

Arizona Municipal Tax Code Commission

Commission has not met its statutory purpose to review, hold hearings on, and approve or deny amendments to the Model City Tax Code because it lacks a quorum of members to hold public meetings

Sunset Review

September 2022
Report 22-108

A Report to the Arizona Legislature

Lindsey A. Perry
Auditor General





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September 20, 2022

Members of the Arizona Legislature

The Honorable Doug Ducey, Governor

Mr. Jesus Rene Lopez, Chairman
Arizona Municipal Tax Code Commission

Transmitted herewith is the Auditor General's report, *A Sunset Review of the Arizona Municipal Tax Code Commission*. This report is in response to a December 17, 2020, resolution of the Joint Legislative Audit Committee. The sunset review was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq. I am also transmitting within this report a copy of the Report Highlights to provide a quick summary for your convenience.

As outlined in its response, the Arizona Municipal Tax Code Commission agrees with all the findings and plans to implement all the recommendations directed to it. My Office will follow up with the Commission in 6 months to assess its progress in implementing the recommendations.

My staff and I will be pleased to discuss or clarify items in the report.

Sincerely,

Lindsey A. Perry

Lindsey A. Perry, CPA, CFE
Auditor General

cc: Arizona Municipal Tax Code Commission members
Robert Woods, Director, Arizona Department of Revenue

Arizona Municipal Tax Code Commission

Commission has not met its statutory purpose to review, hold hearings on, and approve or deny amendments to the Model City Tax Code because it lacks a quorum of members to hold public meetings

Audit purpose

To provide responses to the statutory sunset factors.

Key findings

- The Commission was established in 1988 to review, hold public hearings on, and approve or deny proposed amendments to the Model City Tax Code, a uniform sales and use tax act that Arizona cities and towns are statutorily required to adopt that is intended to facilitate uniform city taxes while providing cities with options to tax or exempt certain items.
- Statute requires the Commission to consist of 9 members who are mayors or members of the governing bodies of Arizona cities and towns, and the Governor appoints 5 members, the Arizona Senate President appoints 2 members, and the Speaker of the Arizona House of Representatives appoints 2 members.
- The Commission last met in May 2019 but has not met its statutory objective and purpose since that time. For example, the Arizona Department of Revenue reported that it received 3 proposed amendments to the Model City Tax Code in 2021 for the Committee's consideration. However, as of June 2022, the Commission had not held a hearing to consider these amendments because it lacked a quorum of members to hold a public meeting.
- The Commission lacks a quorum because all its members' terms had expired as of October 2021, and as of April 2022, the Commission had 5 vacancies.
- The Model City Tax Code is at risk of becoming obsolete and no longer meeting the needs of Arizona cities, towns, taxpayers, and businesses because the Commission cannot hold a public meeting to obtain input and determine whether to adopt proposed changes.

Key recommendations

- The Governor, Arizona Senate President, and Speaker of the Arizona House of Representatives should consider appointing Commission members, as set forth in statute.
- Once the Commission's members have been appointed and it has a quorum of members, the Commission should meet to review and consider, for approval or disapproval, any proposed amendments to the Model City Tax Code that have been submitted to it, as required by statute.



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The Arizona Auditor General has completed a sunset review of the Arizona Municipal Tax Code Commission (Commission). This sunset review determined whether the Commission has met its statutory objective and purpose and provides responses to the statutory sunset factors.

Commission history and purpose

The Commission was established in 1988, and its statutory objective and purpose is to review, hold public hearings on, and approve or deny proposed amendments to the Model City Tax Code.¹ According to A.R.S. §42-6052, any Arizona city, town, taxpayer, or the Arizona Department of Revenue (Department) may submit a proposed Model City Tax Code amendment to the Commission for review and consideration for approval. This statute also requires the Commission to hold a public hearing at least 60 days after receiving a proposed amendment to consider adopting the amendment.²

According to A.R.S. §42-6052, all cities and towns must adopt the changes to the Model City Tax Code approved by the Commission, with the following 2 exceptions:

- The Commission may approve an amendment to the Model City Tax Code submitted by a city or town that does not apply to any other city or town. For example, the Model City Tax Code includes articles that apply only to the cities of Phoenix, Mesa, and Tucson.
- The Commission may approve an optional amendment to the Model City Tax Code to be adopted only by those cities and towns that choose to do so. For example, cities and towns may choose to adopt an option to exempt livestock, feed, and agricultural chemicals purchased by ranchers and farmers from TPT.

A.R.S. §42-6052 further states that a city or town may not adopt an amendment to any provision of the Model City Tax Code unless the Commission has approved the amendment. See Sunset Factor 2, pages 3 and 4, for information related to the Commission not meeting its statutory objective and purpose, including not reviewing, holding public hearings on, and approving or denying proposed amendments to the Model City Tax Code because of vacant Commission member positions.

¹ Arizona Revised Statutes (A.R.S.) §42-6052.

² According to A.R.S. §42-6052, at least 30 days after receiving a proposed amendment, and at the request of a city, town, taxpayer, or the Department, the Commission must hold an informational public hearing to review and receive comments on the proposed amendment. The Department is also required to provide a legal analysis of the proposed amendment to the Commission at the informational public hearing.

Key terms

Model City Tax Code—The Model City Tax Code is a uniform sales and use tax act that Arizona cities and towns are statutorily required to adopt. Although intended to facilitate uniformity among city taxes, the Model City Tax Code provides cities with options to tax or exempt certain items that are not part of the model language of the Model City Tax Code.

Transaction Privilege Tax (TPT)—TPT is a tax imposed on a seller for the privilege of doing business in the State, regardless of whether the seller passes on the economic burden of the tax to the buyer. Because it is usually passed on to the buyer, this tax is commonly referred to as a sales tax. Statutes define various business activities that are subject to TPT, such as retail sales and hotel/motel lodging.

Source: Auditor General Staff review of A.R.S. §§42-5061 et seq. and 42-6052, Arizona Administrative Code (AAC) R15-5-2002, Arizona Joint Legislative Budget Committee. (2021). *State of Arizona 2021 tax handbook*. Phoenix, AZ. Retrieved 6/30/2022 from <https://www.azjlb.com/revenues/21taxbk.pdf>.

Finally, A.R.S. §42-6003 states that TPT-related disputes between 2 or more cities and/or towns, such as disputes related to the right to tax a transaction, the right to collect tax, or tax rates, may be submitted to the Commission for resolution. See Sunset Factor 6, page 5, for more information.

Commission membership, administrative support, and budget

A.R.S. §42-6052 requires the Commission to consist of 9 members who are mayors or members of the governing bodies of Arizona cities and towns. According to statute, the Governor appoints 5 Commission members, the Arizona Senate President appoints 2 Commission members, and the Speaker of the Arizona House of Representatives appoints 2 Commission members. Commission members serve 3-year terms and are not eligible to receive compensation for their service. The Department Director or the Director's designee serves as a nonvoting ex officio Commission member.

As of October 2021, all 9 Commission members' terms had expired. A.R.S. §38-295 allows public officers to continue to discharge the duties of their office after a term has expired until a successor is appointed. As of April 2022, the Commission website listed 4 members and the ex officio member, but 1 of the 4 listed members passed away in June 2022. Of the other 5 member positions, 3 have been vacant since 2018 and 2 Commission members resigned in calendar year 2021 because they no longer served as mayors in their respective communities. See Sunset Factor 2, pages 3 and 4, for more information on the Commission not meeting its statutory objective and purpose because of vacant Commission member positions.

A.R.S. §42-6052 requires the Department to provide administrative and staff support for the Commission. The Department reported that depending on the amount of Commission activity, between 6 and 9 Department staff, including administrative, city services team, and policy/legal employees, provide part-time support for Commission-related business in addition to their other Department duties and responsibilities. A.R.S. §42-6052 also requires the Department to maintain the official copy of the Model City Tax Code and post it on its website.

The Commission does not receive any State General Fund appropriations or revenues from other sources, and the Department reported it does not receive any revenues intended to pay for the costs of providing support to the Commission. According to the Department, it did not track its costs for supporting the Commission in fiscal years 2020 and 2021 because the administrative support the Department provides the Commission is primarily related to Commission meetings, and the Commission did not meet during those 2 fiscal years.



Pursuant to A.R.S. §41-2954(D), the legislative committees of reference shall consider but not be limited to the following factors in determining the need for continuation or termination of the Commission.

Sunset factor 1: The objective and purpose in establishing the Commission and the extent to which the objective and purpose are met by private enterprises in other states.

The Commission was established in 1988, and its statutory objective and purpose is to review, hold public hearings on, and approve or deny proposed amendments to the Model City Tax Code (see Introduction, page 1, for additional information on the Model City Tax Code).

We did not identify a governmental entity or private enterprise in another state that has a similar objective or purpose.

Sunset factor 2: The extent to which the Commission has met its statutory objective and purpose and the efficiency with which it has operated.

The Commission has not met its statutory objective and purpose because it lacks the required quorum of members to hold a public meeting. Specifically, the Commission's objective and purpose is to review and consider proposed amendments to the Model City Tax Code, hold public hearings to obtain comments and testimony on these proposed amendments, and approve or deny them. A.R.S. §42-6052 requires the Commission to hold a public hearing at least 60 days after receiving a proposed amendment to consider adopting the amendment. The Arizona Department of Revenue reported that it received 3 proposed amendments to the Model City Tax Code in calendar year 2021 to be considered by the Commission. However, as of June 2022, the Commission had not met to consider adopting the 3 proposed amendments because it lacked a quorum of members to hold a public meeting.³ The 3 proposed amendments requested the Commission to consider the following changes to the Model City Tax Code: (1) allowing construction contracting deductions related to income-producing capital equipment; (2) exempting from TPT gross income from the rental, leasing, and licensing for the use of tangible personal property by a parent company to a subsidiary under certain conditions; and (3) exempting from TPT the retail sale of certain services to Arizona school districts.

Absent the ability to hold a public hearing, the Commission is not able to meet its statutory objective and purpose to consider, obtain input on, and determine whether to adopt proposed changes to the Model City Tax Code submitted by Arizona cities and towns, and taxpayers, including businesses, that seek changes. As a result, the Model City Tax Code cannot be amended to adapt to the changing needs of individual cities and towns, taxpayers, and businesses because the Commission must first approve amendments before cities and towns can adopt them. Thus, the Model City Tax Code is at risk of becoming obsolete and/or no longer meeting the needs of Arizona cities and towns, taxpayers, and businesses.

The Commission lacks the required quorum of members because all Commission members' terms had expired, and several positions were vacant. As discussed in the Introduction (see page 2), as of October 2021, all 9 Commission members' terms had expired. As of April 2022, although the Commission's website indicated the Commission had 4 members, 1 of these 4 members passed away in June 2022 and the other 5 positions were vacant. House of Representatives staff reported that they have not yet filled Commission member

³ The Commission last met in May 2019.

positions because they were busy with other priorities. Senate staff and the Governor's Office of Boards and Commissions did not respond to our inquiries regarding efforts to fill Commission member positions.

Recommendations

1. The Governor, Arizona Senate President, and Speaker of the Arizona House of Representatives should consider appointing Commission members, as set forth in statute.
2. Once the Commission's members have been appointed and it has a quorum of members, the Commission should meet to review and consider, for approval or disapproval, any proposed amendments to the Model City Tax Code that have been submitted to it, as required by statute.

Commission response: As outlined in its [response](#), the Commission agrees with the finding and will implement the recommendation.

Sunset factor 3: The extent to which the Commission serves the entire State rather than specific interests.

The Commission has not served the entire State but also has not served specific interests. Although statutorily required to hold public hearings to obtain input on any changes to the Model City Tax Code proposed by the Arizona Department of Revenue and Arizona cities and towns, taxpayers, and businesses throughout the State, as discussed in Sunset Factor 2 (see pages 3 and 4), the Commission has not met this requirement because it lacks a quorum of members that would be required to hold public hearings.

Additionally, 1 Commission member has not complied with Department policies designed to help ensure compliance with the State's conflict-of-interest laws. Specifically, statute requires public officers and employees of public agencies to avoid conflicts of interest that might influence or affect their official conduct.⁴ These laws require employees/public officers to disclose substantial financial or decision-making interests and then refrain from participating in matters related to the disclosed interests. The Department has developed and implemented a conflict-of-interest process that includes a policy requiring public officers, including Commission members, to complete conflict-of-interest disclosure forms (disclosure forms) annually. We requested Commission members' completed disclosure forms from the Department, and it provided disclosure forms signed in March 2022 for 3 of 4 Commission members and the Commission's ex-officio member. According to the Department, it has never been able to obtain a signed disclosure form from 1 Commission member.⁵

Recommendation

3. All Commission members should complete conflict-of-interest disclosure forms annually as required by Department policy.

Commission response: As outlined in its [response](#), the Commission agrees with the finding and will implement the recommendation.

Sunset factor 4: The extent to which rules adopted by the Commission are consistent with the legislative mandate.

This factor does not apply because the Commission does not have authority to adopt rules.

Sunset factor 5: The extent to which the Commission has encouraged input from the public before adopting its rules and the extent to which it has informed the public as to its actions and their expected impact on the public.

The Commission does not have statutory authority to adopt rules; therefore, it has not needed to obtain public input for this purpose. However, statute requires the Commission to hold public hearings to obtain input on any changes to the Model City Tax Code proposed by Arizona cities and towns, taxpayers, or the Department.

⁴ A.R.S. §38-501 et seq.

⁵ This Commission member has never attended a Commission meeting since being appointed.

As discussed in Sunset Factor 2 (see pages 3 and 4), although the Commission received 3 proposed amendments in calendar year 2021, it has not held public hearings on these proposed changes because it lacks a quorum of members. Because the Commission did not meet during our audit, we could not assess its compliance with open meeting law requirements.

Sunset factor 6: The extent to which the Commission has been able to investigate and resolve complaints that are within its jurisdiction and the ability of the Commission to timely investigate and resolve complaints within its jurisdiction.

The Commission does not have statutory authority to investigate complaints. However, A.R.S. §42-6003 states that TPT-related disputes between 2 or more cities and/or towns, such as disputes related to the right to tax a transaction, the right to collect tax monies, or adjust tax rates, may be submitted to the Commission for resolution. Our review of Commission agendas and meeting minutes indicated that no such disputes were discussed at Commission meetings in calendar years 2012 through 2019.⁶ Additionally, as of April 2022, the Commission Chair reported that there have not been any such disputes submitted to the Commission since at least October 2018 when he began serving on the Commission.

Sunset factor 7: The extent to which the Attorney General or any other applicable agency of State government has the authority to prosecute actions under the enabling legislation.

The Commission's enabling statutes do not specifically address its employment of legal counsel. Further, A.R.S. §41-192, which outlines the Attorney General's powers and duties, does not specifically exempt the Commission from receiving legal advice and services from the Attorney General. However, the Department is statutorily required to provide the Commission with legal analysis related to its responsibilities. Specifically, according to A.R.S. §42-6052, at the request of a city, town, taxpayer, or the Department, the commission must hold an informational public hearing to review and receive comments on a proposed amendment to the Model City Tax Code, and the Department is required to provide a legal analysis of the proposed amendment to the Commission at the informational public hearing.

Sunset factor 8: The extent to which the Commission has addressed deficiencies in its enabling statutes that prevent it from fulfilling its statutory mandate.

According to the Commission Chair, the Commission has not identified any deficiencies in its enabling statutes that prevent it from fulfilling its statutory mandate.

Sunset factor 9: The extent to which changes are necessary in the laws of the Commission to adequately comply with the factors listed in this sunset law.

We did not identify any needed changes to the Commission's statutes.

Sunset factor 10: The extent to which the termination of the Commission would significantly affect the public health, safety, or welfare.

Terminating the Commission would not likely affect public health, safety, or welfare. However, if the Commission were terminated and its responsibilities were not transferred to another entity, there would be no governmental entity to perform its responsibilities to review and consider proposed amendments to the Model City Tax Code and serve as a venue for Arizona cities and towns, taxpayers, and businesses to participate in public hearings related to proposed amendments. This would prevent any proposed or needed changes to the Model City Tax Code from being adopted, which could result in the Model City Tax Code becoming obsolete and of little value to Arizona cities and towns, taxpayers, and businesses.

⁶ The Commission's website had meeting agendas posted for all 10 Commission meetings held between September 2012 and May 2019. Written meeting minutes or video recordings were available for 7 of the 10 meetings.

Sunset factor 11: The extent to which the level of regulation exercised by the Commission compares to other states and is appropriate and whether less or more stringent levels of regulation would be appropriate.

This factor does not apply because the Commission does not have regulatory authority.

Sunset factor 12: The extent to which the Commission has used private contractors in the performance of its duties as compared to other states and how more effective use of private contractors could be accomplished.

This factor does not apply because the Commission does not have statutory authority to enter into contracts.



SUMMARY OF RECOMMENDATIONS

Auditor General makes 1 recommendation to the Governor, Arizona Senate President, and Speaker of the Arizona House of Representatives and 2 recommendations to the Commission

The Governor, Arizona Senate President, and Speaker of the Arizona House of Representatives should:

1. Consider appointing Commission members, as set forth in statute (see Sunset Factor 2, pages 3 and 4, for more information).

The Commission/Commission members should:

1. Once its members have been appointed and it has a quorum of members, meet to review and consider, for approval or disapproval, any proposed amendments to the Model City Tax Code that have been submitted to it, as required by statute (see Sunset Factor 2, pages 3 and 4, for more information).
2. Complete conflict-of-interest disclosure forms annually as required by Department policy (see Sunset Factor 3, page 4, for more information).



Objectives, scope, and methodology

The Office of the Auditor General has conducted a sunset review of the Commission pursuant to a December 17, 2020, resolution of the Joint Legislative Audit Committee. The audit was conducted as part of the sunset review process prescribed in A.R.S. §41-2951 et seq.

We used various methods to address the audit's objectives. These methods included reviewing the Commission's statutes, interviewing active Commission members and Department staff, and reviewing information from the Commission's website. In addition, we used the following specific methods to meet the audit objectives:

- To obtain information for the Introduction, we reviewed the Department's website and *State of Arizona 2021 Tax Handbook* regarding the Model City Tax Code, and Department-provided information regarding Commission member vacancies.⁷
- To obtain additional information for the Sunset Factors, we spoke with Arizona House of Representatives staff, and reviewed 3 Model City Tax Code proposed amendments the Commission received in calendar year 2021, statutory and Department policy requirements related to conflict-of-interest, and Commission members' signed conflict-of-interest disclosure forms completed in calendar year 2022.

Our work on internal controls included reviewing and testing the Commission's compliance with statutory requirements related to its responsibilities and the Department's conflict-of-interest policy. We reported our conclusions on applicable internal controls in our responses to the statutory Sunset Factors (see pages 3 through 6).

We conducted this sunset review in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We express our appreciation to the Commission members and the Department for their cooperation and assistance throughout the audit.

⁷ Arizona Joint Legislative Budget Committee. (2021). *State of Arizona 2021 tax handbook*. Phoenix, AZ. Retrieved 6/20/2022 from <https://www.azjlbcbudget.com/revenues/21taxbk.pdf>.

COMMISSION RESPONSE

MUNICIPAL TAX CODE COMMISSION



August 30, 2022

Lindsey A. Perry, CPA, CFE
Arizona Auditor General
2910 N. 44th Street, Suite 410
Phoenix, AZ 85018-7271

Dear Lindsey,

In response to the current audit, I provide the following:

Sunset Factor 2: The extent to which the Commission has met its statutory objective and purpose and the efficiency with which it has operated.

Recommendation 1: Once the Commission's members have been appointed and it has a quorum of members, the Commission should meet to review and consider, for approval or disapproval, any proposed amendments to the Model City Tax Code that have been submitted to it, as required by statute.

Board response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: Upon convening the next Municipal Tax Code Commission meeting the adoption of the Auditor General's recommendations will be made part of the agenda.

Sunset Factor 3: The extent to which the Commission serves the entire State rather than specific interests.

Recommendation 2: All Commission members should complete conflict-of-interest disclosure forms annually as required by Department policy.

Board response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: Upon convening the next Municipal Tax Code Commission meeting the adoption of the Auditor General's recommendations will be made part of the agenda.

Thank you for the opportunity to respond to the recent audit from your office.

Sincerely,

A handwritten signature in black ink, reading "René Lopez, Jr." in a cursive style.

René Lopez, Jr.
Chairman, Municipal Tax Code Commission

