

ARIZONA DEPARTMENT OF REVENUE

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ARIZONA GENERAL TAX RULING GTR 96-1

**(On July 31, 2020 the statutory references were updated to show their new numbers.
See the footnotes for details. No substantive changes were made.)**

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

ISSUE:

General requirements for the maintenance and retention of books, records and other sources of information received, created, maintained or generated through various computer, electronic and imaging processes and systems.

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 42-1105(D)¹ provides that every person subject to the taxes administered by A.R.S. Title 42, Chapter 1, Article 2, shall keep and preserve suitable records and other books and accounts necessary to determine the tax for which the person is liable for the period prescribed by A.R.S. § 42-1104².

A.R.S. Title 42, Chapter 1, Article 2³ applies generally to the administration of income tax, withholding tax, transaction privilege tax, telecommunication services excise tax, county excise taxes and any other privilege excise tax administered by the department, severance tax, use tax, luxury tax, rental occupancy tax, estate tax, tax on water use and jet fuel excise and use tax.

A.R.S. § 42-1104⁴ prescribes a four year statute of limitation during which the department may issue a tax assessment and provides exceptions to this general rule.

A.R.S. § 42-1125⁵ provides civil penalties in regard to tax returns and also for a taxpayer who fails to comply with the department's verification of tax liability.

¹ This ruling originally referenced A.R.S. § 42-114.B which was moved to A.R.S. § 42-1105(D).

² This ruling originally referenced A.R.S. § 42-113 which was moved to A.R.S. § 42-1104.

³ Article 2 was renumbered to Article 3 effective January 1, 1999.

⁴ See footnote 2.

⁵ This ruling originally referenced A.R.S. § 42-136 which was moved to A.R.S. § 42-1125.

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DEFINITIONS:

"Electronic Data Interchange (EDI) technology" means the computer-to-computer exchange of business information in a standardized, structured, electronic format.

"Database Application System" means a software system that controls, relates, retrieves, and provides accessibility to data stored in a data base.

"Hard Copy" means source documents, summary records, reports, or other data printed on paper.

"Machine-sensible record" means a record in electronic format that is intended for use as data by an electronic computer. Machine-sensible records do not include hard copy records that are recorded on paper or stored in or by an imaging system (e.g., microfilm, microfiche, or storage-only imaging systems).

"Storage-only imaging system" means a system of computer hardware and software that provides for the storage, retention and retrieval of documents originally created on paper. It does not include any system, or part of a system, that manipulates or processes any information or data contained on the document in any manner other than to reproduce the document in hard copy or as an optical image.

DISCUSSION:

This ruling specifies the requirements that the department considers essential when a taxpayer's records are maintained within an Electronic Data Processing (EDP) system. All taxpayers, including those using EDP, must have a method of producing visible and legible records that provide the necessary information for verification of tax liability. In addition to the requirements set forth below for EDP tax accounting systems, those persons who have an EDP system using EDI technology should consult the specific provisions covering those systems.

Technologies are constantly evolving, and new systems and techniques are being utilized by businesses on a continuing basis. This ruling is intended to aid the taxpayer in maintaining:

1. the integrity and consistency of records;
2. the accessibility of these records for a department audit;
3. documentation to substantiate that the correct tax liability is reported;
and,
4. records that are material in the determination of tax compliance.

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This ruling also sets forth the requirements for taxpayers who either:

1. have the ability to produce records on microfilm, microfiche, or other storage-only imaging systems directly on-line from the computer or off-line from magnetic tape; and/or,
2. have records transferred onto microfilm, microfiche or other storage-only imaging systems from original documents or hard copy printouts, and who want to keep their books and records on microfilm, microfiche, or other storage-only imaging system.

RULING:

GENERAL REQUIREMENTS

Recorded Data

EDP records must provide an opportunity to trace any transaction back to the original source or forward to a final total. If hard copies of documents relating to transactions are not made at the time the transaction is processed, the system must have the ability to access records which document and verify these transactions. All machine-sensible records must be retained in a retrievable format that provides the information necessary to determine the correct tax liability.

General and Subsidiary Books of Accounts

A hard copy general ledger, with source references, should be generated upon request to coincide with financial reports for tax reporting periods. In cases where subsidiary ledgers are used to support the general ledger accounts, the subsidiary ledgers should also be generated upon request to coincide with financial reports.

Supporting Documents and Audit Trail

The audit trail should be designed so that the details underlying the summary accounting data may be identified and made available to the department upon request. The system should be designed so that supporting documents such as sales invoices, purchase invoices, vouchers, exemption certificates, and documents verifying the amounts of transferred funds, or microfilm, microfiche, or other storage-only imaging system copies thereof, may be identified and made available to the department upon request.

Program Documentation

For taxpayers utilizing EDP systems, documentation must be made available to the department upon request that provides a complete description of the EDP system. This documentation must be sufficiently detailed to include at a minimum:

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1. the application being performed;
2. the procedures employed in each data processing application;
3. the controls used to ensure accurate and reliable processing; and,
4. the controls used to prevent the unauthorized addition, alteration, or deletion of the retained records.

The following information pertaining to all electronically stored data must be provided to the department when requested:

1. a description of the format of the electronically stored data, including the meaning of all codes which are used to represent information;
2. flowcharts for the system and its programs;
3. descriptions of labels used in programs;
4. source program listings of programs including those which provide the formulas and account derivations from which the retained files were created;
5. detailed charts of accounts and account descriptions being used for the specific periods at issue; and,
6. evidence that the retained records reconcile to the books and to the tax return.

Record Keeping Requirements

All machine-sensible records that are material to the administration of the law must be retained by the taxpayer. The retained records must provide the information sufficient to determine the correct tax liability of the taxpayer. Machine-sensible records and related documentation shall be retained until their contents are no longer material to the administration of any related tax liability determination of the taxpayer. This period of time shall be determined by the statute of limitations, including extensions, waivers or closing agreements.

Where a taxpayer uses an EDP accounting system, the level of record detail preserved, in combination with other records related to the transactions, must be equivalent to that contained in an acceptable paper record. For example, a taxpayer should retain machine-sensible records that contain transaction-level detail used in establishing tax liability, documentation of its EDP accounting systems, and records that are necessary to reconcile the machine-sensible records to the books and tax return. The retained records must be sufficient in quantity, quality, format, and organization to allow the department to retrieve and use the records, print hard copies, and produce other output.

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The taxpayer must ensure that the machine-sensible records contain sufficient transaction-level detail information, such that the details of the transaction and the underlying source documents can be identified and made available to the department upon request. The taxpayer may capture the necessary information at any level within the EDP accounting system provided that the audit trail, authenticity and integrity of the records can be established. The records and information must also facilitate the determination of the correct tax liability.

If a taxpayer creates machine-sensible records as part of the normal course of business, appropriate records must be maintained to support the reported tax information. However, taxpayers are not required to construct machine-sensible records other than those created in the ordinary course of business. A taxpayer who does not create the electronic equivalent of a traditional paper document in the ordinary course of business, such as an invoice, is not required to construct such a record for tax purposes. If hard copy records are not produced or received in the ordinary course of transacting business (e.g., when the taxpayer uses EDI technology), such hard copy records at the transactional (source document) level need not be created. Original documentation must be maintained to provide the necessary information for verification of tax liability.

Machine-Sensible Records Maintenance Requirements

In devising record management practices, taxpayers should consider the labeling of records, the security of the storage environment, the creation of back-up copies and their storage location, and the use of periodic testing to confirm the integrity of the records. The department recommends that taxpayers adhere to the standards of the National Archives and Record Administration (NARA) for the storage, maintenance, and periodic checks of electronic records.

The taxpayer's computer hardware and software shall accommodate the extraction and conversion of the retained machine-sensible records.

Systems Resource Requirements

A taxpayer who maintains records in machine-sensible format as well as hard copy format, shall make the records available upon request. The taxpayer is further required to provide the department with access to the computer resources necessary to process the retained machine-sensible records during an audit. For example, this access may include computer terminal access, computer time, personnel, and paper upon which records may be printed.

However, these requirements may be satisfied through a variety of means that take into account a taxpayer's facts and circumstances. After an evaluation, the department may determine that:

1. the taxpayer's computer resources are not necessary for an examination; or,

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2. the taxpayer may convert machine-sensible records to a different medium (e.g., from mainframe files to microcomputer diskette), or copy the data to media for processing and examination by the department at off-site facilities.

Effect on Hard Copy Record Keeping Requirements

Taxpayers are not relieved of the statutory requirements to retain hard copy records created or received in the ordinary course of business. Hard copy records may be retained on paper or in microfiche, microfilm, or other storage-only imaging system formats.

NOTE: Hard copies of exemption certificates or other similar documents must be available upon request.

Computer printouts that are created for validation, control, or other temporary purposes need not be retained. However, this does not preclude the department from requesting hard copy printouts of any retained machine-sensible records.

SPECIFIC SYSTEMS

EDI

For taxpayers using EDI technology, the detail in the retained machine-sensible records, in combination with any other records related to the transactions (e.g., the underlying contracts, pricing information and exemption certificates), must be equivalent to the level of detail contained in an acceptable paper record. For example, the retained records for an electronic invoice must contain identification of the vendor by name, invoice date, product description, quantity purchased, price, amount of tax, indication of tax status, shipping detail, etc. Codes may be used that identify the vendor or product if the taxpayer provides a method that allows the department to interpret the coded information.

The taxpayer may capture information at any level within the accounting system provided that the information is sufficient to allow the department to establish an audit trail and to verify the authenticity and integrity of the retained records. For example, a taxpayer using EDI technology receives electronic invoices from its suppliers. The taxpayer retains the completed and verified EDI transactions in its accounts payable system rather than retaining the EDI transactions themselves. Since neither the EDI transactions nor the accounts payable systems capture information from the invoice pertaining to product description and vendor name (i.e., they contain only codes for that information), the taxpayer also retains other records, such as its vendor master file and product code description lists and makes them available during an audit. In this example, the taxpayer need not retain its EDI transaction for tax purposes.

Microfilm, Microfiche and Other Storage-Only Imaging System Records

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Microfilm, microfiche, or other storage-only imaging systems that reproduce general books of accounts, journals, supporting records, sale invoices, purchase invoices and credit memoranda, are considered reliable records if the following are satisfied:

1. documentation establishing the procedures used with a microfilm, microfiche, or other storage-only imaging system is maintained, and operational personnel for such systems are made available on request;
2. procedures are provided with appropriate documentation so that the original document can be followed through the system;
3. internal procedures for inspection and quality assurance are established;
4. procedures are established for the effective identification, processing, storage and preservation of microfilm, microfiche, or other storage-only imaging records making them readily available for as long as the contents are necessary under statutory requirements;
5. when displayed on an appropriate reader or viewed on paper, the material must exhibit a high degree of legibility and readability (For this purpose, "legibility" is defined as the quality of a letter or numeral that enables the observer to identify it positively or quickly to the exclusion of all other letters or numerals. "Readability" is defined as the quality of a group of letters or numerals being recognizable as words or complete numbers.); and,
6. a detailed index of all microfilm, microfiche, or other storage-only imaging system data must be maintained in a manner that permits the immediate location of any particular record.

A reader/printer must be made available to the department for reading, locating, and reproducing any record retained on a microfilm, microfiche, or other storage-only imaging system. If any part of the books and records are maintained in any machine-readable data medium prior to being retained on a microfilm, microfiche, or other storage-only imaging system, the provisions outlined above must be met.

Other Requirements

The utilization of a service bureau, time-sharing service, or computer network service does not relieve the taxpayer of the record keeping responsibilities described in this ruling.

In addition to the requirements of this ruling, a taxpayer must adhere to any other record keeping requirements as specified by the Arizona Revised Statutes or the Arizona Administrative Code. All records must be maintained for the period of time specified by

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A.R.S. § 42-113, or for a longer period of time if the retained records are material in establishing the tax liability for other periods.

Harold Scott, Director

Signed: March 6, 1996

Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law which are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement which provides interpretation, details or supplementary information concerning the application of the law. Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling. See GTP 92-1 for more detailed information regarding documents issued by the Department of Revenue.