

Municipal Proposal **on Tax Simplification**

*Good for taxpayers, good for business,
good for cities, good for Arizona*

Prepared by

League of Arizona Cities and Towns

Municipal Proposal: Introduction

Cities and towns are united in our support of tax simplification - a goal that is good for taxpayers, good for businesses, and good for Arizona. Governor Brewer highlighted the importance of this issue with the creation of her Transaction Privilege Tax Simplification Task Force on May 31, 2012, on which cities and towns were actively engaged. Tax simplification in Arizona is a noble goal that will not only make it easier for businesses in our cities and towns to focus on creating jobs and driving our economy, but also signal to companies outside our boundaries that Arizona is “open for business.”

Tax simplification is a concept easy to support but difficult to define. As a demonstration of the commitment of Arizona's mayors and councils to work proactively with the governor in simplifying our tax system, this document provides a sincere, alternative proposal for consideration. This proposal achieves tax simplification by reducing and streamlining administrative burdens on taxpayers based on sound fiscal management, and without creating severe financial risk to municipal or state budgets.

Municipal Proposal: Overview

1. Collection and Administration

Creates “one-stop shop” for taxpayers through a third-party website managed by the Arizona Department of Revenue (DOR), paid for by municipalities.

- a. Moves admin of the online portal (enacted by Laws 2012, Chapter 332) to DOR.
- b. Expedites and expands the online portal to:
 - i. Create a single point of payment.
 - ii. Create a single point of licensing.
 - iii. Include all transaction privilege tax (TPT) taxing jurisdictions.
- c. Makes necessary changes to comply with Marketplace Fairness Act.

2. Auditing

Provides taxpayers with a single audit managed and organized by DOR.

- a. All audits are conducted or coordinated by DOR.
 - i. Multi-City Taxpayer: Audit participation limited to DOR and no more than two municipalities.
 - ii. Single-City Taxpayer: DOR has right of first refusal to lead the audit; or designate lead auditor.
- b. Municipal auditors may only perform auditing functions if they have entered into an intergovernmental agreement (IGA) with DOR.
- c. DOR, in cooperation with other auditing entities, will develop and publish binding:
 - i. uniform audit procedures
 - ii. rulings and interpretations
- d. All audits cover and bind all jurisdictions for the audited period.

3. Prime Contracting TPT

Makes common sense improvements and answers critical questions.

- a. Include provisions of HB 2535 (independent functional utility).
- b. Commission an independent consulting firm to research and answer questions looming regarding prime contracting.

Municipal Proposal: Collection and Administration

1. *Online Portal – Statutory*

- a. Expedite portal implementation to July 1, 2014.
- b. Expand participation to include all TPT taxing jurisdictions by January 1, 2015.
- c. Provides DOR with administrative oversight of the online portal upon full implementation by all taxing jurisdictions.
- d. Online portal services shall include:
 - i. Single point of licensing.
 - ii. Single point of filing.
 - iii. Single point of payment.
 - iv. Jurisdiction identification based on location. (GIS)

2. *Online Portal – RFP*

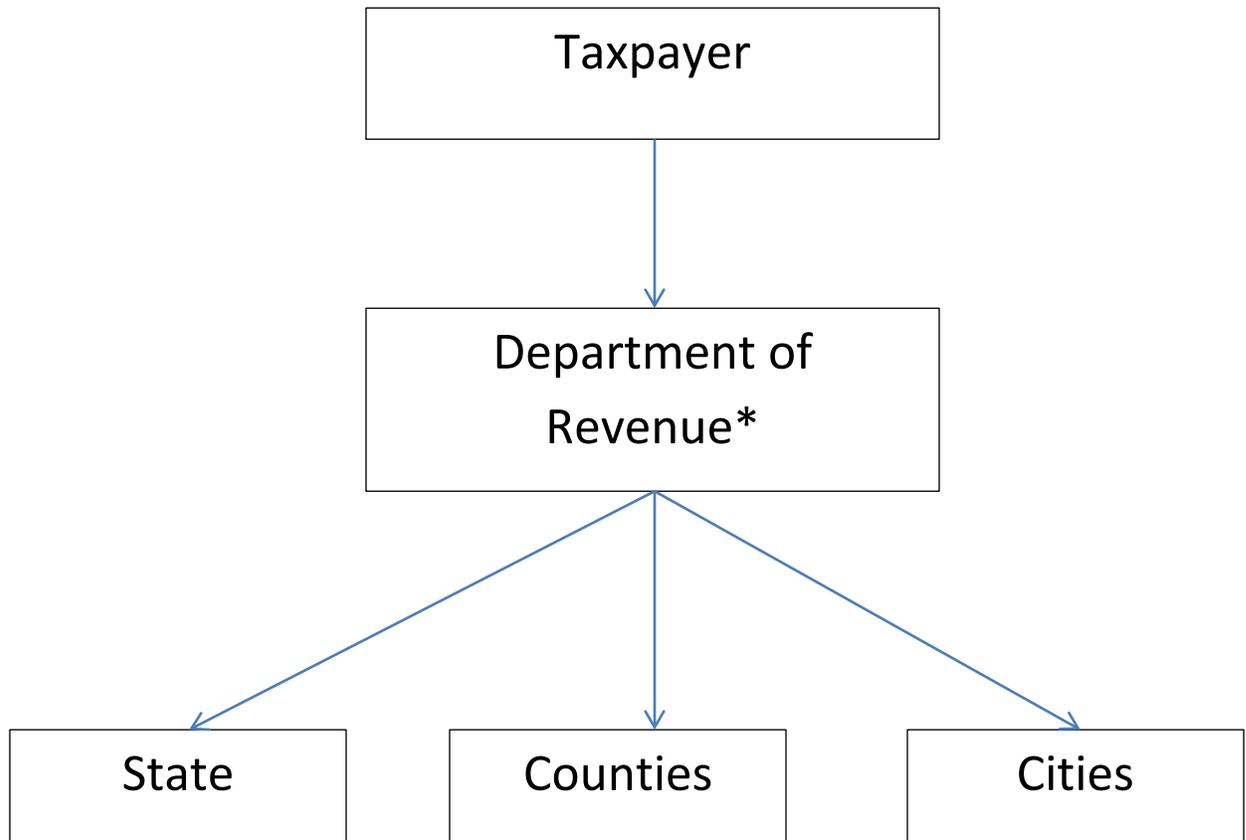
- a. Require the online portal to capture data to the same specificity as currently collected by each non-program city.
- b. Require the online portal to consolidate data in a manner compatible with DOR systems.
- c. Taxing jurisdictions pay for portal based on transactions.
- d. Provide link to DOR online database of information, interpretations and contact information.
- e. Require participating municipalities to pay for creation of the portal.

3. *Collection of TPT from Remote Sellers (Marketplace Fairness Act)*

- a. A remote seller shall only receive one account number for use by all TPT taxing jurisdictions.
- b. Specify that remote sellers shall use the online portal, once available.
- c. Specify that DOR shall perform all audits of remote sellers.
- d. Cities and towns shall not audit a remote seller.
- e. Specify that remote sellers are only subject to retail TPT and not subject to any other classification.
- f. Specify that remote sellers file on the same filing frequency as brick and mortar taxpayers.

- g. The state and municipalities shall establish a uniform retail tax base. In the event of a conflict, remote sellers shall be subject to retail TPT based on statute.
- h. Sourcing shall be based on point of receipt as contained in proposed language of ARS 42-5039.
- i. DOR shall publish information regarding taxability of products and services under the retail tax classification as well as provide a boundary database.
- j. DOR shall develop and provide software and any updates necessary for creating tax returns free of charge.
- k. DOR must establish procedures to recognize certified software providers (CSP) and provide relief from liability as required.
- l. DOR shall provide remote sellers and CSPs with 90-days' notice of rate changes.
- m. Exempts remote sellers that qualify as a small seller.
- n. Defines *remote sale* and *remote seller*.
- o. Makes provisions conditional upon federal authorization to tax remote sellers.

Municipal Proposal: Collection and Administration Flow Chart



*This function will be served through a third-party website that will provide both online functionality and compatibility with accounting software. Additionally, the website will offer taxpayers tools like address verification to correctly identify taxing jurisdictions and provide a single point of contact for:

- Registration
- Licensing
- Filing/Payment

Municipal Proposal: Auditing

1. Auditing Principles

- a. Defines *audit* as a systematic and comprehensive examination of the taxpayer's accounting books and records involving analysis, tests, confirmations and/or verifications.
- b. All audits cover all jurisdictions, regardless of initiating entity.
- c. Specifies that there will be no other audits covering the same period, except as authorized under ARS 42-2059.
- d. Non-DOR auditors may only participate in auditing process if the municipality has entered into an IGA with DOR to govern:
 - i. Management structure
 - ii. Standardized auditing procedures
 - iii. Confidentiality requirements
 - iv. Personnel policies and procedures
- e. Specifies that DOR has sole authority to audit remote sellers (as defined in ARS 42-5040).
- f. Clarifies DOR has sole authority to audit taxpayers doing business in county only
- g. For taxpayers in program cities without supplemental auditing authority – DOR shall initiate audit within six months of receipt of request. If DOR is unable to initiate within six months, the audit assignment will be determined by the Unified Audit Committee (UAC).
- h. Except for remote sellers and county-only audits, participation is limited to DOR and two municipalities.

2. Single Audit Procedures

- a. Single audit coordination is managed by DOR
- b. Requesting jurisdiction send notice to DOR
 - i. DOR determines current audit status

- ii. DOR option must be chosen within 30 days of request; notification sent from DOC to requesting jurisdiction
- c. DOR initiated; DOR acts as lead jurisdiction
- d. City/town requests audit through DOR:
 - i. DOR may elect to perform audit; audit to be initiated within six months of the date that the request is filed with DOR. If DOR is unable to initiate within six months, the audit assignment will be determined by UAC.
 - ii. DOR may decline; requesting jurisdiction becomes lead auditor, but DOR may still choose to participate.
 - iii. DOR may request an alternate lead audit jurisdiction; UAC selects lead jurisdiction, but DOR may still choose to participate.
- e. DOR shall coordinate all closing agreements related to municipal TPT with the affected municipalities prior to final settlement.

3. *Single Audit Procedure Uniformity*

- a. DOR, in coordination with the UAC, shall establish uniform auditing procedures to be used by all state and local auditors.
- b. DOR, in coordination with the UAC, shall create standard auditor training tools covering state tax statutes, Model City Tax Code (MCTC), uniform auditing functions and procedures.
- c. DOR shall create a Single Audit Manual and publish the manual on its website.

4. *Single Tax Interpretation*

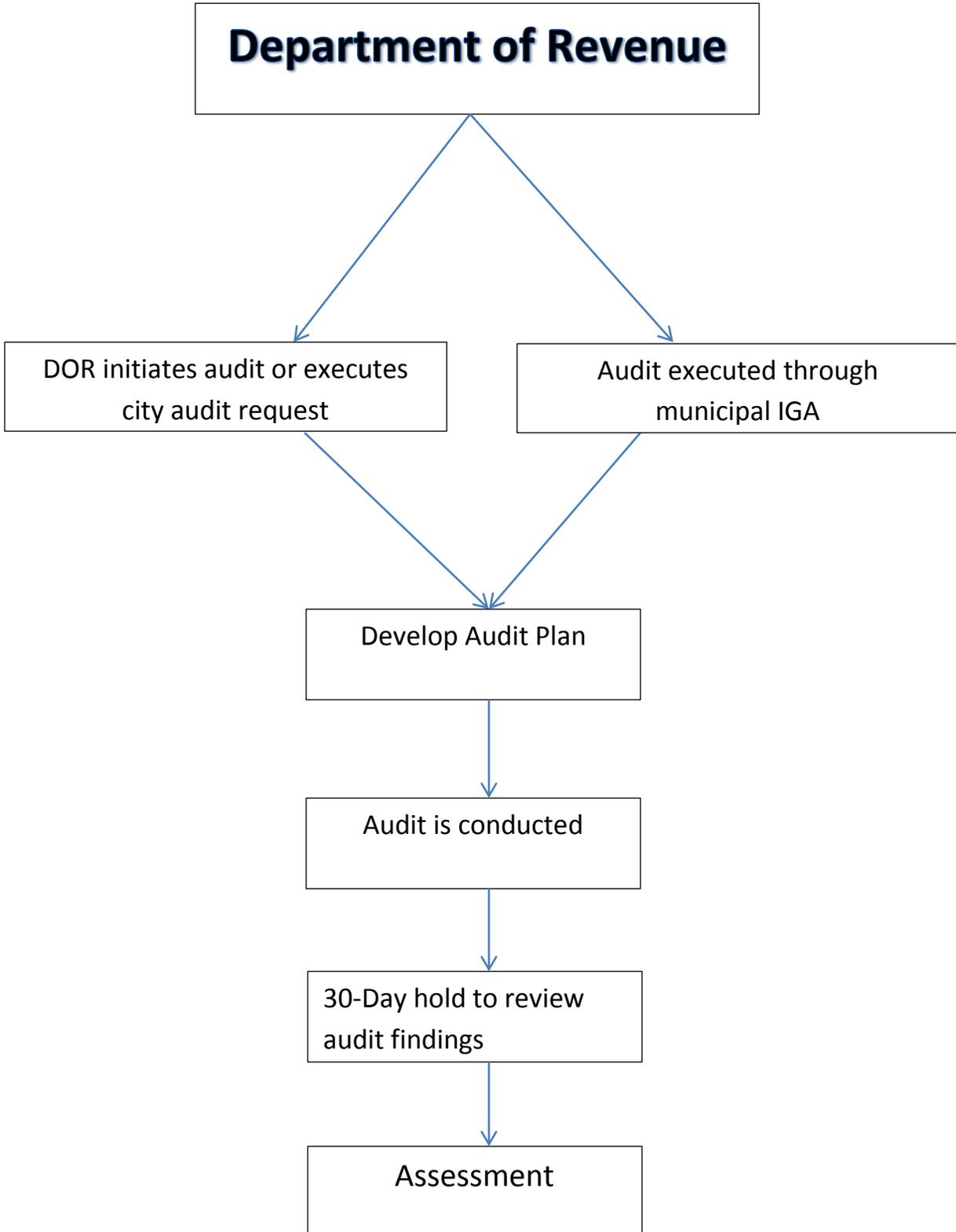
- a. Codify DOR Uniformity Committee and consolidate with UAC Ruling Subcommittee
- b. Require the director of DOR to create Uniformity & Ruling Committee (URC)
 - i. URC receives and rules on all taxpayer interpretation requests (state statute and Model City Tax Code)
 - ii. DOR appoints four representatives; at least one must be a tax attorney

- iii. Cities and towns appoint three representatives; at least one must be a tax attorney
- iv. All determinations posted on DOR website
- c. URC determinations are binding on DOR and cities and towns.
- d. All preliminary audit results are subject to review by the taxing jurisdictions for 30 days prior to issuance; interpretation issues are resolved by URC prior to final audit assessment.

5. ***Other***

- a. Six-year look-back period for voluntary disclosure, waive penalties and cannot waive interest. No audits of that period except pursuant to ARS 42-2059.
- b. Modify ARS 42-2003 to allow DOR and municipalities to share all audit and taxpayer information with each other. Municipalities and DOR are required to protect taxpayer confidentiality.

Municipal Proposal: Auditing Flow Chart



Municipal Proposal: Prime Contracting TPT

1. ***Independent Functional Utility*** – Include provisions of HB 2535, which clarifies that tangible personal property with independent functional utility is exempt from prime contracting TPT.
2. ***Third-Party Analysis***
 - a. Hire a qualified independent consulting firm through the State Procurement Office to research and evaluate issues related to the prime contracting (PC) TPT including:
 - i. Observed and verified rates of noncompliance by PC TPT and retail taxpayers.
 - ii. Amount of PC TPT materials purchased out of state.
 - iii. Amount and locations of PC TPT materials purchased in state.
 - iv. Observed costs of labor and materials related to PC TPT projects.
 - v. Evaluate tax policy related to trades (plumbers, electricians, HVAC, etc.).
 - vi. Comparison of finance models and mechanisms employed by other states and local governments to address impacts of growth.
 - vii. Examination of PC TPT in context of historical and existing state and local tax policy.
 - b. Commission and complete on or before November 30, 2013. Report is distributed to governor, speaker of the house, senate president and the League of Arizona Cities and Towns.

Municipal Proposal: Miscellaneous

1. Align MCTC and state TPT statutes.
2. Require the Joint Legislative Budget Committee to provide a fiscal note on legislation proposing any change to transaction privilege and/or use taxes prior to its consideration by any standing committee or Committee of the Whole.

Municipal Proposal: Tax Simplification Checklist

How does the Municipal Proposal on Tax Simplification Compare?

Throughout the extensive discussion on the complex topic of tax simplification, proponents of the original bill have consistently pointed to key items they believe fulfill their criteria for simplification. Below is a chart that shows how our proposal not only fulfills the stated criteria, but also significantly exceeds these requirements to achieve even greater simplification.

	Municipal Proposal	HB 2657/ HB 2111
Complies with the Marketplace Fairness Act	Y	N
Preserves critical municipal tax information	Y	N
Tax software compatibility	Y	N
Ensure a single interpretation for all audits	Y	N
Ensure that local businesses are audited by those familiar with the community	Y	N
Ensure that state and local revenues are not at risk	Y	N
Obtains the necessary information to make sound fiscal decisions	Y	N
Single point of payment	Y	Y
Single point of licensing	Y	Y
Create a single point of filing	Y	Y
Protects taxpayer confidentiality	Y	Y
Create a single entity for auditing	Y	Y