ARIZONA TAX NEWS

Jane Dee Hull, Governor

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E-Mail Your Questions

If you have a question that you cannot find the answer to, our Technical Assistance personnel may prove useful to you. We will gladly respond to any e-mail technical tax inquiry. All inquiries will be responded to within two working days. E-mail your question to: TaxpayerAssistance@revenue.state.az.us

In the interest of maintaining confidentiality, DOR cannot respond to inquiries that include a Social Security number, FEIN, TPT or W/H number, or other specific taxpayer identifiers.

BR/ITS Discovery Phase Comes to a Close

The discovery phase of BR/ITS, the Department's reengineering project, was completed on February 28. The vendors who have been working on their response to the agency's Request for Proposals have submitted their effort to the State Purchasing Office for evaluation on that date. Of the original four chosen to participate in the discovery phase, only two remain; Accenture and American Management Systems. The discovery phase, a period in which the vendors worked in the agency and analyzed our systems and processes, began in July of 2001. Except for a two-month suspension due to economic and budget problems, the work has continued non-stop since then. Agency staff worked closely with the vendors as they scrutinized every facet of the Department's business processes. There have been numerous presentations by the vendors to employees to get feedback on proposed changes. An evaluation team of people from inside and outside the Department of Revenue will review the proposals. It is hoped that the successful vendor will be notified before the end of the fiscal year (June 30) and work will begin on implementation of the winning proposal shortly thereafter.

Voluntary Disclosure Program

The Arizona Department of Revenue offers a voluntary disclosure program for those taxpayers who might not have fulfilled their transaction privilege tax, use tax, or corporate income tax obligations in Arizona. Most often, Arizona allows a "look-back" period of four years to suffice for the total period of time that taxes were unremitted. Providing that no taxes were collected during the period, and that the taxpayer had not previously been contacted by the Department regarding their obligations for this period, penalties could possibly be waived as well.

How to Request an Agreement

A request for a voluntary disclosure agreement is most commonly prepared by a company's representative. Include the following in the proposal:

- Propose terms for the Department's consideration.

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REMINDER

FOR NON-EFT TPT FILERS

To avoid a delinquency, postmark your March 2002 TPT return no later than April 25, 2002 or deliver to DOR no later than April 29, 2002.

JANUARY SUMMARY OF GENERAL FUND REVENUES

	January 2002	Fiscal Year Total
Individual Income Tax		
Net Collections	$256,533,964	$1,279,587,350
Percent Change *	(11.7%)	(5.1%)
Corporate Income Tax		
Net Collections	$6,561,461	$175,151,380
Percent Change *	(32.2%)	(45.0%)
Transaction Privilege, Severance & Use Taxes		
Net Collections	$281,757,548	$1,739,491,313
Percent Change *	(0.2%)	(0.4%)
Total Big Three Tax Types		
Net Collections	$544,852,973	$3,194,230,043
Percent Change *	(6.3%)	(6.4%)

( ) Decrease from same month last year.

*** Percent change from same month last year.**

Individual Income Tax

Individual Income Tax Receipts

	January 2002	January 2001	%
Gross Collections	$97,484,872	$103,690,175	(6.0)
Withholding	201,771,003	229,465,406	(12.1)
Refunds	(7,565,530)	(9,634,615)	(21.5)
Urban Rev Sharing	(35,156,381)	(33,037,720)	6.4
Net Collections	**$256,533,964**	**$290,483,246**	(11.7)

Fiscal Year Total	**(01/02)**	**(00/01)**	**%**
Gross Collections	$267,432,344	$295,943,415	(9.6)
Withholding	1,368,369,705	1,381,376,036	(0.9)
Refunds	(110,120,032)	(97,354,719)	13.1
Urban Rev Sharing	(246,094,667)	(231,264,040)	6.4
Net Collections	**$1,279,587,350**	**$1,348,700,692**	**(5.1)**

Included in the refund amounts above are refunds relating to the alternative fuel vehicle income tax credit. In January $570,912 in alternative fuel vehicle credits were processed. After offsetting $73,396 in tax liability, refunds for this credit totaled $497,516. This amount does not include withholding and estimated payments returned to taxpayers because their liability was covered by the alternative fuel vehicle credit. Additional refunds were paid out of corporate income tax.

TAX CALENDAR

APRIL 2002

Due Date		For Period Ending
15	Income Tax Returns:	12/31/01
	Form 120: Corporation	
	Form 140: Individual	
	Form 141: Fiduciary	
	Form 165: Partnership	
15	Form 120: Corporation with Automatic Extension	6/30/01
15	Form 120S: S Corporation	1/31/02
15	Form 99T: Exempt Organization Annual Information Return	11/30/01
15	Form 120ES: Estimated Tax Payment, Corporation	
	First Installment	12/31/02
	Second Installment	10/31/02
	Third Installment	7/31/02
	Fourth Installment	4/30/02
22	Form TPT-1: Transaction Privilege Tax: March Monthly Filers and Quarterly Filers	3/31/02
22	Bingo: Financial Reports	3/31/02
22	Luxury Tax: Various Forms	3/31/02
25	EFT Form TPT-1 and Payment: Transaction Privilege Tax: March Monthly Filers,	3/31/02
30	1st Quarter Withholding Forms	3/31/02
30	Unclaimed Property Reports: Life Insurance Companies - (Report accounts dormant for 5 years as of December 31, 2001)	

Withholding Tax Payment Information:

If the average amount of Arizona income taxes withheld in the preceding four calendar quarters **exceeds** $1,500 the employer must make its Arizona withholding payments to the Department of Revenue at the same time as the employer is required to make federal withholding deposits.

If the average amount of Arizona income taxes withheld in the preceding four calendar quarters **does not exceed** $1,500 the employer must make its Arizona withholding payments to the department on a quarterly basis.

The Arizona Tax News is a monthly publication of the Arizona Department of Revenue. Information contained herein is of a general nature and is not designed to address complex issues in detail. Taxpayers requiring information concerning a specific tax matter should contact the appropriate office. This newsletter is available in alternative formats upon request by calling the telephone number shown below. Subscription information may be obtained from: **Tony Manzo** at (602) 542-4672.

ALTERNATIVE FUEL VEHICLE REPORT FOR DECEMBER, 2001

Pursuant to A.R.S. §§43-1086, 43-1086.01, 43-1086.02, 43-1174, 4-1174.01 and 43-1174.02, credits are allowed for the following:

- The purchase or lease of an alternative fuel vehicle;
- The purchase and installation of a vehicle refueling apparatus;
- The construction or operation of an alternative fuel delivery system.

The taxpayer shall claim the credit with the filing of the Arizona income tax return. In accordance with S.B. 1004, Section 37 (A), the Director of the Department of Revenue shall report the following amounts related to:

- The aggregate dollar amount of alternative fuel related credits claimed under sections 43-1086, 43-1086.01, 43-1086.02, 43-1174, 43-1174.01 and 43-1174.02, Arizona Revised Statutes, on income tax returns during the preceding calendar month.

For the period of December 1 through December 31, 2001, the department received 41 individual income tax returns with claims for alternative fuel related credits totaling $0.7 million. A total of 5,164 individual income tax returns with claims have been received from January through December, totaling $97.6 million in credit. The department also received 10 corporate income tax returns in December with claims for alternative fuel related credits totaling $0.3 million. A total of 166 corporate income tax returns with claims have been received from January through December, totaling $15.9 million in credit.

- The dollar amount of verified credits claimed in the preceding calendar month not used to offset income taxes under title 43, Arizona Revised Statutes.

For the period December 1 through December 31, 2001, the department issued 141 individual income tax refunds for alternative fuel related credits. There was $2,412,055 in AFV credits on these 141 returns. After offsetting $379,108 in liability, $2,032,947 was refunded. The department issued 3 corporate refunds for alternative fuel related credits. There was $174,642 in AFV credit on these 3 returns. After offsetting $8,379 in liability, $166,263 was refunded.

Combining the corporate and individual income tax return amounts results in $2,199,210 that should be transferred from the Budget Stabilization Fund into the General Fund for December 2001. In last fiscal year, $66,360,441 was paid from the Budget Stabilization Fund into the General Fund. In this fiscal year, $25,698,251 is the total to be paid from the Budget Stabilization Fund, putting the overall total coming from the Budget Stabilization Fund for alternative fuel vehicle credits at $92,058,692.

- The cumulative dollar amount of the credits claimed in all taxable years, beginning from and after December 31, 2000.

The cumulative dollar amount of credits (individual and corporate) claimed is $113.4 million.

- Any estimated amounts remaining to be claimed as credits in each fiscal year.

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ARIZONA TRANSACTION PRIVILEGE TAX RULING TPR 02-1

(This ruling supersedes and rescinds Arizona Transaction Privilege Tax Ruling TPR 96-3)

ISSUE:
Complimentary food and drink provided by restaurants or lodging facilities.

APPLICABLE LAW:
Arizona Revised Statutes (A.R.S.) § 42-5001(5) states that "gross proceeds of sales" means the value proceeding or accruing from the sale of tangible personal property without any deduction on account of the cost of property sold, expense of any kind or losses, but cash discounts allowed and taken on sales are not included as gross income.

A.R.S. § 42-5001(13) states that "sale" means any transfer of title or possession, or both, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatever, including consignment transactions and auctions, of tangible personal property or other activities taxable under this chapter, for a consideration.

A.R.S. § 42-5061 imposes the transaction privilege tax on the retail classification. The retail classification is comprised of the business of selling tangible personal property at retail. The tax base for the retail classification is the gross proceeds of sales or gross income derived from the business.

A.R.S. § 42-5061(A)(5) provides that the tax imposed on the retail classification does not apply to the gross proceeds of sales or gross income from sales to persons engaged in business classified under the restaurant classification of articles used by human beings for food, drink or condiment, whether simple, mixed or compounded.

A.R.S. § 42-5061(A)(47) provides that the tax imposed on the retail classification does not apply to the gross proceeds of sales or gross income from tangible personal property sold to a person engaged in business and subject to tax under the transient lodging classification if the tangible personal property is a personal hygiene item or articles used by human beings for food, drink or condiment, except alcoholic beverages, which are furnished without additional charge to and intended to be consumed by the transient during the transient's occupancy.
A.R.S. § 42-5061(A)(52) provides that the tax imposed on the retail classification does not apply to the gross proceeds of sales or gross income from sales of any spirituous, vinous or malt liquor by a person that is licensed in this state as a wholesaler by the department of liquor licenses and control pursuant to title 4, chapter 2, article 1.

A.R.S. § 42-5074 imposes the transaction privilege tax under the restaurant classification, which is comprised of the business of operating restaurants, dining cars, dining rooms, lunchrooms, lunch stands, soda fountains, catering services or similar establishments where articles of food or drink are sold for consumption on or off the premises. The tax base for the restaurant classification is the gross proceeds of sales or gross income derived from the business.

A.R.S. § 42-5151(20) defines "use or consumption" as the exercise of any right or power over tangible personal property incidental to owning the property except holding for sale or selling the property in

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the regular course of business.

A.R.S. § 42-5155 imposes Arizona's use tax on tangible personal property purchased from a retailer which is used, stored or consumed in Arizona, and stipulates that the use tax applies to any tangible personal property that was purchased for resale which is subsequently used or consumed by the purchaser.
A.R.S. § 42-5159(A)(13)(k) provides that the use tax does not apply to tangible personal property purchased by a person engaged in business under the transient lodging classification if the tangible personal property is a personal hygiene product or articles used by human beings for food, drink or condiment, except alcoholic beverages, which are furnished without additional charge to and intended to be consumed by the transient during the transient's occupancy.

A.R.S. § 42-5159(A)(25) provides that the use tax does not apply to tangible personal property that is used or consumed in a business subject to § 42-5074 for human food, drink or condiment, whether simple, mixed or compounded.

DISCUSSION:
Establishments Taxed Under the Restaurant Classification

Restaurants and drinking establishments frequently supply food and drink to customers free or at reduced prices. The food or drink is provided as an incentive to bring customers to the establishment or as goodwill to increase the customers' enjoyment of the establishment. Examples include complimentary food furnished to customers as a buffet, as individual items provided to a table of customers, or discounts on customers' purchase of menu items.

All sales of tangible personal property are subject to transaction privilege tax under the retail classification unless a specific statutory exclusion or deduction applies. A.R.S. § 42-5061(A)(5) provides that the transaction privilege tax does not apply to the gross proceeds of sales or gross income from sales of articles used by human beings as food, drink or condiment when purchased by establishments taxable under the restaurant classification. Therefore, retailers that sell food items to restaurants are not subject to transaction privilege tax on the gross proceeds of sales or gross income from such sales.

Use tax is imposed on the use or consumption in this state of tangible personal property that is purchased from a retailer. The use tax does not apply if the transaction privilege tax was paid when the item was purchased. A purchaser who purchases tangible personal property for resale but subsequently uses or consumes the property is subject to use tax. However, A.R.S. § 42-5159(A)(25) provides that the use tax does not apply to food that is used or consumed in a business subject to the restaurant classification. Food provided free of charge by a restaurant or bar for a business purpose, such as attracting new customers, is exempt from use tax. Food provided free of charge by a restaurant or bar for a non-business purpose, such as feeding the owner's family, is subject to use tax on the purchase price of the food.

However, pursuant to A.R.S. § 42-5074, a business classified under the restaurant classification must pay the transaction privilege tax on its gross proceeds of sales or gross income. Cash discounts allowed and taken on sales are not included in the gross proceeds of sales under the restaurant classification. Thus, the transaction privilege tax only applies to the gross income received from the items sold.

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Establishments Taxed Under the Transient Lodging Classification

Laws 2001, Chapter 137 (Senate Bill 1130) amended the retail classification and use tax statutes to provide that tax does not apply to articles used by human beings for food, drink or condiment, except alcoholic beverages, sold to a person engaged in business and subject to tax under the transient lodging classification, which are furnished without additional charge to and intended to be consumed by the transient during the transient's occupancy. This enactment is effective from and after August 9, 2001, and applies retroactively to taxable periods beginning from and after June 7, 1994. (**See TPP 01-2 for information regarding the procedure for requesting a refund of tax paid that is available under the retroactive provisions of this legislation.**)

Lodging facilities such as hotels, motels, bed and breakfasts, inns or other lodging facilities in the business of providing lodging to transients in exchange for consideration may provide complimentary food and beverages to their customers. Examples of complimentary items include continental breakfasts and free social hours where alcoholic and non-alcoholic beverages and food are provided to customers. A lodging facility provides a service. As a business engaged in providing a service, it consumes the food and beverages it purchases for its customers. It does not resell them.

A specific statutory exclusion is provided for sales of food and non-alcoholic beverages by a person conducting business under the retail classification, sold to a transient lodging business that will provide the items to guests at no additional charge. The gross proceeds of sales or gross income from such sales are not subject to tax. Additionally, the gross proceeds of sales or gross income from sales of alcoholic beverages by a licensed liquor wholesaler are not subject to tax.

Sales of prepared food items by a restaurant or caterer are subject to tax under the restaurant classification and not the retail classification. There are no deductions or exclusions under the restaurant classification for sales to a transient lodging business. Therefore, the gross proceeds of sales or gross income from sales by a restaurant or caterer to a transient lodging business are taxable, notwithstanding that the transient lodging business will furnish the food to guests at no additional cost.

A hotel may contain a restaurant that is a separate legal entity. If the restaurant business purchases and prepares the food that is given free of charge by the hotel to transient lodgers and the restaurant is paid by the transient lodging business, the restaurant is subject to transaction privilege tax on the amounts received from the transient lodging business. If the restaurant is not paid by the transient lodging business for the food given free of charge to transient lodgers, then the restaurant is subject to use tax on the food since it is not used or consumed in the furtherance of the restaurant business.

RULING:

A restaurant that provides complimentary food or beverages to its customers as a business strategy to increase sales is not subject to use tax on the food or beverage. If the food is given away for a purpose unrelated to the restaurant business then the restaurant is subject to use tax on the purchase price of the food and beverage. The restaurant is subject to transaction privilege tax on its gross receipts.

Mark W. Killian, Director
Signed: February 19, 2002

ARIZONA INDIVIDUAL INCOME TAX RULING
ITR 02-1

(Supersedes Arizona Guidelines For Exempt Securities G 91-4)

ISSUE:
Arizona individual income tax treatment of obligations of the United States Government, federal agencies, and United States Territories.

APPLICABLE LAW:
31 United States Code (U.S.C.) § 3124(a) prohibits all states from imposing an income tax on interest income from direct obligations of the United States Government.

Various U.S.C. sections prohibit state taxation of income from certain obligations of United States government sponsored enterprises and agencies and from certain obligations of United States Territories. See Appendix for specific code sections.

Arizona Revised Statutes (A.R.S.) § 43-961 (5) disallows deductions when such deductions are allocable to a class of income that is not required to be included in the taxpayer's Arizona adjusted gross income or Arizona taxable income.

A.R.S. § 43-1022(6) provides a subtraction from Arizona gross income for interest income received on obligations of the United States. The amount subtracted must be reduced by any interest on indebtedness, or other related expenses, incurred to purchase or carry such obligations and deducted in arriving at Arizona gross income.

LEGAL REFERENCES:
Rockford Life Insurance Company v. Illinois Department of Revenue, 482 U.S. 182, 107 S. Ct. 2312 (1987), held that instruments commonly known as "Ginnie Maes" issued by private financial institutions and guaranteed by Government National Mortgage Association are not exempt from state taxation.

Nebraska Department of Revenue v. Loewenstein, 513 U.S. 123, 115 S. Ct. 557 (1994), held that 31 U.S.C. § 3124(a) does not prohibit states from taxing interest income derived from repurchase agreements involving United States government obligations.

DISCUSSION:
Interest Income From Exempt Obligations
Federal law prohibits all states from imposing an income tax on interest income from direct obligations of the United States Government. Additionally, federal law may prohibit state taxation of interest income from the obligations of government-sponsored enterprises and agencies and from the obligations of United States Territories. Exempt interest income that is included in Arizona gross income (Federal adjusted gross income) may be subtracted in computing Arizona adjusted gross income. Part I of the Appendix which is attached to this ruling lists those obligations whose interest income is exempt from Arizona income tax.

Deduction of Related Expenses
Interest or other related expenses incurred to purchase or carry tax exempt obligations cannot be deducted. If such expenses are included in a taxpayer's Arizona gross income, the subtraction of exempt interest must be reduced by the amount of the expenses. If the taxpayer itemizes deductions on his or her Arizona return, the

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expenses must be excluded from the taxpayer's Arizona itemized deductions.

Gain on Sale
Any gain recognized for federal income tax purposes on the sale of United States bonds and notes or other tax exempt obligations is not considered to be interest on such obligations and is subject to Arizona income tax.

Repurchase Agreements
Interest from Repurchase Agreements involving United States government obligations is not exempt and is subject to Arizona income tax.

Interest Income From Taxable Obligations
There are a number of obligations that are issued under the authority of an act of Congress which are subject to Arizona income tax. These obligations may be guaranteed by the United States Treasury or supported by the issuing agency's right to borrow from the Treasury while other obligations may be backed by the pledge of full faith and credit of the United States Government. However, these obligations are not direct obligations of the United States Government to pay a specified sum at a specified date nor is the interest from these obligations specifically exempt from state taxation by the respective authorizing acts. Therefore, interest income from such obligations is subject to Arizona income tax. Part II of the Appendix lists some obligations that are subject to Arizona income tax.

RULING:
Interest income received from the obligations listed in Part I of the Appendix which is attached to this ruling is exempt from Arizona income tax.
Interest or other related expenses incurred to purchase or carry tax exempt obligations cannot be deducted. If such expenses are included in a taxpayer's Arizona gross income, the subtraction of exempt interest must be reduced by the amount of the expenses. If the taxpayer itemizes deductions on the taxpayer's Arizona return, the expenses must be excluded from the taxpayer's Arizona itemized deductions.
Any gain recognized for federal income tax purposes on the sale of United States bonds and notes or other tax exempt obligations is subject to Arizona income tax.
Interest income received from repurchase agreements involving United States government obligations is subject to Arizona income tax.
Interest income received from the obligations listed in Part II of the Appendix is subject to Arizona income tax.

Mark W. Killian, Director
Signed: January 17, 2002

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Through December, 5,330 (corporate and individual) claims have been received. Those claims reviewed include 5,178 claims for 5,679 vehicles, 25 claims for refueling stations and 586 claims for refueling apparatus. (Claims that have not yet been reviewed are not included in this count.) While most returns for 2000 filers have been received, there may be additional claims made through late filers and amended returns. Also, according to grant applications, there are taxpayers who will first qualify for a credit on their 2001 tax returns.. At this time, the department has no independent means of estimating the amount yet to be claimed. If you should have any questions, please contact Anthony Forschino at (602) 542-4672.

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- Describe the nature and extent of a company's business in Arizona, including when activities first began in Arizona, whether the company has employees or representatives in Arizona, and if any property is owned in the state. Explain all marketing activities in the state as well.

- Indicate whether the company has been contacted by the Department in the past, and describe the nature of the contact. State if any tax has been collected in the past.

NEGOTIATIONS

- During the negotiations between the representative and the Department, the taxpayer may remain anonymous. The disclosure request will be assigned an identification number. Only when the agreement is finalized will the company's identity be required.

- The representative and the taxpayer will have the opportunity to peruse proposed drafts of the agreement, and to suggest alterations.

- When the two parties concur, the taxpayer will sign three copies of a final version and submit them to the Department for approval by a function executive. One of the three copies will then be forwarded to the taxpayer for their records.

- At this point the Department will register or license the taxpayer, who will then proceed to fulfill present and future tax obligations.

- With the finalization of the agreement, the taxpayer will usually be required to submit a schedule of taxable amounts for the four-year look-back period. From this information, the Department will produce a billing which, when paid, should satisfy past tax obligations for the period indicated in the agreement.

IMPORTANT NOTICE

Due to the current budget situation in the state, the Department of Revenue may discontinue the customary quarterly mailing of withholding forms. Additional details will be made available, as they are known. Check our website (www.revenue.state.az.us) for updates, and look for additional information in the 2nd quarter mailing.

To ensure proper posting of your returns and payments, please use the following addresses:

Transaction Privilege (Sales) and Use Tax
PO Box 29010
Phoenix AZ 85038-9010

Withholding Tax
PO Box 29009
Phoenix AZ 85038-9009

Corporate, S-Corp, Partnership and Exempt Organization Tax
PO Box 29079
Phoenix AZ 85038-9079

Withholding Tax Telephone Numbers
Phoenix area: 602-255-2060
Other Arizona areas: 1-800-843-7196

Increased Security

If you visit our offices in the Phoenix metropolitan area, you'll notice some changes made in response to our changing world. At the 1600 W Monroe office, all visitors (and employees) must pass through metal detectors and have parcels, handbags, briefcases, etc searched. At the other offices, there are no metal detectors, but all bags are searched. We apologize for the inconvenience and thank you for your understanding and patience.