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Governor

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November 18, 2022

Pursuant Arizona Revised Statutes (“A.R.S.”) § 42-2080, attached please find two draft documents that the Department hereby proposes and publishes for public review and comment:

- The Department’s guidelines for administering the income tax credit program for qualifying charitable organizations (“QCOs”) and
- A guidance statement on the Department’s treatment of English language acquisition services for purposes of administering the QCO program.

These documents will become final and effective only upon due consideration of any public comments received on these documents and response to such comments.

Comments must be submitted in writing to the following contact:

Alejandra Garcia, QCO Program Manager, Office of Economic Research & Analysis
algarcia@azdor.gov

To ensure timely receipt and review of submissions, all commenters are strongly encouraged to submit their written comments electronically. However, you may submit your comments, addressed to the above contact, by mail to: Arizona Department of Revenue, 1600 W. Monroe St., Mail Code 4012, Phoenix, AZ 85007.

All written comments must be electronically submitted or postmarked on or before **Monday, December 19, 2022**. The Department will consider requests for extensions of time received on or before that date.

Thank you in advance for your time and continued efforts to provide meaningful feedback to the Department.

**TAX CREDIT PROGRAM GUIDELINES FOR
QUALIFYING CHARITABLE ORGANIZATIONS (QCOs)**

(A.R.S. § 43-1088)

DRAFT: NOVEMBER 18, 2022

Prepared by: Arizona Department of Revenue

**TAX CREDIT PROGRAM GUIDELINES FOR
QUALIFYING CHARITABLE ORGANIZATIONS (QCOs)**

(A.R.S. § 43-1088)

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Section 1. Overview

Pursuant to Arizona Revised Statutes (A.R.S.) section 43-1088(A), Arizona provides an income tax credit for an individual who makes a contribution to a Qualifying Charitable Organizations (QCO).

Before QCOs can receive contributions eligible for these tax credits, they must first be certified by the Arizona Department of Revenue (ADOR). ADOR's certification pertains solely to an organization's qualification for the Arizona tax credit program, as required by state statute, and is *not* a determination or assessment of the organization's value and benefit to the public good. Moreover, this program is wholly independent of general licensing or operations requirements.

Being recognized by the Internal Revenue Service (IRS) as a charitable organization under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended, is not the same as being a QCO for purposes of this Arizona tax credit. The requirements to become a QCO are in addition to the IRS requirements for charitable organizations. To request certification or recertification as a QCO, a charitable organization must complete the application form and submit it along with required documentation to ADOR.

Individuals making cash donations to these charities certified as QCOs may claim these tax credits on their Arizona individual income tax returns.

Section 2. Requirements for a Qualified Charitable Organization

An organization must meet *all* of the following criteria to qualify as a QCO:

1. The organization is a nonprofit 501(c)(3) or is a designated community action agency that receives community services block grant program monies pursuant to 42 United States Code (U.S.C.) section 9901.
2. The organization spends over 50 percent of its budget to provide *qualifying services to eligible populations*.
 - a. Qualifying services: By statute, there are 8 categories of services that qualify for purposes of meeting the 50% spending threshold, as long as they are provided and used in Arizona: (i) cash assistance, (ii) medical care, (iii) childcare, (iv) food, (v) clothing, (vi) shelter, (vii) job placement and job training services, or (viii) any other support that is reasonably necessary to meet immediate basic needs. These services will be referred to interchangeably as "qualifying services" or "basic needs services".
 - b. Eligible populations: To be counted toward the 50% spending threshold, the organization's services must be furnished to one of three categories of Arizona residents: (i) Temporary Assistance for Needy Families (TANF) benefit recipients, (ii) low-income residents, or (iii) individuals who have a chronic illness or physical disability. As defined in statute,
 - i. "Low-income residents" means persons whose household income is less than 150% of the federal poverty level.

- ii. “Individuals who have a chronic illness or physical disability” means individuals whose primary diagnosis is a severe physical condition that may require ongoing, medical or surgical intervention.

All individuals meeting the criteria of any one of these three categories of benefit recipients are referred to interchangeably as “qualifying individuals,” “eligible populations” or “eligible recipients”.

3. The organization provides a statement indicating plans to continue spending at least 50% of its budget on services to Arizona residents who fall within one or more of the three eligible populations.
4. The organization provides a statement indicating it does not offer, pay for, or provide coverage for abortions, and does not financially support any other entity that provides, pays for, or provides coverage of abortions.

A. Eligible Populations

There are three categories of individuals who are considered to be eligible recipients of basic needs services for purposes of these tax credits.

Low-income residents are defined as individuals living at or under 150% of the federal poverty level. Organizations claiming that their clients meet this criteria are required to explain the verification process used to determine this criteria has been met.

Individuals who receive Temporary Assistance for Needy Families (TANF) benefits are also considered part of an eligible population.

“Individuals who have a chronic illness or physical disability” means individuals whose primary diagnosis is a severe physical condition that may require ongoing medical or surgical intervention. Disabilities that are not physical in nature do not qualify. Organizations will be expected to describe the illnesses and physical disabilities from which their clients suffer. An additional guidance document addressing Chronic Illnesses and Physical Disabilities is forthcoming.

All individuals who otherwise meet the qualifying population criteria must also be Arizona residents.

B. Qualifying Services

With few exceptions, the services provided by the organization need to be provided directly to the eligible recipients. Exceptions will be noted below.

Providing access to or paying for immediate basic needs services is accepted as a basic needs service. For example, some organizations employ case workers that match eligible clients with providers of basic needs services, even when those basic needs services are not the main goal of the organization itself. Such matching services are considered to be basic needs services.

1. Cash Assistance

Cash assistance must be provided directly to the client. It can also include the provision of gift cards. For a cash payment to be considered qualified, the organization cannot demand that the money be spent on anything specific (e.g., food, clothing, gas).

Payments/scholarships to schools, camps, activities, or team sports do not constitute cash assistance. Payments to a service provider that provides basic needs services (like a utility company, an apartment complex, a doctor, or a hospital) does not constitute cash assistance, but instead should be considered as providing access to the services directly.

2. Medical Care

In order for medical care to be considered qualifying services, the care must be provided by the applicant organization directly, or indirectly by providing access to medical care (by paying for it, providing transportation to it, or connecting the eligible client with the medical care).

The medical care must be provided by a medical professional. This includes doctors, nurses, physicians assistants, midwives, optometrists, ophthalmologists, dentists, chiropractors, psychologists, psychiatrists, licensed therapists, and acupuncturists.

A variety of therapeutic services have been accepted as basic need services, provided that they are prescribed by or referred by medical personnel and provided by professionals.

Payment for medical care by the applicant organization is allowed as a basic needs service.

Transportation to medical appointments is considered a qualifying service as it provides access to medical care.

Care coordination services are considered qualifying services, as such services foster and facilitate access to and the provision of medical services.

3. Childcare

As defined in A.R.S. Title 46: "Child" means a person who is under 13 years of age. "Child care" means the compensated service that is provided to a child who is unaccompanied by a parent or guardian during a portion of a twenty-four hour day.

Childcare must be *regular and predictable* to be considered a basic needs service. Any programming provided to children in the course of offering childcare is not relevant to the determination.

It is not necessary for the care to be provided by a licensed day care center in order for it to be considered a basic needs service.

For care of persons 13 years of age or over, refer to ["Immediate Basic Needs Services"](#) below.

4. Food

Provision of food is intended to include food products for home preparation as well as the provision of prepared meal(s). Food can include snacks or refreshments at an event, provided that the event itself is considered a basic needs service.

Distribution or donation of perishable food items to another organization so that they can provide food directly to the eligible population has been determined to be a qualifying service (example: Waste Not collects perishable food and distributes to other charities so that they can distribute the food).

5. Clothing

Qualified clothing includes, but is not limited to baby clothes, shirts, pants, skirts, school uniforms, socks, underwear, shoes, boots, coats, and interview attire.

The provision of clothing does not qualify as a basic needs service if it consists of a single item of clothing per client. For example, a t-shirt provided as part of participation in an event does not constitute the provision of clothing as a basic needs service.

The provision of sports team uniforms does not qualify as a basic needs service.

6. Shelter

The direct provision of permanent or temporary housing and the payment of rent are each considered a qualifying service. Providing furnishings for a home is considered a qualifying service. Providing or paying for the maintenance of a home is considered a qualifying service. Payment of utility bills is considered a qualifying service.

Depreciation is not considered a qualifying service.

Transportation to shelter is considered a qualifying service.

7. Job Training

Job training is expected to be for a specific job. Education to help obtain a GED or prepare for college is not considered job training.

The employment of the employee who is employed as part of job training is not considered an eligible service. However, the employment of the trainer performing the job training is considered an eligible service. Thus, the wages of the employee being trained do not count toward the 50% spending threshold, whereas the wages of the trainer do count toward the 50% spending threshold.

The provision of transportation to job training or job interviews is considered a basic needs service.

For English Acquisition Learning Services, refer to [“Immediate Basic Needs Services”](#) below.

8. Immediate Basic Needs Services

Activities that provide or promote safety are considered immediate basic needs services. For example, providing immediate support to crime victims and providing crisis training to individuals with disabilities and law enforcement each have been considered immediate basic needs services.

Day care or adult day care for chronically ill or physically disabled individuals, if it provides respite for a caregiver, has been determined to be an immediate basic needs service.

The provision of hygiene products is considered an immediate basic needs service.

English Language Acquisition Services for English language learners are considered another example of immediate basic needs services (see guidance document on [English Language Acquisition Services](#)).

9. Services That Do Not Qualify

As a general principle, when determining whether a particular service qualifies, it is necessary to consider both the activity and the context or particular application in which it is offered to an eligible population. This analysis helps inform whether the service is being provided to meet a recipient's immediate basic needs. Examples of services that are not considered to meet immediate basic needs include but are not limited to:

- Training for life skills, parenting skills or empowerment or character education;
- General education;
- Recreation, including sports, wellness, and exercise;
- Non-therapy pets/animal encounters, sanctuary groups, and animal rescue;
- Furnishing items that are useful but not essential to daily living, such as items (computers, school backpacks and school supplies) intended for recipients to use for school;¹
- Toys and gifts (birthday or holiday), although the provision of gifts of (significant) clothing may qualify as basic needs services;
- Holiday parties;
- Fundraising and/or donations to organizations (even to organizations that are qualified for the credits).

The distribution to eligible populations of goods and services that have been donated to the organization does *not* qualify as a basic needs service.

10. Financials

At least 50% of the organization's expenses in the most recently completed fiscal year must have been used to provide qualifying services to an eligible population.

¹ These items are illustrative of items intended for use by recipients for school. However, the same items *could* qualify if intended for use by recipients for purposes essential for daily living.

The financials provided and considered need to be for the entire organization named in the IRS 501(c)(3) determination letter, unless the organization has a group exemption letter.

ADOR does not accept the financials for “programs” that are part of a larger organization.

We consider expenses as a representation of the “budget” referenced in A.R.S. § 43-1088. We do not consider sources of income or revenue.

Expenses related to fundraising, advertising, or marketing do not count toward the 50% spending threshold, although they are included within the calculation.

Depreciation is entirely excluded from the 50% spending threshold calculation.

The value of donated items (including food) or in-kind services is entirely excluded from the 50% threshold calculation.

ADOR does not accept the IRS Form 990 as an example of acceptable financials because the Form 990 does not provide sufficient detail relevant to the application of the state tax credit. The preferred statement of financials is the [Statement of Functional Expenses](#).

Supplemental material matching the qualifying services provided to the eligible population with the expenses is expected. For example, if only some of the population served is an eligible population, then the financials and supplemental information should reflect the portion of the expenses that support the eligible population. If only some of the services provided are qualifying services, then the financials and supplemental information need to reflect the portion of the expenses that support the qualifying services.

Section 3. Umbrella Charitable Organizations

Umbrella organizations are not certified by ADOR.

In order for an organization to collect donations as an Umbrella Organization, it must pass 100% of those donations on to certified QCOs on the ADOR list. No amounts may be kept for overhead purposes. An additional guidance document on [Umbrella Organizations](#) is forthcoming.

Section 4: Pass-through Services

An additional guidance document addressing [Pass-through Services](#) is forthcoming.

Section 5: The Application Review Process

Once received, ADOR will enter the organization name and contact information into its QCO database. A QCO Code will be assigned at that time. The QCO Code is the code that a taxpayer uses to claim the tax credit on their tax return.

When reviewing the application, ADOR will follow the evaluation process described below. The goal of the applicant organization should be to be as responsive as possible with the materials it submits, thereby minimizing the need to provide additional clarification or supplementation later.

Incomplete applications and inadequate explanations will delay the approval process and may result in denial.

ADOR will contact applicant organizations as needed by email and/or previously scheduled phone calls.

If, at any time during the process, it is clear that the organization will not qualify, ADOR staff may suggest that the organization withdraw its application.

ADOR staff is unable to make recommendations or provide counseling to the applicant organization as to how it could modify its operations to make it more likely for the organization to meet the QCO criteria.

Application Evaluation Process

- Does the application contain all of the required components? Is each section of the application completed?
 - Is the application signed?
 - If submitted via paper, can ADOR read the handwriting? (Please PRINT. If the application is not clear and legible, the review of the application may be delayed.)
 - Was an IRS 501(c)(3) determination letter included?
 - Was a narrative included? Does it name and describe specific programs?
 - Was financial information included?
 - Is the material provided understandable? (Please note that undefined abbreviations and jargon are not helpful to evaluators who may not know what they mean.)
- If anything is missing, ADOR will ask the organization to correct, supplement, or withdraw its application.
- Once ADOR has received the required components, the substantive review will commence.
- Based on the narrative, has the organization shown that it serves an eligible population?
 - If **No**, ADOR will ask the organization to correct, supplement, or withdraw the application.
 - If **Yes**, has the organization shown what portion of its client population qualifies as an eligible population?

- If **Yes**, ADOR will approve the application.

ADOR requests that applicant organizations *not* send the following items as part of their applications:

- Brochures
- Bank statements
- Check registers
- IRS Forms 990 (Return of Organization Exempt From Income Tax)
- Entire copies of financial audits (especially spiral-bound paper copies that ADOR must manually pull apart to scan)
- Excessively technical narratives that use abbreviations and jargon that individuals outside of the industry would not understand

Section 6: Provisional Certification

When a new organization wishes to receive QCO certification, but does not have a full year of actual services and expenses, it can apply for a one-year provisional certification.

At the end of the provisional year, the organization will be asked to provide a Statement of Functional Expenses for a full year of operation so that ADOR can determine whether the actual expenses satisfy the 50% spending threshold. If financials cannot be provided, or if the financials do not support that at least 50% of expenses were for qualified services for an eligible population, the organization will no longer be considered a QCO. That said, the provisional certification will be respected through the end of the provisional year, thus providing certainty to taxpayers claiming the credit for donations made during the provisional year.

Section 7: Following Approval

Once approved, ADOR will notify the organization by sending the organization an email with a letter and the certification attached. In the future, the certificates issued will have an expiration date.

ADOR updates the QCO list each week. Changes established by Wednesday morning will be included on the published QCO list by Friday evening.

In addition to the revised list being published on the ADOR website, the revised information is made available to tax preparation vendors as well.

Section 8. Appeal Process

If ADOR does not approve the QCO application for certification, the applicant may appeal the decision in accordance with A.R.S. Title 41, Chapter 6, Article 10.

Section 9: Periodic Updates

A. Law Changes

If legislation is passed that alters the criteria for approval, it may be necessary for ADOR to contact a QCO to determine whether the organization still qualifies. Such a change could become effective at any time. If a law change occurs, and if an organization fails to provide the supplemental information that ADOR requests, ADOR may remove the organization from the QCO list.

B. Scheduled Recertifications

ADOR is committed to performing periodic recertifications of existing QCOs. The current schedule requires that each organization be recertified once every 5-6 years. The recertifications are important to maintain the integrity of the QCO list and the tax credit program as a whole, given that an organization may:

- Close operations;
- Change the nature and scope of the services provided;
- Change the client populations served;
- Change how it spends its money;
- Change how much money it spends providing qualifying services to an eligible population; or
- Change how much money it spends on services and populations that do not meet the QCO criteria.

Even a seemingly minor change may cause an organization to no longer meet the criteria of a QCO. A recertification requires the organization to reapply as if it were a new organization.

The following list provides common scenarios ADOR has encountered under which a charitable organization has failed to meet the criteria for certification or recertification as a QCO:

General/Operational

- The applicant is a program within a larger organization and lacks both standalone 501(c)(3) status and standalone financials.
- The organization exists to pool money to be passed along to other charitable organizations.

- The organization cannot provide data sufficient to verify that its service recipients meet the qualifying population criteria.
- The organization does not provide direct services and only collects items to be passed along to other charitable organizations.

Services

- Organizations that provide many different services, some which do not qualify, have found it difficult to meet the statutory 50% spending threshold for providing qualifying services to an eligible population.
- The organization provides direct services to pets or animals belonging to individuals who may meet the eligible population criteria but who are not themselves receiving basic needs services from the organization.
- An organization provides social or emotional need services that do not meet the qualifying services criteria.
- A significant portion of an organization's services and expenses are provided to individuals who are not Arizona residents.

Financials

- The organization engages in a high level of spending on advertising or fundraising.
- The organization spends a significant amount on staff who do not actively contribute to the provision of qualifying services.
- The organization makes a one-time large, non-qualified expenditure, making the 50% spending threshold difficult to meet. (Example: Organization received a grant to provide services to clients located outside of the United States. For the year being evaluated, Organization's income was higher than normal and its expenses were also higher than normal as compared to other years. The out-of-the-ordinary expense made it impossible for the organization to meet the 50% spending threshold for providing qualifying services to an eligible population.)
- The value of in-kind donations received by the organization and distributed to clients is included as part of expenses, and yet actual monetary outlay does not meet the 50% spending threshold.
- An organization has such variable expenses that it cannot attest it will continue being able to meet the 50% spending threshold on future qualifying services.

Please note that this list is provided for illustrative purposes only and is not exhaustive in scenarios under which ADOR may find that an organization fails to meet the criteria requisite for QCO status.

Section 10: QCO Contact Information

It is critical that each QCO provides ADOR with updated contact information when there is a change in organization name, address, or relevant staff.

In addition, if an organization's 501(c)(3) status terminates or it ceases operations, it is necessary for the organization to notify ADOR so that the published QCO list can be updated accordingly.

Section 11: ADOR Contact Information

Applications, questions, and communications should be submitted to the QCO program. Electronic communication is preferred via QCO@azdor.gov.

As a last resort, paper applications may be sent to the following address:

Qualified Charitable Organization Program
Office of Economic Research & Analysis
Arizona Department of Revenue
P.O. Box 29099
Phoenix, AZ 85038

Questions can be directed to Alejandra Garcia, QCO Program Manager (602-716-6372, ext.2). Please note, the processing and response times for applications submitted by paper instead of electronically may be delayed.



Qualified Charitable Organization
Guidance Document
QCOGD 2022-XX

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Treatment of English Language Acquisition Services

****DRAFT: 11/18/22****

Issue

Do “services,” as defined under Arizona Revised Statutes (“A.R.S.”) § 43-1088(L)(6) and as applied to the individual income tax credit for contributions to qualifying charitable organizations (“QCOs”), include English acquisition services provided and used in Arizona? If so, do English acquisition services constitute “other assistance that is reasonably necessary to meet immediate basic needs?”

Short Answer

Yes, English acquisition services provided and used in Arizona are services under A.R.S. § 43-1088(L)(6) and constitute “other assistance that is reasonably necessary to meet immediate basic needs.”

1. Legally and historically, the primacy of the English language and the ability to read, write, speak, and understand it are entrenched within this state’s expectations of functioning within civil society. On this basis, English acquisition is a basic need for Arizona residents.
2. Determining whether the QCO’s English acquisition services are reasonably necessary to service recipients so as to meet their *immediate* basic needs requires consideration of
 - a. The level of English language acquisition services provided to Arizona residents, and
 - b. The populations of Arizona residents served by the QCO.

For example, qualifying services often consist of instruction in English language skills offered to English language learners that are of a basic or remedial nature when compared to English language instruction offered to persons who either are native English language speakers or already have acquired reasonable fluency in English in terms of vocabulary comprehension, reading, and writing. The purpose of the instruction must be to transition the English language learner to either a state of greater English fluency or an ability to function effectively in society.

Application

In considering whether the English acquisition services offered by a QCO under A.R.S. § 43-1088 are reasonably necessary to meet an English language learner’s immediate basic needs, the scope of English language instruction must be considered. For instance, it would be difficult to consider complex English grammar instruction offered to English language speakers with reasonable fluency to be “immediate” in nature.

Examples of programs that are reasonably necessary to meet English language learners’ immediate basic needs include:

Qualified Charitable Organization Guidance Document

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****DRAFT: 11/18/22****

- For instruction of persons 18 years of age or older, adult education classes for the teaching of English to foreigners that meet or exceed the rules prescribed by the Arizona Department of Education's Division of Adult Education.¹
- For instruction of persons under 18 years of age, English immersion and English instruction models adopted and approved by the State Board of Education under A.R.S. § 15-756.01.

Secondly, the populations of Arizona residents served by QCOs also inform whether the need can reasonably be considered "immediate." While the population might often include non-native English speakers, it could also include individuals who are native speakers but nevertheless possess demonstrably marginal or substandard proficiency in the English language, including adults who lack sufficient mastery of basic educational or basic English language skills needed to function effectively in society.² ADOR may consider evidence presented by a QCO of oral evaluations or standardized tests of English vocabulary comprehension, reading, and writing in which learners serviced by the QCO demonstrate a lack of basic English language proficiency.

As a general principle, the instruction will commonly consist of instruction in English language skills offered to English language learners that is of a basic or remedial nature when compared to English language instruction offered to persons who either are native English language speakers or already have acquired reasonably fluency in English in terms of vocabulary comprehension, reading, and writing. The purpose of the instruction must be to transition the English language learner to either a state of greater English fluency or an ability to function effectively in society.

To establish that such courses offered by a QCO are reasonably necessary to meet immediate basic needs, the Department will accept supporting documentation showing that the remedial or basic English instruction offered by the QCO meets the requirements of any of the following:

- the Equal Educational Opportunities Act of 1974 (EEOA),³
- Title II (Adult Education and Literacy) of the Workforce Innovation and Opportunity Act (WIOA),⁴ or
- Title III Part A (English Language Acquisition, Language Enhancement, and Academic Achievement Act) of the Elementary and Secondary Education Act (ESEA) and similar federal acts and grant programs.

¹ A.R.S. § 15-232.

² See A.R.S. § 15-191.

³ 20 U.S.C. §§ 1701-58.

⁴ Pub. L. No. 113-128, 128 Stat. 1425 (2014).