ARIZONA DEPARTMENT OF REVENUE

THE REVENUE IMPACT OF ARIZONA'S TAX EXPENDITURES FY 2004/05

PREPARED FOR: THE GOVERNOR AND 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. §42-1005.

The preliminary 2005 report provides a broad range of information. The report contains sections for all taxes imposed by the state, however, the individual income tax section of this report contains only credit data. The final report will contain additional information made available through the 2003 Individual Income Tax Simulation Model.

If you have any questions or comments regarding this report, please contact the Arizona Department of Revenue at (602) 716-6090.

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THE 2005 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. §42-1005.

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 1993 to $2,100. From tax years 1993 through 2002, the age 65 and over exemption has 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 or calendar 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[1]

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.

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). The average fair market value of aircraft owned by the federal government and operated in Arizona is unknown. It is known that there were 109 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 2004/05. The average fair market value of each aircraft is approximately $131,100, which equates to a tax value of $71,450 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 72 aircraft of this type registered by bona fide aircraft dealers in Arizona in fiscal year 2004/05. The tax value of these aircraft was approximately $402,607.

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 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. In fiscal year 2004/05, there were 37 nonresident aircraft based in Arizona. The total aircraft license tax paid by nonresidents falling into this category in fiscal year 2004/05 was $15,635. The value of this expenditure can be calculated by multiplying this figure by four, which yields the foregone tax collections allowed by this preferential rate, or $62,542.

Aircraft in storage or being repaired is charged a license tax of $20 (A.R.S. §28-8337). There are 279 aircraft, which have been granted this license tax rate with a fair market value of approximately $ 494.8 million. The tax value of this preferential license tax is $2.5 million 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 84 aircraft 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 $1,260.

[1]Any figures presented for Aircraft License Tax Expenditures were provided by the Arizona Department of Transportation.

A.R.S. §28-8339 allows a $20 license tax for an *antique, classic, warbird, glider, experimental, homebuilt, or balloon aircraft*. There are 3,109 aircraft registered in Arizona under this provision, with a total market value of $ 12.4 million. 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 $0.

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 11 nonresident-owned maintenance aircraft and 18 manufacturer's aircraft registered in Arizona, for a total market value of $142.9 million. 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 $713,875.

SUMMARY OF AIRCRAFT LICENSE TAX EXPENDITURES

	Revenue Gain
AIRCRAFT LICENSE TAX EXEMPTIONS:	
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	$71,450
Aircraft owned by an aircraft dealer for sale	402,607
PREFERENTIAL TAX RATES	
Preferential rate for nonresidents with aircraft in the state from 90 to 210 days	$62,542
Preferential rate for aircraft in storage or being repaired	2,468,634
Preferential rate for salvage aircraft in storage or being repaired	1,260
Preferential rate for antique, classic, warbird, etc., aircraft	0
Preferential rate for maintenance aircraft	0
Preferential rate for manufacturer's aircraft	713,875

TOTAL QUANTIFIABLE AIRCRAFT LICENSE TAX EXPENDITURES[2] $3,720,367

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*No Information Available.

[2]These tax expenditures represent foregone revenues to the state aviation fund.

AVIATION FUEL TAX EXPENDITURES

AVIATION FUEL TAX EXPENDITURES[3]

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. 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. §28-5610. *Aviation fuel moving in interstate or foreign commerce, not destined or diverted to a point within this state* is exempt from aviation fuel tax. There is no requirement for reporting this information, 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. §28-5610). 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 a*viation fuel for use in applying seeds, fertilizer or pesticides* (A.R.S. §28-5611A). If such fuel were subject to taxation in fiscal year 2004/05, an additional $842 would have been received.

Aviation fuel, which is exported from the state, is exempt from aviation fuel tax (A.R.S. §28-5611A). The taxpayer must apply for a refund. If such fuel were subject to taxation in fiscal year 2004/05, an additional $5,933 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. §28-5611A). No requests for refunds were made in fiscal year 2004/05.

[3]Any figures presented for Aviation Fuel Tax Expenditures were provided by the Arizona Department of Transportation.

SUMMARY OF AVIATION FUEL TAX EXPENDITURES

	Revenue Gain
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	$842
Exported aviation fuel	5,933
Aviation fuel lost due to fire, theft or other accident	0

TOTAL QUANTIFIABLE AVIATION FUEL TAX EXPENDITURES[4] $6,775

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* No Information Available.

[4]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 fiscal year 2004/05, this group of taxpayers subtracted $3.1 million from gross receipts. 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 $77,121. 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 0.31%. (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 0.32% results in potential collections of $9,914.

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 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 (recipients of less than $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. However, the tax rate of 0.32% mentioned previously, is considered to be the effective tax rate for Class A. This would make 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 $145,756. (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 1.60%. 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.

Class	Original Tax Collections*	New Tax Collections	Difference
A	$ 9,915	$ 49,614	$39,699
B	$241,023	$269,390	$28,367
C	$351,391	$283,326	($68,066)
Total	$602,329	$602,329	$ 0

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

SUMMARY OF BINGO TAX EXPENDITURES

	Revenue Gain
Subtraction from Gross Receipts for Class A Licensees	
Option 1	$77,000
Option 2	9,900
Preferential Tax Rates for Class A and Class B Licensees	
Option 1	$145,700
Option 2	0
TOTAL QUANTIFIABLE BINGO TAX EXPENDITURES[5] RANGES FROM	**$9,900 -$145,700**

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[5]These tax expenditures represent foregone revenues to the state general fund.

BOXING
TAX EXPENDITURES

BOXING TAX EXPENDITURES[6]

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 fiscal year 2004/05, 40 boxing contests were held. At each event, 75 complimentary tickets were issued with an average price of $25 each. Had the value of these tickets been taxable, an additional $3,000 in boxing taxes would have been received.

[6]Any figures presented for Boxing Tax Expenditures were provided by the Arizona Boxing Commission.

SUMMARY OF BOXING TAX EXPENDITURES

	Revenue Gain
Complimentary tickets issued	$3,000
TOTAL QUANTIFIABLE BOXING TAX EXPENDITURES[7]	**$3,000**

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[7]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 $700 million in net corporate income taxes during fiscal year 2004/05. Net corporate income tax is deposited into the general fund. However, 15% of the tax is distributed to cities and towns two years after the year in which it was collected. For example, 15% of tax collected in fiscal year 2004/05 will be distributed to incorporated cities and towns in fiscal year 2006/07. Therefore, only 85% of the tax collected is actually available for the state's use. This fact should be kept in mind when reviewing the reported tax value of subtractions and credits. The assumption can be made that 85% of the tax value is general fund revenue, with the remaining 15% distributed to cities and towns two years after collection.

Arizona corporate taxable income is calculated beginning with federal taxable income. Therefore, by conforming Arizona law to the Internal Revenue Code, any subtractions allowed under federal law in the calculation of federal taxable income are allowed under Arizona law. From federal taxable income, certain additions and subtractions are allowed to reach Arizona taxable income. After calculating tax liability, corporate taxpayers may take advantage of a number of 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 return. The Arizona legislature must approve legislation to conform to the definition of federal taxable income as of January of each 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 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.*
- *Certain taxes paid or accrued during the tax year.*
- *Interest paid on certain debts.*

- *Other deductions including amortization of organizational expenses, losses from partnership trade or business activities, travel and meal expenses, membership dues, etc.*

It is not possible to estimate the tax value of these subtractions. While the Department of Revenue receives information from the Internal Revenue Service from federal tax returns for corporations with an Arizona address, data 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(1)].
- *Qualifying fraternal beneficiary societies, orders or organizations* [A.R.S. §43-1201(2)].
- *Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit* [A.R.S. §43-1201(3)].
- *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(4)].
- *Nonprofit business leagues, chambers of commerce, real estate boards or boards of trade* [A.R.S. §43-1201(5)].
- *Nonprofit qualifying civic leagues or organizations operated exclusively for the promotion of social welfare, or local organizations of employees* [A.R.S. §43-1201(6)].
- *Clubs organized and operated exclusively for pleasure, recreation and other non-profit making purposes* [A.R.S. §43-1201(7)].
- *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(8)].
- *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(9)].
- *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 membership is limited to officers or employees of the U.S. government* [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 that 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 statutes set out certain items that can be subtracted from federal taxable income to reach adjusted income attributable to Arizona. The tax value of these subtractions 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. §43-1022(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* [§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 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. §43-1022(12)].
- *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. §43-1022(13)].
- *The amount allowed by §43-1025 for contributions during the taxable year of agricultural crops to charitable organizations* [A.R.S. §43-1022(14)].
- *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. §43-1022(15)].
- *An adjustment for federal bonus depreciation* [A.R.S. §43-1022(28, 29)].

- *Arizona capital loss carryover in an amount not to exceed $1,000 for tax years beginning prior to 1/1/88* [A.R.S. §43-1122(2)].
- *Expenses and interest relating to tax-exempt income disallowed pursuant to §265 of the Internal Revenue Code* [A.R.S. §43-1122(3)].
- *Dividends received from another corporation owned or controlled directly or indirectly by a recipient corporation* [A.R.S. §43-1122(4)].
- *Interest income received on obligations of the U.S.* [A.R.S. §43-1122(5)].
- *Dividend income from foreign corporations* [A.R.S. §43-1122(6)].
- *The amount of net operating loss allowed by A.R.S. §43-1123* [A.R.S. §43-1122(7)].
- *State income tax refunds received which were included as income in computing federal taxable income* [A.R.S. §43-1122(8)].
- *Expense recapture included in income pursuant to §617 of the Internal Revenue Code for mine exploration expenses* [A.R.S. §43-1122(9)].
- *Deferred exploration expenses allowed by A.R.S. §43-1127* [A.R.S. §43-1122(10)].
- *Exploration expenses related to the exploration of oil, gas or geothermal resources* [A.R.S. §43-1122(11)].
- *Amortization of pollution control devices* [A.R.S. §43-1122(12)].
- *Amortization of the cost of child care facilities* [A.R.S. §43-1122(13)].
- *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(14)].
- *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(15)].
- *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(16)].
- *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* [A.R.S. §43-1122(17)].

ARIZONA NET OPERATING LOSSES

All corporate taxpayers are allowed to subtract from their Arizona adjusted gross 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 $6.3 billion in tax year 2003. In many cases a corporation's reported net operating loss exceeded its Arizona adjusted gross income. Subtracting the net operating loss in these cases resulted in negative taxable income. To calculate the tax value of the net operating losses, the loss was multiplied by 6.968% for those businesses with positive taxable income. For those businesses with negative taxable income, that portion of net operating loss that was used to reduce taxable income to zero was multiplied by 6.968%[8]. These calculations result in a maximum tax value of $64 million.

About 24.8% of the 48,317 corporations that filed Arizona corporate income tax returns for tax year 2003 reported net operating losses. The table below shows the number of corporations by size of net operating loss and by whether or not there was enough taxable income to generate a tax liability other than the minimum $50 tax.

[8]For example, if the net operating loss was $10,000 and the negative taxable income was $9,000, adding back the loss results in $1,000 of net operating loss being used to reduce taxable income to zero. The tax rate was applied against the $1,000 to arrive at the tax value of the operating loss.

2003 - Size of NOL	# with Tax Liability greater than $50	# with Tax Liability less than or equal to $50	Total
$1 to $99	59	608	667
$100 to $999	273	1,130	1,403
$1,000 to $9,999	974	2,911	3,885
$10,000 to $49,999	775	2,466	3,241
$50,000 to $99,999	191	754	945
$100,000 to $499,999	233	927	1,160
$500,000 to $999,999	33	197	230
$1,000,000 to $9,999,999	37	314	351
Over $9,999,999	4	88	92
Total	**2,579**	**9,395**	**11,974**
NOL $ Value	$292,096,345	$6,042,699,718	$6,334,796,063

COMMERCIAL TAX CREDITS

A tax credit reduces corporate tax liability, as opposed to a subtraction, which reduces taxable income. Most tax credits that currently exist in Arizona corporate tax law are nonrefundable; any credit amount greater than a firm's tax liability will not be refunded. The unused credit is then carried forward for use in future tax years. A corporation receives a credit for expenditures in the following areas:

- *for increased employment in enterprise zones* (A.R.S. §43-1161).
- *for the purchase of recycling equipment* (A.R.S. §43-1164).
- *for employment and for property taxes paid by a qualified defense contractor* (A.R.S. §43-1165, 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 costs in constructing a qualified environmental technology manufacturing, producing or processing facility* (A.R.S. §43-1169).
- *1for expenses to purchase property used to control or prevent pollution* (A.R.S. §43-1170).
- *for expenses incurred for tangible personal property used to control or prevent pollution, relating to agriculture* (A.R.S. §43-1170.01).
- *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 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 the fair market value of a vehicle, up to $1500, donated to the wheels to work program* (A.R.S. §43-1177).
- *for coal consumed in generating electric power* (A.R.S. §43-1178).
- *a refundable credit for providing technological skills training to not more than 20 employees* (A.R.S. §43-1179).
- *a refundable credit for conveying ownership or development rights of agricultural property to an agricultural preservation district (*A.R.S. §43-1180)
- *for donating real property or improvements to a school district* (A.R.S. §43-1181)
- *for donations made directly to the Clean Elections Fund* (A.R.S. §16-954B)
- *for corporations that elected to file consolidated returns in Arizona and amended their 1986 through 1993 tax returns, thus creating a credit that could be taken over ten years.*

When reviewing the credit data, 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, figures stated here will change next year and figures cited in previous years will not match what is presented here. Second, information cannot be revealed about certain credits claimed without breaching confidentiality. If less than three 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 confidential information being divulged about other credits, then that information cannot legally be released.

Data for tax year 2003 is shown below, but **it is preliminary**. For tax year 2002, corporations claimed 477 commercial tax credits and used a total of $25.3 million in credits to offset taxes and get refunds where allowed. Asterisks indicate instances in which release of information would breach confidentiality laws.

TYPE OF CREDIT	2001		2002		2003	
	#	$ USED	#	$ USED	#	$ USED
Enterprise zone	128	$6,456,049	127	$5,944,633	67	$3,047,546
Recycling equipment	4	21,442	4	5,145	4	3,426
Defense contracting	0	0	**	**	**	**
Military reuse zone	3	109,373	**	**	**	**
Research & development	123	9,301,385	124	10,901,624	79	21,592,007
Environmental technology facility	3	1.084,588	**	**	0	0
Pollution control device	29	2,173,882	28	1,386,455	18	1,739,959
Agricultural pollution control equip't	**	**	**	**	0	0
Construction materials	3	100	3	100	**	**
Agricultural water conservation system	**	**	**	**	**	**
Underground storage tanks	0	0	**	**	0	0
Alternative fuel vehicles (Nonref)	**	**	8	32,969	5	1,726
Alternative fuel vehicles (Refundable)	12	218,560				
Neighborhood electric vehicles	20	69,701	16	31,172	8	19,026
Vehicle refueling apparatus & infrastructure (Nonref)	**	**	**	**	**	**
Vehicle refueling apparatus & infrastructure (Refundable)	0	0				
Alternative fuel delivery systems (Nonref)	3	184,431	3	1,039	**	**
Alternative fuel delivery systems (Refundable)	0	0				
Employment of TANF recipients	6	57,851	7	173,550	5	461,980
Solar hot water plumbing stub outs & electric vehicle recharge outlets	0	0	0	0	0	0
Donation of motor vehicle to wheels to work program	0	0	0	0		
School site donation	**	**	**	**	**	**
Agricultural preservation district	0	0	0	0	0	0
Taxes paid for coal consumed in generating electrical power	**	**	**	**	0	0
Technology training	10	40,595	4	41,083	**	**
Clean election	97	2,913	102	646	111	1,563
Consolidated filer	35	3,492,320	30	2,196,494	32	2,335,704
Total	**498**	**$24,207,863**	**477**	**$25,310,248**	**345**	**$29,902,588**

SUMMARY OF CORPORATE INCOME TAX EXPENDITURES

	Revenue Gain
Subtractions Allowed in Calculation of Federal Taxable Income:	
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
Certain taxes paid or accrued during the tax year	NIA
Interest paid on certain debts	NIA
Other miscellaneous deductions	NIA
Exempt Organizations:	
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
Arizona Subtractions from Federal Taxable Income:	
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
Amortization by a qualified defense contractor	NIA
Gain on amortized capital investment by a qualified defense contractor	NIA
Dividend income received from Arizona corporations	NIA*

* No Information Available.

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
State income tax refunds	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
Contributions to individual medical savings accounts	NIA
Excess capital loss carryover	NIA
Net Operating Losses	**$64,022,000**
Commercial Tax Credits:	
Enterprise zone employment	$3,048,000
Recycling equipment	3,000
Defense contracting	NR[9]
Military reuse zone	NR
Research & Development	21,592,000
Environmental technology facility	0
Pollution control devices	1,740,000
Agricultural pollution control equipment	0
Construction materials	NR
Agriculture water conservation system	NR
Underground storage tanks	0
Alternative fuel vehicles	2,000
Neighborhood electric vehicles	19,000
Vehicle refueling apparatus and infrastructure	NR
Alternative fuel delivery systems	NR
Employment of TANF recipients	462,000
Solar hot water plumbing stub outs and electric vehicle recharge outlets	0
Donation of motor vehicles to wheels to work program	0
Taxes paid for coal consumed in generating electrical power	0
Agricultural preservation district	0
Technology training	NR
School site donation	NR
Clean election	2,000
Consolidated filer	2,336,000
Total Commercial Tax Credits	**$29,903,000**

[*] No Information Available.

[9] NR indicates that the information is not releasable due to Arizona confidentiality laws. Fewer than ten license holders took advantage of this refund.

TOTAL QUANTIFIABLE CORPORATE INCOME TAX EXPENDITURES[10]
..... $93,925,000

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[10]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. Estate tax collections totaled $31.2 million in fiscal year 2004/05.

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.*

The total deductions allowed from the federal credit in fiscal year 2003/04 was $1.5 million. This deduction is a dollar-for-dollar reduction in the estate tax liability.

SUMMARY OF ESTATE TAX EXPENDITURES

	Revenue Gain
Deduction from federal credit for state death taxes	$1,458,721
TOTAL QUANTIFIABLE ESTATE TAX EXPENDITURES[11]	**$1,458,721**

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[11]These expenditures represent foregone revenues to the state general fund.

FIDUCIARY INCOME TAX EXPENDITURES

FIDUCIARY INCOME TAX EXPENDITURES

Arizona imposes fiduciary income tax on trusts and estates. The taxability of the income is determined by the residence of the fiduciary, beneficiary or deceased taxpayer. For estates, the tax applies to the entire taxable income if the deceased taxpayer was an Arizona resident. The fiduciary or beneficiary residence is immaterial. In contrast, for trusts, the tax applies to the entire taxable income when the fiduciary or beneficiary is an Arizona resident.

Arizona taxable income is calculated beginning with federal taxable income. By conforming Arizona law to the Internal Revenue Code, subtractions allowed under federal law in calculating federal taxable income are allowed under Arizona law. From federal taxable income, certain additions, subtractions and exemptions are allowed to reach Arizona taxable income. After calculating tax liability, fiduciary taxpayers may reduce their tax liability by using a credit for taxes paid to other states or countries or a credit for clean elections.

Fiduciary income tax is deposited into the general fund. However, 15% of the tax is distributed to cities and towns two years after the year in which it was collected. For example, 15% of tax collected in fiscal year 2004/05 will be distributed to incorporated cities and towns in fiscal year 2006/07. Therefore, only 85% of the tax collected, or of the tax value of any expenditure, is actually available for the state's use. This fact should be kept in mind when reviewing the reported tax value of the various subtractions, exemptions and credits.

SUBTRACTIONS ALLOWED IN THE CALCULATION OF FEDERAL TAXABLE INCOME

The starting point for calculating 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 approve legislation to conform to the definition of federal taxable income by January of each 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 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.*
- *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

The Arizona fiduciary income tax return lists the following specific items that can be subtracted from federal taxable income to reach adjusted gross income attributable to Arizona:

- *Negative Arizona fiduciary adjustment from another trust or estate.* This adjustment is used if the Schedule K-1 indicates a difference between the federal and state distributable income. [A.R.S. §43-1332(1)].
- *Interest income on U.S. obligations.* Interest income received on U.S. obligations, 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 obligations. [A.R.S. §43-1022(6)]
- *Energy efficient residence.* The amount authorized by A.R.S. §43-1031 for constructing an energy efficient residence. [A.R.S. §43-1022(27)]

The remaining subtractions on the Arizona fiduciary tax form 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.* Benefits, annuities and pensions totaling not more than $2,500 received from any of the following: 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 or 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; an optional retirement program established by a community college district board; or a retirement plan established for employees of a county, city or town in Arizona. [A.R.S. §43-1022(2)]
- *Refunds from other states.* The amount of any income tax refunds received from states other than Arizona and included as income. [A.R.S. §43-1022(7)]
- *Annuity income.* 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. §43-1022(8)]
- *Wood stoves and fireplaces.* The amount authorized by A.R.S. §43-1027 for the purchases of qualified wood stoves, wood fireplaces or gas fired fireplaces. [A.R.S. §43-1022(21)]
- *Operating loss carryover.* 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. §43-1022(23)]
- *Federal credits.* The portion of any wages or salaries paid or incurred by the taxpayer 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. §43-1022(15)]
- *Individual medical savings accounts.* 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. [A.R.S. §43-1022(22)]

- *Contribution of agricultural crops.* The amount allowed by A.R.S. §43-1025 for contributions of agricultural crops to charitable organizations [A.R.S. §43-1022(14)].
- *Installment income.* 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. §43-1022(5)]
- *Holocaust survivors.* The amount authorized by A.R.S. §43-1030 relating to holocaust survivors. [A.R.S. §43-1022(26)]
- *Adjustment for bonus depreciation allowed under IRC §168(k) added to Arizona gross income.* This adjustment relates to the 30% and/or 50% bonus depreciation allowed at the federal level. [A.R.S. §43-1022(28)]
- *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. §43-1022(3)].
- *Exemptions for blind persons, persons over 65, dependents and qualifying ancestors.* Exemptions are allowed for blind persons ($1,500), persons over 65 years ($2,100), dependents ($2,300) and qualifying ancestors that live with the taxpayer and requires assistance with activities of daily living ($10,000) [A.R.S. §43-1022(1)].
- *Distributions from individual retirement accounts.* 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. §43-1022(4)]
- *Partner's share of income.* 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. §43-1022(9)]
- *Partner's share of losses.* 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. §43-1022(10)]
- *Sale of income producing property.* 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. §43-1022(11)]
- *Amortization of capital investment.* 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. §43-1022(12)]
- *Gain on capital investment.* 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. [§43-1022(13)]
- *State lottery winnings.* The amount of winnings less than $5000 in a taxable

year from any of the state lotteries, except that all such winnings before 3/22/83, including periodic distributions from such winnings made after 3/2/83, may be subtracted. [A.R.S. §43-1022(16)]

- *Mining exploration expenses.* 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. §43-1022(17)]
- *Social security benefits.* The amount included pursuant to §86 of the IRC, relating to taxation of social security and railroad retirement benefits. [A.R.S. §43-1022(18)]
- *Compensation for armed forces active service.* To the extent not already excluded, 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)
- *Adoption costs.* The amount of unreimbursed 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. §43-1022(20)]
- *Qualified educational expenses.* Any amount of qualified educational expenses distributed from a qualified state tuition program determined pursuant to §529 of the Internal Revenue Code and that is included in income. [A.R.S. §43-1022(24)]
- *Installment sale subject to tax in another state.* Any item of income resulting from an installment sale that has been properly subject to tax in another state in a previous year and is included in Arizona gross income in the current taxable year. [A.R.S. §43-1022(25)].
- *Income from a trust established as a medical savings accounts* In the cast of a trust that is established as a medical savings account pursuant to A.R.S. §43-1028, income earned by the trust is included in the trsut's Arizona gross income. [A.R.S. §43-1332(2)].
- *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. §§43-1333].

In tax year 2003, all subtractions on fiduciary tax returns were reported in aggregate with the exception of "Income from a trust established as a medical savings account." Income of $73,199 was reported. Using an effective tax rate of 4.38%, the tax value of this subtraction was $3,203.

All other subtractions that reduced tax liability totaled $95.6 million. (This does not include subtractions that were greater than income. Those subtractions would have no tax value because they didn't actually offset any income.) Using the effective tax rate of 4.38%, the tax value of these subtractions was $4,134 million.

PREFERENTIAL TAX RATES

Fiduciary income tax is calculated according to a graduated tax rate schedule as shown below:

at least	but less than	
$0	$10,000	2.87% of taxable income
10,000	25,000	3.20% of taxable income, minus $33
25,000	50,000	3.74% of taxable income, minus $168
50,000	150,000	4.72% of taxable income, minus $658
150,000	and over	5.04% of taxable income, minus $1,138

As can be seen from the table, lower taxable incomes are taxed at a lower rate. If all taxpayers were treated identically, the same tax rate would be applied regardless of the amount 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 5.04%, determining the impact of taxing all income at 5.04% would seem appropriate.* However, no taxpayer currently pays 5.04% tax on all taxable income. If a flat tax rate of 5.04% was applied regardless of income level, all taxpayers would experience a tax increase.

A more reasonable approach to a flat tax rate would be to apply the effective tax rate on taxable income for all fiduciary taxpayers. Applying this effective tax rate to all fiduciary taxpayers will result in the same tax collections as with the graduated tax rate structure; however, the burden of the tax will shift. Taxpayers with lower Federal Adjusted Gross Income would pay more tax and taxpayers with higher Federal Adjusted Gross Income would pay less tax.

CREDITS

After fiduciary income tax liability is calculated, two credits can 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 2003, $2.5 million was claimed as credit for taxes paid to other states or countries. Additionally, if the trust or estate makes a contribution to the Clean Elections Fund, a credit may be claimed for those contributions. The total clean elections credit claimed in 2002 by estates and trusts was $56. Both credits are a direct reduction to tax liability.

SUMMARY OF FIDUCIARY INCOME TAX EXPENDITURES

	Revenue Gain
SUBTRACTIONS IN CALCULATION OF FEDERAL TAXABLE INCOME:	
Deduction for interest paid	NIA*
Deductible taxes	NIA
Deductible fiduciary 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

SUBTRACTIONS FROM FEDERAL TAXABLE INCOME:

Negative Arizona fiduciary adjustment from another trust or estate
Interest income on U.S. obligations
Energy efficient residence
U.S./state pensions not over $2,500
Income tax refunds from other states
Annuity income included pursuant to §72 of the IRC
Certain IRA distributions or 401Ks
Qualified wood stoves and fireplaces
Installment income recognized pursuant to IRC
Excess operating loss carryover
Certain federal credits
Medical savings accounts
Contribution of agricultural crops
Installment income
Holocaust survivors
Adjustment for bonus depreciation
Federal income from other fiduciaries
Exemptions for blind persons, persons over 65 years of age, dependents and qualifying ancestors
Distributions from individual retirement accounts
Partner's share of income
Partner's share of losses
Sale of income producing property
Amortization of capital investment
Gain on capital investment
State lottery winnings
Mining explorations expenses
Social security benefits

* No Information Available.

Compensation for armed forces active service
Adoption costs
Qualified educational expenses
Installment sale subject to tax in another state
Income from a trust established as a medical savings account.....$3,000
Arizona distribution to beneficiaries
Value of subtractions other than medical savings account trusts $4,184,000

TOTAL TAX VALUE OF SUBTRACTIONS FROM FEDERAL TAXABLE INCOME.....$4,187,000

CREDIT FOR TAXES PAID TO OTHER STATES/COUNTRIES.....$2,461,000

CREDIT FOR CONTRIBUTIONS TO THE CLEAN ELECTION FUND.....$56

TOTAL QUANTIFIABLE FIDUCIARY INCOME TAX EXPENDITURES[12] $6,648,000

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[12]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 was $11.81 in tax year 2004.

EXEMPTIONS

If an airline is operating in Arizona with a maximum passenger capacity of less than 56 seats and a maximum pay load capacity of less than 18,000 pounds (A.R.S. §42-14251.10), this *small flight property shall be valued at 30% of its original cost less depreciation* multiplied by the assessment ratio (A.R.S. §42-14254C). Had the taxable value been 100%, the state would have raised $2.6 million more in fiscal year 2004/05.

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 25% to 5%. For flight property, the *assessment ratio is equal to the ratio which the total net assessed valuation of all taxable property in class 1, class 6 paragraph 3 and personal property in class 2 bears to the total full cash value of such property* (A.R.S. §42-14255*)*. For tax year 2004, the assessment ratio used for flight property was 21%. 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, 25%, tax collections would have increased by $5.6 million.

SUMMARY OF FLIGHT PROPERTY TAX EXPENDITURES

	Revenue Gain
EXEMPTION	
Tax value at 30% for small airplanes	$2,567,719
PREFERENTIAL ASSESSMENT RATIOS:	
Preferential assessment ratio at 25%	$5,633,995
TOTAL QUANTIFIABLE FLIGHT PROPERTY TAX EXPENDITURES[13]	**$8,201,715**

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[13]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 approximately 81.9% of the tax that would have been levied in fiscal year 2004/05 had they been legally bound to pay property tax. Given the repeal of the state rate, the dollar expenditure that 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.

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INDIVIDUAL INCOME TAX EXPENDITURES

INDIVIDUAL INCOME TAX EXPENDITURES

No information is available on individual income tax expenditures at this time. At the final printing of this publication, data will be included. The individual income tax information included in the final report will be made available through the 2003 Individual Income Tax Simulation Model.

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, $5.04 ($100 times the maximum tax rate of 5.04%). On the other hand a $100 credit reduces tax liability by the full $100.

Family Tax Credit

Single and married filing separately filers with a federal adjusted gross income of $10,000 or less, and married filing jointly filers with a federal adjusted gross income of $31,000 or less with dependents, may claim the family tax credit (A.R.S. §43-1073). The amount of the credit is set at $40 per person in the household, and is capped at $240 for married filing jointly and unmarried head of household filers, and $120 for single and married filing separately filers.

Property Tax Credit

The property tax credit program provides *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.

Clean Elections Credit

A credit is allowed for *donations made directly to the Clean Elections Fund or a clean election donation made on the individual income tax return*. The credit is not to exceed 20% of the tax liability or $530 for single filers ($1,060 for married filing jointly) whichever is greater. The maximum credit is adjusted biennially (A.R.S. §16-954B).

Credit for Increased Excise Taxes Paid

A refundable credit is allowed against income tax *to mitigate the increase in transaction privilege tax rates for education* (A.R.S. §43-1072.01). To qualify, claimants must have federal adjusted gross income of $25,000 or less for married filing jointly or $12,500 or less for single filers. The credit shall not exceed $25 for each person who is a resident and for whom a personal or dependent exemption is allowed with a maximum credit of $100 per household.

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).

Enterprise Zone Credits

Enterprise zone credits are income tax *credits provided for non-retail 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 $500 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 $1,000 per net new employee can be claimed. The limit in the third year of continuous employment is $1,500 per net new employee.

Research and Development Credit
A.R.S. §43-1074.01 provides a tax credit for *research and development expenses*. The amount of credit is computed based on the excess of the qualified research expenses for the taxable year over the base amount.

Recycling Equipment Credit
The recycling equipment credit is an income tax credit *for businesses or individuals that 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 lessor of 25% of the tax liability for that tax year or $5,000.

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).

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.

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.

Pollution Control Device Credit
The pollution control device credit is a tax credit *for expenses incurred to purchase real or personal property that is used in Arizona in the taxpayer's trade or business to control or prevent pollution* (A.R.S. §43-1081). The amount of the credit is equal to the lesser of 10% of the purchase price or $500,000.

Agricultural Pollution Control Equipment Credit
A credit is allowed for *expenses that a taxpayer (involved in the commercial production of livestock, livestock products or agricultural, horticultural, viticultural or floricultural corps or products) incurs to purchase tangible personal property that is primarily used in the taxpayer's trade or business in the state to control or prevent pollution* (A.R.S. §43-1081.01).

Construction Materials Credit
A.R.S. §43-1082 provides a tax credit of 5% of the purchase price of *new construction materials incorporated into a qualifying facility located in Arizona if the facility has a total cost of $5 million.*

Solar Energy Device Credit
A solar energy credit is provided for an individual who *installs a solar energy device in his or her residence in Arizona.* The credit for buying or installing such a device is 25% of the cost, including installation, or $1,000, whichever is less (A.R.S. §43-1083).

Agricultural Water Conservation System Credit
A credit is allowed for expenses incurred by a taxpayer to *purchase and install an agricultural water conservation system* (A.R.S. §43-1084). The agricultural water conservation system must be primarily designed to substantially conserve water on land that is used to produce agricultural products, raise, harvest or grow

trees, or sustain livestock. The amount of the credit is 75% of the qualifying expenses.

Underground Storage Tanks Credit
Taxpayers that incur *expenses for corrective actions taken with respect to the release of a regulated substance from an underground storage tank* are allowed an income tax credit. The credit is 10% of the amount spent for corrective actions during the taxable year, if certified by the Department of Environmental Quality. (A.R.S. §43-1085)

Alternative Fuel Vehicles Credit
An income tax credit was provided for *the purchase of one or more new alternative fuel vehicles for use in this state or for expense incurred for converting one or more conventional vehicles to operate on alternative fuel* (A.R.S. §43-1086). This credit is now only available to the extent that the taxpayer had unused carry forward from prior years.

Vehicle Refueling Apparatus Credit
A.R.S. §43-1086.01 provided a credit for the *purchase of a vehicle refueling apparatus including storage tanks, for installation on one or more properties in Arizona.* This credit is now only available to the extent that the taxpayer had unused carry forward from prior years.

Alternative Fuel Delivery System Credit
A credit was allowed for *construction costs or operating costs for constructing or operating an alternative fuel delivery system in Arizona* (A.R.S. §43-1086.02). This credit is now only available to the extent that the taxpayer had unused carry forward from prior years.

Employment of TANF Recipients Credit
A.R.S. §43-1087 provides for an income tax credit for *net increases in qualified employment of recipients of temporary assistance for needy families who are Arizona residents.* A maximum of $500 per each net new employee can be claimed in the first year of employment, $1,000 in second year of employment and $1,500 in the third year.

Contributions to Charities that Provide Assistance to the Working Poor Credit
Up to $200 in voluntary cash contributions to a charitable organization that spends at least 50% of its budget on services to Arizona residents who receive TANF benefits or low income Arizona residents (income of less than 150% of the federal poverty level) can be taken as an income tax credit (A.R.S. §43-1088).

Private School Tuition Organization Credit
The private school tuition organization credit is allowed for *cash contributions to a school tuition organization*, up to $500 for single/married filing separate and $625 for married filing joint/unmarried head of household filers. (A.R.S. §43-1089).

Public School Extra Curricular Activity Fee Credit
A.R.S. §43-1089.01 allows an income tax credit for the amount of *fees paid to a public school located in Arizona for the support of extra curricular activities,* up to $200 for single/married filing separate and $250 for married filing joint/unmarried head of household filers.

School Site Donation Credit
A.R.S. §43-1089.02 provides a credit for *donation of real property and improvements to a school district or charter school for use as a school or a site for the construction of a school.* The amount of the credit is 30% of the value of real property and improvements donated.

Solar Hot Water Heater Plumbing Stub Outs and Electric Vehicle Recharge Outlets Credit
A credit is allowed for *costs incurred of installing an electric vehicle recharge outlet and for including solar hot water heater plumbing stub outs in one or more houses in Arizona constructed by the taxpayer.* (A.R.S. §43-1090)

Donation of Motor Vehicles to Wheels to Work Program Credit
A credit is allowed for the *fair market value of any vehicle that is donated to the wheels to work program*

with a maximum credit of $1,500 per vehicle (A.R.S. §43-1090.01).

Agricultural Preservation District Credit
A *refundable* credit is allowed for a taxpayer who *conveys ownership or development rights of Class Two property to an agricultural preservation district* (A.R.S. §43-1081.02). The amount of the credit is either the appraised value of the property or the difference between the appraised value of the undeveloped land and the appraised value of the land for development purposes. The credit cannot exceed $33,000 in a calendar year.

Technology Training Credit
A *refundable* credit is allowed for *providing technological skills training to employees* (A.R.S. §43-1088.01). The credit is equal to 50% of the cost of training in taxable year, not to exceed $1,500 per employee, for a maximum of 20 employees.

TYPE OF CREDIT	# of claimants	2003 (Millions)
Family tax credit	417,451	$7.45
Property tax credit	15,022	5.30
Clean elections credit	32,042	0.73
Credit for increased excise taxes paid	546,116	29.42
Credit for taxes paid to other states	25,563	62.15
Enterprise zone credit	172	1.35
Research and development credit	DNA[14]	DNA
Recycling equipment credit	DNA	DNA
Defense contracting credit	DNA	DNA
Military reuse zone credit	DNA	DNA
Environmental technology credit	DNA	DNA
Pollution control device credit	DNA	DNA
Agricultural pollution control equipment credit	DNA	DNA
Construction materials credit	DNA	DNA
Solar energy device credit	DNA	DNA
Agricultural water conservation system credit	DNA	DNA
Underground storage tanks credit	0	0.00
Alternative fuel vehicles credit (nonrefundable)	45	0.057
Alternative fuel vehicle credit – neighborhood electric vehicle portion	1,168	1.53
Vehicle refueling apparatus credit (nonrefundable)	3	0.05
Alternative fuel delivery system credit (nonrefundable)	0	0.00
Employment of TANF recipients credit	DNA	DNA
Contributions to charities that provide assistance to the working poor credit	17,467	3.26
Private school tuition organization credit	58,122	29.45
Public school extra curricular activity credit	201,407	27.75
School site donation credit	DNA	DNA
Solar hot water heater plumbing stub outs and electric vehicle recharge outlets credit	DNA	DNA
Agricultural preservation district credit (refundable)	DNA	DNA

[14] Data was not available for this credit at the time of publication.

TYPE OF CREDIT	# of claimants	2003 (Millions)
Technology training credit (refundable)	DNA	DNA
TOTAL VALUE OF ALL CREDITS (credit used and refunded) [15]	**1,314,578**	**$168.45**

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[15] Figures for all credits shown here are subject to change due to the verification process.

INSURANCE PREMIUM TAX EXPENDITURES

INSURANCE PREMIUM TAX EXPENDITURES[16]

Each admitted insurer doing business in the state is required to annually report its total direct premium income to the Arizona Department of Insurance (A.R.S. § 20-224). Total direct premium income excludes "*...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 insurers are not required to report this information to the Department of Insurance. However, there is data available for "*considerations received on annuity contracts.*" Insurance companies reported $3,408.8 million in these considerations (of which $55.0 million were reported by fraternal benefit societies) which, if taxed at a two-percent rate, would have resulted in $68.2 million in revenues to the state in Fiscal Year 2005.

Insurers subject to Guaranty Fund assessments may 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)]. Because insurers have not been assessed by either of the Insurance Guaranty Funds for over five years, no credits emanating from Guaranty Fund assessments were available to offset insurer Calendar Year 2004 insurance tax liabilities (and thus, Fiscal Year 2005 tax revenues).

A.R.S. §§ 20-224.03 and 20-224.04, added by Laws 1999, Chapter 185, and amended by Laws 2002, Chapter 237, provide credits to insurers that increase their employment of individuals who reside in enterprise zones if the insurers meet a series of requirements, and provide credits to insurers that have offices established in military reuse zones as established in Title 41, Chapter 10, Article 3 and that meet other requirements. To date, three insurers have been certified by the Department of Commerce as being eligible to use these credits, and the insurers are permitted to adjust prior-year tax returns to the extent the insurers are eligible for credits in the prior years. Only two insurers reported credits relating to Calendar Year 2004, totaling $378.5 thousand, which offset the insurer's Fiscal Year 2005 insurance premium tax obligations. A.R.S. § 20-224.03(H) prevents the enterprise zone credit from causing a foreign insurer to have to pay a corresponding increase in retaliatory taxes required under A.R.S. § 20-230 (described later).

Domestic life and disability insurers that pay their certificate of authority renewal fees are eligible for credits against their insurance premium taxes. A.R.S. §§ 20-167(D). The sum of these credits reduced Fiscal Year 2005 premium tax revenues by $12.5 thousand.

Surplus lines insurers do not remit ordinary premium tax. Instead, surplus lines brokers are responsible for remitting premium taxes collected from insureds when coverage is placed in the surplus lines market. The tax rate is 3% of gross premiums less certain prescribed statutory reductions. [A.R.S. § 20-416.] Surplus lines 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-

[16]Any figures presented for Insurance Premium Tax Expenditures were provided by the Department of Insurance.

420(A)]. Surplus lines tax is not imposed on coverage provided to federally recognized Native American governments in accordance with Attorney General Opinion I95-13 (R95-11). Surplus lines tax is not imposed on coverage provided to the State of Arizona pursuant to A.R.S. § 41-621(F), which exempts the Department of Administration from the provisions of Title 20, Chapter 2, Article 5 -- the Article that, in part, imposes the surplus lines tax. In total, surplus line brokers reported $7.3 million in premiums exempted from Calendar Year 2004 premium tax. The tax on these premiums would have been $218.4 thousand if they were taxed at the three-percent rate at which non-exempt surplus lines premiums are taxed.

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 that 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 with the General Fund (A.R.S. § 20-227). In Calendar Year 2005, insurers wrote $42.1 million of taxable fire insurance premium for risks in *qualified* locations resulting in $277.9 thousand in insurance premium tax paid during Fiscal Year 2005 for those risks. If risks in qualified locations were subject to the 2.2% tax rate applied to other fire insurance premiums, insurers would have paid $926.3 thousand in Fiscal Year 2005, a difference of $648.4 thousand. The portion of the difference allocable to the General Fund (15%) would have been $97.3 thousand although for the purposes of this report, we suggest the tax expenditure is $648.4 thousand (i.e. to include the amounts transferred for firefighter retirement plans). The effect of the tax rate difference may be mitigated by retaliatory tax, described later.

Title 20, Chapter 4, Article 14, added by Laws 2001, Chapter 327, requires the Department of Insurance, effective July 1, 2002, to license "captive insurers." All other states that license captive insurers impose upon them an insurance premium tax. Arizona law does not provide for a premium tax for captive insurers. However, the Director of Insurance has discretion over the license fees and renewal fees imposed upon captive insurers, and those fees are higher than the fees for other types of insurers licensed in Arizona, and are also higher than the fees captive insurers pay in some other states. Non-Arizona captive insurer's premiums are typically taxed at a lower tax rate (often on a sliding scale based on premium volume) than other types of insurers' premiums, and all the premiums from a non-Arizona captive's nationwide program may be taxed by the domiciliary state (whereas for other types of insurers, only premiums relating to risks underwritten in that state are taxable). In total, Arizona captive insurers reported $4.4 million in premiums exempted from Calendar Year 2004 premium tax. If Arizona applied Vermont's captive insurance tax structure (which is a sliding rate structure depending upon premium volume), the premiums would have been taxed at a 0.40% rate, and Arizona would have collected $17.8 thousand in captive insurance premium tax. However, were a premium tax imposed upon captive insurers, the Director would likely establish lower license and renewal fees so Arizona could remain competitive at attracting and retaining captive insurers. With the current population of captive insurers, the fee reduction would eliminate most of the benefit realized by imposing a tax. As Arizona's captive insurance industry develops, we expect that the amount captives would pay in insurance premium taxes would exceed the amount by which our captive insurance license and renewal fees exceed other license and renewal fee amounts.

Non-profit hospital, medical, dental and optometric service corporations, are subject to

insurance premium taxes "*...on premiums received to effect or maintain its subscription contract, except that the tax shall not apply with respect to any 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 received therefrom** (A.R.S. § 20-837). The total of exempted net premiums in Calendar Year 2004 was $217.7 million and if the State were able to apply the two-percent tax rate, the State would have collected $4.4 million in additional premium taxes in Fiscal Year 2005.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 prohibits states from taxing Medicare Advantage (formerly Medicare+Choice) premiums. Specifically, 42 U.S.C. §1395w-24(g) states *"No state may impose a premium tax or similar tax with respect to payments to Medicare+Choice organizations under section 1853* ***or premiums paid to such organizations under this part."*** In Calendar Year 2004, one insurer reported $3.0 million in premiums subject to this preemption. If those premiums were subject to the Arizona 2% tax rate, the state would have collected $60.0 thousand in Fiscal Year 2005. One additional insurer reported $3.4M in premiums subject to this preemption, but failed to deduct them in its tax calculation, so the $67.3 thousand tax overpayment will be refunded when the insurer files an amended tax report and refund claim.

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 and 8909(f)]. In Calendar Year 2004, 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 $372.2 million. If Arizona were able to tax those premiums at a two-percent rate, the state would have collected $7.4 million in Fiscal Year 2005.

"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)]. The payments exempted under this section represent capitation payments that the Federal Government pays to Medicare+Choice providers who provide health care services to Medicare recipients. For Calendar Year 2004, exempt premiums totaled $1,417.0 million, which, if taxed at a two-percent rate, would have yielded $28.3 million in additional premium taxes in Fiscal Year 2005.

Premiums for farmowners multiperil coverage reinsured by the Federal Crop Insurance Corporation (FCIC) (7 U.S.C. § 1508) are exempt from state insurance premium taxation (7 U.S.C § 1511). In Calendar Year 2004, insurers collected $12.7 million in premiums reinsured by the FCIC which, if taxable at a two-percent rate, would have resulted in an additional $254.9 thousand being collected by the state in Fiscal Year 2005.

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(J)] eliminated premium taxes on premiums paid for 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. . . .*

During Calendar Year 2004, aggregate net premiums received for health benefits plans issued to small employers were $680.1 million. Had the tax rate on these premiums remained at two percent, an additional $13.6 million would have been deposited to the General Fund in Fiscal Year 2005.

A.R.S. § 20-883 provides exemptions from insurance premium taxes (and other state, county, district, municipal and school taxes) to fraternal benefit societies that are qualify under A.R.S. § 20-893. Fraternal benefit society

premiums exempted from tax totaled $89.8 million for Calendar Year 2004. This amount includes $55.0 million in annuity considerations reflected earlier in this report. If the $34.8 million in insurance premiums (excluding annuities) had been taxed at a two-percent rate for Calendar Year 2004, $695.3 thousand in Fiscal Year 2005 premium taxes would have been generated.

A.R.S. § 20-230 allows the Department of Insurance to charge foreign and alien insurers the same taxes, fees, fines, penalties, licenses, deposit and other obligations that the laws of their state or country impose on Arizona insurers doing business in their state or country. This *retaliatory tax*, as it is commonly known, guarantees that insurers incorporated 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 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 insurer's states of domicile, it is impossible to calculate the exact effect Arizona would realize if the above-described qualifications and exemptions of insurance premium taxes were not in place. Therefore, the estimates provided do not include consideration for the possible effect of retaliation. It is fair to say, however, that retaliatory tax would be diminished to some degree if tax expenditures were reduced.

SUMMARY OF INSURANCE PREMIUM TAX EXPENDITURES

	Revenue Gain
SUBTRACTIONS FROM TOTAL PREMIUM INCOME:	
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 (includes $898,900 of tax expenditures relating to considerations received by fraternal benefit societies)	$68,177,000
Unabsorbed portion of any premium deposit	NIA
TOTAL QUANTIFIABLE SUBTRACTIONS FROM PREMIUM INCOME	**$68,177,000**
AVAILABLE TAX CREDITS	
INSURANCE GUARANTY FUND ASSESSMENT TAX CREDIT	$0
DOMESTIC LIFE AND DISABILITY INSURER TAX CREDIT	$12,500
ENTERPRISE ZONE AND MILITARY REUSE ZONE TAX CREDITS	$378,500
TOTAL AVAILABLE TAX CREDITS	**$391,000**
EXEMPTIONS FOR SURPLUS LINE INSURANCE:	
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
Insurance on federally reorganized Native American governments	NIA
Insurance on the State of Arizona	NIA
TOTAL EXEMPTIONS FOR SURPLUS LINE INSURANCE	**$218,400**
PREFERENTIAL RATE ON QUALIFIED FIRE INSURANCE	**$648,400**
ABSENCE OF CAPTIVE INSURANCE PREMIUM TAX	**$0**
GOVERNMENT PROGRAM EXEMPTIONS:	
Hospital, medical, dental and optometric service corporation premiums paid by federal, state and municipal governments	$4,353,900
Medicare Advantage plan premiums (including potential refund of $67,300)	$127,300
Life and health insurance premiums paid by the Federal Employee Health Benefits Fund	7,446,600

*No Information Available.

Health care services organization premiums received from the U.S. Secretary of Health and Human Services 28,340,900
Premiums for coverage reinsured by the Federal Crop Insurance Corporation..... $254,900
Accountable health plan group health insurance to small employers..... 13,601,700
Exempt fraternal benefit societies (other than annuity considerations reported earlier) 695,300
TOTAL GOVERNMENT PROGRAM EXEMPTIONS $54,820,600

TOTAL QUANTIFIABLE INSURANCE PREMIUM TAX EXPENDITURES[17] $124,273,200

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[17]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 $8.9 million could have been generated in fiscal year 2004/05 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. §42-5354). Information is not available on this tax exemption.

SUMMARY OF JET FUEL EXCISE AND USE TAX EXPENDITURES

	Revenue Gain
PREFERENTIAL TAX RATES:	
Jet fuel over 10 million gallons	**$8,950,000**
EXEMPTIONS:	
International flights which originated within the state	NIA*
TOTAL QUANTIFIABLE JET FUEL EXCISE AND USE TAX EXPENDITURES[18]	**$8,950,000**

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* No Information Available.

[18]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 $344.6 million for fiscal year 2004/05. The potential for additional luxury tax collections would have been $442.1 million 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 $10.2 million. The remaining $431.9 million would be the result of standardizing the liquor tax rate to $3.00 per gallon in exchange for the current rates.

ITEMS TAXED AT A PREFERENTIAL RATE

Current Arizona law (A.R.S. §42-3052) provides for liquor to be taxed at four different rates: *(1) spirituous liquor at the rate of $3.00 per gallon*; *(2) on each container of vinous liquor, except cider, of which the alcoholic content is not greater than 24% by volume, at the rate of $0.84 per gallon (3) on each container of vinous liquor of which the alcoholic content is greater than 24% by volume*[19]*, containing eight ounces or less, $0.25;* and *(4) on each gallon of malt liquor or cider, $0.16.* By applying the standard $3.00 per gallon rate across all liquor types, the resulting revenues would have been:

	FY 2004/05
Vinous	
At $3/gallon	$36,592,186
Actual	$10,245,812
Difference	$26,346,374
Malt	
At $3/gallon	$384,701,200
Actual	$20,517,397
Difference	$364,183,802
Total	**$390,530,176**

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, $0.35 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	$22,039,962	$ 2,625,067	($19,414,895)
Vinous	$10,245,812	$ 4,358,308	($ 5,887,504)
Malt	$20,517,397	$45,819,796	$25,302,398
Total	**$52,803,172**	**$52,503,172**	**$0**

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 according to A.R.S. §42-3052.06. 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. §42-3206 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.

[19]The department has received no tax collections for this liquor type.

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 $5.1 million in fiscal year 2004/05.

According to A.R.S. §42-3209A, a distributor may return *unused* tobacco product stamps for a refund. Luxury tax is also refunded if *the cigarettes become unfit for sale due to breakage or spoilage* (A.R.S. §42-3008A2). 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 $5.1 million in fiscal year 2004/05 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. §42-3008A). No information is available on the value of this exemption.

EXEMPTIONS FOR LIQUOR

Liquids containing less than 1/2% alcohol by volume are exempt from luxury tax (A.R.S. §42-3001.10A, .13 & .14B). Since, reporting is not required by this group of taxpayers, there is no available information on potential luxury tax collections.

In accordance with A.R.S. §42-3001.10B, .13 & .14C, taxable liquors *does not include medicines that are unsuitable for beverage purposes*. No information is available on medicine, which includes liquor and is unsuitable for beverage purposes.

According to A.R.S. §42-3008A, 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*. 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 $114,446 in tax revenue lost in fiscal year 2004/05.

SUMMARY OF LUXURY TAX EXPENDITURES

	Revenue Gain
PREFERENTIAL TAX RATES ON LIQUOR:	**$ 431,796,000**
TOBACCO PRODUCT EXEMPTIONS AND REFUNDS:	
Tobacco powder or products used exclusively for agricultural or horticultural purposes & unfit for human consumption	NIA*
Discounts	$5,098,000
Breakage or spoilage refunds	5,109,000
Exported from state after cigarette stamps purchased	NIA
TOTAL TOBACCO PRODUCT EXEMPTIONS AND REFUNDS	**$ 10,207,000**
LIQUOR EXEMPTIONS AND REFUNDS:	
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	$114,446
TOTAL LIQUOR EXEMPTIONS AND REFUNDS	**$114,446**
TOTAL QUANTIFIABLE LUXURY TAX EXPENDITURES[20]	**$ 442,117,500**

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* No Information Available.

[20]These expenditures represent foregone revenues to the state general fund and the corrections fund.

MOTOR CARRIER FEE TAX EXPENDITURES

MOTOR CARRIER FEE EXPENDITURES[21]

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 are distributed to the state highway fund, counties, and cities/towns.

PREFERENTIAL VEHICLE FEE RATES

Motor Carrier Fee

The basic motor carrier fee is set at amounts ranging from $64 to $800. The fees are flat amounts based on gross vehicle weight (A.R.S. §28-5854). The vehicle weight for this schedule ranges from 12,001 pounds to 80,000 pounds. Lightweight motor vehicles with a declared gross weight of 12,000 or fewer pounds pay a flat rate of $64 per vehicle (A.R.S. §28-5492). Lighter vehicles are granted preferential fee amounts. The value of this expenditure is currently unavailable. However, during fiscal year 2004/05, Arizona based carriers paid $19.0 million in motor carrier fees.

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 weighing 26,000 pounds or more. To qualify, the vehicle must begin and end its trip at the same point without adding 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.

A $4.00 commercial registration fee is added to the gross weight fee for each registered vehicle. Commercial registration fees collected for Arizona based vehicles was not available for fiscal year 2004/05.

Gross Weight Fee

The gross weight fee is set at amounts ranging from $7.50 to $918, dependent upon vehicle weight (A.R.S. §28-5433). The vehicle weight for this schedule ranges from up to 8,000 pounds to 80,000 pounds. Vehicles in excess of 80,000 are subject to special permits. Lighter vehicles are granted preferential fee amounts. Total gross weight fees collections for Arizona based vehicles during fiscal year 2004/05 was not available.

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.

[21]Figures presented for Motor Carrier Tax Expenditures were provided by the Department of Transportation.

If a privately owned school bus is temporarily operated for purposes other than providing 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 to $2,217, depending upon vehicle weight and age. Vehicle weight for this schedule ranges from up to 8,000 pounds to 80,000 pounds. Highway use fees collected for Arizona based vehicles totaled $4.6 million during fiscal year 2004/05. 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 to $1,095 (A.R.S. §28-5471). The values of these expenditures are currently unavailable.

Due to reporting practices, the Department of Transportation is unable to split out foreign based motor carrier fee collections. However, the total amount received from both of these carriers in fiscal year 2004/05 was $84.1 million. This amount includes registration fees, motor carrier fees, gross weight fees, & highway use fees prorated for miles driven in Arizona. The values of these expenditures are also 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. §28-5432C1). 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. §28-5432C2) if used exclusively for transportation of pupils in connection with school curriculum, training of pupils or transportation of property for charitable purposes without compensa-tion. 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. §28-5432C3). 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. §28-5432C4). 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. §28-5473D). No information is available on this tax exemption.

SUMMARY OF MOTOR CARRIER TAX EXPENDITURES

	Revenue Gain
PREFERENTIAL FEE RATES:	
Motor Carrier Fee	
Same motor carrier fees for all Arizona based 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
Commercial Registration Fee	NIA
Gross Weight Fee	
Same gross weight fees for all Arizona based 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 Arizona based vehicles	NIA
Foreign Based Carriers	
Registration fees, motor carrier fees, gross weight fees and highway use fees	NIA
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
Farm vehicles	NIA
TOTAL QUANTIFIABLE MOTOR CARRIER FEE EXPENDITURES[22]	**NIA**

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*No Information Available.

[22]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[23]

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 then file for a refund (A.R.S. §28-5610B). 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. §28-5610A5). No information is available on this tax expenditure.

Motor vehicle fuel sold to the United States or an instrumentality or agency of the United States is exempt from the motor vehicle fuel tax (A.R.S. §28-5610A6). During fiscal year 2004/05, $415,887 was refunded for this exemption.

Motor vehicle fuel that is sold within an Indian Reservation to an enrolled member of the Indian tribe is excluded from taxation per A.R.S. §28-5610A3. The total amount refunded for this provision during fiscal year 2004/05 was $1,126,513.

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. §28-5611A). In fiscal year 2004/05, $1,119,119 in motor vehicle fuel tax was refunded based on this exemption.

Motor vehicle fuel purchased in Arizona, for which proof of export is available and either exported by a supplier or sold by a supplier to a distributor for immediate export is exempt from motor vehicle fuel tax (A.R.S. §28-5610A1-2). Requests for refunds against import liability in the amount of $2,056,720 were received in fiscal year 2004/05.

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. §28-5611A4). No refunds of this type were requested for fiscal year 2004/05.

[23]Any figures presented for Motor Vehicle Fuel Tax Expenditures were provided by the Arizona Department of Transportation.

SUMMARY OF MOTOR VEHICLE FUEL TAX EXPENDITURES

	Revenue Gain
Motor vehicle fuel moving in interstate or foreign commerce	NIA*
Motor vehicle fuel sold to the United States or an instrumentality or agency of the United States	$415,900
Motor vehicle fuel sold to Native Americans on Reservations	1,126,510
Motor vehicle fuel used other than in motor vehicles, watercraft and motor vehicles operating on a transportation facility or toll road	1,119,120
Motor vehicle fuel purchased for export	2,056,720
Motor vehicle fuel lost due to fire, theft or other accident	0

TOTAL QUANTIFIABLE MOTOR VEHICLE FUEL TAX EXPENDITURES[24] $4,718,250

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* No Information Available.

[24]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[25]

HORSE OR HARNESS RACING PREFERENTIAL RATES

For horse or harness races, the state receives 2% of the gross amount of the first $1 million wagered on live races in pari-mutuel pools and 5% of the gross amount exceeding $1 million (A.R.S. § 5-111.D). If the state received 5% of all dollars wagered in horse or harness live races, the state would have received an additional $1.38 million in fiscal year 2005. The State General Fund did not receive revenues from greyhound, horse or harness live racing.

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 (A.R.S. § 5-111.D). The state share of the pari-mutuel tax was reduced by $4.47 million in fiscal year 2005 due to this exemption.
- Any county fair racing association may have one racing meeting each year (A.R.S. § 5-111.E). All such racing meetings are exempt from the state tax on horse or harness live racing. If county fair racing meetings were not exempt from the tax, the state would have received an additional $125,300 in pari-mutuel revenues during fiscal year 2005.
- Moneys from charity racing days are also exempt from the state tax (A.R.S. § 5-111.F). Taxation of these events would have raised an additional $87,259 in pari-mutuel revenues during fiscal year 2005.
- The percentage paid to the state for greyhound racing and for horse or harness racing shall be reduced by 1% of the total amount wagered in counties with a population of 500,000 or more and by 2% in all other counties for those permittees who make approved capital improvements to existing race tracks (A.R.S. § 5-111.03.A). The state share of the pari-mutuel tax was reduced by $88,296 due to this reduction in the percentage during fiscal year 2005.
- 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 greyhound racing and for horse or harness racing was reduced by the amount equal to the amount of the hardship tax credit (A.R.S. § 5-111.I). The state share of the pari-mutuel tax was reduced by $2.42 million in hardship tax credits in fiscal year 2005.

[25]Any figures presented for Pari-mutuel Tax Expenditures were provided by the Arizona Department of Racing.

SUMMARY OF PARI-MUTUEL TAX EXPENDITURES

	Revenue Gain
PREFERENTIAL TAX RATES FOR HORSE OR HARNESS RACING	$1,381,103
PARI-MUTUEL TAX EXEMPTIONS:	
Reduction in pari-mutuel tax on simulcast out-of-state races	4,474,797
County fair racing association meetings	125,300
Charity racing days	87,259
Reduction in pari-mutuel tax for capital improvements to race tracks	88,296
Reduction in pari-mutuel tax for hardship tax credit	2,418,043
TOTAL QUANTIFIABLE PARI-MUTUEL TAX EXPENDITURES[26]	**$8,574,799**

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[26]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 administration of county fair racing betterment retirement fund; the breeders award fund; the stallion award fund; the greyhound adoption fund; the agriculture consulting and training fund; and the state general fund.

PRIVATE CAR PROPERTY TAX EXPENDITURES

PRIVATE CAR PROPERTY TAX EXPENDITURES

Businesses which 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 $11.81 in 2004.

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 25% to 5%. For private car property, the *assessment ratio is equal to the ratio which the total net assessed valuation of all taxable property in class 1, class 6 paragraph 3 and personal property in class 2 bears to the total full cash value of such property* (A.R.S. §42-14308*)*. For tax year 2004, the assessment ratio used for private car property was 21%. 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, 25%, tax collections would have increased by $251,240.

SUMMARY OF PRIVATE CAR PROPERTY TAX EXPENDITURES

	Revenue Gain
Preferential assessment ratio at 25%	$251,240
TOTAL QUANTIFIABLE PRIVATE CAR PROPERTY TAX EXPENDITURES[27]	**$251,240**

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[27]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 47¢ (calculated annually) 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.

Although the state property tax per $100 of net assessed value is now set at $0, exemptions filter through to the tax base at the local level. As mentioned earlier in this section, these exemptions do affect state revenues.

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, school buildings 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* (42-11104A).
- *Property and buildings pursuant to a lease or lease-purchase agreement leased from a school district or a community college district* (42-11104B).
- *Hospitals for relief of the indigent or afflicted, appurtenant land and their fixtures and equipment to such buildings, as long as they are not used or held for profit* (42-11105A).
- *Grounds and buildings owned by agricultural societies, as long as they are used for those*

purposes only, and not used or held for profit (42-11108).

- *Property or buildings used or held 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* (42-11109A).
- *Cemeteries set apart and used for interring the dead, except such portions thereof that are used or held for profit* (42-11110).
- *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* (42-11112).
- *Property used for operation of a health care institution which provides medical, nursing 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* (42-11105B).
- *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, 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* (42-11106.01).
- *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 to pay for principal, interest and operating expenses as long as that organization was not created or operating for the primary purpose of providing the subsidy or payment* (42-11106.02)
- *Property of charitable institutions for relief of the indigent or afflicted, including the lands appurtenant to such property, with their fixtures, equipment and other reasonably required property, as long as such institutions and property are not held or used for profit* (42-11107).
- *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* (42-11113).
- *Property held by a charitable organization for transfer to this state or a political subdivision of this state to be used as parkland if no rent or valuable consideration is received by the charitable organization* (42-11114A).
- *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* (42-11117).
- *Property held by a charitable organization to preserve and protect scientific, biological, geological, paleontological, natural or archaeological resources* (42-11115)
- *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.* (42-11118A)
- *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* (42-11119).
- *Property of musical, dramatic, dance and community art groups, botanical gardens, museums and zoos as long as the property is used for those purposes and not used or held for profit* (42-11116).
- *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* (42-11122).

- *Animal and poultry feed, including salts, vitamins and other additives, for animal or poultry consumption* (42-11123).
- *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 predominantly for those purposes and not used or held for profit* (42-11120).
- *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 (42-11121).*
- *Personal property moving through the state or consigned to a warehouse in the state from a point outside this state for storage or assembly in transit to a final destination outside this state* (42-11128A).
- *Property claimed to have no situs in this state for the purposes of taxation shall be considered property-in-transit or futures contract property* (42-11128B).
- *Airline company aircraft* (42-14255).
- *Property owned or used by districts for the purpose of irrigation water delivery shall be exempt from taxation when used for district purposes* (48-3472A).

2004 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 at the end of this section shows the a Additional State Aid to Education tax roll that was billed in 2005, including additional amounts that were billed for legal class 3 property on the personal property tax roll.

ADDITIONAL STATE AID TO EDUCATION

	ASAE Tax Roll	Personal Property Tax Roll	County Total
Apache	$ 521,339	$ 29,743	$ 551,082
Cochise	3,927,295	134,107	4,061,402
Coconino	6,099,947	54,019	6,153,966
Gila	2,942,874	57,135	3,000,009
Graham	528,431	43,395	571,825
Greenlee	91,791	5,5508	97,299
La Paz	232,368	0	232,368
Maricopa	[28]	[29]	185,469,729
Mohave	7,558,129	138,001	7,696,130
Navajo	3,342,417	53,672	3,396,089
Pima	52,375,222	1,035,657	53,410,879
Pinal	10,767,916	818,206	11,586,122
Santa Cruz	1,852,876	17,252	1,870,128
Yavapai	10,466,781	162,538	10,629,319
Yuma	[29]	[29]	5,399,888
Total			**$294,126,235**

[28] The breakdown between real and personal property is not available from Maricopa and Yuma counties.

SUMMARY OF PROPERTY TAX EXPENDITURES

	Revenue Gain
ADDITIONAL STATE AID TO EDUCATION	**$294,126,235**
TOTAL QUANTIFIABLE PROPERTY TAX EXPENDITURES[29]	**$294,126,235**

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[29]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. Mining severance is taxed at the rate of 2.5% (A.R.S. §42-5202C) and is levied upon the net severance base. The net severance base is defined as fifty percent of the difference between the gross value of production and the production costs (A.R.S. §42-5204).

The timber severance tax is levied on the timber products derived from timbering activity (A.R.S. §42-5202D). Total severance tax collections in fiscal year 2004/05 totaled $16.4 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 $1,000.

SEVERANCE TAX CREDITS

A credit is allowed against severance tax imposed *for accounting and reporting expenses incurred by the taxpayer* (A.R.S. §42-5017A). The credit equals 1% of the amount of tax due, not to exceed $10,000 in any calendar year. In fiscal year 2004/05, information about the value of the severance tax accounting credit was unavailable.

SEVERANCE TAX EXCLUSIONS

Mining Severance

The net severance base is *fifty percent* of the difference between the gross value of production and the *production costs.* (A.R.S. §42-5204) Both the fifty percent factor and the value of production costs are exclusions from severance taxation. Taxing the net severance base at 100% would have generated an additional $16.4 million in fiscal year 2004/05. The tax value of the production costs is unknown.

SUMMARY OF SEVERANCE TAX EXPENDITURES

	Revenue Gain
PREFERENTIAL TIMBER SEVERANCE TAX RATE FOR OTHER TIMBER PRODUCTS	$1,000
SEVERANCE TAX CREDITS:	
Accounting credit	NIA*
SEVERANCE TAX EXCLUSIONS:	
Fifty percent factor	16,399,000
Production Costs	NIA
TOTAL QUANTIFIABLE SEVERANCE TAX EXPENDITURES[30]	**$16,499,000**

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* No Information Available.

[30]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 2004/05 totaled more than $4.6 billion. Of that amount, $977.2 million was distributed to the counties and cities. The remaining $3.6 billion was deposited into the State General Fund. Potential transaction privilege and use tax collections from the various transaction privilege tax exemptions would have, at a minimum, increased collections by more than 173%. The quantifiable exemptions discussed in this report represent potential collections of $8 billion. Additionally, lost revenues due to preferential tax rates, e.g., those items taxed at a rate below 5%, total $308.4 million while credits totaled $22.2 million. Therefore, the State of Arizona could be collecting at least an additional $8.4 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.

The Proposition 301-Education Tax, collected $538 million at the 0.6% rate. While the two taxes are collected on roughly the same tax base, the Proposition 301 monies are dedicated to Education related funds. We continue to present the value of exemptions at the 5% rate. The effect of these exemptions on Proposition 301 can be estimated by taking 12% of the amounts shown later in this section. For fiscal year 2004/05, the value of the exemptions on the Proposition 301 Education funds was $965 million.

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[31]	0%
28	Rental Occupancy Tax	3.0%

If the activities in these categories had been taxed at a 5% rate in fiscal year 2005, additional transaction privilege tax of $308.4 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. §42-5015). 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. No refunds were paid in fiscal year 2004/05.

A credit is allowed against transaction privilege tax imposed *for accounting and reporting expenses incurred by the taxpayer* (A.R.S. §42-5017). The credit equals 1% of the amount of tax due, not to exceed $10,000 in any calendar year. In fiscal year 2004/05, the value of the accounting credit equaled $22.2 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 that have both taxable and exempt sales, there is some information on the value of the exemption. Those businesses that only have exempt sales generally do not file

[31]The tax rate for this class changed to 0% from 1.0% effective July 1, 1997.

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. §42-5061A1, A2). Service industries can be broken down into several major categories as defined by the U.S. Census Bureau: (1) professional, scientific and technical; (2) health care and social assistance; (3) administrative and business support; (4) personal care; (5) educational; and (6) other services. Examples of each of these service categories are listed at the end of this section. A summary of potential transaction privilege tax revenue from these major categories is as follows:

Professional, Scientific and Technical	$571,727,000
Health Care and Social Assistance	$630,362,000
Administrative and Business Support	$460,229,000
Personal Care	$40,248,000
Educational	$25,714,000
Other Services	$114,021,000

Total transaction privilege tax revenue available from these businesses is $1.8 billion. Although the estimate of potential tax collections provided here does not include estimates for all services, the majority has been captured.

The business of *selling tangible personal property at wholesale*, by definition, is not taxable. During fiscal year 2004/05, wholesale trade was estimated to be $65.1 billion. If taxed at a 5% rate, collections from this category would be $3.3 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. §42-5001.5). 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. §42-5001.6). 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. §42-5061A3). In fiscal year 2004/05 businesses deducted $281 million for such contracts. Taxing these contracts at a 5% rate would have resulted in collections of $14.1 million.

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. §42-5061A4; 42-5074B6; A.R.S. §42-5159A15a). 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. §42-5061A7). No information is available on this tax expenditure.

Items required by prescription, such as *prescription drugs and medical oxygen* (A.R.S. §42-5061A8, A.R.S. §42-5159A16), are exempt from transaction privilege tax. In fiscal year 2004/05 businesses took $4.4 billion in deductions for prescriptions and medical oxygen. Had these purchases been taxed at a rate of 5%, collections would be $219.6 million.

Insulin, syringes, glucose test strips (A.R.S. §42-5061A10, A.R.S. §42-5159A19), *eyeglasses and contact lenses* (A.R.S. 42-5061A11, A.R.S. §42-5159A18), p*rosthetic appliances* prescribed or recommended by a physician, dentist or other professional (A.R.S. §42-5061A9, A.R.S. §42-5159A17) and *hearing aids* (A.R.S. §42-5061A12, A.R.S. §42-5159A20) are exempt from transaction privilege and use tax, as are *durable*

medical equipment (A.R.S. §42-5061A13, A.R.S. §42-5159A21). In fiscal year 2004/05 deductions of $152.9 million were taken for these items. Had they been taxed, collections would have been $7.6 million.

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. §42-5061A14). In fiscal 2004/05 a total of $1 billion for other tangible personal property sold to a nonresident and delivered out of state. Were these transactions taxable, an additional $52.7 million would have been collected.

Food for home consumption (A.R.S. §42-5061A15, A.R.S. §42-5159A22) was exempted from transaction privilege and use tax effective July 1980. This includes items purchased with food stamps (A.R.S. §42-5061A16, A.R.S. §42-5159A23). In fiscal year 2004/05 deductions of $8.1 billion were taken for these items. A 5% tax on these would have brought in $404 million in additional revenues.

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. §42-5061A17, A.R.S. §42-5159A28.) Deductions of $26.5 million were taken for this exemption in fiscal 2004/05. At a rate of 5%, these deductions would have generated $1.3 million had they been taxable.

Meals provided to employees of restaurants are exempt from transaction privilege and use taxation (A.R.S. §42-5061A18, A.R.S. §42-5159A24). Using an average value of $7.33 per meal, employees of full service restaurants working five days per week would consume meals worth $155.2 million. This converts to tax collections of $7.8 million at a 5% tax rate for fiscal year 2004/05.

No transaction privilege or use tax is applied to food, drink or condiment purchased for *school lunches* (A.R.S. §42-5061A19, A.R.S. §42-5159A26). No information is available for this tax expenditure.

Arizona lottery ticket sales (A.R.S. §42-5061A20, A.R.S. §42-5159A27), amounting to $397.6 million in fiscal year 2004/05, are not taxable. Additional tax collections of $19.9 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. §42-5061A21). 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. §42-5061A25a,b, §42-5063C3, §42-5065B2, §42-5066B3, §42-5067B, §42-5074B8; A.R.S. §42-5159A13a, b, d). In fiscal year 2004/05 deductions of $434 million were taken for these exemptions. Had they been taxed at 5%, $21.7 million would have been collected.

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. §42-5061A25c, A.R.S. §42-5061A25d, A.R.S. §42-5159A13e). 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. §42-5061A25e, A.R.S. §42-5159A13j). During fiscal 2004/05, businesses deducted $20.4 million for this exemption. At 5%, this would have raised $1 million had it been taxable.

Sales of tangible personal property to a *nonprofit charitable organization that provides residential apartment housing for low income persons over sixty-two years of age in a facility that qualifies for a federal housing subsidy*, is exempt from the transaction privilege and use tax (A.R.S. §42-5061A25f, A.R.S. §42-5159A13l) The gross proceeds of sales from a *contract for construction of a residential apartment housing facility that qualifies for a federal housing subsidy for low income persons over sixty-two years of age and that is owned by a nonprofit charitable organization* is exempt from the prime contracting classification of transaction privilege tax (A.R.S. §42-5075B13). Information is not available on these expenditures.

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. §42-5061A26, 42-5065A2, A.R.S. §42-5159A29). Arizona Highways magazine is the primary publication of this type. No information is available on the value of this exemption.

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. §42-5061A27a) were estimated using the 2002 Census of Construction Industries for Arizona. On the basis of estimated cost of materials of $6.9 billion in this category, potential tax collections at a 5% tax rate would have been $347.4 million. *Sales of articles to be incorporated into a manufactured product* (ACRR R15-5-1839, A.R.S. §42-5159A4) were estimated using the 2002 Census of Manufacturing. On the basis of estimated sales of $17.8 billion, potential tax collections at a 5% tax rate would have been $888.7 million in fiscal year 2004/05.

The sale of a motor vehicle is exempt from transaction privilege tax under two conditions (A.R.S. §42-5061A28). 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. In fiscal 2004/05 $442 million was deducted for this exemption. Had these transactions been taxable an additional $22.1 million would have been collected. 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. In fiscal 2004/05 a total of $111.2 was deducted for this exemption. An additional $5.6 million would have been collected at the 5% rate.

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. §42-5061A29, A.R.S. §42-5159A13f). No information is available on the tax value of this exemption.

Tangible personal property sold and sales under the amusement and restaurant classifications 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. §42-5061A30; 42-5073A5 42-5074B4; A.R.S. §42-5159A15b). 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. §42-5061A32, 42-5073A6; 42-5074B5; A.R.S. §42-5159A15c). 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. §42-5061A31, A.R.S. §42-5159A14). 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. §42-5061A33, A.R.S. §42-5159A9). In fiscal year 2004/05 $7.7

million was deducted for this exemption. Had it been taxable, $380,000 would have been collected.

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. §42-5061A34, A.R.S. §42-5159A34). 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. §42-5061A35). In fiscal year 2004/05 $39 million was deducted for this exemption. Had it been taxable, $1.9 million would have been collected.

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. §42-5061A36, A.R.S. §42-5063B2, A.R.S. §42-5063B3, A.R.S. §42-5159A33). In fiscal year 2004/05 $58.6 million was deducted for this exemption. Had it been taxed at the 5% rate an additional $2.9 million.

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. §42-5061A37, A.R.S. §42-5159A30). No information is available for this expenditure.

The *gross proceeds of sales or gross income derived from sales of machinery, equipment, utility product, 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. §42-5061E, 42-5063C4). 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. §42-5159E). 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. §42-5061A38, A.R.S. §42-5159A31). In fiscal year 2004/05 $9.5 million was deducted for this exemption. At a rate of 5% $475,000 would have been collected.

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. §42-5061A39, A.R.S. §42-5159A35). In fiscal year 2004/05 $11 million was deducted for this exemption. At a rate of 5% $550,000 would have been collected.

Under the retail classification and the restaurant classification, *sales of food, drink or condiment for consumption within the premises of any 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. §42-5061A41; 42-5074B9; A.R.S. §42-5159A36). During fiscal year 2004/05 $23.9 million was deducted for this exemption. Had this been taxed at 5%, $1.2 million would have been collected.

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. §42-5061A42, A.R.S. §42-5159A37). In fiscal year 2004/05 $475 million was deducted for this exemption. Had it been taxable, $23.8 million would have been collected.

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. §42-5159A8). *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.

§42-5061A43). Information is not available on these expenditures.

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. §42-5061A44, A.R.S. §42-5159A7). In fiscal 2004/05 $2.9 million was deducted for this exemption. Had it been taxable, $146,000 would have been collected.

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. §42-5061A45). During fiscal 2004/05 a total of $22.5 million was deducted for this exemption. Were these transactions taxable, an additional $1.1 million would have been collected.

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 or articles used for drink or condiment, except alcoholic beverages, which are furnished to and to be consumed by the transient during his occupancy* (A.R.S. §42-5061A46, A.R.S. §42-5159A13k). 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. §42-5061A47, A.R.S. §42-5159A42). 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. §42-5061A48, A.R.S. §42-5159A12). During fiscal 2004/05 $1.5 million is deductions were claimed for this exemption. At a rate of 5%, tax collections would have been $73,000 had these items been taxable.

Under the retail classification and the restaurant classification*, 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. §42-5061A49; 42-5074C; A.R.S. §42-5159A43). In fiscal 2004/05 $8.6 million was deducted for this exemption. Had this been taxable, an additional $430,000 would have been collected.

Sales of new alternative fuel vehicles, as defined in A.R.S. §43-1086, if the vehicle was manufactured as a diesel fuel vehicle and converted to operate on alternative fuel, and equipment that is installed in a conventional diesel fuel motor vehicle to convert the vehicle to operate on an alternative fuel. (A.R.S. §42-5061A50, A.R.S. §42-5159A44) Information is not available on this expenditure.

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. (A.R.S. §42-5061A51) No information is available on the value of this tax expenditure.

Sales of tangible personal property to be incorporated or installed as part of environmental response or remediation activities under A.R.S. §42-5075B6. (A.R.S. §42-5061A52) No information is available on the value of this tax expenditure.

Sales of tangible personal property by a nonprofit organization if the organization produces, organizes or promotes cultural or civic related festivals or events and no part of the organization's net earnings inures to the benefit of any private shareholder or individual. (A.R.S. §42-5061A53) No information is available on the value of this tax 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. §42-5061B1, A.R.S. §42-5159B1). Limited information is available on this type of machinery or equipment. Using the 2002 Census of Manufacturing and inflating the capital expenditure figure by the rate of increase in the Producer Price Index for machinery and equipment, an estimated $1.0 billion in sales of this machinery taxed at 5%

would have brought in an additional $52.2 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. §42-5061B2, A.R.S. §42-5159B2) and *sales of machinery or equipment used in drilling for or extracting oil or gas from the earth* (A.R.S. §42-5061B10, A.R.S. §42-5159B10) are not taxed. The Census of Mining provided figures for capital expenditures of machinery and equipment for 2002. Inflating this figure by the rate of increase in the Producer Price Index for machinery and equipment resulted in an estimate of $183.5 million for sales of this machinery in fiscal year 2004/05. A 5% tax on this machinery would have brought in $9.2million 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. §42-5061B3, A.R.S. §42-5159B3). 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. §42-5061B4, A.R.S. §42-5159B4). Transformers and control equipment used in transmission substation sites are included in this exemption. During fiscal 2004/05 $493.8 was deducted for this exemption. Had this been taxable, an additional $24.7 million would have been collected.

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. §42-5061B5, A.R.S. §42-5159B5). 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. §42-5061B6, A.R.S. §42-5159B6). In fiscal 2004/05 $187.1 million was deducted for this exemption. Had this been taxable, $9.4 million would have been collected.

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. §42-5061B7, A.R.S. §42-5159B7). During fiscal 2004/05 $31.4 million was deducted for this exemption. Had it been taxable, $1.6 million would have been collected.

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. §42-5061B8, A.R.S. §42-5159B8). 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. §42-5061B9, A.R.S. §42-5159B9). 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. §42-5061B11, A.R.S. §42-5159B11). No information is available on this exemption.

Groundwater measuring devices and their installation required under A.R.S. §45-604 are exempt from transaction privilege and use tax (A.R.S. §42-

5061B12, A.R.S. §42-5075B2, A.R.S. §42-5159B12). 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. §42-5061B13, A.R.S. §42-5159B13). This equipment consists of tractors, tractor-drawn implements, self-powered implements and drip irrigation lines. No information is available on the value of this exemption.

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. §42-5061B14, A.R.S. §42-5159B14). 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. §42-5061B15, A.R.S. §42-5159B15). 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. §42-5061B16, A.R.S. §42-5159B16a). 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. §42-5064B4). 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. §42-5061B17, A.R.S. §42-5159B17). This includes the integrated systems, fixtures, piping, movable partitions, lighting and property that is necessary for control of the clean room. No information is available on the value of this exemption. The income derived from *the installation, assembly, repair or maintenance of the clean rooms* is exempt from taxation under the contracting classification. (A.R.S. §42-5075B12). No information is available on the value of this exemption.

Machinery and equipment used directly in the feeding of poultry, the environmental control of housing for poultry, the movement of eggs within a production and packaging facility or the sorting or cooling of eggs. (A.R.S. §42-5061B18, A.R.S. §42-5159B18). No information is available on the value of this exemption.

Machinery or equipment, including related structural components, that is employed in connection with manufacturing, processing, fabricating, job printing, refining, mining, natural gas pipelines, metallurgical operations, telecommunications, producing or transmitting electricity or research and development and that is used directly to meet or exceed rules or regulations adopted by the federal energy regulatory commission, the United States environmental protection agency, the United States nuclear regulatory commission, the Arizona department of environmental quality or a political subdivision of this state to prevent monitor, control or reduce land, water or air pollution. (A.R.S. §42-5061B19, A.R.S. §42-5159B19) No information is available on the value of this exemption.

Machinery and equipment that are sold to a person engaged in the commercial production of livestock, livestock products or agricultural, horticultural, viticultural or floricultural crops or products in this state and that are used directly and primarily to prevent, monitor, control or reduce air, water or land pollution. (A.R.S. §42-5061B20, A.R.S. §42-5159B20) No

information is available on the value of this exemption.

Machinery or equipment that enables a television station to originate and broadcast or to receive and broadcast digital television signals and that was purchased to facilitate compliance with the telecommunications act of 1996. . (A.R.S. §42-5061B21, A.R.S. §42-5159B21) No information is available on the value of this exemption.

The *portion of the sales price of heavy trucks and trailers that reflect the federal luxury excise tax* (A.R.S. §42-5061E) 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. §42-5061F). Information is not available on these expenditures.

The gross proceeds of sales or gross income derived from sales of machinery, equipment, materials and other tangible personal property used directly and predominantly to construct a qualified environmental technology manufacturing, producing or processing facility as described in A.R.S. §41-1514.02. (A.R.S. §42-5061D) No information is available on the tax value of this exemption.

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. §42-5061J, A.R.S. §42-5159A39). For those *sales of tangible personal property made directly to the United States government that are not deducted under A.R.S. §42-5061J*, 50% of the gross proceeds or gross income derived will be deducted from the tax base (A.R.S. §42-5061K). Data is not available on the value of these exemptions.

The gross proceeds of sales or gross income derived from a manufacturer's cash rebate on the sales price of a motor vehicle if the buyer assigns the buyer's right in the rebate to the retailer; or the waste tire disposal fee imposed pursuant to A.R.S. §44-1302. (A.R.S. §42-5061M1, §42-5061M2). No data is available on the tax value of the waste tire disposal fee. During fiscal 2004/05 $283.6 million was deducted for the manufacturer's cash rebate. At a rate of 5%, the tax value of this exemption is $14.2 million.

Sales of solar energy devices and the contractor's retail cost of a solar energy device that the contractor supplied and installed are to be deducted from the tax base, but the deduction is not to exceed $5,000 for each device (A.R.S. §42-5061N, A.R.S. §42-5075B14). Information is not available on this expenditure. In fiscal 2004/05 a total of $7.3 million was deducted for this exemption. At a rate of 5%, the value of the exemption is $367,000

Sales of wireless telecommunication equipment to a person who holds the equipment for sale or transfer to a customer as an inducement to enter into or continue a contract for telecommunications services taxable under A.R.S. §42-5064 is considered a sale for resale under the transaction privilege and use taxes (A.R.S. §42-5061P, A.R.S. §42-5159A41). 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. §42-5061O). 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. §42-5062A3). The 2002 Census of Health Care and Social Assistance indicated that the value of ambulance services in fiscal 2004/05 were $228 million. At a rate of 5%, $11.4 million would have been collected.

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. §42-5062A4). No information is available on the tax value of this exemption.

The transporting classification of the transaction privilege tax also excludes *transporting freight or property for hire by a railroad operating exclusively in this state if the transportation comprises a portion of a single shipment of freight or property, involving more than one railroad, either from a*

point in this state to a point outside this state or from a point outside this state to a point in this state. (A.R.S. §42-5062A5) 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. §42-5062B1). 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. §42-5063B1) are essentially sales of electricity for resale. Information on this activity is not available.

Sales of alternative fuel, as defined in A.R.S. §1-215 to a used oil fuel burner who has received a permit to burn used oil or used oil fuel under A.R.S. §49-426 or 49-480. (A.R.S. §42-5063B3) No data is available on the tax value of this exemption.

Sales of ancillary services, electric distribution services, electric generation services, electric transmission services and other services that are related to providing electricity to a retail electric customer who is located outside this state for use outside this state if the electricity is delivered to a point of sale outside this state. (A.R.S. §42-5063B4) 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. §42-5063c1, A.R.S. §42-5159F1). 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. §42-5063c2, A.R.S. §42-5159F2). 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. Information is not available for this expenditure at this time.

Income from interstate telcommunication services (A.R.S. §42-5064) is not taxable under the telecommunications classification of transaction privilege tax. No data is available on the tax value of this exemption.

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. §42-5064A1). The National Cable Television Association provides that in 2004, Arizona had 1,229,910 basic cable subscribers. With an average expanded basic monthly fee of $39.96, the estimated revenues were $589.8 million. Potential collections from a tax rate of 5% would equal an estimated $29.5 million in fiscal year 2004/05.

Sales of internet access services to subscribers and customers. (A.R.S. §42-5064A2). In fiscal 2004/05 $21.8 million was deducted for this exemption. Had it been taxable at the 5% rate, $1.1 million would have been collected.

End user common line charges and carrier access charges established by federal communications regulations are exempt from transaction privilege tax (A.R.S. §42-5064B2, A.R.S. §42-5064B3). No information is available on the tax value of this exemption.

Sales of direct broadcast satellite television services pursuant to 47 Code of Federal Regulations parts 25 and 100 by a direct broadcast satellite television service that operates pursuant to 47 Code of Federal Regulations parts 25 and 100. (A.R.S. §42-5064B4) No data is available on the tax value of this exemption.

The gross proceeds from *manufacturing or publishing books* are exempt from transaction privilege tax (A.R.S. §42-5065A1). No data is available on the tax value of this exemption.

The *gross income derived from advertising* is excluded from the tax base for the publication classification under transaction privilege tax (A.R.S. §42-5065B1). Advertising receipts for fiscal year 2004/05 were estimated using the 2002 Census of Professional, Scientific and Technical Services to be $600 million. A 5% tax on advertising would have resulted in $30 million in potential tax collections.

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. §42-5066B1). 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. §42-5066B2). 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. §42-5070B3). 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. §42-5071A1). 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. §42-5071A4). No information is available on this exemption.

Leasing or renting tangible personal property for incorporation into comprising any part of a qualified environmental technology facility. (A.R.S. §42-5071A5) No data is available on the value of this exemption.

Leasing or renting aircraft, flight simulators or similar training equipment to students or staff by nonprofit, accredited educational institutions that offer associate or bachelor's degrees in aviation or aerospace related fields. (A.R.S. §42-5071A6) No data is available on the value of this exemption.

Leasing or renting photographs, transparencies or other creative works used by this state on internet web sites, in magazines or in other publications that encourage tourism. (A.R.S. §42-5071A7) No data is available on the value of this exemption.

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. §42-5072C). No data is available on the value of this exemption.

Tuition and fees paid to universities and community colleges (A.R.S. §42-5073A1) are exempt from transaction privilege tax. Information on tuition figures for fiscal year 2004/05 were not available.

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. §42-5073A2, A.R.S. §42-5073B1). Information about this exemption is not available.

Events sponsored by the Arizona Coliseum and Exposition Center Board (A.R.S. §42-5071A2, §42-5073A3) are not subject to transaction privilege tax. Information about this exemption is not available.

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. §42-5073A4). Information about this exemption is not available.

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. §42-5073A7). During fiscal year 2004/05, admissions to such contests are estimated to have been $13.1 million. At 5%, potential tax collections would have been $0.7 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. §42-5073A8). 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. §42-5074B2). 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. §42-5074B3). No information is available on the value of this tax expenditure.

Under the restaurant classification of transaction privilege tax, *sales to qualifying hospitals*. (A.R.S. §42-5074B7). 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. §42-5075B and B1) 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 2004/05 was $7.6 billion. At a 5% tax rate, the tax on the labor component is $379.4 million. However, during fiscal 2004/05, $13.1 billion was deducted from transaction privilege tax returns for the 35% deduction, a significantly higher number. At a 5% tax rate, the tax on the 35% deduction would have been $655.7 million. In fiscal 2004/05 $1.2 billion was deducted for the cost of land. Had land been taxable at the 5% rate, an additional $59.5 million would have been collected.

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. §42-5075B4). 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. §42-5075B5). 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. §42-5075B6). Information is not available on this expenditure.

The gross proceeds of sales that are from a contract entered 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. §42-5061B 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. §42-5075B7). 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. §42-5075B8). Information is not available on this expenditure.

Income from a contract for *the construction of an environmentally controlled facility for the raising of poultry*

for the production of eggs and the sorting, cooling and packaging of eggs is exempt from the prime contracting classification of transaction privilege tax (A.R.S. §42-5075B10). Information is not available on this expenditure.

Income from a contract with a person in the agricultural industry for *construction, alteration, repair, improvement movement, wrecking, demolition, addition to or subtraction from any building, highway, road, excavation, manufactured building or other structure, development or improvement used directly and primarily to prevent, monitor, control or reduce air water or land pollution*. (A.R.S. §42-5075B11) No information about this expenditure is available.

Income from a contract entered into for the *construction of a launch site*, as defined in 14 Code of Federal Regulations section 401.5. (A.R.S. §42-5075B15) No information about this expenditure is available.

Income from a contract entered into for the *construction of a domestic violence shelter that is owned and operated by a nonprofit charitable organization*. (A.R.S. §42-5075B16) No information about this expenditure is available.

Gross proceeds of sales or gross income derived from contracts to perform post-construction treatment of real property for termite and general pest control, including wood destroying organisms. (A.R.S. §42-5075B17) No information is available on the value of this tax exemption.

Gross proceeds of sales or gross income derived from contracts to build certain state university research infrastructure projects. (A.R.S. §42-5075B18) No information is available on the value of this tax exemption.

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. §42-5159A10). 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. §42-5159A13c). 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. §42-5159A13h). 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. §42-5159A32). No information is available on the value of this exemption.

Use tax does not apply to *tangible personal property* that is or directly enters into and becomes an ingredient or part of *cards used as prescription plan identification cards* (A.R.S. §42-5159A38). Information is not available on this expenditure.

TRANSACTION PRIVILEGE AND USE TAX EXPENDITURES

PREFERENTIAL TAX RATE CATEGORIES	Additional Collections At A 5% Rate
Nonmetalliferous Mining; Oil and Gas Production	$5,947,000
Commercial Lease	302,415,000
Rental Occupancy Tax	48,000
Total Preferential Tax Rates	**$308,410,000**

CREDITS	
Motion Picture Production Company refund	0
Accounting Credit	$22,167,000
Total Credits	**$22,167,000**

EXEMPTIONS	
Professional Scientific and Technical Services:	
Legal	$119,159,000
Architectural and Engineering	136,669,000
Design Services	12,559,000
Computer System Design and Related Services	148,351,000
Management, Scientific and Technical Consulting	79,092,000
Market Research, Polling	4,835,000
Photographic Services	4,279,000
Veterinary Services	16,887,000
Accounting, Tax Preparation & Bookkeeping	49,895,000
Total Reportable Professional, Scientific and Technical Services	$571,727,000
Health Care and Social Assistance Services:	
Physicians	$240,689,000
Dentists	71,469,000
Chiropractors	11,139,000
Optometrists	706,000
Mental Health Practitioners	2,268,000
Physical, Occupational and Speech Therapy	8,264,000
Podiatrists	2,864,000
Miscellaneous Health Practitioners	3,054,000
Outpatient Care Centers	67,733,000
Medical Diagnostic Labs	37,089,000
Home Health Services	24,464,000
Other Amubulatory Health Services	11,564,000
Nursing and Residential Care Facilities	89,878,000
Individual and Family Social Services	34,337,000

Community Food and Housing, Emergency Relief Services	$18,427,000
Vocational Rehabilitation	6,416,000
Total Reportable Health Care and Social Assistance Services	$630,362,000

Administrative and Business Support Services

Administrative and Support Services	$179,195,000
Business Support Services	55,144,000
Services to Buildings and Dwellings	85,843,000[32]
Management of Companies	27,284,000
Investigation and Security	27,212,000
Other Support Services	51,669,000
Waste Management	33,883,000
Total Administrative and Business Support Services	$460,229,000

Personal Care Services

Barber	$576,000
Beauty Salons	14,942,000
Nail Salons	694,000
Other Personal Care	3,340,000
Death Care Services	8,227,000
Drycleaner & Laundry	6,192,000
Pet Care (not Veterinary)	1,434,000
Parking lot/garages	4,843,000
Total Personal Care Services	$40,248,000

Educational Services

Business School/Computer/Management Training	$5,276,000
Technical and Trade Schools	15,993,000
Dance Schools	1,172,000
Exam Preparation	1,082,000
Driving Schools	917,000
Other Miscellaneous Schools	1,274,000
Total Educational Services	$25,714,000

Other Services

Automotive Repair and Maintenance	$83,738,000
Electronic and Precision Repair and Maintenance	9,884,000
Commercial, Industrial Machinery Repair and Maintenance	13,981,000
Personal and Household Goods Repair and Maintenance	6,417,000
Total Other Services	$114,021,000

Wholesale Trade	$3,257,177,000
Cash Discounts	NIA*
Trade-Ins	NIA
Sale of Warranty or Service Contracts	14,058,000
Sale of Tangible Personal Property by a Nonprofit Organization	NIA

[32] A portion of these services many be taxable.
* No Information Available.

Sale of Stocks and Bonds ..... NIA*
Prescription Drugs and Medical Oxygen $219,568,000
Eyeglasses and Contact Lenses, Insulin, Insulin Syringe and Glucose Test Strips, prosthetic appliances, hearing aids and durable medical equipment 7,647,000
Sales to Nonresidents for use outside Arizona if the property is shipped or delivered outside the state 52,701,000
Food for Home Consumption 403,958,000
Textbooks that are required by any state university or community college 1,327,000
Meals Provided to Employees of Restaurants 7,760,000
Food Used in School Lunches ..... NIA
Sale of Arizona Lottery Tickets 19,878,000
Precious Metal Bullion and Monetized Bullion ..... NIA
Tangible Personal Property sold to a Qualifying Hospital or a Qualifying Health Care Organization 21,722,000
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 1,022,000
Tangible Personal Property Sold to a Non-Profitable Organization which Provides Housing for Low Income Persons Over Sixty-Two Years ..... NIA
Gross Proceeds from Contracts to Build Housing for Nonprofits to House Low Income Persons Over Sixty-Two Years ..... 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 347,432,000
Sale of Articles to be Incorporated into a Manufactured Product 888,733,000
Exempt Motor Vehicle Sales (certain nonresidents and Indians) 27,676,000
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
Seeds, Seedlings, Roots, Bulbs, Cuttings and Other Propogative Material used to commercially produce agricultural, horticultural, viticultural or floricultural crops in Arizona 383,000
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 1,953,000
Sales of Natural Gas or Liquefied Petroleum Gas used to Propel a Motor Vehicle 2,928,000
Paper Machine Clothing Used or Consumed in Paper Manufacturing ..... NIA

* No Information Available.

Machinery, Equipment, Utility Product, 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 $475,000
Sales of Liquid, Solid or Gaseous Chemicals Used in Manufacturing, Processing Fabricating, Mining, Refining, Metallurgical Operations or Research and Development 552,000
Sales of Food or Drink Consumed on the Premises of a Jail, Prison, ... 1,196,000
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 23,791,000
Livestock, Poultry, Feed and Supplies for Use or Consumption in the Businesses of Farming, Ranching and Feeding Livestock and Poultry ..... NIA
Sale or Purchase of Implants Used as Growth Promotants and Injectable Medicine 146,000
Sales of Motor Vehicles at Auction to Nonresidents of this State for Use Outside of this State 1,125,000
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 73,000
Tangible Personal Property Consisting of Food, Beverages and Condiments Sold to or Purchased by a Commercial Airline 431,000
Sale of New Alternative Fuel Vehicles and Conversion Equipment ..... NIA
Sale of Spirituous, Vinous or Malt Liquor by a Liquor Wholesaler ..... NIA
Property to be Incorporated as Part of Environmental Response or Remediation Activities ..... NIA
Tangible Personal Property by a Nonprofit that Produces, Organizes or Promotes Cultural or Civic Related Festivals ..... NIA
Machinery or Equipment used directly in Manufacturing, Processing, Fabricating, Job Printing, Refining or Metallurgical Operations 52,190,000
Sale of Machinery or Equipment Used in Mining and in Drilling for or Extracting Oil or Gas from the Earth 9,177,000
Certain Equipment used in the Telecommunications Industry ..... NIA
Machinery, Equipment or Transmission Lines used directly in Producing or Transmitting Electrical Power 24,690,000
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 9,356,000
Certain Aircraft, Navigational and Communication Instruments 1,570,000
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

* No Information Available.

Certain Groundwater Measuring Devices and their installation.....NIA*
New Machinery and Equipment Used for Commercial Production of
Agricultural, Horticultural, Viticultural and Floricultural Crops.....NIA
Machinery or Equipment used in Research and Development.....NIA
Machinery and Equipment Purchased by or on Behalf of Owners of a
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
Gross Income from Installation, Assembly, Repair or Maintenance Clean Rooms.....NIA
Machinery and Equipment Used in the Feeding of Poultry or Production
and Packaging of Eggs.....NIA
Machinery and Equipment used to Meet Land, Water and Air Quality Standards.....NIA
Machinery and Equipment used by Agriculture to Prevent, Monitor,
Control or Reduce Pollution.....NIA
Digital Television Machinery and Equipment Purchases for Compliance
with the Telecommunications Act of 1996.....NIA
Portion of Sales Price of Luxury Automobiles that Reflects the Federal Luxury Excise Tax.....NIA
Portion of Sales Price of Use Fuel that Reflects the Federal Luxury Excise Tax.....NIA
Gross Income from Machinery, Equipment and Materials used Directly
to Construct a Qualified Environmental Technology Facility.....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. §42-5061L.....NIA
Gross Income from Motor Vehicle Manufacturer's Cash Rebates if
Assigned to the Retailer.....$14,181,000
Gross Income derived from the Waste Tire Disposal Fee.....NIA
Sales of Solar Energy Devices.....367,000
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.....11,401,000
Public Transportation Services for Dial-A-Ride Programs and Special Needs
Transportation Services.....NIA
Gross Proceeds for Transporting Freight or Property by an Exclusively Arizona
Railroad for Portions of Single Shipments Involving Other Railroads.....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 Alternative Fuel to a Used Oil Fuel Burner.....NIA
Sales of Electric Services to a Retail Electric Customer Who Is Located
Outside This State for Delivery and Use Outside the State.....NIA
Revenues Received by a Municipally Owned Utility in the form of Fees Charged
to Persons Constructing Residential, Commercial or Industrial Developments.....NIA

* No Information Available

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 Telecommunication Services ..... NIA
Sales of Intrastate Telecommunications Services by a Cable Television System or by a Microwave Television Transmission System $29,488,000
Sales of internet access services 1,088,000
End User Common Line Charges and Carrier Access Charges Established by Federal Communications Regulations ..... NIA
Sales of Direct Broadcast Satellite Television Services ..... NIA
Manufacturing or Publishing Books ..... NIA
Gross Income of Publications Derived from Advertising 29,987,000
Sales to a Person who Distributes Printing, Engraving, Embossing or Copying Without Consideration In Connection With the Publication of a Newspaper or Magazine ..... NIA
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
Operating Coin Operated Washing, Drying and Dry Cleaning Machines ..... NIA
Operating Coin Operated Car Washing Machines ..... NIA
Leasing or Renting Personal Property for Incorporation into a Qualified Environmental Technology Facility ..... NIA
Leasing or Renting Aircraft or Training Equipment by a Non-Profit School Offering Aviation and Aerospace Degrees ..... NIA
Leasing or Renting Photographs, Transparencies or Other Creative Works used by this State on Internet Web Sites, in Magazines or Other Publications that Encourage Tourism ..... NIA
Freight Charges Relating Nonmetalliferous Mineral Products ..... NIA
Tuition and Fees Paid to Universities & Community Colleges ..... NIA
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 ..... NIA
Events Sponsored by the Arizona Coliseum & Exposition Board ..... NIA
Musical, Dramatic or Dance groups or a Botanical Garden, Museum or Zoo that Qualifies as a Nonprofit Charitable Organization ..... NIA
Sales of Admissions to Intercollegiate Football Contests 656,000
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
Restaurant Sales to Qualifying Hospitals ..... NIA
Wages & Salaries for Labor Employed in Construction 655,680,000

* No Information Available

Sale Price of Land $59,518,000
Contracting in a Military Reuse Zone for a Manufacturer, Assembler or Fabricator of Aviation or Aerospace Products ..... NIA*
Gross Proceeds from Contracts to Construct a Qualified Environmental Technology Facility ..... NIA
Gross Proceeds of Sales from a Contract to Provide Response to a Release or Suspected Release of a Hazardous Substance ..... NIA
Gross Proceeds of Sales from a Contract to Install, Assemble, Repair or Maintain Machinery that does not become permanently attached. ..... NIA
Income Received from a Contract for Constructing a Lake Facility Development in a Commercial Enhancement Reuse District ..... NIA
Income from Contracts for Construction of Facilities for Raising Egg Producing Poultry, or the Production and Packaging of Eggs ..... NIA
Income from Contracts for Construction Work to Prevent, Monitor, Control or Reduce Pollution in the Agriculture Industry ..... NIA
Income from Contracts for Construction of a Launch Site ..... NIA
Income from Contracts for Construction of a Domestic Violence Shelter ..... NIA
Gross Proceeds from Contracts to Perform Post-Construction Treatment of Real Property for Termite and General Pest Control ..... NIA
Gross Proceeds from Contracts to Construct Certain State University Research Infrastructure Projects ..... 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 Organization- 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
Total Exemptions $8,045,366,000

TOTAL QUANTIFIABLE TRANSACTION PRIVILEGE AND USE TAX EXPENDITURES[33] $8,375,944,000

Value of Exemptions from the Proposition 301-Education Tax $965,444,000

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* No Information Available
[33]These expenditures represent foregone revenues to the state general fund, counties and incorporated cities/towns.

UNDERGROUND STORAGE TANK TAX EXPENDITURES

UNDERGROUND STORAGE TANK TAX EXPENDITURES[31]

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. Revenue from this tax is 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). Currently, there are 94 federal tanks in use with an average tank capacity of 10,004 gallons. There are 68 state tanks currently in use with an average tank capacity of 10,670 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). Since the Arizona Department of Environmental Quality does not regulate these types of tanks they are not required to be registered with the department and can no longer be tracked. As with the underground storage tanks owned by the federal government and the state of Arizona, the owner/operators of these types of underground storage tanks are not required to report the number of times their tanks are refueled. Due to the 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 types of tanks are not required to register their tanks with the Department of Environmental Quality nor with the State Fire Marshal. Municipalities regulate these types of tanks in their own city. Thus, due to the lack of information, it is not possible to determine the impact.

[31]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 Gain
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[32] ..... NIA

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* No Information Available.

[32]These expenditures represent foregone revenues to the DEQ Assurance Account.

UNEMPLOYMENT INSURANCE TAX EXPENDITURES

UNEMPLOYMENT INSURANCE TAX EXPENDITURES[33]

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;*
  - *(7) or under a cafeteria plan within the meaning of § 125 of the Internal Revenue Code if 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.*

[33]Any figures presented for Unemployment Insurance Tax Expenditures were provided by the Arizona Department of Economic Security.

- *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 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. §23-615.06D, for governmental entities or §501C3 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 week.*
- *Services performed by impaired individuals who cannot be readily absorbed 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, 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.*

There is no requirement for reporting wages or remuneration for the exemptions mentioned above, therefore, no information is available on the value of these tax expenditures.

SUMMARY OF UNEMPLOYMENT INSURANCE TAX EXPENDITURES

	Revenue Gain
Exemptions from wages	NIA*
Exemptions from the definition of employee	NIA
Exemptions from employment	NIA
TOTAL QUANTIFIABLE UNEMPLOYMENT INSURANCE TAX EXPENDITURES[34]	**NIA**

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* No Information Available.

[34]These expenditures represent foregone revenues to the state unemployment insurance fund.

USE FUEL TAX EXPENDITURES

USE FUEL TAX EXPENDITURES[35]

There is a tax of 26¢ 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 purchased in Arizona and used outside of the state (A.R.S. §28-5728). The total amount refunded for this type of purchase during fiscal year 2004/05 was $312,908.

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 (A.R.S. §28-5709). The amount of refunds issued for fiscal year 2004/05 was $11.9 million. Liquid use fuel, used for export purposes is taxed at a $0.26 per gallon rate. The amount refunded for this type of use fuel was $1.4 million.

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. §28-5716A7a). *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 also exempt from use fuel tax (A.R.S. §28-5716A7b). Refunds granted for these types of exemptions together totaled $7.5 million in fiscal year 2004/05.

Liquid use fuel sold within an Indian reservation to an enrolled member of the tribe is excluded from taxation per A.R.S. 28-5716A3. The total amount refunded for this provision during fiscal year 2004/05 was $49,382.

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 2004/05 is $2.3 million.

Effective April 1, 1997, all clean burning fuels are no longer taxed (A.R.S. §28-5708A2). Since taxpayers who consume alternative fuels are not required to report their use information to the department, no information is available on this exemption.

[35]Any figures presented for Use Fuel Tax Expenditures were provided by the Arizona Department of Transportation.

SUMMARY OF USE FUEL TAX EXPENDITURES

	Revenue Gain
PREFERENTIAL TAX RATES:	
Fuel purchased in Arizona and used outside the state	$312,900
Light class and exempt vehicles use rate	11,900,000
Liquid use fuel used for export	1,400,000
EXEMPTIONS:	
Farm tractors, implements of husbandry and road rollers or vehicles designed and used for grading, paving, earth moving and other construction work on highways	7,500,000
Native American Refunds	49,382
Administration exemption for use fuel suppliers	2,300,000
Exemption for clean burning fuels	NIA*

TOTAL QUANTIFIABLE USE FUEL TAX EXPENDITURES[36] **$23,462,282**

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*No Information Available.

[36]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[37]

Under current law, Arizona imposes a vehicle license tax at the rate of $2.95 for each $100 in vehicle value during the first twelve months of life of the vehicle. During the succeeding periods, the tax rate is $3.04. However, the vehicle value is 60% of the manufacturer's base retail price in the first year and declines by 16.25% 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 these 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, is not required to pay a vehicle license tax. Vehicles which are exempt from registration are:

- *Farm tractors* (A.R.S. §28-2153D1)
- *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. §28-2153D2)
- *Road rollers or road machinery, including power sweepers, temporarily operating or moved upon the highway* (A.R.S. §28-2153D3)
- *Vehicles operated by an owner under special provisions relating to lienholders, manufacturers, dealers and nonresidents* (A.R.S. §28-2153D4)
- *Motorized or nonmotorized equipment designed primarily for and used in mining operations and only incidentally operated or moved on a highway* (A.R.S. §28-2153D5)
- *A motor vehicle being towed by a tow truck which has been registered* (A.R.S. §28-2153D6)
- *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. §28-2153D7)
- *Wheeled equipment, such as compressors, forklifts, portable cement mixers, tow dollies, tar pots, water trailers, welders, etc.* (A.R.S. §28-2153D8)

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 that tribe and who purchases an unregistered vehicle for removal to the Indian reservation* (A.R.S. §28-2154C). 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. §28-2511A) 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

[37]Any figures presented for Vehicle License Tax Expenditures were provided by the Arizona Department of Transportation.

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. §28-5802). There is no information available on vehicle license tax exemptions granted to veterans in fiscal year 2004/05.

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). Information is not available on this expenditure.

SUMMARY OF VEHICLE LICENSE TAX EXPENDITURES

	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[38]	**NIA**

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*No Information Available.

[38]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[39]

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, the law enforcement fund and the 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 $439,932 would have been collected in fiscal year 2004/05.

For nonresident owners, the watercraft license tax is $2.90 per foot of length of each watercraft up to and including eighteen feet and $5.50 per foot of length for each foot over eighteen feet. If the tax on the watercraft were $5.50 per foot regardless of length, $959,163 in additional revenues would have been received in fiscal year 2004/05.

Watercraft agents are boat dealers who have been given the authority to issue temporary watercraft certificates for new boats only. This is pursuant to A.R.S. §5-322A4, which states undocumented watercraft can operate *under a valid temporary certificate issued pursuant to the rules adopted by the Game and Fish Commission*. The customer may use his/her boat while the paperwork is being processed. Since the watercraft agent is responsible for submitting the fees and license tax along with the paperwork, the value for this type of watercraft is included in the preferential tax rates previously mentioned.

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. It is estimated that approximately 50 federal boats are on Arizona waters with an average length of 16 feet. If these vessels were subject to taxation, an additional $500 in watercraft license tax revenues would have been collected in fiscal year 2004/05.

Watercraft dealer registration is different than any other. Decals and certificates that are issued are not attached to a specific boat; they can be switched between boats owned by the same dealer for the purpose of demonstrating the boats for sale. The fee for this type of registration, per A.R.S. §5-321C is $2.50. Since we have no way of knowing how many boats a dealer has on his lot at any given time, we are unable to give an estimate of the revenue.

Foreign watercraft temporarily using the waters of the state (A.R.S. §5-322A1) are 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 in the negligible to non-existent range.

Also exempt from the watercraft license tax are *watercraft used solely as lifeboats* (A.R.S. §5-322A3). Due to the makeup of the boating population

[39]Any figures presented for Watercraft License Tax Expenditures were provided by the Arizona Department of Game and Fish.

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 in the negligible to non-existent range.

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 $3,798 in fiscal year 2004/05 if their watercraft were not exempt from this tax.

A.R.S. §5-322H exempts *owners of commercial watercraft from the license tax* but those taxpayers are not exempt from the advalorem property taxes. If this type of watercraft had been taxed in fiscal year 2004/05, an additional $16,927 would have been collected.

Military personnel stationed in Arizona who can provide proof that they are non-residents, they are exempt from this tax. This exemption resulted in a tax expenditure of $9,642 in fiscal year 2004/05.

Residents of Indian reservations, who can provide proof that they reside on that portion of the reservation within the boundaries of Arizona established for the tribe of which they are a member, are exempt from this tax. If reservations were taxed in fiscal year 2004/05, an additional $177 would have been collected.

SUMMARY OF WATERCRAFT LICENSE TAX EXPENDITURES

	Revenue Gain
PREFERENTIAL TAX RATES:	
Resident preferential rates	$439,932
Nonresident preferential rates	959,163
EXEMPTIONS:	
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	3,798
Owners of commercial watercraft not exempt from ad valorem tax	16,927
Watercraft owned by non-resident military personnel	9,642
Watercraft owned by residents of Indian reservations	177
TOTAL QUANTIFIABLE WATERCRAFT LICENSE TAX EXPENDITURES[40]	**$1,430,139**

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* No Information Available.

[40]These tax expenditures represent foregone revenues to the watercraft licensing fund, the state lake improvement fund and the law enforcement and boating safety fund.

WORKERS' COMPENSATION PREMIUM LIEU TAX EXPENDITURES

WORKERS' COMPENSATION PREMIUM LIEU TAX EXPENDITURES[41]

Workers' compensation premiums are taxed at a rate up to 4.5% on all premiums collected during the calendar year, less certain deductions from total premiums (A.R.S. §23-961J). 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 2004 the deductions from premiums totaled $68.7 million which results in a tax expenditure of $3.1 million.

[41]Any figures presented for Workers' Compensation Premium Lieu Tax Expenditures were provided by the Industrial Commission of Arizona.

SUMMARY OF WORKERS' COMPENSATION PREMIUM LIEU TAX EXPENDITURES

	Revenue Gain
Deductions from total premiums	$3,091,500
TOTAL QUANTIFIABLE WORKERS' COMPENSATION PREMIUM LIEU TAX EXPENDITURES[42]	**$3,091,500**

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[42]These expenditures represent foregone revenues to the Administrative and Special Funds of the Industrial Commission.