

STATE OF ARIZONA

Arizona Department of Revenue



Douglas A. Ducey
Governor

Carlton Woodruff
Interim Director

March 8, 2019

Lindsey Perry, Auditor General
Arizona Office of the Auditor General
2910 North 44th Street, Suite 410
Phoenix, Arizona 85018

Dear Ms. Perry:

The Arizona Department of Revenue (Department) appreciates the opportunity to respond to the report of the Auditor General, *A Performance Audit: TPT Administration and Enforcement*. Additionally, the Department would like to thank your staff for the professional and collaborative approach of the Office of the Auditor General during the audit process. As discussed in the enclosed response, the Department will implement all recommendations contained in the report.

Thank you,

Carlton Woodruff
Interim Director

Finding 1: Department should ensure businesses have active TPT licenses

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

identified, how the identified errors are resolved, and who is responsible for overseeing the review process.

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

Finding 7: Department should enforce existing statutory TPT filing requirements

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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