight over railroad lines not owned, leased or operated by the business are subject to a private car property tax in Arizona. The taxable value, or net assessed value, of the private car property is determined by multiplying the full cash value of the property by an assessment ratio. The tax rate that is applied to the net assessed value is equal to the average primary and secondary property tax rates in the taxing districts of the state, which was \$12.70 in 1997.

Arizona statutes set out the assessment ratios to be used in determining the net assessed values of the various classes of property. These assessment ratios range

from 27% to 1%. For private car property, the *assessment ratio is equal to the ratio which the total net assessed valuation of all taxable property in classes 1 (mines and timber), 2 (utilities) and 3 (commercial and industrial) and personal property in class 4 (agricultural and vacant land) bears to the total full cash value of such property* (A.R.S. §42-746). For tax year 1997, the assessment ratio used for private car property was 23%. This is considered to be a preferential assessment ratio because it is an average of the assessment ratios in several other classes of property. If private car property had an assessment ratio equal to the highest assessment ratio imposed, 27%, tax collections would have increased by \$260,325.

**SUMMARY OF PRIVATE CAR PROPERTY TAX EXPENDITURES**

Preferential assessment ratio at 27%..... Revenue Gain  
\$260,000

**TOTAL QUANTIFIABLE PRIVATE CAR PROPERTY TAX  
EXPENDITURES<sup>31</sup>**  
..... **\$260,000**

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<sup>31</sup>These expenditures represent foregone revenues to the state general fund.

# **PROPERTY TAX EXPENDITURES**



# PROPERTY TAX EXPENDITURES

The property tax system in Arizona has many components. These components are intertwined, making it difficult to address the impact of tax expenditures on one component in isolation. The state no longer levies a property tax per \$100 of net assessed value on primary values, so state revenues are affected by exemptions from property tax in three ways.

First, basic state aid, or a basic level of funding for education per student statewide, is provided through the state, the county and school districts. The school district's responsibility is determined by multiplying a uniform tax rate by assessed valuation. If this amount is less than the basic level of funding, additional revenues are received from the county, funded by the county equalization rate of 53¢ per \$100 of net assessed value. If county equalization revenues cannot bring the school district to its basic level of funding, the state provides the rest of the basic state aid. Therefore, exemptions from the property tax base may increase the state's portion of basic state aid.

The second and third methods concern taxation of homeowner property. Frequently, if a political subdivision sees a decline in property values, the tax rate imposed by that subdivision increases so that a consistent revenue stream is provided from the property tax. The same is true if the political subdivision sees its taxable base decrease, through exemptions from the property tax. Through a program called additional state aid (commonly known as homeowner's rebate), the state pays 35% of a

homeowner's school district tax bill, up to \$500. If a homeowner's tax bill increases due to higher tax rates, the state will be required to pay a larger amount of money. Finally, the state pays the part of a homeowner's primary tax bill that exceeds 1% of the limited property value. Higher tax rates could mean a larger state payment.

Given the repeal of the 47¢ state rate, the tables which previously appeared in this report, showing the impact upon the state of property which is exempt from taxation, are no longer necessary. However, because the exemptions filter through to the tax base at the local level, descriptions of the exemptions remain. These are followed by a table which presents the cost of additional state aid to education to the state.

Article IX of the Arizona Constitution exempts:

- *property owned by widows, subject to limitations*
- *property owned by widowers, subject to limitations*
- *property owned by disabled persons, subject to limitations*
- *all federal, state, county and municipal property.*
- *property of educational, charitable and religious associations or institutions not used or held for profit.*
- *household goods owned by the user and used solely for noncommercial purposes.*
- *stocks of raw or finished materials, unassembled parts, work in process or finished products constituting the inventory of a retailer or wholesale*

*located within the state and principally engaged in the resale of such materials, parts or products, whether or not for resale to the ultimate consumer.*

There are also exemptions from property taxation listed in the statutes, as follows:

- *Libraries, colleges, schoolhouses and other buildings used for education, with their furniture, libraries and equipment, and the lands appurtenant to and used with such buildings, as long as they are used for the purpose of education and not used or held for profit (42-271.A.03).*
- *Property and buildings pursuant to a lease or lease-purchase agreement leased from a school district or a community-college district (42-271.A.04).*
- *Hospitals and other charitable institutions for relief of the indigent or afflicted and the lands appurtenant to such buildings, with their fixtures and equipment, not used or held for profit (42-271.A.05).*
- *Grounds and buildings belonging to agricultural societies, as long as they are used for those purposes only, and not used or held for profit (42-271.A.06).*
- *Property or buildings used primarily for religious worship, including furniture and equipment, and the land and improvements appurtenant to and used with such buildings, as long as the property is not used or held for profit (42-271.A.07).*
- *Cemeteries set apart and used for interring the dead, except such portions thereof that are used or held for profit (42-271.A.08).*
- *Observatories maintained for astronomical research and education for the public welfare, together with all*

*property used in the work or maintenance of observatories, including property held in trust, as long as the observatories and other property are used for such purposes only and not used or held for profit (42-271.A.10).*

- *Property used for operation of a health care institution which provides medical services, nursing services or health-related services to handicapped persons or persons sixty-two years of age or older and which is not used or held for profit (42-271.A.11).*
- *Property used for the operation of a residential apartment facility which is not used or held for profit, which is structured for handicapped persons or persons sixty-two years of age or older, which is located adjacent to a property exempted from taxation and which is owned and operated by the same persons or associations as such other adjacent property (42-271.A.12).*
- *Property used for the operation of a residential apartment housing facility which is not used or held for profit, which is structured for handicapped persons or persons sixty-two years of age or older and for which a subsidy or payment is given by federal, state or local government or by nonprofit organizations in a substantial amount in relation to the amount given or the total annual operating expenses (42-271.A.13).*
- *Property of other charitable institutions for relief of the indigent or afflicted, including the lands appurtenant to such property, with their fixtures and equipment, and other reasonably required property, as long as such institutions and property are not held or used for profit (42-271.A.14).*

- *Grounds and buildings belonging to societies for the prevention of cruelty to animals and for sheltering, caring for and controlling animals, as long as the grounds and buildings are used for those purposes only and not held or used for profit (42-271.A.15).*
- *Property held by a charitable organization for transfer to this state or a political subdivision of this state to be used as park land if no rent or valuable consideration is received by the charitable organization (42-271.A.16).*
- *Property belonging to a volunteer fire department if the property is used exclusively for fire suppression and prevention activities and neither used nor occupied by or for the benefit of any person (42-271.A.17).*
- *Property held by a charitable organization to preserve and protect scientific, biological, geological, paleontological, natural or archaeological resources (42-271.A.18).*
- *Property that is owned by a volunteer nonprofit organization that is operated exclusively to promote social welfare and provide community quasi-governmental services in an unincorporated area of a county. (42-271.A.19)*
- *Property that is owned by a volunteer nonprofit organization, used exclusively for the purpose of performing roadway cleanup and beautification on a gratuitous basis, not used or held for profit and not used or occupied by or for the benefit of any person (42-271.A.20).*
- *Property of musical, dramatic and dance groups, botanical gardens, museums and zoos as long as the property is used for those purposes and not used to held for profit (42-271.A.21).*
- *A commodity that is consigned for resale in a warehouse in this state in or from which the commodity is deliverable on a contract for future delivery subject to the rules of a commodity market regulated by the United States commodity futures trading commission (42-271.A.22).*
- *Animal and poultry feed, including salts, vitamins and other additives, for animal or poultry consumption (42-271.A.23).*
- *Property that is owned by a United States Veterans' Organization that qualifies as a charitable organization and is recognized under either section 501 (C)(3) or 501 (C)(19) of the Internal Revenue Code if the property is used exclusively for those purposes and not used or held for profit. (42-271.A.24).*
- *Property that is not used or held for profit and that is owned by a community service organization the mission of which is to serve a population that includes persons who are indigent or afflicted, as defined in this section, and that qualifies as a charitable organization and is recognized under §501 (C)(3) of the internal revenue code if the community service organization is primarily engaged in delivering services on that property consisting of fitness programs, camping programs, health and recreation services, youth programs, child care, senior citizen programs, individual and family counseling, employment and training programs, services for individuals with disabilities, meals, feeding programs and disaster relief. (42-271.A.25).*
- *Personal property moving through the state or consigned to a warehouse in the state from a point without the state for storage or assembly in transit*

to a final destination without the state (42-631.A).

- *Property claimed to have no situs in this state for the purposes of taxation shall be considered property-in-transit or futures contract property (42-631.C).*
- *Airline company aircraft (42-705.B).*
- *Property owned or used by districts for the purpose of irrigation water delivery shall be exempt from taxation when used for district purposes (48-3472.A).*

### 1997 ADDITIONAL STATE AID TO EDUCATION

Pursuant to A.R.S. §15-972, a report indicating the amount of additional State Aid to Education is prepared each year. This additional aid is the amount referred to as the "Homeowner's Rebate." (The state pays 35% of a homeowner's school district tax bill, up to \$500.) The summary report below includes an

estimate by county of additional State Aid to Education amounts required for the billing of legal Class 5 property on the unsecured personal property tax rolls that will occur between July 1997 and June 1998.

### ADDITIONAL STATE AID TO EDUCATION

	Total ASAE Secured Tax Roll	Estimated Unsecured Fiscal 98
Apache	\$288,901	\$20,000
Cochise	2,824,888	160,000
Coconino	4,158,936	120,000
Gila	1,841,474	100,000
Graham	380,757	30,000
Greenlee	72,667	8,000
La Paz	155,127	40,000
Maricopa	106,617,961	1,750,000
Mohave	5,314,129	175,000
Navajo	1,803,972	150,000
Pima	32,919,414	900,000
Pinal	3,683,149	330,000
Santa Cruz	1,098,968	15,000
Yavapai	6,397,936	260,000
Yuma	2,864,347	220,000
<b>Total</b>	<b>\$170,422,629</b>	<b>\$4,278,000</b>

**SUMMARY OF PROPERTY TAX EXPENDITURES**

	<u>Revenue Gain</u>
ADDITIONAL STATE AID TO EDUCATION .....	\$174,701,000
<b>TOTAL QUANTIFIABLE PROPERTY TAX EXPENDITURES<sup>32</sup></b> .....	<b>\$174,701,000</b>

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<sup>32</sup>These expenditures represent foregone revenues to the state general fund.



# **SEVERANCE TAX EXPENDITURES**



# SEVERANCE TAX EXPENDITURES

Persons engaged in the business of mining or timbering in Arizona are subject to a severance tax. The mining severance tax is taxed at the rate of 2.5% (A.R.S. §42-1462C) and is levied upon the net severance base, defined as the greater of:

1. The weighted mineral value (computed by dividing the mining costs by the production costs and multiplying by the gross value of production), or
2. The Arizona value, which is 50% of the difference between the gross value of production and the out-of-state processing costs.

The timber severance tax is levied on the timber products derived from timbering activity (A.R.S. §42-1462D). Severance tax collections in Fiscal Year 1997/98 totaled \$27.1 million.

## PREFERENTIAL SEVERANCE TAX RATES

Timber severance is taxed depending on the type of timber product. The tax rate for ponderosa pine timber products is \$2.13 per thousand board feet and the tax rate for all species except ponderosa pine is \$1.51 per thousand board feet. The tax rate for all other species except ponderosa pine is a preferential rate over the ponderosa pine rate. If all other timber products were taxed at \$2.13 per

thousand board feet, timber severance tax collections would increase by \$200.

## SEVERANCE TAX CREDITS

A credit is allowed against severance tax imposed *for accounting and reporting expenses incurred by the taxpayer* (A.R.S. §42-1322.04). The credit equals 1% of the amount of tax due, not to exceed \$10,000 in any calendar year. In Fiscal Year 1997/98, the value of the accounting credit equaled \$64,200 for severance tax.

## SEVERANCE TAX EXCLUSIONS

### Mining Severance

Price, as a component in determining the gross value of production in the calculation of the net severance base, does not include *the charges made by a severer for manufacturing, fabricating or other transforming activities of a refined metalliferous mineral product before making a sale* (A.R.S. §42-1461.8). In reporting the severance tax to the Arizona Department of Revenue, however, the calculations involved in determining the net severance base are not submitted. Therefore, there is no information regarding the tax value of this exclusion.

<b>SUMMARY OF SEVERANCE TAX EXPENDITURES</b>
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	<u>Revenue Gain</u>
<b>PREFERENTIAL TIMBER SEVERANCE TAX RATE FOR OTHER TIMBER PRODUCTS</b> .....	\$200
<b>SEVERANCE TAX CREDITS:</b>	
Accounting credit .....	\$64,000
<b>SEVERANCE TAX EXEMPTIONS:</b>	
Charges made by a mining severer for manufacturing, fabricating or other transforming activities of a refined metalliferous mineral product .....	NIA*
<b>TOTAL QUANTIFIABLE SEVERANCE TAX EXPENDITURES</b> <sup>33</sup> .....	<b>\$64,200</b>

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\* No Information Available.

<sup>33</sup>These expenditures represent foregone revenues to the state general fund, counties and incorporated cities and towns.

**TRANSACTION PRIVILEGE  
AND USE TAX  
EXPENDITURES**



# TRANSACTION PRIVILEGE AND USE TAX EXPENDITURES

Transaction privilege and use tax gross collections in Fiscal Year 1997/98 totaled \$3.027 billion. Potential transaction privilege and use tax collections from the various transaction privilege tax exemptions would have, at a minimum, increased collections by more than 137%. The quantifiable exemptions discussed in this report represent potential collections of \$4.140 billion. Additionally, lost revenues due to preferential tax rates, e.g., those items taxed at a rate below 5%, total \$185.4 million while credits totaled \$13.1 million. Therefore, the State of Arizona could be collecting at least an additional \$4.338 billion in transaction privilege and use tax if the credits, exempted items and items taxed at a preferential rate were taxed at a 5% rate.

## PREFERENTIAL TRANSACTION PRIVILEGE TAX RATES

In most categories, sales in Arizona are taxed at a 5% rate. Three categories of taxable activities, however, are taxed at a lower rate. These activities and the corresponding tax rates are as follows:

CODE	TAXABLE ACTIVITIES	RATE
2	Non-Metal Mining, Oil & Gas Production	3.125%
13	Commercial Lease <sup>34</sup>	0%
28	Rental Occupancy Tax	3.0%

If the activities in these categories had been taxed at a 5% rate in Fiscal Year

<sup>34</sup>The tax rate for this class changed to 0% from 1.0% effective July 1, 1997.

1997/98, additional transaction privilege tax of \$185.4 million would have been collected.

## TRANSACTION PRIVILEGE AND USE TAX REFUNDS AND CREDITS

*A motion picture production company that produces at least one motion picture in Arizona in a year may apply for a refund, considered to be a remission of transaction privilege and use taxes paid (A.R.S. §42-1322.01). The amount of the refund is 50% of the transaction privilege and use taxes imposed with respect to tangible personal property purchased by the motion picture production company. Due to confidentiality guidelines, information on this exemption cannot be released.*

A credit is allowed against transaction privilege tax imposed *for accounting and reporting expenses incurred by the taxpayer (A.R.S. §42-1322.04). The credit equals 1% of the amount of tax due, not to exceed \$10,000 in any calendar year. In Fiscal Year 1997/98, the value of the accounting credit equaled \$13.1 million.*

## TRANSACTION PRIVILEGE AND USE TAX EXEMPTIONS

Certain types of income or sales by businesses are exempt from transaction privilege and use tax. Some of these businesses have taxable sales as well as exempt sales; some have no taxable sales

at all. In the case of those businesses which have both taxable and exempt sales, there is some information on the value of the exemption. Those businesses which only have exempt sales generally do not file transaction privilege tax returns; therefore, no figures are reported for the value of the exempt business. The following information lists all exemptions identified in the Arizona Revised Statutes, whether information was available on the tax value of the exemption or not.

The primary type of business exempt from transaction privilege tax in Arizona is the business of *providing a service* (A.R.S. §42-1310.01A1, A2). Service industries can be broken down into three major categories: (1) professional; (2) business; and, (3) personal services. Examples of professional services include legal, engineering and medical businesses. Types of business services include repair shops and management consulting. Cleaning services, beauty shops, sports and social services, such as day care, are examples of the personal service category. A summary of potential transaction privilege tax revenue from these three major categories is as follows:

Professional Services	\$463,948,000
Business Services	\$284,987,000
Personal Services	\$96,678,000

Total transaction privilege tax revenue available from these businesses is \$845.6 million. Although the estimate of potential tax collections provided here does not include estimates for all services, the majority have been captured. A detailed list of the services included can be found in the table at the end of this section.

The business of *selling tangible personal property at wholesale*, by definition, is not taxable. During Fiscal Year 1997/98, wholesale trade was estimated to be \$35.278 billion. If taxed at a 5% rate, collections from this category would be \$1.764 billion.

The transaction privilege and use tax is levied upon the gross income or the gross proceeds of sales. Gross proceeds of sales do not include *cash discounts* allowed (A.R.S. §42-1301.5). The value of merchandise traded in on the purchase of new merchandise when the *trade-in* allowance is deducted from the sales price of the new merchandise before completion of the sale is exempt (A.R.S. §42-1301.6). No information is available on the value of cash discounts or trade-ins.

*Sales of warranty or service contracts* are exempt from transaction privilege tax (A.R.S. §42-1310.01A3). No information is available on this tax expenditure.

*Sales of tangible personal property by any nonprofit organization and operated exclusively for charitable purposes and recognized by the department and the United States Internal Revenue Service as such a nonprofit organization for charitable purposes* are exempt from transaction privilege and use tax (A.R.S. §42-1301.01A4, A.R.S. §42-1409A15a). No information is available on this tax expenditure.

The *sale of stocks and bonds* is not subject to transaction privilege tax in Arizona (A.R.S. §42-1310.01A7). Using the 1992 Census of Financial, Insurance, and Real Estate Industries and inflating the Arizona receipts for security brokers

& dealers, the potential tax collections from a 5% tax rate would be an estimated \$27.9 million in Fiscal Year 1997/98.

*Items required by prescription, such as prescription drugs and medical oxygen (A.R.S. §42-1310.01A8, A.R.S. §42-1409A16), insulin, syringes, glucose test strips (A.R.S. §42-1310.01A10, A.R.S. §42-1409A19), and eyeglasses and contact lenses (A.R.S. 42-1310.01A11, A.R.S. §42-1409A18) are exempt from transaction privilege and use tax. Sales of prescription drugs in Arizona, are believed to be approximately \$810.2 million. Taxing these sales at a 5% rate would result in \$40.5 million in additional tax collections to the state. Potential tax collections of \$5.6 million would result from taxing sales of eyeglasses and contact lenses.*

*Prosthetic appliances prescribed or recommended by a physician, dentist or other professional (A.R.S. §42-1310.01A9, A.R.S. §42-1409A17) and hearing aids (A.R.S. §42-1310.01A12, A.R.S. §42-1409A20) are exempt from transaction privilege and use tax, as are durable medical equipment (A.R.S. §42-1310.01A13, A.R.S. §42-1409A21). No information is available for this tax expenditure.*

*Sales to nonresidents of Arizona for use outside Arizona if the vendor ships or delivers the tangible personal property outside of the state are exempt from transaction privilege tax (A.R.S. §42-1310.01A14). No information is available on this tax expenditure.*

*Food for home consumption (A.R.S. §42-1310.01A15, A.R.S. §42-1409A22) was exempted from transaction privilege and use tax effective July 1980. This includes*

*items purchased with food stamps (A.R.S. §42-1310.01A16, A.R.S. §42-1409A23). Food sales deductions are still reported but very difficult to capture. A survey of deductions reported by the state's largest grocery stores provides an estimate of food sales in Fiscal Year 1997/98 of \$243.2 million.*

*Textbooks sold by any bookstore that are required by any state university or community college are not subject to the transaction privilege or use tax (A.R.S. §42-1310.01A17, A.R.S. §42-1409A28). Sales of textbooks at universities and community college bookstores are estimated to be \$25.8 million in FY 1997/98. A 5% tax on these sales would have brought in \$1.3 million in additional revenues.*

*Meals provided to employees of restaurants are exempt from transaction privilege and use taxation (A.R.S. §42-1310.01A18, A.R.S. §42-1409A24). Using an average value of \$7.10 per meal, employees of restaurants working five days per week would consume meals worth \$249.3 million. This converts to tax collections of \$12.5 million at a 5% tax rate.*

No transaction privilege or use tax is applied to food, drink or condiment purchased for *school lunches* (A.R.S. §42-1310.01A19, A.R.S. §42-1409A26). No information is available for this tax expenditure.

*Arizona lottery ticket sales (A.R.S. §42-1310.01A20, A.R.S. §42-1409A27), amounting to \$250.7 million in Fiscal Year 1997/98, are not taxable. Additional tax collections of \$12.5 million would have been received if the sales were taxed at a 5% rate.*

The sale of *precious metal bullion and monetized bullion* to the ultimate consumer is exempt from transaction privilege tax (A.R.S. §42-1310.01A21). Precious metal bullion is defined as precious metal, including gold, silver, platinum, etc., which has been smelted or refined so that its value depends on its contents and not on its form. Monetized bullion means coins and other forms of money which are manufactured from gold, silver, etc., and which have been used as a medium of exchange. No information is available for this tax expenditure.

*Tangible personal property sold to a qualifying hospital or a qualifying health care organization* used by the organization solely to provide health and medical related educational and charitable services is exempt from transaction privilege and use tax (A.R.S. §42-1310.01A25a,b, A.R.S. §42-1409A13a, b, d). No information is available on this tax expenditure.

*Tangible personal property sold to or purchased by qualifying community health centers and health care organizations* dedicated to assisting blind, visually impaired, and multi-handicapped children are exempt from transaction privilege and use tax (A.R.S. §42-1310.01A25c, A.R.S. §42-1310.01A25d, A.R.S. §42-1409A13e, A.R.S. §42-1409A13i). No data is available on the value of this exemption.

Sales of tangible personal property to a *nonprofit charitable organization that regularly serves meals to the needy and indigent on a continuing basis at no cost* is exempt from the transaction privilege and use tax (A.R.S. §42-1310.01A25e,

A.R.S. §42-1409A13j). No information is available on the value of this exemption.

No transaction privilege or use tax is charged on *magazines or other periodicals or other publications by this state to encourage tourist travel* (A.R.S. §42-1310.01A26, A.R.S. §42-1409A29). Arizona Highways magazine is the primary publication of this type. This information is not available at this time.

Articles or materials purchased to be incorporated into a final product for sale are exempt from transaction privilege and use tax. Two examples of this exemption can be quantified. *Sales of articles to a contractor with a transaction privilege tax license for incorporation or fabrication under a construction contract* (A.R.S. §42-1310.01A27) were estimated using the 1992 Census of Construction Industries for Arizona. On the basis of estimated sales of \$3.1 billion in this category, potential tax collections at a 5% tax rate would have been \$155.9 million. *Sales of articles to be incorporated into a manufactured product* (ACRR R15-5-1839, A.R.S. §42-1409A4) were estimated using the 1992 Census of Manufactures. On the basis of estimated sales of \$13.4 billion, potential tax collections at a 5% tax rate would have been \$671.4 million in Fiscal Year 1997/98.

The sale of a motor vehicle is exempt from transaction privilege tax under two conditions (A.R.S. §42-1310.01A28). If the *buyer is a nonresident of this state and the state of residence does not allow a corresponding use tax exemption and if the nonresident has secured a special thirty-day nonresident vehicle registration*, the transaction is not

taxable. Also, if the *purchaser is an enrolled member of an Indian tribe who resides on the Indian reservation established for that tribe*, no tax can be imposed. No information is available for this tax expenditure.

*Tangible personal property purchased or leased by a nonprofit charitable organization that engages in and uses such property exclusively for training, job placement or rehabilitation programs or testing for mentally or physically handicapped persons* is exempt from the transaction privilege and use tax (A.R.S. §42-1310.01A29, A.R.S. §42-1409A13f). No information is available on the tax value of this exemption.

Tangible personal property sold by a *nonprofit organization if the organization is associated with a major league baseball team or a national touring professional golf association* is not subject to transaction privilege or use tax (A.R.S. §42-1310.01A30, A.R.S. §42-1409A15b). Similar qualified organizations which sponsor or operate a *rodeo featuring primarily farm and ranch animals* are also exempt from the transaction privilege and use tax (A.R.S. §42-1310.01A32, A.R.S. §42-1409A15c). No information is available on these tax expenditures.

*Sales of commodities, as defined by title 7 United States Code § 2, that are consigned for resale in a warehouse in or from which the commodity is deliverable on a contract for future delivery subject to the rules of a commodity market* are exempt from transaction privilege and use tax (A.R.S. §42-1310.01A31, A.R.S. §42-1409A14). No information is available on the tax value of this exemption.

*Sales of new semitrailers manufactured in Arizona or new parts manufactured in Arizona* for semitrailers sold by the manufacturer to a person who holds an interstate commerce commission license for use in interstate commerce are not subject to transaction privilege tax (A.R.S. §42-1310.01A33). No information is available on the tax value of this exemption.

There is no transaction privilege or use tax on the *sale of seeds, seedlings, roots, bulbs, cuttings and other propogative material to persons who uses those items to commercially produce agricultural, horticultural, viticultural or floricultural crops in Arizona* (A.R.S. §42-1310.01A34, A.R.S. §42-1409A9). No information is available on the tax value of this exemption.

*Machinery, equipment and certain supplies used to assist the physically or developmentally disabled or those persons with head injuries* are exempt from transaction privilege and use tax (A.R.S. §42-1310.01A35, A.R.S. §42-1409A34). No information is available on the value of this exemption.

*Tangible personal property shipped or delivered directly to a foreign country for use in that country* is exempt from transaction privilege tax (A.R.S. §42-1310.01A36). No data is available on the value of this exemption.

*Sales of natural gas or liquefied petroleum gas used to propel a motor vehicle* are exempt from transaction privilege and use tax (A.R.S. §42-1310.01A37, A.R.S. §42-1409A33). No information is available on the value of this exemption.

*Paper machine clothing sold to a paper manufacturer and directly used or consumed in paper manufacturing* is exempt from transaction privilege and use tax (A.R.S. §42-1310.01A38, A.R.S. §42-1409A30). No information is available for this expenditure.

The *gross proceeds of sales or gross income derived from sales of machinery, equipment, materials and other tangible personal property used directly to construct a qualified environmental technology manufacturing, producing or processing facility* are deducted from transaction privilege tax base (A.R.S. §42-1310.01E). Use tax does not apply to the *storage, use or consumption in Arizona of machinery, equipment, materials or other tangible personal property* if use directly to construct a qualified environmental technology manufacturing, producing or processing facility (A.R.S. §42-1409D). Information is not available on these expenditures.

Sales of *coal, petroleum, coke, natural gas, virgin fuel oil and electricity* to an environmental technology manufacturer, producer or processor and that are directly used or consumed in the generation or provision of on-site power or energy are exempt from transaction privilege and use tax (A.R.S. §42-1310.01A39, A.R.S. §42-1409A31). Information is not available on the value of these expenditures.

Sales of *liquid, solid or gaseous chemicals used in manufacturing, processing, fabricating, mining, refining, metallurgical operations or research and development* are exempt from transaction privilege and use tax if the chemicals are used for the purpose of causing or

permitting a chemical or physical change to occur in the materials as a part of the production process (A.R.S. §42-1310.01A40, A.R.S. §42-1409A35). Information is not available on this expenditure.

*Sales of food or drink consumed on the premises of a jail or prison or any other institution* under the jurisdiction of the county sheriff, DOC, DPS, or DYTR are exempt from transaction privilege and use tax (A.R.S. §42-1310.01A42, A.R.S. §42-1409A36). No data is available on the value of this exemption.

*Motor vehicles and any repair and tangible personal property that becomes a part of the motor vehicles sold to a licensed motor carrier* subject to a fee under title 28, chapter 9, article 6 who lease or rent the property are not subject to transaction privilege or use tax (A.R.S. §42-1310.01A43, A.R.S. §42-1409A37). No information is available on the value of this exemption.

*Livestock, poultry, feed and supplies for use or consumption in the businesses of farming, ranching and feeding livestock and poultry*, not including fertilizers, herbicides and insecticides are not subject to use tax in Arizona (A.R.S. §42-1409A8). *Sales of livestock and poultry feed, salts, vitamins for livestock or poultry consumption* sold to persons engaged in producing livestock, poultry or products are exempt from transaction privilege tax (A.R.S. §42-1310.01A44). The sale of animal feed was estimated using the 1992 Census of Agriculture and was inflated by the feed portion of the Industry Price Index. On the basis of estimated feed sales of \$221.2 million, potential tax collections at a 5% tax rate

would have been \$11.1 in Fiscal Year 1997/98.

There is no transaction privilege or use tax on the sale or purchase of *implants used as growth promotants and injectable medicines for livestock and poultry* owned by persons engaged in producing or feeding livestock or poultry (A.R.S. §42-1310.01A45, A.R.S. §42-1409A7). Information is not available on this expenditure.

Sales of *motor vehicles at auction to nonresidents of this state* for use outside this state if the vehicles are shipped or delivered outside of the state are exempt from the transaction privilege tax (A.R.S. §42-1310.01A46). No information is available on the value of this exemption.

Transaction privilege and use tax does not apply to sales of tangible personal property to persons engaged in business under the transient lodging classification if the property is *personal hygiene products which are furnished to and to be consumed by the transient during his occupancy* (A.R.S. §42-1310.01A47, A.R.S. §42-1409A13k). Information is not available on this expenditure.

*Sales or purchases of alternative fuel to a used oil fuel burner* who is permitted under §49-426 or §49-480 to burn used oil or used oil fuel are exempt from transaction privilege and use tax (A.R.S. §42-1310.01A48, A.R.S. §42-1409A42). No information is available on this tax expenditure.

*Printed, photographic, electronic or digital media materials for use in libraries funded with public moneys in Arizona*, are exempt from transaction privilege and use tax (A.R.S. §42-

1310.01A49, A.R.S. §42-1409A12). No information is available on the value of this tax expenditure.

*Tangible personal property sold to or purchased by a commercial airline that consist of food, beverages and condiments and accessories used for serving*, if the items are provided without additional charge, are exempt from transaction privilege and use tax (A.R.S. §42-1310.01A50, A.R.S. §42-1409A43). Information is not available on this expenditure.

*Machinery or equipment used directly in manufacturing, processing, fabricating, job printing, refining or metallurgical operations* is not subject to transaction privilege or use tax (A.R.S. §42-1310.01B1, A.R.S. §42-1409B1). Limited information is available on this type of machinery or equipment. Using the 1992 Census of Manufactures and inflating this figure by the rate of increase in the Producer Price Index for machinery and equipment, an estimated \$981.9 million in sales of this machinery taxed at 5% would have brought in an additional \$49.1 million in revenues.

*Sales of machinery or equipment used in mining* directly in the process of extracting ores or minerals from the earth for commercial purposes (A.R.S. §42-1310.01B2, A.R.S. §42-1409B2) and *sales of machinery or equipment used in drilling for or extracting oil or gas from the earth* (A.R.S. §42-1310.01B10, A.R.S. §42-1409B10) are not taxed. The Census of Mineral Industries provided figures for capital expenditures of machinery and equipment for 1992. Inflating this figure by the rate of increase in the Producer Price Index for machinery and equipment resulted in an estimate of

\$215.8 million for sales of this machinery in Fiscal Year 1997/98. A 5% tax on this machinery would have brought in \$10.8 million in additional revenues.

*Tangible personal property sold to persons engaged in business under the telecommunications classification*, consisting of central office switching equipment, switchboards, private branch exchange equipment, microwave radio equipment and carrier equipment including optical fiber, coaxial cable and other transmission media which are components of carrier systems are exempt from the transaction privilege and use tax (A.R.S. §42-1310.01B3, A.R.S. §42-1409B3). No information is available on this tax expenditure.

*Machinery, equipment or transmission lines used directly in producing or transmitting electrical power*, but not including distribution is exempt from the transaction privilege and use tax (A.R.S. §42-1310.01B4, A.R.S. §42-1409B4). Transformers and control equipment used in transmission substation sites are included in this exemption. No information is available on this exemption.

*Neat animals, horses, asses, sheep, swine or goats used or to be used as breeding or production stock* are not subject to the transaction privilege or use tax (A.R.S. §42-1310.01B5, A.R.S. §42-1409B5). No information is available on the tax value of this exemption.

There is no transaction privilege or use tax on *pipes or valves four inches in diameter or larger used to transport oil, natural gas, artificial gas, water or coal slurry* (A.R.S. §42-1310.01B6, A.R.S. §42-1409B6). No information is

available on the value of this tax expenditure.

*Aircraft, navigational and communication instruments* sold to (a) a person holding a federal certificate of public convenience and necessity or foreign air carrier permit for air transportation in intrastate, interstate or foreign commerce, (b) any foreign government for use outside of Arizona, or (c) nonresidents who will not use such property in Arizona other than in removing such property from Arizona are not subject to the transaction privilege and use tax (A.R.S. §42-1310.01B7, A.R.S. §42-1409B7). No data is available on the value of this exemption.

*Machinery, tools, equipment and related supplies used or consumed directly in repairing, remodeling or maintaining aircraft, aircraft engines or aircraft component parts by or on behalf of a certified or licensed carrier of persons or property* are exempt from tax (A.R.S. §42-1310.01B8, A.R.S. §42-1409B8). No information is available on this exemption.

*Railroad rolling stock, rails, ties and signal control equipment used directly to transport persons or property in intrastate or interstate transportation for hire* is exempt from the transaction privilege and use tax (A.R.S. §42-1310.01B9, A.R.S. §42-1409B9). No data is available on the value of this exemption.

Transaction privilege and use tax do not apply to sales of *buses or other urban mass transit vehicles which are used directly to transport persons or property for hire or pursuant to a governmentally adopted and controlled urban mass*

*transportation program and which are sold to bus companies holding a federal certificate of convenience and necessity* (A.R.S. §42-1310.01B11, A.R.S. §42-1409B11). No information is available on this exemption.

*Groundwater measuring devices* required under A.R.S. §45-604 are exempt from transaction privilege and use tax (A.R.S. §42-1310.01B12, A.R.S. §42-1409B12). No information is available on the value of these devices.

*New machinery and equipment (never sold at retail pursuant to leases or rentals which do not total two years or more) used for commercial production of agricultural, horticultural, viticultural and floricultural crops in Arizona* are exempt from transaction privilege and use tax (A.R.S. §42-1310.01B13, A.R.S. §42-1409B13). This equipment consists of tractors, tractor-drawn implements, self-powered implements and drip irrigation lines. The potential tax collections can be estimated using the 1992 Census of Wholesale Trade for Arizona and inflating the sales for this category. Based on estimated sales of \$195.5 million, the potential tax collections would be \$9.8 million in Fiscal Year 1997/98.

Transaction privilege and use tax does not apply to sales of *machinery or equipment used in research and development*. Research and development means basic and applied research in the sciences and engineering, and designing, developing or testing prototypes, processes or new products, including research and development of computer software that is embedded in or an integral part of the prototype or new product or that is required for machinery

or equipment to function effectively (A.R.S. §42-1310.01B14, A.R.S. §42-1409B14). No information is available on the value of this exemption.

*Machinery and equipment purchased by or on behalf of owners of a soundstage complex and primarily used for motion picture, multimedia or interactive video production* are exempt from transaction privilege and use tax (A.R.S. §42-1310.01B15, A.R.S. §42-1409B15). Information is not available on the value of this exemption.

*Tangible personal property used by any direct broadcast satellite television or data transmission service or facility* to receive, store, convert, produce, generate, decode, encode, control or transmit telecommunications information is exempt from transaction privilege and use tax (A.R.S. §42-1310.01B16, A.R.S. §42-1409B16). The broadcast satellite television or data transmission service or facility must operate within federal regulations. *Sales of services by direct broadcast satellite television services* that operate within federal regulation are not taxable under the telecommunications classification (A.R.S. §42-1310.04B4). No information is available on the value of these exemptions.

*Clean rooms* that are used for manufacturing, processing, fabrication or research and development of semiconductor products are exempt from transaction privilege and use taxes (A.R.S. §42-1310.01B17, A.R.S. §42-1409B17). This includes the integrated systems, fixtures, piping, movable partitions, and property that is necessary for control of the clean room. No information is available on the value of this exemption.

The *portion of the sales price of luxury automobiles* (A.R.S. §42-1310.01D) and *portion of the sales price of heavy trucks and trailers that reflect the federal luxury excise tax* (A.R.S. §42-1310.01F) are exempt from transaction privilege tax. The *portion of the sales price of use fuel that reflects the federal luxury excise tax* is also exempt from transaction privilege tax (A.R.S. §42-1310.01G). Information is not available on these expenditures.

*Sales of overhead materials or other tangible personal property to a manufacturer, modifier, assembler or repairer* are exempt from transaction privilege and use tax if the gross proceeds of sales derived from the property are exempt from transaction privilege tax due to performing a contract between the United States government and the manufacturer, modifier, assembler or repairer (A.R.S. §42-1310.01K, A.R.S. §42-1409A39). For those *sales of tangible personal property made directly to the United States government that are not deducted under A.R.S. §42-1310.01K*, 50% of the gross proceeds or gross income derived will be deducted from the tax base (A.R.S. §42-1310.01L). Data is not available on the value of these exemptions.

*Sales of solar energy devices* are to be deducted from the tax base, but the deduction is not to exceed \$5,000 for each device (A.R.S. §42-1310.01O). Information is not available on this expenditure.

*Sales of wireless telecommunication equipment as an inducement to enter into or continue a contract* for telecommunications services taxable under A.R.S. §42-1310.04 is considered a

sale for resale under the transaction privilege and use taxes (A.R.S. §42-1310.01Q, A.R.S. §42-1409A41). In addition, the *gross proceeds of sales or gross income do not include the sales commissions* received as a result of a customer entering or continuing a contract (A.R.S. §42-1310.01P). Information is not available on these expenditures.

*Ambulances or ambulance services* provided under Title 48 or certified pursuant to Title 36, chapter 21.1 or provided by a city or town in a county with a population of less than 150,000 is not subject to taxation under the transporting classification of the transaction privilege tax (A.R.S. §42-1310.02A3). No information is available on the tax value of this exemption.

The transporting classification of the transaction privilege tax excludes *public transportation services for the dial-a-ride programs and special needs transportation services* (A.R.S. §42-1310.02A4). No information is available on the tax value of this exemption.

*The gross proceeds of sales or gross income derived from transporting for hire persons, freight or property by a railroad pursuant to a contract with another railroad* is exempt from transaction privilege tax if the other railroad has already paid the transaction privilege tax on the transporting of goods (A.R.S. §42-1310.02B). No data is available on the tax value of this exemption.

*Sales of electricity to a distributor who has a transaction privilege tax license* (A.R.S. §42-1310.03A1) are essentially sales of electricity for resale. Information on this activity is not available at this

time from the Arizona Corporation Commission.

*Sales of natural gas or liquefied petroleum gas used to propel a motor vehicle* are not taxable under the utility classification of transaction privilege tax (A.R.S. §42-1310.03A2). No data is available on the tax value of this exemption.

*Revenues received by a municipally owned utility in the form of fees charged to persons constructing residential, commercial or industrial developments or connecting residential, commercial or industrial developments to a municipal utility system if the fees are segregated and used only for capital expansion, system enlargement or debt service of the utility system* are excluded from the taxable base under the utilities classification of transaction privilege tax (A.R.S. §42-1310.03B1). No information is available on the tax value of this exemption.

*Revenues received by any person owning a utility system in the form of reimbursement or contribution compensation for property and equipment installed to provide utility access to, on or across the land of an actual utility consumer if the property and equipment become the property of the utility* are excluded from the taxable base under the utilities classification of the transaction privilege tax (A.R.S. §42-1310.03B2). No information is available on the tax value of this exemption.

*Interstate sales of electricity, natural gas and water* (ACRR R15-5-2014) are exempt from transaction privilege tax. In searching for the information on these transactions, it was found that interstate

sales of natural gas and water are minimal, if such sales occur at all. Information is not available for this expenditure at this time.

*Income from interstate telephone messages* (A.R.S. §42-1310.04) is not taxable under the telecommunications classification of transaction privilege tax. Revenue data for local telephone companies and long distance inter LATA companies is not available from the Arizona Corporation Commission.

*Sales of intrastate telecommunications services by a cable television system or by a microwave television transmission system that transmits television programming to multiple subscribers* are not subject to transaction privilege tax (A.R.S. §42-1310.04A). The National Cable Television Association provides that in 1997, Arizona had 992,000 basic cable subscribers. Using an average monthly rate of \$32.39, the estimated cable television revenues were \$385.7 million. Potential collections from a tax rate of 5% would equal an estimated \$19.3 million in Fiscal Year 1997/98.

*End user common line charges and carrier access charges established by federal communications regulations* are exempt from transaction privilege tax (A.R.S. §42-1310.04B2, A.R.S. §42-1310.04B3). Using a 1995 report published by the Federal Communications Commission, Industry Analysis Division, an estimate of \$140.0 million in revenues from end user access charges was calculated for 1997. This revenue would have provided an additional \$7.0 million in tax collections in Fiscal Year 1997/98.

The gross proceeds from *manufacturing or publishing books* are exempt from transaction privilege tax (A.R.S. §42-1310.05A1). The potential tax collections can be estimated using the 1992 Census of Manufacturing value of shipments for Arizona. Based on an estimated \$35.5 million in sales, the potential tax collection would have been \$1.8 million in Fiscal Year 1997/98.

The *gross income derived from advertising* is excluded from the tax base for the publication classification under transaction privilege tax (A.R.S. §42-1310.05B1) and was estimated using the 1992 Census of Services. Based on estimated sales of \$194.9 million, potential tax collections at a 5% tax rate would have been \$9.7 million in Fiscal Year 1997/98.

The gross proceeds of sales to a person in Arizona who has a transaction privilege tax license and who *distributes printing, engraving, embossing or copying without consideration in connection with the publication of a newspaper or magazine* are not included in the taxable base under the job printing classification of the transaction privilege tax (A.R.S. §42-1310.06B1). No information is available on this exemption.

*Sales of job printing, engraving, embossing, and copying for use outside the state if the materials are shipped or delivered out of the state, regardless of where title to the materials passes or their free on board point* are exempt from the job printing classification (A.R.S. §42-1310.06B2). No data is available on the tax value of this exemption.

*Leasing or renting four or fewer rooms of an owner-occupied residential home,*

furnishing no more than a breakfast meal, with no more than 50% average annual occupancy rate is not subject to the transaction privilege tax under the transient lodging classification (A.R.S. §42-1310.10B3). No information is available on the value of this exemption.

*Leasing or renting films, tapes or slides used by theaters or movies, which are engaged in business under the amusement classification, or use by television stations or radio stations* is not subject to the transaction privilege tax under the personal property rental classification (A.R.S. §42-1310.11A1). No information is available on the value of this exemption.

*Operating coin operated washing, drying and dry cleaning machines or coin operated car washing machines at establishments for the use of such machines* are not subject to transaction privilege tax (A.R.S. §42-1310.11A4). Potential tax revenue for Fiscal Year 1997/98 is \$2.4 million from coin-operated laundries and dry cleaning services and \$0.7 million from coin-operated car washing machines. These figures are included in the detailed list of exempt business and personal services at the end of this section.

*Freight charges* included in the sales price of any nonmetalliferous mineral product are subtracted from the taxable base under the mining classification of the transaction privilege tax (A.R.S. §42-1310.12C). No data is available on the value of this exemption.

*Tuition and fees paid to universities and community colleges* (A.R.S. §42-1310.13A1) are exempt from transaction privilege tax. A total of \$85.9 million

was collected in Fiscal Year 1997/98 for tuition and fees from the community colleges. At this time, information is not available from the universities. A 5% tax on these tuition and fee payments would have brought in \$4.3 million.

*Private or group instructional activities and membership and initiation fees for health or fitness clubs or private recreational establishments with memberships greater than 28 days* are exempt from the amusement classification of transaction privilege tax (A.R.S. §42-1310.13A2, A.R.S. §42-1310.13B1). Potential tax revenue can be estimated by growing the 1992 Census of Service Industries receipt data for Arizona. Estimated sales for the above categories equal \$93.0 million, which gives a potential collection figure of \$4.7 million.

*Events sponsored by the Arizona Coliseum and Exposition Center Board* (A.R.S. §42-1310.13A3) are not subject to transaction privilege tax. The Exposition Center Board reported FY 1997/98 income from transactions that are normally taxable at \$9.0 million. At a 5% rate, this gives a potential collection figure of \$0.4 million.

*A musical, dramatic or dance group or a botanical garden, museum or zoo that qualified as a nonprofit charitable organization* is exempt from transaction privilege tax under the amusements classification (A.R.S. §42-1310.13A4). The impact of this exemption can be quantified by growing the 1992 Census of Service Industries data for Arizona. On the basis of estimated sales of \$99.9 million for those categories, potential tax collections at a 5% rate equal \$5.0 million in Fiscal Year 1997/98.

*Sales of admissions to intercollegiate football contests if the contests are operated by a nonprofit organization* are exempt from transaction privilege tax (A.R.S. §42-1310.13A7). Admissions to the intercollegiate events totaled an estimated \$7.3 million in Fiscal Year 1997/98. At a 5% rate, this gives a potential collection figure of \$0.4 million.

*Fees and assessments received by a homeowners organization* from members or guests of members are not taxable under the amusement classification (A.R.S. §42-1310.13A8). The value of this exemption is not available.

Under the restaurant classification of transaction privilege tax, *sales by a congressionally chartered veterans organization of food or drink prepared for consumption on the premises leased, owned or maintained by the organization* are exempt from tax (A.R.S. §42-1310.14B2). No information is available on the value of this exemption.

*Sales by churches, fraternal benefit societies and other nonprofit organizations which do not regularly engage or continue in the restaurant business for the purpose of fund raising* are exempt from transaction privilege tax (A.R.S. §42-1310.14B3). No information is available on the value of this tax expenditure.

While income from prime contracting is taxable, both the *sale price of land and the wages and salaries paid for any labor employed in construction* (A.R.S. §42-1310.16) are not taxable. The tax is limited to that portion which is essentially materials (tax is applied to 65% of gross proceeds). The amount of

contracting wages and salaries estimated by the Department of Economic Security for Fiscal Year 1997/98 was \$3.9 billion. At a 5% tax rate, the tax on the labor component is \$193.7 million. An estimate for the total sales price of land is not available.

The gross proceeds of sales or gross income received from a contract entered into for the construction, alteration, repair, addition, subtraction, improvement, movement, wrecking or demolition of any building, highway, road, railroad, excavation or other structure, project, development or improvement located in a *military reuse zone for a manufacturer, assembler or fabricator of aviation or aerospace products* is exempt from transaction privilege tax under the prime contracting classification (A.R.S. §42-1310.16B4). No information is available for this exemption.

The gross proceeds of sales derived from a *contract to construct a qualified environmental technology manufacturing, producing or processing facility* is exempt from transaction privilege tax under the prime contracting classification (A.R.S. §42-1310.16B5). The value of this exemption is not available.

The gross proceeds of sales from a *contract to provide response to a release or suspected release of a hazardous substance* is exempt from the prime contracting classification of transaction privilege tax (A.R.S. §42-1310.16B6). Information is not available on this expenditure.

The gross proceeds of sales that are from a contract enter into for the installation, assembly, repair or maintenance of

machinery or other tangible personal property that is deducted under the retail classification A.R.S. §42-1310.01B and that *does not become permanently attached* to the structure or project is exempt from the prime contracting classification of transaction privilege tax (A.R.S. §42-1310.16B7). No information is available on the value of this tax expenditure.

Income received from a contract for *constructing a lake facility development in a commercial enhancement reuse district* is exempt from the prime contracting classification of transaction privilege tax (A.R.S. §42-1310.16B8). Information is not available on this expenditure.

Use tax does not apply for *tangible personal property not exceeding \$200 in any one month purchased by an individual at retail outside the continental limits of the United States* for personal use and enjoyment (A.R.S. §42-1409A10). No data is available on the value of this exemption.

*All purchases made by a residential care institution that is operated in conjunction with licensed nursing care institutions* are exempt from use tax (A.R.S. §42-1409A13c). Information is not available on this expenditure.

*Tangible personal property purchased by a nonprofit charitable organization from the parent or affiliate organization that is located out of state* is exempt from use tax (A.R.S. §42-1409A13h). No data is available on the value of this exemption.

*Motor vehicles that are removed from inventory and are provided to charitable or educational institutions or state*

*universities or their affiliated organizations* are exempt from use tax (A.R.S. §42-1409A32). No information is available on the value of this exemption.

Use tax does not apply to *tangible personal property* which is or directly

enters into and becomes an ingredient or part of *cards used as prescription plan identification cards* (A.R.S. §42-1409A38). Information is not available on this expenditure.

## TRANSACTION PRIVILEGE AND USE TAX EXPENDITURES

<b>PREFERENTIAL TAX RATE CATEGORIES</b>	<b>Additional Collections At A 5% Rate</b>
Nonmetalliferous Mining; Oil and Gas Production .....	\$3,571,000
Commercial Lease.....	181,715,000
Rental Occupancy Tax .....	84,000
<b>Total Preferential Tax Rates.....</b>	<b>\$185,370,000</b>

### CREDITS

Motion Picture Production Company refund .....	?? <sup>35</sup>
Accounting Credit .....	<u>\$13,082,000</u>
<b>Total Credits.....</b>	<b>\$13,082,000</b>

### EXEMPTIONS

#### Professional Services:

Legal .....	\$74,745,000
Engineering.....	32,140,000
Architectural .....	11,805,000
Surveying.....	1,332,000
Accounting, Auditing & Bookkeeping .....	28,099,000
Physicians.....	163,025,000
Osteopathic Physicians.....	9,774,000
Optometrists.....	3,399,000
Chiropractors.....	8,515,000
Dentists.....	35,001,000
Nursing & Personal Care Facilities .....	22,255,000
Medical & Dental Lab Services.....	14,009,000
Other Health Services.....	<u>59,849,000</u>
<b>Total Professional Services.....</b>	<b>\$463,948,000</b>

#### Business Services:

Services to Dwellings & Other Buildings .....	\$16,585,000
Management, Consulting & Public Relations .....	37,451,000
Credit Reporting, Collection Agencies.....	7,613,000
Stenographic & Reproduction Services <sup>36</sup> .....	1,769,000
Personnel Supply Services.....	34,585,000
Research & Development Laboratories.....	13,068,000
Testing Laboratories & Facilities .....	4,951,000
Detective Agencies & Protective Services .....	9,753,000

<sup>35</sup>These question marks ("??") indicate that release of this information would result in violation of Arizona confidentiality laws. Fewer than ten license holders took advantage of this refund.

<sup>36</sup>Not elsewhere classified.

Interior Designing.....	\$1,246,000
Telephone Answering Service.....	834,000
Computer Programming, Data Processing & Other Computer Related Services.....	78,292,000
Automobile Parking.....	1,336,000
Automotive Repair Shops.....	41,549,000
Automotive Services, Except Repair.....	8,152,000
Electrical & Electronic Repair Shops.....	9,652,000
Reupholstery & Furniture Repair .....	1,048,000
Watch, Clock & Jewelry Repair .....	273,000
Other Repair Shops/Related Services.....	<u>16,830,000</u>
Total Business Services.....	\$284,987,000
<u>Personal Services:</u>	
Laundry, Cleaning & Garment Services.....	\$15,631,000
Beauty Shops & Barber Shops.....	11,844,000
Shoe Repair, Shoeshine & Hat Cleaning.....	166,000
Funeral Service & Crematories .....	3,340,000
Miscellaneous Personal Services.....	4,552,000
Motion Picture Production Distribution .....	5,017,000
Other Amusement & Recreation Services <sup>37</sup> .....	27,110,000
Child Day Care Services.....	6,609,000
Other Social Services.....	14,703,000
Correspondence & Vocational Schools.....	<u>7,706,000</u>
Total Personal Services.....	\$96,678,000
Wholesale Trade.....	\$1,796,904,000
Cash Discounts.....	NIA*
Trade-Ins .....	NIA
Sale of Warranty or Service Contracts.....	NIA
Sale of Tangible Personal Property by a Nonprofit Organization.....	NIA
Sale of Stocks and Bonds.....	27,904,000
Prescription Drugs and Medical Oxygen .....	40,512,000
Eyeglasses and Contact Lenses.....	5,575,000
Insulin, Insulin Syringe and Glucose Test Strips .....	NIA
Prosthetic Appliances.....	NIA
Hearing Aids .....	NIA
Durable medical equipment .....	NIA
Sales to Nonresidents for use outside Arizona if the property is shipped or delivered outside the state.....	NIA
Food for Home Consumption.....	243,188,000
Textbooks that are required by any state university or community college.....	1,290,000
Meals Provided to Employees of Restaurants.....	12,467,000
Food Used in School Lunches.....	NIA

<sup>37</sup>bid.

\* No Information Available

Sale of Arizona Lottery Tickets.....	\$12,536,000
Precious Metal Bullion and Monetized Bullion.....	NIA*
Tangible Personal Property sold to a Qualifying Hospital or a Qualifying Health Care Organization .....	NIA
Tangible Personal Property Sold to or Purchased by Qualifying Community Health Centers and Health Care Organizations.....	NIA
Tangible Personal Property Sold to a Non-Profitable Organization which Regularly Serves Meals to the Needy and Indigent .....	NIA
Magazines or other Periodicals or other Publications To Encourage Tourist Travel .....	NIA
Sale of Articles to a Contractor for Incorporation or Fabrication Under a Contract.....	155,863,000
Sale of Articles to be Incorporated into a Manufactured Product .....	671,407,000
Exempt Motor Vehicle Sales (certain nonresidents and Indians) .....	NIA
Tangible Personal Property Purchased by a Nonprofit Charitable Organization that uses such property for training, etc., for mentally or physically handicapped persons .....	NIA
Tangible Personal Property Sold by a Nonprofit Organization associated with a major league baseball team or a national touring professional golf association.....	NIA
Tangible Personal Property Sold by a Nonprofit Organization associated with a rodeo featuring primarily farm and ranch animals.....	NIA
Sales of Commodities under Futures Contracts Consigned to a Warehouse for Resale.....	NIA
Sales of New Semitrailers or New Semitrailer Parts Manufactured in Arizona.....	NIA
Seeds, Seedlings, Roots, Bulbs, Cuttings and Other Propogative Material used to commercially produce agricultural, horticultural, viticultural or floricultural crops in Arizona.....	NIA
Machinery, Equipment and Certain Supplies Used to Assist the Physically or Developmentally Disabled or those Persons with Head Injuries .....	NIA
Tangible Personal Property Shipped or Delivered Directly to a Foreign Country for use in that Country .....	NIA
Sales of Natural Gas or Liquefied Petroleum Gas used to Propel a Motor Vehicle.....	NIA
Paper Machine Clothing Used or Consumed in Paper Manufacturing .....	NIA
Machinery, Equipment, Materials and Other Tangible Personal Property Used to Construct a Qualified Environmental Technology Facility.....	NIA
Sales of Coal, Petroleum, Coke, Natural Gas, Virgin Fuel Oil and Electricity to an Environmental Technology Facility.....	NIA
Sales of Liquid, Solid or Gaseous Chemicals Used in Manufacturing, Processing Fabricating, Mining, Refining, Metallurgical Operations or Research and Development.....	NIA

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\* No Information Available

Sales of Food or Drink Consumed on the Premises of a Jail, Prison, or any Other Institution and Nonprofit Charitable Organizations that Regularly Serve Meals to the Needy and Indigent on a Continuing Basis.....	NIA*
Motor Vehicles and any Tangible Personal Property or Repair that Becomes a Part of the Motor Vehicles sold to a Licensed Motor Operator that Lease or Rent the Property.....	NIA
Livestock, Poultry, Feed and Supplies for Use or Consumption in the Businesses of Farming, Ranching and Feeding Livestock and Poultry.....	\$11,058,000
Sale or Purchase of Implants Used as Growth Promotants and Injectable Medicine.....	NIA
Sales of Motor Vehicles at Auction to Nonresidents of this State for Use Outside of this State.....	NIA
Personal Hygiene Products Which are Furnished to and to be Consumed by Hotel Occupant .....	NIA
Sales or Purchases of Alternative Fuel to a Used Oil Fuel Burner .....	NIA
Printed, Photographic, Electronic or Digital Media Materials for use in Publicly Funded Libraries.....	NIA
Tangible Personal Property Consisting of Food, Beverages and Condiments Sold to or Purchased by a Commercial Airline .....	NIA
Machinery or Equipment used directly in Manufacturing, Processing, Fabricating, Job Printing, Refining or Metallurgical Operations .....	49,096,000
Sale of Machinery or Equipment Used in Mining and in Drilling for or Extracting Oil or Gas from the Earth .....	10,790,000
Certain Equipment used in the Telecommunications Industry .....	NIA
Machinery, Equipment or Transmission Lines used directly in Producing or Transmitting Electrical Power .....	NIA
Neat Animals, Horses, Asses, Sheep, Swine or Goats used or to be used as breeding or production stock.....	NIA
Pipes or Valves Four Inches in Diameter Used to Transport Oil, Natural Gas, Artificial Gas, Water or Coal Slurry.....	NIA
Certain Aircraft, Navigational and Communication Instruments .....	NIA
Machinery, Tools, Equipment Used in Repairing, Remodeling or Maintaining Aircraft, Aircraft Engines or Aircraft Component Parts.....	NIA
Railroad Rolling Stock, Rails, Ties and Signal Control Equipment Used to Transport Persons or Property for hire .....	NIA
Buses or Other Urban Mass Transit Vehicles Used to Transport Persons for hire or pursuant to a governmentally adopted and controlled urban mass transportation program .....	NIA
Certain Groundwater Measuring Devices.....	NIA
New Machinery and Equipment Used for Commercial Production of Agricultural, Horticultural, Viticultural and Floricultural Crops .....	9,776,000
Machinery or Equipment used in Research and Development .....	NIA
Machinery and Equipment Purchased by or on Behalf of Owners of a	

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\* No Information Available

Soundstage Complex .....	NIA
Tangible Personal Property Used by any Direct Broadcast Satellite Television or Data Transmission Service or Facility .....	NIA*
Sales of Services by Direct Broadcast Satellite Television Services.....	NIA
Clean Rooms Used for Manufacturing, Processing Fabrication or Research and Development .....	NIA
Portion of Sales Price of Luxury Automobiles that Reflects the Federal Luxury Excise Tax.....	NIA
Sales of Overhead Materials or Other Tangible Personal Property to a Manufacturer, Modifier, Assembler or Repairer if Performing a Contract between the United States Government and the Manufacturer .....	NIA
Sales of Tangible Personal Property made to the United States Government Not Deducted under A.R.S. §42-1310.01K.....	NIA
Sales of Solar Energy Devices.....	NIA
Sales of Wireless Telecommunication Equipment as an Inducement to Enter Into or Continue a Contract for Telecommunication Services or Sales Commissions Received.....	NIA
Ambulances or Ambulance Services.....	NIA
Public Transportation Services for Dial-A-Ride Programs and Special Needs Transportation Services .....	NIA
Gross Proceeds of Sales or Gross Income Derived from Transporting For Hire Persons, Freight or Property by a Railroad Pursuant to a Contract with Another Railroad .....	NIA
Sales of Electricity to a Distributor .....	NIA
Sales of Natural Gas or Liquefied Petroleum Gas used to Propel a Motor Vehicle.....	NIA
Revenues Received by a Municipally Owned Utility in the form of Fees Charged to Persons Constructing Residential, Commercial or Industrial Developments.....	NIA
Revenues Received By Any Person Owning a Utility System in the Form of Reimbursement or Contribution Compensation for Property and Equipment Installed to Provide Utility Access to, on or across the land of an actual utility consumer.....	NIA
Interstate Sales of Electricity, Natural Gas & Water.....	NIA
Interstate Telephone Messages.....	NIA
Sales of Intrastate Telecommunications Services by a Cable Television System or by a Microwave Television Transmission System .....	\$19,286,000
End User Common Line Charges and Carrier Access Charges Established by Federal Communications Regulations.....	7,000,000
Manufacturing or Publishing Books .....	1,776,000
Gross Income Derived from Advertising.....	9,744,000
Sales to a Person who Distributes Printing, Engraving, Embossing or Copying Without Consideration In Connection With the Publication of a Newspaper or Magazine .....	NIA

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\* No Information Available

Sales of Job Printing, Engraving, Embossing, and Copying for Use Outside the State if the Materials are Shipped or Delivered Out of the State.....	NIA
Leasing or Renting Four or Fewer Rooms of an Owner Occupied Residence	
Bed and Breakfast with less than 50% Average Annual Occupancy .....	NIA*
Leasing Films, Tapes or Slides Used by Theaters or Movies or Used By	
Television Stations or Radio Stations.....	NIA
Freight Charges Relating Nonmetalliferous Mineral Products.....	NIA
Tuition and Fees Paid to Universities & Community Colleges .....	\$4,297,000
Private or Group Instructional Activities and Membership and Initiation	
Fees for Health or Fitness Clubs or Private Recreational Establishments	
with Memberships Greater than 28 Days .....	4,651,000
Events Sponsored by the Arizona Coliseum & Exposition Board.....	450,000
Musical, Dramatic or Dance groups or a Botanical Garden, Museum or	
Zoo that Qualifies as a Nonprofit Charitable Organization.....	4,997,000
Sales of Admissions to Intercollegiate Football Contests.....	364,000
Fees and Assessments Received by a Homeowners Organization.....	NIA
Sales By a Congressionally Chartered Veterans Organization of Food	
or Drink.....	NIA
Sales By Churches, Fraternal Benefit Societies and Other Nonprofit	
Organizations Which Do Not Regularly Engage or Continue in the	
Restaurant Business for the purpose of fund raising .....	NIA
Wages & Salaries for Labor Employed in Construction.....	193,689,000
Contracting in a Military Reuse Zone for a Manufacturer, Assembler	
or Fabricator of Aviation or Aerospace Products.....	NIA
Gross Proceeds of Sales from a Contract to Provide Response to a Release	
or Suspected Release of a Hazardous Substance.....	NIA
Tangible Personal Property Not Exceeding \$200 Purchased By An	
Individual at Retail Outside the Continental United States - USE	
TAX ONLY .....	NIA
Purchases Made by a Residential Care Institution that is Operated in	
Conjunction with Licensed Nursing Care Institutions - USE	
TAX ONLY .....	NIA
Tangible Personal Property Purchased by a Nonprofit Charitable	
Organization from the Parent or Affiliate Organization Located	
Out of State - USE TAX ONLY .....	NIA
Motor Vehicles Removed From Inventory and Provided to Charitable	
or Educational Institutions or State Universities or their Affiliated	
Organizations- USE TAX ONLY .....	NIA
Tangible Personal Property which Directly Enters into or becomes an	
Ingredient or Part of Cards Used as Prescription Plan Identification Cards	
- USE TAX ONLY .....	NIA

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\* No Information Available

Total Exemptions.....	\$4,140,233,000
<b>TOTAL QUANTIFIABLE TRANSACTION PRIVILEGE AND USE TAX EXPENDITURES<sup>38</sup> .....</b>	<b>\$4,338,685,000<sup>39</sup></b>

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<sup>38</sup>These expenditures represent foregone revenues to the state general fund, counties and incorporated cities/towns.

<sup>39</sup>Changes from previous years may be a result of changes in the Census/Base year figures and/or measurable changes in economic activity, as in the case of construction-based figures.



# **UNDERGROUND STORAGE TANK TAX EXPENDITURES**



## UNDERGROUND STORAGE TANK TAX EXPENDITURES<sup>40</sup>

An underground storage tank tax is imposed by A.R.S. §49-1031. For purposes of this tax, it is presumed until proven differently that all regulated substances which are motor vehicle fuel, aviation fuel and diesel and which are refined, manufactured, produced, compounded or blended in Arizona, or imported into the state, will be placed in an underground storage tank from which the fuel is dispensed to users who consume the fuel and do not further distribute it. The tax is levied at the rate of 1¢ per gallon of regulated substance. Revenues from this tax are deposited into the Department of Environmental Quality Assurance Account, used for corrective action projects.

This tax does not apply to *underground storage tanks operated by the United States or Arizona and its agencies* (A.R.S. §49-1031C). There are 403 federal and state tanks currently in use. Average tank capacity is approximately 10,000 gallons. The Department of Environmental Quality does not require the owners/operators of these tanks to report the total number of times they are refueled. Therefore, there is no information on the tax value of this tax expenditure.

*Underground storage tanks used for the purpose of storing, handling or distributing naphtha-type jet fuel or kerosene-type jet fuel* are exempt from the underground storage tank tax (A.R.S. §49-1031C). The Arizona Department of Environmental Quality has registered 142 naphtha-type jet fuel or kerosene-type jet fuel tanks, with an average tank capacity of 25,000 gallons. As with the underground storage tanks owned by the federal government and the state of Arizona, the owner/operators of these type of underground storage tanks are not required to report the number of times the tanks are refueled. Due to this lack of information, there is no way to calculate the impact of this tax expenditure.

*Above-ground storage tanks* are not subject to this tax. The owners/operators of these type of tanks are not required to register their tanks with the Department of Environmental Quality. The State Fire Marshall has reported that 2,500 above-ground storage tank sites have registered with his agency, with approximately two tanks per site. However, there is no legal requirement for this registration. Due to the lack of information, there are no figures for the impact of this exemption.

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<sup>40</sup>Any figures presented for Underground Storage Tank Tax Expenditures were provided by the Arizona Department of Environmental Quality.

**SUMMARY OF UNDERGROUND STORAGE TANK TAX  
EXPENDITURES**

	Revenue <u>Gain</u>
Underground Storage Tanks Operated by the U.S. or Arizona.....	NIA*
Tanks used for Naphtha-Type or Kerosene-Type Jet Fuel .....	NIA
Above-Ground Storage Tanks.....	NIA

**TOTAL QUANTIFIABLE UNDERGROUND STORAGE TANK TAX  
EXPENDITURES<sup>41</sup>**  
 ..... \$0

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\* No Information Available.

<sup>41</sup>These expenditures represent foregone revenues to the DEQ Assurance Account.

**UNEMPLOYMENT  
INSURANCE TAX  
EXPENDITURES**



# UNEMPLOYMENT INSURANCE TAX EXPENDITURES<sup>42</sup>

Unemployment insurance is based upon the wages paid by the employer to the employee during the calendar year. A.R.S. §23-622 sets out the following exemptions from the definition of wages:

- *That part of the remuneration in excess of \$7,000 paid in a calendar year to an individual by an employer with respect to employment during the calendar year, unless that part of the above specified excess remuneration is subject to a tax, under federal law, against which credit may be taken for contributions required to be paid into a state unemployment fund by employers subject to the federal law.*
- *The amount of any payment, including monies paid by an employer for insurance or annuities, made to or on behalf of an employee or his/her dependents under a plan or system established by an employer which makes provision for the employees generally on account of sickness or accident disability, medical or hospitalization expenses in connection with sickness or accident disability or death.*
- *The payment by an employer, without deduction from the remuneration of the employee, of the tax imposed upon an employee under § 3101 of the Internal Revenue Code relating to federal insurance contributions with respect to remuneration paid to an employee for*

*domestic service in a private home or for agricultural labor.*

- *Any payment on account of sickness or accident disability, or medical or hospitalization expenses in connection with sickness or accident disability, made by an employing unit to an employee after the expiration of six calendar months following the last calendar month in which the employee worked for such employing unit.*
- *Any payment made to an employee or his/her beneficiary (1) from or to a trust described in § 401(a) of the Internal Revenue Code relating to qualified pension, profit sharing and stock bonus plans which is exempt from tax under § 501(a) of the Internal Revenue Code, (2) under or to an annuity plan which is a plan described in § 403(a) of the Internal Revenue Code, (3) under a simplified employee pension as defined in § 408(k)(1) of the Internal Revenue Code other than contributions described in § 408(k)(6) of the Internal Revenue Code, (4) under or to an annuity contract described in § 403(b) of the Internal Revenue Code, (5) under or to an exempt governmental deferred compensation plan, (6) to supplement pension benefits under a plan or trust described in this paragraph to take into account some portion of the increase in the cost of living since retirement, or (7) under a cafeteria plan within the meaning of § 125 of the Internal Revenue Code if*

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<sup>42</sup>Any figures presented for Unemployment Insurance Tax Expenditures were provided by the Arizona Department of Economic Security.

*such a payment would not be treated as wages without regard to such plan.*

- *Remuneration paid in any medium other than cash to an employee for service not in the course of the employing unit's trade or business.*
- *Remuneration paid for agricultural labor performed in any medium other than cash.*
- *Any tip, gratuity or service charge received by an employee, with certain exceptions.*
- *Remuneration which the individual receives for drill, training or other national guard or reserve activity which occurs on not more than one weekend per month.*
- *Remuneration paid to an employee if at the time of the payment it is reasonable to believe that a corresponding deduction is allowable under § 217 of the Internal Revenue Code relating to moving expenses.*
- *Any contribution, payment or service provided by an employer which may be excluded from gross income under the provisions of § 120 of the Internal Revenue Code.*
- *Any payment made or benefit furnished to an employee if it is reasonable to believe that the employee will be able to exclude the payment or benefit from income under § 127, relating to educational assistance, or § 129, relating to dependent care assistance, of the Internal Revenue Code.*
- *The value of meals or lodging furnished by the employer if it is reasonable to believe that the employee will be able to exclude these items from income under § 119 of the Internal Revenue Code.*
- *Any payment made by an employer to a survivor or the estate of a former*

*employee after the calendar year in which the employee died.*

- *Any benefit provided to an employee if it is reasonable to believe that the employee will be able to exclude the benefit from income under § 74(c) relating to employee achievement awards, section 117 relating to qualified scholarships or § 132 relating to certain fringe benefits of the Internal Revenue Code.*

An employee is an individual who performs services for an employer and who is subject to the direction, rule or control of the employer as to both the method of performing the services and the result to be accomplished. This definition, per A.R.S. §23-613.01A, does not include:

- *An individual who performs services as an independent contractor, business person, agent or consultant, or in a capacity characteristic of an independent profession, trade, skill or occupation.*
- *An individual subject to the direction, rule, control or subject to the right of direction, rule or control of an employing unit solely because of a provision of law regulating the employing unit.*
- *An individual or class of workers that have been exempted by the Internal Revenue Service from paying Federal Unemployment Tax.*
- *An individual or class or workers that have been exempted by the Internal Revenue Service from paying Federal Unemployment Tax for a certain period of time.*
- *An individual or class of workers that have previously not been found not to be workers in prior audits by the Department, but have currently been*

*found to be employees due to prior audit errors, will not be charged for any previous time but will be required to begin reporting those workers during the next quarter.*

Employment means any service of whatever nature performed by an employee for an employer. Exclusions, which are found in A.R.S. §23-615(6)(d), for governmental entities or 501(c)(3) non-profit employers include the following services:

- *Services performed in the employ of a church, convention, association of churches or an organization supervised, controlled or principally supported by a church, convention or association of churches operated primarily for religious purposes.*
- *Services performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his or her ministry; or by a member of a religious order in the exercise of duties required by such order.*
- *Services performed by an elected official, member of the legislature or judiciary of this state or a political subdivision, in the exercise of his or her duties.*
- *Services performed as a member of the state national guard or air national guard.*
- *Services performed as an employee on a temporary basis in case of a fire, storm, snow, earthquake, flood or similar emergency.*
- *Services in a position which is designated under or pursuant to state law as a major non tenured policy making or advisory position, or a policy making or advisory position of which the duties ordinarily do not require more than eight hours per*

- *Services performed by impaired individuals who cannot be readily adsorbed into the competitive labor market in a facility conducted for the purpose of providing a program of rehabilitation for such individuals.*
- *Services performed by an individual in an unemployment work relief or work training program financed in part or in whole by a governmental entity.*
- *Services performed by an inmate of a custodial or penal institution.*

Types of exempt employment are set out in A.R.S. §23-617, as follows:

- *Agricultural labor which works less than some portion of twenty weeks in a given calendar year or unless the labor receives wages of \$20,000 or more in a calendar quarter.*
- *Domestic service in a private home, local college club or local chapter of a college fraternity or sorority which receives less than \$1,000 in wages in a calendar quarter.*
- *Service performed on a vessel or aircraft not an American vessel or American aircraft, if the employee is employed on such vessel or aircraft when outside the United States.*
- *Service performed by an individual in the employ of his/her children or spouse, and service performed by an individual under the age of 21 in the employ of a parent.*
- *Service performed in the employ of another state, or any political subdivision of another state, or an instrumentality of one or more thereof which is wholly owned by one or more other states or political subdivisions and which exercises only governmental as distinguished from proprietary functions, and service performed in the employ of any political subdivision of*

*this or any other state to the extent the instrumentality, with respect to such service, is exempt under the Constitution of the United States from the tax imposed by §3301 of the federal Internal Revenue Code.*

- *Service with respect to which unemployment compensation is payable under an unemployment compensation established by an act of Congress.*

- *Service performed in a calendar quarter in the employ of an organization exempt from income tax under § 501(a) or § 521 of the Internal Revenue Code, if the remuneration for the services is less than \$50.*

- *Service performed in the employ of a school, college or university, if the service is performed by a student enrolled and regularly attending classes, or by the spouse of such a student.*

- *Service performed in the employ of a corporation, community chest fund or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational; purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of a private shareholder or individual and with further qualifications.*

- *Services performed by a student nurse in the employ of a hospital or a nurses' training school by an individual enrolled and regularly attending classes, and service performed as an intern in the employ of a hospital by an individual who has completed a four years' course in a medical school.*

- *Service performed by an individual for an employing unit as an insurance agent or as an insurance solicitor, if paid by commission.*

- *Service performed by an individual under the age of 18 in the delivery or distribution of newspapers or shopping news, with qualifications.*

- *Service performed by an individual for an employing unit as a licensed real estate broker or licensed cemetery broker or a licensed real estate salesman or licensed cemetery salesman, if paid by commission.*

- *Service performed in the employ of a foreign government including service as a consular or other officer or employee or a non diplomatic representative.*

- *Service performed in the employ of an instrumentality wholly owned by a foreign government if certain qualifications are met.*

- *Service covered by an arrangement between the department and agency charged with the administration of any other state or federal unemployment compensation law pursuant to which all services performed by an individual for an employing unit is deemed to be performed entirely within such agency's state.*

- *Casual labor not in the course of the employer's trade or business.*

- *Service performed by an individual for an employing unit as a securities salesman, if paid solely by commission.*

- *Service performed in the employ of a hospital if such service is performed by a patient of the hospital.*

- *Service performed by individuals solely to the extent that the compensation includes commissions, overrides or profits realized on sales primarily resulting from the in-person solicitation of orders for or making sales of consumer goods in the home.*

- *Services performed by an individual for an employing unit in the preparation of tax returns and related*

*schedules and documents if all such services are performed for remuneration solely by way of commission.*

The exemptions mentioned above result in no requirement for reporting wages or remuneration paid. Therefore, no information is available for the tax value of these tax expenditures.

<b>SUMMARY OF UNEMPLOYMENT INSURANCE TAX EXPENDITURES</b>
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	<u>Revenue Gain</u>
Exemptions from wages.....	NIA*
Exemptions from the definition of employee.....	NIA
Exemptions from employment.....	NIA
 <b>TOTAL QUANTIFIABLE UNEMPLOYMENT INSURANCE TAX EXPENDITURES<sup>43</sup></b>	
.....	<b>\$0</b>

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\* No Information Available.

<sup>43</sup>These expenditures represent foregone revenues to the state unemployment insurance fund.

# **USE FUEL TAX EXPENDITURES**



## USE FUEL TAX EXPENDITURES<sup>44</sup>

There is a tax of 27¢ per gallon on each gallon of use fuel (all fuel that is not considered motor vehicle fuel, like diesel fuel) used in the propulsion of a motor vehicle on any highway within this state, with the exception of clean burning use fuel. The proceeds of this tax are distributed to the state highway fund, counties and incorporated cities and towns. There is a \$0.02 per gallon credit for all use fuel used outside of the state.

### PREFERENTIAL USE FUEL TAX RATES

Fuel used on *light class motor vehicles used on a highway in this state for convenience and facility or on vehicles exempt from gross weight fees* is taxed at \$0.18 per gallon as opposed to \$0.27 per gallon for all other use class vehicles (A.R.S. §28-5709). The amount of refunds issued for Fiscal Year 1997/98 is \$2,428,000.

### EXEMPTIONS TO THE USE FUEL TAX

*Farm tractors and implements of husbandry designed primarily for or used in agricultural operations* and only incidentally operated or moved upon a highway are exempt from the use fuel tax

(A.R.S. §28-5716.A7a). No information is available on this tax exemption.

*Road rollers or vehicles which are designed and used primarily for grading, paving, earth moving and other construction work on highways* and which are not designed or used primarily for transportation of persons or property and which are incidentally operated or moved over the highway are exempt from use fuel tax (A.R.S. §28-5716.A7b). There is no information available on this tax exemption.

*Each supplier that properly remits use fuel tax may retain four-tenths of one per cent of the tax imposed to cover the costs of administration of the tax* (A.R.S. §28-5751). This amount would have been collected by the state if this provision were not in effect. The value of this provision for Fiscal Year 1997/98 is \$653,000.

Effective April 1, 1997, all clean burning fuels are no longer taxed (A.R.S. §28-5708.B2). Because taxpayers who consume alternative fuels do not report their use information to the department, no information is available on this exemption.

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<sup>44</sup>Any figures presented for Use Fuel Tax Expenditures were provided by the Arizona Department of Transportation.

<b>SUMMARY OF USE FUEL TAX EXPENDITURES</b>
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	<u>Revenue Gain</u>
<b>PREFERENTIAL TAX RATES:</b>	
Light class and exempt vehicles use rate .....	\$2,428,000
<b>EXEMPTIONS:</b>	
Farm tractors and implements of husbandry designed primarily for or used in agricultural operations.....	NIA
Road rollers or vehicles which are designed and used primarily for grading, paving, earth moving and other construction work on highways.....	NIA
Administration exemption for use fuel suppliers.....	\$653,000
Exemption for clean burning fuels.....	NIA
 <b>TOTAL QUANTIFIABLE USE FUEL TAX EXPENDITURES<sup>45</sup></b>	
.....	<b>\$3,081,000</b>

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<sup>45</sup>These tax expenditures represent foregone revenues to the state highway fund, counties and incorporated cities and towns.

# **VEHICLE LICENSE TAX EXPENDITURES**



# VEHICLE LICENSE TAX EXPENDITURES<sup>46</sup>

Arizona imposes a vehicle license tax at the rate of \$4 for each \$100 in vehicle value. However, the vehicle value is 60% of the manufacturer's base retail price in the first year and declines by 15% each year thereafter. The minimum vehicle license tax is \$10. The proceeds of this tax are distributed to the state highway fund, counties, incorporated cities and towns, county assessors and the state general fund.

## PREFERENTIAL VEHICLE LICENSE TAX RATES

Three classes of motor vehicles pay lower vehicle license tax rates. Privately owned motor vehicles which are exclusively operated as a school bus (A.R.S. §28-5804), privately owned ambulances and fire fighting vehicles (A.R.S. §28-5806), and motor vehicles powered by alternative fuels (A.R.S. §28-5805) have a vehicle value in the first year of 1% of the manufacturer's base retail price. The minimum tax for both vehicles is \$5.00. The information on this tax expenditure is not available at this time.

## EXEMPTIONS FROM THE VEHICLE LICENSE TAX

Any vehicle which is not required to be registered in Arizona does not have to pay a vehicle license tax. Vehicles which are exempt from registration are:

- *Farm tractors* (A.R.S. §28-2153.D1)

- *Trailers used solely in the operation of a farm for transporting the unprocessed fiber or forage products of a farm or any implement of husbandry designed primarily for or used in agricultural operations and only incidentally operated or moved upon a highway* (A.R.S. §28-2153.D2)
- *Road rollers or road machinery, including power sweepers, temporarily operating or moved upon the highway* (A.R.S. §28-2153.D3)
- *Vehicles operated by an owner under special provisions relating to lienholders, manufacturers, dealers and nonresidents* (A.R.S. §28-2153.D4)
- *Motorized or nonmotorized equipment designed primarily for and used in mining operations and only incidentally operated or moved on a highway* (A.R.S. §28-2153.D5)
- *A motor vehicle being towed by a tow truck which has been registered* (A.R.S. §28-2153.D6)
- *A golf cart or other motor vehicle used in the operation of a golf course and only incidentally operated or moved on a highway* (A.R.S. §28-2153.D7)
- *Wheeled equipment, such as compressors, forklifts, portable cement mixers, tow dollies, tar pots, water trailers, welders, etc.* (A.R.S. §28-2153.D8)

Also exempt from vehicle license taxes are *vehicles purchased by an enrolled member of an Indian tribe who resides on the Indian reservation established for*

<sup>46</sup>Any figures presented for Vehicle License Tax Expenditures were provided by the Arizona Department of Transportation.

*that tribe and who purchases an unregistered vehicle for removal to the Indian reservation (A.R.S. §28-2154.C). Information on this exemption is not available.*

*Vehicles owned by a foreign government, by a consul or other official representative of a foreign government, by the United States, by a state or political subdivision of a state, by an Indian tribal government or by a nonprofit organization which presents to the motor vehicle division a form approved by the director of the division of emergency management (A.R.S. §28-2511.A) are exempt from vehicle license tax. There is no information available on this tax exemption.*

There are vehicle license tax exemptions allowed for *veterans, under certain*

*conditions, and for disabled individuals, within stated limits.* A veteran residing in Arizona is exempt from license tax for a vehicle acquired by financial aid from the veterans' administration (A.R.S. §28-5802). Any veteran that is certified by the veterans' administration to be 100% disabled and drawing compensation on that basis is not required to pay vehicle license tax (A.R.S. §28-5803). There is no information available on vehicle license tax exemptions granted veterans in Fiscal Year 1997/98. Disabled Arizona residents are not required to pay vehicle license tax on a vehicle they own if they are a recipient of public monies as a disabled individual under title 16 of the Social Security Act. However, only one vehicle may be claimed for this exemption (A.R.S. §28-5803.C).

<b>SUMMARY OF VEHICLE LICENSE TAX EXPENDITURES</b>
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Revenue Gain

**PREFERENTIAL TAX RATES:**

School buses.....	NIA *
Ambulances and fire fighting vehicles.....	NIA
Motor vehicles operated by alternative fuels .....	NIA

**EXEMPTIONS:**

Farm tractors .....	NIA
Trailers used solely in the operation of a farm for transporting the unprocessed fiber or forage products of a farm or any implement of husbandry designed primarily for or used in agricultural operations.....	NIA
Road rollers or road machinery .....	NIA
Any owner permitted to operate a vehicle under special provisions relating to lienholders, manufacturers, dealers and nonresidents.....	NIA
Motorized or nonmotorized equipment designed primarily for and used in mining operations.....	NIA
Motor vehicles being towed by a tow truck .....	NIA
Golf carts or other motor vehicles on a golf course. ....	NIA
Wheeled equipment.....	NIA
Vehicles purchased by Indians residing on the reservations.....	NIA
Vehicles owned by a government or by a nonprofit organization with a form approved by the division of emergency management .....	NIA
Vehicles owned by certain veterans.....	NIA
Vehicle owned by disabled individuals.....	NIA

**TOTAL QUANTIFIABLE VEHICLE LICENSE TAX  
EXPENDITURES<sup>47</sup>**

..... \$0

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<sup>47</sup>These tax expenditures represent foregone revenues to the counties, incorporated cities and towns, county assessors, the state highway fund and the state general fund.



# **WATERCRAFT LICENSE TAX EXPENDITURES**



# WATERCRAFT LICENSE TAX EXPENDITURES<sup>48</sup>

Arizona imposes a watercraft license tax on watercraft operating on all of the waterways of this state. Revenues received from this tax are deposited in the watercraft licensing fund, the state lake improvement fund, and the law enforcement and boating safety fund.

## WATERCRAFT LICENSE TAX PREFERENTIAL RATES

The watercraft license tax is 45¢ per foot of length of each watercraft up to and including eighteen feet and 68¢ per foot of length for each foot over eighteen feet (A.R.S. §5-321A) for resident owners. The taxation of smaller watercraft at a lower rate than larger watercraft is a preferential tax rate. If the tax on watercraft were 68¢ per foot regardless of length, additional revenues of \$462,458 would have been collected in Fiscal Year 1997/98.

For nonresident owners, the watercraft license tax is \$1.45 per foot of length of each watercraft up to and including eighteen feet and \$2.75 per foot of length for each foot over eighteen feet. If the tax on the watercraft were \$2.75 per foot regardless of length, \$428,662 in additional revenues would have been received in Fiscal Year 1997/98.

## EXEMPTIONS FROM WATERCRAFT LICENSE TAX

*Vessels owned by agencies of the federal government in performance of their official duties are exempt from the watercraft license tax (A.R.S. §5-302A). These vessels are also covered under A.R.S. §5-322A2 under the exemption for military or public vessels of the United States. If these vessels were subject to taxation, an additional \$544 in watercraft license tax revenues would have been collected in Fiscal Year 1997/98.*

*Persons doing business as marine dealers and licensed in Arizona are not required to register in their name any watercraft in their possession that may be offered for resale (A.R.S. §5-321C). There is no way of knowing how many boats any of the 462 dealers that are registered may have at any point in time because there is no watercraft license tax requirement. Therefore, no information is available on this exemption.*

*Foreign watercraft temporarily using the waters of the state (A.R.S. §5-322A1) is exempt from the watercraft license tax. The only time that foreign vessels operate in this state would be during a major regatta or race. A large majority of these races occur on the Colorado River, specifically Lake Havasu, which is a navigable waterway under the jurisdiction of the U.S. Coast Guard. The loss of revenue from this exemption is negligible to non-existent.*

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<sup>48</sup>Any figures presented for Watercraft License Tax Expenditures were provided by the Arizona Department of Game and Fish.

Also exempt from the watercraft license tax are *watercraft used solely as life boats* (A.R.S. §5-322A3). Due to the make-up of the boating population in Arizona, the incidence of lifeboats is nearly non-existent. Only very large boats on large bodies of water have the need or can even physically accommodate a lifeboat. Therefore, any revenue lost due to this exemption would be negligible.

A.R.S. §5-322.A4 pertains to *undocumented watercraft operating under a valid temporary certificate issued pursuant to the regulations prescribed by the Game and Fish Commission* which states that "Watercraft agents are boat dealers who have been given the authority to issue temporary watercraft certificates for new boats only. The customer may use his/her boat while the paperwork is being processed. The agent has sent in the fees and license tax with the paperwork; therefore, these watercraft

would be included in the preferential tax rates above."

*Any watercraft owned by the state or by any political subdivision* is exempt from the watercraft license tax (A.R.S. §5-322B). The state and its political subdivisions would have been subject to tax in the amount of \$3,933 in Fiscal Year 1997/98 if their watercraft were not exempt from this tax.

A.R.S. §5-322H exempts *owners of commercial watercraft not exempt from the ad valorem property tax*. If this type of watercraft had been taxed in Fiscal Year 1997/98, an additional \$23,293 would have been collected.

*If military personnel stationed in Arizona can provide proof that they are non-residents*, they are exempt from this tax. This exemption resulted in a tax expenditure of \$5,830 in Fiscal Year 1997/98.

<b>SUMMARY OF WATERCRAFT LICENSE TAX EXPENDITURES</b>
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	<u>Revenue Gain</u>
<b>PREFERENTIAL TAX RATES:</b>	
Resident preferential rates.....	\$462,000
Nonresident preferential rates.....	429,000
 <b>EXEMPTIONS:</b>	
Vessels owned by the agencies of the federal government .....	\$500
Persons doing business as marine dealers and licensed in Arizona.....	NIA*
Foreign watercraft temporarily using the waters of the state.....	NIA
Life boats.....	NIA
Watercraft owned by the state or by a political subdivision .....	4,000
Owners of commercial watercraft not exempt from ad valorem tax.....	23,000
Watercraft owned by non-resident military personnel .....	6,000
 <b>TOTAL QUANTIFIABLE WATERCRAFT LICENSE TAX EXPENDITURES<sup>49</sup></b>	
.....	<b>\$924,500</b>

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\* No Information Available.

<sup>49</sup>These tax expenditures represent foregone revenues to the watercraft licensing fund, the state lake improvement fund and the law enforcement and boating safety fund.



**WORKMEN'S  
COMPENSATION PREMIUM  
LIEU TAX EXPENDITURES**



## WORKMEN'S COMPENSATION PREMIUM LIEU TAX EXPENDITURES<sup>50</sup>

Workmen's compensation premiums are taxed at a rate up to 3% on all premiums collected during the calendar year, less certain deductions from total premiums (A.R.S. §23-961G). These deductions are for applicable cancellations, returned premiums, and policy dividends or

refunds paid or credited to policyholders within Arizona and not reapplied as premiums for new, additional or extended insurance. During Calendar Year 1997, the deductions from premiums totaled \$92,833,240 which results in a \$2,784,997 tax expenditure.

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<sup>50</sup>Any figures presented for Workmen's Compensation Premium Lieu Tax Expenditures were provided by the Industrial Commission of Arizona.

<b>SUMMARY OF WORKMEN'S COMPENSATION PREMIUM LIEU TAX EXPENDITURES</b>
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	<u>Revenue Gain</u>
Deductions from total premiums.....	\$2,785,000
<b>TOTAL QUANTIFIABLE WORKMEN'S COMPENSATION PREMIUM LIEU TAX EXPENDITURES<sup>51</sup></b>	
.....	<b>\$2,785,000</b>

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<sup>51</sup>These expenditures represent foregone revenues to the Administrative and Special Funds of the Industrial Commission.

