CORPORATE INCOME TAX

DESCRIPTION

The corporate income tax is levied on corporations that engage in business within Arizona. The tax rate currently is 6.968% of taxable income. A multi-state company must allocate a portion of its income to Arizona based on its Arizona property, payroll, and sales.

The corporate income tax is an important revenue source for the state, representing slightly less than 8% of forecasted General Fund revenues. A portion of corporate income tax collections (along with individual income tax collections) is shared with incorporated cities and towns within the state.

COLLECTIONS

Table 1 below provides historical corporate income tax collections for the last 20 years. Corporate income tax receipts are deposited into the General Fund, after sufficient amounts have been deposited into the tax refund account to meet the requirements for tax refunds [A.R.S. § 42-1116].

Table 1

CORPORATE INCOME TAX COLLECTIONS

Fiscal Year	State General Fund	Fiscal Year	State General Fund
FY 2005	$701,859,285	FY 1995	$419,690,900
FY 2004	$494,044,869	FY 1994	$331,395,000
FY 2003	$389,406,300	FY 1993	$263,242,400
FY 2002	$346,280,400	FY 1992	$211,445,600
FY 2001	$541,173,600	FY 1991	$191,672,500
FY 2000	$523,180,000	FY 1990	$178,067,100
FY 1999	$545,389,000	FY 1989	$200,869,700
FY 1998	$535,295,300	FY 1988	$150,748,800
FY 1997	$600,890,500	FY 1987	$198,948,600
FY 1996	$448,039,400	FY 1986	$168,682,700

SOURCE: Department of Revenue annual reports - amounts are net of refunds and charge-offs. A portion of corporate income tax collections is shared with incorporated cities and towns – see Table 2 in Individual Income Tax section.

DISTRIBUTION

Based on an initiative measure approved by the voters in 1972, an Urban Revenue Sharing Fund was established. The initiative provided that a percentage of income tax revenues (including both individual and corporate income tax) be shared with incorporated cities and towns within the state. Currently, 15% of net income tax revenues from 2 years prior is distributed to cities and towns. This distribution is based on the last U.S. decennial census, a special census, or revised population figures approved by the Department of Economic Security (DES). Table 2 (Distribution of Individual and Corporate Income Tax) in the Individual Income Tax section provides historical urban revenue sharing distributions [A.R.S. § 42-206].

WHO PAYS THE TAX

Any corporation, excluding exempt organizations, having Arizona taxable income is subject to the corporate income tax [A.R.S. § 43-1111].

Exempt organizations include those exempt from federal income tax under section 501 of the Internal Revenue Code (generally "non-profit" organizations), as well as a specific list of exempt organizations included in state statute [A.R.S. § 43-1201].

The income of a corporation owned by an Indian tribe or tribal member not subject to Arizona's corporate income tax if its income is derived from businesses located on the reservation. Income from a corporation not owned by a tribe or tribal member, regardless of whether it is located on a reservation, is subject to the state corporate income tax. Corporations owned by tribes or tribal members that derive their income from non-reservation sources are subject to the income tax in the same manner as all other corporations with income in Arizona.

There are no specific statutory references related to the imposition of Arizona state income tax on tribal members or corporations. Thus, to facilitate the administration of state income tax on Indian reservations, the Department of Revenue has adopted income tax rulings based on the decisions in several court cases.

Small business corporations which make a "subchapter S" election for a taxable year under the Internal Revenue Code are not subject to the corporate income tax. The income of these corporations is generally passed through to each shareholder, who is then taxed under the state's individual income tax [A.R.S. § 43-1126].

The United States, the state, counties, towns, school districts, or other political subdivisions of the state or federal government are excluded from the definition of a taxpayer, and are exempt from the corporate income tax [A.R.S. § 43-104].

EXEMPTIONS

Organizations that are exempt from federal income tax under Section 501 of the Internal Revenue Code are also exempt from state income tax. In addition, the following organizations are exempt from state income tax [A.R.S. § 43-1201]:

(1) Labor, agricultural, and horticultural organizations except for cooperative organizations.
(2) Fraternal beneficiary societies, orders, or organizations that both: (a) operate under the lodge system or for the exclusive benefit of the members of a fraternity, and (b) provide for the payment of life, sick, accident, or other benefits to their members or their dependents.
(3) Cemetery companies that are owned and operated exclusively for the benefit of their members or are not operated for profit.
(4) Corporations that are organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children and animals.
(5) Business leagues, chambers of commerce, real estate boards, and boards of trade that are not organized for profit.
(6) Civic leagues or organizations that are not organized for profit.
(7) Clubs that are organized and operated exclusively for pleasure, recreation, and other non-profitable purposes.
(8) Corporations that are organized for the exclusive purpose of holding title to property, collecting income from such property, and turning over the entire net income to an organization which itself is exempt from income tax.
(9) Voluntary employees' beneficiary organizations that provide for the payment of life, sick, accident or other benefits to their members or their dependents, if both of the following apply: (a) no part of their net earnings inures to the benefit of any private shareholder or individual, and (b) 85% or more of the income consists of monies collected from members and contributions by the employer of the members.
(10) Teachers' or public employees' retirement fund organizations that are of a purely local character, if both of the following apply: (a) no part of their net earnings inures to the benefit of any private shareholder or individual, and (b) the income consists solely of monies received from public taxation, assessments on the salaries of members, and income from investments.
(11) Religious or apostolic organizations or corporations, if such organizations or corporations have a common treasury or community treasury.
(12) Voluntary employees' beneficiary organizations that provide for the payment of life, sick, accident or other benefits to their members, their dependents or designated beneficiaries, if both of the following apply: (a) admission to membership is limited to individuals who are officers or employees of the United States Government, and (b) no part of the net earnings inures to the benefit of any private shareholder or individual.
(13) Corporations classified as diversified management companies under Section 5 of the federal Investment Company Act of 1940.
(14) Insurance companies that are subject to the insurance premium tax.
(15) Mutual ditch, irrigation or water companies or similar nonprofit organizations if 85% or more of their income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

(16) Workers' compensation pools established pursuant to A.R.S. § 23-961.01

TAX BASE AND RATE

The tax base for the corporate income tax is defined as "Arizona taxable income", which is further defined as the "Arizona gross income" (equal to a corporation's federal taxable income), adjusted by a series of additions and subtractions as specified in Title 43, Article 3 of the Arizona Revised Statutes (A.R.S. § 43-1121 - A.R.S. § 43-1130.01) [A.R.S. § 43-1101].

The tax rate for corporate income tax is 6.968% of a corporation's net Arizona taxable income or $50, whichever is greater [A.R.S. § 43-1111].

Corporations which have income from both within the state and outside of the state are required to allocate their Arizona taxable income according to the type of income as follows: [A.R.S. § 43-1132]

- *Business income*. Allocated to Arizona by multiplying the income by a factor which weights the value of the taxpayer's property in Arizona at 25%, the value of the taxpayer's payroll at 25%, and the value of sales within the state at 50%. Laws 2005, Chapter 289 will allow corporations, when certain conditions are met, to elect an alternative computation that would increase the sales factor weight to 60% in 2006, 70% in 2007, and 80% in 2008 and after [A.R.S. § 43-1139 - A.R.S. § 43-1145].

- *Nonbusiness income*. Includes rents and royalties from real property or tangible personal property, capital gains, interest and dividends, and patent and copyright royalties. Income is generally allocated to Arizona to the extent the property is utilized or located in the state, or if the taxpayer's commercial location is in the state [A.R.S. § 43-1134 - A.R.S. § 43-1138].

- *Sale of other than tangible personal property*. Allocated to Arizona if the income producing activity is performed within the state, or, if the activity is performed both inside and outside of the state, if the greater proportion of the activity is performed within the state [A.R.S. § 43-1147].

- *Sale of tangible personal property*. Allocated to Arizona if the property is delivered or shipped to a purchaser within the state [A.R.S. § 43-1146].

If the allocation and apportionment provisions do not fairly represent the extent of the taxpayer's business activity in the state, the taxpayer may petition for, or the Department of Revenue may require, an alternative method of allocation [A.R.S. § 43-1148].

TAX REFUNDS AND/OR TAX CREDITS

Laws 2002, Chapter 238 established the Arizona Joint Legislative Income Tax Credit Review Committee. The Committee is required to determine the purpose of income tax credits, develop performance standards for evaluating the credits, and evaluate the benefits to the state. The Committee reviews each tax credit every 5 years according to a rotating schedule [A.R.S. § 43-221].

Corporate income tax credits available to taxpayers that reduce their liability or make them eligible for refunds are described below. The value of tax credits used and carried forward through calendar year 2002 (the latest year available) is summarized by the Arizona Department of Revenue summary report attached at the end of this section.

Current statutes include the following tax credits:

- *Agricultural Pollution Control Equipment.* A tax credit is allowed for taxpayers engaged in agriculture to reclaim 25% of the cost of real property or equipment, not to exceed $25,000 in a taxable year, that is used to control, prevent, monitor or reduce air, water or land pollution. The credit can be carried forward for 5 years [A.R.S. § 43-1170.01].

- *Agriculture Preservation District*. For tax years from and after December 31, 2000, a refundable credit is allowed for an agricultural property owner that conveys ownership or development rights to an agricultural preservation district. No district can award credits exceeding $10 million. The credit is equal to the appraised value of owned property transferred to the district or the difference between the appraised value of undeveloped land and the appraised value of the land for development purposes. No individual credit can exceed $33,000 in a calendar year [A.R.S. § 43-1180].

- *Agricultural Water Conservation System*. A tax credit can be claimed for 75% of the qualifying expenses in purchasing and installing an agricultural water conservation system. This credit is in lieu of itemized deductions for such expenses, in which case, the taxpayer must add the credit back into Arizona gross income in computing taxable income. This non-refundable tax credit can be carried forward for no more than 5 years [A.R.S. § 43-1172].

- *Alternative Fuel Delivery System Credit.* A taxpayer may claim a credit for the costs to construct or operate an alternative fuel delivery system (AFDS) in Arizona that is capable of dispensing alternative fuel to an alternative fuel vehicle. Laws 2000, 7th Special Session, Chapter 1 limited the credit for AFDS to those individuals who had a purchase order or contract for the system before October 20, 2000 and for which actual construction began before November 9, 2000. The credit is equal to 100% of costs incurred up to a maximum of $400,000. For alternative fuel delivery systems not satisfying the requirements of the previous system, the credit is 50% of costs up to a $200,000 maximum [A.R.S. § 43-1174.02].

- *Alternative Fuel Vehicles Credit*. A contract or purchase order for the vehicle must have been entered into prior to October 21, 2000. No refundable credit is allowed after December 31, 2001. The non-refundable credit was repealed, but the carry-forward for the non-refundable credit can still be used after December 31, 2001 [A.R.S. § 43-1174].

- *Arizona National Guard Employees*. A tax credit of $1,000 per employee is allowed for businesses that employ Arizona National Guard members who are called to active duty [A.R.S § 43-1167.01].

- *Construction Materials*. A non-refundable credit is allowed for new construction materials incorporated into a qualifying facility located entirely in Arizona. Construction must have begun on or after January 1, 1994 and be completed on or before December 31, 1999. The credit is 5% of the purchase price for materials used to construct buildings costing more than $5 million that are predominately used for manufacturing, mining, refining, satellite/data transmission, and research and development [A.R.S § 43-1171].

- *Coal Consumed in Generating Electric Power*. The credit is for 30% of the amount paid by the seller or purchaser as transaction privilege tax or use tax on coal sold to the taxpayer to be consumed in generating electrical power within the state. The credit can be carried forward for 5 years [A.R.S. § 43-1178].

- *Corporate Consolidated Credit.* Prior to the enactment of Laws 1994, Chapter 41, if a group of corporations demonstrated a large degree of interdependence, the Department of Revenue (DOR) would require the group to file its Arizona income tax return as a combined or unitary entity. After the law's passage, a group of corporations could elect to file a consolidated return in Arizona for the same corporations that filed a federal income tax return as a consolidated group. DOR could no longer require alterations of the component firms even if DOR did not agree with the consolidated grouping. Prior to the law's passage, DOR generally required a combined return that was different than the federal consolidated return in order to more accurately reflect income derived from Arizona sources. Effective July 17, 1994, corporations could elect to form a consolidated group that would contain the same members at the federal level. Consolidated returns could be filed from tax year 1994 forward and amended returns could be filed for tax years 1986 through 1993 if they were filed before January 1, 1995. The amended returns yielded credits for previous tax payments as well as interest accrued through December 31, 1994. Total tax credit established for 1986 through 1993 plus interest was $115 million. The tax credits were nonrefundable and the total was to be spread over 10 years. In the 11th year, DOR was required to refund all unused credit, even if it exceeds the corporation's tax liability in that year. DOR estimated that the remaining credits to be claimed will result in refunds of $(4.0) million in FY 2007 and $(55.5) million in FY 2008.

- *Defense Contractor Employment*. The credit applies to defense contractors certified by the Arizona Department of Commerce. The non-refundable credit is for net increases in employment due to full-time equivalent (FTE) positions being transferred from exclusively defense-related activities to exclusively private commercial activities. A tax credit is also allowed for a portion of property taxes paid on class 3 (commercial or industrial) property. For each FTE net employment increase, $2,500 is credited in the first year, $2,000 in year 2, $1,500 in year 3, $1,000 in year 4 and $500 in year 5. Property tax credits depend on the number of FTE Positions created (see below) [A.R.S § 43-1165].

- *Defense Contractor Property Taxes*. The credit for property tax paid is: 40% if more than 900 FTE Positions are created; 30% for 601 to 900 positions; 20% for 301 to 600 positions; and, 10% for up to 300 positions. The credits can be carried forward for 5 years [A.R.S. § 43-1166].

- *Enterprise Zones*. To qualify, at least 35% of the full time equivalent employees claimed must reside in an enterprise zone. For non-retail businesses, the credit is equal to 25% of the taxable wages paid to a qualified FTE employee in the first year of employment, 33% in the second year of continuous employment, and 50% in the third year, not to exceed $500, $1,000, and $1,500 respectively. The credit may not be taken for more than 200 employees [A.R.S. § 43-1161].

- *Environmental Technology Facility Construction Costs*. A non-refundable credit is allowed for expenses incurred in constructing a qualifying facility involved in recycled materials or renewable energy. The credit is equal to 10% of the amount spent to construct the facility, including land acquisition, improvements, building improvements, machinery and equipment, but not to exceed 75% of the tax liability for the taxable year. The credits can be carried forward for 15 years [A.R.S. § 43-1169].

- *Healthy Forests*. To qualify, a business must be engaged in harvesting, transportation or initial processing of forest products, including biomass. Products must contain at least 50% biomass, and at least half of the biomass must be from Arizona sources. The business must have at least 3 permanent full-time employees and must be engaged in enhancing forest health, watersheds or public safety. The credit is equal to 25% of the taxable wages paid to a qualified FTE employee in the first year of employment, 33% in the second year of continuous employment, and 50% in the third year, not to exceed $500, $1,000, and $1,500 respectively. The credit may not be taken for more than 200 employees and may be carried forward for 5 years [A.R.S. § 43-1162].

- *Motion Picture Productions.* An income tax credit is available to businesses that produce motion pictures in Arizona. Motion picture productions with qualified expenses of $250,000 to $1 million in a 12-month period may receive a tax credit equal to 10% of production costs; production expenses from $1 million to $3 million may be credited for 15% of production costs, while productions spending more than $3 million in the state may claim a credit equal to 20% of production costs. The total amount of income tax credits approved may not exceed $30 million in 2006, $40 million in 2007, $50 million in 2008, $60 million in 2009 and $70 million in 2010. The tax credits may be sold or transferred, in whole or in part, to other taxpayers. The law requires taxpayers claiming the credits to meet various reporting requirements and for film companies to recruit Arizona residents to hold 25% of full-time positions in 2006, 35% in 2007 and 50% in 2008 and after [A.R.S. § 43-1163].

- *Military Reuse Zones*. A non-refundable credit is allowed for net full-time equivalent (FTE) employment increases in a military re-use zone. The employees must be engaged in aviation or aerospace manufacturing or services. Credits also are allowed for dislocated civilian military base employees. For net FTE increases, a credit is allowed for each newly created position of $500 to $3,000, depending on whether or not the employee is a dislocated military base employee, and the number of years of employment (1-5 years). The credits can be carried forward for 5 years [A.R.S. § 43-1167].

- *Pollution Control Equipment*. The credit is allowed for purchases of real or personal property used to control or prevent pollution. The qualifying facilities must be built or purchased to comply with U.S. Environmental Protection Agency or Arizona Department of Environmental quality regulations. The credit amount is equal to the lesser of 10% of the purchase price or $500,000 in a taxable year. It was capped at $750,000 in 1995 and 1996. The credits can be carried forward for 5 years [A.R.S. § 43-1170].

- *Research and Development*. A credit of 20% of qualified research expenses over a "base amount" (defined in the Internal Revenue Code) for expenses up to $2.5 million ($500,000 credit), plus 11% of expenses over $2.5 million. The credit was capped at $1.5 million for CY 2001 and $2.5 million for CY 2002. If a taxpayer has carried forward qualified research expenses from tax years beginning before January 1, 2001, the expenses convert to credit by multiplying expenses carried forward by 20%. Credit carried forward from tax years beginning before January 1, 2003 may be limited. The amount carried forward from the specified tax years must be less than or equal to: the lesser of tax liability less current year credit (thereby zeroing out liability), or the difference between $500,000 and the current year credit [A.R.S. § 43-1168].

- *School Site Donation*. The credit is allowed for donations of real property and improvements to a school district or charter school as a school construction site. The credit is for 30% of the value of real property and improvements donated and can be carried forward for 5 years [A.R.S. § 43-1181].

- *Solar Hot Water Heater Plumbing Stub Outs and Electric Vehicle Recharge Outlets Installed in Houses Constructed by Taxpayer*. Up to $75 for each installation for each separate house or dwelling unit. The credit may be transferred to the purchaser of the house or dwelling [A.R.S. § 43-1176].

- *Technology Training*. A refundable credit is allowed for providing technological skills training to not more than 20 of the taxpayer's employees. The credit is equal to 50% of the amount spent, but not more than $1,500 per employee. The credits, which are capped at $2.5 million, are certified through the Arizona Department of Commerce [A.R.S. § 43-1179].

- *Temporary Assistance for Needy Families Employment*. For net increases in employment, a credit for each newly created position of 25% of the taxable wages paid in the first year of employment, 33% in the second year of continuous employment, and 50% in the third year, not to exceed $500, $1,000, and $1,500 respectively [A.R.S. § 43-1175].

- *Vehicle Refueling Apparatus*. The refundable credit is for the cost of the vehicle refueling equipment, while the non-refundable credit was equal to the greater of $2,000 or the cost of the equipment. The credit can be carried forward for 5 years [A.R.S. § 43-1174.01].

- *Water Conservation Systems.* The credit is for the installation of water conservation system plumbing stub-outs to encourage the reuse of "graywater," or waste water. It provides a tax credit of up to $200 per installation, with a 5-year carry-forward period, and caps the total amount of tax credit issued at $500,000 per year. The credit will be available for 5 years, beginning in 2008 [A.R.S. § 43-1182].

- *Vehicle Refueling Apparatus*. The refundable credit is for the cost of the vehicle refueling equipment, while the non-refundable credit was equal to the greater of $2,000 or the cost of the equipment. The credit can be carried forward for 5 years [A.R.S. § 43-1174.01].

PAYMENT SCHEDULE

A corporation that anticipates an Arizona income tax liability over $1,000 is required to pay estimated tax payments during the year. Generally, the estimated payments must equal the lesser of 90% of the tax liability for the current year, or 100% of the tax liability for the prior year. Large corporations (defined as having federal tax liability of $1 million or more for any 1 of the preceding 3 years) are required to pay estimated payments of 90% of the current year tax liability. Estimated payments are required in 4 installments based on the Internal Revenue Code. A taxpayer that does not make required estimated payments, or underpays the required payment, is subject to a penalty [A.R.S. § 43-582].

The balance of the tax, after accounting for taxpayer's estimated payments, is due by April 15 following the close of the calendar year; or, the 15th day of the 4th month following the close of the fiscal year, if the taxpayer files a tax return on a fiscal year basis [A.R.S. § 43-501].

An extension may be granted if 90% of the tax liability is paid by the original due date and the extension request is received by the original due date. No extension may be granted beyond 6 months from the original due date [A.R.S. § 42-1107].

IMPACT OF TAX LAW AND REVENUE CHANGES

The following section is a summary by year of tax law changes that have been enacted by the Legislature since 1999. The estimated initial dollar impact of these changes is summarized by fiscal year in Table 2 below.

Table 2

INITIAL DOLLAR IMPACT OF TAX LAW AND REVENUE CHANGES

Session/Chapter	Description	Revenue Impact
FY 2008		
L 05, Ch 289	Corporate Sales Factor	$ (32,000,000)
L 05, Ch 292	Water Conservation Systems Credit	(500,000)
Subtotal FY 2008		(32,500,000)
FY 2007		
L 94, Ch 41	Corporate Consolidated Credit	$ (4,000,000)
L 05, Ch 317	Motion Picture Tax Incentives	$ (8,000,000)
Subtotal FY 2007		(12,000,000)
FY 2006		
L 05, Ch 264	Arizona Nation Guard Employment Credit	$ (250,000)
L 05, Ch 334	IRS Conformity	$ (3,000,000)
Subtotal FY 2006		(3,250,000)
FY 2005		
L 04, Ch 196	IRS Conformity	$ (1,850,000)
L 04, Ch 289	Enterprise Zone Tax Credits and Exemptions	(200,000)
L 04, Ch 326	Healthy Forests	Unknown
Subtotal FY 2005		(2,050,000)
FY 2004		
L 03, Ch 262	DOR Revenue Generating Proposal	$ 9,130,000
Subtotal FY 2004		9,130,000
FY 2003		
L 03, 1st SS, Ch 1	DOR Revenue Generating Proposal	$ 418,000
L 02, Ch 50	Repeal Dividends Income Tax Subtraction	11,200,000
L 02, Ch 344	IRS Conformity	5,610,000
Subtotal FY 2003		16,810,000
FY 2002		
L 00, Ch 239	Technology Training Credit	$ (2,500,000)
Subtotal FY 2002		(2,500,000)
FY 2001		
L 01, Ch 296	IRS Conformity	$ (470,000)
L 00, Ch 405	Alternative Fuel Vehicle Credit	(7,300,000)
L 99, 1st SS, Ch 5	(Trigger) Rate Reduction, R&D Cap Removed	(37,000,000)
L 99, Ch 168	Alternative Fuel Vehicles	(1,052,100)
L 99, Ch 190	Income Allocation (Airline Bill)	(700,000)
Subtotal FY 2001		(46,522,100)
FY 2000		
L 00, Ch 252	IRS Conformity	$ (15,000)
L 98, Ch 208	Wheels to Work	(1,140,000)
L 98, Ch 286	Tax Exemptions, Deductions	(577,300)
Subtotal FY 2000		(1,732,300)

FY 1999		
L 99, Ch 317	IRS Conformity	$ 993,000
L 98, Ch 3	1998 Tax Relief Act: Reductions/Elimination	(10,000,000)
L 98, Ch 137	Income Tax Credits: Coal Taxes	(1,600,000)
L 97, Ch 300	Welfare Reform: Arizona Works	(585,200)
Subtotal FY 1999		(11,192,200)

2005 TAX LAWS

Laws 2005, Chapter 148 clarified the definition of pollution control equipment that would qualify for the related individual and corporate income tax credits. While the changes were expected to have a positive impact on future corporate tax collections, the amount of the savings is unknown. (Effective August 12, 2005)

Laws 2005, Chapter 249 increased the termination date and subsequent renewal terms for military reuse zones from 5 years to 10 years and clarified the information that must be provided to the Department of Commerce in order to qualify for income tax credits claimed for net increases in employment. (Effective August 12, 2005)

Laws 2005, Chapter 264 created a tax credit of $1,000 per employee for businesses that employ Arizona National Guard members who are called to active duty. The credit is estimated to reduce corporate income tax collections by $(250,000) in FY 2006. (Effective January 1, 2006)

Laws 2005, Chapter 278 made technical changes to the Healthy Forest initiative passed in 2004 and provided some additional tax incentives. It reduced from 10 to 3 the number of full-time employees a business must have in order to qualify for income tax incentives, and it reduced the number of work hours defining full-time employment from 1,750 hours to 1,500 hours per year. The amount of required health insurance coverage for employees of a qualified business also was reduced. (Effective August 12, 2005)

Laws 2005, Chapter 289 allows a multi-state corporation, after certain conditions are met, to elect an enhanced sales factor formula to compute its Arizona income tax liability. The corporation may elect the existing double-weighted (50%) sales factor or an 80% sales factor, to be phased in from 60% in tax year 2007, 70% in tax year 2008, and 80% in tax year 2009. The enhanced sales factor formula is allowed only if one or more corporations announce, on or after June 1, 2005, that one or more capital investment projects in the state, individually or collectively, exceed $1 billion. The corporations are required to notify the Joint Legislative Budget Committee (JLBC) and the Governor's Office of Strategic Planning and Budgeting (OSPB) of their intent to make these investments. In July 2005, one corporation notified JLBC and OSPB of its intent to invest approximately $3 billion in a new manufacturing facility. The corporations are also required to notify JLBC and OSPB by December 15, 2007 that the projects have commenced and are estimated to cost more than $1 billion. JLBC and OSPB are required to jointly publish a list in 2006, 2007 and 2008 of corporations that have reported on their projects and to notify the Department of Revenue and Legislative Council that the conditions for the enhanced sales factor have been met by December 31, 2007. Any corporation that elects the enhanced sales factor formula is required to participate in an economic impact analysis to be conducted by JLBC, which is required to produce a report of the analysis by July 1, 2011. On or before December 31, 2005, 2006, 2007 and 2008, each corporation that made capital investment commitments is required to report on each project's status, projected costs, the amounts actually spent to date, and any changes and updates in the project. The enhanced sales factor formula is estimated to reduce tax corporate income tax collections by $(32.0) million in FY 2008. The fiscal impact of the enhanced sales factor formula is estimated to increase to $(120.0) million when fully implemented in FY 2011. (Effective January 1, 2008, retroactive to January 1, 2007)

Laws 2005, Chapter 292 created a corporate income tax credit for the installation of water conservation system plumbing stub-outs to encourage the reuse of "graywater," or waste water. It provides a tax credit of up to $200 per installation, with a 5-year carry-forward period, and caps the total amount of tax credit issued at $500,000 per year. The credit is available for 5 years beginning in 2008. It is estimated to reduce corporate income tax collections by $(500,000) in FY 2008. (Effective January 1, 2007)

Laws 2005, Chapter 317 establishes individual and corporate income tax credits for businesses that produce motion pictures in Arizona. Motion picture productions with qualified expenses of $250,000 to $1 million in a 12-month period may receive a tax credit equal to 10% of production costs; production expenses from $1 million to $3 million may be credited for 15% of production costs, while productions spending more than $3 million in the state may claim a credit equal to 20% of production costs. The total amount of income tax credits approved may not exceed $30 million in 2006, $40 million in 2007, $50 million in 2008, $60 million in 2009 and $70 million in 2010. The tax credits may be sold or transferred, in whole or in part, to other taxpayers. The law requires taxpayers claiming the credits to meet various reporting requirements and for film companies to recruit Arizona residents to hold 25% of full-time positions in 2006, 35% in 2007 and 50% in 2008 and after. It is estimated to reduce corporate income tax collections by $(8.0) million in FY 2007. (Effective July 1, 2006, retroactive to January 1, 2006)

Laws 2005, Chapter 334 included changes to Arizona income tax statutes in order to conform to changes to the U.S. Internal Revenue Code (IRC). Arizona gross income (AGI) is the base amount apportioned from a corporation's federal gross income that is used to calculate Arizona corporate income tax liability. Changes to federal gross income affect the state's income tax collections. The federal government enacted 2 bills during 2004 (the Working Families Tax Relief Act and the American Jobs Creation Act) to which Laws 2005, Chapter 334 conformed. The net fiscal impact of conforming Arizona corporate individual income tax statutes to the IRC is estimated to be $(3.0) million in FY 2006 and $5.2 million in FY 2007. (Effective January 1, 2006)

2004 TAX LAWS

Laws 2004, Chapter 196 provided for partial conformity with the U.S. Internal Revenue Code and federal tax law changes that became effective during 2003. The federal government enacted 3 tax bills during 2003: the Jobs and Growth Tax Relief Reconciliation Act, the Military Family Tax Relief Act, and the Medicare Prescription Drug, Improvement, and Modernization Act. The Legislature conformed to the tax law changes in these federal acts except for the provisions related to additional bonus depreciation allowances and investment deductions by small businesses. According to the Department of Revenue, the fiscal impact to the General Fund is estimated to be $(800,000) in FY 2004, $(1,850,000) in FY 2005, and $(2,040,000) in FY 2006. (Various effective dates, including an emergency clause)

Laws 2004, Chapter 289 made several changes to tax statutes:

1. Updated the income tax credit review schedule to add those credits that were reviewed in 2003 to the review schedule for 2008.

2. Repealed the individual and corporate income tax credits for costs incurred in corrective actions for releases from underground storage tanks. Since this credit was not being used, there was no related fiscal impact.

3. Allowed the enterprise zone job creation tax credits to be claimed for the second and third years of qualified employment even if the credits for the first year were not claimed on the original tax return. The jobs must have been created before January 1, 2002 and certified by the Arizona Department of Commerce. According to the Department of Revenue, the fiscal impact of this provision could be $(200,000) to $(300,000) per fiscal year.

4. Clarified that a business may remain eligible for enterprise zone tax credits if retail sales accounted for less than 10% of the business conducted at the zone location. This is likely to have a very small fiscal impact.

5. Provided a retail sales tax exemption for sales of food, beverages and promotional items to employees and occasional guests of businesses within enterprise zones. This is also likely to have a very small fiscal impact.

6. Made technical and conforming changes and made the tax law amendments retroactive to tax years beginning from and after December 31, 2003.

(Effective August 25, 2004)

Laws 2004, Chapter 326 provides for the state Department of Commerce to certify businesses that process and add value to biomass from Arizona's forest areas. Qualified businesses are eligible for individual and corporate income tax credits based on net increases in employment, and sales and use tax exemptions for qualified construction and equipment. A business can claim a credit for up to 200 new jobs. The bill provides for income tax credits and sales tax exemptions to be forfeited, or "clawed back," if a business' certificate is revoked. The legislation's fiscal impact cannot be determined. This legislation may result in a reduction in revenue to the extent that businesses qualify for the job creation tax credits and sales tax exemptions. However, the secondary impact would include the positive effects from the jobs created and the related income and sales tax collections. (Effective June 3, 2004)

2003 TAX LAWS

Laws 2003, 1st Special Session, Chapter 1 appropriates $3,275,800 from the General Fund to DOR for a revenue generating plan. See Laws 2003, Chapter 262 for a more complete explanation of this issue. The program is projected to generate $5,838,000 in additional General Fund revenues in FY 2003, of which $418,000 is attributable to the corporate income tax. (Contained various effective dates)

Laws 2003, Chapter 61 eliminated the "Wheels to Work Program" and repealed the program's motor vehicle donation tax credit. (Effective September 18, 2003)

Laws 2003, Chapter 262 appropriates $6,552,000 from the General Fund to DOR for a revenue generating program. The program is projected to generate new revenue through increased audit and collections activity. It is expected to generate $53,249,000 in additional General Fund revenues in FY 2004, of which $9,130,000 is attributable to the corporate income tax. This act represents the annualization of the revenue generating program begun by Laws 2003, 1st Special Session, Chapter 1. (Contained various effective dates)

Laws 2003, Chapter 263 established a tax amnesty program, which allows DOR to abate or waive all or part of penalties and to impose reduced interest payments for tax liabilities for all qualifying taxpayers. To qualify for the program, a taxpayer must pay at least one-third of the total amount due by October 31, 2003 and the entire balance due by May 1, 2004. The amnesty program is projected to generate $25,000,000 in additional General Fund revenues in FY 2004, of which $4,500,000 is attributable to corporate income tax. The actual amount of tax amnesty monies reported for FY 2004 was $47,125,500, of which approximately $31,575,000 was attributable to corporate income tax. The tax amnesty monies included $4,000,000 in on-going collections and $43,125,500 in one-time revenues. The provision is repealed after June 30, 2004. The one-time revenue impact of the tax amnesty program has not been included in the tax law changes table at the beginning of this section.

2002 TAX LAWS

Laws 2002, Chapter 50 repeals the deduction of stock dividends, earned from Arizona companies, which are allowed in state corporate income tax calculations. Stock dividends from non-Arizona companies are currently not deductible. The repeal of this deduction applies retroactively to December 31, 2001. The legislation is estimated to have a positive impact on state General Fund revenues of $11,200,000 per year beginning in FY 2003.

Laws 2002, Chapter 237 provided modifications to the state's enterprise zone program both with respect to income tax credits and property reclassification. For example, the act clarified and narrowed the definition for the enterprise zone program with respect to retail activity. The act also limited the number of qualified employment positions that are eligible for the premium or income tax credits under this program. The fiscal impact of this act is unknown. (Effective retroactively from January 1, 2002)

Laws 2002, Chapter 344 conformed Arizona tax statutes to the current Internal Revenue Code. The act includes provisions relating to the Economic Growth and Tax Relief Reconciliation Act of 2001, the Fallen Hero Survivor Benefit Fairness Act of 2001 and the Job Creation and Worker Assistance Act of 2002, except for the bonus depreciation provision (which impacts the corporate income tax). The act also adjusted the Urban Revenue Sharing (URS) program from 15% to 14.8% for 2 years. The JLBC Staff estimated that the conformity provisions would increase corporate income tax revenues by $5.6 million in FY 2003. The URS adjustments are expected to increase the General Fund by $5.7 million. (Contained various effective dates)

2001 TAX LAWS

Laws 2001, Chapter 235 provides, if total General Fund revenues exceed projections in FY 2001 or FY 2002, a corporate income tax rate reduction from 6.968% to 6.8%. It also allows a corporate taxpayer to elect to use the current apportionment formula of 25% property, 25% payroll, and 50% sales, or a revised apportionment formula based on an increased sales factor, with weights of 17.5%, 17.5%, and 65% respectively. These tax reductions are estimated to cost a combined $(34 million) in FY 2003, based on an estimated cost of $(12 million) for the rate reduction and $(22 million) for the optional apportionment formula provision. These costs are not included in Table 2, since revenues did not exceed the projections.

Laws 2001, Chapter 296 conformed state income tax laws to the federal Internal Revenue Code, which provides the framework for calculating state personal and corporate income taxes. Changes to federal tax calculations affect state income tax revenues. Estimates of the dollar impact of both the retroactive and prospective federal tax law changes are prepared by the Department of Revenue using estimates provided by the Bureau of the Census, U.S. Department of Commerce, Arizona Department of Economic Security, and other state and federal agencies. The estimated incremental General Fund cost of this act is $(470,000) in FY 2001, $(628,000) in FY 2002, and $(217,000) in FY 2003. (Effective January 1, 2001)

Laws 2001, Chapter 370 extends the Arizona Enterprise Zone Program through June 30, 2006 and expands and modifies the program. The program includes a corporate income tax credit for increasing employment in an enterprise zone. The program segregates the minimum investment requirements for small manufacturers in rural areas into the following categories: $2 million for communities with a population of 80,000 or more persons; $1 million for communities with a population of 10,000 to 80,000 persons; and, $500,000 for communities with a population of less than 10,000 persons. The bill maintains the $2 million investment requirement for those cities/towns located in a county with a population of 250,000 or more that are located less than 25 air miles from the exterior boundary of the largest city in the county.

2000 TAX LAWS

Laws 2000, 6th Special Session, Chapter 1 imposed an immediate 1-year moratorium on income tax credits for alternative fuel vehicles, alternative fuel delivery systems and vehicle refueling apparatus. No purchases made after this date would qualify for a tax credit. (Effective October 20, 2000)

Laws 2000, 7th Special Session, Chapter 1 eliminated the alternative fuel tax credit program, modified eligibility, and allowed up to $200,000,000 from the Budget Stabilization Fund (BSF) to be used to reimburse the General Fund for the estimated lost tax revenues. It also provided for reimbursement of individuals and corporations that incurred a financial loss due to the modification of the program. Money will be transferred from the BSF to the Consumer Loss Recovery Fund to pay for the financial losses, and transferred from income tax losses.

The legislation also requires that the BSF be annually reimbursed no more than $16,000,000 from the General Fund until all outgoing payments related to the tax credit program are restored, including lost interest. The JLBC in June of each year will calculate a BSF repayment schedule. The Treasurer shall transfer money back to the BSF, without an appropriation, in the amounts identified in this annual JLBC report. The Legislature has already set aside $16,000,000 in FY 2001, FY 2002 and FY 2003 for this purpose.

Laws 2000, Chapter 48 codified the "triggered" FY 2000 tax reductions in the vehicle license tax and the corporate income tax that were enacted as parts of Laws 1999, 1st Special Session, Chapter 5. The bill simply clarified the tax reductions from the prior year and there were no revenue reductions associated with the legislation.

Laws 2000, Chapter 239 provides employers a tax credit for employee technology skills training. The tax credit will be equal to 50% of the cost of the training but is capped at $1,500 per employee. The Arizona Department of Commerce will administer the program and certify eligible tax credits to be forwarded to the Department of Revenue.

The provisions of the legislation became effective on January 1, 2001. The tax credits associated with the training program were estimated to reduce corporate income tax collections by $(2,500,000) beginning in FY 2002.

Laws 2000, Chapter 252 conformed state income tax laws with the federal Internal Revenue Code, which determines the calculation of state personal and corporate income taxes. Changes to federal tax calculations affect state income tax revenues. Estimates of the dollar impact of both retroactive and prospective federal tax law changes are prepared by the Department of Revenue using estimates provided by the Bureau of the Census, U.S. Department of Commerce, Arizona Department of Economic Security, and other state and federal agencies. The estimated incremental General Fund cost of this act is $(15,000) in FY 2000, $36,000 in FY 2001, and $154,000 in FY 2002. (Effective January 1, 2000)

Laws 2000, Chapter 334 allowed a personal or corporate income tax credit, in lieu of a deduction, for any real property and improvements that are donated to a school district or charter school for use as a school or as a site for the construction of a new school. This act is estimated to have no fiscal impact. (Effective January 1, 2001)

Laws 2000, Chapter 405 modified and expanded the tax credit incentives for the purchase of alternative fuel vehicles and fueling stations.

1999 TAX LAWS

Laws 1999, Chapter 168 modified the individual and corporate income tax credits for the purchase of alternative fuel vehicles (AFVs), and modified the tax credits related to the construction of alternative fuel stations. The revised tax credits for AFVs are equal to a specified percentage of the purchase price of the vehicle. This percentage depends on the type of alternative fuel that the vehicle uses. Prior to the enactment of this legislation, AFV tax credits were equal to a fixed amount plus a percentage of the AFV's incremental cost above that of a regular fueled vehicle.

In addition, the tax credits related to alternative fuel stations were raised from 25-50% of costs to 50-100% of costs. However, the new legislation subtracts any grant money from the amount of the tax credit. Finally, the act removed the tax deductions related to AFVs and fueling stations for both the individual and corporate income tax. The tax credits for the purchase of an AFV and for the purchase of a refueling apparatus are effective January 1, 1999. The tax credit for the construction and operation of a fueling station is effective January 1, 1998.

Laws 1999, Chapter 190 established a separate corporate income tax apportionment formula for corporations engaged in air commerce. The act stipulates that multi-state airlines shall apportion income to this state by multiplying income by a fraction; the numerator is the revenue aircraft miles flown within this state for flights beginning or ending in Arizona, and the denominator is the revenue aircraft miles flown by the airline everywhere. (Effective January 1, 2001)

Laws 1999, Chapter 191 exempted from income allocation and apportionment corporate taxpayers that only hold contractual consignment inventory if a specific set of conditions is met. (Effective January 1, 1999)

Laws 1999, Chapter 317 conformed the Arizona statutory definition of the Internal Revenue Code (IRC) to the IRC definition. This provision is effective January 1, 1999. It also retroactively incorporates the Federal Tax and Trade Relief Extension Act of 1998, the Federal Internal Revenue Service Restructuring and Reform Act of 1998, and the Federal Surface Transportation Revenue Act of 1998. This provision is effective retroactive to January 1, 1998. The estimated impact is $(2.0) million per year.

Laws 1999, Chapter 318 reduced the corporate income tax rate from 8.0% to 7.968% and eliminated various corporate income tax credits. (Effective January 1, 2000)

Laws 1999, Chapter 325 reduced the Urban Revenue Sharing percentage from 15.8% to 15% starting in FY 2001. In FY 2001, $2,000,000 is appropriated from the General Fund to the State Treasurer for distribution to cities and towns having a population of 60,000 persons or less in order to mitigate the effect of a reduced Urban Revenue Sharing percentage. (Effective July 1, 2000)

Laws 1999, 1st Special Session, Chapter 5 provided a series of conditional tax rate reductions that are dependent on the level of FY 1999 General Fund revenues. Included in these "triggered" tax cuts are 4 corporate income tax rate reductions at 0.25% intervals. If all 4 corporate income tax rate reductions were ultimately implemented, the tax rate would fall to 7%. (Effective January 1, 2001). These triggered tax cuts were enacted.

A listing of tax law changes prior to the 1999 legislative session is available on the JLBC Web site located at www.azleg.state.az.us/05taxbook/05taxbk.pdf