

The March 2019 Arizona Department of Revenue performance audit found that the Department should improve its TPT licensure, filing, distribution, and enforcement processes. We made 32 recommendations to the Department, and its status in implementing the recommendations is as follows:

### Status of 32 recommendations

Implemented	12
Implemented in a different manner	1
Partially implemented	6
Partially implemented in a different manner	2
In process	5
<b>Not implemented</b>	<b>6</b>

Although the Department has implemented or partially implemented 21 of 32 recommendations, including some in a different manner, it is in the process of implementing 5 recommendations and has not implemented 6 recommendations. However, according to the Department, 9 of 11 outstanding recommendations will be addressed with its development and implementation of a new integrated tax system by ensuring that this new system includes controls to address the identified deficiencies associated with these recommendations. The Department has also reported that some of the recommendations it has partially implemented will be further addressed by the new tax system. In June 2023, the Department awarded a contract for the development and implementation of a new integrated tax system that will be implemented in various stages through fiscal year 2028 at an estimated cost of \$105 million. Additionally, the Department has made progress implementing the remaining 2 outstanding recommendations. Because the Department reported that the majority of outstanding recommendations will be addressed with its implementation of a new integrated tax system, if directed by the Joint Legislative Audit Committee (JLAC), we will assess its efforts to implement the new tax system and outstanding recommendations from the March 2019 performance audit as part of the Department's next sunset review, which is required to be completed by October 2027. Therefore, unless otherwise directed by JLAC, this report concludes our follow-up work on the Department's efforts to implement the recommendations from the March 2019 performance audit report.

### Finding 1: Department should ensure businesses have active TPT licenses

1. The Department should continue implementing its new license-compliance program, including its plans to use information provided by cities and towns and data analytics to identify and license unlicensed businesses to meet its goals.

**Partially implemented at 36 months**—As reported in the 36-month follow-up report, the Department continued to use information provided by cities and towns and a third-party tool that generates operating business lists to identify and license unlicensed businesses. However, it had not incorporated data analytics into its license-compliance program to help ensure operating businesses have active TPT licenses and did not plan to do so as part of its existing tax system. The Department reported that it intends to incorporate data analytics into its license-compliance program as part of its new integrated tax system. As of June 2023, the Department has awarded a contract for the development and implementation of a new integrated tax system, which it estimates will cost nearly \$105 million and be implemented in various stages through fiscal year 2028.

2. The Department should review the effectiveness of its new license-compliance program and make improvements as needed.

**Partially implemented at 36 months**—The Department reported that it continually reviews the effectiveness of its license-compliance program. For example, the Department uses lists of businesses in various jurisdictions to identify unlicensed businesses. According to the Department, it has made further progress since the 36-month followup by bringing an additional 766 businesses into compliance with TPT licensing requirements in fiscal year 2022. Additionally, as explained in Recommendation 1, the Department plans to incorporate data analytics into its license-compliance program as part of its new integrated tax system.

## Finding 2: Department should improve nonfiler program to ensure operating businesses maintain active TPT licenses

3. The Department should improve the nonfiler license-cancellation notice to include language explaining statutory TPT licensing and filing requirements, informing the taxpayer of late-filing and late-payment penalties, requiring the taxpayer to inform the Department whether the business is operating or not, and informing the taxpayer to take action to resolve instances of noncompliance with TPT filing requirements.

**Implemented at 54 months**—The Department has improved its nonfiler license-cancellation notice by including the recommended language.

4. The Department should develop and implement a process to verify businesses' statuses prior to canceling licenses through its nonfiler program, such as through continued and/or expanded collaboration with cities and towns or through its new license-compliance program.

**Partially implemented at 36 months**—Although the Department has continued to expand its collaboration with cities and towns to verify businesses' statuses, it still has not developed an internal process to routinely verify the statuses of businesses located in all 91 cities and towns prior to canceling licenses for operating businesses that have not filed TPT returns.

## Finding 3: Department should help ensure accurate address information for TPT licenses

5. The Department should implement its plan to add address-standardization controls to AZTaxes.gov and add these controls to its tax system.

**Partially implemented at 36 months**—The Department implemented address-standardization and validation controls in AZTaxes.gov to help prevent taxpayers from entering inaccurate address information. However, the Department has not implemented similar controls in its tax system to help prevent Department staff from entering inaccurate addresses but reported planning to do so in its new integrated tax system, which it plans to develop and implement through fiscal year 2028 (see explanation for Recommendation 1).

6. The Department should identify and analyze trends in taxpayer behavior that contribute to inaccurate address information and develop and implement a targeted taxpayer education campaign to address the behavior.

**Partially implemented at 36 months**—As reported in our 18-month follow-up report, the Department conducted an education campaign from June to December 2020 intended to inform all taxpayers about the importance of address accuracy and remind them to keep their address information up to date. The Department reported that the number of post office returns for undeliverable mail decreased after it conducted its education campaign. However, the Department also reported that because its tax system cannot collect data related to post office returns, as of November 2021, the Department cannot analyze trends related to inaccurate address information and develop a targeted taxpayer education campaign based on these trends. In its response to this followup, the Department indicated that its development and implementation of a new integrated tax system will include

an ability to collect data related to post office returns and provide the Department with the information it needs to analyze and identify trends in taxpayer behavior (see explanation for Recommendation 1).

7. The Department should, until it implements its plan to add address-standardization controls to AZTaxes.gov and its tax system, review the effectiveness of its manual process to review newly issued licenses and work with Department IT staff to look for ways to automate this process.

**Not implemented**—The Department has implemented address-standardization controls in AZTaxes.gov (see explanation for Recommendation 5) but has not implemented these controls in its tax system. According to the Department, it plans to implement address-standardization controls in its new integrated tax system (see explanation for Recommendation 1). Additionally, although the Department reported that its staff continue to manually review licensing information in the tax system for potential errors, the Department has not reviewed the effectiveness of its manual process or looked for ways to automate this process.

## Finding 4: Department should take steps to better identify and address TPT underreporting or misreporting

8. The Department should evaluate whether additional IT controls in its suspense-rule process could be implemented to reduce the risk of misreported or underreported TPT, implement any identified additional IT controls, and assess the effectiveness of its efforts.

**Not implemented**—The Department reported that it had stopped working on this recommendation and Recommendation 9 as of July 2020 and that it plans to implement necessary IT controls for the suspense-rule process and data analysis capabilities in its new integrated tax system to reduce the risk of misreported or underreported TPT (see explanation for Recommendation 1).

9. The Department should analyze its return-processing procedure, develop and implement a plan to reduce the risk of misreported or underreported TPT through data analysis, and assess the effectiveness of its efforts.

**Not implemented**—See explanation for Recommendation 8.

10. The Department should develop and implement a plan to identify and address errors in its tax system licensing information and assess the effectiveness of its data-cleanup efforts.

**Implementation in process**—As reported in our 18-month follow-up report, the Department worked with the Arizona Department of Administration—Arizona Strategic Enterprise Technology Office (ASET) to evaluate its data-management capabilities and identified areas for improvement, including improving the quality and accuracy of its tax system data and its processes for correcting erroneous data. Additionally, since our 36-month followup, the Department reported that it has conducted data-cleanup efforts as part of its planning for and efforts to develop and implement a new integrated tax system. For example, in a June 2023 status report for its new tax system, the Department indicated that it is reviewing taxpayer accounts with balances exceeding 10 years and reported obtaining approval from the Attorney General's Office to write off some of these balances. We will review these writeoffs in early 2024 as part of the State's fiscal year 2023 financial audit. The Department also reported beginning its review of TPT data in partnership with cities and towns and that its data-cleanup efforts will continue until it converts to the new integrated tax system (see explanation for Recommendation 1).

11. The Department should develop and implement a plan to increase TPT taxpayer use of AZTaxes.gov for TPT license applications and enforce statutory requirements for electronic TPT return filing in conjunction with Recommendation 19 in Finding 7.

**Implemented at 12 months**

12. The Department should develop and implement targeted taxpayer education campaigns to help ensure accurate TPT license information in conjunction with Recommendation 6 in Finding 3.

**Implementation in process**—The Department reported that limitations of its current tax system do not allow for collection and assessment of sufficient data to develop a targeted taxpayer education campaign. However,

the Department has conducted 5 public trainings since March 2022 to provide taxpayer education regarding compliance with TPT licensure, filing, and payment requirements to recreational marijuana businesses. Additionally, the Department reported that it will rely on and use data that it anticipates will be collected, retained, and available for assessment in its new integrated tax system to develop and implement additional targeted taxpayer education campaigns (see explanation for Recommendation 1).

## **Finding 5: Department should consistently perform reviews to ensure staff accurately process TPT error-resolution changes**

13. The Department should consult with its legal counsel and determine its statutory authority to make changes to information recorded in its tax system from taxpayers' TPT returns.

**Implemented at 12 months**

14. The Department should develop and implement written policies and procedures that require error-resolution staff to (1) consult with taxpayers prior to making changes to TPT return information in its tax system when the information necessary to process the return is not available in the tax system, (2) document communication or attempted communication with taxpayers in these situations, and (3) document the reasons when changes are made in the tax system.

**Implemented at 12 months**

15. The Department should develop and implement written policies and procedures for its error-resolution quality control process that specify how often reviews should occur, how many returns per staff person should be reviewed, what should be reviewed, if the information should be verified with the taxpayer, the time frames for addressing any errors identified through reviews, and who is responsible for performing and overseeing the error-resolution quality control process.

**Partially Implemented at 54 months**—The Department has developed and implemented written policies and procedures for its error-resolution quality control process that specify how often reviews should occur, what should be reviewed, if the information should be verified with the taxpayer, time frames for addressing any errors identified through reviews, and who is responsible for performing and overseeing the error-resolution quality control process. However, Department staff responsible for conducting reviews did not perform the required number of reviews. Specifically, our review found that the percentage of TPT transactions reviewed in February 2023 for 2 of 3 Department employees who primarily process TPT transactions fell below the percentage required by Department policy. Additionally, the Department reported having a small backlog in quality control reviews during its peak TPT processing time frames but continues to improve the efficiency of its reviews to lower the number of backlogged transactions.

## **Finding 6: Department should ensure tax correction notices are accurate and adequately instruct TPT taxpayers**

16. The Department should resolve IT programming issues for TPT tax correction notices to ensure they are accurate and timely.

**Not implemented**—In January 2020, the Department initiated a project to review the information sent in all taxpayer correspondence—including its TPT tax correction notices—to ensure its correspondence is clear, concise, and accurate. In July 2021, the Department put this project on hold while it focused on other projects. The Department reported it plans to address this recommendation with the implementation of its new integrated tax system and that its taxpayer correspondence, including TPT tax correction notices, will be modified in the new tax system (see explanation for Recommendation 1).

17. The Department should improve text content to ensure that TPT tax correction notices provide appropriate taxpayer instruction for all types of TPT errors, overpayments, and underpayments.

**Not implemented**—See explanation for Recommendation 16.

18. The Department should evaluate its TPT tax correction notice quality review policy to identify and implement improvements to ensure the policy is effective in identifying and resolving inaccurate or confusing information on TPT tax correction notices, such as specifying how often reviews should occur, how staff should review the content and calculations on the notices, how staff should track notices that are reviewed and the errors identified, how the identified errors are resolved, and who is responsible for overseeing the review process.

**Implemented at 54 months**—The Department revised its tax correction notice quality review procedure, and our review of TPT tax correction notices reviewed by Department staff in January and February 2023 found that they adhered to the revised procedure.

## **Finding 7: Department should enforce existing statutory TPT filing requirements**

19. The Department should implement and annually update the necessary tax system programming changes to enforce the statutory TPT e-filing requirements included in Laws 2017, Ch. 60, §15.

**Implemented at 18 months**

20. The Department should enforce statutory e-filing requirements included in Laws 2016, Ch. 208, §11, to help ensure accurate filing by property management companies on behalf of residential rental property owners.

**Implementation in process**—The Department has continued to educate property management companies (PMCs) about the requirement to file TPT returns electronically and reported that 86 percent of registered PMCs are filing TPT returns electronically. Additionally, the Department reported that it further intends to address this statutory requirement by incorporating functionality within a new integrated tax system to facilitate property management companies' e-filing capability (see explanation for Recommendation 1).

21. The Department should, while it works to implement its enforcement strategy, evaluate and implement changes to its policy for processing paper-filed TPT returns from property management companies to ensure taxpayer payments are applied correctly and the taxpayer is educated on statutory filing requirements.

**Implemented at 36 months**

22. The Department should complete the necessary tax system programming changes to enforce late-filing penalties required by Laws 2017, Ch. 60, §3.

**Implemented at 12 months**

23. The Department should consult with its legal counsel to determine if the Department should retroactively assess the correct TPT late-filing penalty for late filings where the penalty was not correctly assessed since August 2017.

**Implemented at 18 months**

## **Finding 8: Department should address issues that affect the accuracy of city/town TPT distributions**

24. The Department should identify and implement opportunities to streamline or automate the Department's process for manually adjusting and tracking city/town TPT distributions to help reduce the risk of process errors, where possible.

**Not implemented**—The Department has not identified or implemented opportunities to streamline or automate its manual city/town TPT distribution process and reported that its new integrated tax system will include the ability to calculate and record city/town TPT distributions based on address of taxpayer, region code reported, location

code reported, tax rate for jurisdiction, percent to be allocated, return line item amounts, and other factors (see explanation for Recommendation 1).

25. The Department should complete its IT project to address the 39 scenarios affecting city/town TPT distributions.

**Implementation in process**—The Department has completed work on 35 of 42 scenarios affecting city/town distributions, including 1 scenario it recently reported completing as of January 2024. The Department identified an additional 3 scenarios it needed to address after we issued our audit report and reported it is in the process of completing and/or planning work for the remaining scenarios with an expected completion date of June 30, 2024.

## **Finding 9: Department should further collaborate with cities and towns to enhance its TPT enforcement efforts**

26. The Department should continue to implement its plans to increase the number of TPT audits it performs and reduce the amount of time TPT audit staff spend on nonaudit tasks.

**Partially implemented in a different manner at 36 months**—Since our March 2019 performance audit, the Department reported that it has reevaluated its TPT auditors' priorities and its definitions of audit and nonaudit tasks. Specifically, the Department reported that reviewing TPT refund requests requires the same skillset as performing audits and consumes a significant portion of TPT audit resources. Therefore, the Department determined that reviewing taxpayers' requests for TPT refunds should no longer be considered a nonaudit task and instead has set goals and performance metrics for its TPT auditors to complete TPT audits and review TPT refund requests. Since the 36-month followup, the Department has continued this approach and reported meeting some of its performance goals. Specifically, for fiscal year 2023, the Department reported completing 133 TPT audits, exceeding its goal of 100, and reviewing 459 refund requests, exceeding its goal of 240. However, our review of auditor time spent on audit tasks for January 2022 through January 2023 found that for 11 of 13 months, audit staff did not meet the performance goal of spending 75 percent of their time on audit tasks.

27. The Department should discuss opportunities to leverage available audit resources with cities and towns and implement identified opportunities for the benefit of the State and cities and towns.

**Implemented in a different manner at 36 months**—The Department continues to collaborate with cities and towns to perform TPT audits and review TPT refund requests (see explanation for Recommendation 26 for additional information about the Department's reevaluation of TPT auditors' priorities and responsibilities).

28. The Department should determine what data would be helpful in assessing the collections pilot program's effectiveness.

**Implemented at 12 months**

29. The Department should collect and analyze relevant data from the collections pilot program to assess the program's effectiveness and make continued program improvements.

**Implemented at 12 months**

30. The Department should ensure it obtains city/town input for any OIC it considers that includes TPT owed to a city/town and train staff on this process.

**Implemented at 54 months**—Our review of all 12 OICs for calendar year 2022 found that the Department provided the taxpayer's offers to the cities/towns for their review, including the taxpayer's total tax liability owed to the city or town and the taxpayer's offer to pay all or a portion of this liability. Additionally, our review of the Department's training log found that all employees with OIC responsibilities have received training on this process.



31. The Department should analyze collections-case characteristics to determine under what circumstances a lien would be most advantageous and develop and implement policies and procedures to help staff know when and how to use them.

**Partially implemented in a different manner at 36 months**—The Department did not analyze collections-case characteristics to determine the circumstances under which a lien would be advantageous. Instead, based on staff knowledge and experience, the Department developed guidance for staff to use when considering a lien and provided training to staff on when and how to use liens.

32. The Department should collaborate with the cities and towns to establish a process for determining when issuing liens is advantageous and most effective for both parties. In addition, it should also collaborate with the cities and towns to establish a process that allows the cities and towns to help pay for liens they request.

**Implementation in process**—In May 2023, the Department developed a process for cities to review possible lien cases, including procedures for communicating with cities and towns regarding potential liens and operational requirements for use of liens. However, these procedures do not outline a process for working with cities and towns to help pay for the liens they request.