

NOTICES OF FINAL RULEMAKING

The Administrative Procedure Act requires the publication of the final rules of the state's agencies. Final rules are those which have appeared in the *Register* first as proposed rules and have been through the formal rulemaking process including approval by the Governor's Regulatory Review Council or the Attorney General. The Secretary of State shall publish the notice along with the Preamble and the full text in the next available issue of the *Register* after the final rules have been submitted for filing and publication.

NOTICE OF FINAL RULEMAKING

TITLE 15. REVENUE

CHAPTER 2. DEPARTMENT OF REVENUE INCOME AND WITHHOLDING TAX SECTION

SUBCHAPTER E. TAX EXEMPT ORGANIZATIONS

PREAMBLE

- 1. Sections Affected**

R15-2E-101	<u>Rulemaking Action</u>
R15-2E-201	Amend
R15-2E-202	Amend
R15-2E-203	Amend
R15-2E-301	Amend
- 2. The specific authority for the rulemaking, including both the authorizing statute (general) and the statutes the rules are implementing (specific):**

Authorizing statute: A.R.S. § 42-1005

Implementing statutes: A.R.S. §§ 43-1201, 43-1202, 43-1211, 43-1212, 43-1213, 43-1214, 43-1215, 43-1216, 43-1231, and 43-1242
- 3. The effective date of the rules:**

May 14, 2001
- 4. A list of all previous notices appearing in the Register addressing the final rule:**

Notice of Rulemaking Docket Opening: 6 A.A.R. 1916, May 26, 2000

Notice of Recodification: 6 A.A.R. 2308, June 23, 2000

Notice of Proposed Rulemaking: 7 A.A.R. 618, February 2, 2001
- 5. The name and address of agency personnel with whom persons may communicate regarding the rulemaking:**

Name:	Jim Bilski, Tax Analyst
Address:	Tax Research & Analysis Section Arizona Department of Revenue 1600 W. Monroe Phoenix, AZ 85007
Telephone:	(602) 542-4672
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- 6. An explanation of the rule, including the agency's reasons for initiating the rule:**

These rules describe the circumstances for denying an organization's tax-exempt status, how the organization can regain its tax-exempt status, and the return filing requirements for tax-exempt organizations. As a result of legislative changes and the five-year review of 15 A.A.C. 2, the Department is proposing to amend the rules to conform to current statutes, remove language that is obsolete or that is repetitive of statute, and conform to current rulemaking guidelines.

7. Reference to any study that the agency relied on in its evaluation of or justification for the final rule and where the public may obtain or review the study, all data underlying each study, any analysis of the study and other supporting material:

None

8. A showing of good cause why the rule is necessary to promote a statewide interest if the rule will diminish a previous grant of authority of a political subdivision of this state:

Not applicable

9. The summary of the economic, small business, and consumer impact:

It is expected that the benefits of the rules will be greater than the costs. The amendment of these rules will benefit the public by making the rules conform to current statute, removing language that is obsolete or that is repetitive of statute, rearranging the rules in a more logical manner and conforming to current rulemaking guidelines, which will make the rules more accurate as well as clearer and easier to understand. The Governor's Regulatory Review Council, the Secretary of State's Office, and the Department will incur the costs associated with the rulemaking process. Taxpayers are not expected to incur any expense in the amendment of these rules.

10. A description of the changes between the proposed rules, including supplemental notices, and final rules (if applicable):

As recommended by the staff of the Governor's Regulatory Review Council, the Department made various nonsubstantive grammatical and formatting changes.

11. A summary of the principal comments and the agency response to them:

The Department did not receive any written or oral comments on the rulemaking actions after the publication of the Notice of Proposed Rulemaking.

12. Any other matters prescribed by statute that are applicable to the specific agency or to any specific rule or class of rules:

None

13. Incorporations by reference and their location in the rules:

None

14. Was the rule previously adopted as an emergency rule?

No

15. The full text of the rules follows:

TITLE 15. REVENUE

**CHAPTER 2. DEPARTMENT OF REVENUE
INCOME AND WITHHOLDING TAX SECTION**

SUBCHAPTER E. TAX-EXEMPT ORGANIZATIONS

ARTICLE 1. ORGANIZATIONS EXEMPT FROM TAX

Section

R15-2E-101. Feeder Organization Not Exempt from Tax

ARTICLE 2. DENIAL OF EXEMPT STATUS

Section

R15-2E-201. Denial of Exemption to ~~Organizations Engaged in Prohibited Transactions~~

R15-2E-202. ~~Determination of Reasonable Accumulation of Income~~ Denial of Exemption Under A.R.S. § 43-1214 in the Case of Certain Organizations Accumulating Incomes

R15-2E-203. ~~Procedure to Recover Exempt Status~~ Future Status of Organization Denied Exemption

ARTICLE 3. RETURNS OF EXEMPT ORGANIZATIONS

Section

R15-2E-301. Returns of Tax-Exempt Organizations

ARTICLE 1. ORGANIZATIONS EXEMPT FROM TAX

R15-2E-101. Feeder Organization Not Exempt from Tax

A. ~~In determining the primary purpose of an organization~~ For purposes of A.R.S. § Section 43-1202, all circumstances must be considered, including the size and extent of the trade or business and as well as the size and the extent of those

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activities of ~~the that~~ organization that are specified in the applicable paragraph of A.R.S. § Section 43-1201 ~~in determining the primary purpose of an organization.~~

1. If a subsidiary organization of a tax-exempt parent organization ~~is would itself be exempt on the ground that the activities of the organization are an integral part of the exempt activities of the parent organization, the exemption will remain valid not be lost even if~~ because, as a matter of accounting between the 2 organizations, the subsidiary derives a profit from the dealings with the parent organization; ~~for example,~~

Example: A ~~a~~ subsidiary organization that is operated for the sole purpose of furnishing electric power used by the tax-exempt parent organization ~~is exempt from tax, which is a tax-exempt educational organization in carrying on its educational activities.~~

2. ~~However, If the~~ a subsidiary organization of a tax-exempt parent organization is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business ~~that which is would be an unrelated trade or business, unrelated to the parent's exempt activities, if regularly carried on by the parent organization. then the subsidiary organization is not exempt from tax.~~

Example: For example, if ~~If~~ a subsidiary organization is operated primarily for the purpose of furnishing electric power to consumers other than the tax-exempt parent organization ~~and the subsidiary organizations of the tax-exempt parent, then it the subsidiary organization is not exempt since such because the business would be an unrelated trade or business if regularly carried on by the parent organization. Similarly, if the subsidiary is owned by several unrelated exempt organizations and is operated for the purpose of furnishing electric power to each of them, it is not exempt since such because the business would be an unrelated trade or business if regularly carried on by any 1 of the tax-exempt organizations.~~

B. In certain cases, an organization that carries on a trade or business for profit but is not operated for the primary purpose of carrying on ~~such the~~ trade or business is subject to tax under A.R.S. Section § 43-1231.

ARTICLE 2. DENIAL OF EXEMPT STATUS

R15-2E-201. Denial of Exemption to Organizations Engaged in Prohibited Transactions

~~A. The prohibited transactions enumerated in Section 43-1213, are in addition to and not in limitation of the restrictions contained in Section 43-1201, paragraph (4). Even though an organization has not engaged in any of the prohibited transactions referred to in Section 43-1213, it still may not qualify for tax exemption in view of the general provisions of Section 43-1201.~~

~~B. An organization described in Section 43-1201 which has engaged in any prohibited transaction after December 31, 1953, shall not be exempt from taxation under Section 43-1201 for any taxable year subsequent to the taxable year in which there is mailed to it a notice in writing by the Department that it has engaged in such prohibited transaction. Such notification by the Department shall be by registered mail to the last known address of the organization. However, notwithstanding the requirement of notification by the Department, exemption shall be denied with respect to any taxable year if such organization during or prior to such taxable year commenced the prohibited transaction with the purpose of diverting income or corpus from the exempt purposes and such transaction involved a substantial part of the income or corpus of such organization. The term, "taxable year" for the purpose of this section means the established annual accounting period of the organization, or if the organization does not have such an established annual accounting period, the "taxable year" of the organization means the calendar year.~~

~~A. The Department shall deny exempt status to an organization described in A.R.S. § 43-1201(4), if the organization:~~

- ~~1. Violates the restrictions in A.R.S. § 43-1201(4), or~~
- ~~2. Engages in any of the prohibited transactions listed in A.R.S. § 43-1213, or~~
- ~~3. Has unreasonable accumulations of income as defined in A.R.S. § 43-1214 at the end of the taxable year.~~

~~B. Subsections (A)(2) and (A)(3) do not apply to organizations listed in A.R.S. § 43-1215.~~

~~C. The Department shall send written notification to an organization that is denied exemption under subsection (A). The Department shall send the notification by registered mail to the last known address of the organization.~~

R15-2E-202. Determination of Reasonable Accumulation of Income Denial of Exemption Under Section 43-1214 in the Case of Certain Organizations Accumulating Incomes

~~A. Any organization described in Section 43-1201 other than an organization described in Section 43-1215 shall not be exempt under Section 43-1201 if the amounts accumulated out of income during the taxable year or any prior taxable years but not actually paid out for exempt purposes by the end of the taxable year are unreasonable. Amounts accumulated from income become unreasonable when more income is accumulated than is needed or when the duration of the accumulation is longer than is needed in order to carry out the purpose constituting the basis for the exemption of the organization. Furthermore, an organization shall not be exempt under Section 43-1201 if amounts accumulated from income are used to a substantial degree for purposes or functions other than those constituting the basis for the organization's exemption or if such amounts are invested in such a manner as to jeopardize the carrying out of the purpose of function constituting the basis for the exemption of the organization.~~

~~B-A. The term, "income", for For the purpose of A.R.S. Section § 43-1214, "income" is determined means gains, profits, and income determined under the same principles applicable used to determine in determining the earnings or profits of a cor-~~

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poration. ~~The amount accumulated from income during the taxable year or any prior taxable year shall be determined under the principles applicable in determining the accumulated earnings or profits of a corporation. The following are not included in~~ in determining the reasonableness of an accumulation ~~of from income, the following will be disregarded:~~

1. The accumulation of gain on the sale or exchange of a donated asset to the extent that ~~such~~ the gain represents the excess of the fair market value of ~~such~~ the assets when acquired by the organization over the substituted basis in the hands of the organization, ~~and~~
2. The accumulation of gain on the sale or exchange of property held for the production of investment income such as dividends, interest, and rents where the proceeds of that sale or exchange are within a reasonable time reinvested in property acquired and held in good faith for the production of investment income.

~~C.B.~~ Whether the conditions specified in A.R.S. Section § 43-1214 are present in any case ~~must~~ shall be determined from all the facts. The conditions specified in A.R.S. Section § 43-1214 may result from the use of only 1 organization or of a chain of 2 or more organizations.

R15-2E-203. Procedure to Recover Exempt Status ~~Future Status of Organization Denied Exemption~~

- A. Any organization denied exemption under A.R.S. Section § 43-1201(4), ~~due to by reason of~~ the provisions of A.R.S. Section §§ 43-1211 or 43-1212 may file a new claim for exemption with the Department, ~~in any taxable year following the taxable year in which notice of denial of exemption was issued.~~ The claim shall ~~must~~ contain ~~or have attached in addition to~~ the information generally required of an organization claiming exemption under A.R.S. Section § 43-1201 ~~and~~ an affidavit that the organization has ceased engaging in any transactions prohibited by A.R.S. Section § 43-1213 and will not knowingly engage in a prohibited transaction. ~~An authorized~~ prepared by a principal officer of that ~~the~~ organization shall sign the ~~authorized to make that~~ affidavit.
- B. If the Department has determined that ~~such organization has ceased engaging in any transactions prohibited by Section 43-1213 and the Department is satisfied that such organization will not knowingly again engage in a prohibited transaction and that the organization also satisfies all other standards under Section 43-1201, it~~ The Department shall notify the organization in writing ~~if it has satisfied all exemption requirements.~~ The organization in such case will be exempt subject to the provisions of Sections 43-1201 and 43-1211 with respect to the taxable years subsequent to the taxable year in which such claim is filed. Section 43-1216 contemplates that an organization denied exemption because of the terms of such section will be subject to taxation for at least 1 full taxable year. The term "taxable year" for the purposes of this Section means the established annual accounting period of the organization; or if the organization does not have an established annual accounting period, the "taxable year" of the organization means the calendar year.

ARTICLE 3. RETURNS OF EXEMPT ORGANIZATIONS

R15-2E-301. Returns of Tax-Exempt Organizations

- A. ~~Requirement of annual returns.~~ Every organization required to file a return under A.R.S. § 43-1242 ~~except those set forth in Section 43-1242(A), exempt from tax under Section 43-1201 having gross income in excess of \$25,000 irrespective of whether it is chartered by, or affiliated or associated with any central parent, or any other organization except organizations specifically exempted from filing annual returns shall file annually with the Department a return of information specifically stating the items of gross income, receipts, and disbursements, and such other information as may be prescribed by the Department in the instructions on the form or issued by it therewith. Returns shall~~ file the return be on the basis of the established annual accounting period of the organization. ~~If~~ Where the organization does not have ~~such~~ an established accounting period, ~~then such returns~~ the return is due ~~shall~~ be on the basis of the calendar year.
- B. ~~Date for filing annual returns.~~ The Tax-exempt organizations shall file the Arizona exempt organization annual information returns ~~return or a copy of its equivalent federal information return of information shall be filed to the Department on or before the 15th day of the 5th full calendar month following~~ after the close of the period for which the return is required to be filed taxable year.