



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Special Audit

Government Property Lease Excise Tax

December • 2015
Report No. 15-307



Debra K. Davenport
Auditor General

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December 22, 2015

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The Honorable Debbie Lesko, Chairman
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Transmitted herewith is a report of the Auditor General, *A Special Audit of the Government Property Lease Excise Tax*. This report is in response to Laws 2010, Ch. 321 and was conducted under the authority vested in the Auditor General by Arizona Revised Statutes §41-1279.03. I am also transmitting within this report a copy of the Report Highlights for this audit to provide a quick summary for your convenience.

We developed the recommendations included in this report in consultation with the county treasurers, county assessors, and representatives from the counties, cities, towns, Arizona Department of Revenue, and Arizona Department of Education. Therefore, the report does not include responses to the audit recommendations from each of the multiple parties that are responsible for administering the government property lease excise tax.

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

Sincerely,

Debbie Davenport
Auditor General

Attachment

Government Property Lease Excise Tax

REPORT HIGHLIGHTS SPECIAL AUDIT

GPLET overview

Our Conclusion

We conducted a special audit of the government property lease excise tax (GPLET) to address whether GPLET, as modified by Laws 2010, Ch. 321, provides a viable revenue stream to counties, cities and towns, community college districts, and school districts (jurisdictions). We found that the changes to the GPLET laws may not increase revenues because most lessees do not pay the increased GPLET rates. In addition, we found that improvements are needed to ensure GPLET is accurately calculated, collected, distributed, and reported to ensure jurisdictions receive all GPLET revenues due to them. Because of limited information, we could not evaluate the effect of GPLET on the development of vacant or underutilized property, on new economic development, and whether slum or blighted areas improved through an abatement of GPLET.

In 1996, the Legislature passed laws to allow Arizona's cities, towns, counties, and county stadium districts (government lessors) to lease property they own to private parties (lessees) for nongovernmental use. In addition, the government lessors can enter into agreements with lessees to develop unused or underutilized property to help revitalize a community. Because the property is owned by the government, it is exempt from paying property taxes, and instead GPLET is assessed and distributed to jurisdictions.

In 2010, the Legislature amended the GPLET laws to increase the GPLET rates for new leases entered into on or after June 1, 2010, limit lease terms, and eliminate the ability to reduce payments over time. Additionally, the changes in law required the Arizona Department of Revenue to annually adjust the GPLET rates based on inflation and establish new reporting requirements to improve accountability and transparency. However, those government property improvement leases and development agreements entered into or approved prior to June 1, 2010, are still subject to the GPLET rates established in 1996.

Changes to GPLET laws may not increase revenues as expected

Although the Legislature changed the GPLET laws in 2010 to increase revenues distributed to jurisdictions, these statutory changes may not increase revenues as expected because most lessees do not pay the increased GPLET rates. We analyzed leases included on the County Treasurer Reporting Forms (Reporting Forms) during calendar year 2014 and determined that most leases are either exempt from paying GPLET or continue to pay GPLET under the old GPLET rates and laws, which include a provision that allows lessees to reduce GPLET payments over time. Because so few leases are subject to the new GPLET rates and laws, the changes to the GPLET laws may not increase revenues as expected unless government lessors enter into a substantial number of new government property improvement lease agreements that are subject to the new GPLET rates.

Based on our review of the Reporting Forms for calendar year 2014, almost half of the government property improvement leases we identified are exempt from paying GPLET. Further, because statutes do not require county treasurers to report exempt leases, the number of exempt leases could be much higher. There are 15 different types of government property improvement leases that are exempt from paying GPLET. For example, leases with other government entities, nonprofit organizations, low-income housing, and various types of athletic and entertainment facilities, including some restaurants, movie theaters, and retail shops, are exempt under statute.

Recommendation

The Legislature should consider forming a task force to evaluate the GPLET exemptions.



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Improvements are needed to ensure GPLET is accurately calculated, collected, distributed, and reported

Various actions are needed to help improve the overall administration of GPLET to ensure jurisdictions receive all GPLET revenues due to them. A lack of understanding of the processes for calculating, collecting, distributing, and reporting GPLET, and a lack of policies and procedures by the parties charged with administering GPLET contributed to the lost revenues and incomplete or inaccurate reporting. We reviewed a random sample of 12 leases in effect from June 1, 2010 through December 31, 2014, and found that \$236,119 was not collected and disbursed to jurisdictions because the GPLET liability for 11 leases was incorrectly calculated and 1 lease was incorrectly assessed GPLET. These errors were the result of using an incorrect GPLET rate or excluding information needed to properly calculate the GPLET liability. Additionally, from the sample items, 5 lessees did not submit a GPLET return or payment for at least 1 calendar year. County treasurers also did not assess penalties and interest on delinquent GPLET payments. Further adding to the errors, our review found that GPLET reporting was incomplete or inaccurate and that some distributions were not made to the appropriate jurisdictions.

GPLET process is not well understood and lacks adequate procedures—Many city, town, and county officials (parties) who are responsible for GPLET administration indicated a general lack of understanding regarding GPLET laws and requirements. Additionally, the lessees did not always understand how to accurately calculate GPLET. Further, the parties lack adequate policies and procedures to ensure GPLET is properly calculated, collected, distributed, and reported. Specifically, the parties did not review GPLET returns for accuracy; reconcile payments to lease agreements; or communicate with other parties administering GPLET.

Incomplete GPLET reporting could affect equalization assistance payments to school districts—The Arizona Department of Education (ADE) is required to consider the valuation of properties subject to GPLET, as reported by the county assessors, in its calculation of equalization assistance payments made to school districts. However, we found that some county assessors did not notify ADE of the valuation of properties subject to GPLET. As a result, the State and counties may have paid more in equalization assistance payments than required.

Legislature should consider modifying GPLET processes—The Legislature should consider modifying statutes regarding the processes and time frames for calculating, collecting, distributing, and reporting GPLET revenues. For example, the government lessor should calculate the GPLET liability instead of the prime lessee because the government lessors have the information required to perform the calculation and are responsible for levying GPLET. Additionally, the Reporting Forms should be completed by both the government lessors and county treasurers to help ensure all GPLET payments are received and distributed to the jurisdictions. Further, to allow the parties sufficient time to complete these proposed recommendations and others outlined in the report, the tax due date and other time frames should be modified.

Parties administering GPLET should develop and implement policies and procedures—Even if the Legislature takes no action, policies and procedures would improve the administration and oversight of the GPLET calculation, collection, distribution, and reporting processes.

Recommendations

The Legislature should consider modifying statutes regarding the processes for calculating, collecting, distributing, and reporting GPLET revenues.

Parties administering GPLET should develop and implement policies and procedures to help ensure that GPLET revenues are accurately calculated, collected, distributed, and reported.

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Introduction

Audit scope and objectives

Laws 2010, Ch. 321, required the Office of the Auditor General to conduct a special audit of the government property lease excise tax (GPLET). As required in the law, this report addresses the following:

- Whether GPLET, as modified in 2010, achieves the goal of providing a viable revenue stream for counties, cities and towns, community college districts, and school districts; and information and recommendations regarding leases exempt from paying GPLET (see Chapter 1, pages 9 through 13);
- Accountability for government property leases subject to GPLET, whether efficient processes have been established for collecting and distributing GPLET, compliance with laws for administering GPLET, and recommended improvements (see Chapter 2, pages 15 through 26); and
- Information regarding property tax revenues previously received from vacant or underutilized property being redeveloped, tax revenues generated from new economic activity compared with the loss of property tax revenues, and the success of tax abatement (see text box), under the laws amended in 2010, in promoting redevelopment in slum and blighted areas (see Other Pertinent Information, pages 27 through 28).

Tax abatement—The temporary suspension in paying GPLET, not to exceed 8 years.

Source: Auditor General staff analysis of Arizona Revised Statutes (A.R.S.) §42-6209.

Government property lease excise tax overview

The State of Arizona's GPLET was established pursuant to Laws 1996, Ch. 349, and allows Arizona's cities, towns, counties, and county stadium districts to become government lessors and lease property they own to private parties (lessees) for nongovernmental use and collect an excise tax, which provides a revenue stream to counties, cities and towns, community college districts, and school districts (collectively referred to as jurisdictions). Not only can the government lessor lease existing property to private parties, it can also enter into an agreement with a private party to help develop unused or underutilized property, which revitalizes the community by creating a government property improvement (see textbox). The government entity owning this property can then lease the government property improvement to private parties. Because the property is owned by the government, it is

Government property improvement—A building for which a certificate of occupancy has been issued, for which the title of record is held by a government lessor, that is situated on land held by a governmental lessor, and is available for use for any commercial, residential rental, or industrial purpose.

Source: Auditor General staff analysis of A.R.S. §42-6201.

exempt from property taxes.¹ However, the private party leasing the property may be subject to an excise tax, known as GPLET, which is based on factors other than the property's value, such as the building's square footage and the improvement's primary use. This approach provides benefits to both the lessee and the jurisdictions that receive a share of GPLET monies collected. For example, the lessee receives a tax incentive because the GPLET amount is generally less than what would be owed through a property tax if the property were privately owned. Additionally, jurisdictions receive a share of GPLET monies from government properties that would be exempt from taxation without GPLET (see page 5 for more information). However, some lessees, depending on the nature of the government property improvement, are statutorily exempt from paying GPLET (see Chapter 1, pages 9 through 13, for more information).

County Treasurer Reporting Form—An annual report prepared by each county treasurer of all GPLET returns and payments received and GPLET monies distributed to the jurisdictions in the preceding calendar year. The county treasurer is required by law to submit the report to the Arizona Department of Revenue (ADOR) by February 15 and provide copies to the government lessors and the Joint Legislative Budget Committee.

Source: Auditor General staff analysis of A.R.S. §42-6204 and review of the County Treasurer Reporting Forms for calendar years 2010 through 2014.

Based on auditors' review of individual leases reported on the County Treasurer Reporting Forms (see textbox), several Arizona cities, towns, and counties have entered into government property improvement leases. Specifically, during calendar year 2014, 23 cities and towns and 4 counties reported entering into government property improvement leases. Additionally, auditors identified 268 government property improvement leases in effect during calendar year 2014. However, based on auditors' review of the County Treasurer Reporting Forms, lease agreements, and discussion with parties responsible for administering GPLET, these totals are understated because not all lease agreements were reported (see Chapter 1, pages 9 through 13, for more information).

Laws amended to increase GPLET revenues by raising GPLET rates, limiting lease terms, and eliminating ability to reduce payments

In 2010, the Legislature amended GPLET laws to respond to growing concerns about the insufficient revenues the tax generated. When established in 1996, GPLET was intended to provide a tax revenue stream to counties, cities and towns, community college districts, and school districts to offset the loss in property taxes from the private use of government-owned buildings. However, because of growing concerns regarding the loss of revenues due to properties subject to GPLET paying a reduced excise tax, which is statutorily further reduced over the term of the lease, the Legislature amended GPLET laws in 2010. Specifically, Laws 2010, Ch. 321, made several changes for new leases, including increasing GPLET rates, requiring the ADOR to annually adjust these rates based on inflation, and modifying the tax structure to prevent lessees from reducing their GPLET payments over the term of the lease.²

¹ Art. IX, Sec. 2, of the Arizona Constitution states that all federal, state, county, and municipal property shall be exempt from taxation.

² A.R.S. §42-6203(B)(3) requires the GPLET rates to be adjusted using the average annual (positive or negative) percentage change for the 2 most recent fiscal years in the producer price index for new construction published by the United States Bureau of Labor Statistics.

Table 1 shows the GPLET rates prior to and after the statutory change. Additionally, the 2010 statutory change established new reporting requirements to improve accountability and provide transparency to stakeholders. All of these changes became effective for government property lease agreements and development agreements signed on or after June 1, 2010 (see textbox). The law also allowed lease and development agreements that were approved before June 1, 2010, to follow the old GPLET rates and laws that allow GPLET payments to decrease over time. Table 2 on page 4 provides a comparison of GPLET laws before and after the June 1, 2010, changes.

Development agreement—An agreement between a city, town, county, or stadium district and a private party to help develop unused or underutilized property. Once the property is developed, the agreement allows the government to lease the property to the private party for nongovernment use.
 Source: Auditor General staff analysis of A.R.S. §§42-6201 and 42-6206.

**Table 1: Base GPLET rates by property use
 Calendar years 1996 through 2014**

Property use ¹	Base GPLET rate for leases entered into prior to June 1, 2010	Base GPLET rate for leases entered into on or after June 1, 2010			
	1996 through present	2010 through 2011	2012	2013	2014
Rates per square foot:					
One story office	\$ 1.00	\$ 2.00	\$ 2.05	\$ 2.15	\$ 2.22
Two to seven story office	1.25	2.30	2.35	2.48	2.55
Eight or more story office	1.75	3.10	3.17	3.34	3.44
Retail building space	1.50	2.51	2.57	2.70	2.79
Hotel/motel structure	1.50	2.00	2.05	2.15	2.22
Warehouse/industrial space	0.75	1.35	1.38	1.45	1.50
Residential rental	0.50	0.76	0.78	0.82	0.84
Other ²	1.00	2.00	2.05	2.15	2.22
Rates per parking space	100.00	200.00	204.67	215.32	222.02

¹ According to A.R.S. §42-6203(F), the GPLET rate applied shall be determined by the predominant use to which the government property improvement is devoted. Predominant use means the use to which 85 percent or more of the functional area of a government property improvement is devoted. If there is no single predominant use, the GPLET shall be determined by applying the appropriate property use rate to the building space devoted to each use.

² If the use of the government property improvement does not fall into one of the eight property-use categories, the “other” rate should be used to calculate the GPLET liability.

Source: Auditor General staff analysis of A.R.S. §42-6203 and review of ADOR documents.

**Table 2: Comparison of GPLET laws before and after June 1, 2010, changes
As of December 22, 2015**

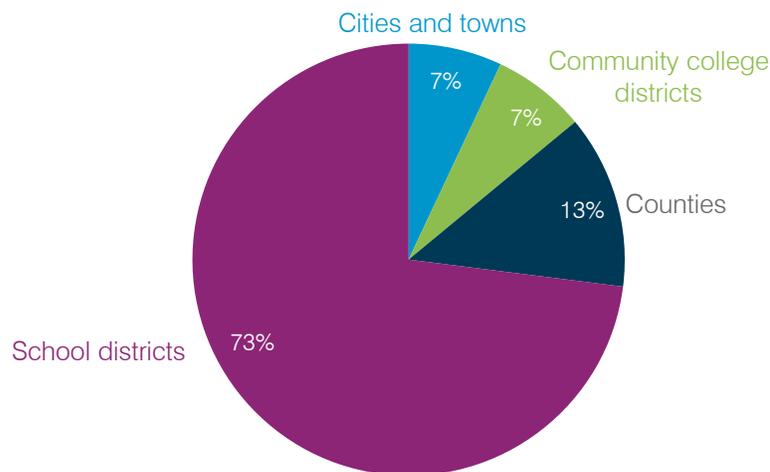
Before 2010 changes	After 2010 changes
Leases and development agreements	
Lease agreements did not have a term limitation and could be entered for an indefinite period of time.	Lease agreements are limited to a maximum term of 25 years. Additionally, within 12 months of the expiration date of the development lease the title shall be conveyed to the lessee.
No previous requirement.	Within 30 days of entering into a lease, the government lessor shall record a memorandum of lease with the county recorder and submit a copy of the lease or an abstract of the lease to both the county treasurer and the ADOR.
No previous requirement.	The ADOR shall maintain a public database by county, and city or town, of all government property leases that are subject to GPLET.
No previous requirement.	The county assessor shall notify the county treasurer and the ADOR if it becomes aware of government property improvements that are or should be subject to GPLET.
Payments, GPLET returns, and other reports	
The government lessor levied and collected an annual GPLET, and the lessee filed a GPLET return with the government lessor on a form prescribed by the government lessor.	The government lessor levies and the county treasurer collects an annual GPLET, and the lessee files a GPLET return by December 1 with the county treasurer on a form prescribed by the ADOR.
No previous requirement.	By February 15, the county treasurer shall submit a report to both the ADOR and each government lessor of all GPLET returns and payments received in the preceding calendar year and monies distributed to the counties, cities or towns, community colleges, and school districts.
GPLET rates	
GPLET rates range from \$.50 to \$1.75 per square foot and \$100 per parking space. Additionally, GPLET rates can be reduced by 20 percent every 10 years until the liability reaches zero. These are classified as "Schedule A" rates on the GPLET return form, GPLET worksheet, and rate charts provided by the ADOR.	Leases signed on or before June 1, 2010, are subject to the old laws and GPLET rates. That includes leases signed after June 1, 2010, if a development agreement, ordinance, or resolution was approved before June 1, 2010, by the governing body. Under these conditions, the lease can be entered into within 10 years after the agreement or resolution was approved.
	New GPLET rates were established for leases and development agreements signed on or after June 1, 2010. Rates range from \$.76 to \$3.10 per square foot and \$200 per parking space. Additionally, the GPLET rate paid in the initial year may be reduced by 10 percent under certain circumstances. These are classified as "Schedule B" rates on the GPLET return, GPLET worksheet, and rate charts provided by the ADOR.
No previous requirement.	The ADOR will annually adjust the GPLET rates, using the average annual percentage change (positive or negative) for the 2 most recent fiscal years in the producer price index for new construction.
Tax abatement	
A government lessor may abate the GPLET for a limited period, ending 8 years after the certificate of occupancy is issued and meets the following requirements:	A city or town may abate the GPLET for a limited period of time, ending 8 years after the certificate of occupancy is issued and meets the following requirements:
<ul style="list-style-type: none"> • The improvement resulted or will result in an increase in value of at least 100 percent; and • The improvement is located in a single central business district in a slum or blighted area that is established pursuant to Title 36, Ch. 12, Art. 3. • No previous requirement. 	<ul style="list-style-type: none"> • The improvement resulted or will result in an increase in value of at least 100 percent; and • Improvement is located in a single central business district, defined as a single and contiguous geographical area and (i) located entirely within a slum or blighted area; and, (ii) geographically compact and no larger than the greater of 5 percent of the total land area within the exterior boundaries of the city or town, or 640 acres. • Restricts a city or town from designating more than one central business district within its corporate boundaries, and prevents it from entering into agreements within 1 year of designating the central business district.

Source: Auditor General staff analysis of Laws 2010, Ch. 321.

Counties, cities and towns, community college districts, and school districts receive GPLET monies

The county treasurers are responsible for distributing GPLET revenues to the jurisdictions where the government property improvements are leased. Statute requires that the county treasurer distribute monies within 30 days of receipt. As shown in Figure 1, school districts receive the largest share of the monies.¹ Additionally, all interest and penalties assessed on delinquent GPLET payments is required to be deposited in the county's general fund.

Figure 1: GPLET revenue distribution percentages by jurisdiction¹
As of December 22, 2015



¹ If one of the jurisdictions above is not entitled to a share of GPLET revenues, those monies shall be distributed to the other applicable jurisdictions in the same proportion. For example, if the property is located on unincorporated county land, the 7 percent normally allocated to cities and towns would be allocated to the remaining jurisdictions.

Source: A.R.S. §42-6205.

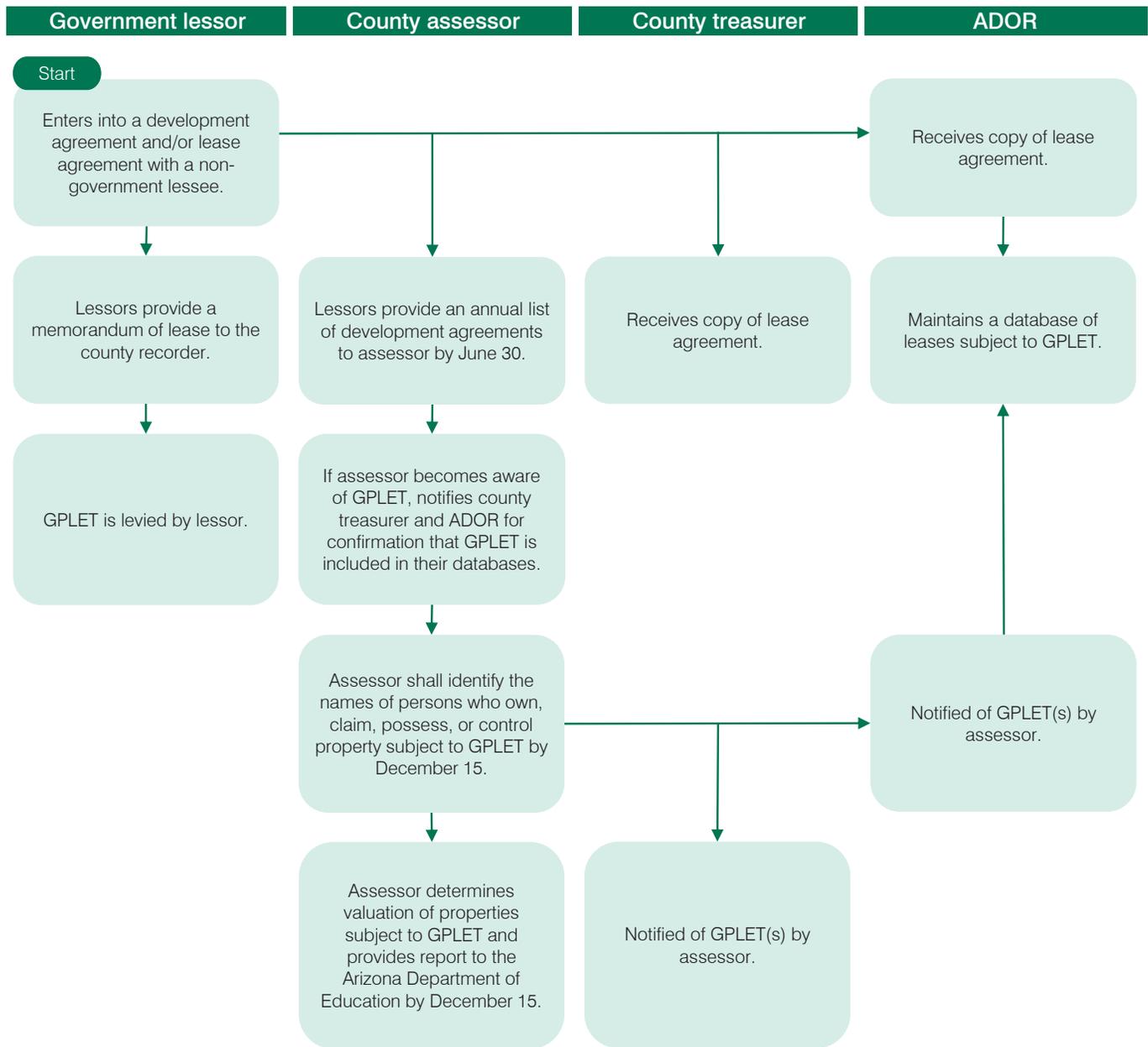
The majority of GPLET revenues the jurisdictions receive are used to pay for general operating costs. For example, some cities and community college districts reported that their share of GPLET revenues are used to support daily operating costs, like payroll and administrative costs. However, one community college district reported that a portion of its monies is used to pay debts.

Several parties have roles in GPLET administration

The government lessor and lessee that enter into the lease agreements, the county treasurer and county assessor of the county in which the property is located, and the ADOR each have responsibilities for the administration of GPLET. Figure 2 on page 6 provides an overview of

¹ Because of reporting errors, auditors could not determine the total amount of GPLET revenues distributed to the various jurisdictions for calendar years 2010 through 2014 (see Chapter 2, pages 15 through 26, for more information).

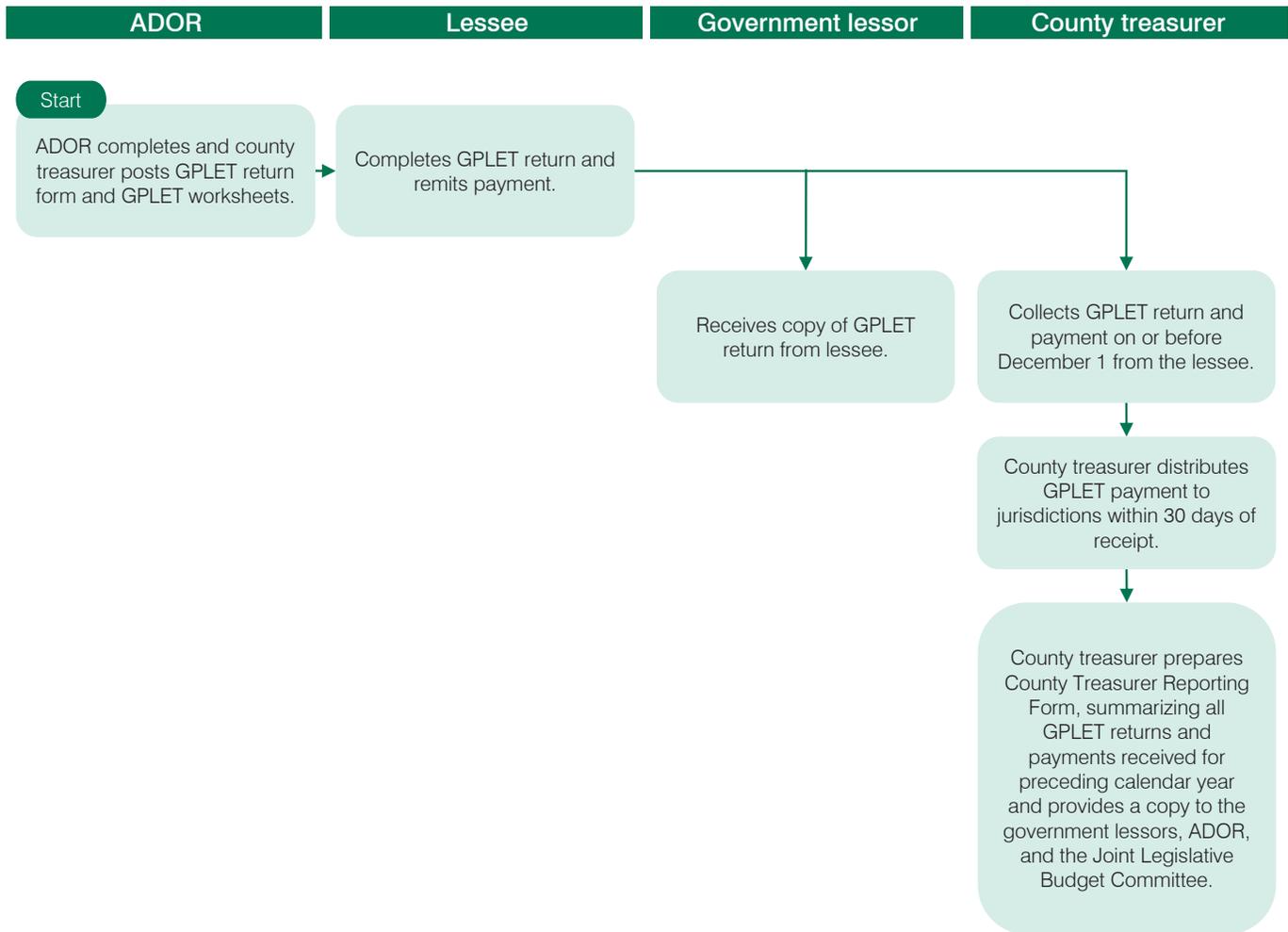
**Figure 2: Lease and development agreement reporting process
As of December 22, 2015**



Source: Auditor General staff analysis of A.R.S. §§42-6202, 42-6206, and 42-13051.

these parties and their responsibilities for reporting lease and development agreements. For example, government lessors enter into lease agreements and are required to provide copies to the county treasurer and the ADOR. Figure 3 on page 7 shows the processes for collecting, distributing, and reporting GPLET. For example, the county treasurer is required to collect the GPLET return and payment by December 1 and distribute the GPLET payment to the benefiting jurisdictions within 30 days.

Figure 3: GPLET collection, distribution, and reporting processes
As of December 22, 2015



Source: Auditor General staff analysis of A.R.S. §§42-6204 and 42-6205.

Chapter 1

As required by Laws 2010, Ch. 321, §10, this chapter addresses whether GPLET, as modified in 2010, achieves the goal of providing a viable revenue stream for counties, cities and towns, community college districts, and school districts and issues relating to leases exempt from paying GPLET.

Changes to GPLET laws may not increase revenues as expected

Although the Legislature enacted laws to increase government property lease excise tax (GPLET) revenues for counties, cities and towns, community college districts, and school districts (collectively referred to as jurisdictions), these statutory changes may not increase revenues as expected. Specifically, as previously stated in the Introduction (see page 2), in 2010, the Legislature amended GPLET laws to increase revenues generated from new government property improvement leases subject to GPLET to help offset the loss of property tax revenues. However, most lessees do not pay the increased GPLET rates because the majority of their lease agreements are either exempt from paying GPLET or, as allowed by statute, continue to pay GPLET under the old GPLET rates and laws, which include a provision that allows lessees to reduce GPLET payments over time. As a result, most of those lessees are not required to pay GPLET or will make reduced payments over time, which may result in declining revenues to the jurisdictions. Further, for those government lessors and their lessees that entered into development agreements and leases prior to June 1, 2010, under the old GPLET rates and structure, it would be difficult to modify the GPLET requirements for these leases. However, the Legislature should consider convening a task force to evaluate the existing exemptions to the GPLET laws.

Most lessees do not pay the increased GPLET rates, which may result in declining GPLET revenues over time

Although the GPLET laws were changed in 2010 to generate more GPLET revenues, most lessees are not subject to the changed GPLET rates and, as a result, GPLET revenues may actually decrease in the future as opposed to increasing. Specifically, most of the calendar year 2014 government property improvement leases auditors identified were either exempt from paying GPLET or subject to the old GPLET rates and rate structure and, therefore, do not pay the increased GPLET rates. Because most lessees do not pay the increased GPLET rates and the older GPLET rates decrease every 10 years, GPLET revenues may decline over time unless Arizona government entities enter into a substantial number of new government property improvement leases that would then be subject to the increased GPLET rates.¹

¹ Auditors were unable to identify the number of new leases entered into during calendar year 2015 because the County Treasurer Reporting Forms that would include this information are not required to be completed until February 15, 2016.

Many lease agreements are exempt from GPLET—Based on auditors' review of individual government property improvement leases reported on the County Treasurer Reporting Forms during calendar year 2014, almost half of the lease agreements were exempt from paying GPLET. Specifically, 131 of the 268 government property improvement leases identified by auditors, or 49 percent, were exempt from paying GPLET. Additionally, this number does not include unreported exempt leases. Although Arizona Revised Statutes (A.R.S.) §42-6204 requires the county treasurer to report all GPLET returns and payments received on the County Treasurer Reporting Form, it does not require exempt government property improvement leases to be reported. As a result, the number of exempt leases could be much higher than the 131 leases identified by auditors. For example, according to a city official, one Arizona city has over 300 exempt leases. However, based on a review of the calendar year 2014 County Treasurer Reporting Form, only 24 of these exempt leases had been voluntarily reported.

According to A.R.S. §42-6208, there are 15 types of government property improvement lease agreements that are exempt from GPLET (see textbox on page 11 for the list of exemptions). These include leases with other government entities, nonprofit organizations, low-income housing, and various types of athletic and entertainment facilities. For example, a government-owned property that has been leased to a private party can be exempt from paying GPLET if it is used primarily for entertainment or if it is located within a government-owned transportation facility. Examples of exempt leases auditors identified included restaurants, movie theaters, and retail shops because they were classified by the government lessors as entertainment facilities or located within a transportation facility.¹

To assess the impact of the lost GPLET revenues as a result of a lease being classified as exempt, auditors selected an entertainment facility lease and estimated the GPLET if the lease were subject to GPLET. Based on auditors' analysis, the property could have generated \$33,881 in GPLET revenues in calendar year 2014. However, because the property is exempt, the county, city, community college district, and school districts will not receive GPLET revenues or other types of property taxes from this entertainment facility lease.

Many lease agreements are subject to lower GPLET rates, and more leases could fall into this category—In addition to the exempt leases, auditors also identified numerous government property improvement leases that are not subject to the new GPLET rates the Legislature established in 2010. Specifically, any government property improvement leases signed prior to June 1, 2010, are not subject to the new GPLET rates. For the 268 lease agreements auditors identified that were in effect during calendar year 2014, 121 individual leases, or 45 percent, were subject to the old GPLET rates and rate structure. As a result, these lessees paid a GPLET rate ranging from \$0.50 to \$1.75 per square foot and \$100 per parking space instead of the GPLET rates adopted in the 2010 legislation, which are much higher and have increased annually since calendar year 2010. For example, the calendar year 2014 GPLET rate ranged from \$0.84 to \$3.44 per square foot plus \$222.02 per parking space (see Table 1 on page 3 for the GPLET rates). In addition, the GPLET liability of the lessees of these 121 properties decreases by 20 percent every 10 years until GPLET reaches zero, which would result in declining revenues for the jurisdictions.

¹ Examples of exempt leases are based on auditors' review of the exempt leases voluntarily reported on the County Treasurer Reporting Forms during calendar years 2010 through 2014. However, because government lessors are not required to report exempt leases, auditors could not determine the reason each lease was exempt from paying GPLET.

Types of government property improvement leases exempt from GPLET

1. Property used for a governmental activity.
2. Property used for public housing.
3. Easements and rights-of-way of railroads and gas, electric, water, pipeline and telephone utilities.
4. Property used primarily for athletic, recreational, entertainment, artistic, cultural or convention activities, including use incidental to those purposes including concession stands.
5. Property used for or in connection with aviation, including hangars, tie-downs, aircraft maintenance, sale of aviation related items, charter and rental activities, commercial aircraft terminal franchises, rental car operations, parking facilities and restaurants, stores and other services that are located in a terminal.
6. A commercial airline's use of the runways and terminal facilities of state, city, town, or county airports and public airports.
7. Transportation facility that is constructed under public-private partnerships in transportation, as set forth in Title 28, Ch. 22 of Arizona Revised Statutes.
8. Interests in lands held in trust by this state pursuant to Title 37, Ch. 2, Art. 1 of Arizona Revised Statutes.
9. Interests in property held in trust for an Indian or an Indian tribe by the United States government.
10. Interests in property that is defined as "contractor-acquired property" or "government-furnished property" in the federal acquisition regulations, 48 Code of Federal Regulations section 45.101, and that is owned by the government and used to perform a government contract.
11. Property of a corporation that is organized by or at the direction of a county, city or town to be used for public purposes that the county, city or town pledges to lease or lease-purchase with county or municipal special or general revenues.
12. Interests in property used by an Internal Revenue Code (IRC) §501(c)(6) tax exempt chamber of commerce if the property is used predominantly for the chamber's tax exempt purposes.
13. Interests in property used by organizations that are exempt from taxation under IRC §501(c)(3).
14. Interests in parking garages or decks if the parking garages or decks are owned and operated by a government lessor or operated on behalf of a government lessor, by an entity other than the prime lessee, pursuant to a management agreement with the government lessor.
15. Residential rentals if the prime lessee is the occupant.

Source: Auditor General staff analysis of A.R.S. §42-6208.

Additionally, government lessors can still enter into leases that would be subject to the old GPLET rates. According to A.R.S. §42-6203(A), a government property improvement lease or development agreement that the governing body approved before June 1, 2010, shall follow the old GPLET rates and laws. In addition, it also allows the lease agreements to be entered into up to 10 years after the development agreement was approved. For example, a government lessor could have approved a development agreement authorizing a lease on May 31, 2010, and that government lessor would have through May 31, 2020, to enter into a lease agreement for that property that would be subject to the old GPLET rates.

Finally, A.R.S. §42-6203(A)(4) allows some existing development agreements that are subsequently amended to continue to be subject to the old laws and GPLET rates if the amendment furthers the original purpose.¹ This could potentially allow government lessors to amend their development agreements beyond 2020, and those corresponding leases would be subject to the old laws and GPLET rates.

Few lease agreements are subject to the new laws and increased GPLET rates—Because many leases are either exempt from paying GPLET or are subject to the old GPLET rates and laws, very few lease agreements are subject to the new laws, and therefore, revenues may not increase as expected. Specifically, of the individual leases auditors identified in effect during calendar year 2014, only 16 of the 268 government property improvement leases, or 6 percent, were subject to the new GPLET rates. Since few leases are subject to the new laws and GPLET rates, the changes to GPLET laws will not increase revenues unless the cities, towns, counties, and stadium districts enter into substantial number of new government property improvement lease agreements that are subject to the new GPLET rates.²

Legislature should consider forming task force to evaluate GPLET exemptions

The Legislature should consider establishing a task force to evaluate the existing exemptions to the GPLET laws. As previously mentioned, A.R.S. §42-6208 allows 15 types of leases to be exempt from paying GPLET, and 49 percent of the calendar year 2014 government property improvement leases auditors identified were exempt from paying GPLET. Evaluating these exemptions and potentially reducing the types of new leases that are exempt from paying GPLET could increase GPLET revenues for the counties, cities and towns, community college districts, and school districts. Task force members should include appropriate stakeholders, such as legislators, government lessors, and representatives from the jurisdictions that receive GPLET revenues. Legislation forming the task force should identify membership, its overall purpose and expected outcomes, and deadlines for reporting recommendations to the Legislature.

Recommendation:

- 1.1. The Legislature should consider forming a task force to evaluate the exempt properties allowed under A.R.S. §42-6208. Task force members should include appropriate stakeholders, such as legislators, government lessors, and representatives from the jurisdictions that receive the GPLET revenues. Legislation forming the task force should

¹ A.R.S. §42-6203(A)(4) states that a lease or development agreement that is subject to the old laws and GPLET rates and is subsequently amended would continue to follow the old laws, if the amendment meets all of the following conditions: (1) furthers the purpose of the original lease or development agreement, (2) any land added under the amendment is contiguous to the land under the original lease or development agreement and does not increase the land area by more than 50 percent, and (3) any government property improvement added under the amendment does not increase the area of gross building space by more than 100 percent.

² Auditors were unable to identify the number of new leases entered into during calendar year 2015 because the County Treasurer Reporting Forms that would include this information are not required to be completed until February 15, 2016.

identify membership, its overall purpose and expected outcomes, and deadlines for reporting recommendations to the Legislature.

Chapter 2

As required by Laws 2010, Ch. 321, §10, this chapter addresses the accountability for government property leases subject to GPLET, the efficiencies in collecting and distributing GPLET, and compliance with laws for administering GPLET.

Improvements are needed to ensure GPLET is accurately calculated, collected, distributed, and reported

Various actions are needed to help improve the overall administration of the government property lease excise tax (GPLET) to ensure that the counties, cities and towns, community college districts, and school districts receive all GPLET revenues due to them. Specifically, auditors' review of GPLET's calculation, collection, distribution, and reporting processes identified the following:

- The GPLET liability for a random sample of 12 leases in effect from June 1, 2010 through December 31, 2014, was incorrectly calculated for 11 leases, resulting in a loss of revenues totaling \$236,556;
- 1 of the 12 leases was incorrectly assessed GPLET resulting in the incorrect collection of \$437;
- Total GPLET revenues collected and distributed are unknown because County Treasurer Reporting Forms were either incomplete or inaccurate; and
- Some county assessors did not report the determined valuation of properties subject to GPLET to the Arizona Department of Education (ADE) as required by law, which could affect payments to school districts.

A lack of understanding of the processes for calculating, collecting, distributing, and reporting GPLET, and a lack of policies and procedures by the parties charged with administering GPLET (see textbox) contributed to the lost revenues and incomplete and inaccurate reporting. Therefore, the Legislature should consider revising statutes to strengthen the process for administering GPLET. Further, regardless of any legislative action, the parties that are charged with administering GPLET should follow applicable laws and develop and implement policies and procedures to ensure GPLET is accurately calculated, collected, distributed, and reported.

The parties and their responsibilities for administering GPLET

- **Government lessor**—Entering lease agreements, enforcing lease terms, and reporting leases to the county treasurer and the Arizona Department of Revenue (ADOR).
- **County treasurer**—Collecting and distributing GPLET, assessing penalties and interest, and reporting GPLET collections and distribution to the ADOR and government lessors.
- **County assessor**—Reporting to ADE the determined valuation of properties subject to GPLET.
- **ADOR**—Maintaining a database of lease agreements, annually adjusting GPLET rates, and updating the GPLET return form and GPLET worksheets.

Source: Auditor General staff analysis of Arizona Revised Statutes (A.R.S.) §§42-6201 through 42-6210 and 42-13051.

Counties, cities and towns, community college districts, and school districts did not receive all GPLET revenues because GPLET not always appropriately assessed and collected

Although counties, cities and towns, community college districts, and school districts (collectively referred to as jurisdictions) receive GPLET revenues, these jurisdictions have not always received the total GPLET revenues that they should have because not all GPLET liability has been appropriately assessed and collected. For example, auditors' review of a random sample of 12 leases found that the GPLET liability for 11 of these leases was incorrectly calculated and 1 was incorrectly assessed GPLET, resulting in inaccurate GPLET payments to the jurisdictions. Additionally, some GPLET collection and distribution amounts county treasurers reported for calendar years 2010 through 2014 were either incomplete or incorrect.

GPLET liability not always appropriately assessed or collected—Based on auditors' review of a random sample of 12 leases, the GPLET liability for all 12 of these leases was incorrectly assessed; therefore \$236,119 in GPLET revenues, including penalties, were not collected and disbursed to the jurisdictions.¹ Specifically, auditors found that some GPLET liability was calculated incorrectly or not collected at all, penalties and interest were not assessed and collected, or lessees were incorrectly assessed GPLET. Because auditors' review of the random sample identified errors in all of the leases sampled, it is likely that similar errors exist in other government property improvement leases. Auditors' review of the administration and collection of GPLET identified the following problems:

- **GPLET liability calculated incorrectly**—GPLET is assessed based on the square footage and/or number of parking spaces leased, the use of the property, and other considerations like the original certificate of occupancy and primary and secondary property tax rates. Auditors' review of a random sample of 12 leases found the GPLET liability for 11 of the leases was incorrectly determined for at least 1 calendar year between June 1, 2010 and December 31, 2014.² The GPLET calculations, which the lessee or the government lessor completed, either used the incorrect GPLET rate, did not include all property subject to GPLET, or used incorrect GPLET rates published by the ADOR. Specifically, the GPLET liability for 11 of the leases was incorrectly calculated because the lessee or the government lessor either used the incorrect GPLET rate, did not include all property subject to GPLET, or were affected by the ADOR publishing the incorrect GPLET rates.³ For example, one lessee entered into a lease agreement after June 1, 2010; however, when filing its GPLET return form, the lessee used the GPLET rates reserved for leases that had been executed prior to June 1, 2010. This lessee also excluded 50 parking spaces from its GPLET liability calculation. As a result, this lessee underpaid its calendar year 2014 GPLET liability by \$29,146. Further, another lessee underpaid its calendar year 2013 GPLET liability by \$23,343 because it used the incorrect rate as published by the ADOR. Specifically, although the ADOR adjusted the GPLET rates for calendar year 2013 and posted them to its Web site, the ADOR did not update

¹ As interest accumulates until GPLET is paid, the \$236,119 excludes interest as these amounts are unpaid.

² Auditors sampled a total of 12 leases filed with the county treasurers as reported on the County Treasurer Reporting Forms in calendar years 2010 through 2014. See Appendix A, page a-1, for additional information on the methods used to select this sample.

³ Auditors identified a lessee that overpaid its GPLET by \$33.

the GPLET rates included in the calendar year 2013 GPLET worksheets that were submitted to the county treasurers and used by lessees to calculate their GPLET liability.

- **Uncollected GPLET not identified**—Some government lessors did not identify uncollected GPLET. Based on the random sample of 12 leases, 5 lessees did not submit a GPLET return or payment for at least 1 calendar year from June 1, 2010 through December 31, 2014. For example, auditors identified one lease agreement that was executed in October 2010, but the lessee did not submit its initial GPLET payment until December 2014, which included GPLET for only calendar year 2014. In this instance, the government lessor did not identify the uncollected GPLET and the lessee did not pay its GPLET liability for the first 3 years resulting in \$32,375 in unpaid GPLET, not including penalties and interest.
- **Penalties and interest not assessed**—The county treasurers did not assess penalties and interest on delinquent GPLET payments received after December 1 of each year. Although county treasurers are responsible for assessing penalties and interest, auditors determined that penalties and interest were not assessed from June 1, 2010 through December 31, 2014. For example, a county treasurer did not assess an estimated \$25,865 in penalties and interest against one lessee for paying its GPLET 129 days after the due date. In another example, a county treasurer did not assess an estimated \$1,393 in penalties and interest for one lessee that paid its GPLET 21 days after the due date. Because penalty and interest payments are distributed to a county's general fund, these unassessed amounts represent a loss of revenue to the counties.
- **Incorrectly assessed GPLET resulting in lessee paying GPLET not owed**—For 1 of the 12 leases, a government lessor inappropriately assessed GPLET on a government-owned property that should not have paid GPLET. Specifically, one government lessor incorrectly assessed \$437 in GPLET on a property without a building. Because undeveloped land does not meet the definition of a government property improvement, the property should not have been assessed GPLET.

County treasurer reports of GPLET were incomplete or incorrect—Auditors' review of the annual County Treasurer Reporting Forms for calendar years 2010 through 2014 determined that the GPLET revenues the county treasurers reported were either incomplete or incorrect in some cases and, as a result, total GPLET revenues collected and distributed could not be determined. For example, one annual County Treasurer Reporting Form did not include \$427,806 in GPLET revenues and distributions because those payments were collected after the report's February 15 due date. However, the county treasurer did not revise its report to include these revenues. In another instance, the County Treasurer Reporting Form erroneously included \$6,000 in rent payments as GPLET revenues that were correctly excluded from distributions to jurisdictions. Additionally, one county treasurer incorrectly classified a GPLET payment as property taxes, resulting in incomplete reporting and incorrect distribution of these monies to the jurisdictions. Although the county treasurer collected GPLET, it distributed the revenues using the property tax distribution percentages rather than the GPLET distribution percentages, which are different. As a result, \$890,343 was not reported as GPLET revenues and was not appropriately distributed to the jurisdictions (see Figure 1, page 5, for the GPLET distribution percentages).

GPLET calculation, collection, distribution, and reporting processes not well understood and lack adequate guidance

The processes for calculating, collecting, distributing, and reporting GPLET are not well understood and are not supported by adequate policies and procedures to guide the parties responsible for its administration. Many of the parties who are responsible for GPLET administration have reported that they did not fully understand the laws governing GPLET and their responsibilities for administering it, and two components of the process can make it challenging for lessees to accurately calculate their GPLET liability. Additionally, the responsible parties have not established adequate policies and procedures to efficiently and effectively administer GPLET.

Not all parties understand GPLET administration responsibilities and process can make it challenging for lessees to accurately calculate GPLET liability—Auditors' interviews with city, town, and county officials indicated a general lack of understanding regarding GPLET requirements. For example, not all parties understand what qualifies as a government property improvement and if it is subject to GPLET. Further, some parties indicated that they did not know who was responsible for enforcing the payment of a delinquent GPLET.

In addition, two components of the process can make it challenging for lessees to accurately calculate their GPLET liability. First, the lessee must obtain information from multiple sources to complete their GPLET return. For example, in order to calculate GPLET liability, a lessee must contact the county treasurer to determine the primary and secondary property tax rates that apply to their property. Further, the lessee must contact the government lessor to obtain the date of original certificate of occupancy issued for its property. Second, the determination of the correct GPLET rate may be confusing because the GPLET return includes two different rate structures with multiple variations of each rate. Specifically, the lessee must choose from two different GPLET rate structures based upon the earlier date of the lease agreement, development agreement, or city ordinance or resolution. Within each rate structure, the lessee must then select from nine different GPLET base rates determined by the use of the property (see Table 1 on page 3). Finally, the lessee must further determine if additional adjustments are required, which may increase or decrease the GPLET base rate. The erroneous calculation of GPLET liability identified by auditors suggests that lessees may not have obtained all information required to correctly calculate their GPLET liability.

GPLET administrators lack adequate policies and procedures to effectively administer GPLET—The various parties who are responsible for administering GPLET have not established efficient and effective policies and procedures to ensure GPLET is properly calculated, collected, distributed, and reported. Specifically:

- **No oversight to ensure the accuracy of the GPLET return**—According to A.R.S. §42-6202(A), the government lessor is responsible for levying GPLET. This would require the government lessors to ensure that the GPLET returns their lessees submit are accurate. However, most government lessors who had GPLET leases in calendar years 2010

through 2014 have not established processes to ensure that they are receiving all GPLET returns and ensuring the accuracy of those GPLET returns.¹

- **ADOR lacks documented procedures to review and approve GPLET rates and GPLET worksheets**—Statute requires the ADOR to annually adjust GPLET rates and prepare the GPLET return forms and accompanying GPLET worksheets to assist lessees in appropriately calculating and remitting GPLET. However, the ADOR has not established documented processes for developing and reviewing the annual adjustment of GPLET rates and preparation of GPLET return forms and GPLET worksheets to ensure the accuracy of the GPLET return forms and GPLET worksheets. As previously mentioned, the ADOR did not update the GPLET rates included in the calendar year 2013 GPLET worksheets, which lessees used to calculate their GPLET liability.
- **No reconciliation to ensure all payments are collected**—According to A.R.S. §42-6204(F), the county treasurer shall submit a County Treasurer Reporting Form to the ADOR and government lessors of all GPLET returns and payments received for each calendar year. This report provides an annual summary of GPLET payments received, by lessee and property, and amounts distributed to the jurisdictions as reported by the county treasurer as of February 15. However, most government lessors who had GPLET leases in calendar years 2010 through 2014 did not have procedures in place to reconcile the GPLET collected as reported on the County Treasurer Reporting Form to their lease agreements to identify any unpaid GPLET.
- **Lack of communication**—Multiple parties are responsible for administering GPLET but do not fully communicate with one another to ensure all GPLET revenues are collected. According to A.R.S. §42-6202, the government lessor shall levy and the county treasurer shall collect an annual GPLET on each lessee's use of the government property. Auditors' interviews with government lessors and county treasurers indicated that a lack of communication has contributed to uncollected and inaccurate GPLET payments. For example, the government lessor is responsible for ensuring GPLET is accurately paid, while the county treasurer is responsible for collecting GPLET; therefore, communication between these parties is vital. However, because of a lack of communication, the government lessor did not always know which of their lessees paid GPLET, how much was paid, and if any payments were outstanding. Additionally, the county treasurers did not always know which lessees should have paid GPLET and how much should be collected.
- **Some county treasurers lack processes to assess and bill penalties and interest on delinquent GPLET payments**—According to A.R.S. §42-6204(C) and (D), the county treasurer shall collect a penalty and interest, as outlined in A.R.S. §42-1123, on payments not received by December 1. Specifically, A.R.S. §42-1123 requires the county treasurer to calculate the interest using federal rates that change monthly, rounded to the nearest full percent, plus 3 percentage points. However, not all county treasurers have established a process to assess and bill penalties and interest on payments received after December 1. Further, officials from six county treasurers' offices reported the method to calculate the interest established in statute is complex, which may have contributed to the lack of assessed interest.

¹ According to A.R.S. §42-6204(B) the lessee shall file a GPLET return with the county treasurer and submit a copy to the government lessor.

Incomplete GPLET reporting could affect equalization assistance payments to school districts

Equalization assistance payments—The amount of money that the State and county provide to a school district over and above the property taxes the district receives by levying a state-wide uniform tax rate, called the qualifying tax rate.

Source: Auditor General staff analysis of A.R.S. §15-971.

Equalization assistance payments (see textbox) made to school districts consider the valuation of properties subject to GPLET, and therefore, unreported values could cause the State and counties to pay more in equalization assistance payments to school districts than required. According to A.R.S. §42-13051, the county assessor shall report the determined valuation of properties subject to GPLET

annually to ADE by December 15. ADE uses this information to estimate how much GPLET revenues a school district will receive. Additionally, this information affects state and county equalization assistance payments because these payments should be reduced based on the amount of GPLET revenues a school district receives. However, some county assessors did not report the determined valuation of properties subject to GPLET to ADE. Based on a review of the County Treasurer Reporting Forms for calendar year 2014 and interviews with one county assessor and treasurer, auditors determined that there were seven counties with government property improvement leases subject to GPLET. However, only three of these seven county assessors reported the valuation of properties subject to GPLET to ADE.

Auditors' interviews with some county assessors indicated a general lack of understanding regarding the requirement to report to ADE or indicated that they had not been made aware of the GPLET properties by the government lessors and therefore did not complete a report to ADE. As a result, the calculation for equalization assistance payments was affected because ADE did not have the valuation of properties subject to GPLET from four counties. Further, because these determined valuations were not included in the calculation, the State and counties may have paid more in equalization assistance payments to school districts than required.¹

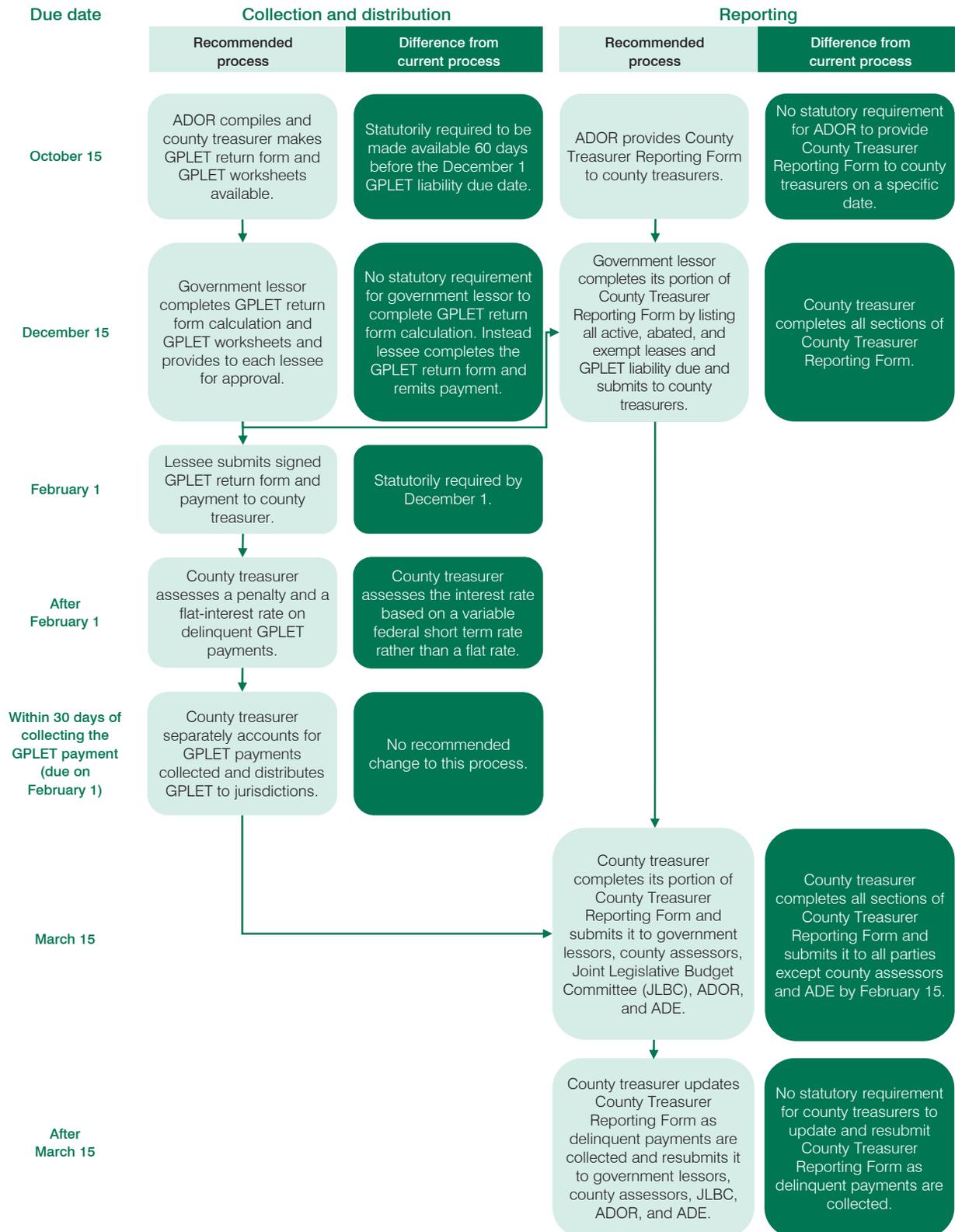
Legislature should consider modifying GPLET calculation, collection, distribution, and reporting processes and time frames

The Legislature should consider modifying statutes regarding the processes and time frames for calculating, collecting, distributing, and reporting GPLET revenues. Statutory changes regarding GPLET should help to improve the issues auditors identified. Specifically, the Legislature should consider the following changes, which are shown in Figure 4 (see page 21), that auditors developed in consultation with the county treasurers, county assessors, and representatives from the counties, cities and towns, the ADOR, and ADE:²

¹ Because the valuation of properties subject to GPLET was not available, auditors were unable to determine the monetary impact to equalization assistance payments the State and counties made.

² These recommendations do not apply to those leases entered by the National Park Services of the United States Department of the Interior of a property improvement located in the county, pursuant to A.R.S. §42-6210.

Figure 4: Summary of recommended legislative changes to due dates and GPLET collection, distribution, and reporting processes As of December 22, 2015



Source: Auditor General staff analysis of A.R.S. §§42-6204 and 42-6205 and discussions with various government officials.

- Modifying A.R.S. §42-6204 to make the following three changes to the collection and distribution processes:
 - Changing the date the GPLET return form and GPLET worksheets are compiled by the ADOR and made available by the county treasurer to October 15 instead of 60 days before the GPLET liability is due;
 - Requiring the government lessors to complete the GPLET return form calculation and GPLET worksheets and submit to the lessee for review and signature attesting to the accuracy of the GPLET liability by December 15 rather than the lessees completing the GPLET return form; and
 - Changing the GPLET due date from December 1 to February 1.

Specifically, the government lessor should obtain the GPLET return form from the county treasurer's Web site on October 15 and complete the GPLET return form and supporting calculations and submit to the lessee for review and signature attesting to its accuracy by December 15. Government lessors are best suited to perform this responsibility because they have the information required to properly calculate the GPLET liability and are required by A.R.S. §42-6202 to levy the GPLET. Further, based on discussions with some government lessors, auditors determined that 60 days would provide the government lessors sufficient time to calculate the GPLET liability. Changing the annual GPLET due date from December 1 to February 1 will provide the government lessors sufficient time to calculate GPLET liabilities and the lessees sufficient time to review and certify the calculation and pay GPLET.

- Modifying A.R.S. §42-6204(C) to establish a flat interest rate for calculating interest due on delinquent GPLET payments. By establishing a flat rate, the calculation of interest would be simplified, thereby minimizing the amount of time the county treasurers need to calculate the interest and increasing their likelihood of properly assessing and collecting the interest. Based on discussions with some county treasurers, establishing a flat rate similar to the rates established under property tax laws would simplify their process for assessing and collecting interest.
- Modifying A.R.S. §42-6204(F) to better clarify the responsibilities and requirements related to the County Treasurer Reporting Form (Reporting Form), which should improve accountability and help ensure that all GPLET revenues are collected, distributed, and reported. Specifically, suggested changes include:
 - Requiring the ADOR to provide the Reporting Form to the county treasurers by October 15 instead of 60 days before the GPLET due date.
 - Requiring the government lessor to complete a portion of the Reporting Form to identify all government property improvement leases it has entered into rather than having the county treasurers complete all sections. Specifically, each lessor should be required to include all active, abated, and exempt leases on the Reporting Form, as well as the county recorder number, lease end date, applicable GPLET rate chart A or B, the abatement end date, if applicable, and the total GPLET due. The Reporting

Form should be submitted to the county treasurer by December 15. This process would help the county treasurer identify the lessees that should pay GPLET and how much should be collected. Additionally, reporting the exempt and abated leases would help the county assessors to more accurately report the determined valuation of properties subject to GPLET to ADE.

- Requiring the county treasurers to complete a portion of the Reporting Form to identify all GPLET payments collected and monies distributed to the jurisdictions, including school district names and amounts, and if applicable, penalties and interest assessed and collected. This process would help the government lessor to identify unpaid GPLET.
- Requiring the county treasurers to provide a copy of the completed Reporting Form to the county assessors and ADE. Although statute requires a completed Reporting Form to be filed with the ADOR, the government lessor, and JLBC, a completed form should also be provided to both the county assessors and ADE. By providing them a copy of the report, county assessors can reconcile the government property improvements on the Reporting Form to properties that they reported to ADE and ADE can verify it received the appropriate information from the county assessors.
- Changing the due date for filing the Reporting Form from February 15 to March 15. This change would provide the various parties with sufficient time to complete the Reporting Form.
- Requiring the county treasurers to submit a revised Reporting Form to government lessors, county assessors, JLBC, the ADOR, and ADE as delinquent payments are collected. Currently statute does not require revised Reporting Forms to be submitted. This updated information would assist government lessors with their responsibility to follow up with lessees who are delinquent in paying GPLET. Further, because the ADOR is responsible for maintaining an accurate report of total GPLET revenues collected and distributed, the ADOR should also receive the revised copies of the Reporting Forms.

GPLET administrators should develop and implement policies and procedures

Regardless of any legislative action, the parties who are charged with GPLET administration should develop and implement policies and procedures to help ensure that GPLET revenues are accurately calculated, collected, distributed, and reported. Specifically:

Government lessors should develop and implement policies and procedures to:

- Obtain a copy of the GPLET return to verify that the lessee has accurately calculated its GPLET liability and remitted payment to the county treasurer if the Legislature does not revise statute to require government lessors to complete the GPLET return on behalf of its lessees;

- Reconcile the GPLET liability collected as reported on the Reporting Form to their lease agreements to help ensure that all amounts have been collected. If any unpaid amounts are identified, the government lessor should contact the delinquent lessee and take appropriate action to ensure unpaid GPLET liabilities are collected; and
- Ensure an annual list of development agreements is provided to the county assessor by June 30, as required by statute.

County treasurers should develop and implement policies and procedures for calculating, assessing, and collecting penalties and interest on GPLET payments received after the due date.

County assessors should develop and implement policies and procedures to ensure that the determined valuation of all government property improvements subject to GPLET are reported to ADE by December 15 as required by A.R.S. §42-13051.

The ADOR should document and follow policies and procedures to ensure the GPLET return form and GPLET worksheets, which include the GPLET rate charts, are reviewed and approved prior to being published and sent to the county treasurers.

Finally, once policies and procedures have been developed and implemented, the various parties should train applicable staff on these policies and procedures.

Government lessors should review leases to identify uncollected GPLET

To address the risk that GPLET may have been underpaid or uncollected, the government lessors should develop and implement an action plan to review its lessees and determine if each lessee has appropriately paid GPLET. As previously stated, auditors' review of a random sample identified errors in all leases reviewed—for example, GPLET was incorrectly calculated and uncollected, penalties and interest were not assessed, and one property was incorrectly assessed GPLET; therefore, it is likely that similar errors exist in other government property improvement leases. Specifically, government lessors should review all government property improvement lease agreements to identify those lease agreements subject to GPLET and compare those lease agreements to the payments reported on the Reporting Form in calendar years 2010 through 2014 to help ensure all applicable GPLET was collected. Finally, the government lessors should take steps to recover any unpaid GPLET identified, if it is cost-effective to do so.

Recommendations:

- 2.1. The Legislature should consider modifying statutes to clarify the process for calculating, collecting, distributing, and reporting GPLET revenues. Specifically:

- a. Modifying A.R.S. §42-6204 to make the following three changes to the collection and distribution process:
 - Changing the date the GPLET return form and GPLET worksheets are compiled by the ADOR and made available by the county treasurers to October 15 instead of 60 days before the GPLET liability is due;
 - Requiring the government lessors to complete the GPLET return form calculation and GPLET worksheets and submit to the lessee for review and signature attesting to the accuracy of the GPLET liability by December 15; and
 - Changing the GPLET due date from December 1 to February 1.
- b. Modifying A.R.S. §42-6204(C) to establish a flat interest rate for calculating interest due on delinquent GPLET payments.
- c. Modify A.R.S. §42-6204(F) to better clarify the responsibilities and requirements related to the County Treasurer Reporting Form (Reporting Form), which should improve accountability and help ensure that all GPLET revenues are collected, distributed, and reported. Specifically:
 - Requiring the ADOR to provide the Reporting Form to the county treasurers by October 15.
 - Requiring the government lessor to complete a portion of the Reporting Form to identify all government property improvement leases it has entered into. Specifically, each lessor should report all active, abated, and exempt leases on the Reporting Form, as well as the county recorder number, lease end date, applicable GPLET rate chart A or B, the abatement end date, if applicable, and the total GPLET liability due. The Reporting Form should be submitted to the county treasurer by December 15.
 - Requiring the county treasurers to complete a portion of the Reporting Form to identify all GPLET payments collected and monies distributed to the jurisdictions, including school district names and amounts, and if applicable, penalties and interest assessed and collected.
 - Requiring the county treasurers to provide a copy of the completed Reporting Form to the county assessors and ADE.
 - Changing the due date for filing the Reporting Form from February 15 to March 15.
 - Requiring the county treasurers to submit a revised Reporting Form to government lessors, county assessors, JLBC, the ADOR, and ADE as delinquent payments are collected.

2.2. Government lessors should develop and implement policies and procedures to:

- a. Obtain a copy of the GPLET return to verify that the lessee has accurately calculated its GPLET liability and remitted payment to the county treasurer if the Legislature does not revise statute to require government lessors to complete the GPLET return on behalf of its lessees;
 - b. Reconcile the GPLET liability collected as reported on the Reporting Form to their lease agreements to help ensure that all amounts have been collected. If any unpaid amounts are identified, the government lessor should contact the delinquent lessee and take appropriate action to ensure unpaid GPLET amounts are collected; and
 - c. Ensure an annual list of development agreements is provided to the county assessor by June 30 as required by statute.
- 2.3. County treasurers should develop and implement policies and procedures for calculating, assessing, and collecting penalties and interest on GPLET payments received after the due date.
 - 2.4. County assessors should develop and implement policies and procedures to ensure that the determined valuation of all government property improvements subject to GPLET are reported to ADE by December 15 as required by A.R.S. §42-13051.
 - 2.5. The ADOR should document and follow policies and procedures to ensure the GPLET return form and GPLET worksheets, which include the GPLET rate charts, are reviewed and approved prior to being published and sent to the county treasurers.
 - 2.6. Once policies and procedures have been developed and implemented, the various parties should train applicable staff on these policies and procedures.
 - 2.7. Government lessors should develop and implement an action plan to review its lessees and determine if each lessee has appropriately paid GPLET. Specifically, government lessors should review all government property improvement lease agreements to identify those lease agreements subject to GPLET, and compare those lease agreements to the payments reported on the Reporting Form in calendar years 2010 through 2014 to help ensure all applicable GPLET was collected. Finally, the government lessors should take steps to recover any unpaid GPLET identified, if it is cost-effective to do so.

Other Pertinent Information

As required by Laws 2010, Ch. 321, §10, this chapter addresses property tax revenues previously received from vacant or underutilized property being redeveloped, tax revenues generated from new economic activity compared with the loss of property tax revenues, and the success of tax abatement under the laws amended in 2010, in promoting redevelopment in slum or blighted areas.

The other pertinent information section addresses matters that were not included in the previous chapters (see textbox) and contains no recommendations. Specifically, this section provides information regarding auditors' consideration of property tax revenues previously being received from vacant or underutilized property, tax revenues generated from new economic activity, and the success of tax abatement in promoting redevelopment in slum or blighted areas.

Limited information prevents complete analysis of GPLET impacts

As previously stated in Chapter 1 (see pages 9 through 13), as of calendar year 2014, few government property improvement leases have been subject to the new government property lease excise tax (GPLET) laws that became effective June 1, 2010, which limited the number of leases available for auditors' review to assess the impact of property tax revenues previously being received from vacant or underutilized property and tax revenues generated from new economic activity. Specifically, based on auditors' sample of 12 lease agreements paying GPLET and 2 abated government property improvement lease agreements within the audit period of June 1, 2010 through December 31, 2014, auditors identified only 1 lease agreement that could be analyzed for these considerations. Further, because a qualifying government property improvement may be temporarily suspended from paying GPLET for a period not to exceed 8 years (see textbox), a sufficient amount of time has not passed since the law's June 1, 2010, effective date to assess the success of the tax abatement in promoting redevelopment in slum or blighted areas.

Tax abatement—A city or town may temporarily suspend the payment of GPLET for a period not to exceed 8 years if the government property improvement meets the following requirements:

- Is located in a single central business district, defined as a single and contiguous geographical area and located entirely within a slum or blighted area; and
- Will result in an increase in value of at least 100 percent.

Source: Auditor General staff analysis of Arizona Revised Statutes (A.R.S.) §42-6209.

GPLET revenues for one lease agreement exceeded property tax revenues, and economic analysis shows positive economic impact—A government property improvement lease generated more than \$400,000 in increased revenues in 1 year by paying GPLET rather than property taxes, and an independent economic analysis shows that the lease will generate an estimated \$6.8 million in new community revenues, which is in excess of the loss of property taxes and other related incentives. Specifically, auditors identified one government property improvement lease agreement where the property tax previously being received from the underutilized property could be compared to the GPLET revenue received. A group of parcels previously used for agricultural purposes collectively paid \$28,863 in property taxes in 2011. Upon completion of a development agreement in which a warehouse and office structure were built, the

property's ownership transferred to the government lessor who then leased the property to a private party. In 2012, the lessee paid \$432,676 in GPLET, or a \$403,813 increase over the property tax paid in 2011. Further, auditors' review of the economic analysis conducted by an independent third party indicated that the government property improvement would produce an estimated \$6.8 million in economic and fiscal benefits in excess of the loss in property taxes and other related incentives, such as a grant and fee waivers, totaling an estimated \$1.6 million. Therefore, the considerable increase in GPLET revenues over property taxes and the independently conducted economic analysis indicate a positive economic and fiscal result for the jurisdictions. However, auditors were unable to determine if this result would be similar for other vacant or underutilized property being redeveloped.

Success of tax abatement in promoting redevelopment unknown—Auditors were unable to evaluate the success of tax abatement, as modified on June 1, 2010, in promoting redevelopment in slum or blighted areas because either insufficient time has passed or information to evaluate tax abatements was not available. As previously mentioned, the payment of GPLET may be abated for a period of up to 8 years, and the government property improvement leases auditors identified were still in the abatement period. Specifically, auditors identified two abated government property improvements entered in calendar year 2013, which will continue to be abated until 2020 or later. Additionally, auditors were unable to measure the success of the abatement because information regarding the economic and fiscal benefits of these leases was not available.¹ Until sufficient time has passed and information is available to measure the economic impact, the success of tax abatement in promoting redevelopment cannot be measured.

¹ A.R.S. §42-6206(B)(1)(b) requires the government lessor to determine that within the term of the lease or development agreement, the economic and fiscal benefit to the government will exceed the benefits received by the lessee for development agreements entered after June 1, 2010. Pursuant to statute, this shall be determined by obtaining an economic analysis from a third party. However, a lease or development agreement for residential rental housing is exempt from obtaining the economic analysis.

Appendix A

Methodology

This appendix provides information on the methods used to meet the objectives of the special audit of GPLET. The Auditor General and staff express appreciation to the staff at the Arizona Department of Revenue, Arizona Department of Education, the county treasurers, the county assessors, staff at the counties, cities and towns, and members of the League of Arizona Cities and Towns for their cooperation and assistance throughout the special audit.

Auditors used a variety of methods to study the viability of the government property lease excise tax (GPLET) revenue stream and other issues addressed in this report. These methods included reviewing applicable laws, conducting interviews with staff at each of the 15 counties, which included the county treasurers, county assessors, and finance personnel; government lessors, including staff at various cities and towns; the Arizona Department of Revenue (ADOR); the Arizona Department of Education; and members of the League of Arizona Cities and Towns. Auditors also reviewed government property improvement lease agreements, GPLET return forms, the County Treasurer Reporting Forms, and other records.

As previously mentioned in Chapter 2 on page 17, the County Treasurer Reporting Forms were incomplete or incorrect and government lessors did not maintain a complete listing of properties subject to GPLET. As a result, auditors could not identify a complete population of lease agreements subject to GPLET. In order to estimate the number of GPLET leases subject to laws established as of June 1, 2010, auditors had to analyze lease agreements, development agreements, meeting minutes, and the County Treasurer Reporting Forms to estimate a population. Specifically, based on auditors' analysis of the County Treasurer Reporting Forms for calendar years 2010 through 2014, lease agreements on the ADOR's Web site as of March 17, 2015, and discussions with various government lessors, auditors identified a total of 24 lease agreements within the 5-year period that were subject to the new laws established as of June 1, 2010. Of these lease agreements, 22 paid GPLET during the 5-year period and 2 were abated or temporarily suspended from paying GPLET.

In addition, auditors used the following specific methods:

- To assess the viability of the GPLET revenue stream, as modified in 2010, auditors analyzed the lease agreements reported on the calendar year 2014 County Treasurer Reporting Forms because they were the most recent County Treasurer Reporting Forms available and compared those to the lease agreements on the ADOR's Web site as of March 17, 2015.¹ Auditors identified 268 lease agreements in effect during January 1, 2014 through December 31, 2014. Auditors further analyzed those lease agreements and determined that 131 were exempt from paying GPLET, 121 were subject to the old laws and lower GPLET rates, and 16 were subject to the new laws and GPLET rates.² However, as previously mentioned in Chapter 1 on page 10 and Chapter 2 on page 17, not all exempt leases were reported and the County Treasurer Reporting Forms were incomplete or incorrect.

¹ Government lessors should provide the ADOR with a copy of the lease within 30 days of signing. Therefore, auditors used the ADOR's database as of March 17, 2015, because that would have provided sufficient time—more than the required 30 days—for the government lessor to provide the copy and for the ADOR to include the lease within the database.

² Auditors' analysis of the 16 lease agreements in calendar year 2014 did not include 8 lease agreements in the population of 24 leases because 4 lease agreements were unavailable to analyze, 3 lease agreements expired prior to calendar year 2014, and 1 lease agreement was incorrectly assessed GPLET as previously mentioned in Chapter 2 on page 17.

- To assess the accountability for government property improvement leases subject to GPLET, the efficiencies in collecting and distributing GPLET, and compliance with laws, auditors sampled from the 22 leases paying GPLET in effect from June 1, 2010 through December 31, 2014. Specifically, auditors selected a random sample of 12 lease agreements, ensuring the sample included at least 1 lease from each government lessor and payments throughout the audit period, and evaluated the GPLET liabilities to ensure GPLET was appropriately assessed, collected, distributed, and reported. Additionally, auditors examined the 12 lease agreements to evaluate if all applicable GPLET payments had been made by the lessees during calendar years 2010 through 2014.
- To assess the property tax revenues previously being received from vacant or underutilized property, tax revenues generated from new economic activity, and the success of tax abatement in promoting redevelopment in slum and blighted areas, auditors examined the sample of 12 leases agreements paying GPLET and two abated government property improvement leases. From these leases, auditors identified only one lease agreement that met the considerations for test work for property tax revenues previously being received from vacant or underutilized property and tax revenues generated from new economic activity. For this lease, auditors reviewed the lease agreement, economic analysis completed by an independent third party, and prior property taxes paid for the property. However, because there was only one lease agreement, auditors were unable to assess the success of the activities or make recommendations for improvement. Further, auditors were unable to evaluate the success of the tax abatement in promoting redevelopment in slum or blighted areas of the two abated government property improvement leases because sufficient time had not passed.

