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Arizona

Prepared by Lex Mundi member firm,
Snell & Wilmer L.L.P.

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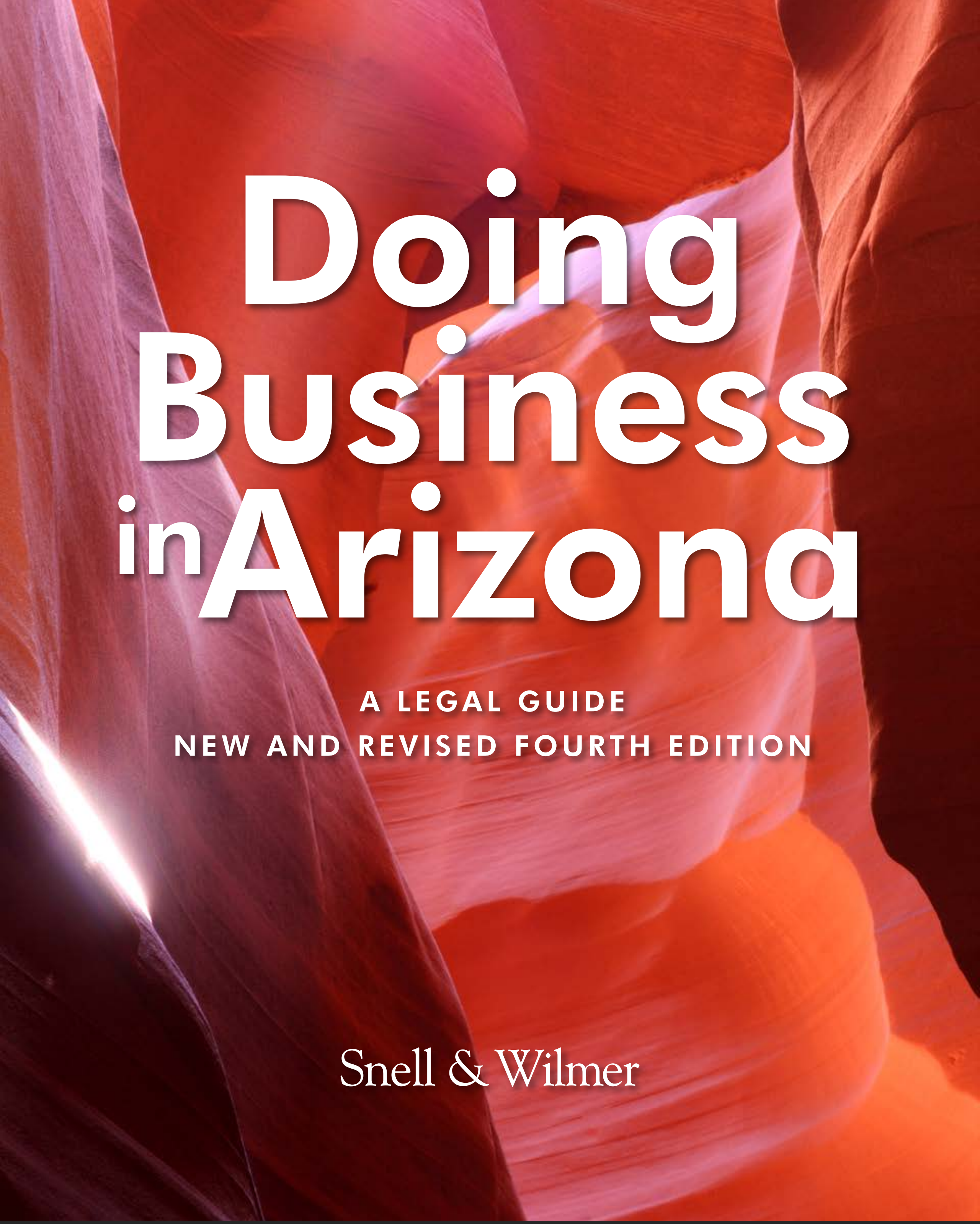

Doing Business in Arizona

A LEGAL GUIDE

NEW AND REVISED FOURTH EDITION

Snell & Wilmer

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DOING BUSINESS IN ARIZONA

A LEGAL GUIDE

New and Revised Fourth Edition

by

Snell & Wilmer L.L.P.

Layout and design by Eddie Gordon

Dedicated to the continued growth of good business in Arizona

ACKNOWLEDGEMENTS

Doing Business in Arizona is a reference book that has evolved over many years through its published four editions. While the names of the original authors from the first editions may have faded, we owe a debt of gratitude for their hard work in pioneering the inaugural and subsequent editions of the book.

As the editor, I'd like to acknowledge partners Barry Halpern and Barb Dawson for their leadership and involvement in Lex Mundi over the years.

As the bulk of Doing Business in Arizona contains numerous business and finance articles, I extend a big thank you to the Business and Finance group that wrote many chapters of this book. Extra credit thanks to Business and Finance attorneys Joseph Miller, Michael Donahey and Jeffrey Scudder for their collaboration on writing six articles. Additional Snell & Wilmer attorneys who authored the chapters in Section III include John F. Baird, M. Lawrence Brown, Manuel H. Cairo, Nancy K. Campbell, R. Shane Capps, Christopher P. Colyer, Michael M. Donahey, Marc A. Erpenbeck, Dan W. Goldfine, Joshua Grabel, Geoffrey L. Gunnerson, Charles F. Hauff Jr., William A. Kastin, Stephanie R. Leach, Michael T. Liburdi, Carlene Y. Lowry, Karlene E. Martorana, Craig R. McPike, Monica C. Michelizzi, Joseph M. Miller, Bahar A. Schippel, Jeffrey A. Scudder, L. William Staudenmaier, Marvin S. ("Bucky") Swift, Jr., Joseph Yoshimitsu Viola and Rebecca A. Winterscheidt.

Writing this book has truly been a collaborative effort. Other Snell & Wilmer attorneys on the Ethics Committee reviewed every word of this document. Special thanks to the Ethics team: Robert F. Kethcart, lead Ethics attorney; Anne W. Bishop, Benjamin M. Greenberg and Benjamin W. Reeves.

Snell & Wilmer

As the largest business law firm in Arizona and one of the largest in the western United States, Snell & Wilmer handles the full range of transactional and litigation legal issues facing businesses today. Over the years, our attorneys have gained extensive experience representing businesses of all sizes across virtually every industry.

Snell & Wilmer represents clients ranging from large, publicly traded, multinational corporations to small businesses, emerging enterprises, individuals and entrepreneurs. We have worked with clients through every stage of business development and growth, many of whom have yielded some of Arizona's most viable business ventures. Our clients value working with a legal team that not only knows the law, but understands their business, their industry, and the trends and challenges that can affect their ability to minimize risk and maximize success. Such an understanding is critical to building and maintaining successful relationships.

Given the depth and breadth of our experience, our attorneys provide the highest quality legal advice and business counsel. The long-term business and strategic relationships we have forged over the years have sustained our firm's Phoenix and Tucson, Arizona offices. These same relationships have helped fuel the expansion of Snell & Wilmer throughout the West, matching the geographic footprint of many of our clients' growing businesses.

Snell & Wilmer's commitment to helping businesses succeed in Arizona is the driving force behind our publication of this fourth edition of Doing Business in Arizona. Through a broad discussion of common legal issues faced by Arizona businesses, especially those that are unique to the state, we anticipate that this book will serve as an invaluable resource to companies and entrepreneurs starting or expanding a business in Arizona.

Snell & Wilmer L.L.P.

John J. Bouma, Chairman

Brett W. Johnson, Editor

CONTRIBUTING AUTHORS

Editor
Brett W. Johnson

Antitrust
Michael T. Liburdi and Dan W. Goldfine

Conventional Financing
Marc R. Currie

Corporations
Joseph M. Miller, Jeffrey A. Scudder and Michael M. Donahey

Employee Benefits
Nancy K. Campbell and Marvin S. ("Bucky") Swift, Jr.

Employment
Stephanie R. Leach

Federal Income Taxation
Geoffrey L. Gunnerson, William A. Kastin, Bahar A. Schippel and Carlene Y. Lowry

Forms of Business Ownership
Joseph M. Miller, Jeffrey A. Scudder and Michael M. Donahey

General Partnerships
Joseph M. Miller, Jeffrey A. Scudder and Michael M. Donahey

Immigration
Manuel H. Cairo and Rebecca A. Winterscheidt

Intellectual Property
R. Shane Capps and Charles F. Hauff Jr.

Limited Liability Companies
Joseph M. Miller, Jeffrey A. Scudder and Michael M. Donahey

Limited Partnerships
Joseph M. Miller, Jeffrey A. Scudder and Michael M. Donahey

Real Property
M. Lawrence Brown, Joseph Yoshimitsu Viola, John F. Baird and Joshua Grabel

Sole Proprietorships
Joseph M. Miller, Jeffrey A. Scudder and Michael M. Donahey

Tax Exempt Financing
Monica C. Michelizzi

Environmental
Christopher P. Colyer and Marc A. Erpenbeck

State and Local Taxation
Craig R. McPike

Water Rights
Karlene E. Martorana and L. William Staudenmaier

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PART I: A BRIEF FACTUAL LOOK AT ARIZONA

Arizona is highly regarded for its sunshine, spring training baseball, the Grand Canyon and spectacular vistas. Beyond the sunrises, sunsets and overall scenery, Arizona ranks as the 10th best in the nation for its business climate, which includes affordable housing, low taxes, small state government, favorable regulations, a skilled, available workforce and quality of life. Arizona is home to thousands of prospering companies.

The following is a snapshot of where Arizona ranks in the Top 10:

No. 1	The Phoenix-Mesa-Glendale metroplex leads Atlantic Cities' "Top Ten Cities" list for "Where the Jobs Are in 2020."
	Phoenix leads nation in home value gains (Core-Logic) The Phoenix-Mesa metro took the No. 1 position on the list with a 23.5 percent jump in median list prices from a year ago, to $179,000.
	ASU: No. 1 ranking as the nation's largest school in terms of enrollment figures.
	First in overall work force (CNBC, 2011).
	No. 1 in most business start-ups (*Business Facilities* magazine).
No. 2	Arizona is ranked No. 2 among "Alternate Energy Industry Leaders."
	Tucson is ranked No. 2 among Atlantic Cities' "Top Ten Cities" list for "Where the Jobs Are in 2020."
	Second lowest in the nation in unemployment insurance tax (Small Business and Entrepreneurship Council, 2010).

No. 3	Arizona is ranked third in the nation for new construction jobs.
	Arizona has the third most solar-related jobs in the country.
	Arizona is ranked No. 3 in "Biotechnology Strength Emerging Biotech Hubs."
	Arizona is ranked third lowest in the nation in state and local government employees per 100 residents (Beacon Hill Institute, 2008).
No. 4	Arizona ranked No. 4 in job growth in the past year, from July 2011 to July 2012. Phoenix tied for the fourth-highest growth among metro areas, according to the ASU analysis of data from the U.S. Bureau of Labor Statistics.
No. 5	Arizona is ranked No. 5 in "Aerospace/Defense Industry Leaders" (*Business Facilities* magazine).
No. 6	Phoenix is the sixth largest city in the United States with a population of 1,445,632. Phoenix grew 9.4 percent since 2000.
	Sixth lowest in the nation in property taxes (Small Business and Entrepreneurship Council, 2010).
No. 8	Arizona is ranked eighth in the nation in government and fiscal policy (Beacon Hill Institute, 2008).
No. 10	Arizona ranks as the 10th best in the nation for its business climate.

Population and Job Growth

SINCE 2000, Arizona's population has increased by 24.6 percent, which was the nation's second largest percentage increase. The U.S. population, as a whole, increased by 9.7 percent. Arizona's growth rate represents a 60.5 percent increase over the national average.[1]

Of Arizona's largest 10 cities, nine are in Maricopa County. The only city in the top 10 that is not in Maricopa County is Tucson, located in Pima County, another of Arizona's 15 counties.

Population Trends

	2010	2005	2000
Arizona	6,392,017	5,939,292	5,130,632
Phoenix	1,445,632	1,461,575	1,321,045
Tucson	520,116	529,770	486,699[1]

Data from U.S. Census

The majority of the growth is in Maricopa County, the fourth largest county in the country. Maricopa County's population grew 24.2 percent.

1 U.S. Census Bureau: http://www.census.gov/population/projections/SummaryTabA1.pdf

The Phoenix-Mesa-Glendale metropolitan area has a population of 4,192,887 making it the 13th largest U.S. metropolitan area. Metro Phoenix grew by 28.9 percent from 2000 to 2010.

Out of 263 cities nationwide, nine incorporated cities in the Phoenix metro area have a population of 100,000 or more. They are Chandler, Gilbert, Glendale, Mesa, Peoria, Phoenix, Scottsdale, Surprise and Tempe. Of those nine cities, Gilbert and Surprise posted the largest gains at 90 and 283 percent respectively. Data on the nine cities follows:

1. Phoenix, the state's capital, is ranked No. 6 in population (1,445,632) and grew 9.4 percent since 2000.
2. Mesa is ranked No. 38 (439,041) and grew 10.8 percent since 2000.
3. Chandler is ranked No. 80 (236,123) and grew 33.7 percent since 2000.
4. Glendale is ranked No. 88 (226,721) and grew 3.6 percent since 2000.
5. Scottsdale is ranked No. 92 and grew 7.2 percent since 2000.
6. Gilbert is ranked No. 101 and grew 90 percent since 2000.
7. Tempe is ranked No. 146 and grew 2 percent since 2000.
8. Peoria is ranked No. 153 and grew 42.2 percent since 2000.

9. Surprise is ranked No. 216 and grew 281 percent since 2000.

Posting the largest population increase in Arizona is the city of Maricopa, located just south of greater Phoenix. Maricopa's population increased 4,081 percent up from 1,040 in 2000 to 43,482 in 2010. The town of Sahuarita, located south of Tucson, grew 679.1 percent in population from 3,242 in 2000 to 25,259 in 2010.[2]

- According to U.S. Census figures, Pima County's population fell from 2009-2010 for the first time on record.
- State health department figures report that the number of Arizona births is dropping at the fastest rate since 1950.

2 Green Valley News, March 16, 2011, "Sahuarita is second-fastest growing area in state" http://www.gvnews.com/sahuarita_sun/article_8f2a2e0e-4fec-11e0-8d0b-001cc4c002e0.html

Ten largest U.S. Cities 2005 and 2010 (number in thousands)

		POPULATION		Change from 2005 to 2010	
RANK	**CITY**	**2005**	**2010**	**Number**	**Percent**
1.	New York, NY	8,143.2	8,175.1	31.9	.4
2.	Los Angeles, CA	3,844.8	3,792.6	-52.5	-1.7
3.	Chicago, IL	2,842.5	2,695.6	-147	-5.1
4.	Houston, TX	2,016.6	2,099.4	82.8	4.1
5.	Philadelphia, PA	1,463.3	1,526.0	62.7	42.
6.	Phoenix, AZ	1,461.6	1,445.6	-17.7	-1.21
7.	San Antonio, TX	1,256.5	1,327.4	70.9	5.6
8.	San Diego, CA	1,255.5	1,307.4	51.9	4.1
9.	Dallas, TX	1,213.8	1,197.8	-16	-13.1
10.	San Jose, CA	912.3	946	33.6	3.6

Arizona ranked No. 4 in job growth in the past year, from July 2011 to July 2012. Phoenix tied for the fourth-highest growth among metro areas, according to the ASU analysis of data from the U.S. Bureau of Labor Statistics.[3]

Overall, the Phoenix metro area added 36,500 jobs between April 2011 and April 2012, placing it fifth in the country for total job gains.[4] Specifically, Arizona gained 6,000 medical office jobs in 2011, paying an average annual salary of $55,000. Arizona also added 3,400 jobs averaging $65,000 a year in professional and technical services fields.

Forbes ranks Phoenix 9th among USA's Boom Towns

According to a July 2011 article by Forbes.com, Phoenix is one of Forbes top 10 "Next Big Boom Towns" predicted for the next decade. Forbes ranks Phoenix ninth overall among the country's 52 largest metro areas. Forbes' ranking was based on job growth, family formation, population growth, migration of educated workers and immigrants, and business startup potential.[5]

3 Azcentral.com, "Arizona ranks 4th in Job Growth, August 23, 2012 http://www.azcentral.com/business/articles/20120823arizona-ranks-th-job-growth.html

4 Phoenix Business Journal, "Phoenix No. 5 for job growth during past year," June 4, 2012 http://www.bizjournals.com/phoenix/news/2012/06/04/phoenix-no-5-for-job-growth-during.html

5 Forbes magazine, "The Next Big Boom Towns In The U.S.," July 6, 2011 http://www.forbes.com/sites/joelkotkin/2011/07/06/the-next-big-boom-towns-in-the-u-s/

According to *Business Facilities* magazine, Arizona emerged as the state with the most business start-ups.[6]

The Phoenix-Mesa-Glendale metroplex leads Atlantic Cities' "Top Ten Cities" list for "Where the Jobs Are in 2020." Tucson follows its northern neighbors for the No. 2 spot. Atlantic Cities' methodology was based on industry employment projections, climate, education and density.[7]

Among metropolitan markets with a workforce of over 1,000,000, the Phoenix-Mesa-Glendale metroplex climbed to third, from 12th place, in nonagricultural job growth for June 2012 over June 2011, posting an impressive 2.69 percent gain, which represented 45,300 jobs. Other areas in which the Phoenix/Mesa/Glendale metroplex ranked in the top three are government: No. 1 overall and No. 1 in local government with 210,300 and 148,100 jobs respectively; No. 2 in construction with 90,100 jobs.[8]

Arizona ranks third in nation for construction job increase

According to the U.S. Bureau of Labor Statistics, Arizona's construction sector recorded a total of 121,100 total new con-

6 Business Facilities Magazine, "Ranking Report," July/August 2012: http://businessfacilities.com/2011/wp-content/uploads/2012/07/BFJulAug12_staterankings_LR.pdf

7 Atlantic Cities', "Where the Jobs Will Be in 2020," February 7, 2012 http://www.theatlanticcities.com/jobs-and-economy/2012/02/where-jobs-will-be-2020/1153/

8 ASU W.P. Carey School of Business http://wpcarey.asu.edu/bluechip/jobgrowth/secure_msa_over.cfm

struction jobs representing a job increase of 11,000 jobs, which equaled a 10 percent jump from the previous year, climbing to No. 3, from No. 24 in 2011 among U.S. states.[9]

Construction earnings grew $.23 billion (2.5 percent) in Arizona in the second quarter of 2012, accounting for nearly two-thirds of the national $2.75 billion gain.[10]

Non-farm job growth figures are more favorable than previous years. The 2012 figure increased slightly from 1,698,400 to 1,745,600, ranking Phoenix-Mesa-Scottsdale to No. 4 in the country. Historically, this tri-city area was ranked No. 1 in 2006, No. 8 in 2007, No. 22 in 2008, No. 26 in 2009 and 2010. By 2011, Phoenix-Mesa-Scottsdale climbed to No. 7 before reaching the No. 4 spot in 2012.

Over 2012, total non-farm employment increased by 44,700 jobs or 1.9 percent. Gains were observed in all but two of the 11 major sectors. Educational and Health Services (EHS) sector added the most jobs over the year with a gain of 17,000 (+4.9 percent) jobs. Within the EHS sector, Health Care accounted for 12,900 of the job gains, while Educational Services and Social Assistance added 2,900 and 1,200 jobs respectively. The next largest over-the-year increase was in the Leisure and Hospitality (LH) sector with 10,400 jobs added.

9 Phoenix Business Journal, "Arizona ranks third for construction job growth for May," June 18, 2012 http://www.bizjournals.com/phoenix/news/2012/06/18/arizona-ranks-third-in-construction.html?page=all

10 Bureau of Economic Analysis: http://www.bea.gov/newsreleases/regional/spi/2012/pdf/spi0912.pdf

Food Services and Drinking Places added 9,300 of the jobs gained in LH.

Growth rate in 2012 is expected to be better than 2011 across all regions. Phoenix is forecast to grow at a faster pace (1.4 percent) than Tucson (.7 percent), balance of state (.8 percent), and the state overall (1.2 percent). For 2012, the forecast job gains for Phoenix MSA (metro statistical areas) are 24,600 jobs, Tucson MSA are 2,500 jobs and balance of state are 2,800 jobs.

Gains in 2012 are expected in seven out of the 11 major sectors. Educational and Health Services; Leisure and Hospitality; and Trade, Transportation and Utilities sectors are forecast to have the majority of these job gains.

EHS is expected to have the largest job gains of all the major sectors with an increase of 28,400 jobs in Arizona, or 8.3 percent, from 2010-2012. LH is expected to add 14,500 jobs over the 2010-2012 time period.

Manufacturing is projected to have an increase of 7,000 jobs, or 4.7 percent, resulting from pent-up domestic demand and rising export demand from overseas economic expansion. Almost all fabrication industries are forecast to have job gains with the exception of aerospace because of cutbacks in federal programs and outsourcing.

For the first time since the beginning of the economic downturn in 2007, Arizona is projected to have over-the-year gains in 2011 and 2012 for a two-year total of 45,400 nonfarm jobs, or 1.9 percent. But, projected gains in nonfarm employment for Arizona have been revised downward by 12 percent since the original April forecast.[11]

11 ASU W.P. Carey School of Business: https://www.wpcarey.asu.edu/bluechip/job-growth/secure_msa_over.cfm

Personal Income

In 2011, Arizona had a per capita personal income (PCPI) of $35,875. This PCPI ranked 40th in the United States and was 86 percent of the national average of $41,663.[12] The 2011 PCPI reflected an increase of 3.9 percent from 2010. The 2010-2011 national change was 4.3 percent.[13]

12 Bureau of Economic Analysis: http://www.bea.gov/scb/pdf/2012/09 percent20September/D percent20pages/0912dpg_k.pdf

13 East Valley Tribune, "Arizona's per capita personal income up 3.9 percent in 2011," March 30, 2012: http://www.eastvalleytribune.com/money/article_20b2c662-7ac9-11e1-b682-001a4bcf887a.html

Exports

Exports have been a driving force in Arizona's economic recovery. The first half of 2011 marked the state's highest year-to-date increase in exports in at least five years as Arizona's total export sales jumped to $8.9 billion, which was a $1.2 billion increase. The rise in exports follows 10 years in which Arizona had the fourth-slowest growth rate among states in international trade, according to the administration's data.

The state's largest market was Mexico. Arizona posted merchandise exports of $6 billion to Mexico in 2011, 33.6 percent of the state's total merchandise exports. Mexico was followed by Canada ($2.1 billion), China ($1 billion), Japan ($837 million) and United Kingdom ($793 million).

The state's largest merchandise export category is computers and electronic products, which accounted for $5 billion of Arizona's total merchandise exports in 2011. Other top merchandise exports are transportation equipment ($2.8 billion), machinery ($1.7 billion), minerals and ores ($1.3 billion) and agricultural products ($1 billion).

Despite the growing numbers, the past two years are still down from the 2008 record of $19.8 billion. Arizona's export shipments of merchandise in 2011 totaled $17.8 billion.

In 2010, the following metropolitan areas in Arizona recorded merchandise exports: Phoenix-Mesa-Scottsdale ($9.3

billion), Tucson ($2.1 billion), Yuma ($258 million), Flagstaff ($163 million), Lake Havasu City-Kingman ($126 million) and Prescott ($49.2 million).

Arizona is the largest copper exporter in the U.S. and rising copper prices were a major factor in Arizona's burgeoning export figures that have been rising steadily since 2009. Average copper prices during the first quarter in 2012 were $3.82 per pound. Copper prices averaged $4.31 per pound during the first quarter in 2011, up about $1 per pound a year earlier. Average copper prices in 2011 averaged $4.31 per pound during the first quarter in 2011, up about $1 per pound a year earlier, Phoenix-based Freeport McMoRan Copper & Gold Inc. said in a financial report.[14]

Arizona businesses exported $17.5 billion worth of goods and materials in 2011, a 12 percent increase over 2010, when Arizona's exports totaled $15.6 billion.

Exports of NAICS Total All Merchandise from Arizona

	2006	2007	2008	2009	2010	2011
World	18,299,246,622	19,227,791,370	19,784,243,422	14,023,462,270	15,635,757,846	17,793,213,040
Mexico	5,369,420,286	5,235,202,519	5,909,663,703	4,546,743,514	5,053,241,813	5,971,962,036
Canada	1,846,933,936	2,193,280,071	2,319,476,445	1,762,315,711	1,960,522,904	2,135,184,416
China	1,196,296,678	1,317,118,960	1,254,539,127	821,766,006	1,037,248,587	1,002,824,075

14 Cronkite News, "Growing Mexican trade helps Arizona keep pace with other states," October 31, 2011: http://cronkitenewsonline.com/2011/10/growing-mexican-trade-helps-arizona-exports-keep-pace-with-other-states/

Japan	686,017,730	716,381,878	731,701,015	526,363,923	623,567,753	837,058,880
UK	802,941,378	959,219,602	1,012,956,668	596,731,473	658,268,431	793,425,061
Germany	755,464,086	1,011,120,486	963,765,855	586,679,198	662,697,780	769,910,544
Singapore	1,242,644,027	1,139,645,176	1,008,036,129	524,483,981	660,231,870	583,919,320
Thailand	443,901,360	492,745,622	468,579,906	306,944,438	606,610,837	553,874,922
Malaysia	807,955,375	539,240,114	382,443,594	339,718,072	411,085,981	498,856,409
France	495,831,226	512,032,650	608,249,965	493,645,131	431,008,595	484,895,782

Provided by the Office of Trade and Industry Information (OTII), Manufacturing and Services, International Trade Administration, U.S. Department of Commerce[15]

Exports Support Jobs for Arizona's Workers

Export-supported jobs linked to manufacturing account for an estimated 4.3 percent of Arizona's total private-sector employment. Over one-quarter (25.6 percent) of all manufacturing workers in Arizona depend on exports for their jobs (2009 data latest available).

Exports Sustain Thousands of Arizona Businesses

A total of 5,359 companies exported from Arizona locations in 2009. Of those, 4,772 (89 percent) were small and medium-sized enterprises with fewer than 500 employees.

Small and medium-sized firms generated over one-quarter (28 percent) of Arizona's total exports of merchandise in 2009.[16]

15 U.S. Department of Commerce: http://tse.export.gov/TSE/MapDisplay.aspx

16 Department of Commerce—International Trade Administration http://www.trade.gov/mas/ian/statereports/states/az.pdf

Leading Industries

Arizona's healthcare facilities that draw patients from around the world include the Mayo Clinic Hospital in Phoenix, Cancer Treatment Centers of America in Goodyear and Barrow Neurological Institute in Phoenix. Banner Health, the Mayo Clinic and Dignity Health (formerly Catholic Healthcare West) are among the medical companies that have added employees.

The Phoenix Area is Ranked First Among All U.S. Metro Areas in Growth in Health-Care Jobs

Dignity Health, which includes St. Joseph's Hospital and Medical Center and Chandler Regional Hospital, has or will be adding workers because of a shift to electronic medical records and additional physician hires in some programs, such as neurology, obstetrics and gynecology.[17]

Arizona's construction sector saw major growth over the past year as it is currently ranked third for construction job

17 Arizona Republic, Arizona top companies: Jobs added in 2010, April 24, 2011 http://www.azcentral.com/business/articles/2011/04/24/20110424arizona-top-companies-job-growth.html

growth. A total of 121,100 total construction jobs were posted in Arizona in May 2012, which was up 11,000 from 2011.[18]

Arizona's 25 Largest Employers[19]

Employer	City	2012 Employees	2011 Employees	2011 Ranking	Employee Change from 2011
1. Wal-Mart	Bentonville, AR	31,637	30,000	1	+5.2 percent
2. Banner Health	Phoenix, AZ	28,993	28,353	2	+2.2 percent
3. Wells Fargo	San Francisco, CA	13,859	14,000	3	-1 percent
4. Bank of America	Charlotte, NC	13,000	13,000	4	–
5. McDonalds	Oakbrook, IL	12,770	12,770	5	–
6. Raytheon	Waltham, MA	12,000	11,500	8	+4.2 percent
7. J.P. Morgan Chase	New York, NY	11,600	10,500	9	+9.5 percent
8. Apollo Group	Phoenix, AZ	11,031	12,000	6	-8.1 percent
9. Intel Corp	Santa Clara, CA	11,000	9,700	11	+11.8 percent

18 Phoenix Business Journal, "Arizona ranks third for construction job growth in May," June 18, 2012: http://www.bizjournals.com/phoenix/news/2012/06/18/arizona-ranks-third-in-construction.html?page=all

19 Arizona Republic, Arizona top companies: 2012 http://www.azcentral.com/business/rep100/

Employer	City	2012 Employees	2011 Employees	2011 Ranking	Employee Change from 2011
10. Kroger	Cincinnati, OH	10,767	12,000	6	-10.3 percent
11. Honeywell International	Morristown, NJ	10,100	9,716	10	+3.8 percent
12. US Airways	Tempe, AZ	9,260	8,926	13	+3.6 percent
13. Target	Minneapolis, MN	8,587	9,300	12	-7.7 percent
14. Home Depot	Atlanta, GA	8,050	8,000	15	+0.6 percent
15. Dignity Health	San Francisco, CA	7,945	8,291	14	-4.2 percent
16. Circle K	Laval, QC, Canada	7,919	5,690	24	+28.1 percent
17. American Express Co	New York, NY	7,740	7,465	18	+3.6 percent
18. Freeport-McMoran	Phoenix, AZ	7,600	7,000	19	+7.9 percent
19. Walgreens	Deerfield, IL	7,494	7,750	16	-3.3 percent
20. UofA Health Network	Tucson, AZ	7,041	6,000	23	+14.8 percent
21. Bashas'	Chandler, AZ	6,741	6,641	21	+1.5 percent
22. Scottsdale Healthcare	Scottsdale, AZ	6,686	6,556	22	+1.9 percent

Employer	City	2012 Employees	2011 Employees	2011 Ranking	Employee Change from 2011
23. Pinnacle West	Phoenix, AZ	6,663	6,900	20	-3.4 percent
24. General Dynamics	Fall Church, VA	5,402	5,026	25	+7 percent
25. Boeing	Seattle, WA	4,878		26	+1.6 percent

The Arizona Republic 100 list is not scientific, as it relies on numbers self-reported by companies. The reported employee numbers can vary throughout a year, especially for seasonal businesses. And, some companies complicate the comparisons because they do not distinguish between full and part-time workers. Still, the list helps identify how Arizona's largest employment sectors are changing. Notably:

- Health care, financial and hospitality companies appear to be adding the most workers.
- Intel Corp. recently announced plans for a fabrication plant in Chandler with 1,000 projected workers beginning in 2013.
- Lower-paying retailers have climbed the list over the years. Retailers are not necessarily adding a lot of workers. Wal-Mart, the state's largest employer since 2002, has reported job decreases in Arizona for the past three years. McDonald's Corp., on the other hand, has been growing, adding almost 1,000 jobs over the year and has climbed from No. 14 in 2008 to No. 5 this year.

Other companies that added a sizeable number of workers come from a variety of sectors and grew for a variety of reasons. They include Grand Canyon University, Go Daddy Corp., Freeport-McMoRan Copper and Gold, Asarco, Avnet Inc. and Verizon Wireless.

Grand Canyon University, for example, added almost 700 workers last year because of two years of record enrollment, as more people return to school to improve their job skills.

"Larger employers—those with at least 500 employees—represent just less than 3 percent of all Arizona companies with employees," said Tom Rex, an ASU economist. "But they represent almost 60 percent of the payrolls."[20]

Seasonally adjusted data from the U.S. Bureau of Labor Statistics show the over-the-year job losses slowed considerably, from 5.3 percent in January to a fraction of a percentage point by December, suggesting that some companies were starting to add workers. Arizona finally started gaining jobs in February and March of this year, compared with the same months a year earlier.

20 Arizona Republic, "Bulk of state's largest companies added jobs in 2010," April 24, 2011 http://www.azcentral.com/arizonarepublic/business/articles/2011/04/24/20110424arizona-top-companies-job-growth.html

Location

The 2011 Milken Institute Best-Performing Cities Index ranks the top 200 U.S. metropolitan cities by how well they are creating and sustaining jobs and economic growth. The components include job, wage and salary and technology growth.

- The Arizona city showing the biggest improvement is Flagstaff, which moved up from No. 106 in 2009 to No. 57 in 2011.
- Among the U.S.'s largest cities, Phoenix fell to 136th in 2011 from 117th in 2010. Tucson took one step up in 2010 to 77 from 78 in 2009. By 2011, Tucson's rankings fell to 112.
- Flagstaff fared better, coming in at 57th in 2011, up from 87th in 2010.
- Phoenix's five-year wages and salaries growth rate from 2003-2008 ranked in the 20th spot. However, 2008-2009 set Phoenix back with a score of 96.30 and a ranking at 190. Phoenix's job growth from April 2009 to April 2010 was -2.08.
- In the smaller cities category, Yuma dropped from 40th in 2009 to 83rd in 2010 to 88 in 2011.
- Posting the largest decline of all the smaller metro areas was Prescott, which dropped 92 points from No. 50 in 2009 to 143 in 2010 and two more points in 2011 to 145.[21]

	2009	2010	2011
Metro Cities			
Tucson	78	77	112
Phoenix	93	117	136
Small Metros			
Flagstaff	106	87	57
Yuma	40	83	88
Prescott	50	143	145

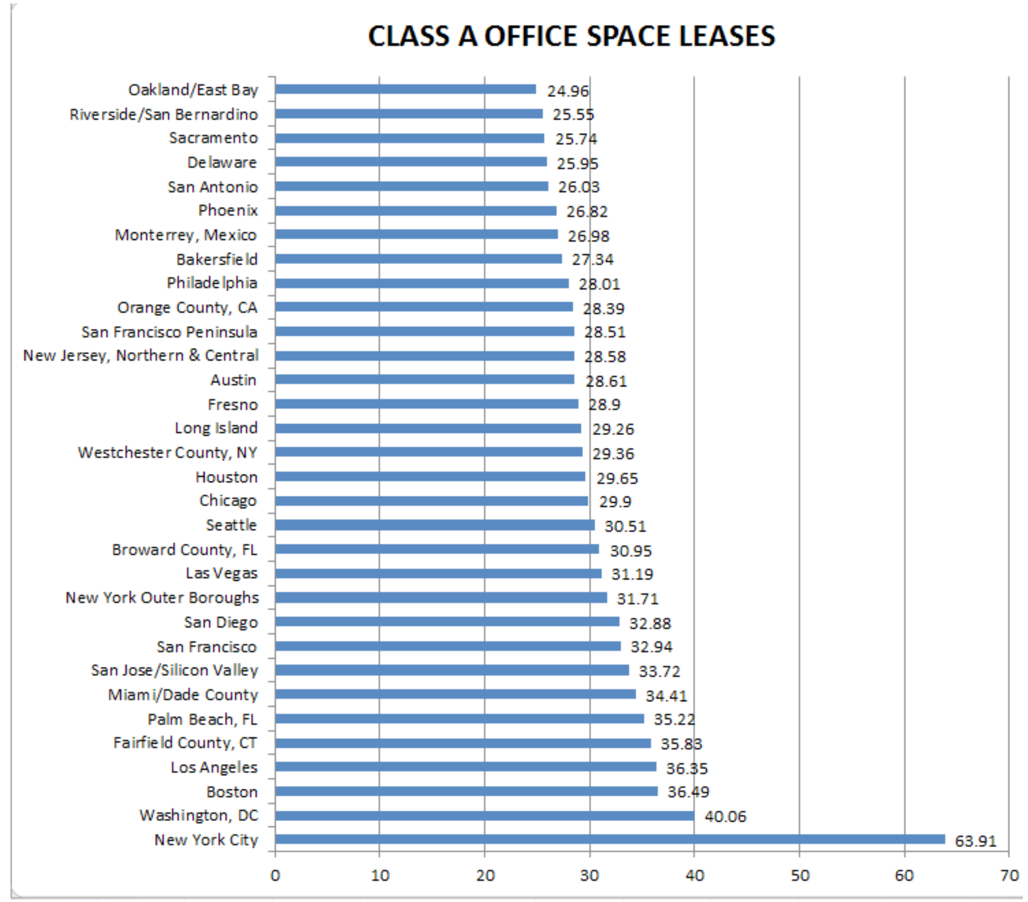
21 Milken Institute 2011 Best-Performing Cities—State View—Arizona http://bestcities.milkeninstitute.org/bestcities2011.taf?rankyear=2011&type=state&state=AZ

Business Costs

Arizona offers one of the nation's lowest costs of doing business due to its low taxes and small state government. Arizona's overall state and local tax burden ranks ninth in the country, with 8.5 percent of per-capita income going to taxes. The national average is 9.7 percent. Arizona's taxes on property, gas and personal income all remain low compared to the rest of the country. Arizona also has a small state government compared to its population. Arizona's low tax burden has led to the following rankings:

- Second lowest in the nation in unemployment insurance tax
- Third lowest in the nation in state and local government employees per 100 residents
- Sixth lowest in the nation in property taxes
- Seventh lowest in the nation in average workers' compensation costs
- Eighth in the nation in government and fiscal policy [22]

22 Arizona Commerce Authority: azcommerce.com/facts-and-figures/az-at-a-glance/



Labor Force

ARIZONA climbed from No. 2 to No. 1 in overall workforce in 2011.[23]

Arizona

- The median age was 35.9
- The average household size was 2.63 people per household
- Among the state's occupied housing units, 66 percent were owned, compared with 34 percent that were rented[24]

Between 1990 and 2000, Arizona's workforce grew by 53 percent, compared with 21 percent nationally. Between 2000 and 2011, the nation's workforce shrank by nearly 2 percent, while Arizona added a net 6 percent.[25]

23 CNBC, 2011 http://www.cnbc.com/id/43266509

24 U.S. Census Bureau: http://www.census.gov/newsroom/releases/archives/2010_census/cb11-cn137.html

25 Arizona Central: "Arizona tax cuts greatly benefit corporations," November 19, 2011 http://www.azcentral.com/arizonarepublic/news/articles/2011/11/19/20111119tax-cuts-arizona-corporations.html

Productive R&D Activity

Arizona has one of the largest concentrations of science and technology students and graduates in the country through its three large public universities—Arizona State University, University of Arizona and Northern Arizona University. These institutions have large science and technology research programs that have contributed to the high number of engineers living in the state.

Arizona's universities and its research-intensive companies drive Arizona's research and development (R&D) activities and make it one of the nation's top patenting states. Intel, IBM, Honeywell International and Freescale Semiconductors lead the state's patenting activity. Arizona is a leader in semiconductor device manufacturing, solid-state devices, computer memory, electrical systems and optics. Arizona excels in the ability of its small firms to attract federal funding for commercialization and the state's universities' ability to attract federal R&D funding.

The state excels in a number of metrics of research activity and funding, including:

- Seventh in patents awarded per 1,000 individuals in science and engineering occupations
- Ninth in academic science and engineering article output per 1,000 science and engineering doctorate holders in academia (NSF, 2010)
- 11th in patents

Strong High-Tech Economy

Many recent studies have hailed Arizona's potential for growth over the next few years due to the state's continued strong economic performance and its vibrant technology community. Arizona is expected to increase its venture capital investments, business openings and jobs over the next few years. The Milken Institute placed Arizona in the top 10 of technology-focused state economies. Other studies (listed below) have ranked the state as a strong performer in high-tech business formations and business IPOs. In addition, the University of Arizona's undergraduate entrepreneurship program has been ranked fourth in the country and its graduate program ranked 13th.

Overall economic indices and high-tech metrics in which Arizona has been ranked highly include:

- Second in economic outlook
- Second in entrepreneurial activity
- Seventh in growth prospects
- Seventh in IPOs
- Eighth in economic performance
- 10th in risk-capital and entrepreneurial infrastructure
- 10th in technology concentration and dynamism[26]

26 Arizona Commerce Authority: http://www.azcommerce.com/facts-and-figures/az-at-a-glance/

Arizona is one of several states that have made a strategic investment in developing biotech as a critical growth sector. Arizona is ranked third behind Utah and Virginia.[27]

Intel Corporation, Arizona

Intel Corporation will invest $5 billion in a state-of-the-art production facility in Chandler to create highly sophisticated semiconductors. When the facility opens in 2013, it will be one of the most advanced high-volume semiconductor manufacturing plants in the world, producing transistors as small as 14 nanometers. Approximately 1,000 new jobs will be created.[28]

2012 Arizona Silver Shovel Winner Population: 5-9 Million

Arizona is one of the 2012 Silver Shovel winning states. Listed below are the top 2011 investment projects, creating high value-added jobs in new or expanded facilities, which led Arizona to its recognition as a Silver Shovel winner.[29]

27 Business Facilities Magazine, "Ranking Report," July/August 2012: http://businessfacilities.com/2011/wp-content/uploads/2012/07/BFJulAug12_staterankings_LR.pdf

28 Area Development Site and Facility Planning Newsletter http://www.areadevelopment.com/AnnualReports/Summer2012/projects-of-the-year-job-creation-552221.shtml

29 Area Development Site and Facility Planning Newsletter http://www.areadevelopment.com/AnnualReports/Summer2012/projects-of-the-year-job-creation-552221.shtml

Company	City	Jobs Created
Intel	Chandler	1,000
Amazon	Phoenix	NA
EBay / PayPal	Chandler	2,000
Cognizant Technology Solution	Phoenix	500
Rioglass Solar	Surprise	100
Gestamp Solar Steel	Surprise	300
Dick's Sporting Goods	Goodyear	300
Magnum International	South Phoenix	150
Bombadier Inc.	Tucson	200
Maxwell Technologies	Peoria	150

Education

Arizona is served by three public universities governed by the Arizona Board of Regents: The University of Arizona, Arizona State University and Northern Arizona University. All three state universities in Arizona have reported record enrollment this fall.

The fall of 2012 marked a banner year for ASU, the largest of the three universities, as the University posted a record enrollment of 73,373 undergraduate and graduate students, according to preliminary fall-enrollment figures that were recently released. The University of Arizona exceeded 40,000 students this fall for the first time. Northern Arizona University has 26,002 students.[30]

Private higher education in Arizona is dominated by a large number of for-profit and "chain" (multi-site) universities. Prescott College is the only traditional, single-site, non-profit, four-year private college in Arizona.

Arizona has a wide network of two-year vocational schools and community colleges. The Maricopa County Community College District (MCCCD) is the largest community college

30 AZ Central, "Arizona's state universities set enrollment records," September 23, 2012: http://www.azcentral.com/community/tempe/articles/2012/09/20/20120920arizona-state-universities-set-enrollment-records.html#ixzz28FlYPCxw

district in the nation, serving more than 200,000 students annually at 11 locations:

1. Chandler-Gilbert Community College, Chandler, Mesa, Sun Lakes
2. Estrella Mountain Community College, Avondale and Buckeye
3. GateWay Community College, Phoenix
4. Glendale Community College, Glendale
5. Mesa Community College, Mesa
6. Paradise Valley Community College, Paradise Valley
7. Phoenix College, Phoenix
8. Rio Salado Community College, distance learning community college
9. Scottsdale Community College, Scottsdale
10. South Mountain Community College, Phoenix

During 2010, the Maricopa Community Colleges (MCCCD) posted an enrollment increase of more than 10 percent. MCCCD attributed the increase to two major factors.

1) When the economy declines, student enrollment in community colleges increases so people have access to job training or to advance their education.

2) Tuition was the second factor at work in 2010, which was when Arizona's universities increased tuition dramatically. Since the Maricopa Community Colleges did not increase tuition, the gap in costs between a community college education

and that of the first two years at a state university increased significantly.[31]

Private colleges and universities in Arizona include:

- American Indian College, Phoenix
- Apollo Group (owns and operates four higher-learning institutions):
    - University of Phoenix
    - Western International University
    - Axia College, the College for Financial Planning
    - The Institute for Professional Development
- Arizona Christian University, Phoenix (formerly Southwestern College)
- Art Center College of Design, Tucson
- Art Institute of Tucson
- Art Institute of Phoenix
- Brown Mackie College, Phoenix
- Collins College, Phoenix (design)
- Embry-Riddle Aeronautical University, Prescott
- Grand Canyon University, Phoenix
- International Baptist College, Chandler
- Midwestern University, Glendale
- Northcentral University, Scottsdale
- Ottawa University, Phoenix
- Phoenix School of Law, Phoenix

31 Maricopa County Community College District, Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2011: http://www.maricopa.edu/business/reporting/CAFRs/CAFR percent20FY1011.pdf

- Prescott College, Prescott
- Southwest College of Naturopathic Medicine, Tempe
- Thunderbird School of Global Management, Glendale
- University of Advancing Technology, Tempe
- Western Governors University, Phoenix
- Western International University, Phoenix

The following are additional higher education facilities in Arizona.

Two-year institutions:

- Arizona Western College, Yuma
- Central Arizona College, Coolidge
- Cochise College, Cochise County
- Coconino County Community College (seven locations)
- Eastern Arizona College, Thatcher
- Mohave Community College, Kingman
- Northland Pioneer College, Navajo County
- Pima Community College, Tucson
- Yavapai College, Prescott

Tribal institutions:

- Navajo Nation
- Diné College, Tsaile
- Tohono O'odham Community College, Sells

Private, four-year institutions:

- Arizona Christian University, baccalaureate university affiliated with the Conservative Baptist Association of America in Phoenix
- The Art Center Design College, baccalaureate art and design college in Tucson
- Embry-Riddle Aeronautical University, Prescott, master's engineering university in Prescott
- Prescott College, master's university with an environmental studies focus in Prescott
- Grand Canyon University, Phoenix

Graduate institutions:

- A.T. Still University, graduate-level education in whole person healthcare, Mesa
- Midwestern University, health sciences graduate school in Glendale
- Phoenix School of Law, law school in Phoenix
- Southwest College of Naturopathic Medicine, naturopathic medical school in Tempe
- Thunderbird School of Global Management, business graduate school in Glendale

For-profit institutions:

- The Art Institute of Phoenix, Phoenix
- The Art Institute of Tucson, Tucson

- CollegeAmerica, Flagstaff, Phoenix
- Collins College, Tempe, Phoenix
- DeVry University, Phoenix
- Dunlap-Stone University, Phoenix
- High-Tech Institute, including Arizona College of Allied Health, Glendale, Arizona
- Lamson College, Tempe
- Northcentral University, Prescott
- Scottsdale Culinary Institute, Scottsdale
- Sessions College for Professional Design, Tempe
- University of Advancing Technology, Tempe
- University of Phoenix, Phoenix
- Western International University, Phoenix

Religious institutions:

- American Indian College, Assemblies of God Bible College, Phoenix
- Cook College and Theological School, Nondenominational Tribal Bible College, Tempe
- Fuller Theological Seminary, Nondenominational Bible College, Phoenix
- International Baptist College, Independent Baptist Bible College, Tempe
- Phoenix Seminary, Nondenominational seminary, Phoenix
- The World University, Nondenominational Bible College, Benson

There are a total of 164 public school districts 2,042 public schools,[32] 634 charter schools and 582 private schools. [33]

Arizona Public School Statistics

Arizona Public Schools:	2,042	
Number of Students:	1,012,068	
Arizona Elementary Schools:	1,097	
Arizona Middle Schools:	255	
Arizona High Schools:	464	
Number of Male Students:	521,810	
Number of Female Students:	490,258	
Asian-Pacific Islander Students:	22,307	514,413 (total minority students)
American Indian-Alaskan Students:	66,906	
Black Students:	48,970	
Hispanic Students:	376,230	
White Students:	497,655	

32 Education Bug: http://arizona.educationbug.org/public-schools/?subdomain=arizona

33 Private School Review: http://www.privateschoolreview.com/state_private_schools/stateid/AZ

Government

THE State of Arizona government is made up of three separate branches: Executive, Legislative and Judicial. However, the Arizona Corporation Commission, which regulates companies and utilities, is often referred to as the fourth branch of Arizona government due to its independence and control over significant interests related to Arizona's governance.

- The Executive branch consists of approximately 130 agencies that carry out the law and perform the day-to-day business of state government.
- The Arizona State Legislature is a bicameral body with 30 Senate members and 60 members in the House of Representatives. Each district is served by one Senator and two House members (http://www.azleg.gov) The Legislative branch also includes the Auditor General, the Joint Legislative Budget Committee and Legislative Council.
- The Judicial branch is comprised of the Arizona Supreme Court, the Arizona Court of Appeals and the Superior Court augmented by the counties' Justice of the Peace Courts and the municipalities' Municipal Courts.

Arizona's executive branch is headed by a governor, who is elected to a four-year term. The governor may serve any number of terms, though no more than two in a row. Arizona does not have a governor's mansion so governors reside in their private residences. All executive offices are housed in the executive tower at the state capitol. The current governor of Arizona is Jan Brewer (R), who assumed office after Janet Napolitano became Secretary of Homeland Security. Arizona has had four female governors—more than any other state. Other elected executive officials include the Secretary of State, State Treasurer, State Attorney General, Superintendent of Public Instruction, State Mine Inspector and a five-member Corporation Commission. All elected officials hold a term of four years, and are limited to two consecutive terms (except the office of the state mine inspector, which is exempt from term limits). Arizona is one of seven states that do not have a specified lieutenant governor. The secretary of state is the first in line to succeed the governor in the event of death, disability, resignation or removal from office. The line of succession also includes the attorney general, state treasurer and superintendent of public instruction. Since 1977, four secretaries of state and one attorney general have risen to Arizona's governorship through these means.

Each Legislature covers a two-year period. The first session following the general election is known as the first regular session and the session convening in the second year is known as the second regular session. Each regular session begins on the second Monday in January and adjourns for the year no later than Saturday of the week in which the 100th day from the beginning of the regular session falls. The current majority party is the Republican Party, which has held power in both houses since 1993.

The Arizona Supreme Court is the highest court in Arizona. The court currently consists of one chief justice, a vice chief justice and three associate justices. Justices are appointed by the governor from a list recommended by a bi-partisan commission, and are re-elected after the initial two years following their appointment. Subsequent re-elections occur every six years. The supreme court has appellate jurisdiction in death penalty cases, but almost all other appellate cases go through the Arizona Court of Appeals beforehand. The court has original jurisdiction in a few other circumstances, as outlined in the state constitution. The court may also declare laws unconstitutional, but only while seated *en banc*. The Arizona Court of Appeals, further divided into two divisions, is the intermediate court in the state. Division One is based in Phoenix, consists of 16 judges and has jurisdiction in the western and northern regions of the state, along with the greater Phoenix area. Division Two is based in Tucson, consists of six judges and has jurisdiction over the southern regions of the state. Judges are selected in a method similar to the one used for state supreme court justices. Each of Arizona's 15 counties has a superior court, the size and organization of which are varied and generally depend on the size of the particular county.

Arizona operates on a fiscal year that begins on July 1 and ends on the following June 30.[34]

Arizona's Capitol is in Phoenix, which has won many awards and honors, including the prestigious Carl Bertelsmann Award (in 2009) for being the best-run city government in the world and a "best-managed city" designation by *Governing* Magazine. The National Civic League has selected Phoenix as an "All-America City" five times. Phoenix was selected as an All-America City for the fifth time in 2009.[35] Cost saving initiatives that helped Phoenix save $40 million helped the city earn an Outstanding Achievement in Innovation Award in April 2012 from the Alliance for Innovation, a nonprofit organization that promotes innovation among local governments.[36]

34 General Accounting Office: http://www.gao.az.gov/transparency/documents/Glossary.pdf

35 City of Phoenix: http://www.phoenix.gov/news/061909phxaac.html

36 City of Phoenix: http://phoenix.gov/citygovernment/awards/awardslist/041812innovaward.html

Taxes

ARIZONA is generally regarded as friendly for commerce. Citing everything from low unemployment insurance to the lack of franchise and inventory taxes, Arizona touts itself as a low-cost place to do business.

Last year, the 22nd Tax Foundation, a nonpartisan research group that generally supports low taxes, ranked Arizona 22nd best for all corporate taxes and sixth for all property taxes.[37] One exception is the business property tax rate, which is considered relatively high now, but is set to drop in coming years. *Chief Executive* magazine ranks the state 10th best for business, citing its favorable taxation and regulation climate.[38]

With falling tax rates, Arizona has aggressively pitched itself as a low-cost place to do business.

The Facts on Arizona's Tax Climate

4.54 percent individual income tax top rate	**6.968 percent** corporate income tax flat rate	**6.6 percent** sales tax	**$1,119** property tax collections per capita

37 The Arizona Republic, "Arizona tax cuts greatly benefit corporations," November 19, 2011: http://www.azcentral.com/news/20111119tax-cuts-arizona-corporations.html

38 Chief Executive.net: http://chiefexecutive.net/best-worst-states-for-business-2012

Individual Income Tax System

Arizona's personal income tax system consists of five brackets and a top rate of 4.54 percent kicking in at an income level of $150,000. In 2009, Arizona's state-level individual income tax collections were $393 per person.

Personal Income Tax

Arizona collects income taxes from its residents at the following five rates:

For single and married filing separately taxpayers:

- 2.59 percent on the first $10,000 of taxable income
- 2.88 percent on taxable income between $10,001 and $25,000
- 3.36 percent on taxable income between $25,001 and $50,000
- 4.24 percent on taxable income between $50,001 and $150,000
- 4.54 percent on all taxable income more than $150,000.

For married persons filing joint returns and heads of households, the rates remain the same but the income brackets are doubled.

Corporate Income Tax System

Arizona's corporate tax structure consists of a flat rate of 6.968 percent on all corporate income. That rate ranks 26th highest among states levying corporate income taxes. In 2009, state-level corporate tax collections (excluding local taxes) were $90 per capita, which ranked 34th highest nationally.

Arizona's corporate income tax rate is set to fall by 30 percent from 2014 to 2017 and could end up one of the lowest in the nation. The decrease will save businesses an estimated $270 million in taxes over the four years.

Privilege Tax

Arizona Transaction Privilege Tax (sales) and Use Tax rates increased to 6.6 percent effective July 1, 2010. The state of Arizona does not levy a state tax on food for home consumption or on drugs prescribed by a licensed physician or dentist. However, some cities in Arizona do levy a tax on food for home consumption.

Incorporated municipalities also levy transaction privilege taxes, which, with the exception of their hotel/motel tax, are generally in the range of 1.5 percent to 3.5 percent. The combined sales tax rates for some localities exceed 15 percent.

Sales and Excise Taxes

Arizona levies a 5.6 percent general sales or use tax on consumers, which is slightly below the national median of 5.85 percent. Combined state and local general and selective sales tax collections in 2007 were $1,800 per person, which ranked seventh highest nationally. Arizona's gasoline tax stands at $.18 per gallon (ranked 41st highest nationally) and its cigarette tax stands at $2 per pack of 20 (10th highest nationally). The sales

tax was adopted in 1933, the gasoline tax in 1921 and the cigarette tax in 1935.

Property Taxes Comparatively Modest

Arizona is one of the 37 states that collects property taxes at the state and local levels. Arizona collected $1,043 per capita in state and local property taxes in fiscal year 2008.

Personal and real property taxes:

- Tax jurisdictions set tax rates on the basis of the total assessed valuation within their boundaries and the amount of the levy to be raised. Total tax rates may vary considerably from one area to another.
- Owner-occupied residential properties are valued by local assessors using one of two methods: replacement cost new less depreciation or sales analysis. Each assessor selects which method to use based upon technical considerations such as the accuracy of each method for that area and the number of sales available for analysis.
- Arizona also taxes personal property, which is defined as all types of property except real estate. Taxable personal property includes property used for commercial, industrial and agricultural purposes. Personal property is considered to be movable and not permanently attached to real estate.
- Personal property taxes are due October 1. If the tax amount is over $100, one-half is due October 1 and

the remainder is due the following March 1. One-half of the amount of the taxes that are unpaid is delinquent after November 1 and the remaining half that is unpaid is delinquent after May 1.

- In lieu of a personal property tax on automobiles, the state imposes an annual vehicle license tax, which is based on an assessed value of 60 percent of the manufacturer's base retail price reduced by 16.25 percent for each year since the vehicle was first registered in Arizona.

The City of Kingman, Arizona has no primary property taxes or personal income tax. The City encourages business development to occur within special enterprise zones in which companies can realize additional financial benefits.[39]

Inheritance and Estate Taxes

- For estates of individuals who died after 2004, Arizona no longer imposes an estate tax.
- Neither does the state impose an inheritance or gift tax.[40]

The state's remaining credits account for 20 percent of the credits used, but their cash value is significant: $96 million as a group from 2000 to 2008.

39 arizonacrossroads.com: http://www.arizonacrossroads.com/default.asp?id=1014

40 Arizona Department of Revenue: http://www.azdor.gov/Portals/0/Brochure/900.pdf

Small businesses generally get little help from such credits. Still, the Arizona Small Business Association supported the corporate-tax changes passed earlier this year that included the credits.

"We wanted to make sure we had a seat at the table and be sure we got at least a piece of the pie," said Arizona Small Business Association CEO Donna Davis, adding that a business property-tax exemption and job training in the law help small businesses. Otherwise, "it's (the credits) usually limited in who it helps and it usually helps those who were going to be taking that action anyways."

The enterprise-zone credit allowed dozens of employers in certain areas to reduce their annual tax bills by part of the salaries they paid for certain new jobs. Businesses get a $3,000 credit for up to 200 workers a year, spread over three years.

Raytheon Co., which makes missiles, was eligible for $728,000 in tax credits under the program. Apollo Group, which operates the University of Phoenix, was eligible to receive up to $600,000 in tax credits. Organizations affiliated with the private-prison operator, Corrections Corporation of America, were eligible for a total of $589,000.

Although scores of companies were listed, about half of the nearly $11 million in enterprise-zone credits statewide went to 14 companies. All were eligible to cut their tax bill by $200,000 or more. These credits were tied to 5,100 jobs added over a three-year span.

While the research-and-development and enterprise-zone credits are the most common, a host of other credits benefit particular businesses.

From 2006 to 2008, 25 or fewer companies claimed a total of more than $33 million from those tax credits.

Taxpayer confidentiality rules generally prevent the Arizona Department of Revenue from revealing the number of businesses claiming a specific tax credit when fewer than three used the credit.

In 2007, for example, 12 companies claimed eight types of tax credits totaling $13 million. A year later, four claimed three types of credits worth nearly $12 million.

One of the credits was for defense contracting.

The credit rewards businesses for bringing in new employees and offers property-tax relief as well.

Tax experts say the sizable amount of unclaimed credits the companies carried forward suggest they paid little, if any, state income tax that year.[41]

Arizona's corporate income tax rate is set to fall by 30 percent from 2014 to 2017 and could end up one of the lowest in the nation. The decrease will save businesses an estimated $270 million in taxes over the four years.

The state gives national companies one of the nation's most generous methods for calculating how much income is subject

41 azcentral.com, "Arizona tax credits rising for business," November 22, 2011: http://www.azcentral.com/news/articles/2011/11/21/20111121arizona-tax-credits-rising-for-business.html

to state income tax. Changes to that formula were made in 2005 at the urging of Intel Corp. and other companies and business groups.

In Arizona, lawmakers have taken action. During the downturn, they approved more tax cuts for corporations and grudgingly sent to voters a proposal to temporarily raise the sales tax, paid primarily by consumers. Voters overwhelmingly approved it. Most of the business tax cuts take effect after the tax hike expires, raising concerns that the state could face a new round of budget cuts at that time.

The state also has cut individual income taxes over two decades, which benefits not only consumers but thousands of business owners who pay their corporate taxes through their individual tax returns.

Nationally, median income dropped 6.2 percent from the 2007 peak to 2010, the latest period available. In Arizona, it fell 10.7 percent. The state's median income also remains below the national average, as it has since at least 1969. In 2010, Arizona's median income was $46,789, compared with $50,046 for the nation.[42]

Arizona 2011 Annual Report

Fiscal year 2011 can be considered a milestone year in that Arizona collected more than $12 billion as an agency despite

42 azcentral.com, "Arizona tax credits rising for business," November 22, 2011: http://www.azcentral.com/news/articles/2011/11/21/20111121arizona-tax-credits-rising-for-business.html

the challenges of a poor economy. Total taxes collected by the department during the year exceeded $12.2 billion, including more than $6.5 billion that was deposited directly into the state General Fund. Included in this total is over $487 million that was collected through the department's tax enforcement efforts. By collecting over $487 million through the audit, license compliance and collections programs, the department nearly met its $504 million target set at the beginning of the year; performing at 97 percent of goal.

Highlights in Fiscal Year 2011

During fiscal year 2011, the state tax rates ranged from 2.5 percent to 6.6 percent depending on the type of business, with most rates at 5.6 percent. Gross revenue exceeding $6.95 billion was remitted by Transaction Privilege, Severance and Use Tax license holders during fiscal year 2011.

On May 18, 2010, voters approved Proposition 100, which temporarily increases the state transaction privilege and use rate on most transactions by one percentage point beginning June 1, 2010 and ending May 31, 2013.

Corporate Income Tax Major Features

Every corporation doing business in Arizona is required to file a corporate income tax return. Corporations filed corporate income tax returns with the state and made payments of $560 million during fiscal year 2011.

Individual Income Tax Major Features

For tax year 2008 filed in 2009, approximately 2.6 million individual filers reported Arizona gross income (defined as federal adjusted gross income) totaling more than $118.9 billion. Individuals with Arizona gross income of more than $75,000, in the preceding or current year, are required to file Arizona estimated tax payments. An individual can apply any portion of an income tax refund toward the following year's income tax as an estimated payment.[43]

43 Arizona Department Of Revenue, Fiscal Year 2011 Annual Report: http://www.azdor.gov/Portals/0/AnnualReports/FY11_Annual_Report_Web.pdf

Housing

PHOENIX-Mesa is No. 1 on the Realtor.com "Turnaround Town" list for the second quarter in a row. Median list prices are up 29.73 percent compared to the same time last year. The area experienced the largest increase in median list prices of all the 146 metropolitan statistical areas (MSAs) monitored by Realtor.com. Unemployment in Phoenix was 7.5 percent in June 2012, which has had a significant impact on improving the local economy and growing demand for housing, evident by the -37.84 percent year-over-year quarterly decline in the median age of inventory. [44]

The desert city has made amazing strides according to experts and is now somewhat of a role model for the nation's real estate recovery. A few other factors contributing to Phoenix's resurgence include work on the city's transportation system and the opportunity to host the NFL's 2015 Super Bowl.

- Year-over-year median list price appreciation: 26.94 percent
- Year-over-year change in median age of inventory: -32.94 percent
- Year-over-year change in inventory: -48.04 percent

44 Realtor.com, "Top 10 Turnaround Towns of 2012's Second Quarter," August 9, 2012: http://realestate.aol.com/blog/2012/08/09/top-10-turnaround-towns-of-2012s-second-quarter/#photo-10

- Unemployment rate (Feb 2012): 7.8 percent[45]

That trend continued into July 2012, when metro Phoenix's home sales and price increases were leading the nation. The region's median home price increased again in June, but at a slower pace than previous months. The sales price of an existing home in Maricopa County climbed to $146,000 in June, up $1,000 from May, according to AZ Bidder/Information Market data. That is the smallest month-to-month increase since December, when the median climbed $100 from November to reach $120,000.

In June 2012, 7,499 resales were recorded in the region, which marks the lowest level of 2012 since February, when 6,751 existing homes changed hands. A slight slowing in both price and sales increases is considered a good thing for metro Phoenix's housing market. The area's very low supply of houses for sale is sparking bidding wars and many regular buyers are being outbid too often by investors.[46]

45 U.S. News and World Report: http://www.usnews.com/news/slideshows/top-10-turnaround-towns/2

46 Azcentral.com, "Metro home sales, prices increase in June, but at slower pace," July 13, 2012: http://www.azcentral.com/business/realestate/articles/2012/07/10/20120710metro-home-sales-prices-increase-june-slower-pace.html

Greater Phoenix Real Estate Market: Housing Sales and Median Prices, Annual 2006-2011[47]

MEDIAN SALES PRICE

	Single-family		Townhouse/Condominium	
Year	Resale	New	Resale	New
2006	260,600	306,355	174,000	225,400
2007	255,000	285,085	176,000	253,650
2008	186,000	235,955	150,000	231,000
2009	140,000	208,040	108,000	187,365
2010	142,000	222,360	95,000	201,960
2011	127,000	222,300	81,000	256,750

NUMBER OF SALES

	Single-family			Townhouse/Condominium			
Year	**Resale**	**New**	**Total**	**Resale**	**New**	**Total**	**Grand Total**
2006	67,035	38,485	105,520	13,995	7,090	21,085	126,605
2007	54,570	25,850	80,420	12,745	3,975	16,720	97,140
2008	81,700	14,960	96,660	9,420	2,510	11,930	108,590
2009	112,730	8,320	121,050	13,735	1,070	14,805	135,855
2010	106,975	6,825	113,800	16,955	455	17,410	131,210
2011	106,850	6,225	113,075	16,155	260	16,415	129,490

47 ASU W.P. Carey http://realty.wpcarey.asu.edu/arec/market_update.html#sales

Transportation

The Arizona Department of Transportation (ADOT) provided the following snapshot of Arizona's transportation profile.

People

- 6.4 million (2010) travel 63 billion vehicle miles annually
- 75 percent of population lives in Tucson and Phoenix metro areas
- 13 percent of all Arizonans are 65 or older
- 300,000 visitors living in Arizona in winter months

Highways

- 129,780 total lane miles
- 19,912 lane miles operated and maintained by ADOT
- Interstates I-10, I-40, I-17, I-8, and I-19 combine for 1,170 lane miles
- Good or better pavement conditions on most roads
- >70 percent of investment used to expand current system (2006-2010 ADOT investment patterns)

Transit

- 40 transit systems

- Transit use increased more than 50 percent (2002-2009)
- Riders concentrated in metro areas of Phoenix, Tucson and Flagstaff
- More than 200,000 passengers per day ride Valley Metro in Phoenix
- Amtrak: Sunset Limited and Sunset Chief cross-state routes

Bridges

- 7,348 structures
- 2,040 bridges operated and maintained by ADOT

Cross Border

- Six international border crossings with Mexico (the largest at Nogales)
- 13,000 vehicles and 13,000 pedestrians cross at Nogales daily

Freight

- 557 million tons move through Arizona annually
- 75 percent (by weight) on Arizona Highways, including I-10 and I-40
- 25 percent (by weight) by rail (BNSF and UP)
- More than 1 percent (by weight) via air

Air

- 12 commercial airports

- 71 reliever and general aviation airports serve non-commercial air
- Access to commercial airports is largely one-hour driving time or less
- Passenger boardings total more than 23 million enplanements annually
- 8.5 million visitors arrive in Arizona by air annually [48]

Airports

The number of airports in Arizona reads like a typical Tempe temperature in the summer: 114! Of those, 14 airports are Native-American owned, 11 are privately owned and six are international airports: Bisbee Douglas International Airport, Laughlin Bullhead International Airport, Nogales International Airport, Phoenix Sky Harbor International Airport, Tucson International Airport and Yuma International Airport. ADOT's system of airports adds approximately $38.5 billion to the state's economy every year.[49]

As Arizona's main airport, Phoenix Sky Harbor International is served by more than 18 airlines, providing nonstop service to more than 100 cities in the United States and around the world. Nearly 6.3 million passengers flew into and out of Sky Harbor during the first two months of 2012, which is

48 Arizona Department of Transportation: http://www.whatmovesyouarizona.gov/PDF/TIA_ExecSum_0610.pdf

49 Arizona Department of Transportation: http://www.azdot.gov/CCPartnerships/News/NRel3241.asp

up by 66,200 compared to the same two months from a year earlier. Passenger traffic at Sky Harbor International Airport is ranked as the nation's 10th busiest. More than 6.65 million passengers used Sky Harbor in January—February 2007 before the recession and real estate crash.[50]

Tucson International Airport is served by 10 airlines that provide nonstop service to 15 cities.

In 2011, Phoenix-Mesa Gateway Airport served nearly one million passengers, with more than 171,200 takeoffs and landings, making it the 65th busiest airport in the United States.[51]

The biggest developments in transportation over the past few years has been the Light Rail and the PHX Sky Train™.

Valley Metro Rail, Inc. (METRO) is responsible for the development and operation of the region's (Phoenix, Tempe, Mesa) high-capacity transit system. The 20-mile light rail starter line opened December 2008 and served 13.2 million riders in 2011, exceeding the prior year by 4 percent. The system has well-exceeded all system projections. METRO has 50 vehicles in its fleet, each with a comfort capacity of 175 passengers. The vehicles are state-of-the art technology and, similar to the stations, customized for the desert climate and operating environment.

50 Flightstats: http://www.flightstats.com/go/Airport/airportDetails.do?airportCode=phx

51 Federal Aviation Administration: http://www.azdot.gov/CCPartnerships/News/NRel3241.asp

METRO is responsible for building a future 57-mile high-capacity transit system as defined in the Regional Transportation Plan by 2032. Planning, design and/or construction has initiated on the six extensions that make up the remainder of the 37 miles yet to be built; a study is also underway for South Central Phoenix. Three of the extensions have been defined as light rail corridors: the Central Mesa, Northwest and Phoenix West. A 2.6-mile modern streetcar line will be built in central Tempe. The other two—Glendale and Northeast Phoenix—have yet to determine a specific transit route and mode.[52]

In Tucson, an approved four-mile modern streetcar line is scheduled to be complete by October 2013. The Tucson Modern Streetcar will have these core benefits for its community: connect major activity centers such as downtown Tucson, the University of Arizona, the Fourth Avenue and Main Gate business districts, and the Westside redevelopment district, create new jobs and foster economic development and improve transit service for the region.[53] In addition to driving economic growth and generating more public-private development, it will improve transit service and offer easy connections for bus riders, bicyclists and pedestrians; connect major activity centers among The University of Arizona, the Fourth Avenue Business District, Downtown Tucson and the historic West-

52 Valley Metro, Light Rail System: http://www.valleymetro.org/images/uploads/lightrail_publications/Light-Rail-System-Factsht_08-14-12.pdf

53 Tucsonstreetcar.com: http://tucsonstreetcar.com/documents/FAQ_4_6_12.pdf

side; and offer a sustainable transit option that will improve our environment and reduce congestion.[54]

PHX Sky Train™, the latest innovation in transportation, will clear the air and 20,000 cars from Phoenix roadways each day. Sky Harbor Airport's free, elevated, electric PHX Sky Train™ will help relieve curbside traffic jams, reduce wait times, provide hassle-free travel in climate-controlled vehicles and connect to the Valley's light rail and bus lines. When it opens in early 2013, the unmanned PHX Sky Train™ will run seven days a week, 365 days a year, with trains arriving every three to four minutes to carry people between 44th and Washington streets, the East Economy Lot and Terminal 4. The PHX Sky Train™ will be the most effective and efficient way to meet passenger demand and maintain customer service levels. The PHX Sky Train™ made its inaugural run on May 14, 2012 and is expected be completed in early 2013. The Sky Train™ project is the only LEED (Leadership in Energy and Environmental Design) certified airport people-mover in the country. Additionally, the PHX Sky Train™ project has created more than 6,000 jobs. Costs for Stage 1 and Stage 1a are approximately $644 million and $240 million respectively. Funding for the train comes from airport bonds that are backed by Passenger Facility Charges and other airport revenues. The airport also

54 tucsonstreetcar.com: http://www.tucsonstreetcar.com/documents/FAQ_4_6_12.pdf

receives federal grant money for some major construction projects.[55]

Trucking

Although many trucking companies have operations in the state, only two of the nation's top 100 trucking firms are based in Arizona: Swift Transportation and Knight Transportation.

The number of vehicles the size of a semi or larger that are registered in Arizona fell from a peak of 45,172 in 2007 to 33,809 at the end of June 2010—a 25 percent drop. [56]

International trade within North America has grown. Trade using trucks, rail and pipelines grew almost 38 percent through June 2010 among the U.S., Canada and Mexico this year, according to the Bureau of Transportation Statistics of the U.S. Department of Transportation. Arizona ranked fourth among all the states for trading with Mexico using surface transportation, with value reaching $998 million.[57]

All this increased demand for trucking services has done wonders for trucking company profits.

55 skyharbor.com: http://skyharbor.com/PHXSkyTrain/Funding.html

56 Azcentral.com: "Transportation data suggests economy moving forward," September 12, 2010 http://www.azcentral.com/arizonarepublic/business/articles/2010/09/12/20100912transportation-data-economy.html

57 The Arizona Republic, "Transportation data suggests economy moving forward," September 12, 2010 http://www.azcentral.com/arizonarepublic/business/articles/2010/09/12/20100912transportation-data-economy.html

Rail

Arizona had nine freight railroads in 2008 and ranked 35th in the total number of railroad miles. Coal, chemicals and farm products are the main products brought into Arizona, while copper, scrap and waste products are among the major exports.

Union Pacific, which operates the main rail line through Phoenix, reported its best-ever quarterly results in July 2012. Diluted earnings per share of $2.10 improved 32 percent. Operating revenues totaled $5.2 billion, up 7 percent. Operating income totaled $1.7 billion, up 24 percent. Operating ratio of 67 percent improved 4.3 points. Customer satisfaction index reached 93, up one point and tied the best-ever quarterly record.[58]

Shipping

While Arizona does not have seaports, it has the North American headquarters for Neptune Orient Lines (NOL) Group, whose primary business is operating the world's fifth-largest container shipping line known as APL. The company has about 400 employees in Phoenix. The NOL Group reported a net profit of $100 million for the April-June 2010 period—up from a loss of $146 million a year earlier. Volumes of goods moved in the first half of the year increased 39

58 Union Pacific Railroad, "Union Pacific Reports Best-Ever Quarterly Results," July 19, 2012 http://www.uprr.com/newsinfo/releases/financial/2012/0719_2qearnings.shtml

percent to 1.35 million FEUs. An FEU is the equivalent of a 40-foot container. "A number of analysts and economists have attributed it (increase in volume) to retailers replenishing their inventories that were deeply depleted during 2009," said Gene Seroka, who is APL's president of the Americas in Phoenix.[59]

State Highway System

There are 60,465 centerline miles and 129,780 lane miles of highways across the state, of which 6,953 centerline miles and 19,912 lane miles are operated and maintained by the ADOT and comprise the State Highway System. These highways are generally in "good" condition for travelers, with 99 percent of rural interstates and 97 percent of urban interstates and expressways defined as being in "acceptable" or better condition. Arizona has 7,348 bridges and other structures and ADOT maintains 2,040 bridges on the state system.

The federal government maintains 22 percent of the roads in Arizona through its Federal Lands and Highways Program due to the large number of national parks and federal lands. There are 22 federally recognized American Indian Tribes and Native Nations with reservation land in Arizona. This tribal land includes 1,324 centerline miles of highways. Tribal governments have jurisdictional decision-making authority over non-state owned roads and improvements on their reservation

59 The Arizona Republic, "Transportation data suggests economy moving forward," September 12, 2010 http://www.azcentral.com/arizonarepublic/business/articles/2010/09/12/20100912transportation-data-economy.html

land, as well as any proposed projects to accommodate and improve regional traffic circulation.[60]

60 Arizona Department of Transportation, "What Moves You Arizona, Long-Range Transportation Plan 2010-2035," November 2011: http://www.whatmovesyouarizona.gov/PDF/TIA_ExecSum_0610.pdf

Utilities

The Arizona Corporation Commission has jurisdiction over the quality of service and rates charged by public service utilities. By state law, public service utilities are regulated monopolies given the opportunity to earn a fair and reasonable return on their investments. What is fair and reasonable in any particular case has been and always will be open to debate in rate hearings before the Commission. Generally, the Commission tries to balance the customers' interest in affordable and reliable utility service with the utility's interest in earning a fair profit.[61]

The Utilities Division monitors the operations of approximately 708 companies providing utility service within the State of Arizona. Article XV of the Arizona Constitution defines "public service corporations" as "those furnishing gas, oil, or electricity for light, fuel or power; water for irrigation, fire protection, or other public purposes; or those transmitting messages or furnishing telegraph or telephone service." The Commission's regulatory responsibilities are established in the Arizona Constitution (Article XV) and the Arizona Revised

61 Arizona Corporation Commission: http://www.azcc.gov/Divisions/Administration/about.asp

Statutes (§40-201, *et seq*.), and further defined in the Arizona Administrative Code (Title 14, Chapter 2).

The Division oversees the following numbers of utilities:

- Telecommunications companies ……... 265
- Water utility companies....................... 282*
- Sewer companies................................. 44*
- Water and sewer 19*
- Electric companies................................ 16
- Gas utilities... 5

*The Commission oversees more than 400 individual water and sewer systems. Multiple systems can be operated by the same utility company.[62]

Arizona is a renewable energy leader, consistently ranked in the top three among alternative energy leaders and is ranked No. 2 in Alternate Energy Industry Leaders by *Business Facilities* magazine's annual state ranking issue.[63]

Arizona has one nuclear power plant and extensive solar energy potential. Its large desert areas offer some of the highest solar power potential in the country and the Colorado River is a tremendous source of hydropower. While Arizona ranks near the middle of the states in total energy consumption, per capita energy consumption is low and the state economy is not energy intensive. The transportation sector is the leading energy-consuming sector in the state.

The Palo Verde Nuclear Generating Station is the largest nuclear generation facility in the United States and averaged over 3.3 gigawatts (GW) of electrical power production in 2008 to serve approximately 4 million people. Arizona Public Service (APS) owns 29.1 percent of the station and operates the facility, which is located about 45 miles west of central Phoenix. Other owners include Salt River Project (17.5 percent), El Paso Electric Co. (15.8 percent), Southern California Edison (15.8 percent), PNM Resources (10.2 percent), Southern California Public Power Authority (5.9 percent), and the Los Angeles Dept. of Water & Power (5.7 percent).[64]

Arizona's Future in Renewable Energies

Arizona is a rapidly growing leader in solar energy research and development. The state's solar work force grew 26 percent from 2010 to 2011. New projects include Rioglass Solar ($95 million, 100 employees), Gestamp Solar Steel ($25 million, 300 employees), Maxwell Technologies ($26 million, 150 workers), and Magna International, whose new 166,000-square-foot facility will employ 150 people to manufacture components for the solar panel market.

"Arizona is taking a global approach to its role in the renewable energy industry," says Don Cardon, president and CEO

62 Arizona Corporation Commission: http://www.azcc.gov/Divisions/Administration/Annr/2007-2008/final, percent202007-08.pdf

63 Business Facilities, "Ranking Report," July/August 2012: http://businessfacilities.com/2011/wpcontent/uploads/2012/07/BFJulAug12_staterankings_LR.pdf

64 Wikipedia, "Palo Verde Nuclear Generating Station": http://en.wikipedia.org/wiki/Palo_Verde_Nuclear_Generating_Station

of the Arizona Commerce Authority. "Our state is home to some of the world's largest solar companies, the U.S. military's largest solar plant, and the world's premier photovoltaic testing laboratory. With more than 100 significant solar energy businesses already here, Arizona has established itself as one of the world's preeminent locations for solar industry expansion."[65]

Mesquite Solar 1, a photovoltaic solar power plant, currently under construction in Maricopa County, is projected to generate nearly 350,000 megawatt hours of electricity in the first full year of production, or enough to power nearly 31,000 homes. Owned by Sempra Generation, this generation project is supported by a power purchase agreement to sell power to the Pacific Gas & Electric Company.[66]

Petroleum

Arizona receives its petroleum product supply from southern California and El Paso, Texas. A new refinery in Yuma County, Arizona, about 96 miles southwest of Phoenix, is expected to be fully operational by late 2013. The refinery is planning to receive its crude supplies from Alberta oil sands that will be shipped by barge to Mexico and shipped by pipeline to Arizona. The facility will have a capacity to refine 163,000 barrels per day of crude oil and produce 6.3 million gallons per day of petroleum clean fuels such as CARB3 (California Air Resources Board fuel specification), Arizona Clean Burning Gasoline, ultra-low sulfur gasoline, as well as other petroleum products. This new facility will be Arizona's first refinery and could be the first refinery in the United States specifically designed to produce clean petroleum fuels.

An oxygenated motor gasoline blend is used in the Tucson area during the winter and in Maricopa County (Phoenix) year-round. Arizona also requires the use of a motor gasoline blend with low volatility in the area just south of Phoenix.

Natural Gas

The electric power sector dominates natural gas consumption in Arizona, consuming roughly three-fourths of state supply. Winters are generally mild and almost two-fifths of Arizona households rely on natural gas as their primary energy source for home heating. Arizona relies on interstate and international deliveries to meet most of its natural gas demand.

A new natural gas-fired power plant that can produce between 25–575 megawatts was completed in Coolidge, southeast of Phoenix, in May 2011.

Coal and Electricity

Substantial coal production takes place in the Black Mesa Basin in northeast Arizona. Arizona's first refinery is expected to be fully operational in 2012. Once completed, it could be the first in the United States specifically designed to produce

65 areadevelopment.com: http://www.areadevelopment.com/AnnualReports/Summer2012/silver-shovel-awards-5-9million-population-662221.shtml

66 energy.gov: http://energy.gov/articles/energy-department-finalizes-337-million-loan-guarantee-mesquite-solar-1-innovative-solar

clean petroleum fuels such as CARB3 (California Air Resources Board fuel specification), Arizona Clean Burning Gasoline and ultra-low sulfur gasoline.

Arizona's coal production takes place primarily in the Black Mesa Basin and large volumes of coal move in and out of the state via rail. More than one-third of the coal produced in Arizona is delivered to coal-fired generators in Nevada. The remaining two-thirds, along with coal supplies transported primarily from New Mexico, are consumed at power plants in the state.

Coal-fired plants supply almost two-fifths of Arizona's demand for electricity. Natural gas-fired plants and nuclear power supply most of the remainder. Arizona's sole nuclear power plant, the three-unit Palo Verde plant, provides about one-fourth of the state's total electricity generation.

The Glen Canyon and Hoover dams, both located on the Colorado River in northern Arizona, provide hydroelectric power.

More than one-half of Arizona households rely on electricity as their primary energy source for home heating.[67]

Water

Central Arizona Project (CAP) is designed to bring about 1.5 million acre-feet of Colorado River water per year to Pima, Pinal and Maricopa counties. CAP carries water from Lake Havasu near Parker to the southern boundary of the San Xavier Indian Reservation southwest of Tucson. It is a 336-mile long system of aqueducts, tunnels, pumping plants and pipelines and is the largest single resource of renewable water supplies in Arizona.[68]

Arizona receives its water from four main sources: the Colorado River, Arizona surface water, groundwater and effluent water. The Colorado River serves seven U.S. states and Mexico. Its water is collected and distributed through a series of federally constructed reservoirs that divert water to each state with its rights and distribution quantity dictated by the "Law of the River," a legal body set up specifically for the distribution of Colorado River water. Northern regions of Arizona rely on the Colorado River as their main source of water, which is distributed through the CAP, the largest aqueduct system ever constructed in the United States. Of Phoenix's water supply, 95 percent comes from the 17.2 percent of water supplied through lakes, streams and other surface water not reliant on the Colorado River, with the remaining 5 percent coming from city-owned wells. This water is stored in storage reservoirs and distributed by complex delivery systems throughout the state.

The main source of Phoenix's water supply is dependent on water from the Salt, Verde and Gila Rivers. A large portion of Arizona's water supply comes from the ground or aquifers.

67 U.S. Energy Information Administration: http://www.eia.gov/state/state-energy-profiles-analysis.cfm?sid=AZ

68 Central Arizona Project: http://www.cap-az.com/

Climate

DUE to its large area, unique desert and mountain landscapes with variations in elevation, Arizona has a wide variety of localized climate conditions. In lower elevations, the climate is primarily desert, with mild winters and hot summers. From late fall to early spring, the weather is mild, averaging a minimum of 60 F. Temperatures from November through February range from 40-75 F with occasional frosts. About midway through February, the temperatures start to rise again with warm days and cool breezy nights. June through September bring a dry heat ranging from 90-120 F. Arizona's all-time record high of 128 F was recorded at Lake Havasu City on June 29, 1994 and July 5, 2007; the all-time record low of –41 F was recorded at Hawley Lake on January 7, 1971.[69]

Due to the primarily dry climate, large temperature swings often occur between day and night in less developed areas of the desert. The swings can be as large as 50 F in the summer months. In the state's urban centers, the effects of local warming result in much higher measured nighttime lows than in the recent past.

69 Coolweather.net, Arizona Annual Temperatures and Records: http://coolweather.net/statetemperature/arizona-temperature.htm

The northern third of Arizona is a plateau at significantly higher altitudes than the lower desert, and has an appreciably cooler climate, with cold winters and mild summers. Extreme cold temperatures are not unknown; cold air systems from the northern states and Canada occasionally push into the state, bringing temperatures below zero F to the northern parts of the state.

Indicative of the variation in climate, Arizona has both the metropolitan area with the most days over 100 F (Phoenix), and the metropolitan area in the lower 48 states with nearly the most days with a low temperature below freezing (Flagstaff).

Arizona's average annual rainfall is 12.7 inches, which comes during two rainy seasons, with cold fronts coming from the Pacific Ocean during the winter and monsoons in the summer. The summer monsoon season occurs when the dew point rises dramatically for a brief period. Dew points as high as 81 F have been recorded during the Phoenix monsoon season. This hot moisture brings lightning, thunderstorms, wind and torrential, albeit brief, downpours.

Yuma leads the nation and the state as the sunniest city in the United States. Yuma counts 242 sunny days. Arizona cities that follow Yuma's lead are Phoenix at 211, Tucson at 193, Winslow at 177 and Flagstaff at 162.

Attractions

Home to five distinct regions, dozens of national and state parks—including the Grand Canyon—and hundreds of towns and cities, Arizona's landscape is as diverse as it is beautiful.

Discover the unique wonders of each Arizona region. If you're too hot in southern Arizona, a quick drive north will cool you down. If you need a break from the rural solitude in Cochise County, an hour drive to Tucson will connect you to the city.

Impressive natural attractions are found in six national forests, 21 Native American reservations, 27 state parks, and 26 national parks, monuments, recreation areas and historic sites. Other points of interest include the Arizona State Capital Museum, the Deer Valley Rock Art Center, the Mission San Xavier del Bac, the Phoenix Zoo, the Desert Botanical Garden, Colossal Cave Mountain Park, the Arizona Science Center and the Kitt Peak Observatory of the University of Arizona.

The Grand Canyon, one of the most awesome and well-known attractions in the world, is 277 miles long and offers activities ranging from sightseeing to guided rim walks to white-water adventures. Outdoor adventure seekers can explore Arizona's many rivers, lakes, caves, canyons and mountains through a multitude of recreational opportunities such

as rafting, kayaking, water skiing, rock climbing, biking, hot air ballooning, hiking, camping, boating, fishing, bicycling, horseback riding, hang gliding and winter sports, including downhill and cross-country snow skiing. If you're a schusser, there are four ski resorts in Arizona: Arizona Snowbowl outside of Flagstaff, Sunrise Park Resort in the White Mountains, Elk Ridge in Williams and Mt. Lemmon in the Catalinas north of Tucson. The Flagstaff Nordic Center offers cross country skiing. If golf is your game, you've come to right place. Arizona boasts 421 golf courses![70] Sports fans enjoy a host of professional sports franchises: major league baseball with the Arizona Diamondbacks; NFL football with the Arizona Cardinals; AFL football with the Arizona Rattlers; NBA basketball with the Phoenix Suns; WNBA basketball with the Phoenix Mercury; and NHL hockey with the Phoenix Coyotes.

At 15 teams strong, the 2011 Cactus League spring training season set the all-time record for overall league attendance with 1,595,614 attendees at 233 games. The 2011 season also represented the first time all 15 Major League Baseball teams were consolidated in the Phoenix-metropolitan area, which saw the opening of the league's newest stadium, Salt River Fields at Talking Stick.[71] Ten spring training stadiums in Arizona play host to the following teams: Los Angeles Dodgers, Chicago White Sox, Cleveland Indians, Cincinnati Reds, Chicago

70 Golflink.com, Arizona Golf Courses: http://www.golflink.com/golf-courses/state.aspx?state=AZ

71 Cactusleague.com: http://www.cactusleague.com/

Cubs, Seattle Mariners, San Diego Padres, Milwaukee Brewers, Oakland A's, Arizona Diamondbacks, Colorado Rockies, San Francisco Giants, Texas Rangers, Kansas City Royals and Anaheim Angels.

When Glendale hosts the Super Bowl in 2015, it will be the game's third visit to Arizona. Since 2008, when the Super Bowl was held last in Glendale, the Metro light rail opened in late 2008, offering a spine of connectivity from Phoenix to Mesa; the Sheraton Phoenix Downtown Hotel opened in the latter half of that year, making up part of the 1,500 hotel rooms built downtown since then, while 25 downtown Phoenix restaurants debuted; a year later, an expansion tripled the size of the Phoenix Convention Center.[72]

The state is also a welcome destination for football fans as Arizona plays host to two bowl games each year—the Tostitos Fiesta Bowl and the Buffalo Wild Wings Bowl. Arizona also hosts annual professional rodeos and racing enthusiasts have their choice of cars, horses and greyhounds.

72 Azcentral.com, "Super Bowl 2015: NFL selects Arizona," October 12, 2011: http://www.azcentral.com/community/glendale/articles/2011/10/11/20111011phoenix-arizona-super-bowl-2015-brk.html

Quality of Life

Arizona offers an exceptionally high quality of life. State residents enjoy agreeable weather, stunning landscapes, good jobs and a lower than average cost of living. Companies easily recruit talented employees to Arizona, thanks to all of the state's unique advantages.

Arizona at a Glance

Capital

Phoenix

Population

6,482,505 (Arizona 2011 estimate)
1,469,471 (Phoenix 2011 estimate)

Labor Force

3.005 million

Major Industries

Total Nonfarm 2,413,200 jobs
Total Private 2,000,800 jobs
Service-Providing 2,141,000 jobs
Private Service-Providing 1,728,000 jobs
Trade, Transportation, and Utilities 474,900 jobs
Goods Producing 272,800 jobs
Professional and Business Services 345,500 jobs
Government 412,400 jobs
Retail Trade 297,900 jobs
Educational and Health Services 280,400 jobs
(Source: azstats.gov, January 2012)

Unemployment Rate

8.3 percent (Arizona – August 2012)[73]
7.1 percent (Phoenix – August 2012)[74]
7.2 percent (Tucson – August 2012)[75]

Expanding Industries

Construction; leisure and hospitality; professional and business services; financial activities; education and health services

Corporate Income Tax

6.98 percent (for tax year 2006) (Arizona Department of Revenue)

Transaction Privilege (Sales) Tax

6.6 percent state tax on the gross proceeds from retail sales.

73 Department of Numbers: http://www.deptofnumbers.com/unemployment/arizona/

74 Department of Numbers: http://www.deptofnumbers.com/unemployment/arizona/phoenix/

75 Department of Number: http://www.deptofnumbers.com/unemployment/arizona/tucson/

PART II: THE UNITED STATES LEGAL SYSTEM

The United States Legal System

THIS overview is intended for those with little knowledge of the United States legal system who would appreciate a brief basic introduction. Readers already familiar with the legal system may quickly scan this section.

The United States System of Laws

The laws of the United States are found in several different sources: the United States Constitution, the constitutions of the 50 states, federal laws passed by Congress, state laws passed by state legislatures, ordinances passed by local governing bodies, rules and regulations adopted by federal and state agencies, tribal laws that apply on Indian reservations and the common law.[76] Additionally, judges make law by interpreting legislative intent, a process that has the effect of expanding or contracting the scope of statute law and by ruling on cases where no written law precisely applies. Judicial rulings, and the opinions that support them, become precedent and influence the outcome of subsequent cases.

The law has two principal categories: criminal and civil. State and federal governments prosecute criminal cases. Convictions in criminal cases may lead to fines and/or imprison-

76 Common law is a body of law based on judicial decisions.

ment. In contrast, civil laws are enforced through suits brought by private parties and can never lead to imprisonment. Civil law includes many different areas of the law, such as contract law, product liability law and tort law.[77] Criminal and civil law often overlap and some behavior may subject a person both to criminal penalties and to civil liability. For example, an automobile accident may involve both criminal and civil law. Violation of antitrust laws is another example where criminal and civil law may overlap.

77 Tort law deals with civil remedies for intentional or negligent injuries to people or their property.

The United States Court System

The United States has both a single federal system and 50 separate state court systems. The federal system administers federal law, which principally consists of the statutes enacted by the U.S. Congress. State courts, in general, interpret laws passed by state legislatures. A third, but significantly smaller court system, consists of tribal courts, which administer laws that apply on Indian reservations.[78]

Each court system has several levels. At the lowest level is the trial court or court of first impression. In the federal system, the district court is the court of first impression. In Arizona, the Superior Court is usually the court of first impression. Cities and towns have municipal courts charged with administering local ordinances. Justice and small claims courts handle relatively minor matters, such as lawsuits where the total amount claimed is small ($5,000 or less in Arizona justice courts). Most courts try both criminal prosecutions and civil suits. Criminal suits are brought in the name of the United States or of the particular state and are prosecuted by U.S. attorneys, state attorneys general, county attorneys and city attorneys. Private litigants bring civil suits. Individuals

78 Indian reservations are separate sovereignties located within the United States.

may represent themselves in court actions, although attorneys usually represent them.

Disputed questions of fact are tried and decided at the trial court, which can be a municipal court, a justice court, a superior court or a district court, depending on which has jurisdiction (a concept discussed below). The court applies legal principles to the facts producing a judgment. In criminal cases, the verdict is either guilty or not guilty. In civil cases, the judgment will be to award or deny relief to the plaintiff, the party who brought the suit against the other side, the defendant. In a civil suit, a judgment is usually for monetary relief, but in appropriate cases, an injunction may issue directing the defendant to do or to refrain from doing something. In a civil suit, the winning side also recovers its allowable court costs from the other side and, in some cases, recovers its own attorneys' fees. The amount of damages recovered includes actual dollar loss and sometimes recovery for pain and suffering or a multiple of actual damages. At times, particularly outrageous conduct may merit punitive damages. In the trial court, a jury of laymen, usually 12, but sometimes as few as eight or six, decides which version of contested facts is the true version. The judge decides and applies the law and renders judgment. Not all cases involve a jury; some are decided entirely by the judge based on the facts and the law. In criminal cases, the defendant has a right to a trial by jury.

In civil cases, the defendant or plaintiff cannot always insist upon a jury because the nature of the particular case determines whether a jury is required.

The appellate courts are above the trial courts. In the state court system, the decision of the trial court may be appealed to the state Court of Appeals and, from there, to the Arizona Supreme Court. If a question of federal or constitutional law is involved, a party may appeal to the U.S. Court of Appeals and from there to the U.S. Supreme Court. Both the U.S. Supreme Court and state supreme courts have broad discretionary powers to decide whether to review decisions of lower courts. Each year the U.S. Supreme Court accepts only a handful of cases for review, out of the thousands of petitions for certiorari filed.

Courts of Appeals do not hold trials, hear witnesses or receive new evidence. Instead, they review written briefs and hear oral arguments presented by attorneys. Appellate courts decide whether the proceedings and outcome in the lower courts are in accordance with applicable law. An appellate court may affirm the lower court's decision, reverse the lower court and direct an opposite outcome, dismiss the case entirely or return the case to the trial court for a new trial, sometimes with express instructions as to how to correct errors made in the first trial.

At the heart of the justice system lays the adversarial concept of opponents who fight a battle of words in court before unbiased neutrals. The judge requires the parties to follow procedural rules and decides questions of law. The jury or, if there is no jury, the judge, decides the facts and determines a winner. The underlying rationale is that each side will present its best possible case and that the impartial judge and jury will be able to fairly decide the outcome.

Court proceedings are often slow and expensive. Cases may take a year or more to come to trial. If appealed, it may take five years or more to reach a final conclusion. In civil matters, speedier and less expensive ways of resolving disputes are available through private agreement. There are a number of alternate dispute methods administered by public and private organizations, such as the American Arbitration Association and the Federal Mediation and Conciliation Service.

In mediation, a neutral third party works with the parties conveying settlement offers and counteroffers. Conciliation is similar to mediation, except that the conciliator takes a more active role in proposing compromise solutions. Arbitration is the oldest alternate method and the one most often used. In arbitration, the parties select a neutral arbitrator or panel of arbitrators who perform the roles of both judge and jury to decide the matter after a hearing. The hearings are usually far shorter, less expensive and more flexible than court proceedings. Arbitration awards can be enforced through court proceedings and can be appealed on very limited grounds, such as arbitrator bias or that the arbitration award went beyond the scope of the matter that the parties agreed to arbitrate. Arbitration is mandatory in civil cases in Arizona in which the plaintiff seeks to recover $50,000 or less.

Interrelationship and Priorities Among Federal, State and Local Laws

For a court to be able to issue a binding judgment, it must have jurisdiction of two kinds. The first is personal jurisdiction over the litigants (*in personam*) or, in some cases, over a physical thing such as certain goods or a piece of land (*in rem*). Courts acquire *in personam* or *in rem* jurisdiction by having the persons or things within the boundaries of the geographical area within which the court is authorized to act and by giving formal notice in the manner required by law, such as serving a summons. In some cases, persons physically outside the area of jurisdiction can be brought within its jurisdiction by mailing them copies of the summons and other pleadings or, when their whereabouts are unknown, by publishing the summons in a newspaper. This alternate means of service is available when the absent defendant has caused a significant event to take place within the area of the court's jurisdiction.

Second, the court must also have subject matter jurisdiction. This means that the court must be authorized to apply the particular laws being invoked by the parties. The starting point here is the general rule that each court administers the laws enacted by the legislative body of the system to which it belongs. Municipal courts enforce city ordinances, state courts enforce state laws, federal courts enforce federal laws and Indian courts enforce tribal laws. However, there are exceptions. Certain acts may violate both state and federal laws. Some actions may take place in more than one state, or violate the laws of more than one state and some laws take precedence over others. Physical areas overlap. Tribal reservations are within counties, counties within states and states within the United States. Some courts have broad general jurisdiction and others have only limited subject-matter jurisdiction. In a given matter, a single court may have exclusive jurisdiction. In other situations, more than one court may have concurrent jurisdiction. Sometimes a case begun in state court can be moved to a federal court or vice versa. Depending on the facts, a given court, state or federal, may apply federal law, state law, constitutional law or more than one set of laws to various aspects of the case. Not surprisingly, complex rules govern which court has jurisdiction over a particular matter and which law applies.

No matter which court has jurisdiction, there is a clear order of priority to resolve conflicts of law. The U.S. Constitution has the highest priority and the U.S. Supreme Court is the final authority on the reach and meaning of the U.S. Constitution. The Supreme Court has the power to invalidate laws passed by Congress or by state legislatures as being unconstitutional. Next in order of priority are the laws passed by the U.S. Congress, which take priority over (preempt) state and tribal laws, but only if the federal law is enacted on a subject on which the U.S. Constitution gives Congress authority to act. Congressional legislative authority is very

broad. Congress, for example, can pass laws that preempt state laws having anything to do with interstate commerce. But Congress' legislative authority is not universal. Matters of purely state concern are reserved to state legislatures; in those areas, state laws prevail. County and municipal ordinances are subordinate to state laws because counties and municipalities are subordinate state instrumentalities. On reservations, tribal laws take precedence except when Congress has preempted tribal laws or has given authority to the states to enact laws that reach into tribal reservations.

Administrative Agencies and Regulations

THE influence of the many administrative agencies—state, federal and local—is extensive. Agencies have the authority to adopt rules and regulations, many with the force of law. Agencies are the creatures of the legislatures that created them and their authority is determined by the legislatures. Agencies always deal with a single subject matter, although the subject may be broad and far-reaching. Agencies adopt rules and regulations through formal procedures that usually provide for public notices and public hearings. Enforcement of agency rules and regulations often occurs through citations for alleged violations, followed by a hearing. The final agency determination is similar to a court judgment. Many agency proceedings are so similar to court proceedings that they are referred to as quasi-judicial.

Some examples of federal agencies include the National Labor Relations Board (NLRB), the Occupational Safety and Health Administration (OSHA), the Equal Employment Opportunity Commission (EEOC), the Federal Communication Commission (FCC) and the Securities and Exchange Commission (SEC). In Arizona, in addition to the FCC agencies that administer state laws that are parallel to federal laws, the Arizona Corporation Commission (ACC) regulates public utilities (among other things) and other state agencies

license and regulate professions such as law, medicine and engineering. Zoning is an important concern for investors in real property. It is governed by county and municipal ordinances and administered by local zoning boards and commissions.

A basic principle of agency jurisdiction is that the parties must first exhaust their administrative remedies before going to court. Agency determinations are often given great weight; it is difficult to overturn an agency ruling in a court action. Nevertheless, recourse to the courts is always available, both as to the adoption of agency rules and regulations and as to the agency rulings and decisions. The requisite exhaustion of administrative remedies prior to court action is always time consuming and often expensive. This is particularly true in tax matters, as the full amount of the contested tax must usually be paid as a precondition of bringing a suit. However, a taxpayer that is successful on appeal of an adverse tax ruling will not only get the return of taxes paid under protest, but also interest.

PART III:
SELECTED LEGAL SUBJECTS

Forms of Business Ownership

Joseph M. Miller, Jeffrey A. Scudder and Michael M. Donahey

Arizona's corporate laws were designed to ensure profitable cultivation of Arizona's natural resources and foster a fertile environment for investment and innovation. Consistent with this central concern, Arizona's Constitution authorized the formation of corporate entities and established the Arizona Corporation Commission (ACC). The ACC's broad responsibilities extend beyond the regulation of public service utilities. The ACC has the responsibility, subject to legislative oversight, to issue certificates of incorporation or licenses to foreign corporations to do business in Arizona and to administer the Arizona Securities Act. In addition, the ACC is authorized to administer the Arizona Limited Liability Company Act, collect annual reports from Arizona corporations and has the responsibility to engage with the public and disseminate pertinent information to the business sector. The ACC is also empowered with the related rule-making, enforcement and investigative powers to effectively carry out those responsibilities. The ACC has jurisdiction over all private corporations and public-service corporations. In addition to the Arizona Secretary of State, the ACC plays an important role in the formation, operation and termination of Arizona businesses.

Arizona's courts also play an important role. The decisions of the ACC are subject to administrative and judicial review.

In addition, the jurisdiction of Arizona's superior courts extends to suits by and against corporations, resulting in a body of judicial opinions guiding individuals in their selection and operation of business ownership forms in Arizona.

An individual may choose among several alternate forms of ownership to make an investment or to conduct business in Arizona. The choice of form of ownership is important because it affects not only the manner in which the investment or business will be operated, but also the extent to which federal and state laws will apply. The choice will determine who will make management decisions, whether owners will be liable for investment or business-related obligations, whether interests in the investment or business can be easily transferred and how the owner's income tax liability will be determined.

The five most common forms of ownership in Arizona are sole proprietorships, general partnerships, limited partnerships, corporations and limited liability companies. Each form of ownership offers specific advantages. The following should be considered when selecting a form of ownership:

- required formalities;
- suitability of the form of ownership as a vehicle for raising capital and borrowing funds;
- method by which the owners manage and control the business;
- manner of dividing profits and losses;
- extent to which owners may be personally liable for business obligations;

- ability of owners to transfer their interests;
- effect of an owner's death, bankruptcy or withdrawal upon the continuing existence of the business; and
- record-keeping requirements.

The objectives of the owners can sometimes be accomplished through a combination of forms of ownership when a single form would not suffice. The following chart summarizes these criteria.

Foreign persons also may use forms of ownership initiated or created outside of Arizona or the United States to take action or conduct business in Arizona. Foreign corporations and other types of business entities or associations are permitted to do business in the state. However, foreign persons may encounter reluctance on the part of local lenders or merchants to do business with businesses organized outside the United States. For this reason, foreign persons may wish to use one or more entities organized in Arizona, or in another state of the United States, to make investments or to conduct business. A business organized under Arizona law can be a subsidiary or affiliate of a foreign business organization.

Additional helpful information about corporate forms or filings of existing entities can be found at the following websites:

- Arizona Corporation Commission: www.azcc.gov/
- Arizona Secretary of State: www.azsos.gov/business_services/filings.htm

Chart: Entity Considerations

	Organizational Formalities	Capitalization and Debt Financing
Sole Proprietorship	Generally none	Capital limited to amount committed by proprietor; ability to obtain financing generally limited to financial condition of proprietor
General Partnership	Oral partnership agreement is permitted; advisable to adopt written partnership agreement	Partners free to structure their respective capital obligations as they may agree; ability to obtain financing generally limited to financial condition of the partners
Limited Partnership	Certificate of limited partnership must be filed; advisable to adopt written limited partnership agreement	Partners free to structure their capital obligations as they may agree; absent limited partner guarantees, ability to obtain financing generally limited to financial condition of the general partners
Corporation	Articles of incorporation and certificate of disclosure must be filed; directors' meeting must be held; bylaws must be adopted	Capital raised through issuance of shares; significant freedom to develop share structure best suited for corporate needs; debt financing may require shareholder guarantees
Limited Liability Company	Articles of organization must be filed; advisable to adopt written operating agreement	Members free to structure their respective capital obligations as they may agree; debt financing may require member guarantees

	Control	Profits and Losses
Sole Proprietorship	Exclusively vested in proprietor	Exclusively allocated to proprietor
General Partnership	Partners have equal voice in all management decisions unless the partnership agreement establishes different management rights	Significant freedom to allocate among partners in partnership agreement
Limited Partnership	Typically exercised by general partners with rights of limited partners to ratify certain decisions, including sale of assets and liquidation	Significant freedom to allocate among partners in partnership agreement
Corporation	Vested in board of directors; members are subject to election and removal by shareholders	Dividends generally allocated among shareholders in accordance with stock ownership; exception for holders of preferred stock, who may be given dividend rights superior to common shareholders
Limited Liability Company	Vested in managers or members, depending on management structure	Significant freedom to allocate among members in operating agreement

	Personal Liabilities	Transferability of Interest
Sole Proprietorship	Generally unlimited personal liability	Assets of proprietorship generally freely transferable
General Partnership	Generally unlimited personal liability except in the case of a limited liability partnership	Generally requires agreement of all partners to assign economic interests
Limited Partnership	General partners generally have unlimited personal liability except in the case of a registered limited liability partnership; liability of limited partners generally limited to contributions made or agreed to be made	Transfer of any general partner's economic interest typically requires consent of all partners; limited partner may substitute another party if permitted under partnership agreement or by consent of all partners
Corporation	Liability of shareholders generally limited to investment in shares	Shares freely transferable unless restricted by articles, bylaws, agreement or securities laws
Limited Liability Company	Liability of members generally limited to investment in membership interests	Generally consent of members needed for transfer of membership interest

	Continuity of Existence
Sole Proprietorship	No continuity; death terminates proprietorship
General Partnership	Withdrawal, bankruptcy, death or expulsion causes dissolution of partnership unless remaining partners elect to continue business in accordance with partnership agreement
Limited Partnership	Withdrawal, bankruptcy, death or expulsion of general partner causes dissolution of partnership unless remaining general partners elect to continue business in accordance with partnership agreement or, if no remaining general partners, all limited partners appoint one or more new general partners to continue partnership
Corporation	A corporation has perpetual existence unless otherwise specified in the articles; continuity not disrupted by events affecting shareholders
Limited Liability Company	Generally, withdrawal, bankruptcy, death or expulsion of the last remaining member causes dissolution unless otherwise provided for in an operating agreement

	Taxation	Reports
Sole Proprietorship	Not a separate taxable entity; income or loss exclusively allocable to proprietor	Preparation of tax return
General Partnership	Not a separate taxable entity; income or loss generally allocable to partners in accordance with partnership agreement	Preparation of tax return; maintenance of books and records
Limited Partnership	Not a separate taxable entity; income or loss generally allocable to partners in accordance with partnership agreement	Preparation of tax return; maintenance of books and records
Corporation	Generally a separate taxable entity that pays tax on entity profits; additional tax results to shareholders upon distribution of dividends	Annual reports must be filed with Arizona Corporation Commission; corporation must provide annual financial reports to shareholders; preparation of annual tax returns; certain corporate transactions involving foreign parties subject to special federal tax record keeping requirements
Limited Liability Company	Not a separate taxable entity; income or loss generally allocable to members in accordance with operating agreement	Preparation of annual tax returns except in the case of certain single member companies; maintenance of books and records

Sole Proprietorships

Joseph M. Miller, Jeffrey A. Scudder and Michael M. Donahey

Sole proprietorship describes the direct ownership of a business enterprise by a single individual or single marital community of husband and wife. The characteristics are summarized in the preceding chart and detailed in the following paragraphs.

Organizational Formalities

No formalities are involved nor documents required to organize a sole proprietorship. However, if the owner conducts business operations under a name other than the owner's name, a certificate of "fictitious name" must be recorded with the county recorder of each county in which the business is conducted.

Capitalization and Debt Financing

In a sole proprietorship, the owner's ability to obtain capital and financing is likely to be limited by the owner's net worth or financial strength, which tends to limit proprietorships to smaller businesses.

Management and Control

The operation of a sole proprietorship is within the owner's sole control. The owner is not required to keep a written record of management decisions. Because there is a single owner, there can be no management conflicts, except as between husband and wife in a marital community proprietorship. Under Arizona's community property laws, husband and wife have equal rights in, and equal control over, community property, unless they otherwise agree.

Profits and Losses

A sole proprietor retains all profits and bears all losses of the business. If the owner should enter into any agreement with another for the sharing of income or expenses relating to a business or investment, the agreement may create a general partnership, with unintended consequences.

Extent of Owner's Liability

Because a sole proprietorship is not a separate legal entity, it does not protect its owner from personal liability for business obligations. A sole proprietor has unlimited personal liability for the debts and obligations of the business, even after the business is sold or terminated. Insurance can be purchased to protect the sole proprietor's personal assets from some liability risks.

Transferability of Interest

The sale of a sole proprietorship can be accomplished through a sale of the assets used in the business. Assets, as a general rule, are freely transferable, but restrictions may apply

to some. For example, the sale of a franchise might be restricted by the terms of the franchise agreement.

Continuity of Existence

A sole proprietorship has no continuity of existence independent of its owner and ends upon the owner's death.

Tax Considerations

Because a sole proprietorship is not a separable taxable entity, the income or loss from operation of the proprietorship is included with the owner's other income or loss in calculating the owner's taxable income. Taxes are further discussed in the "Taxation" chapters.

Record Keeping Requirements

A sole proprietorship is not subject to any special reporting requirements. The owner is required to file federal and state income tax returns, payroll tax returns for employees, license applications and other regulatory reports applicable to the business being conducted. In license applications for certain businesses, the owner may be required to disclose more information regarding the owner's personal affairs than if the business were a partnership or corporation.

Limited Liability Company Alternative

Operation of a sole proprietorship is one option available to an individual desiring direct ownership of a business enterprise. Under Arizona law, individuals also have the option of organizing a separate legal entity known as a limited liability company (LLC). An individual can form an LLC by filing articles of organization with and paying a nominal filing fee to the Arizona Corporation Commission. Though an LLC is subject to greater statutory regulation than a sole proprietorship, an LLC has the benefit of providing its members a shield against personal liability greater than their investment in the LLC. In addition, for federal income tax purposes, an LLC with a single member is disregarded and the individual member is taxed on the LLC's operations in the same manner as if that person were operating a sole proprietorship.

Conclusion

The principal advantage of a sole proprietorship is that the owner has exclusive control. The owner does not need to obtain the consent of partners, directors or shareholders. Another advantage is simplicity. No formalities are required to organize or maintain a proprietorship. The chief shortcomings of a sole proprietorship are the exposure of all the owner's personal assets to liabilities of the business and the difficulties that may be encountered in obtaining sufficient funds to finance the business.

General Partnerships

Joseph M. Miller, Jeffrey A. Scudder and Michael M. Donahey

Partnerships are common forms of business ownership used by two or more persons to acquire investment property or to operate a business. The two kinds of partnerships under Arizona law are general partnerships and limited partnerships. The principal differences between a general partnership and a limited partnership are that each of the partners of a general partnership can incur liabilities on behalf of the partnership and that generally each is personally liable for the payment of all partnership liabilities. The partners of a general partnership enjoy significant freedom under Arizona law to fix their rights and obligations by agreement as to most partnership matters.

Organizational Formalities

A general partnership can be created with little formality. Under Arizona law, a general partnership is formed among two or more persons whenever they associate together to carry on a common business enterprise as co-owners for profit. Generally there is no requirement to file any certificate or other organizational documents with any governmental agency. However, if the partners conduct the partnership business under a "fictitious name," one that does not consist of the individual names of all partners, a certificate showing the name and address of each partner must be filed in the county recorder's office of each Arizona county in which the partnership is located. In addition, a partnership may file a statement of partnership authority with the Arizona Secretary of State, which, in addition to providing information about the partnership and partners, states the authority, or limitations on the authority, of some or all of the members to enter into transactions on behalf of the partnership.

A partnership can be created without a written partnership agreement if the co-owners orally agree to form a partnership or if they conduct their enterprise in a manner that demonstrates their intention to share profits and losses as partners. For this reason, a general partnership could inadvertently arise when two or more persons jointly acquire property and share income and expenses. Because a partnership relationship creates significant rights and obligations among co-owners, any arrangement involving the sharing of income and expenses should be carefully considered to determine whether it creates a partnership. If so, a written partnership agreement should be prepared to clearly define the partners' respective rights and obligations, including such items as the sharing of profits and losses, the obligations to fund the ongoing business of the partnership, management decisions and transfer rights. In the absence of a written agreement, Arizona law will dictate the partners' rights and obligations in a manner that may or may not conform to the partners' expectations or desires.

Capitalization and Debt Financing

Partners may contribute cash, property or services to the capital of a general partnership. Arizona law permits the partners' broad discretion to arrange their capital contributions in any way they choose. In most cases, the partners will describe in their partnership agreement the specific capital contributions required of each partner when the partnership is formed. The partnership agreement should also set forth the respective obligations of the partners to contribute additional capital if the business of the partnership requires. The partners may agree to make capital contributions in proportions different from their share of profits and losses or may agree to make additional contributions in proportions different from their initial contributions.

Arizona law permits a general partnership to borrow money or obtain credit from lenders in the name of the partnership. A general partnership may also borrow money from one or more of its partners. Each partner in a general partnership is personally liable to partnership creditors to repay partnership debts if the partnership's assets are insufficient. Consequently, a partnership's ability to borrow money or obtain credit will be influenced by each partner's individual financial condition and credit history, as well as by the partnership's financial condition. Because of each partner's financial responsibility for partnership debts, generally, the partners include a provision in their partnership agreement limiting the partnership's ability to borrow money without the consent of all, or a majority, of the partners.

As an alternative to obtaining its cash requirements from its existing partners or third-party lenders, the partnership may create and issue additional interests in the partnership to new partners who agree to contribute additional capital. Arizona law requires, except as otherwise provided in a partnership agreement, the consent of each existing partner before a new partner is admitted as a member of a general partnership, because the admission of an additional partner may alter the management control of the existing partners and dilute the value of their interests in the partnership's assets and profits.

Management and Control

The partners of a general partnership are free to divide management authority and responsibilities among themselves in whatever manner they agree. If the partners fail to describe any specific management arrangement in their partnership agreement, Arizona law provides that each partner will have an equal voice in all management decisions and that a majority vote of the partners is controlling as to ordinary partnership matters.

In many general partnerships, the partners modify the general rule that all partners have equal management rights. It is quite common, for instance, to give partners voting rights according to their respective contributions to the partnership or their percentage of shares of partnership profits. Partners

may appoint a management committee for the purpose of approving all, or a specified list of, management decisions. The partners may also agree that one specific partner will be the "managing partner" with responsibility for conducting routine transactions within described limitations. One of the most important advantages of the partnership form of business is the wide range of freedom the partners have to devise internal management rules that reflect the needs of the enterprise and the individual partners.

Arizona law provides certain rules that cannot be modified by the partners in their partnership agreement. For example, no matter how the partners may agree to divide management responsibilities among themselves, except in very limited circumstances, third parties who are unaware of the partnership agreement are entitled to rely on the presumed authority of each partner to represent the partnership. Therefore, even if the partnership agreement deprives some of the partners of the right to participate in management, each of the partners is treated as an agent of the partnership for the purpose of carrying on ordinary partnership business. This means that each of the partners has the power to incur partnership debts and liabilities to third parties in the ordinary course of the partnership's business that will obligate both the partnership and all individual partners. Obviously, it is advisable to carefully evaluate the trustworthiness and reliability of all other partners before entering into a general partnership.

Profits and Losses

Partners are free to allocate partnership profits and losses by agreement. If the partners do not specify in their partnership agreement how profits and losses are to be shared, Arizona law provides that profits and losses are shared equally among the partners. Partnership agreements often provide for unequal sharing of profits and losses to reflect differences in amounts or types of contributions made by the partners and, if one of the partners has contributed management or other services to the partnership rather than cash or property, the "service" partner may be given a percentage share of profits greater than the proportion of any cash or property he or she contributed.

In cases in which one partner contributes services and another partner contributes cash, the partners often agree upon complex profit and loss sharing arrangements. One common arrangement is to allocate all or most of the profits to those partners who contribute cash until they receive a "targeted" return on their investment equal to an agreed-upon percentage per year. After the target is achieved, additional profits are then divided between the "service" partner and the other partners in equal shares or in some other agreed-upon proportion. The variety of possible arrangements is limitless.

The partnership agreement should describe when and how the partnership will make distributions of cash or other property to the partners. Frequently, the partners will desire to distribute cash flow from ordinary business operations in the same proportions that they share profits, but following a sale by the partnership of a capital asset, the partners will usually require that the partnership distribute the sale proceeds in proportion to the partners' net capital contributions until capital is returned and that excess proceeds be distributed in proportion to the partners' profit shares. A related issue is the need to decide whether proceeds must be distributed immediately or retained in the partnership to satisfy future requirements.

Extent of Owners' Liability

One of the principal disadvantages of a general partnership is that each of the partners is generally fully liable for the payment of all the partnership's debts and liabilities. The partners' liability is "joint and several." Each partner alone can be sued by a partnership creditor for the full amount of an unpaid partnership liability, even though the partners may have agreed among themselves to share responsibility for the payment of partnership debts in specified portions.

Several steps can be taken to minimize the risk of unlimited liability of the individual partners. Under agreements with a third party, such as leases or loan agreements, the partners may be able to negotiate an agreed-upon limit to the liability of individual partners. A lender also may agree to limit the partners' individual liability for all, or a portion, of a loan to the assets given as collateral by the partnership to secure the loan. With respect to non-contractual partnership liabilities, such as for a personal injury caused by the negligence of a partner, the partners may be able to protect themselves by obtaining liability insurance.

Further, Arizona law authorizes a general partnership to elect classification as a registered limited liability partnership. If a general partnership elects classification as a registered limited liability partnership, each partner is shielded from "vicarious" liability associated with the debts and obligations of the partnership, whether arising in contract, negligence or otherwise. The liability shield of a registered limited liability partnership does not, however, protect a partner from direct liability on account of a partner's own actions, including wrongful acts, negligence or misconduct of the partner or the wrongful actions of others under the partner's direct supervision and control.

During the course of the partnership, the partners may also agree to convert the partnership to a limited partnership and file a certificate of limited partnership. However, a general partner who becomes a limited partner as a result of the conversion remains liable as a general partner for any obligation incurred by the partnership before the conversion takes effect and, under certain circumstances, any obligations incurred within 90 days of the conversion.

Transferability of Interests

Under Arizona law, a partnership is viewed as a personal relationship of trust and confidence among the partners. Therefore, without a special agreement, no partner alone can

transfer the partner's rights and duties as a partner to another person. If a partner desires the ability to transfer his or her interest in a partnership to a new partner, the partner should insist that the partnership agreement provide this right.

Arizona law does permit a partner to transfer the partner's economic rights to receive future partnership distributions of the partner's share of profits and return of contributions. No agreement of any other partners is necessary to transfer such economic rights unless the partnership agreement specifically restricts such transfers. However, because a person who acquires all or a part of a partner's economic rights generally cannot participate in the management of the partnership's business and cannot review the partnership's financial or business records, it is usually difficult or impossible for a partner, without the agreement of the other partners, to sell economic rights for the full value of the partner's interest in the partnership.

Continuity of Existence

One of the important characteristics of a general partnership is that, except as otherwise provided in a partnership agreement, any partner has the ability at any time to cause the dissolution of the partnership by withdrawing from the partnership. In addition, the death, bankruptcy or expulsion of any partner will also cause the dissolution of the partnership, except as otherwise provided in a partnership agreement. However, a partner who wrongfully dissociates (e.g., dissociation before the expiration of a defined partnership term or the completion of a defined undertaking) is liable to the partnership and to the other partners for damages caused by the dissociation, in addition to any other obligation of the partner to the partnership or to the other partners.

Arizona law requires the partnership to wind up its business and liquidate its assets upon any dissolution of the partnership, unless there is an agreement to the contrary. The partners often agree in advance to remain in the partnership for a fixed period or until a specific project is completed to avoid an undesirable and unplanned liquidation. If one of the partners should then withdraw, die, become bankrupt or be expelled prior to this time, Arizona law permits the other partners to continue the partnership business if their partnership agreement so provides. The partnership agreement usually provides a formula for valuing such partner's interest and requires one or more of the continuing partners to pay that value to the former partner. This payment can be required immediately in cash or the partnership agreement may specify deferred payment terms. The partnership, or a dissociated partner, may also file a statement of dissociation to provide notice to third parties of the limitation on the dissociated partner's authority.

If the partnership business is wound up and liquidated after dissolution, Arizona law provides that liquidation proceeds must first be used to pay partnership debts and liabilities owing to persons who are not partners and the remainder distributed among the partners as the partners may agree or, if there is no agreement, first to pay partnership debts owing to partners,

next to return to the partners their previous contributions and finally, to pay the partners in proportion to their profit shares.

Tax Considerations

Typically, a general partnership is not treated as a separate entity taxable for purposes of either the U.S. or Arizona income tax codes. A general partnership is only required to file an annual information return reflecting the partnership's income or loss for the year and each partner's share of the partnership's taxable income or loss. Each individual partner then includes his or her share of the partnership's taxable income or loss in computing taxable income on that partner's individual tax return. In effect, the partnership is treated for income tax purposes as a mere conduit that passes its income and expenses through to the partners. No income tax is imposed upon the partnership itself.

Each partner's share of partnership income or loss for income tax reporting purposes must conform to that partner's share of the economic profits or losses under the partnership agreement. In other words, if partners have agreed to share partnership profits and losses equally, they cannot report partnership income or expenses for tax purposes in different proportions. Furthermore, each partner must include his or her share of partnership taxable income in that partner's annual individual taxable income, even if the partnership does not distribute the income to the partners. For this reason, it is common for the partners to include in their partnership agreement a provision requiring that, in any year in which the partnership has taxable income, there will be a cash distribution sufficient to ensure that the individual partners will have enough funds to pay their tax liability arising out of the partnership.

In the case of a foreign partner who is considered a nonresident alien for federal income tax purposes, the partnership is required to pay a withholding tax on the partnership income associated with a U.S. trade or business that is allocable to the nonresident alien. A discussion of the classification of foreign persons as resident and nonresident aliens is included in the "Taxation" chapter. When the foreign partner files his or her income tax return, the amount withheld by the partnership is treated as a credit against the tax due by the foreign partner. Under the terms of most partnership agreements, the amounts withheld by the partnership and paid to the federal taxing authorities on behalf of the foreign partner are treated as distributions to the partner that reduce the amount of subsequent partnership distributions to which the foreign partner would otherwise be entitled. Alternatively, the withholding payments may be treated as loans by the partnership to the foreign partner, to be recovered by the partnership with interest out of subsequent partnership distributions to which the partner would otherwise be entitled. Under a third option, the partnership agreement may require the foreign partner to contribute the funds necessary for the partnership to make the withholding payments.

Although a partnership is typically not treated as a separate entity for U.S. or Arizona tax purposes, there are circumstances in which a partnership may elect to be taxed as a corporation. In such case, the partnership and the partners are taxed in the same manner as corporations and corporate shareholders.

Record Keeping Requirements

An Arizona general partnership must file annual federal and state informational tax returns that reflect the partnership's income or loss for the year and each partner's share of the partnership's taxable income or loss. Additionally, a general partnership must maintain correct and complete books or records, which may be inspected by any partner. However, no reports of partnership activity are required to be filed with any state agency. If the partnership filed a statement of authority, and such statement is not canceled earlier, the statement is automatically canceled after five years and would need to be refiled.

Conclusion

The primary benefit associated with use of a general partnership is the significant freedom afforded the partners to determine, by agreement, their respective rights and obligations relating to partnership matters, such as capital requirements, sharing of profits and losses and business management. Another benefit is the single level of income taxation resulting from the status of the partnership as a mere non-taxed conduit for tax purposes. The chief disadvantage is that each partner is subject to unlimited personal liability for partnership obligations unless the partnership elects classification as a registered limited liability partnership or takes other steps to insulate the partners from partnership liabilities. Another disadvantage is the considerable practical difficulty in the ability of partners to transfer their interests in the partnership.

Limited Partnerships

Joseph M. Miller, Jeffrey A. Scudder and Michael M. Donahey

A LIMITED partnership may be used by two or more persons or other forms of ownership to acquire investment property or to operate a business. The principal distinction between a limited partnership and a general partnership is that, although a limited partnership must have at least one general partner, a limited partnership is permitted to have one or more "limited partners" who are not personally liable for the partnership's obligations unless they actively participate in management. As in a general partnership, Arizona law provides significant freedom to partners to fix, by agreement, their respective rights and obligations regarding most partnership matters.

Organizational Formalities

A limited partnership is not created under Arizona law until partners have filed a "certificate of limited partnership" with the Arizona Secretary of State and have paid the requisite filing fee. If the partners conduct business prior to filing the required certificate of limited partnership, they run a substantial risk of having the entity treated as a general partnership with liability of all partners for all partnership obligations incurred prior to filing the certificate.

The certificate of limited partnership must disclose basic information about the limited partnership for public inspection, including, among other items:

- the name of the limited partnership, which may not be the same as, nor deceptively similar to, the name of any existing Arizona limited partnership, limited liability company, nor any Arizona corporation, nor any foreign limited partnership, limited liability company or corporation authorized to transact business in the state. The name must include the words "limited partnership" or the initials "L.P." and, in most cases, must not include the name of any limited partner;
- the address of the partnership's office where the partners may inspect copies of the partnership agreement, financial statements and other partnership records;
- the name and address of an agent for service of legal process on the partnership, who may be an individual, an Arizona corporation, or limited liability company, or a foreign corporation or limited liability company authorized to do business in Arizona;
- the name and address of each general partner; and
- the latest date on which the partnership is to dissolve.

If the information in the certificate of limited partnership changes, the general partners are required to file an appropriate amendment with the Arizona Secretary of State. The partnership must amend the certificate within 30 days after

the withdrawal of a general partner or the admission of a new general partner.

The partners in a limited partnership customarily enter into a written partnership agreement at the time the certificate of limited partnership is filed. The purpose of the partnership agreement is to describe the partners' financial responsibilities and economic rights in greater detail than in the certificate and to describe other responsibilities and rights (such as management rights) not covered in the certificate. As with general partnerships, if the partners do not define their rights and obligations in a written partnership agreement, Arizona law will supply any missing rights or obligations in a manner that may or may not be consistent with the partners' expectations.

The limited partners' interests in a limited partnership are generally considered securities under both U.S. and Arizona laws. Care must be taken to ensure that the issuance of the limited partnership interests complies with securities laws.

Capitalization and Debt Financing

As in general partnerships, Arizona law permits the partners of a limited partnership broad discretion to determine among themselves how cash, other property or services will be contributed to the partnership by each partner at the time of formation or at any time thereafter.

A limited partnership is permitted under Arizona law to borrow money from its partners or from third parties. A limited partnership's ability to obtain debt financing may be based upon the financial condition of its general partners, who are individually liable under Arizona law for all partnership debts. The financial condition of a limited partner is not normally taken into account by a partnership lender, except to the extent that the lender is relying upon the limited partner's initial or future capital contribution commitment as a source of repayment of the debt. With respect to a lender's ability to rely on a limited partner's future contributions, this can typically be accomplished by asking the limited partner to sign promissory notes payable to the partnership in the amounts of their future contributions. The promissory notes are then assigned, as collateral, to the lender to secure the loan to the partnership.

A limited partnership may also raise additional capital by creating and issuing additional partnership interests to new partners. Whether the new partner desires to become a general partner or a limited partner, the consent of all the existing partners is required unless the partnership agreement gives the partners authority to issue additional general or limited partnership interests. Because the issuance of additional interests to new partners almost always will dilute the profit shares of the existing partners, partnership agreements that give the general partners this authority usually impose conditions such as requiring a minimum capital contribution for any new limited partner or that any additional limited partner interests be offered first to the existing limited partners.

Management and Control

Arizona law permits the partners of a limited partnership to divide management rights and responsibilities in any manner that they may agree upon, but a limited partner may become personally liable for partnership debts as a general partner if the limited partner participates in the control of the partnership's business. Arizona law permits limited partners to vote on certain specific management matters (for example, the sale of all of the partnership's assets) without risking personal liability as a general partner. Most partnership agreements restrict the management rights of limited partners to these specific matters.

If there are two or more general partners in a limited partnership, the partners may delegate management rights and responsibilities among the general partners as they choose. In the absence of a division of management rights in the partnership agreement, management decisions relating to the partnership's business are made by the general partners, each of whom has an equal voice in the management and conduct of the partnership business. Because limited partners may not be involved in the day-to-day management of the partnership's business, a limited partner, concerned that the general partners may not have taken the necessary steps to enforce a claim of the partnership against a third party, has a special right to bring a legal action (derivative action) against a third party if the general partners refuse to sue the third party. If the limited partner is successful in obtaining a judgment, or a settlement of the claim, the court may award the limited partner reimbursement for expenses and legal fees. The remainder of the recovery will belong to the partnership.

Profits and Losses

The partners in a limited partnership have significant freedom to divide partnership profits and losses and partnership distributions in any manner. If the partners do not allocate profits and losses in their partnership agreement, Arizona law provides that they share profits and losses or distributions of cash or other property in the same proportions as their actual unreturned contributions to the partnership as stated in the partnership records required to be kept by the partnership.

Freedom to allocate profits, losses and distributions by agreement is one of the important advantages of limited (and general) partnerships under Arizona law. The different profit and loss sharing arrangements available to general partnerships are also available to limited partnerships. However, there are considerations that do not arise in general partnerships. The limited partnership agreement generally will, and should, provide that losses in excess of profits be allocated to the limited partners only up to their contributions to the partnership and that all other losses be allocated to the general partners. Also, if any distribution by the partnership causes the net worth of the partnership (the amount by which the value of the partnership's total assets exceeds its total liabilities) to be less than the total contribution of the partners as set forth in the

partnership records, the partners who receive the distributions may be required to return the amount distributed if needed to pay partnership debts.

Extent of Owners' Liability

The general partners of a limited partnership generally have the same "joint and several" liability for partnership debts as do general partners in a general partnership. However, the principal advantage of a limited partnership is that each limited partner's liability for partnership debts is limited, with exceptions, to the contribution that the limited partner has made or agreed to make to the partnership.

There are several exceptions to the limitation on the personal liability of a limited partner. The most important applies when a limited partner participates in the control of the partnership's business. If a limited partner's management participation is substantially the same as a general partner, the limited partner will have joint and several liability for all partnership debts. If a limited partner participates in management but does not exercise substantially the same powers as a general partner, he or she will be liable only to partnership creditors who actually know of his or her management participation.

Several activities in which a limited partner may engage will not be considered participation in control under Arizona law. A limited partner may: (1) consult with and advise a general partner concerning management decisions; (2) be an employee or agent of a general partner or the limited partnership; (3) act as a surety or guarantor for the limited partnership; (4) have a right of approval regarding any amendment to the partnership agreement; and (5) request or attend a meeting of partners. A limited partner will also not be treated as participating in partnership control by reason of a right to vote on any of the following basic decisions:

- the sale, exchange, lease, mortgage, pledge or other transfer of all or substantially all of the partnership's assets;
- the partnership's incurrence of indebtedness other than in the ordinary course of its business;
- the dissolution and winding up of the partnership;
- a change in the nature of the partnership's business;
- the admission or removal of a general partner;
- the admission or removal of a limited partner;
- a transaction involving an actual or potential conflict of interest between a general partner and the limited partnership or the limited partners;
- an amendment to the partnership agreement or certificate of limited partnership; or
- other matters specifically provided for in the partnership agreement.

Another important exception to the general rule of limited liability of a limited partner is that a limited partner must repay excessive partnership distributions. Arizona law prohibits partnership distributions to partners if the value of the partnership's remaining assets is less than the aggregate partnership liabilities owing to third parties. If a limited partner receives a distribution in violation of this prohibition, for six years thereafter, the limited partner may be required to repay the distribution to the partnership. Additionally, if a limited partner receives the return of his or her contribution from the partnership, the limited partner may be required during the following year to return the distribution, if necessary, to pay partnership debts incurred prior to the distribution.

Arizona law authorizes a limited partnership to elect classification as a registered limited liability partnership. If a general partnership elects classification as a registered limited liability partnership, each partner is shielded from "vicarious" liability associated with the debts and obligations of the partnership, whether arising in contract, negligence or otherwise. The liability shield of a registered limited liability partnership does not, however, protect a partner from direct liability due to the partner's own actions, including wrongful acts, negligence or misconduct of the partner or the wrongful actions of others under a partner's direct supervision and control.

To elect classification as a registered limited liability partnership, the partnership must file an application with the Arizona Secretary of State. Further, the name of the partnership must reflect the status of the partnership as a registered limited liability partnership. The partnership must file an annual report to retain status as a registered limited partnership.

Transferability of Interests

A general partner of a limited partnership may sell or assign his or her interest in the partnership to another person and make that person a general partner only as provided in writing in the partnership agreement or, if not provided in the partnership agreement, then only with the consent of all other partners. A limited partner may substitute a buyer or assignee of his or her partnership interest as a new limited partner, if done in accordance with the provisions of the partnership agreement or, if not provided in the partnership agreement, then upon the consent of all other partners. Compliance with state and federal securities laws may be required in connection with any such transfer of rights.

If a general partner or limited partner desires merely to sell or assign the partner's economic rights to receive partnership distributions without providing the buyer or assignee any management or voting rights as a partner, Arizona law permits the transfer of these economic rights, unless the transfer is prohibited by the partnership agreement. In many cases, the limited partners will desire to restrict the assignment of a general partner's economic rights in order to maintain the general partner's incentive to manage the partnership's business. Also, the general partners may desire to restrict a limited partner's assignment of economic rights until the limited partner has made all of his or her agreed-upon capital contributions.

Continuity of Interest

A limited partnership is dissolved at the time of a general partner's withdrawal, removal, bankruptcy, death or, if the general partner is a corporation or other legal entity, upon termination of a general partner's legal existence. However, any such event affecting a limited partner will not cause the dissolution of a limited partnership unless the partnership agreement provides otherwise. Without other agreements, if a limited partnership is dissolved, the partnership's business must be wound up and liquidated.

In order to prevent an unwanted liquidation of a limited partnership following its dissolution, the remaining general partners may continue the business of the partnership without liquidation if the partnership agreement so permits. If there are no remaining general partners, then the partnership business may be continued without liquidation if, within 90 days of dissolution, all of the limited partners (or a lesser number or percentage as specified in the partnership agreement) agree to appoint one or more new general partners.

If the partnership's business is not continued following a dissolution, the proceeds of liquidation must first be used to pay existing partnership liabilities other than liabilities for distributions to existing or former partners. If the proceeds of liquidation exceed the partnership's liabilities, the remaining proceeds are distributed in whatever manner the partnership agreement provides. In the absence of a provision in the partnership agreement for distribution of liquidation proceeds, the remaining proceeds must be distributed first to satisfy unpaid obligations to partners who withdrew from the partnership prior to dissolution, second to the existing partners until they have received the return of their contributions and third to the existing partners in the same proportions as their prior contributions to the partnership.

Tax Considerations

The income tax treatment of a limited partnership and its partners is generally the same under the U.S. and Arizona tax codes as the treatment of general partnerships. A limited partnership typically is not required to pay income tax on its net income, but simply reports each partner's share of partnership income or loss to be included in the partner's individual income tax return. Like a general partnership, a limited partnership is required to pay a withholding tax on behalf of a foreign partner characterized as a nonresident alien for federal income tax purposes. Like a general partnership, a limited partnership may elect to be taxed as a corporation. In such case, the partnership and the partners are treated in the same manner as a corporation and corporate shareholders, respectively.

Record Keeping Requirements

An Arizona limited partnership must file annual federal and state informational tax returns that reflect the partnership's income or loss for the year and each partner's share of the partnership's taxable income or loss. A limited partnership

must maintain correct and complete financial records that may be inspected by any limited partner. No annual activity reports need to be filed with any state agency.

Conclusion

The principal benefit of using a limited partnership is the protection against the personal liability of the limited partners. A limited partner's risk associated with the partnership is generally limited to the amount contributed or required to be contributed to the limited partnership. Other benefits arising from use of a limited partnership include the significant freedom of the partners to allocate the sharing of profits and losses and the single level of taxation resulting from the status of the partnership as a mere non-taxed conduit for tax purposes. The primary shortcoming of a limited partnership is that, in contrast to a corporation, one or more of the owners (the general partners) will be subject to unlimited personal liability for the obligations of the partnership unless the partnership elects classification as a registered limited liability partnership.

Limited Liability Companies

Joseph M. Miller, Jeffrey A. Scudder and Michael M. Donahey

Limited liability companies have become an established form of business organization in Arizona. The limited liability company is intended to give flexibility to businesses in meeting their tax and business objectives.

As a general rule, a limited liability company combines some of the best characteristics of partnerships and corporations while eliminating some of their less desirable characteristics. The owners, or members, of a limited liability company, like shareholders of a corporation, are not generally liable for the debts of the business. Yet, like a partnership, double taxation is avoided because the profits of a limited liability company are not subject to income tax liability imposed upon the company. Furthermore, unlike limited partners in a limited partnership, members of a limited liability company may actively participate in management without becoming subject to unlimited personal liability. The members of a limited liability company enjoy significant freedom under Arizona law to fix their rights and obligations by agreement as to most matters.

Organizational Formalities

One or more persons may form a limited liability company by signing and filing articles of organization with the Arizona Corporation Commission (ACC). The person or persons need

not be members of the limited liability company at the time of or after formation. If the members conduct business prior to filing the articles of organization, they run a substantial risk of having the limited liability company treated as a general partnership with liability of all members for all obligations incurred prior to filing the articles.

The articles of organization must disclose basic information about the limited liability company for public inspection, including, among other items:

- the name of the limited liability company. It must include the words “limited liability company” or “limited company” or the abbreviation “L.L.C.” or “L.C.” and must not include the words “association,” “corporation” or “incorporated” nor an abbreviation of these words;
- the name and address of an agent for service of legal process on the limited liability company. This agent may be an individual, an Arizona limited liability company, a corporation, a foreign limited liability company or corporation authorized to do business in Arizona;
- one of the following statements (as applicable):
  - management of the limited liability company is vested in a manager or managers;
  - management of the limited liability company is reserved to the members;

- the name and address of either of the following (as applicable):
  - if management is vested in a manager or managers, each person who is a manager of the limited liability company and each person who owns a 20 percent or greater interest in the company;
  - if management is reserved to the members, each person who is a member of the limited liability company; and
- the latest date, if any, on which the limited liability company must dissolve.

A limited liability company's articles of organization are amended by filing articles of amendment with the ACC. A limited liability company must amend its articles of organization if there is a statement in the articles that is false when it was made or if facts described in the articles have changed, making the articles inaccurate in any respect. For example, an amendment is required if the membership changes and management has been reserved to the members. If management has not been reserved to the members, an amendment is required after any change in managers or in the members holding 20 percent or greater interest in the limited liability company. A limited liability company may also file a restatement of its articles of organization, if necessary. Articles of organization, articles of amendment or restated articles must also be published in a newspaper of general circulation.

The members in a limited liability company customarily enter into an operating agreement at the time the articles of organization are filed. The purpose of the operating agreement is to describe the members' financial responsibilities, management rights and profit and distribution shares. As with general partnerships and limited partnerships, if the members do not define their rights and obligations in an operating agreement, Arizona law will supply any missing rights or obligations in a manner that may or may not be consistent with the members' expectations.

The members' interests in a limited liability company may be securities under both U.S. and Arizona laws. Care must be taken to ensure that the issuance of members' interests complies with securities laws to the extent that the members' interests are securities.

Capitalization and Debt Financing

As in general partnerships and limited partnerships, Arizona law permits the members of a limited liability company broad discretion to determine among themselves how cash, other property or services will be contributed to the limited liability company by each member at the time of formation or at any time thereafter.

A limited liability company is permitted under Arizona law to borrow money from its members or from third parties. The financial condition of a member is not normally taken into account by a lender, except to the extent that the lender is relying upon the member's initial or future capital contribution commitment as a source of repayment of the debt. Members will sometimes be asked by a lender to the limited liability company to sign promissory notes payable to the limited liability company in the amounts of their future contributions. The promissory notes are then assigned as collateral to the lender to secure the loan to the limited liability company.

A limited liability company may also raise additional capital by creating and issuing additional interests in the limited liability company to new members. Unless the operating agreement provides otherwise, the consent of all members is required to issue new interests in the limited liability company. Because the issuance of additional interests to new members almost always will dilute the profit shares of the existing members, operating agreements that give the limited liability company the authority to issue additional interests usually impose conditions, such as requiring a supermajority vote for any new member or that any additional interests be offered first to the existing members.

Management and Control

Arizona law permits the members of a limited liability company to divide management rights and responsibilities among the members or to grant management rights and responsibilities to "managers" designated or elected by the members. Unlike a limited partner in a limited partnership, a member does not become personally liable for limited liability

company debts if the member participates in the control of the limited liability company's business. In the absence of an operating agreement to the contrary, Arizona law permits members to vote on certain specific management matters, such as the approval of a plan of merger or consolidation or the issuance of a new interest in the limited liability company.

If the members delegate management responsibilities to managers, the members will not be involved in the day-to-day management of the limited liability company's business. If a member becomes concerned that the managers may not have taken the necessary steps to enforce a claim of the limited liability company against a third party, each member has a special right to bring a legal action (called a "derivative action") to obtain a judgment in the name of the limited liability company against the third party if the managers refuse to sue the third party. If the member is successful in obtaining a judgment or a settlement of the claim, the court may award the member reimbursement for expenses and legal fees. The remainder of the recovery will belong to the limited liability company.

Profits and Losses

The members in a limited liability company have significant freedom to divide limited liability company profits and losses and limited liability company distributions in any manner they choose. If the members do not allocate distributions in their operating agreement, Arizona law provides that distributions will be shared by the members in proportion to their actual contributions to the limited liability company and, after all contributions have been returned, distributions will be shared equally by the members.

The members' freedom to allocate profits, losses and distributions by agreement is one of the important advantages of limited liability companies under Arizona law. Different profit and loss sharing arrangements are also available to general partnerships and limited partnerships.

Extent of Owners' Liability

Any member, manager, employee, officer or agent of a limited liability company is not liable solely by reason of being a member, manager, employee, officer or agent, for the debts of the limited liability company. Members of a limited liability company are only liable to the extent of their actual or agreed-upon capital contributions. This is different from the liability of general partners in a general partnership or of the general partners in a limited partnership who have "joint and several" liability for partnership obligations. It is also different from the liability of limited partners in a limited partnership. Each limited partner's liability for partnership debts is generally limited to the contribution that the limited partner has made or agreed to make to the partnership. However, if a limited partner participates in the control of the partnership's business, the limited partner will also become liable for all partnership debts.

Transferability of Interests

A member cannot sell or assign his or her interest in a limited liability company to another person and make that person a member without the consent of all other members, unless all the members have previously agreed in their operating agreement that such consent is not necessary. As noted above, compliance with state and federal securities laws may be required in connection with any such transfer of rights.

If a member desires merely to sell or assign the member's economic rights to receive limited liability company distributions without giving the buyer or assignee any management or voting rights as a member, Arizona law permits the transfer of these economic rights unless the transfer is prohibited by the members' operating agreement.

Continuity of Existence

A limited liability company is dissolved as provided for in the operating agreement or by the written consent of a majority of the members as well as those members entitled to receive, upon dissolution and liquidation, assets valued at more than one-half the total value of the limited liability company's assets. The withdrawal of the last remaining member may also result in dissolution, unless all the members, or their assigns, admit at least one new member within 90 days or the members previously agreed in their operating agreement that such consent is not necessary at the time of a member's withdrawal, removal, bankruptcy, death or, if the member is a corporation or other legal entity, upon termination of the member's legal existence. Without other agreements among the members, if a limited liability company is dissolved, the limited liability company's business must be wound up and liquidated. The ACC may involuntarily dissolve a limited liability company if the company fails to amend its articles as required by law or if the company has failed to make a required publication.

After dissolution and prior to filing articles of termination or judicial or administrative termination, the limited liability company maintains its separate existence. However, during this period, the limited liability company may only carry on the business necessary to wind up and liquidate its business and affairs, including collecting assets, disposing of property that will not be distributed to members, discharging liabilities or distributing remaining property to the members according to their interests. In order to prevent an unwanted liquidation of a limited liability company following its dissolution, the members may continue the business of the limited liability company pursuant to a right in the operating agreement or, if the operating agreement does not provide such a right, by agreement or consent of all the remaining members.

If the limited liability company's business is not continued following a dissolution, the proceeds of liquidation must first be used to pay existing limited liability company obligations other than liabilities for distributions to existing or former members. If the proceeds of liquidation exceed the limited liability company's obligations, the remaining proceeds are

distributed in whatever manner the members' operating agreement provides. In the absence of a provision in the operating agreement for distribution of liquidation proceeds, the remaining proceeds must be distributed: first, to satisfy unpaid obligations to members who withdrew from the limited liability company prior to dissolution; second, to existing members until they have received a return of their contributions; and, third, to the members in proportion to their interests.

Tax Considerations

The income tax treatment of a multi-member limited liability company and its members is generally the same under U.S. and Arizona tax codes as the treatment of limited partnerships. A multi-member limited liability is not required to pay income tax on its net income, but simply reports each member's share of limited liability company income or loss to be included in the member's individual income tax return. Unless it elects to be taxed as a corporation, a single-member limited liability company is disregarded as an entity separate from its owner under the U.S. Tax Code and for Arizona income tax purposes. Accordingly, a single-member limited liability company does not file a separate income tax return. Like a limited partnership, a limited liability company is required to pay a withholding tax on behalf of a foreign member characterized as a nonresident alien for federal income tax purposes.

Similar to limited partnerships, a limited liability company may elect to be taxed as a corporation. In such case, the limited liability company and its members are treated in the same manner as a corporation and corporate shareholders.

Record Keeping Requirements

An Arizona multi-member limited liability company must file annual federal and state informational tax returns that reflect the limited liability company's income or loss for the year and each member's share of the limited liability company's taxable income or loss. The company must maintain copies of a current list of the names and addresses of its members, the original articles of organization and all written operating agreements and amendments. A limited liability company must also maintain correct and complete financial records, which may be inspected by any member. No annual activity reports need to be filed with any state agency.

Conclusion

The principal benefit available with use of a limited liability company is the protection against the personal liability of the members. A member's risk associated with the limited liability company is generally limited to the amount contributed, or required to be contributed, to the limited liability company. Limited liability companies also afford members significant freedom to structure member and/or manager rights and obligations according to the parties' wishes through an operating agreement, including the allocation of economic rights such as the sharing of profits, losses and distributions, as well as management powers and responsibilities. Members also benefit from the single level of taxation resulting from the treatment of the limited liability company as a non-taxable partnership for income tax purposes.

Corporations

Joseph M. Miller, Jeffrey A. Scudder and Michael M. Donahey

Corporations, popular vehicles for making investments or conducting business, can accommodate wide variations in the number of owners (shareholders), ranging from the corporation in which all the outstanding shares are owned by one person, to the "closely held" corporation, in which the shares are held by a limited number of persons, to the "publicly held" corporation, in which share ownership is held by hundreds or thousands of shareholders. Arizona also authorizes or recognizes alternative corporate forms, including non-profit corporations, foreign corporations and professional or business development corporations. Arizona laws governing corporations are designed to permit corporate operations with minimal "red tape."

Organizational Formalities

Several formalities must be observed in forming a corporation. The incorporator (i.e., the person who forms the corporation) must file the corporation's articles of incorporation and a certificate of disclosure with the Arizona Corporation Commission (ACC) with the accompanying filing fee. A corporation's articles of incorporation must include the following information:

- the name of the corporation, which must include one of the following words (or an abbreviation), "association," "bank," "company," "corporation," "limited" or "incorporated." Subject to limited exceptions, the name selected for a corporation must be distinguishable from that of any existing Arizona corporation, limited partnership or limited liability company, any foreign corporation, limited partnership, or limited liability company that is registered in, or otherwise authorized to, conduct business in Arizona as well as certain fictitious or trade names of other entities;
- a statement of the character of the business that the corporation initially intends to conduct (the business that the corporation may conduct, however, is not limited to that which is stated);
- the aggregate number of shares of stock that are authorized for issuance;[79]
- the name, address and signature of each incorporator who files the articles of incorporation;[80]
- the name, street address and signature of the corporation's initial statutory agent and the address of the

79 A corporation's articles of incorporation usually authorize a greater number of shares than the corporation intends to issue in connection with its formation. This provides flexibility to issue additional shares in the future without amending the articles of incorporation.

80 Incorporators need not be shareholders of the corporation, nor Arizona residents.

corporation's known place of business if different from that of its statutory agent;[81] and
- the name and address of each initial director of the corporation.

The articles of incorporation may also include other provisions not in conflict with applicable laws, including provisions eliminating or limiting the liability of directors to the corporation or its shareholders for monetary damages for actions taken or any failure to take action as a director with certain specified exceptions. Within 60 days after the commission approves the filing, the articles of incorporation must also be published in a newspaper of general circulation.

The certificate of disclosure must identify and describe certain criminal convictions of or judicial actions against all persons who, at the time of its delivery, are officers, directors, trustees, incorporators and persons controlling or holding more than a 10 percent interest in the corporation, as well as a brief statement disclosing whether any person who, at the time of its delivery, are officers directors, trustees, incorporators and persons controlling or holding more than a 20 percent interest in the corporation and who have served in any such capacity

81 Every corporation doing business in Arizona must appoint a statutory agent to receive formal notices and to accept service of process in lawsuits filed against the corporation. A statutory agent must be either a corporation or limited liability company authorized to do business in Arizona or an individual who is a resident of Arizona. A statutory agent, although merely ministerial, is important because service of process gives a court jurisdiction and starts the running of the time within which the corporation must respond in order to avoid entry of judgment by default against it.

or held a 20 percent interest in any other corporation on the bankruptcy or receivership of the other corporation.

After filing the articles of incorporation and the certificate of disclosure, the directors named in the articles of incorporation must hold an organizational meeting to elect officers and transact other appropriate business. The adoption of corporate bylaws is among the first items of business. The bylaws of a corporation set out the details of corporate governance and normally contain provisions relating to the conduct of business and to the rights and powers of shareholders, directors and officers. Bylaws must be consistent with Arizona law and with the articles of incorporation.

Capitalization and Debt Financing

The proceeds from the sale of a corporation's shares normally provide the principal source of capital for the corporation. An Arizona corporation may issue any number of shares, up to the maximum number of shares that are authorized for issuance in its articles of incorporation. The board of directors establishes the price for each share to be issued. Payment for shares may be made to the corporation in cash, other property or in past services actually performed for the corporation. Promissory notes and promises of future services cannot be used as valid consideration for the issuance of shares.

Shares of a corporation are "securities" under both federal and state securities law. In issuing shares, care must be taken to ensure that all applicable securities law requirements are satisfied.

An Arizona corporation has great flexibility to issue various classes of shares, each with different rights, to develop a share structure suited to its needs. For example, as a means of attracting additional investors and selling additional shares, the corporation may issue shares that provide preferred rights, such as a right to dividends or a first right to the proceeds on the sale of corporate assets, in the event of dissolution of the corporation. The corporation also may issue shares that lack voting rights or that provide either limited or preferential voting rights.

In general, subject to applicable securities laws, shares can be sold by the corporation to any party at any time. However, the articles of incorporation may grant "preemptive" rights to existing shareholders, giving them the first opportunity to purchase additional shares in proportion to the number of shares already held by them. Preemptive rights are often useful in closely held corporations to preserve the relative proportion of share ownership among the existing shareholders.

Funds needed for corporate operations can also be obtained through the sale of debt securities, such as bonds or debentures. Bonds and debentures are repaid over a period of time with interest. They do not grant the holder any ownership interest in the corporation, but they rank ahead of stock in payment priority. Additionally, corporations can borrow money from financial institutions. A corporation that is new,

closely held or thinly capitalized may encounter difficulty in borrowing funds, unless its shareholders personally guarantee the corporation's repayment obligations.

Management and Control

Management of a corporation is vested in its board of directors. Each director must be an individual. Generally, there is no limit to the number of directors that a corporation may have. Directors are required to manage the business of the corporation in good faith, with the ordinary care that a prudent person would exercise under similar circumstances and in a manner the director reasonably believes to be in the best interests of the corporation. Directors need not be shareholders of the corporation nor Arizona residents unless the articles of incorporation or bylaws so provide.

Meetings of the board of directors may be held within or outside Arizona and may be held by conference telephone or other communications equipment. The directors also may take action by unanimous written consent without holding a meeting. Unless a different number is specified in the bylaws or articles of incorporation, a majority of directors constitutes a sufficient number of directors, or "quorum," necessary for the transaction of business at a meeting of the board.

A corporation's shareholders elect the directors. At the annual election of directors, each shareholder has the right to vote the number of shares owned by the shareholder, multiplied by the number of directors to be elected. A shareholder may cast all of his or her votes for one candidate or allocate votes in any manner among the candidates. Under this system of "cumulative" voting, shareholders can elect directors in rough proportion to the percentage of shares they own.

If the articles of incorporation provide, and to the extent that it does not infringe upon the shareholders' cumulative voting rights, the term of office of the board of directors may be divided into a "staggered board" usually consisting of two or three groups. With a staggered board, only the directors in a particular group stand for election at each annual meeting, so only a half or third of the board is elected in any given year. Staggered boards promote continuity of management by preventing a shareholder or group of shareholders from replacing all of the directors at a single annual shareholder meeting.

Subject to certain exceptions, the shareholders may remove one or more of a corporation's directors from office for any reason at a shareholders' meeting called expressly for that purpose. If less than the entire board is to be removed, no director may be removed if the votes cast against removal would be sufficient to elect the director to the board under the cumulative voting system. Subject to certain exceptions, any vacancy on the board of directors may be filled by either the remaining directors or the shareholders. The replacement director holds office until the next election of directors.

Shareholders enjoy rights in addition to the rights associated with the election and removal of directors. If the directors desire to sell, exchange or otherwise dispose of all or substantially all of the corporation's property, other than in the usual and regular course of the corporation's business, a majority of the outstanding voting shares of the corporation usually must approve the transaction. If the directors desire to merge the corporation with another corporation, approval by shareholders holding a majority of the outstanding voting shares of each corporation is required in most instances.

If a shareholder disagrees with (or "dissents" from), among other things, a sale or disposition of all or substantially all of the corporation's assets or a merger of the corporation with another corporation, subject to certain limitations, the shareholder may, by complying with certain notice and other statutory requirements, require the corporation to purchase his or her shares. If the corporation and the dissenting shareholder cannot agree on a value for the shares, the corporation must request a court to determine their value. These "dissenters' rights" do not extend to holders of shares of an Arizona corporation registered on a national securities exchange (e.g., NYSE or NASDAQ), nor to a class or series of shares that are held by 2,000 or more shareholders of record, unless the corporation's articles of incorporation otherwise provide.

In certain cases, Arizona law provides rights to existing management to avoid the effects of hostile takeovers. For example, the voting rights of shares of issuing public corporations that are acquired in a control share acquisition may be limited. An issuing public corporation would include certain publicly held companies and companies that elect to be subject to such rules in their articles of incorporation if certain additional conditions are satisfied. In addition, subject to certain conditions, an issuing public corporation may be prohibited from engaging in any business combination (such as a merger or share exchange) with any interested shareholder (or affiliate) for a period of three years after the date on which the interested shareholder acquired his/her/its shares in the corporation. Arizona law also permits a corporation to specify in its articles of incorporation that certain matters must be approved by a greater voting requirement than would otherwise be required by law.

The officers of the corporation are responsible for the day-to-day operation of the corporation. Their authority is determined by the board of directors or described in the bylaws. The corporation may have such officers as the shareholders or directors deem appropriate. The board of directors elects the officers; and the officers may then appoint one or more assistant officers if authorized by the bylaws or the board of directors. The same individual may hold any two or more offices. Any officer may be removed at any time by the directors. However, if provided by contract, an officer may be entitled to severance compensation or to continued employment in some other capacity.

Profits and Losses

Profits are shared by the shareholders in the form of dividends. Generally, dividends are distributed to shareholders

proportionately in accordance with share ownership. Unless the articles of incorporation otherwise provide, and subject to certain restrictions (some of which are described below), dividends are declared and paid at the discretion of the board of directors. Holders of preferred shares may enjoy preferential rights to dividend distributions.

Subject to any restriction contained in the articles of incorporation, a corporation may pay dividends in cash, in property or in its own shares. A distribution of dividends may not be made if the corporation is not able to pay its debts in the normal course of business. Also, payment of dividends is not permitted when the corporation's total assets would be less than the sum of its total liabilities plus, unless the articles permit otherwise, the amount needed to satisfy the rights of preferential shareholders on dissolution.

Losses incurred by a corporation may reduce the payment of dividends to shareholders and the price obtainable by shareholders upon a sale of shares. Except in the case of a "Subchapter S" corporation, the losses incurred by a corporation are not shared by the shareholders on a current basis. See "Tax Considerations" below in this chapter.

Extent of Owners' Liability

As a general rule, each shareholder's liability for corporate obligations is limited to the shareholder's investment in the shares of the corporation. This insulates the shareholder's other assets from the debts and other obligations of the corporation.

In some situations, however, a court may "pierce the corporate veil" and disregard the corporation as a legal entity that is separate and distinct from the shareholder, with the effect of making the shareholder personally liable for the corporation's obligations as if the corporation were a proprietorship or partnership.

The corporate veil may be pierced by a court if the corporation is not sufficiently capitalized to meet the obligations reasonably foreseeable for a business of its size and character. Other factors that may lead a court to pierce the veil and disregard the corporation as a distinct legal entity include whether the corporation was used to defraud creditors, whether the corporation's property was used for the personal use of the shareholders in question (sometimes called "co-mingling" of assets), whether the corporation failed to maintain a separate corporate identity, whether the corporation failed to maintain adequate records and whether the corporation disregarded corporate legal formalities. Arizona courts seldom grant relief to corporate creditors under the theory of piercing the corporate veil except in extreme factual circumstances. By providing adequate capital to the corporation, by undertaking honest business practices, by maintaining a distinct line between the corporation's assets and those of its shareholders and by paying attention to simple corporate formalities, use of the corporate structure can easily be maintained to protect the shareholders' separate assets from claims of the corporation's creditors.

Transferability of Interests

The ownership interests of shareholders in a corporation are usually represented by share certificates. In most cases, these are freely transferable, although the corporation need not recognize a purchaser as a shareholder until the transfer of the shares represented by the share certificates is recorded on the corporation's books. Reasonable restrictions on share transfers may be imposed by the corporation's articles of incorporation, or bylaws or by the provisions of an agreement among the shareholders if the existence of such restriction is noted conspicuously on each share certificate. The board of directors of an Arizona corporation may authorize the issuance of shares without certificates as long as the shareholder receives relevant information regarding his/her/its rights. Federal and state securities laws may also impose restrictions on the transferability of shares.

Continuity of Existence

An Arizona corporation will have perpetual existence unless its articles of incorporation provide otherwise. A corporation with perpetual existence will not terminate until formal steps are taken to dissolve the corporation. The death, bankruptcy or transfer of shares of any shareholder will not interrupt the continuing existence of a corporation.

Tax Considerations

Generally, a corporation is treated for both federal and state tax purposes as a taxable entity, separate and apart from its shareholders. A corporation computes its taxable income or loss each year and pays tax at the corporate level on its taxable income. After payment of income taxes, if the corporation distributes dividends to its shareholders, the shareholders usually must include the dividend distributions in their own individual taxable income. Consequently, corporate profits are taxed twice, once when earned by the corporation and a second time when distributed to the shareholders.

Certain corporations may avoid the liability for corporate-level income taxes by filing an election under Subchapter S of the Internal Revenue Code. A corporation can make this election only if, among other requirements, it has permissible shareholders, including individuals (other than non-resident aliens), estates, certain trusts and certain tax-exempt entities. Corporations owned in whole or in part by other corporations, by partnerships or by non-resident aliens are not eligible to make the Subchapter S election and cannot avoid liability for corporate-level income taxes. Classification of foreign persons as resident or nonresident aliens is discussed in the chapter "Immigration." Tax considerations are further considered in the chapters on "Taxation" and "Real Property."

Record Keeping Requirements

Every Arizona corporation is required to file an annual report with the ACC that includes, among other things, the following information:

- the name of the corporation and the state or country under whose law it is incorporated;
- the corporation's address and the name and address of its statutory agent;
- the address of its principal office;
- the names and business addresses of the directors and principal officers of the corporation;
- a statement of the nature of the corporation's business;
- the number of authorized and issued shares for each class of shares;
- a certificate of disclosure containing the same information as set forth in the certificate of disclosure filed with the articles of incorporation; and
- the name of each shareholder who holds more than 20 percent of any class of shares.

An Arizona corporation must file annual federal and state income tax returns. Certain corporations are subject to special record keeping requirements in connection with transactions involving "related" foreign persons.

In addition to the reports that must be filed with state and federal authorities, a corporation must annually provide shareholders with a financial report. Although financial statements may be consolidated, minority shareholders have the right to inspect financial statements of the corporation in which he or she is a shareholder even if those financial statements would normally be consolidated. Every corporation, regardless of its size or number of shareholders, is required to maintain appropriate accounting records, as well as minutes of meetings of its shareholders and board of directors. A corporation must also keep a record of its shareholders, with the names and addresses of all shareholders and the number and class of shares held by each. Under certain circumstances, shareholders have the right to inspect and copy the corporation's books and records.

Conclusion

The primary benefit of forming a corporation is protection against the personal liability of the owners. A shareholder's risk is limited to the amount of capital invested in the corporation, unless there is abuse of the corporate form that justifies piercing the corporate veil. The disadvantages of the use of a corporation include the greater formalities that must be observed and, except when a Subchapter S election is used, the double taxation of business profits, once by taxing the corporation and a second time by taxing shareholders' income.

Real Property

M. Lawrence Brown, Joseph Yoshimitsu Viola, John F. Baird and Joshua Grabel

A common investment in Arizona is ownership and development of real estate. Business operations in Arizona are often accompanied by the purchase or lease of local real estate. Foreign persons who contemplate investment or business activities that involve real estate may find Arizona attractive from a legal standpoint. Arizona has no "alien land laws" that restrict the acquisition or lease of real estate by foreign persons. Foreign persons have the same rights and opportunities as U.S. citizens to acquire or lease Arizona real estate.

Acquisition of Arizona Real Property

In acquiring Arizona real estate, an investor usually acquires either outright ownership of the property ("fee simple" ownership) or a leasehold interest.

PURCHASES

Purchase Agreements

The purchase of fee simple ownership of Arizona real estate is best accomplished through a written purchase agreement. An oral agreement to purchase or sell Arizona real estate generally is not enforceable. Arizona laws leave wide latitude to the parties to structure their transactions. As a result, a written purchase agreement in Arizona is often lengthy and detailed.

A purchase agreement will cover basic matters such as the purchase price of the property, the identity of the property, the timing of the transaction and the allocation between the potential buyer and seller of ongoing income and expense, such as rents or utilities. Most real estate purchases also require investigation of the property by the potential buyer, a process that can involve substantial expenditures of time and money. Therefore, most written purchase agreements provide for a period of time during which the buyer may investigate the property for defects or problems.

Such matters as title, the physical condition and state of repair of any improvements to the property, soil and subsurface conditions, zoning and land use regulations, environmental matters, the availability of financing, the availability of water and other utilities, the financial history of the property and the economic feasibility of the particular investment are of concern to the buyer. The buyer's satisfaction as to such matters may be made an explicit condition of the buyer's obligation to purchase the property. The importance of such investigations and of the prospective buyer making a thorough analysis of all aspects of the transaction are critical if the seller is unwilling to make representations and warranties with respect to the property. Without seller representations and warranties, the buyer may be left without legal recourse against a creditworthy party for problems discovered after the property is purchased.

In Arizona, it is customary for a purchase agreement to provide for an "escrow," an arrangement in which an independent third party (such as a title insurance company) holds documents and money until the parties are prepared to complete the transaction. When the transfer of title and payment of the purchase price finally take place (called the "closing"), the escrow agent disburses the purchase money deposited by the buyer to the seller and records the deed to the property in the public records, thereby completing the purchase.

Often, the prospective buyer will be required to place money into escrow when the purchase agreement is signed. This "earnest money deposit" shows the seller that the prospective buyer is seriously interested in the property and intends to proceed in good faith. By agreement, the earnest money deposit either may or may not be refundable if the prospective buyer does not consummate the transaction.

Letters of Intent

Early in the course of negotiating a real estate transaction, a prospective buyer and seller may wish to memorialize the basic transaction terms in order to have a common framework for further negotiations toward a binding purchase agreement. A letter of intent or letter of understanding may be used for this purpose. A prospective buyer or seller should take care that such a letter does not constitute a binding agreement. The letter should clearly state that it is not intended to be binding, but only a basic outline of terms and conditions that the parties will discuss and negotiate further and that the parties will have no liability to each other if they fail to enter into a final contract.

Title Insurance

The condition of title to property is a key consideration for prospective buyers. A purchase agreement will often require the seller to provide the buyer with a status report on the condition of title to the property, a preliminary title report or commitment for title insurance (known as a "title report") issued by a company in the business of investigating and insuring title to real property. The title report will describe the current ownership of the property; will list any matters that may affect title to the property such as delinquent property taxes and assessments, covenants, conditions, restrictions, easements, liens, and any other encumbrances; and will identify the requirements that must be satisfied before the title company will insure title.

Both the title report and the copies of the "title exceptions" must be reviewed carefully by the prospective buyer during the investigation period to confirm marketable title and that the title exceptions will not interfere with the proposed use or development of the property. Often, it is necessary to obtain a survey of the property, so that the property boundaries can be determined; easements, improvements, and encroachments can be located; and other physical characteristics of the property examined. The purchase agreement may also obligate the seller to remove title matters unacceptable to the buyer or to provide protective title insurance. The prospective buyer's obligation to purchase the property should be conditioned upon review of a title report and upon receipt of a written commitment by a title insurance company to issue a title insurance policy at closing, ensuring the title to be in satisfactory condition approved by the buyer.

At the closing, or very shortly thereafter, the title insurance policy will be issued to the owner. There are two forms of title insurance policies available to owners in Arizona: standard coverage and extended coverage. A number of policy modifications, called endorsements, also are available. Legal counsel should be consulted to determine appropriate policies and endorsements for specific transactions.

The premium for a title insurance policy is determined by the title company that issues the title policy, subject to state-regulated schedules. In Arizona, it is common for the seller to pay the premium cost of a standard owner's policy of title insurance. Payment of the additional premium for any "extended coverage" policy, which provides additional protections such as ensuring the accuracy of boundary line locations, is as negotiated between buyer and seller.

Deeds

Ownership of Arizona real estate is conveyed by delivery of the deed to the buyer. To be valid, a deed must be in writing, must adequately describe the property, must be signed by the seller and must be acknowledged before a notary public. There are additional requirements that apply to deeds to or from trustees or to or from two or more individuals who give or take title in some form of co-ownership that will be discussed in more detail below.

A deed may or may not contain warranties concerning the condition of title. A buyer often prefers to receive a "general warranty deed" in which the seller warrants that the seller owns the property and that no one, including the seller, has done anything to cause the title to be less than as described in the deed. The seller often prefers to provide only a "special warranty deed" in which the seller warrants merely that the seller owns the property and that the seller has not done anything to diminish the title from that described in the deed. An alternative to a general warranty deed or to a special warranty deed is a "quitclaim deed." In a quitclaim deed, the seller makes no promise or warranty whatsoever concerning ownership or condition of title, but merely transfers to the buyer all rights, if any, that the seller has in the property. A buyer should carefully consider the consequences in a given situation before accepting a quitclaim deed.

A deed to Arizona real estate should be recorded promptly with the county recorder of the county in which the property is located. Failure to record a deed promptly may permit third parties, such as innocent purchasers or lien holders, to acquire rights superior to the rights of the buyer.

Arizona law generally requires that an "affidavit of property value" be completed and signed by the parties. The affidavit,

which includes a number of details concerning the real estate transaction, must be filed with the county recorder at the same time as the deed is recorded. All the information disclosed on the affidavit of property value is a matter of public record.

There is a small recording fee for both deeds and affidavits of property value. Arizona does not impose a documentary stamp tax or real estate transfer tax on real estate transactions.

Methods of Holding Title

In acquiring Arizona real estate, attention must be given to the manner in which title to the real estate will be held. Arizona real estate may be owned by any natural person or legal entity or by combinations of persons and legal entities.

Individual Ownership

Any natural person, regardless of age, nationality, religion or race, may own any Arizona real estate interest. Individual ownership may not be the most advisable method by which to acquire property, particularly if the individual is a foreign person. For example, on the death of an individual who owns real estate within the state, Arizona law may require a state probate proceeding to confirm the passage of title to an heir or legatee. Substantial time and expense may be incurred by the heirs of a foreign person in Arizona probate court proceedings.

Corporate Ownership

Any foreign or domestic corporation may hold title to Arizona real estate. A foreign corporation should determine whether or not the corporation must qualify to do business in Arizona prior to the acquisition. If a foreign corporation merely purchases, holds and later sells an interest in undeveloped Arizona real estate in an isolated transaction, this alone would not require the foreign corporation to qualify to do business in the state. However, if the corporation's ownership of an interest in Arizona real property will involve substantial and continuous business activities, such as leasing of property or sales of lots, the foreign corporation should consider qualifying to do business in Arizona.

Partnership Ownership

Foreign or domestic partnerships may also own Arizona real estate. Foreign general partnerships are required to file a certificate of "fictitious name" with the county recorder of each Arizona county in which the partnership will conduct business. This document sets forth the names of the partners as a matter of public record. Every foreign limited partnership must file an "application for registration" as a foreign limited partnership with the Arizona Secretary of State.

Trust and Estate Ownership

Any legally existing trust or estate, whether foreign or domestic, may hold title to Arizona real estate.

Multiple Ownership

Any interest in Arizona real estate may be owned by more than one person or entity. There are four forms of multiple

ownership in Arizona real estate: community property, community property with right of survivorship, tenancy in common and joint tenancy with right of survivorship.

Unless the deed conveying title specifies to the contrary, all interests in Arizona real estate acquired by a husband or wife during their marriage are presumed to constitute "community property" of the husband and wife, regardless of where they reside, although spouses may own property individually ("separate property") as well. In community property ownership each spouse owns an undivided one-half interest. Both spouses must sign a deed in order to convey any interest in their community property to another person or entity. Generally, when property is acquired by gift or inheritance or with the separate funds of a spouse, the acquired property is the separate property of the acquiring spouse and the signature of that spouse alone on the deed is sufficient to transfer the property.

Husband and wife may also acquire title to real property as "community property with right of survivorship." This form of ownership retains all the essential characteristics of community property ownership, in that each spouse owns an undivided one-half interest and both spouses must sign a deed in order to convey any interest in their community property to another person or entity. Community property with right of survivorship eliminates some of the potential disadvantages associated with other forms of ownership. Unlike community property, which requires a probate proceeding upon the death of either spouse, with community property with right of survivorship, the deceased spouse's interest is automatically transferred to the surviving spouse without probate, regardless of any provision to the contrary in the deceased spouse's will. Community property with right of survivorship can also provide a tax advantage upon the death of the first spouse if the sale of the property will result in significant gain, because both the deceased and surviving spouses' interest in the property receive a step-up in basis.

Any combination of natural persons or entities may acquire title to real property as "tenants in common." When title to real property is acquired by tenants in common, each tenant in common has a separate and distinct, proportionate and undivided interest in the property, with a separate interest that is freely transferable. The proportionate interest in the property of the different tenants in common may be equal or unequal. Unless fractional interests are specifically fixed in the instrument of conveyance, each tenant is presumed to own an equal share. Each tenant in common is entitled to the full use and enjoyment of the property, subject to the equal rights of use of the other co-tenants. Except in the cases of conveyances to executors or trustees, or to husbands and wives, any conveyance of an interest in Arizona real estate to two or more persons or entities that fails to specify the form of ownership is presumed to create a tenancy in common.

Any combination of natural persons may acquire title to Arizona real estate as "joint tenants with right of survivorship." A joint tenancy with right of survivorship differs from a tenancy in common in one significant aspect. In the event of the death of an individual joint tenant, the deceased co-owner interest goes automatically to the survivor, joint tenant or, if more than one, is divided equally among the surviving joint tenants, without probate, regardless of any provision to the contrary in the deceased owner's will. In contrast, the interest of a co-owner under a tenancy in common can be transferred by a tenant in common while alive to any other person. On an individual tenant in common's death, the interest passes by will, if there is one, to the deceased's legatees. If there are none, it passes by intestate succession to the deceased's heirs.

Disclosure of Acquisition

Although foreign persons have the same rights and opportunities as U.S. citizens or permanent residents to acquire Arizona real estate, U.S. law requires that certain investments in real estate by foreign persons be disclosed to the federal government. Generally, all information disclosed is confidential and access to the disclosed information is limited to officials and employees of governmental agencies. However, certain disclosure information required in connection with the ownership of agricultural land is available to the public.

Leases

IN GENERAL

A foreign investor may prefer to lease, rather than own, real estate. A lease of real estate is the exclusive right to possess and use real estate for a specified period of time in consideration for the payment of money as rent. The property owner under a lease is the "landlord" or "lessor." The party acquiring the "leasehold" interest in the property is the "tenant" or "lessee." The time period when the lease is in effect is the "term." Although the lessor transfers the use and possession of the leased property to the lessee for the term of the lease, the lessor retains ownership of the property. Upon expiration of the term of the lease, the right to use and possess the property reverts to the lessor. Leases with a term over one year must be in writing to be enforceable.

A lease allocates the economic risks and expenses of property ownership, possession and operation between the lessor and lessee. For example, a lease generally specifies which of the parties will be responsible for the payment of taxes, assessments, utility charges, building maintenance and other costs; what type of insurance coverage each party must maintain; which of the parties is to bear the risk of loss if buildings, structures, improvements or personal property on the leased property are damaged or destroyed; and which of the parties is responsible for maintaining and repairing the property.

Various factors, including the proposed use of a particular property, determine the appropriate contents of a specific lease. Most leases of nonresidential property fall within one of the following categories: "ground leases," "agricultural leases" or "commercial leases."

GROUND LEASES

A ground lease is often made by a landowner who wants to retain ownership of real property but to avoid an active role in its development. A ground lease entitles the lessee to use, develop and operate the leased property without actually owning the property. In turn, a ground lease generally obligates the lessee to assume most of the burdens and responsibilities associated with ownership of the property, including maintenance of the property and payment of real estate taxes. Most ground leases have a term of from 50 to 99 years.

AGRICULTURAL LEASES

A lease of agricultural land involves unique issues. A lessor under an agricultural lease may wish to impose restrictions against the use of pesticides, fertilizers or of other chemicals potentially hazardous to the environment. A lessor may also seek to limit the types of crops that may be grown on the property to qualify for governmental crop subsidies or to maintain an adequate soil nutrient level. A lessor may wish to reserve the right to terminate the agricultural lease if the opportunity to commercially develop the land arises. An agricultural lease should address which party is responsible for ensuring an adequate water supply is provided and maintained for the property and should address the respective parties' responsibilities for growing and harvesting crops and entitlement to any profits from the sale of the crops.

COMMERCIAL LEASES

The terms of commercial leases vary significantly, depending upon the type of property and improvements. A lessor under a shopping center lease often collects both a base rent and an additional rent equal to a percentage of the lessee's sales (percentage rent). A lessor under an office or industrial commercial lease generally does not collect percentage rent, but may be particularly concerned with other economic considerations. For example, if the lessor is paying for the utility costs, the lessor may seek to place specific limitations upon the types and quantities of electrical equipment that the lessee may operate on the property.

In many cases the lessor may contribute funds to modify, or may actually modify, the leased space in preparation for the tenant's occupation. The most extreme example of this type of lease is the "build to suit" lease in which an entire building is constructed by the lessor to lessee specifications and delivered to the lessee when completed. The cost of the construction usually is amortized over the term of the lease, including a return on investment for the lessor-developer. This arrangement can be particularly useful to a foreign business that requires a unique or unusual facility.

OTHER SIGNIFICANT OWNERSHIP INTERESTS

Occasionally foreign investors may acquire real estate interests other than fee simple ownership or a leasehold. Many other types of real estate interests exist. The three most common are "easements," "mineral interests" and "water rights."

EASEMENTS

An easement is an interest in real estate that grants to one person the right to use another person's land for a particular purpose. Typically the right is non-exclusive. As examples, an easement may be given to a telephone company or power company to permit it to place its lines above or under property owned by another party or an easement may be provided to give a right of access over the property of an adjoining landowner. Easements should be in writing and should be recorded in the county recorder's office of the county in which the property is located to provide notice of the easement to third parties. An easement typically "runs with the land," meaning that the easement continues to encumber the property "burdened" by the easement, even if the property is conveyed to another owner.

MINERAL INTERESTS

Mineral interests may be purchased or leased apart from surface rights to real estate. Both the federal and the state governments often "reserve" the mineral rights to many parcels of real estate. These mineral rights may be separately acquired or leased from the U.S. government or from the State of Arizona. Mineral rights reserved by the U.S. government may be acquired through filing mining claims or through purchase applications filed with the U.S. Bureau of Land Management.

Mineral rights reserved by the State of Arizona may be acquired by mining claims, exploration permits and leases issued by the Arizona Department of Mines and Mineral Resources. Mineral rights owned by private parties may be purchased or leased in the same manner as other interests in real estate.

WATER RIGHTS

Water rights present special considerations. In some cases, water rights are attached to land ("appurtenant") and cannot be transferred except in connection with a transfer of the land. In other cases, water rights are personal property rights not connected with any particular land and can be transferred independently. Water rights in Arizona are the subject of complex statutory regulation, explained further in the chapter "Water Rights."

STATE LAND

Privately owned Arizona real estate presents many attractive investment opportunities. In addition, a significant amount of the land in Arizona, including land in prime urban areas, is owned by the State of Arizona and is available for purchase or lease. Fee simple ownership of land may be acquired from the state by purchase or by an exchange of private land for the state land. Special conditions govern the acquisition of state land, whether by direct purchase or by exchange. For instance, state land cannot be sold or exchanged for less than its appraised value and state land, in most cases, must be sold to the highest bidder at an advertised public auction.

Land owned by the State of Arizona may be leased for agricultural, grazing or commercial purposes. The term of an agricultural or grazing lease is limited to not more than 10 years without a public auction, but a lessee of state land has a preferred right to renew an existing agricultural or grazing lease for up to an additional 10 years. A commercial lease of state land may be for up to 99 years, but a commercial lease for a term of over 10 years is subject to competitive bidding at public auction. An application to acquire or lease state land must be made on forms provided by the Arizona State Land Department. An application fee is required and public notice requirements must be satisfied.

The Role of Professionals and Consultants

Real estate brokers match a buyer with a seller of real property. Normally, brokers are employed by the seller to locate an interested buyer, but it is not uncommon for a foreign investor to retain a broker for assistance in locating suitable real estate for purchase. The broker or salesperson, in some cases, may be asked only to identify likely prospects for sale or lease. In other cases, the broker or salesperson may be authorized to negotiate contracts for sale and leases. In still others, the broker or salesperson may be empowered to sign documents on behalf of an owner.

A broker usually receives a commission for services. In a sale, the commission is usually paid by the seller upon the closing of the sale, based on a percentage of the purchase price.

In a lease, the commission is commonly paid by the lessor at the time of execution of the lease or at the time the tenant occupies the leased space. The amount of a lease commission is determined by various formulas. A common one is a percentage of the rent to be paid over a period of years. Another is a specified amount multiplied by the amount of space leased to the tenant.

A written brokerage agreement is usually signed by the party engaging the broker and by the broker. Brokerage agreements can be exclusive, giving a single broker the exclusive right to deal on behalf of an owner. Brokerage agreements can provide that brokers are entitled to a commission only if the transaction is consummated. Unless the agreement expressly says otherwise, a broker will be entitled to a commission on a sale if the broker has procured a ready, willing and able buyer, even if the sale fails to close. In most cases, brokerage agreements must be in writing to be enforceable. Brokerage agreements generally specify the responsibilities of the broker, the amount of the commission to which a broker will be entitled, the conditions that must be satisfied for a broker to earn the commission, the time when the commission will be paid and the duration or term of the brokerage agreement.

With very limited exceptions, it is unlawful to engage in real estate brokerage activities without a license. It is also unlawful to compensate an unlicensed person for brokerage services. If a party to a real estate transaction, or the party's agent, is a licensed broker or salesperson, this must be disclosed to the other party.

Financing Real Estate

INTRODUCTION

When purchasing or developing real estate, the investor will encounter a variety of financing options. There may be existing financing that the investor will have to consider in its own financing strategy. Beyond, or in lieu of, existing financing, other sources include seller financing, conventional financing, public financing and private equity participation.

ASSUMPTION OF EXISTING FINANCING

It is not unusual for the investor to find real property encumbered by existing financing. The investor should obtain as much information as possible about such financing. If the investor chooses to purchase property subject to existing financing, which party remains liable for such financing is a negotiated matter. If the investor wants to assume the existing financing, the loan documents need to be reviewed to determine if there are any transfer restrictions or assumption fees that will be incurred. If existing financing is assumed, the investor may choose to use "wraparound" financing. This type of financing involves a promissory note promising to pay the existing underlying balance, with interest, as well as the investor's new financing. The wraparound financing documentation should be compared to the underlying financing documentation to ensure that their provisions and payment schedules do not conflict.

SELLER FINANCING

When an investor purchases real estate, the seller frequently will agree to accept at the closing only a portion of the total purchase price as a down payment. The balance of the purchase price is evidenced by an investor's promissory note promising to pay the balance over time, with interest. To secure repayment of the promissory note, the investor typically places a deed of trust or mortgage on the purchased property that encumbers the property with a lien. The property may be sold in foreclosure if the investor fails to make payments on the promissory note. Conventional financing, mentioned briefly below, is also discussed in more detail in the "Conventional Financing" chapter. Notes and related security documents may become "securities" subject to special restrictions and requirements.

Seller financing covers only the deferred portion of the purchase price for the property. If additional funds are necessary for the development of the property, they must be obtained from other sources.

CONVENTIONAL FINANCING

The most common sources of borrowed funds for real estate are loans from banks, insurance companies, pension funds and savings and loan associations. Recent developments in the commercial finance markets have somewhat limited the availability of loans for real estate investments, but commercial

financing from institutional lenders, both inside and outside of Arizona, continues to play an important role.

PUBLIC FINANCING

Arizona has a unique form of public financing for Arizona real estate projects. The state permits the formation of "community facilities districts" to construct and finance infrastructure improvements for real estate projects such as roads, sidewalks, drainage facilities and sewers, water and utility systems.

A community facilities district has governmental power to tax and issue bonds. Because the interest paid to the holders of the bonds issued by a community facilities district is generally exempt from federal and state income tax, the interest rate on funds made available through the sale of these bonds is often significantly lower than conventional financing rates.

Below-market interest rates may also be available when financing is provided through the sale of industrial development bonds.

PRIVATE EQUITY PARTICIPATION

A foreign investor with significant capital resources may choose to participate in Arizona real estate investments by becoming an "equity participant" in a business venture with a local real estate developer. Such transactions may be structured several ways. One method is for the equity participant to advance funds to the joint venture to purchase and develop a particular piece of real estate. The developer contributes time and expertise to the joint venture. The equity participant typically is entitled to recover the participant's equity investment and to earn a specified annual return on the investment before any revenues are distributed to the developer. When the equity participant has recovered the equity investment and a specified annual return, any additional revenues are divided between the developer and the equity participant on an agreed percentage basis.

These joint ventures are typically organized in Arizona as limited liability companies or partnerships. Tax and management considerations are generally determinative of the best structure for any given venture.

An investor may choose to be an active or passive investor. An investor who wishes to actively participate to a significant degree in the management of the project may elect to be a manager of a limited liability company or a general partner in a partnership. As a general partner of a partnership, the investor will be exposed to liability for all losses on the project, even beyond the investor's investment. An investor who wishes to invest through a partnership may limit exposure on the project to the investor's equity investment by assuming a more passive role as a limited partner.

Another alternative for an investor seeking acquisition and development funds is a real estate syndication. A real estate syndication usually involves a limited liability company or limited partnership formed to acquire and develop the project. The syndicate is funded by the sale of limited liability company interests or limited partnership interests to one or more equity

investors. The sale of such interests may constitute the sale of "securities" and be regulated by federal and state securities laws.

Development of Arizona Real Estate

In evaluating investment opportunities in Arizona real estate, an investor should consider how the real estate will be put to use. Four areas of concern in real estate development are 1) public regulations and restrictions on the use of land, 2) private regulations and restrictions on the use of land, 3) management and marketing of Arizona real estate and 4) construction of buildings.

PUBLIC REGULATION

Local governments seek to assure and promote coherent, orderly growth in a manner that balances the quality of life of its residents with competing and conflicting needs of the community. Because of these and similar concerns, most Arizona counties, cities and towns, like local governments in other states, have enacted comprehensive land use and zoning regulations. Arizona has a tradition of favoring limited governmental regulation. Local governments in Arizona historically have encouraged economic growth and development. As a result, foreign investors may find the regulatory climate in Arizona for land development more favorable than the regulatory climate in many other states.

Zoning and Land Use Regulations

Arizona counties, cities and towns have broad authority to regulate land uses within their boundaries. Most of these local governmental units have adopted land use plans and zoning ordinances that specify the uses permitted on parcels of land within their jurisdiction. Certain parcels may be zoned by local authorities for agricultural purposes, others for single-family residential uses and still others for commercial or light industrial and manufacturing. A detailed zoning code may specify additional requirements, such as building "set-back lines," parking requirements, landscape requirements, provisions for adequate drainage and flood control, restrictions on building height and others. No development activity can be commenced on land subject to zoning restrictions unless the requirements of the zoning ordinance are satisfied and appropriate building permits are obtained.

If an owner wishes to develop land with a project not permitted by the existing zoning, the owner may apply to the local government to rezone the property, which requires legislative action, or for a variance, which requires administrative/quasi-judicial action. If successful, the effect is to change the zoning classification of the affected property to a zoning classification that permits the use desired by the owner-applicant or to permit a particular use as an exception to existing zoning.

The average rezoning takes three to nine months, depending on the nature and complexity of the issues. The process is initiated by submitting an application to the local government.

The submission is accompanied by detailed plans and drawings for the proposed project. The application is processed by the local government's planning and zoning department and the procedure usually involves extensive negotiations with the department's staff over preconditions to rezoning approval. Common stipulations may include a requirement to convey additional rights-of-way, or to widen streets to provide better access to the project or to provide a landscape buffer between the project and an adjoining landowner.

After the zoning staff has processed the application, a hearing will be held before the local government's planning commission. This body is made up of appointed private citizens who analyze and make recommendations, often very specific, on the application. After the planning commission makes a final decision to approve or reject the application, a formal hearing is then held before the elected governing body (i.e., Board of Supervisors or City/Town Council), which accepts or rejects the decision of the planning commission. At the hearing, the owner-applicant presents the case for approval. If the application is approved, the rezoning is granted and the owner can proceed with the proposed project under the new zoning, subject to complying with any stipulations. Any interested person can appear at these hearings to oppose or support the proposed change. A property owner seeking a rezoning might consider meeting with the surrounding landowners to answer questions and, if possible, resolve their concerns prior to the hearing.

Site Plans and Special Use Permits

Although a particular project may be a permitted use under existing zoning, the codes frequently require the owner to obtain approval of a site plan or a special use permit from the local government prior to development. Site plan and special use permit approvals are required for projects in which the local government, for policy reasons, seeks a more substantial role. The local government may have special concerns with the design of a particular project or with the detailed uses to be made of the property because of the potential impact such design or uses may have on surrounding property and the community at large. Projects likely to require site plan approval or a special use permit are high-rise office buildings, shopping centers, churches, charter schools, resorts, mobile home parks, sports arenas, residential extended care facilities and warehouses.

The procedures for obtaining special use permits and site plan approval vary greatly from jurisdiction to jurisdiction. In simple cases, the procedures may involve only approval of the planning staff. In other cases, the procedures may involve a process similar to rezoning approvals, including public hearings and a requirement of final approval by the local governing body.

Annexation

Occasionally, an investor acquires land outside the boundaries of an existing city or town that is under the jurisdiction of the county. The level of governmental land use regulation

in a county is often less than in a city or town, but the level of public services and amenities also is often less. A landowner therefore may want to have the land annexed into a city or town.

In order for a city or town to annex property, the city or town to which the property will be annexed must consent. Consent must also be obtained from a specified number of persons whose real and personal property would be subject to taxation by the city or town in the event of annexation. The precise procedures for annexation are complex and legal counsel should be consulted.

Municipal Subdivision Regulations

Each local governmental unit in Arizona has the authority to regulate the subdivision of land within its boundaries. Municipal subdivision regulations often require that a detailed map of the planned subdivision ("plat") be prepared, submitted to the local government, approved and recorded with the county recorder prior to the sale or lease of the subdivided land. Municipal subdivision regulations address lot design, setback requirements, street design, placement of public utility lines, drainage and similar matters. Municipal subdivision regulations are independent from, and in addition to, subdivision regulations administered by the Arizona Department of Real Estate. No subdivision may be approved until adequate assurances, such as performance bonds or standby letters of credit, have been provided to the local governmental unit, assuring that roads, utilities, drainage structures and other necessary public facilities will be properly installed by the developer.

Development Fees

As part of obtaining rezonings, site plan approvals, special use permits and building permits, many Arizona cities and towns collect development fees from the project owner. Development fees are assessed to help the local governmental unit offset its costs of providing necessary public services, such as water, sewers and roads. Development fees can be substantial and must be taken into account in any economic feasibility analysis.

Growth Management Regulations

Many Arizona communities create land use plans that govern the zoning regulations of local governments and manage the growth of the local area to minimize the impact on the environment and surrounding communities. These plans may govern the environmental effects, business licenses, parking facilities, open spaces, public transportation, infrastructure and population density of new developments. Community land use plans may also require developers to pay for necessary public facilities themselves in order to provide such services to their developments. Land developers should be aware of the land use plans affecting their developments and design new projects that conform with these plans.

Other Regulations

The uses to which investors put real estate may dictate whether other regulations are applicable. For example, when constructing a building, certain environmental laws may be triggered, as discussed in more detail in "Construction of Buildings" in this section below and in the "Environmental Laws" section.

PRIVATE REGULATION

In addition to public regulation of land uses, individual property owners also may restrict and regulate the uses of their land in ways that will bind subsequent owners and lessees of that land. The most common methods of private regulation are deed restrictions, reciprocal easement agreements and declarations of covenants, conditions and restrictions.

Deed Restrictions

The use of property can be regulated by private deed restrictions, which are covenants or promises expressly stated in recorded deeds. Deed restrictions may benefit certain individuals personally, in which case the restrictions terminate when the benefited owner transfers the owner's interest in the property. Most deed restrictions, however, "run with the land" and bind not only the original owner of the restricted property, but also all succeeding owners.

Deed restrictions often are used to restrict the use of property to a particular purpose, such as "for park purposes only," "for church purposes only" or "for single-family residential purposes only." Deed restrictions are enforceable by court action for injunction, by foreclosure of a lien against the property and sometimes if the owner "assumes" the obligation against the owner personally. Deed restrictions also can impose financial obligations. For example, a deed restriction may compel a property owner to maintain a roadway or other amenity.

Deed restrictions generally are enforceable, provided that the person taking title to the property burdened by the restrictions has notice of the existence of the restrictions through active notice or by "constructive notice," which is provided by recording the deed restrictions, together with a legal description of all the affected properties, in the office of the county recorder of the county where the property is located.

Reciprocal Easement Agreements

Adjoining landowners often enter into reciprocal easement agreements by which they grant each other rights to use portions of their respective lands. Reciprocal easement agreements are commonly used in commercial developments to provide mutual parking and rights-of-way over paved parking areas owned by multiple owners.

Reciprocal easement agreements address uses of the easement property, including maintenance, insurance, construction and allocation of expenses. All who have, or who subsequently succeed to have, title to the property benefited by a reciprocal easement automatically, by virtue of the fact

of possession or ownership, become entitled to the use and benefit of the easement. Similarly, all who possess, or succeed to possess, title to the property burdened by the reciprocal easement are compelled to permit the use of their property as authorized by the reciprocal easement agreement.

Declarations (CC&Rs)

As part of the real estate development process, the owner often records a written declaration of covenants, conditions and restrictions (CC&Rs), which is a comprehensive plan for the development of property. This type of private development control is often used for large residential developments and planned communities. CC&Rs are recorded in the records of the county where the property is located, giving future owners of the property notice of their existence, because the declarations will bind them. Although similar to deed restrictions, CC&Rs are more extensive and may limit the types of improvements that can be constructed on the property. For instance, a CC&R may require conformance to a certain architectural style.

CC&Rs often provide for the organization of a homeowners' or property owners' association to administer and enforce the declaration. Owners of lots and parcels in the development become members of these associations and have obligations to pay regular assessments to the associations. The members usually have voting rights, although a developer almost always controls the association during the early phases of a project. Associations often have the power to enforce the members' obligations to pay assessments by filing liens against the property of delinquent members.

MANAGEMENT AND MARKETING

If real estate is to be operated for investment use rather than used by an owner in the owner's own business, it is common to retain either professional property managers or brokers to assist with the management and leasing of the project. Real estate brokers are also used to sell the property.

Property Management

Property managers generally are responsible for the day-to-day operation of a project. Among the functions performed by a property manager are overseeing necessary services, such as maintenance, repair and security, maintaining tenant relations, supervising project employees and accounting. A property manager is reimbursed by the project owner for costs incurred by the manager in operating a project and is paid a fee. The fee frequently is based on a percentage of the gross collections received from a project, although sometimes there is a guaranty of a minimum fee.

Many of the activities undertaken by property managers are regulated by the Arizona Department of Real Estate. A property manager must obtain a real estate broker's or salesperson's license before engaging in any regulated activities. The Arizona Department of Real Estate requires all property management agreements to be in writing and to include certain mandatory provisions.

Brokers

It is common for an owner to retain a real estate broker or salesperson to assist in the sale or lease of real property. The "Role of Professionals and Consultants" section above describes the role of the broker in real estate transactions.

Sale or Lease of Subdivided Land

When land is divided into multiple parcels for sale or lease, the seller must take into account special federal, state and local laws. Unless land divided into six or more parcels is exempt from regulation, it is necessary, prior to offering the land for sale, to register the subdivided land with the Arizona Department of Real Estate and to obtain from the Arizona Department of Real Estate a public report disclosing facts and details about the subdivision. This public report must be distributed to all prospective purchasers. For federal compliance purposes, Arizona is one of only a handful of "certified" states. Being a certified state means that the federal government will accept the Arizona public report as satisfying federal requirements relating to the sale or lease of subdivided lands if certain requirements are met. Sellers of subdivided land in Arizona can thus avoid a second "subdivision" filing with the federal government.

Before assuming that the subdivision registration process is necessary, it is important to determine if any one of numerous exemptions is applicable. There are exemptions for commercial and industrial properties, improved property, property sold to builders and developers and leases of property for less than one year. Applicability of these exemptions is very technical and the exemptions differ under federal and state law.

Construction of Buildings

PUBLIC REGULATION OF CONSTRUCTION

Ordinarily, before any construction work can begin in Arizona, the owner of the building site must obtain a building permit from the city in which the property is located. If the property is located outside the city limits, the building permit is issued by the county in which the property is located.

Building permits are required in order to give the city or county building agency an opportunity to review the plans and specifications to make sure they comply with all building code requirements. These requirements relate to structural safety and integrity, fire safety, water supply, sewage disposal, access to public streets and zoning restrictions.

In Arizona, a builder is called a "contractor." "General contractors" perform all phases of construction. "Specialty contractors" do only work involving a particular skill, such as plumbing or electrical work. "Subcontractors," who are also often specialty contractors, are engaged by contractors to perform only a part of a larger job for which the contractor was engaged by the owner.

It is unlawful to act as a contractor in Arizona without a contractor's license issued by the Arizona Registrar of Contractors, unless an exemption from licensing is expressly granted by statute. Currently, there are two major exemptions. First, an owner of property who builds or improves structures on the owner's property is exempt from licensing if the structure, or group of structures, is intended for the owner's occupancy and is not intended for sale or for rent. Second, owners of property who build or improve structures on their property are exempt from licensing if they contract for the construction work to be done by a licensed contractor or contractors.

Contractors must be aware of the numerous and complex environmental laws (federal, state and local) that affect construction activities. Construction can cause air, surface water, ground water and soil contamination. Construction may involve the use and storage of hazardous substances and the disposal and refuse of hazardous wastes. All activities are governed by environmental laws. Some require that governmental permits be issued before commencing the work. For more information on environmental laws, see the section on "Environmental Laws."

SELECTION OF CONSTRUCTION PROFESSIONALS

The owner of private property in Arizona is free to choose the architect, engineer, contractor and other members of the construction team. Such a selection process may include private negotiation or competitive bidding, with the selection going to whomever the owner believes best able to produce the desired result on time and within budget.

Architects, engineers and other design professionals are required to be registered or licensed by an Arizona regulatory agency, such as the State Board of Technical Registration.

The architect and the engineer are responsible for the design of the building project, for its style, for its appearance and utility and for its structural soundness. The architect and engineer usually inspect the progress of construction for compliance with the plans and specifications. Although design and construction are separate phases, experienced developers often choose a professional or team of professionals to produce a building project with responsibility for both the design and construction. Owners must carefully examine the qualifications and experience of such design-build professionals because of the concentration of responsibility in a single person or organization.

CONSTRUCTION CONTRACTS

The most widely used forms of construction contracts in Arizona are the printed forms prepared by the American Institute of Architects (AIA). These contract forms are frequently modified by the owner and the contractor as the particular construction project may require, or to change or eliminate unacceptable provisions. Typically, contractors will use their own forms of contract with specialty subcontractors.

PAYMENT OF CONTRACTORS

Architects and engineers are usually paid for design work when the plans and specifications are completed and paid for their inspection work after each inspection.

Whether the construction contract calls for payment of a lump sum amount or the contractor's "cost plus a fixed fee," most construction contracts will require the owner to make progress payments to the contractor, usually monthly. Any application for payment submitted to an owner by a contractor is automatically certified and approved seven days after receipt, unless the owner disputes the amount due during that time. After the seven days expire, the owner must pay the contractor within another 14 days. Unjustified failure to pay the contractor according to the terms of the contract is usually grounds for suspending or terminating the construction work.

Any failure by the owner to pay the contractor, any failure of the contractor to pay specialty subcontractors, or any failure of the subcontractors to pay their workmen or material suppliers, may result in the filing of "mechanics' liens" against the owner's property. These liens may be foreclosed in a manner similar to foreclosure of a mortgage on the property. To prevent or protect against mechanics' liens, owners may require the contractor to furnish construction bonds that guarantee the contractor will perform the work according to the terms of the construction contract (performance bonds) and that payment will be made for all labor and materials furnished on the construction project (payment bonds).

Most construction disputes are resolved by negotiation, often with the active participation of the architect, who is given much authority under the standard AIA contract forms. "Partnering" is a new approach to preventing construction disputes and one that is gaining wide acceptance. Partnering is a process in which the parties meet before construction begins to identify potential problems and suggest solutions. The parties establish a mechanism for handling problems at the job site before the problems rise to the level of disputes. The parties pledge to produce a quality construction project on time, on budget and without litigation.

The favored method of resolving construction project disputes that cannot be settled by negotiation is arbitration rather than court litigation. Private arbitration is designed to be less costly than litigation and is often more likely to reach a fair result because arbitrators are frequently chosen for their special construction industry knowledge. Construction disputes that do reach the courts can be among the most protracted and costly of suits because they often involve complicated facts and require extensive use of expert witnesses.

Conventional Financing

Marc R. Currie

CONVENTIONAL financing is financing provided by banks, commercial finance companies, savings and loan associations, insurance companies, pension funds and other non-governmental lenders. Conventional financing is typically either commercial financing or real estate financing. The proceeds from commercial financing are customarily used to provide working capital for business, inventory or equity financing or to finance a transaction such as the acquisition of a business. The proceeds from real estate financing are commonly used to finance acquisition of real estate or to provide funds for improvements to real estate. This chapter examines general concepts, the documentation of financing and loan transactions and the securing of loans by encumbrances, security interests and guaranties. Financing of real property transactions is also briefly considered in the "Real Property" section. A special kind of financing is treated in the section "Tax-Exempt Financing."

In General

PARTIES

The principal parties to a loan transaction are the lender and the borrower. There may be more than one of each. In a commercial loan, the lender is typically a bank or commercial finance company. In a real estate construction loan, it is a bank or a savings and loan association. In other real estate loans, such as acquisition loans or permanent loans issued following completion of construction, the lender is usually a bank, a savings and loan association, an insurance company or a pension fund.

A lender may require assurances of repayment as security for the borrower's obligations under the loan, such as a mortgage or deed of trust. The owner of the property given as security may be someone other than the borrower, in which case the owner of the property will also become a party to the transaction as the pledgor. A lender may also require a guarantor who will agree to repay the loan in the event the borrower defaults on its obligations.

DURATION OF LOAN

A loan is either a "term" loan or a "demand" loan. A term loan is a loan for a specified period. The borrower under a term loan may be required to make periodic payments of loan principal and interest throughout the term or may be permitted to make a single payment of the entire loan balance at the end of the term. The borrower of a demand loan is required to repay the loan within a short period following the lender's demand for repayment, which may be made at any time.

Most loans by conventional lenders are term loans. Most commercial loans and real estate construction loans have terms

of between one and five years. Other real estate loans, such as "permanent financing," have terms of up to 30 years.

INTEREST

Conventional loans, like other loans, require payment of interest by the borrower. The two most common methods for charging interest are the "flat rate" and the "variable rate." Under a flat rate, the borrower pays the same rate of interest on the unpaid principal throughout the term. Under a variable rate, the rate of interest is determined at various intervals throughout the term by reference to an objective rate standard, such as the London Interbank Offered Rate or other "cost of funds" index, or to the "base" or "prime" rate of interest charged by the lender or by a designated institution. As the objective rate standard changes, the interest rate on a variable rate loan changes. Thus, an interest rate equal to the "prime rate of interest charged by the lender plus one percent" results in a periodically adjusted rising or falling interest rate that always exceeds by one percentage point the prime rate of interest charged by the lender.

Additionally, Arizona does not have a general usury statute, unlike many other states. Thus, in most circumstances, the interest rate can be any rate the parties agree to in writing. There are certain varieties of loans that do have set interest rate maximums.

BASIC LOAN DOCUMENTATION

Most loans are evidenced by a promissory note, which may be supplemented by a credit agreement and other documents between the borrower and lender.

PROMISSORY NOTE

A promissory note sets forth the promise or obligation of the borrower to repay the principal amount of the loan plus interest, with provisions concerning the rate and computation of interest. The promissory note also sets forth the dates when payments of principal and interest come due.

The promissory note and any credit agreement will also state "events of default." On the occurrence of an event of default, the lender typically has the right to demand immediate payment of the entire balance of the loan prior to the due date. The lender may have the right to sell in foreclosure any property securing the loan and may require any guarantor to make payment. Common events of default are failure to make a payment of interest or principal when due, failure to perform some other promise of the borrower and discovery of a misrepresentation made by the borrower in obtaining the loan.

CREDIT AGREEMENT

A credit agreement provides the basic terms of the loan and typically includes representations and warranties by the borrower that are relied upon by the lender, such as warranties of the accuracy of the borrower's financial condition as set forth

in financial statements delivered to the lender. The borrower, if not an individual, will be required to represent that it is duly organized and existing under applicable law and that the borrowing has been duly authorized pursuant to its formation documents.

A credit agreement also customarily includes various covenants, which are requirements with which the borrower must comply until the loan is paid in full. An example is a covenant that the borrower will provide financial information at periodic intervals. A credit agreement may contain both affirmative and negative covenants. Negative covenants restrict a borrower's activities; for example, they may provide that the borrower will not engage in any other financing transactions until the loan is paid in full, that the borrower's net worth will not fall below a stated amount or that the borrower's ratio of debt to equity will not exceed given limits.

A credit agreement commonly specifies events of default, any one of which will authorize the lender to demand payment of the loan, foreclose against security or take other enforcement action. A credit agreement will usually include specific procedures and conditions for any installment funding or future advances.

LOAN SECURITY

A lender may require security for repayment of the loan. Security may be real property, personal property or both. Documentation used to evidence real property security differs from the documentation used when personal property is security. Also, the laws governing the two types of security differ.

REAL PROPERTY SECURITY

Raw land, buildings, improvements to land and the right to collect rent under leases may serve as security for a loan. The real property may be owned by the borrower or by another person or entity that pledges its interest in the property. Under Arizona's community property law, for a valid encumbrance upon community real property, both the husband and wife must sign the encumbrance document.

Mortgages and deeds of trust are used to encumber real property to secure loans. Under either a mortgage or a deed of trust, the owner of the property has the right to possess and use the property while the loan is not in default. Included in any mortgage or deed of trust are representations and warranties by the property owner, such as warranties of ownership and of authority, to encumber the property as security. Covenants are also commonly included, such as that the property will be maintained in good repair, that all applicable insurance will be kept in force, that real estate taxes will be paid when due and that the property will not be sold or further encumbered.

Arizona law allows both mortgages and deeds of trust to encumber fixtures by incorporating or adding a "financing statement" that is filed and recorded. Fixtures are improvements attached to the real estate described in the mortgage or deed of trust.

The mortgage or deed of trust will identify events of default in addition to the events of default specified in the promissory note or credit agreement. The mortgage or deed of trust will describe the actions the lender may take after default, including the right to take possession of the real property, to take action to protect or realize upon the security and to sell the real property through foreclosure or forfeiture proceedings.

The principal difference between a mortgage and a deed of trust is the remedy available to the lender. Under a mortgage, in the event of a default, the lender may accelerate the entire unpaid balance of the loan and may foreclose the mortgage. Foreclosure of a mortgage requires bringing suit for the unpaid amount of the loan and foreclosing against the security. Once judgment is obtained, the lender must request the court to direct the sheriff to sell the real property and use the sale proceeds to pay the loan. This process may take several months, even longer if the borrower contests foreclosure. If the property is sold at a foreclosure sale, the borrower can redeem the property within six months after sale or within one month after sale if the property has been abandoned and is not farmland. Redemption is made by paying the sheriff the price paid by the purchaser at the foreclosure sale, plus the amount of taxes and assessments paid by the purchaser, plus a redemption charge of 8 percent of the sale price.

Under a defaulted deed of trust, the lender has the option to foreclose by suit, as under a mortgage or to hold a trustee's sale. A trustee's sale is a private sale without suit. The sale is held by a trustee named in the deed of trust, often a title company. The sale may be held on a day noticed, which must be at least 90 days after the trustee gives notice of the sale. A trustee's sale thus can be held more quickly than a mortgage foreclosure sale. After a trustee's sale, the borrower has no right to redeem the property. The borrower can reinstate the loan and prevent the trustee's sale at any time prior to the sale by paying the lender only the amount in default (not the entire unpaid balance) together with statutory costs.

The lender may purchase the real property at a foreclosure sale or at a trustee's sale and may credit the unpaid amount of the loan as part of the total payment. Arizona law limits the amount of the "deficiency" that may be collected from the borrower or any guarantor after either a mortgage foreclosure or a trustee's sale under a deed of trust. The recoverable deficiency is the amount, if any, by which the debt exceeds the higher of the sale price at either the foreclosure sale or the trustee's sale or the fair market value of the property on the date of the sale. The lender has 90 days after a trustee's sale to commence a deficiency action. However, if the security for the loan is real property of 2½ acres or less and used as a single one- or two-family residence, in most cases the lender is not entitled to collect any deficiency after either a mortgage foreclosure sale or a deed of trust trustee's sale.

Arizona limits who may be a trustee of a deed of trust. A trustee of a deed of trust must be a person or entity that is specifically listed in the statute as eligible to hold the position.

Banks, real estate brokers, title companies and attorneys are examples of qualified trustees.

PERSONAL PROPERTY SECURITY

Besides real property, personal property can also secure a loan. Personal property often furnished as security includes notes, accounts receivable, deposit accounts, securities, equipment, inventory and contract rights. The property may be owned by the borrower or by another person or entity that pledges a security interest to the lender. Arizona has adopted revised Article 9 of the Uniform Commercial Code, which governs most instances where a person or entity pledges personal property collateral as security, with the exception of cars, boats, aircraft and certain other collateral that may be governed by a different regulatory scheme. In the case of equipment, inventory or accounts receivable, the lender generally allows the party furnishing the property to possess and use the property as long as the loan is not in default. If the personal property is "documentary" personal property such as promissory notes, stocks or bonds, the lender usually must take actual possession of the property and hold it in pledge until the loan is repaid. If the collateral is a deposit account, the lender will usually need to obtain control over the account by having the bank holding the account acknowledge that it will follow the lender's instructions with respect to the account. The Uniform Commercial Code sets forth mandatory but flexible foreclosure procedures to ensure that adequate notice is given and that the foreclosure sale is conducted in a "commercially reasonable" manner.

The person or entity pledging the property generally enters into a security agreement granting the lender rights in the collateral in order for the lender to hold an effective security interest. Personal property security agreements generally contain provisions that are similar to those found in a deed of trust or mortgage, such as representations, that the pledgor owns the personal property and is authorized to provide it as security, a covenant to maintain the property in good condition and, if the personal property consists of contract rights, a covenant not to amend, modify or terminate the contract rights without the approval of the lender. In all cases, the security agreement will contain promises not to sell the personal property or to grant other security interests in the personal property without the lender's approval.

The security agreement will also state events of default and the actions the lender may take if an event of default occurs, including the right to sell the personal property security and to use the proceeds of the sale to pay the loan.

Recording and Filing

Mortgages, deeds of trust, security agreements and pledge agreements are between a lender and the person furnishing the security. They give the lender rights in the property that are enforceable against the party owning the security. To protect its rights in the security against claims by third parties, including

other lenders, judgment creditors and bankruptcy trustees, the lender must take additional action. In the case of real property, the lender must record the mortgage or deed of trust with the county recorder of the Arizona county in which the real property is located. Recording is the filing of the document with the recorder, where it becomes public record and notice to the world, as a matter of law, of the existence of the mortgage or deed of trust.

Generally, in the case of personal property, the lender must file a "UCC-1 financing statement" with the appropriate filing office of the state where the debtor is located. The Uniform Commercial Code provides tests for determining the debtor's location, which, in the case of an entity formed pursuant to the laws of a state (such as a corporation or limited liability company), would be the state of the entity's formation.

Arizona has very strict margin and typeset requirements for recording documents. If the document does not comply with the requirements, it will not be recorded. As mentioned, as to certain documentary personal property, the lender must actually take possession of the property in pledge in order to protect a lender against claims by third parties against the security.

Loan Guaranties

A guaranty is an agreement made by a person, other than the borrower, that the loan will be paid or that other actions, to be performed by the borrower, will be performed. Guaranties are taken when the borrower's credit or security is considered weak or inadequate. For example, in a loan to a small or closely held corporation, the lender will often require guaranties from the shareholders of the corporation. A guaranty may be unlimited, or it may be limited to a specific amount or percentage, or to a single or limited number of transactions, or to obligations incurred within a given period of time.

The obligation of the guarantor comes due upon the borrower's default. If the guaranty so provides, the lender may proceed independently against the guarantor, without first attempting to collect from the borrower or to recover against other security. In Arizona, a married individual executing a guaranty cannot bind the community property of the marital estate without the other spouse's joinder in the guaranty.

Tax-Exempt Financing

Monica C. Michelizzi

Financing for private projects may be available through the issuance and sale of tax-exempt bonds by certain governmental units. The principal benefit is lower-cost financing. Because most purchasers of tax-exempt bonds do not pay federal or state income taxes on the interest received, interest rates on such bonds are typically below the rates generally prevailing in the marketplace. The benefit is passed on to private borrowers in the form of lower interest loans by the governmental unit. Although borrowers in tax-exempt financing transactions may have higher origination costs than with conventional financing, lower interest costs throughout the term of the loan usually produce substantial overall savings.

Tax-exempt financing for private projects in Arizona takes one of two forms: financing provided by the sale of private activity bonds and financing provided by the sale of community facilities district bonds or public improvement district bonds.

Private Activity Bonds

IN GENERAL

The sale of private activity bonds (PABs), once referred to as "industrial development bonds," is designed to provide both for-profit and not-for-profit entities with an attractive means of borrowing money at low cost for investment in Arizona projects. In Arizona, all counties, all major cities and many smaller cities and towns have established industrial development authorities with the ability to issue PABs on behalf of private borrowers. Sales of PABs are governed by both federal and state laws.

QUALIFYING PROJECTS

For business purposes in Arizona, PABs are generally used to provide financing for three types of projects: the acquisition or construction of "manufacturing facilities," the acquisition or construction of "qualified residential rental projects" and the acquisition or construction of "facilities for not-for-profit corporations."

Manufacturing Facilities

A manufacturing facility can be acquired or constructed with financing provided through the sale of PABs. A manufacturing facility is any facility used in the manufacture or production of tangible personal property. Limited on-site office space and warehousing space can be included in a manufacturing facility if it is functionally related and subordinate to day-to-day manufacturing operations.

Several restrictions under federal law affect the amount that can be used to finance the acquisition or construction of specific manufacturing facilities. Interest on tax-exempt bonds issued to finance a manufacturing facility will become taxable if the aggregate amount of the borrower's capital expenditures

(including the expenditures made with bonds proceeds, in the local jurisdiction in which the facility is located during the period beginning three years before the issuance of the bonds and ending three years after the issuance of the bonds) exceeds $20 million. A borrower cannot be the recipient of PABs financing for a manufacturing facility if the aggregate of the financing proceeds, plus other outstanding PABs financings of the borrower for acquisition or construction of facilities elsewhere in the United States, exceeds $40 million.

Qualified Residential Rental Projects

A "qualified residential rental project" can be acquired or constructed with proceeds from the sale of PABs. A qualified residential rental project is a building or buildings with self-contained residential units that are offered for rent to the general non-transient public. Federal law conditions the receipt of PABs financing for the acquisition or construction of qualified residential rental projects on the agreement by the borrower to reserve a percentage of the rental units for rental to individuals or families whose income is less than a set percentage of the median gross income in the jurisdiction.

Facilities for Not-for-Profit Corporations

A corporation or partnership that has been determined to be a not-for-profit entity for federal tax purposes, pursuant to Section 501(c)(3) of the Internal Revenue Code, may finance the construction or acquisition of a headquarters building, health care facilities (hospitals, nursing homes and related equipment) or other facilities designed to achieve its charitable purposes. In general, such financings are not subject to the same restrictions and volume limitations as other PABs.

PROCEDURE

An application for PABs financing must be prepared and submitted to the Industrial Development Authority (IDA) with jurisdiction over the area in which the financed project is or will be located. The IDA will consider the application and may, in its discretion, either grant or decline to grant preliminary approval. This approval is important because project costs and commitments paid or incurred prior to preliminary approval generally may not be reimbursed or paid from the proceeds of PABs financing. Therefore, prospective borrowers should avoid significant financial undertakings with respect to any project until preliminary approval is secured.

Once preliminary approval is obtained, a for-profit applicant must apply to the Arizona Department of Commerce for an allocation of the state's volume limit on PABs financing. Because the state's volume limit is generally allocated on a first-come, first-served basis within the relevant project areas, it is advisable to file applications for allocations on January 1 or as early as possible in the year to improve the chances of securing an allocation.

Following agreement for the sale of the PABs and the terms of the related financing, and prior to their sale, an application must be made to the IDA for final approval. The final

approval is generally preceded by a public hearing, notice of which must be published in a local newspaper. The hearing gives local residents an opportunity to express their opinions. If final IDA approval is obtained, the matter is then presented for ratification by the governing body that organized the IDA, either the board of supervisors of the county or the mayor and council of the city or town. If approved, the financing is thereafter closed.

Once the financing is closed, the issuer of the PABs is responsible for filing Form 8038 with the Internal Revenue Service. The bondholder is then eligible to exclude from gross income the interest on any qualified state or local bond when filing federal and state income tax returns.

Community Facilities and Public Improvement District Bonds

Arizona law authorizes the owners of real property in an area to petition the city for the organization of a "community facilities district." Similarly, the owners of real property in incorporated or unincorporated areas can petition the city or county, as applicable, for the formation of a "public improvement district." Either type of district is permitted to issue tax-exempt bonds to finance a variety of public improvements intended to benefit the district and ultimately to be owned by the district. Projects for construction of streets and sewers are typical. These districts are also often used in Arizona to finance a portion of the costs of large residential or commercial development projects, such as master-planned communities and industrial parks.

Immigration

Manuel H. Cairo and Rebecca A. Winterscheidt

Foreign persons conducting business operations in Arizona may seek an extended stay in the state for themselves or for other foreign persons they seek to employ in Arizona. Admission of foreign persons into the United States is governed exclusively by the U.S. immigration laws. Individual states, such as Arizona, have no immigration authority.

Generally, a foreign person can be admitted into the United States under one of two broad categories—immigrant or nonimmigrant. Immigrant status is an appropriate goal for persons seeking to live permanently in the United States. Individuals with immigrant status can pursue virtually any investment or business objective. Obtaining permanent residency status as an immigrant is commonly referred to as obtaining a "green card."

The number of foreign persons who can obtain immigrant status in any year is limited and there are preferences that favor relatives of U.S. citizens or individuals who possess unique skills that are difficult to find among U.S. workers.

The majority of foreign persons who enter the United States do so through nonimmigrant visas. A nonimmigrant visa allows a foreign person to reside temporarily in the United States for a given period of time and, depending upon the particular visa classification, to engage in specific permitted activities.

Investor Visas Under the Immigration Act of 1990

The 1990 Immigration Act created an employment-based investor immigrant classification (EB-5). Individuals who invest $1 million in capital in a new commercial enterprise or troubled business and who employ 10 or more persons in the United States can receive permanent residence status in the United States. The amount of investment required is adjusted downward if the investment is made in certain targeted high unemployment areas. Congress has authorized 10,000 immigrant visas under this classification with no fewer than 3,000 set aside for investors in the targeted areas. Foreign nationals can apply inadvertently for an EB-5 or reinvest in a Regional Center. These immigrant visa petitions are closely scrutinized.

Type B-1 (Business Visitor) Visa

The B-1 "Business Visitor" visa is designed for foreign persons whose presence in the United States will be limited to a few months to conduct business. Activities associated with business include international trade or commerce; however, the foreign person may not conduct work for hire, accrue most profits in the United States, perform services that are part of the United States labor market or actively manage an investment or business while in the United States. The normal rules

for B-1 activities have been revised for Mexican and Canadian businesspersons under terms of the North American Free Trade Agreement (NAFTA). Under NAFTA, Mexican and Canadian businesspersons have more liberal terms of entry with regard to some B-1 activities than do nationals of other countries.

REQUIREMENTS FOR A B-1 VISA

Among the general requirements for the issuance and maintenance of a B-1 visa are:

- the foreign person must intend to depart the United States at the expiration of the term of the visa;
- the foreign person must possess sufficient financial resources to travel to and depart from the United States; and
- the foreign person must maintain a foreign residence throughout the person's stay in the United States.

PROCEDURE FOR OBTAINING A B-1 VISA

In General

An application for a B-1 visa is made at a U.S. consulate abroad. An applicant is not required to file any paperwork with the U.S. Citizenship and Immigration Services (CIS), the agency that administers the immigration laws.

United States Visa Waiver Program

The United States Visa Waiver Program (VWP) is an expedited method for nationals of certain countries to visit the United States for up to 90 days to engage in activities permitted under a B-1 visa. If a foreign national is from a country that is on the approved visa waiver list, the foreign national can apply for the visa waiver online and avoid having to apply for a B-1 visitation visa.

Type E (Treaty Trader/Investor) Visa

The E "Treaty Trader" or "Treaty Investor" visa category is intended for foreign persons seeking entry into the United States to oversee or work in an enterprise engaged in substantial trade with the United States or to engage in activities relating to a substantial investment in the United States. Separate requirements govern the issuance of E-1 and E-2 visas.

BASIC REQUIREMENTS FOR AN E-1 (TREATY TRADER) VISA

The following basic requirements must be satisfied to obtain an E-1 visa:

- a treaty containing treaty-trader provisions must exist between the United States and the country in which the foreign person has citizenship. A current list of countries with which the United States has outstanding treaties with such provisions can be found in the Visa Bulletin of the U.S. Department of State, Bureau of Consular Affairs;
- at least 50 percent of the sponsoring U.S. employer must be owned by nationals of the treaty country;
- the E-1 applicant must have the same nationality as the treaty enterprise;

- the foreign person or the person's employer must be engaged in ongoing "trade," which, for this purpose, is the exchange, purchase or sale of goods, services or technology;
- the trade engaged in by the foreign person or the person's employer must be "substantial." At present, no minimum dollar amount is used in determining whether a specific amount of trade is substantial. Instead, the evaluation is made on the basis of such factors as the quantity of transactions and the volume, nature and duration of the trade;
- the trade must be "principally" between the United States and the treaty country; and
- the employee or principal must serve the company in a specified capacity: either managerial or involving "essential skills."

BASIC REQUIREMENTS FOR AN E-2 (TREATY INVESTOR) VISA

The following basic requirements must be satisfied to obtain an E-2 visa:

- a treaty containing treaty-investor provisions must exist between the United States and the country in which the foreign person has citizenship. A current list of countries with which the United States has treaties with such provisions is in the Visa Bulletin, U.S. Department of State, Bureau of Consular Affairs; at least 50 percent of the sponsoring U.S. employer must be owned by nationals of the treaty country;

- the E-2 applicant must have the same nationality as the treaty enterprise;
- the foreign person or the person's employer must be engaged in an "active" investment in the United States. To be characterized as active, the business underlying the investment must represent a real operating enterprise productive of some service or commodity. For example, an investment in a manufacturing facility would be an active investment, but an investment in undeveloped land for its potential appreciation in value would not be an active investment;
- the investment of the foreign person or the person's employer must be "substantial." An investment is substantial if the investor personally has at-risk sufficient funds to establish or develop the enterprise. Although no particular dollar amount is required, in a small to medium-sized business, the investor should have personally at risk approximately one-half of the funds necessary to commence operations. The amount at risk can be proportionately smaller for larger businesses;
- the business invested in by the foreign person or the person's employer must either employ U.S. workers

or be capable of creating job opportunities for U.S. workers; and

- the foreign person must fulfill an essential role in the enterprise. If the foreign person is not an employee, the person must own a majority ownership interest (i.e., at least 50 percent of the enterprise). If the foreign person is an employee, the person must serve in a managerial capacity or in a technical capacity for the U.S. enterprise or must supervise persons in technical positions with respect to the U.S. enterprise.

PROCEDURE FOR OBTAINING AN E VISA

An application for an E visa is usually made at a U.S. consulate abroad. The basic procedure is to submit an official application (form DS-160) with a passport and extensive supporting documentation reflecting the applicant's qualifications under the desired E visa category. It is also possible to apply for an E visa through CIS when the person is already in this country in some other nonimmigrant category.

Type H-1 B (Distinguished Merit and Ability) Visa

The H-1 B "Distinguished Merit and Ability" visa is used by companies to temporarily employ foreign persons who qualify as persons in "specialty occupations." An H-1 B visa is usually granted for periods of up to three years. When need is demonstrated, an extension of up to an additional three years, for a total maximum stay of six years, is possible. Note that there are a limited number of H-1B visas each fiscal year and often these numbers are quickly exhausted.

BASIC REQUIREMENTS FOR AN H-1 B VISA

The following two basic requirements must be satisfied to obtain an H-1 B visa:

- the foreign person must be engaged in a "specialty occupation." Specialty occupations are defined as those requiring theoretical and practical application of a body of highly specialized knowledge or attainment of a bachelor's or higher degree in a specific field; and
- the position to be filled in the United States must be of sufficient complexity that it requires a person with specialized knowledge.

PROCEDURE FOR OBTAINING AN H-1 B VISA

An employer seeking to employ a foreign person in a specialty occupation in Arizona must file form I-129 and its H supplement. The form must be accompanied by documentation demonstrating the applicant's qualifications for the H-1 B visa and proof of filing a Labor Condition Attestation in which the employer states: (1) it will pay the H-1B employee the prevailing (average) wage for that position in a particular geographic area; (2) it will provide working conditions that will not adversely affect other similarly employed workers; (3) there is no strike or lockout at the place of business; and (4) notice of the Department of Labor filing has been given to the bargaining representative or has been posted at the business.

Type L-1 (Intra-Company Transferee) Visa

The L-1 "Intra-Company Transferee" visa enables companies with operations abroad to transfer corporate executives and managers, or persons with specialized knowledge, temporarily to the United States to assist in local operations. The L-1 visa has no annual quota and the beneficiary may remain in the United States for a period of five to seven years. The spouse and children of the L-1 visa holder are admitted as L-2s and they are permitted to work.

REQUIREMENTS FOR AN L-1 VISA

The following requirements must be satisfied to obtain an L-1 visa:

- foreign person sought to be transferred to the United States must have been employed abroad in an executive or managerial capacity or in a capacity involving "specialized knowledge" on a full-time basis for at least one of the last three years preceding the visa application. Specialized knowledge refers to particular knowledge of the employer's product, service and equipment and to their application in international markets;
- the U.S. company that will employ the recipient of the L-1 visa must be the same company for whom the employee has worked abroad, or is a parent, subsidiary or affiliate of that company;

- both the U.S. company and its parent, subsidiary or affiliate abroad, must be engaged in active business operations throughout the period the employee remains in the United States. The mere presence of an agent or office either in the United States or abroad is not sufficient; and
- an export license must be obtained when controlled technology is involved.

PROCEDURE FOR OBTAINING AN L-1 VISA

An employer seeking to obtain an L-1 visa on behalf of an employee in connection with employment in Arizona must file form I-129 and its L supplement with the CIS. Note: Canadians may file for an L-1 visa at the border. The form should include supporting documentation demonstrating the applicant's qualifications for the L-1 visa. If the U.S. operation is a start-up, the employer must provide additional information, including evidence that a physical location for the operation has been secured, evidence of preliminary contracts demonstrating that the new operation has customers and evidence that the foreign employer or affiliate has invested sufficient funds to pay the wages of the transferred employees.

Other Visas

A number of other visas may be available in connection with entry into the United States by foreign persons contemplating investment or business activities. Information regarding these

additional visa classifications can be obtained by contacting the CIS, a U.S. consulate abroad or legal counsel with experience in the field of immigration law.

The Legal Arizona Workers Act

Arizona's Legal Arizona Workers Act is one of the toughest employer sanction laws in the United States. Despite numerous court challenges, the Supreme Court of the United States upheld the law as constitutional and it therefore remains in full force and effect. As such, employers are advised to take the requisite measures to comply with its provisions. Those steps should include not only an internal audit of the company's I-9s and registering for E-Verify, but also ensuring that employers have the infrastructure and culture in place to take full advantage of any and all good faith arguments that may otherwise negate the intent or knowledge to hire undocumented workers.

The new law applies to nearly every employer who does business in Arizona. It covers any employer that (1) transacts business in Arizona; (2) has a license issued by an Arizona agency; and (3) employs one or more individuals who perform employment services in Arizona. Violation of the law carries severe penalties. If a company is found to have knowingly violated the state law, the employer must terminate the worker, sign an affidavit that it will not knowingly or intentionally hire unauthorized workers and file quarterly reports for a three-year probationary period. A court may also suspend the employer's business license for not more than 10 business days. The “intentional” hiring of an unauthorized worker extends the probation period from three years to five years and requires mandatory suspension of the employer’s business license for at least 10 days. Repeat offenders face permanent revocation of their business license.

Keep in mind that the Legal Arizona Workers Act does not govern the admission or work authorization of foreign nationals. Instead, this law is intended to curb the presence of unauthorized workers in Arizona by imposing certain sanctions on employers. The intent to sanction employers for intentionally and/or knowingly hiring unauthorized workers can also be found in federal statutes such as the Immigration and Nationality Act and Immigration Reform and Control Act of 1986. Employers should know, therefore, that while Arizona’s law provides limited sanctions associated with business licenses, federal laws may impose severe civil and criminal penalties. Indeed, worksite enforcement by the Immigration and Customs Enforcement has increased dramatically, especially in Arizona and will probably continue to intensify in the coming years.

Antitrust

Michael T. Liburdi and Dan W. Goldfine

United States antitrust laws have evolved in recent decades to reflect real world economics and become more favorable to business. The principal antitrust laws are the federal Sherman and Clayton Acts. The Arizona Legislature has enacted the state’s own Arizona Antitrust Act that shares many features of the federal law. Antitrust violations include illegal agreements among competitors (horizontal restraints), illegal agreements between manufacturers and dealers (vertical restraints) and attempts to monopolize. Certain agreements are always (*per se*) illegal; others are tested by the “rule of reason” as to whether they unreasonably restrain trade. Penalties for antitrust violations can be severe.

Background

The Sherman and Clayton Acts were enacted in the late 1800s, during a period of public concern about the aggregation of economic power. Interpretation of that legislation for the first 70 years reflected this concern. Beginning in the 1970s, there was a sea change with respect to how courts and government enforcement agencies interpret the antitrust laws. More recent interpretations of the antitrust laws have focused, as a result of the “Chicago School” of economics, on economic or allocative efficiency rather than the mere aggregation of economic power. The Chicago School argues that only those trade practices that harm consumer welfare through reductions of output or supracompetitive pricing should be prohibited. The practical result is that the antitrust laws are increasingly favorable toward business and the unrestricted operation of the free market. Many restrictive former antitrust rules have been abandoned.

The "Post-Chicago School" of economics has recently emerged as an alternative approach to antitrust interpretation. The practical result, however, is that some decisions have been characterized as "antibusiness."

Enforcement of federal laws is the responsibility of the United States Department of Justice and the Federal Trade Commission. The Arizona Attorney General is responsible for enforcing the Arizona Antitrust Act. Private plaintiffs can also bring civil suits under both federal and state antitrust laws. Only violations of federal antitrust laws, in fact, only violations of Section 1 of the Sherman Act, which prohibits certain types of horizontal agreements, are subject to criminal penalties, including jail time.

Penalties for civil violations of the antitrust laws can be significant. Large monetary fines can be imposed under federal and state law and criminal sanctions under federal law. In civil suits, private parties may recover three times the actual damages suffered ("treble damages"), plus attorneys' fees.

Horizontal Restraints—Agreements Among Competitors

IN GENERAL

Not all agreements among competitors (horizontal agreements) are illegal under the antitrust laws. The law prohibits only those agreements that "unreasonably" restrain trade within the meaning of Section 1 of the Sherman Act or its Arizona counterpart.

Some horizontal agreements are so plainly anticompetitive, however, that no proof of their unreasonableness is necessary. These are *per se* illegal. No inquiry is made as to the precise harm a *per se* illegal agreement may cause and no business justification is a defense.

The legality of other horizontal agreements is analyzed under the "rule of reason" to determine whether, on balance, the agreement constitutes an unreasonable restraint of trade. Under the rule of reason, all relevant circumstances are weighed, both the positive effects (procompetitive benefits) and negative effects (anticompetitive effects) on competition. As a practical matter, the burden of establishing the anticompetitive effects (e.g., the potential to raise prices above competitive levels) is typically impossible to meet, therefore, most agreements that are subject to the rule of reason analysis are legal.

HORIZONTAL AGREEMENTS AFFECTING PRICE

Agreements among competitors that affect price present the greatest risks. Section 1 of the Sherman Act prohibits not only agreements among competitors that directly raise prices, but also combinations formed for the purpose and with the effect of raising, depressing, fixing, pegging or stabilizing prices. An agreement between competitors setting minimum or maximum prices is illegal *per se*. Agreements among competitors that indirectly affect price, such as agreements to restrict price advertising or to prohibit premiums or discounts, are also illegal *per se*.

TERRITORIAL DIVISIONS AND CUSTOMER ALLOCATIONS

It is illegal for competitors to divide markets among themselves by agreeing not to compete with each other in certain geographical areas or not to compete for certain customers. Such agreements between competitors to divide markets, whether by territorial division or customer allocation, are illegal *per se*.

COVENANTS NOT TO COMPETE

A covenant is often included in an agreement for sale of a business that prohibits the seller from later competing with the purchaser of the business in a particular area for a particular time. Even though most agreements among competitors not to compete in certain geographical areas are illegal *per se*, a covenant not to compete that is an element of a sale of a business is evaluated under the "rule of reason." The covenant not to

compete in the context of the sale of a business is regarded as part of a larger agreement that has a legitimate objective as its principal goal and the public interest in facilitating a transfer of a business is deemed to justify the rule of reason approach. If the covenant is not unreasonably broad in geographical scope and is not unreasonably long in duration, the covenant is legal. Indeed, in Arizona, a properly structured covenant not to compete in terms of reasonable time and geographic scope will likely be legal.

GROUP BOYCOTTS

A group boycott is an agreement among competitors to refuse to deal with another competitor or to refuse to deal with a supplier or customer. The objectives of such an agreement can be to force another party out of business or to compel the acceptance of some condition. A group boycott undertaken by a group of competitors with market power, which has the intent or effect of driving another competitor out of business, generally is illegal *per se*. Other group boycotts are tested under the rule of reason.

JOINT VENTURES

A joint venture is a partnership formed for a particular purpose, such as to perform research and development, or to produce and market a new product. The legality of joint ventures among competitors is usually determined under the rule of reason.

Many factors are considered under a rule of reason analysis of any joint venture to determine whether the anticompetitive effects of the venture are outweighed by competition-enhancing features. Among them are the size of the joint venturers, their share of their respective markets, the contributions of each party to the venture, the reasonableness of their relationship to the purposes of the venture and the likelihood that one or all of the parties would undertake a similar project in the absence of the joint venture. Other factors include the scope and duration of the venture, the nature of the functions transferred by the members of the joint venture to the joint venture itself, the efficiencies created through the formation and function of the joint venture, whether a pattern of joint ventures has emerged in the particular industry and whether the joint venture builds new productive capacity or utilizes existing capacity.

The principal factor is the magnitude of the venture. An "over-inclusive" venture is of concern because it reduces the number of potentially competing parties. Nevertheless, an extremely large venture may be justified if only a venture of that size could successfully achieve the objectives of the venture.

Joint venture status does not insulate otherwise impermissible behavior. Price fixing, illegal group boycotts and territorial or customer allocations are illegal *per se* even though engaged in by a joint venture.

Vertical Agreements—Restraints Between Manufacturers and Distributors or Retailers

Manufacturers or other producers may seek to enter into agreements with distributors and retailers of their products (vertical agreements). Very few vertical agreements are unlawful *per se*. All other vertical agreements are analyzed under the rule of reason and are generally regarded as legal. Generally speaking, under federal law, a plaintiff can only maintain an antitrust action against a vertical participant that has directly sold the goods or services to the plaintiff. Arizona courts have adopted a different approach and permits so-called "indirect purchasers standing" to sue.

EXCLUSIVE DEALING ARRANGEMENTS

An agreement by two businesses to deal exclusively with one another is a common form of vertical agreement; one that often arises in a distributorship arrangement because an exclusive distributorship typically provides a distributor with the right to serve as the exclusive outlet for a manufacturer. Agreements of this kind are judged under the rule of reason. Such exclusivity provisions are generally upheld as not violating the antitrust laws, as long as they do not restrain an undue share of either the manufacturer's or the distributor's market or are one year or shorter in duration.

TERRITORIAL AND CUSTOMER RESTRICTIONS

Territorial and customer restrictions may be sought by a manufacturer. For example, a manufacturer may limit a dealer's sale of the manufacturer's product to a particular geographical area and time, prohibit other dealers from selling the manufacturer's product in the same area or restrict sales by dealers to certain customers. In contrast to horizontal agreements among competitors involving territorial divisions and customer allocations that are illegal *per se*, vertical agreements of this kind between manufacturers and distributors are tested under the rule of reason. The justification is that although vertical agreements limit competition among dealers in the same brand, they may enhance competition among dealers of different brands. Current antitrust scholarship views nearly all vertical territorial and customer restrictions as procompetitive or competitively neutral and therefore legal under the rule of reason.

RESALE PRICE MAINTENANCE

It is illegal for a manufacturer to fix the minimum prices at which its products can be resold by wholesalers and retailers ("resale price maintenance"). Resale price maintenance agreements generally are held to be *per se* unlawful, although antitrust commentators frequently question that rule. The general rule of *per se* illegality does not apply to a manufacturer that issues "suggested" retail prices, provided that the manufacturer does not compel a retailer to follow the suggestions. Likewise, a manufacturer can terminate a distributor that is discounting more than the manufacturer wishes, although antitrust counseling should be obtained before any actions directed at termination are commenced.

Unlike minimum vertical price fixing, maximum vertical price fixing is subject only to the rule of reason test.

Monopolization and Attempts To Monopolize

MONOPOLIZATION DEFINED

Section 2 of the federal Sherman Act and the Arizona Antitrust Act prohibit monopolization and attempted monopolization.

Monopolization is the possession of "monopoly power," plus some conduct that demonstrates intent to exercise or maintain the monopoly power. Monopoly power refers to the power to control prices, which exists if a business can establish appreciably higher prices than those charged by competitors for equivalent goods without a substantial loss of business to competitors.

A business that does not have monopoly power can nevertheless be liable for attempted monopolization if it has sufficient market power such that there is a "dangerous probability" that the business will succeed in attaining monopoly power. Attempted monopolization requires a specific intent to monopolize.

Proof of monopolization, or of attempt to monopolize, is a two-step process. First, it must be demonstrated that the alleged offender has monopoly power in the relevant market or a dangerous probability of attaining market power. Second, there must be proof of some type of monopolistic conduct showing a willful intent to maintain or acquire that power, respectively.

DETERMINATION OF RELEVANT MARKET

The first step in a Section 2 Sherman Act case is to determine the relevant market in which the alleged monopoly power exists. The relevant market is the area of effective competition in which the alleged monopolist operates. This market has two separate dimensions: the products included in the market and the geographic area covered.

Relevant Product Market

The relevant products in the market include all goods or services that are reasonably interchangeable with the products that the alleged offender produces. Some of the factors that courts consider in determining whether products are "reasonably interchangeable," and therefore in the same market, are whether the products have the same or similar characteristics or uses, whether the products are sold to similar customers and whether the products are distributed and sold by the same kinds of distributors or dealers. Products do not have to be identical to be in the same product market, but they must meaningfully compete with each other. In other words, assuming a hypothet-

ical monopolist in products A and B, the question is whether if, in response to that monopolist raising the prices of A and B, a "significant but nontransitory amount," usually 5 percent to 10 percent, the monopolist loses enough sales to product C to make the price increase unprofitable. If so, product C is in the same relevant product market as products A and B.

Relevant Geographic Market

The relevant geographic market is the geographic area in which the sellers of a relevant product or service operate, the area in which the alleged monopolist faces competition from suppliers of competing products and to which purchasers can practically turn for such products or services. In essence, one applies the same hypothetical monopolist "test" to sellers in the broader geographic market as is done with the relevant product market. The relevant geographic area can be as large as the entire world or as small as a city neighborhood.

PROOF OF MARKET MONOPOLY POWER

Once the relevant market is determined, the next inquiry is whether the alleged offender actually has market power in the relevant market. One way to demonstrate market power is direct proof of the alleged offender's actual control over prices by charging supracompetitive prices. But direct evidence is often lacking. In the absence of direct proof, the courts focus on two other considerations: market share statistics and barriers to entry.

Market share statistics are often used to determine market power. Market share statistics show the percentage of the market that the alleged monopolist controls. If the market share is sufficiently large (e.g., 50 percent or more), a court will generally conclude that the alleged offender has market power.

Barriers to entry are also critical. It is often said that even a 100 percent monopolist cannot exercise market power in the absence of entry barriers. Barriers to entry are obstacles that a new business would face if it tried to enter the same market. Barriers to entry may exist when significant capital would be necessary to fund the new business or when the new business would require specialized training or technology.

PROOF OF MONOPOLY CONDUCT

An alleged offender's monopoly power, by itself, does not constitute unlawful monopolization. The monopoly power must be coupled with conduct that is harmful or will result in harm to consumers. This conduct is referred to as anticompetitive conduct. The courts have not fully defined what constitutes anticompetitive conduct, but two of the more common types are "predatory pricing" of products and "refusals to deal." The focus is harm to consumers and not harm to competitors, although the harm to consumers can result from harm to competitors.

Predatory Pricing

Predatory pricing (i.e., pricing below some measure of costs) occurs when a firm prices its products so low that the

intended effect is to discipline or eliminate competition and thereby allow the firm to charge higher prices at a later time. The obvious problem is to distinguish prices that constitute legitimate competitive behavior from prices that are predatory. The courts do not want to discourage low prices if the result is more competition. Courts are skeptical of predatory pricing claims and usually will not uphold them unless it is clearly shown that the alleged offender can both eliminate competition and preclude others from reentering the market once the offender is able to charge monopoly rents and recoup any profit loss during the period of predatory pricing.

Refusals to Deal

It is often difficult to distinguish between legitimate business practices designed to increase market share and practices that are exclusionary or predatory, especially regarding refusals to deal with competitors. Many believe that a business has an absolute right to choose the parties with whom it deals, but this is not always true. Historically, a monopolist's refusal to deal with a business or a competitor is predatory and illegal if the refusal is intended to eliminate competition. Recently, however, the U.S. Supreme Court has announced some movement away from this principle, suggesting that even a monopolist can refuse to deal with competitors. (On the other hand, the European Union has made it clear that it will view a refusal to deal by a monopolist as illegal.)

Price Discrimination Under the Robinson-Patman Act

The Robinson-Patman Act prohibits a seller engaged in commerce from discriminating in price between two or more buyers. A violation of the Robinson-Patman Act requires that there be at least two sales, one of which is interstate in character and that there be actual discrimination in sales of goods. In other words, there must be at least two sales to different customers at different prices. A sale, plus only an offer to sell at a higher price, does not constitute illegal price discrimination. The Robinson-Patman Act also makes it unlawful for a buyer knowingly to induce or receive a discriminatory price, but, in such case, a buyer cannot be found liable unless the seller is also liable.

The Robinson-Patman Act is riddled with exceptions and defenses. Advance antitrust counseling can often allow a company to implement a desired discount, although not always in the precise form the company initially desires.

EXCEPTIONS

For example, the prohibition against price discrimination in the Robinson-Patman Act does not prohibit "functional discounts" price reductions granted by sellers to purchasers based on the position of the purchaser in the distribution chain. An example is a favorable price charged by a manufacturer to a wholesaler, which is less than the price the manufacturer would charge a retailer or a consumer, provided that the functional

discount offered to the one wholesaler is available to all other wholesalers.

There is also an exemption from the Robinson-Patman Act for "delivered pricing" that reflects the costs of transportation. A manufacturer that quotes one price for products available at the factory may quote a higher delivered price for products delivered elsewhere. Although some delivered pricing has been found illegal as nothing more than a subterfuge to diminish price competition, a legitimate delivered pricing structure does not violate the Robinson-Patman Act.

DEFENSES

There are a number of defenses to a claim of price discrimination. Where a seller acts "in good faith to meet an equally low price of a competitor," there is no illegal price discrimination. It also is not a Robinson-Patman Act violation if the price differential is made in response to changing conditions affecting the market or marketability of the product. This defense permits, for example, price cuts on obsolete or seasonal goods. Another defense authorizes price differentials attributable to differences in the cost of manufacture or sale, such as a quantity discount attributable to lower costs achieved by economics of scale.

MERGERS

Section 7 of the federal Clayton Act and Arizona's antitrust laws prohibit a merger if the effect of the merger may be to lessen competition. A merger may be by way of consolidation, stock acquisition or asset acquisition. Mergers are typically challenged by the federal enforcement agencies, the Antitrust Division of the U.S. Department of Justice and the Federal Trade Commission. The key question is whether the proposed transaction will result in increased market concentration in a manner that allows for the exercise of market power.

Market Power

As in monopolization cases, the starting point of merger analysis is to define the appropriate product and geographic markets. Market definition often plays a major role in merger litigation. If the product or geographical market is narrowly defined, the competitive impact of the merger will be more pronounced than in a broader market. Generally, a market is determined by the "interchangeability" of use. Thus, for example, if customers can readily turn to other products or to other geographic areas, those products and geographic areas are within the relevant market. After the relevant market is defined, the proposed transaction's effect on overall concentration of the market is evaluated. If the market has low-market concentration, meaning many (i.e., more than five rather equally matched competitors), the merger likely will pose no antitrust concerns. If four or fewer will have roughly 40 percent or more market share, the enforcement agencies will give the transaction greater scrutiny. If so, the first thing that the enforcement agencies will evaluate will be whether there exists the potential for entry by either additional capacity by

current players or by new capacity from entirely new entrants and whether that new entry could defeat the exercise of market power (i.e., make any "significant but nontransitory" price increase unprofitable). If not, the enforcement agencies will evaluate whether, either by coordinated effect or by unilateral effect, the proposed merger will have anticompetitive effects. The above analysis is quite stringent and very few mergers are successfully challenged.

Compliance with The Hart-Scott-Rodino Antitrust Improvements Act

The Hart-Scott-Rodino Antitrust Improvements Act requires notice to the Department of Justice and the Federal Trade Commission at least 30 days before certain mergers worth $50 million or more can be consummated. After receipt of the prescribed premerger notification, the Department of Justice or Federal Trade Commission may request additional information. This is called a second request. Second requests are often quite onerous and frequently cause the parties to abandon their proposed transaction. If additional information is requested, the merger cannot be consummated until 20 days after the Commission's receipt of all of the additional information. There is no similar notice requirement under Arizona's antitrust laws.

Employment

Stephanie R. Leach

Employers in the United States historically have had significant discretion, as to employment matters, including hiring, discharge and working conditions. In recent years, the workplace has become increasingly regulated and the discretion of employers has been limited by federal and state legislation. Arizona employers have been impacted by this legislation and it is increasingly important for employers to be aware of recent changes.

General Regulation of Employment

Legislation in recent years has increased regulation of the workplace. New legislation addresses equal rights for employees in a variety of protected classes: protected work leave rights for certain employees, wage and hour laws, and other issues. The following provides a brief overview of some of the regulations impacting Arizona employers.

Federal Legislation

Title VII of the U.S. Civil Rights Act of 1964, as amended in 1991 (Title VII)

Title VII prohibits discrimination in employment on the basis of race, color, religion, sex or national origin. The prohibition applies to all elements of the employer-employee relationship, including hiring, firing, wages, promotion and transfer. Title VII applies to every employer that has 15 or more employees engaged in any business affecting interstate commerce.

Title VII is enforced by the federal Equal Employment Opportunity Commission (EEOC). Employees or job applicants can file charges of discrimination with the EEOC. The EEOC itself may also file charges against an employer on behalf of employees or job applicants. Following an investigation and attempts at resolution, the EEOC, employees or job applicants may file a suit against the employer. Remedies available include compelled employment, reinstatement, back pay, compensatory damages, punitive damages and equitable relief and attorneys' fees. Employees are entitled to a jury trial.

Age Discrimination in Employment Act (ADEA)

The ADEA protects individuals who are at least 40 years of age from employer discrimination based on age with respect to hiring, firing, wages, promotions, transfers and other terms, conditions or privileges of employment. The ADEA applies to any employer engaged in business affecting interstate commerce that has 20 or more employees. An exception permits age discrimination when age is a "bona fide occupational qualification" reasonably necessary to the normal operation of the employer's business. Selection of a younger employee over an older one is permitted if reasonably based on factors other than age.

Age discrimination claims must be filed with the EEOC. Thereafter, the EEOC, employees or job applicants can file suit against the employer. Remedies available include compelled employment, reinstatement, back pay awards, liquidated damages and attorneys' fees.

The Rehabilitation Act

The Rehabilitation Act prohibits employers from discriminating against "qualified handicapped persons" and also requires employers to take affirmative steps to provide employment opportunities to handicapped persons. Employers subject to the Rehabilitation Act are federal contractors, subcontractors and recipients of federal financial assistance.

A "qualified handicapped person" is a handicapped person who can perform a particular job. The employer must make reasonable accommodation to the person's handicap, unless doing so would cause the employer undue hardship. A "handicapped person" is defined as any person who has a physical or mental impairment that substantially limits one or more

major life activities, who has a history of such impairment or who is perceived as having such an impairment. Common examples of disabilities include blindness, deafness, heart disease, epilepsy; physical disabilities like being confined to a wheelchair or requiring the assistance of canes or walkers; learning disabilities and certain kinds of mental illnesses. Whether an accommodation is reasonable in a particular circumstance depends upon a number of factors, including the size and financial ability of the employer, the type of business, the number of persons to be accommodated and the nature and cost of the accommodation required.

The U.S. Department of Labor enforces the Rehabilitation Act. Violations can result in cancellation of existing contracts with the U.S. government and disqualification from future contracts.

Americans with Disabilities Act of 1990 (ADA)

The ADA prohibits discrimination against "qualified individuals with disabilities." The prohibition extends to hiring, firing, wages, promotions, transfers and all other terms, conditions or privileges of employment. A "qualified individual with a disability" is one who meets the definition of a "qualified handicapped person" under the Rehabilitation Act. The ADA applies to an employer engaged in a business affecting interstate commerce that has 15 or more employees. The ADA is enforced by the EEOC. Rights of action and remedies under the ADA are similar to the remedies under Title VII described above.

The ADA was amended in 2008 by the Amendments Act and is now known as the ADAAA. One of the central purposes of the Amendments Act is to expand the definition of disability, which Congress criticized as having been too narrowly construed by the Supreme Court. The practical effect of the Amendments Act and interpreting regulations is that more individuals will qualify as disabled and will be entitled to reasonable accommodations at the workplace. Moreover, the broad coverage of the Amendments Act increases the number of employees protected under the ADA, thereby increasing the likelihood of litigation if companies are not complying with the statutory requirements.

The main point for companies to keep in mind is that the primary focus of the ADAAA is on whether discrimination occurred—not whether an individual is disabled. The practical effect is that employers should, in almost all instances, move right into the interactive process as the majority of employees will be able to establish an actual disability or record of a disability. Moreover, the regulations reiterate that an individualized assessment is required to determine whether an impairment substantially limits a major life activity. Accordingly, it is now even more important that human resources representatives sit down with employees and discuss why they may be struggling at work and begin the interactive process to determine if a reasonable accommodation might help, assuming the employee

is disabled. Companies should ensure that these conversations, and all efforts to provide reasonable accommodations, are documented in writing and maintained with their employees' confidential medical files.

Equal Pay Act (Pay Act)

The Pay Act prohibits discrimination in employee wages on the basis of sex. It requires employers to pay equal wages for work at a single site of employment requiring equal skill, effort and responsibility, regardless of sex. Differences in wage rates are permissible if attributable to operation of a seniority system, a merit system, a system that measures earnings by the quantity or quality of production or any other system based on factors other than sex. The Pay Act applies to any employer with two or more employees. The Pay Act is administered by the EEOC. Either the EEOC or the employee may file a lawsuit to enforce the provisions of the Pay Act. Remedies include back pay awards, damages and attorneys' fees.

Section 1981 of the Civil Rights Act of 1870 (Section 1981)

Section 1981 prohibits discrimination based on race or membership in an ethnic group. Any employer (regardless of size) engaged in business affecting interstate commerce is subject to Section 1981. Unlike Title VII, a job applicant or employee is not required to file a charge with the EEOC before suing the employer for a violation of the statute. Significantly, courts have found that Section 1981 applies to at-will employees. Remedies under Section 1981 include requiring employment, back pay, compensatory damages, punitive damages and attorneys' fees.

Genetic Information Nondiscrimination Act (GINA)

The Genetic Information Nondiscrimination Act of 2008 (GINA) was signed into law by President Bush on May 21, 2008. The new law prohibits genetic discrimination in two areas—employment and health insurance. Title II of GINA applies to employers, labor organizations and joint labor-management committees and generally prohibits employment discrimination based on the genetic information of an employee or the employee's family members.

GINA makes it unlawful for an employer to fail or refuse to hire, or to discharge, an employee, or otherwise discriminate against an employee with respect to compensation, terms, conditions or privileges of employment because of the employee's genetic information.

GINA also makes it unlawful for an employer to request, require or purchase genetic information with respect to an employee or an employee's family member, with six limited exceptions.

Regardless of whether an exception applies, GINA makes clear that genetic information, once acquired, may not be used to discriminate against an individual with respect to employment or benefits or disclosed in violation of GINA's confidentiality requirements. If an employer acquires genetic information, such information must be treated and main-

tained as part of the employee's confidential medical records. Such information must be maintained on separate forms and in separate medical files and must be treated as a confidential medical record. This is consistent with the requirements under the Americans with Disabilities Act (ADA) regarding the maintenance and treatment of medical information.

The preceding overview covers only a few of the most fundamental components of GINA's new regulations and is not an exhaustive list of all obligations. Employers would be wise to carefully review the regulations, which may be obtained through the EEOC website. Legal counsel can assist if there are questions about how to interpret and implement the complex provisions.

State Legislation

Arizona Civil Rights Act (Arizona Act)

The Arizona Act mirrors the federal civil rights laws and applies to Arizona employers with 15 or more employees. A claimant may pursue identical claims under Title VII of the U.S. Civil Rights Act and the Arizona Act simultaneously. The Act's prohibition against sexual harassment applies to employers with one or more employees. The Arizona Act is administered by the Civil Rights Division of the office of the Arizona Attorney General.

Federal Legislation

Fair Labor Standards Act (FLSA)

The FLSA establishes minimum wage, overtime pay, record keeping and child labor standards affecting full-time and part-time workers in the private sector and in the federal, state and local government. Virtually all employers are subject to the FLSA. Under the FLSA, employers must pay employees not less than the prescribed minimum wage. The minimum wage is currently $7.65 per hour. Generally, employers and employees may not make agreements to pay and receive less than the FLSA standard.

Under the overtime provisions of the FLSA, most employees must be paid 1½ times their regular rate of pay for all hours worked in excess of 40 hours per week. There are exceptions to the overtime standards for certain employees, including executive, administrative, professional, certain computer personnel, outside sales employees and certain highly compensated employees.

The FLSA is administered and enforced by the Wage-Hour Division of the U.S. Department of Labor. The Labor Department may bring an action against an employer to compel compliance with the FLSA, or employees can sue for unpaid wages, liquidated damages, injunctive relief and attorneys' fees.

Davis-Bacon Act

The Davis-Bacon Act requires employers that contract with the federal government to pay their employees a special minimum wage (i.e., the "prevailing wage" rate for corresponding classes of employees employed on projects of a similar character in the area in which the contracted work is to be performed). The Davis-Bacon Act is enforced by the Labor Department. Failure to pay the required "prevailing wage" can result in termination of the underlying contract and back pay obligations. If the contract is canceled and the work is completed by another contractor, the employer may be liable for any excess costs incurred by the government.

Walsh-Healy Act

The Walsh-Healy Act mandates a special "prevailing minimum" wage, which must be paid to employees of employers that supply goods or materials to the U.S. government. Enforcement and sanctions are similar to those applicable under the Davis-Bacon Act.

Family and Medical Leave Act of 1993 (FMLA)

The FMLA applies to workers who have been employed at least 12 months when the employee works for an employer employing at least 50 people (either at one location or separate worksites within a 75-mile radius). It entitles eligible employees to 12 weeks of unpaid leave during a 12-month period: (1) to care for a newly born or adopted child, (2) due to the employee's serious health condition, (3) to care for a spouse, child or parent with a serious health condition, (4) when a qualifying exigency arising out of the fact that the employee's spouse, son, daughter or parent is a covered military member on active duty, or has been notified of an impending call or order to active duty, in support of a contingency operation exists, or (5) to care for a covered service member with a serious injury or illness if the employee is the spouse, son, daughter, parent or next of kin of the service member. When the leave expires, the employee is entitled to be restored to the same or equivalent position with equivalent pay, benefits and other conditions of employment. The employer must continue the existing health insurance coverage during the leave, but may have the right to recover the premiums if the employee fails to return to work.

Covered military members only include individuals in the Reserves or retired members of the regular Armed Forces or Reserves. The following categories constitute a qualifying exigency: short-notice deployment, military events and related activities, childcare and school activities, financial and legal arrangements, counseling, rest and recuperation, post-deployment activities and additional activities that are agreed to by the employer and employee.

For leave due to the care of a covered service member, eligible employees are entitled to 26 work weeks of leave in a single 12-month period. This leave may be taken to care for a current member of the Armed Forces, including a member of the National Guard or Reserves, who has a serious injury or

illness incurred in the line of active duty for which he or she is undergoing medical treatment, recuperation, or therapy, or is otherwise in outpatient status or on the temporary disability retired list. Additionally, an employee may have multiple family members who qualify as the next of kin and they may take FMLA leave either consecutively or simultaneously.

The FMLA authorizes the Wage and Hour Division of the U.S. Department of Labor to investigate and resolve complaints. Employees may also file suit to enforce their rights under the law without filing an agency complaint. Employers who violate the FMLA or discriminate against employees exercising their rights under it are liable for lost compensation, compensatory damages, liquidated damages and attorneys' fees.

State Legislation

Arizona laws relating to wages and hours generally follow the federal laws governing these issues. In addition, an employer in Arizona is required to designate at least two days each month as fixed pay days, not more than 16 days apart. Discharged employees must be paid all wages due within three working days of the date of discharge or by the end of the regular pay period in which they are discharged, whichever is sooner. Employees who quit must be paid all wages due by the end of the regular pay period in which they terminate. Violations can result in employer liability of three times the amount of wages due.

Federal Legislation

The Occupational Safety and Health Act (OSHA)

OSHA imposes a duty on employers to provide employees with a safe and healthful place to work. OSHA requires all employers to furnish employees with a workplace free from recognized hazards causing, or likely to cause, death, serious physical harm or illness. OSHA is administered by the U.S. Labor Department, which, from time to time, issues mandatory safety standards. The Labor Department is authorized to conduct inspections of the workplace to determine compliance with these standards. Violations of OSHA can result in civil and criminal penalties. In some hazardous situations an employer can be ordered to shut down its operations.

Mine Safety and Health Act (MSHA)

MSHA prescribes standards governing working conditions of employees employed in mining operations. Sanctions for violations of MSHA are similar to the sanctions imposed under OSHA.

State Legislation

Arizona Occupational Safety and Health Act (Arizona OSHA)

Although Arizona OSHA is a federal law enforced by the U.S. Labor Department, Arizona OSHA provides that an individual state may assume responsibility for safety and health within its jurisdiction, provided that the state has a federally approved Arizona OSHA plan. Arizona has assumed responsibility for workplace safety in the state in accordance with standards set by the U.S. Labor Department.

OTHER SIGNIFICANT LAWS

Federal Legislation

Uniformed Services Employment and Reemployment Rights Act (USERRA)

USERRA requires employers to grant employees unpaid time off to fulfill temporary military obligations and also requires employers to rehire individuals who leave work to serve full time in the U.S. Uniformed Services for up to five years. The Act also prohibits discrimination against individuals who apply for, perform or have performed in a uniformed service. In addition to re-employment, covered employees have seniority rights, pension rights and the right to continued health insurance coverage.

Except in certain circumstances, employees must notify their employer in advance of the need for military leave and also must reapply for employment after their service. The time limits for reapplication vary depending on the length of service. Damages recoverable for violation of USERRA include re-employment, lost wages and benefits, liquidated double damages for "willful" violation and attorneys' fees.

Worker Adjustment Retraining and Notification Act of 1988 (WARN)

WARN requires employers of 100 or more employees to provide a 60-day advance notice to employees and to local and state officials before implementing a plant closing or a mass layoff. A "plant closing" is a shutdown of facilities at a single site that results in a loss of jobs for 50 or more employees for at least 30 days. A "mass layoff" is a reduction in the work force of 50 or more workers at a single site, provided that the reduction affects at least one-third of the total work force. A reduction in the work force of 500 or more at a single site is a mass layoff, regardless of the percentage of the work force affected. An employer is not obligated to provide advance notice of a mass layoff if the work force reductions will last for less than six months. A mass layoff that, contrary to initial expectations, extends beyond six months will violate WARN, unless the extension beyond six months is due to business circumstances not reasonably foreseeable and notice is given as soon as it becomes apparent that work force reductions will extend beyond the six-month period. Employers who violate the notice requirements of WARN are liable to each unnotified employee for back pay and benefits for a period of up to 60 days. Employers who violate the notice requirements may also be fined by local governmental units.

Employee Polygraph Act of 1988 (Polygraph Act)

The Polygraph Act prohibits employers from using polygraphs, "lie detectors" or similar devices to screen job applicants or current employees. The Act prohibits an employer from taking any adverse employment action based on the results of a polygraph test or based on an employee's refusal to submit to such a test. The Polygraph Act applies to any employer engaged in interstate commerce, but certain government employers are exempt. Employers may be fined up to $10,000 for each violation. Employees or prospective employees have the right to sue for damages, including reinstatement, back pay, benefits and attorneys' fees.

Immigration Reform and Control Act of 1986 (Immigration Act)

The Immigration Act prohibits employers from employing aliens who are not authorized to work in the United States. To be authorized to work, an alien must be a permanent resident, hold a non-immigrant work visa or possess other authorization from the government. The Immigration Act requires employers to verify the right of each employee to work in the United States and to obtain documents verifying their identity. Virtually all employers are subject to the Immigration Act. Violations of the Immigration Act are punishable by civil and criminal penalties. See also the "Immigration" chapter.

Drug-Free Workplace Act (Drug Act)

The Drug Act requires federal contractors and grantees to implement anti-drug programs. Employers are required to provide information to employees regarding the dangers of drug abuse in the workplace. If an employee is convicted under a criminal drug law for a violation that occurs at the workplace, the employer must notify U.S. authorities. The employer must also impose sanctions against the convicted employee or require the employee to satisfactorily complete a drug abuse or rehabilitation program. The Drug Act does not require drug testing of employees. Employers covered by the Drug Act are those that hold contracts with the U.S. government in excess of $100,000 and recipients of federal financial assistance. Violations of the Drug Act may result in the termination of existing federal contracts and disqualification from future contracts.

State Legislation

Workers' Compensation Act

As do most states, Arizona has workers' compensation insurance laws. The law requires employers to maintain insurance that provides specified benefits to employees for job-related accidents causing injury. The cost of the insurance is paid by employers through payment of premiums into a state fund or to a private insurance carrier. Some employers qualify to be self-insured. Employers are required to document and report workplace accidents resulting in injuries.

Arizona Economic Security Act (AESA)

AESA provides for the payment of benefits for specified periods to individuals who become unemployed through no fault of their own. The cost of the benefits is provided by employers who are required to make periodic contributions to a state unemployment insurance fund.

Arizona Drug Testing of Employees Act (Drug Testing Act)

While the Drug Testing Act neither requires nor prohibits employee drug screening, it grants legal protection to employers who conduct drug or alcohol impairment tests that conform to the requirements of the Act. Compliance protects the employer from liability for actions taken in good faith relating to positive test results, failure to test or detect a specific drug or condition or the elimination of a prevention or testing program.

To comply with the Drug Testing Act, the employer must publish and distribute a written statement to employees describing the drug and alcohol testing policy. The Act contains specific requirements and each policy must describe which employees are subject to testing, under what circumstances, the substances for which the employee is tested, the methods and procedures of testing and the consequences of positive test results or of failure to participate. The employer also must pay for employee testing, compensate the employee for his or her time, ensure that it is done in a reasonable and sanitary area, keep all communications relating to the testing confidential and provide employees with the opportunity, in a confidential setting, to explain a positive test.

1996 Arizona Employment Protection Act

This act strengthens the employment-at-will doctrine, allowing employers or employees to terminate the employment relationship at any time for any reason unless there is a written contract to the contrary. To overcome the presumption that the employment relationship is at-will, the contract must be signed by both the employee and the employer, or be set forth in an employee handbook that identifies itself as a contract or be signed by the party to be charged. Under this law, implied contracts are not enforceable.

The Act also limits "wrongful discharge" suits based on public policy. Before this law, courts allowed lawsuits alleging that a termination was "morally wrong," even if it did not violate a specific law. Now these claims are not allowed. The employee must base the claim on a specific Arizona statute or the state constitution. The Act also protects whistleblowers against termination in retaliation for a refusal to violate Arizona law.

The Act limits remedies in some areas. If the statute provides for a specific remedy, a successful plaintiff may receive no more than that remedy. An employee may not base a claim on the statute to obtain a greater award than the one contained in the statute itself, such as damages for emotional distress, humiliation or punitive damages in a discrimination action.

Such damages can, however, be awarded in a proper case. The Act also shortens the statute of limitations for wrongful termination. To pursue a claim, the employee must file suit within one year of termination.

Arizona Medical Marijuana Act (AMMA)

Arizona voters passed the AMMA in 2010. AMMA provides expansive workplace protections to employees who are users of medical marijuana. The most significant of AMMA's provisions impacting employers are found in A.R.S. § 36-2813. Those provisions protect applicants and employees who use medical marijuana from discrimination.

Regardless of the situation, if an employee is protected by AMMA's provisions, employers should use care in reviewing all the facts and issues before taking any action, just as they would any other incident where allegations of failure to operate equipment or perform job duties safely, otherwise, allegations of discrimination, harassment and retaliation could arise.

Other Matters

Arbitration

Many employers are adopting arbitration provisions into employment contracts. These provisions typically require employees to arbitrate any disagreements arising in the course of employment. Both employers and employees often prefer arbitration to litigation because of its lower cost and quicker resolution of claims. Courts also view arbitration agreements favorably. Courts have sent employment discrimination lawsuits based on Title VII, the ADEA and the ADA to arbitration when an arbitration clause required it. To have a valid arbitration agreement, there must be numerous provisions ensuring both procedural and substantive fairness to employees.

Unionization of Employees

The unionization of employees can affect an employer's discretion in employment matters. Briefly examined below are how a union is recognized, the effect of union recognition and the impact on unionization of Arizona's right-to-work law. Also discussed is the impact when a business is sold upon collective bargaining with unions and upon existing union collective bargaining agreements.

Union Recognition

Unions generally obtain recognition through one of two means: voluntary recognition by the employer or an election under the supervision of the National Labor Relations Board (NLRB). In a voluntary recognition, an employer generally agrees to a "card check" by an impartial third party to verify that a majority of employees wish to be union represented. A card check is an examination of union authorization cards or some other document signed and dated by employees indicating their desire to be represented by the union. This avenue to union recognition has become more common in recent years in certain industries.

More often, an employer will refuse to recognize the union and declare its doubt of the union's claim of majority status. The employer is entitled to place the burden on the union to prove the union's claim of support by an uncoerced majority of employees. In response, the union or an employee will file a petition with the NLRB seeking an NLRB-conducted election by secret ballot. The NLRB petition must be supported by a showing of interest of at least 30 percent of the employees. The showing of interest is usually made by union submission to the NLRB of authorization cards signed and dated by the requisite percentage of employees.

If there is a petition supported by the required showing of interest, the NLRB will schedule a hearing to address the NLRB's jurisdiction and the status of the parties. The principal issue at the hearing often is the determination of an appropriate "unit"—the grouping of all employees, or of some particular class of employees, who will be eligible to vote for or against the union. Those pre-election issues are resolved by the NLRB regional director in the region where the employer's facility is located.

The election is customarily held on the employer's property. The election ballot usually reads, "Do you wish to be represented for purposes of collective bargaining by [the labor union]?" The actual counting of ballots is done by NLRB personnel, but both the employer and employee may be represented at the election by observers. To prevail, the union must obtain a majority of all valid votes cast.

Post-election questions may be raised, and a hearing held, as to the validity of the election or as to conduct affecting the results of the election. Threats, promises of benefits, surveillance or interrogation are examples of conduct that can provide a basis for overturning an election result.

EFFECT OF UNION RECOGNITION

Once a union has achieved recognition, the employer is required to "collectively bargain" with representatives of the union as to wages, hours and other terms and conditions of employment. The employer must bargain with representatives of the union, which then exclusively represents all employees in the bargaining unit. After union recognition, an employer cannot negotiate with any individual employees within the unit, including those opposed to the union.

Neither the employer nor the union is obligated to make concessions. Each side merely has a duty to "bargain in good faith." Good faith on the part of the employer generally requires that the employer have an open mind and a sincere desire to reach an agreement and that it make a sincere effort to do so. If an agreement is reached, a binding contract must be signed for the agreed term, most often from one to three years.

IMPACT OF RIGHT-TO-WORK LAWS

In some states, employees may be required to join a union or pay dues to a union, either to obtain employment or to retain their positions, once the union and the employer have signed a collective bargaining agreement, which provides for

such requirement. This requirement is referred to as "Union Security." The National Labor Relations Act, however, permits individual states to prohibit such Union Security requirements. States that prohibit such requirements are referred to as "Right to Work" states. Arizona is a Right to Work state. No employee in Arizona may be required to join a union or to pay dues to a union as a condition of employment.

EFFECT OF UNION OR BARGAINING AGREEMENT UPON SUCCESSOR EMPLOYER

The question of union representation often is involved in the context of the sale of a business. If employees of the business are represented by a union, the issue may arise of whether the successor employer must bargain collectively with the union or of whether it must abide by the terms of an existing collective bargaining agreement made between the union and the seller.

Generally, the buyer of a business is neither bound by the seller's union contract nor required to bargain collectively with an existing union, unless there is "substantial continuity" of work force between the successor employer and the predecessor employer. Whether substantial continuity exists depends on a number of factors, the most important of which is whether a majority of the employees of the successor employer were employed by the predecessor employer. Even if a duty to bargain is found, a successor employer is not obligated to comply with the terms of an existing collective bargaining agreement, unless the successor employer expressly or implicitly adopts the agreement or if the successor employer is the "alter ego," essentially the same party, as the predecessor employer.

Employee Benefits

Nancy K. Campbell and Marvin S. ("Bucky") Swift, Jr.

ALTHOUGH wages are primary compensation for services, various non-cash benefits are usually an integral part of total compensation. Salaried employees, often called "rank-and-file employees," are generally the recipients of basic benefits, including medical and retirement. "Management employees" (executive personnel) commonly receive basic benefits supplemented by such items as deferred compensation, stock options, restricted stock and other stock-based arrangements. Benefit payments, characteristically established by benefits "plans," are governed principally by federal laws.

Regulation of Employee Benefits

Employee benefits are subject to significant regulation under U.S. law. The Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code (the Code) are the principal federal statutes. State laws generally are superseded (preempted) by federal law.

ERISA

ERISA is a comprehensive regulatory scheme. Under ERISA, employers must meet reporting and disclosure requirements, including annual reports to the U.S. Department of Labor, the agency that administers the regulatory scheme.

ERISA also imposes minimum standards on certain types of plans to assure that basic benefits are provided to rank-and-file employees, rather than being confined to management personnel. In addition, ERISA imposes standards for the administration of employee benefit plans.

ERISA can be enforced through proceedings brought by the Department of Labor, employees, beneficiaries of employees or plan fiduciaries, such as a plan administrator or a plan trustee. The Department of Labor in some cases can impose fines for violations of ERISA.

THE INTERNAL REVENUE CODE

The Code's impact on employee benefit plans is primarily through requirements imposed as a condition of obtaining favorable tax treatment. Failure to satisfy the Code's requirements can result in loss of employer tax deductions for plan contributions made by the employer or of employer deductions for costs of plan benefits paid by the employer. Violations of the Code can also result in the loss of favorable tax treatment for employees as to receipt of benefits from a plan and the taxation of an otherwise tax-exempt trust. For example, for public companies in the United States, compensation in excess of $1 million for the company's most highly compensated executives is not deductible unless certain conditions are satisfied. One of the most common exceptions is for "performance-based" compensation.

IMPACT OF STATE LAW

ERISA generally preempts state laws that relate to employee benefit plans. However, state insurance laws, as they apply to insured plans, are expressly exempted from preemption under ERISA. Accordingly, insured employee welfare benefit plans (but not self-insured plans) are subject to Arizona's laws regulating insurance, including laws requiring that specific benefits be provided by medical plans.

Specific Benefit Arrangements

A variety of benefit arrangements may be provided by employers to employees. Among the most common arrangements are medical plans, qualified retirement plans, nonqualified plans, stock-based compensation arrangements and performance unit plans.

MEDICAL PLANS

Adequate medical coverage is an increasingly important consideration for workers. The availability of employer-provided medical benefits can be an important part of employee compensation. Medical coverage can be provided by an employer in several ways, including through insured and self-insured plans, health maintenance organizations, preferred provider organizations and medical reimbursement arrangements. Under the Code, certain medical plans must not discriminate in favor of highly compensated employees.

The following federal laws also impose requirements on group health plans: ERISA, the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), the Family and Medical Leave Act of 1993, the Uniformed Services Employment and Reemployment Rights Act of 1994, the Americans with Disabilities Act, the Age Discrimination in Employment Act, Title VII of the Civil Rights Act, the Pregnancy Discrimination Act, the Health Insurance Portability and Accountability Act (HIPAA) as amended by the Health Information Technology for Economic and Clinical Health Act, the Mental Health Parity Act of 1996, the Mental Health Parity and Addiction Equity Act of 2008, the Newborns' and Mothers' Health Protection Act of 1996, the Women's Health and Cancer Rights Act of 1998 and the Genetic Information Nondiscrimination Act of 2008.

The Patient Protection and Affordable Care Act was signed into law on March 23, 2010 and was followed shortly thereafter by the Health Care and Education Reconciliation Act of 2010 (collectively the Health Care Reform Act). The Health Care Reform Act has significant implications for employer group health plans. For example, all plans must provide coverage for children to age 26, eliminate pre-existing condition exclusions, eliminate annual and lifetime limits on essential health benefits and prohibit the retroactive rescission of coverage. Non-grandfathered plans (those not in effect on March 23, 2010 and plans to which significant changes have been made since that date) are subject to additional requirements.

Another significant impact of the Health Care Reform Act is the "pay or play" rule. Under this new rule, an employer that fails to offer a plan with qualifying benefits will be assessed a penalty if it has more than 50 full-time equivalent employees. Even if the employer offers a plan with qualifying benefits, if eligible employees opt out of coverage, a different but similar set of penalties come into play. The constitutionality of the Health Care Reform Act is being challenged and will ultimately be decided by the United States Supreme Court.

The Department of Health and Human Services enacted the HIPAA "privacy rules," which generally became effective on April 14, 2003. The privacy rules prohibit "covered entities" (which include employer-provided medical plans) from using or disclosing an individual's "protected health information" for purposes other than the provision of health care and certain other limited purposes. The HIPAA privacy rules require medical plans to adopt policies and procedures designed to safeguard against the improper use or disclosure of protected health information.

Medical benefits usually are provided to employees and their dependents only during employment. Pursuant to COBRA, however, an employer who employs 20 or more employees, and who maintains a group medical plan, must allow certain former employees and their dependents to continue plan coverage, at the employee's expense, for a minimum of 18 months. Collective bargaining agreements often require longer continued health coverage for former employees.

Retirement benefits can be provided through a wide range of qualified plans. A retirement plan is a "qualified plan" if it satisfies detailed Code requirements. A number of favorable tax consequences result from status as a qualified plan. An employer is entitled to a current deduction for contributions made to such a plan. Employees are not taxed on their plan benefits until benefits are actually received. The trust established under a qualified plan to receive contributions is not taxed on its earnings, which permits tax-free compounding of interest. Here are six of the most common types of qualified retirement plans:

Profit-Sharing Plans

Under a profit-sharing plan, employer contributions can be contingent on the employer's profits. More likely, the employer is permitted to make contributions in its discretion, whether or not the employer makes a profit. Contributions made by an employer are allocated to individual accounts established for eligible employees. Upon retirement or other termination of employment, an employee is entitled to benefits based upon the employee's account balance.

Section 401(k) Plans

A 401(k) plan is a profit-sharing or stock bonus plan under which employees make pre-tax contributions that are not taxed until the employee takes a distribution from the plan. Due to a recent change in the law, plans may allow employees

to make after-tax Roth contributions, which are included in taxable income when made. Roth contributions and earnings are not taxed when distributed if they are part of a "qualified distribution." Employee contributions, whether pre-tax or after-tax, may be matched by tax-deductible contributions from the employer.

Stock Bonus Plans

A stock bonus plan is similar to a profit-sharing plan, except that the benefits are generally distributed in stock of the employer. Under certain stock bonus plans, employees are authorized to exercise voting rights with respect to shares allocated to their accounts.

Leveraged Employee Stock Ownership Plans (ESOP)

A leveraged ESOP is a specific type of stock bonus plan under which the plan borrows funds to invest primarily in the employer's stock. Employees who participate in a leveraged ESOP have the right, in certain cases, to vote the shares allocated to their accounts.

Money Purchase Pension Plans

A money purchase pension plan is similar to a profit sharing plan except that it requires fixed annual contributions by an employer without regard to profits. Money purchase pension plans have fallen out of favor recently due to several favorable changes made to profit sharing and Section 401(k) plans as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).

Defined Benefit Pension Plan

Under a defined benefit pension plan, an employee is promised a fixed pension at retirement, the amount being determined by the employee's salary, years of employment or both. The employer is required annually to contribute an amount actuarially sufficient to fund pension benefits.

NONQUALIFIED PLANS

Nonqualified plans play an important role as a tax and retirement planning device for executives. The principal attraction of nonqualified plans is that they are not subject to many of the onerous requirements of ERISA and the Code. Such plans can provide benefits to executives without providing corresponding benefits to rank-and-file employees. Two of the most common forms of nonqualified plans are excess benefit plans and deferred compensation plans.

Excess Benefit Plans

An excess benefit plan provides an executive with a supplemental pension equal to the difference between the pension that the executive would have received under the employer's qualified retirement plan if there were no limitation on benefits imposed by the Code and the limited pension that the executive will actually receive under the qualified plan.

Deferred Compensation Plans

A deferred compensation plan permits covered executives to avoid current income tax by deferring current compensation for a specified period or until retirement. Interest on the deferred amounts during the deferral period may be credited to the executive as a further benefit. To avoid adverse tax consequences to covered executives and to avoid ERISA regulation, nonqualified deferred compensation plans are neither funded nor secured. Executives generally have no greater right to payment than do other unsecured creditors. Although there are ways in which the employer's promise can be secured, there is no way to give executives priority over their employer's other creditors without an adverse tax result.

STOCK-BASED ARRANGEMENTS

The theory underlying stock-based arrangements is that the executive who has the right to acquire the employer's stock or to receive compensation based upon the performance of the stock, will have an incentive to work more diligently for the company's success. Among the most common forms of stock-based arrangements are stock options, restricted stock and stock appreciation rights.

Stock Options

A stock option is a right granted by an employer to an employee that permits the employee to purchase shares of the stock of the employer at a fixed price within a specified period of time. The option permits the employee to share in the appreciation in the stock of the employer while avoiding the risk of depreciation in value. Stock options are of two kinds: incentive stock options and nonqualified stock options.

Incentive Stock Options

Incentive stock options (ISOs) are creations of the Code and must satisfy the Code's requirements. One requirement is that the exercise price of the option (the amount payable by the employee to acquire the stock) cannot be less than the fair market value of the underlying stock on the date of the grant of the ISO. Also, an ISO must be exercised within 10 years after the date of grant.

The principal benefit of an ISO is the tax treatment available to an employee. An employee is not taxed either at the time of the *grant* of an ISO or at the time of the *exercise* of the ISO, unless the employee is subject to the special alternative minimum tax. If the stock acquired upon exercise of an ISO is not sold or disposed of until after a mandated holding period (two years from grant and one year from exercise), any gain to the employee from the sale is capital gain. No deduction is available to an employer in connection with an ISO unless the employee sells the ISO stock before the holding period.

Nonqualified Stock Options

A nonqualified stock option (NQSO) is any option that does not qualify as an ISO. Unlike ISOs, NQSOs are not required to meet specific requirements. As a result of state and federal tax and securities laws, however, NQSOs tend to have

common features. Typical NQSOs permit the employee to purchase stock at a fixed price for a specified period of time at a price at or below the fair market value on the date of grant. Most NQSOs cannot be exercised until a specified period has expired and most expire upon termination of employment, with the exception of death, retirement or disability.

The employee's tax treatment under an NQSO generally is not as favorable as under an ISO. Although the employee generally is not taxed upon grant of an NQSO, the employee will realize taxable ordinary income at the time of exercise of the option equal to the difference between the fair market value of the stock at exercise and the exercise price. The exercise price paid by the employee, plus the income recognized by the employee, is the employee's "basis" in the stock in the event of a subsequent sale. Any amount realized on a subsequent sale that is in excess of the employee's basis is taxable at capital gain rates.

Although no deduction is available to an employer that issues an ISO, an employer that issues an NQSO is entitled to a deduction upon the employee's exercise of an NQSO equal to the amount of income includable by the employee.

Restricted Stock

Restricted stock is stock of the employer issued to an employee for the performance of services. Restricted stock is subject to restrictions on the employee's stock ownership rights. For example, the employee's ownership of some or all of the shares may be made contingent on continued employment by the employer for a specified period. Restricted stock is often issued to an employee without cost to the employee or at a significant discount.

An employee is not subject to tax on restricted stock until the stock restrictions lapse. When the stock restrictions lapse, the employee realizes ordinary income in an amount equal to the excess of the fair market value of the stock, as of the date the restrictions lapse, over the amount, if any, paid for the stock. Any appreciation in the stock that occurs after the restrictions lapse generally is eligible for capital gains treatment upon a subsequent sale.

An employee can elect to be taxed immediately upon the receipt of the restricted stock by filing a special notice with the IRS within 30 days of the stock grant. In such case, the employee realizes ordinary income equal to the excess of the fair market value of the stock on the date of receipt over the amount, if any, paid for the stock. Any appreciation in the stock occurring after the date of receipt is then eligible for capital gains treatment.

Stock Appreciation Rights

A stock appreciation right (SAR) is a right to be paid an amount equal to the difference between the value of a share of an employer's stock on the date the SAR is granted and the value of that share on the date the SAR is exercised. SARs are sometimes granted in conjunction with stock options and often require that the underlying option be exercised as a condition for the exercise of the SAR. Payments under SARs can be made in cash or in employer stock. The tax treatment of SARs is generally the same as the tax treatment of NQSOs.

PERFORMANCE UNIT PLANS

Awards under performance unit plans are usually contingent upon the attainment of corporate performance goals within a specified period of time, such as a specified increase in the market share of the employer or improvement in the performance of the employer relative to a group of competitors.

Participation in a performance unit plan generally is limited to senior executives in a position to have a direct impact upon the employer's success. Eligible employees are awarded a specified number of units valued at a designated dollar amount. The period for measuring performance usually ranges from three to five years. If the goals of the plan are achieved, the employee receives the difference between the value of the unit on the date that it was awarded to the employee and the value of the unit at the end of the performance period. Payment is usually made in cash. An employee granted a performance unit is generally not subject to tax until amounts are actually paid out under the plan.

Intellectual Property

R. Shane Capps and Charles F. Hauff Jr.

Businesses often own valuable intangible assets referred to as “intellectual property.” These assets may consist of trade secrets, trademarks and patentable or copyrightable technology. Federal and state laws provide protection to owners of intellectual property in various circumstances. The following chart summarizes the protections of trade secrets, trademarks, patent and copyrights.

Chart: Summary of Intellectual Property

	Protectable Subject Matter	**Available Protections**	**Eligibility for Protection**	**Commencement of Protection**	**Duration of Protection**
Trade Secrets	Virtually any information, including ideas	Right to prevent disclosure or use of information	Information must not be known or must not be readily ascertainable by other persons; information must also be the object of reasonable efforts under the circumstances to maintain its confidentiality	On creation	Until legitimate and proper discovery by another
Trademarks	Words, names, symbols or devices	Right to prevent others from using same or similar marks to identify merchandise	Use of the mark to adequately distinguish one’s goods or services; registration may provide enhanced protectability	On use of the trademark	So long as properly used as a trademark
Patents	Machines, processes or compositions of matter	Right to exclude all others from making, using, importing, offering to sell or selling patented invention	Novelty, nonobviousness and utility	When granted by the U.S. government	20 years from filing date of patent application, with respect to design patents; 14 years from date granted
Copyrights	Literary works, musical works, artistic works and computer software	Right to prevent others from reproducing copyrighted work; exclusive right to distribute copyrighted work	Tangible form of expression and originality	On creation	Life of the author plus 75 years as respect to works made for hire; 95 years from publication or 120 years from creation, whichever expires first

Patents

IN GENERAL

One who invents or discovers a new machine, device or a new manufacturing process and beginning March 16, 2013 is the first to file for protection may be able to obtain a U.S. patent, which provides the inventor with the exclusive right for a specified time to prevent others from making, using, importing, offering to sell or selling in the United States the patented invention. A patent provides the holder with a limited monopoly on the use of the patented invention. A valid patent forecloses use of the patented invention by any other party, even if another party independently conceives the identical invention.

A utility patent, which generally covers the functional aspects of a machine, manufacturing process, or composition of matter, is enforceable beginning at the grant of the patent and ending 20 years (plus more time for certain delays) after the filing date of the regular patent application. A design patent, which covers the design or appearance of an article of manufacture, is enforceable for 14 years from the issue date of the patent. A provisional patent, which is filed before a regular patent application, establishes a priority filing date and provides up to 12 months to further develop the invention without filing a regular patent application. Anyone without authority from the patent holder who makes, uses, imports or sells in the United States the patented invention during the life of the patent is considered to "infringe" the patent and may be liable for damages.

EFFECT OF FOREIGN PATENTS

A foreign patent generally is not enforceable in the United States. Furthermore, an invention that is the subject of a foreign patent cannot be the subject of a U.S. patent unless an application for a U.S. patent is filed within one year following issuance of the foreign patent. Accordingly, an inventor who holds a foreign patent and who fails to apply for a U.S. patent within one year from the date of the issuance of a foreign patent, usually will have no recourse against others who use the invention in the United States.

REQUIREMENTS FOR PATENTABILITY

Three requirements govern patentability in the United States of a particular invention. First, an invention must be "novel." An invention is novel if it has not previously been known or used by others in the United States, nor patented nor described elsewhere. Second, the invention must be "nonobvious." An invention is nonobvious if it could not have been conceived by a person with ordinary skill in the field to which the invention pertains. Third, the invention must have "utility." An invention has utility if it is useful and is capable of performing the function claimed by the patent.

To determine novelty and, hence, patentability of an invention, it is often useful to search the records of the U.S. Patent and Trademark Office. There, one may examine all U.S. patents, many foreign patents and a large number of technical publications. A patent search customarily is performed by a patent attorney or by an individual with similar technical training, sometimes referred to as a patent agent. A patent attorney or patent agent may be asked to render an opinion regarding the patentability of a particular invention. An inventor can then make an informed decision as to whether to proceed to incur the cost of an actual patent application.

PATENT APPLICATION PROCESS

A U.S. patent application must be filed with the U.S. Patent and Trademark Office. A complete patent application includes five elements. First, the application must include the "specification," a description of what the invention is and what it does. The specification can be filed in a foreign language provided that an English translation, verified by a certified translator, is filed within a prescribed period. Second, the application must include at least one claim. Third, the application must include drawings, if essential to an understanding of the invention. Fourth, the application must include an oath or declaration, which certifies that the inventor believes himself or herself to be the first and original inventor. If the inventor does not understand English, the oath or declaration must be in a language that the inventor understands. Finally, the appropriate fee must be included. Only the first three elements are required to be submitted to receive a filing date. The fee and oath/declaration may be submitted later, within a prescribed time limit.

After a proper application is filed, the application is assigned to an examiner with knowledge of the particular subject matter. The examiner makes a thorough review of the application and the status of existing concepts in the relevant area to determine whether the invention meets the requirements of patentability. The patent review process typically takes approximately 18 months to three years.

Rejection of a patent application by the examiner may be appealed to the Appeals Board. Decisions of the Appeals Board may be appealed to the federal courts.

Provisional patent application requirements are less stringent than those for a regular patent application. The oath or declaration of the inventor and claims are not required and the application is held for the 12-month period without examination.

MARKINGS

After a patent application has been filed, the product made in accordance with the invention may be marked with the legend "patent pending" or "patent applied for." After a patent is issued, products may be marked "patented" or "pat.," together with the U.S. patent number. Marking is not required, but it may be necessary to prove marking in order to recover damages in an infringement action.

RIGHTS TO PATENTED INVENTIONS

Disputes sometimes arise between employers and employees over the rights to inventions made by employees during the course of employment. Accordingly, employers often require employees to execute formal agreements under which each signing employee agrees that all rights to any invention made by the employee during the term of employment will belong to the employer.

CHANGES TO PATENT LAW UNDER THE AMERICA INVENTS ACT

The America Invents Act signed into law on September 16, 2011, provides numerous changes to the U.S. patent system. The act has had an immediate impact on patent litigation both nationally and in Arizona as many litigation-related provisions were effective on the date of enactment. For example, individuals can no longer bring actions for statutory damages based on products that are mismarked as covered by a patent; instead, the federal government can bring an action for statutory damages or private parties can bring an action for compensatory damages based on "competitive injury." Failure to disclose "best mode" is no longer a basis to invalidate a patent. Joinder and consolidation requirements are stricter, preventing patentees from filing a single lawsuit against many different defendants, whose only connection is that they are all accused of infringing the same patent. The failure of an infringer to obtain the advice of counsel or present such advice to the court or jury "may not be used to prove that the accused infringer willfully infringed the patent or that the infringer intended to induce infringement of the patent."

Patent prosecution before the United States Patent and Trademark Office is also heavily affected by the America Invents Act, although many provisions related to prosecution are not effective until a year to 18 months after the Act's enactment. For example, a dispute between individuals filing for the same invention is no longer decided in favor of the first person to invent but is now dependent to the first person to file a patent application or the first person to publically disclose a technology followed by filing a patent application within one year. Similarly, the United States Patent and Trademark Office no longer provides a means to determine questions regarding the first party to invent; instead the United States Patent and Trademark Office provides a means of determining if a patent applicant derived an invention from another patent applicant, now referred to as a derivation proceeding. The assignee of a patent may now file for the patent. The scope of materials that may be cited as "prior art" is expanded to include more foreign references as well as prior public uses or sales anywhere in the world. In addition, under the Act, patent owners can now request the U.S. Patent and Trademark Office to perform supplemental examination of a patent to "consider, reconsider or correct information believed to be relevant to the patent," allowing patent owners an opportunity to address certain issues otherwise missed in the original prosecution of the patent.

Trademarks

IN GENERAL

A mark is often used by a business to identify its merchandise or services and to distinguish them from those supplied by others. A mark can be a word, name, number, slogan, symbol, device or combination.

A trademark should not be confused with a trade name. Although the same designation may function as both a trademark and a trade name, a trade name refers to a business title or the name of a business; a trademark is used to identify the source of goods or services.

SELECTION OF TRADEMARK

A company should carefully consider the trademark selected for its merchandise. The level of protection against infringement of a trademark varies with the "strength" or "uniqueness" of the trademark. "Generic" marks are entitled to no protection at all. "Descriptive" marks are the weakest and least protectable. A descriptive trademark is a name that describes some characteristic, function or quality of the goods. "Arbitrary" and "fanciful" marks are the strongest types of marks. An "arbitrary" mark consists of a word or symbol that is in common usage in the language, but is arbitrarily applied to the goods or services in question in such a way that is not descriptive or suggestive. A "fanciful" mark is a coined name that has no dictionary definition.

Evaluation should also include consideration of the likelihood of success in obtaining federal and state registrations of the trademark. For example, a trademark that is "merely descriptive" cannot be registered under either federal or Arizona law.

Selection of a trademark should be accompanied by a trademark search to determine whether someone else has already adopted or used a mark that is the same or similar to the one desired in one or more relevant areas of commerce. Publications provide lists of existing trademarks, registered and unregistered and there are businesses that specialize in trademark searches. Actual and potential trademark conflicts should be avoided, lest the business become involved in an expensive infringement lawsuit. Of even greater concern is the potential loss of the right to use a mark after considerable expenditure in advertising goods or services bearing the mark.

ADVANTAGES OF TRADEMARK REGISTRATION

Under the trademark laws of the United States and Arizona, the principal method of establishing rights in a trademark is actual use of the trademark. "Registration" of a trademark is not legally required but can provide certain advantages.

Federal registration of a trademark is presumptive evidence of the ownership of the trademark and of the registrant's exclusive right to use of the mark in interstate commerce, strengthening the registrant's ability to prevail in an infringement action. After five years of continued use of the mark following federal registration, the registrant's exclusive right to use the trademark becomes virtually conclusive. Federal registration may assist in preventing the importation into the United States of foreign goods that bear an infringing trademark. There are also other, less tangible advantages of registration, such as the implication of government approval of the trademark.

State registration provides some advantages, but not as extensive as federal registration. State registration is usually advisable, particularly in situations in which a business' sales will occur only in Arizona.

Federal Registration Application Process

Federal trademark registration requires that a trademark application be filed with the U.S. Patent and Trademark Office. The application must identify the mark and the goods with which the mark is used or is proposed to be used and must be accompanied by payment of the requisite fee. After the application is filed, it is reviewed by an examiner who evaluates, among other matters, the substantive ability of the mark to serve as a valid mark and the possibility of confusion with existing marks. If the examiner rejects the application, the examiner's decision can be appealed to the Trademark Trial and Appeal Board. An adverse decision by that body can be appealed to federal court.

If the application is approved, the mark is published in an official publication of the Patent and Trademark Office. Opponents of the registration have 30 days after publication, or such additional time as may be granted, to challenge the registration. If no opposition is raised, or if the opponent's claims are rejected, an applicant whose mark is already in use receives a "certificate of registration." An applicant whose trademark is proposed before use receives for future use a "notice of allowance." An applicant who receives a notice of allowance must, within six months of the receipt of the notice, furnish evidence of the actual use of the trademark. The applicant is then entitled to a certificate of registration. Failure to furnish evidence of the actual use of the mark within the time allowed results in rejection of the application.

POST-CERTIFICATE FEDERAL PROCEDURES

A certificate of trademark registration, issued by the Patent and Trademark Office, remains in effect for 10 years. Registration expires at the end of six years unless the registrant furnishes evidence of continued use of the trademark. The initial 10-year term of a certificate of registration can be renewed for an additional 10-year term by furnishing evidence of continued use of the mark and paying a fee during the one-year period immediately preceding the end of the 10-year period.

After at least five years of continuous use of a trademark following the receipt of a certificate of registration, a registrant can seek to have the status of the trademark elevated from "presumptive" evidence of the registrant's exclusive right to use of the trademark to virtually conclusive evidence of an exclusive right. To do so, the registrant must furnish the Patent and Trademark Office with evidence of continuous use of the trademark for at least five years. Additionally, there must not be any outstanding lawsuit or claim that challenges the registrant's rights to use the mark.

STATE REGISTRATION APPLICATION PROCESS

Arizona trademark registration law requires that a trademark application be filed with the Arizona Secretary of State. The application must identify the mark and the goods or services with which the mark is used and must be accompanied by the requisite fee. In contrast to registration of a mark under federal law, the mark must actually be in use before an Arizona registration application can be filed. If the trademark application is approved, the applicant receives a certificate of registration. A certificate of registration has an initial 10-year term and can be renewed indefinitely for successive 10-year terms.

MARKINGS

Before receipt of a certificate of registration, the designation "TM" can be used in association with the trademark. After a federal certificate of registration has been obtained, merchandise can be marked "Reg. U.S. Pat. Off." or "Registered in the U.S. Patent and Trademark Office," or with an encircled "R" or some similar designation to reflect that the trademark has been federally registered. Marking is not required, but proof of marking may be necessary to recover damages in an infringement action.

TRADE NAMES

Arizona provides separate registration of trade names with the Arizona Secretary of State. The application is simple. The registration remains in effect for five years and may be renewed for successive five-year terms. The Secretary of State will not register any trade name if it might mislead the public or is not readily distinguishable from names, titles or designations previously registered and still in effect, or if it is the same as, or deceptively similar to, an existing corporate name or one that has been reserved.

Copyrights

IN GENERAL

Copyright law provides the author of a copyrightable work (or such person's employer in the case of a "work made for hire") with exclusive rights to use, distribute, modify and display the work. Generally, works are entitled to copyright protection for the life of the author plus 75 years. As to works made for hire, however, copyright protection is for the shorter of 95 years after publication or 120 years after creation. Anyone who, without authority, exercises the rights reserved exclusively to the copyright owner is considered to infringe the copyright and may be liable for damages.

COPYRIGHTABLE WORKS

Works of authorship that qualify for copyright protection include literary works, musical works, dramatic works, pantomimes and choreographic works, pictorial, graphic and sculptural works, motion pictures and other audiovisual works, sound recordings and architectural works. The Computer Software Copyright Act of 1980 expressly made computer software eligible for copyright protection. The precise scope of copyright protection for computer software has not yet been fully defined. Constantly developing technology is likely to present many new issues, presently unforeseen.

All works eligible for copyright protection must meet two specific requirements. First, the work must be fixed in some tangible form; there must be a physical embodiment of the work so that the work can be reproduced or otherwise communicated. Second, the work must be the result of original and independent authorship. The concept of originality does not require that the work entail novelty or ingenuity, concepts of importance to patentability.

ADVANTAGES OF COPYRIGHT REGISTRATION

Copyright protection automatically attaches to a work the moment that the work is created. "Registration" of the work with the U.S. Office of Copyrights, however, provides advantages. A certificate of registration is prima facie evidence of the validity of the copyright, provided registration occurs not later than five years after first publication. With respect to works whose country of origin is the United States, registration is a prerequisite to an action for infringement. With respect to all works, regardless of the country of origin, certain damages

and attorneys' fees relating to the period prior to registration cannot be recovered in an infringement action. Registration also is a useful means of providing actual notice of copyright to those who search the copyright records.

COPYRIGHT REGISTRATION APPLICATION PROCESS

In order to obtain registration of copyright, an application for registration must be filed with the U.S. Copyright Office. The application must be made on the specific form prescribed by the Register of Copyrights and must include the name and address of the copyright claimant, the name and nationality of the author, the title of the work, the year in which creation of the work was completed and the date and location of the first publication. In the case of a work made for hire, a statement to that effect must be included. If the copyright claimant is not the author, a brief statement regarding how the claimant obtained ownership of the copyright must be included. An application must be accompanied by the requisite fee and a copy of the work must be submitted.

COPYRIGHT NOTICE

Until 1989, all publicly distributed copies of works protected by copyright and published by the authority of the copyright owner were required to bear a notice of copyright. A copyright notice is no longer mandatory, but a copyright notice is still advantageous. For example, the defense of "innocent infringement" generally is unavailable to an alleged infringer if a copyright notice is used.

If a copyright notice is used, the notice should be located in such a manner to sufficiently demonstrate the copyright claim. The notice should consist of three elements: first should be the symbol of an encircled "C," or the word "copyright," or the abbreviation "copr."; second should be the year of first publication; and third should be the name of the copyright owner.

WORKS MADE FOR HIRE

In a "work made for hire" the employer is presumed to be the author. Authorship is significant because a copyright initially vests in the author. The parties can rebut the presumption of employer authorship by an express written agreement to the contrary.

The term "work made for hire" applies to any work created by an employee in the course and scope of employment. On occasion, there is dispute as to whether a work created by an employee arose from the employment. Employers often require execution of a formal employment agreement under which the employee expressly agrees that all copyright rights will belong to the employer. A similar agreement is also advisable in connection with the engagement of an independent contractor to perform copyrightable services for a business.

COPYRIGHT PROTECTION FOR FOREIGN AUTHORS

Copyright protection is available under U.S. law for foreign authors until the copyrightable work is published. If the work has been published, the availability of continued U.S.

copyright protection is dependent upon the location of the publication and the nationality or domicile of the author. Copyright protection continues in the United States subsequent to publication if publication by the foreign author occurs in the United States or occurs in a country that is a treaty party. A treaty party is a country or intergovernmental organization, other than the United States, that is a party to an international agreement. If the work is first published by a foreign author outside the United States, continued copyright protection in the United States is available only if the foreign author is either a domiciliary of the United States or a national or domiciliary of a country that is a party to a copyright treaty to which the United States is also a party. A person is generally a domiciliary of the country in which the person resides with the intention to remain permanently.

Trade Secrets

IN GENERAL

Manufacturing businesses and other businesses may possess commercially sensitive information. The ability to benefit from such information and yet keep the information secret from competitors is a common business objective. Substantial protections are available if the information is a "trade secret."

REQUIREMENTS OF A TRADE SECRET

Among items of information characterized as trade secrets have been manufacturing processes, product specifications, employee training manuals, computer programs, databases, marketing plans, financial statements and customer lists.

There are two requirements for business information to qualify as a trade secret. One essential is that the information must not be generally known or readily ascertainable by proper means by other persons. The other is that reasonable efforts must be made to maintain the secrecy of the information. The holder of the trade secret must take affirmative steps to safeguard confidentiality. There are no specific actions that must be taken, but these steps should be considered:

- advise employees through an employee manual or other writing of the employer's policy regarding protection of trade secrets;
- require employees who have access to trade secrets to sign confidentiality agreements;
- physically separate trade secret information from other information;
- install locks on gates and doors leading to areas where trade secrets are housed;
- label trade secret documents clearly with a proprietary notice and instruct employees as to the significance of the notice; and
- restrict access by use of password codes to access computer systems used to store trade secrets.

UNIFORM TRADE SECRETS ACT

Arizona and approximately 40 other states have adopted the Uniform Trade Secrets Act (the Act) or based their respective laws on the Act. Under the Act, a person who obtains a trade secret through improper means such as theft, bribery, misrepresentation or espionage, or a person who obtains a trade secret from another, if such person has reason to know that the trade secret was obtained by improper means, can be enjoined or sued for substantial damages. Legal action may be taken under the Act against competitors, employees, suppliers, partners and virtually any other person or entity who seeks to disclose or use another's trade secret improperly.

Environmental

Christopher P. Colyer and Marc A. Erpenbeck

The diversity and vitality of Arizona's natural environment are key elements of the quality of life in the state. Arizona is widely recognized as having an efficient and workable balance between environmental and developmental objectives. The state's environmental agency works closely with business to foster growth with minimal environmental impairment.

There are four sources of environmental regulation in Arizona:

- federal, primarily through the U.S. Environmental Protection Agency (EPA);
- state, through the Arizona Department of Environmental Quality (ADEQ);
- tribal, through various Native American communities within the state; and
- local, through certain cities and counties.

As the "Grand Canyon State," Arizona aims to protect its unique environmental landscape while also fostering controlled growth and development. In particular, the state possesses one of the seven natural wonders of the world while it is also home to some of the largest copper mines in the world and the largest nuclear generating station in the country. Its primary environmental concerns relate to water and air quality.

Given the state's arid climate, water conservation is a key concern. Likewise, its large expanses of undeveloped desert land produce substantial amounts of dust, leading to more significant regulatory oversight. Lastly, additional environmental regulation may arise given that large portions of the state are comprised of state and national parks and tribal lands. For instance, when Arizona became a state in 1912, it was granted nearly 10 million acres in a state trust for the benefit of public education in the state.

Fortunately, Arizona has significant experience in managing these environmental issues without compromising economic growth. The state and its regulatory entities are quite adept at achieving environmental protection while simultaneously supporting business development.

Air Pollution Control

GENERAL REQUIREMENTS UNDER THE CLEAN AIR ACT

Given Arizona's unique geology, businesses entering the state should be aware of the various issues and requirements arising under the Clean Air Act (CAA), particularly as they pertain to dust control, ozone and greenhouse gases. The CAA (as substantially amended in 1990) is designed to "protect and enhance the nation's air resources so as to promote the public health and welfare and the productive capacity of the population." 42 U.S.C. §§ 7401 to 7671c. The CAA consists of six sections, known as titles that direct EPA to establish national standards for ambient air quality and for EPA and the states to implement, maintain and enforce these standards through a variety of mechanisms. State and local governments oversee, manage and enforce many of the requirements of the CAA. These regulations appear at 40 C.F.R. Parts 50-99. EPA has established air quality standards and timetables for achieving compliance with those standards. EPA also sets minimum air quality levels for "regulated pollutants," which include "criteria pollutants" such as particulates, carbon monoxide, ozone, nitrogen dioxide, lead and sulphur dioxide and "hazardous pollutants," such as asbestos, mercury and other toxic air emissions.

Generally, a CAA permit must be obtained before a business can construct or modify a plant or other facility that emits regulated pollutants into the air. Standards governing the issuance of air quality permits differ, depending upon whether or not the specific area of the plant or facility has achieved compliance with applicable air quality standards. Areas that have met these standards are referred to as "attainment areas." Areas that have not met these standards are referred to as "non-attainment areas."

Attainment Areas and Class I Areas

In attainment areas, a permit is required before a business can construct or modify a facility with the potential to emit 100 or more tons per year of a regulated pollutant. To obtain a permit, the owner or operator must provide for control

of emissions by the "best available control technology." The owner or operator also must perform a preconstruction review demonstrating that the operation of the facility will not result in a "significant deterioration" of air quality. Whether a facility will significantly deteriorate air quality is determined under a classification system that divides attainment areas in the United States into various regions with differing standards of permissible emissions. Increases in pollution are severely restricted in "Class I" regions, which are regions with pristine wilderness or national parks. In Arizona, the Grand Canyon area is a Class I region in which development is effectively precluded. Increases in pollution to facilitate "moderate growth" are permitted in "Class II" regions. All attainment areas in Arizona other than the area surrounding the Grand Canyon are Class II regions.

Non-Attainment Areas

In non-attainment areas, the goal is to prevent new or modified construction from interfering with the achievement of air quality standards. Issuance of a permit to construct or modify a plant or facility in a non-attainment area is subject to more rigorous standards than the standards applicable in attainment areas. Issuance of a permit in a non-attainment area is conditioned upon the installation of pollution control equipment that results in the "lowest achievable emissions rate." The owner or operator of a proposed major plant or facility in a non-attainment area must demonstrate that the benefits of the proposed plant or facility "significantly" outweigh environmental and social harms.

The state's most populous county, Maricopa County, which includes the city of Phoenix, has been classified as a non-attainment area for particulates and ozone. The state's second most populous county, Pima County, which includes the city of Tucson, has been classified as a non-attainment area for particulates.

In 2010, EPA rejected Maricopa County's plan to limit and reduce particulate matter pollution. Consequently, Maricopa County is developing a new state implementation plan containing further regulations and requirements that it hopes will be acceptable to EPA. Accordingly, businesses entering this region should be aware that Maricopa County's pursuit of developing a plan to come into attainment for particulate matter will underlie most air permitting decisions.

Similar particulate matter issues also exist in Pinal County. Likewise, federal and local regulators are placing greater scrutiny on greenhouse gas emissions within the state. This emphasis on limiting greenhouse gases is one of several factors behind Arizona's focus and transition to renewable energy.

NEW SOURCE PERFORMANCE REQUIREMENTS UNDER THE CLEAN AIR ACT

The Clean Air Act provides "source performance standards" that apply to new plants or facilities. Although all major sources of air pollution are required to meet minimal air quality standards, the "new-source" performance standards, which apply in attainment areas as well as non-attainment areas, are designed to ensure that new facilities are built with state-of-the-art pollution control technology. Each source performance standard sets performance criteria for a specific source. To date, there are dozens of source performance standards, including standards for incinerators, stationary gas turbines, fossil fuel-fired steam generators and asphalt concrete plants.

STATE REQUIREMENTS

ADEQ is the state agency charged with the primary responsibility for administering the air quality program. The duties of ADEQ are set forth in A.R.S. § 49-424 and include determining the quantity and nature of emissions of air contaminants, the economic effect of remedial measures on the various areas of the state and the effect on human health and danger to property from air contaminants. Further, ADEQ is specifically required to encourage the various political subdivisions of the state to handle air pollution problems within their jurisdictions.

The Air Pollution Control Hearing Board hears appeals of ADEQ decisions. The Board is composed of five members appointed by the Governor. The Hearing Board is available to hear appeals of permit approvals, denials or revocations, permit revisions or conditional orders and also hears challenges to orders of abatement issued by ADEQ. Decisions by the Hearing Board are appealable to the Superior Court.

ADEQ and the air quality districts of Maricopa, Pima and Pinal Counties administer and enforce the CAA under standards delegated and approved by EPA. In addition to standards relating to criteria pollutants and hazardous pollutants, ADEQ has adopted standards for various "non-criteria pollutants," including dust and odors. ADEQ also has adopted standards for the issuance of permits. The permit process requires that an applicant submit a detailed compliance plan and strict notice requirements must be followed. Public hearings will be held if requested by the public.

GREENHOUSE GAS CAP AND TRADE PROGRAMS

Arizona formally withdrew from the Western Climate Initiative in 2011, a program that would have established requirements that limited greenhouse gas emissions for certain sources, while allowing such sources to trade allowable emissions. Arizona remains interested in joining other multi-state emissions programs that will reduce greenhouse gas emissions in the state.

LOCAL GOVERNMENT REQUIREMENTS

The authority for air pollution control regulation at the county level is vested in the County Board of Supervisors and in the "control officers" who are designated officials in each county. In general, the Board of Supervisors adopts regulations proposed and administered by the control officer and the control officer's staff.

Like the state Air Pollution Hearing Board, each county also maintains a county Air Pollution Control Hearing Board to hear disputes over permit actions and air quality enforcement issues. Some of the counties also maintain an Air Quality Advisory Committee to assist the Board of Supervisors in adopting regulations.

WATER POLLUTION CONTROL

Water quality in Arizona is regulated under federal, state and local laws. Primary regulation is through a permitting program intended to limit discharges of pollutants. Generally, water pollution control in Arizona falls into two categories: surface waters (such as water in streams, rivers, lakes, ponds and springs) and subsurface groundwater.

Surface Water

In General

Under both the federal Clean Water Act and Arizona statutes, water quality standards have been established for all surface water bodies in Arizona. Discharges into surface waters must meet these standards. Every river and stream in Arizona has been inventoried according to its present and potential uses, such as recreational, agricultural or livestock. Discharges into surface waters may not interfere with these designated uses.

Permits to Discharge into Surface Waters

An Arizona Pollutant Discharge Elimination System (AZPDES) permit must be obtained from ADEQ before any facility can discharge regulated pollutants into surface waters of the United States. An application for an AZPDES permit must demonstrate that regulated pollutants in the discharges will not exceed specific standards.

Dredge and Fill Permits

Section 404 of the Clean Water Act prohibits the deposit of dredge or fill materials into the waters of the United States and adjacent wetlands without a permit from the Army Corps of Engineers. Issuance of a dredge and fill permit is conditioned upon state certification that the applicant's discharge will not contravene existing water quality standards. The term "waters of the United States" is broadly interpreted to include tidal waters, streams and lakes. The definition of "jurisdictional wetlands" may include normally dry arroyos and stream beds with a nexus to waters of the United States. Recent EPA policy guidance is expected to significantly expand the types of waters that will fall within the definition of "waters of the United States."

Certain activities are exempt from the dredge and fill permit requirements. Exempt activities include normal farming and ranching, construction or maintenance of stock ponds or irrigation ditches and construction of farm or forest roads.

Industrial Pretreatment Regulation

Publicly owned sewage treatment systems that ultimately discharge effluents into surface waters and industrial facilities that discharge into surface waters or into publicly owned sewage treatment systems are regulated under the Clean Water Act. Such facilities must comply with specific EPA pre-treatment standards and, under certain conditions, must obtain facility-specific discharge permits. These standards are intended to limit discharges of regulated pollutants into surface waters and to protect the systems and their operators from dangerous pollutants, such as corrosive materials. Such systems may also be regulated under county or municipal ordinances.

GROUNDWATER

In General

All underground strata in the state that yield usable quantities of potable water are characterized as "aquifers." Strict standards are imposed by ADEQ to preserve the drinking quality of groundwater from aquifers. Any discharge into an aquifer that would violate these standards is prohibited.

Aquifer Protection Permit Program

Arizona's Aquifer Protection Permit (APP) program is designed to reduce and, where practicable, eliminate the discharge of pollutants to the state's aquifers or groundwater. Subject to certain exemptions, any person or owner or operator of a facility that discharges pollutants that have a reasonable probability of reaching groundwater must obtain an APP from ADEQ. The term "discharge" is broadly defined for purposes of aquifer protection as the "addition of a pollutant from a facility either directly to an aquifer or to the land surface or the vadose zone in such a manner that there is a reasonable probability that the pollutant will reach an aquifer." The APP program provides for two types of permits—general and individual. Individual permits are more expensive and usually have more extensive application requirements as compared to general permits.

Waste

NON-HAZARDOUS SOLID WASTE

Non-hazardous solid waste is any garbage, refuse or sludge that is not hazardous in nature, including discarded solid, liquid and gaseous material. Although ADEQ provides general guidance as to the management of solid waste, most regulation of solid waste occurs at the municipal and county level.

HAZARDOUS WASTE

Resource Conservation and Recovery Act

Under the Resource Conservation and Recovery Act (RCRA), EPA has established standards for the protection of the environment and human health from materials specifically identified as "hazardous waste." The comprehensive regulatory program adopted by EPA regulates waste materials from generation through final disposal. ADEQ administers and

enforces the state hazardous waste program, although Arizona largely incorporates RCRA standards into its regulatory scheme. Regulations address three broad aspects: generation, transportation and treatment, and storage or disposal.

Generation of Hazardous Waste

A facility that generates hazardous waste must advise ADEQ on an annual basis of the level of its generating activities and must comply with specific record keeping, handling and disposal requirements. Before transporting or offering hazardous waste for transportation to an offsite location, the facility must comply with packaging, labeling and marking requirements. If a generating facility stores waste in excess of 90 days, it is subject to the more stringent regulations described below for facilities that store hazardous waste.

Transportation of Hazardous Waste

Transporters of hazardous waste must comply with reporting and record keeping requirements. Among other requirements, a transporter of hazardous waste in Arizona must obtain a special license from the Department of Transportation before moving such materials.

Treatment, Storage and Disposal of Hazardous Waste

A facility that treats, stores or disposes of hazardous waste is subject to extensive regulations. Strict requirements govern the design, construction, maintenance, operation and closure of such a facility in order to minimize the possibility of fire, explosion or unplanned releases of hazardous wastes that could threaten the environment or human health. Among other requirements, treatment, storage and disposal facility personnel must be trained to respond effectively to emergencies. Closure of such facilities must take place in accordance with an approved plan that minimizes the need for further maintenance and the possibility of post-closure escape of hazardous waste. Specific requirements are determined on a facility-by-facility basis.

Underground Storage Tank Regulation

Underground storage tanks are subject to federal and state regulations enforced by ADEQ. An underground storage tank is defined as a tank used to store regulated substances, at least 10 percent of the volume of which is located underground. Regulated substances include petroleum and hazardous pollutants but do not include hazardous waste regulated under the Resource Conservation and Recovery Act. An owner of an underground storage tank must notify ADEQ within 30 days after placement of the tank into operation. An owner or operator of an underground storage tank may be required to comply with other requirements, four of which are discussed below.

TANK PERFORMANCE STANDARDS

A new underground storage tank must comply with federal performance standards governing corrosion protection, leak

detection and spill and overflow protection. An owner and operator must use qualified personnel to install the tank. Existing tanks must be upgraded to meet the performance standards applicable to new tanks. Tanks that fail to meet the standards by designated deadlines must be taken out of service.

FINANCIAL RESPONSIBILITY

An owner or operator of an underground storage tank may be required to demonstrate financial ability to take corrective action in the event of a release. Evidence of financial responsibility can be established by an insurance policy, a guaranty, a surety bond, a letter of credit or qualification with ADEQ as a self-insurer.

SPILL REPORTING AND CORRECTIVE ACTION REQUIREMENTS

Owners and operators of underground storage tanks are required to notify ADEQ no later than 24 hours after detection of a release, or suspected release, from a tank. In some instances, particularly if groundwater may be affected by the release, ADEQ may require the owner or operator to implement a corrective action plan. Prior to 2010, owners and operators could receive state funding to implement these corrective actions, although the state's program has since terminated.

TANK CLOSURE REQUIREMENTS

Underground tanks must be closed in a safe and secure manner that prevents release of regulated substances into the environment. A tank that is closed for a period of less than 12 months must continue to comply with federal standards governing corrosion protection, leak detection, spill and overflow protection and spill reporting requirements. An underground storage tank that is closed for 12 months or longer is subject to special closure requirements, including the requirement to notify ADEQ at least 30 days before closure.

Local Fire Codes

Fire codes established by counties, cities and towns also regulate the storage and handling of hazardous materials. Requirements under these codes vary greatly and each applicable code must be reviewed.

Employee Hazard Communication

Occupational Safety and Health Administration (OSHA) imposes a duty on employers to provide employees with a safe and healthy place to work, which is free from recognized hazards causing or likely to cause death or serious physical harm. The U.S. Labor Department, which administers OSHA, has issued a specific standard for the use of hazardous chemicals in the workplace known as the "OSHA Hazard Communication Standard."

The standard requires employers to inform employees about any "hazardous chemicals" to which they may be exposed. Hazardous chemicals are defined broadly and includes carcinogens, toxins, irritants, corrosives, sensitizers, agents that damage the skin, lungs or eyes and chemicals that are combustible, explosive or flammable. The OSHA Hazard Communication Standard applies to any hazardous chemical known to be present in the workplace to which employees may be exposed under normal working conditions or in a foreseeable emergency. The standard also applies to manufacturers, importers and distributors of hazardous chemicals. It imposes four basic requirements discussed below.

LABELING OF HAZARDOUS CHEMICALS

The OSHA Hazard Communication Standard requires chemical manufacturers, importers or distributors to label, tag or mark each container of hazardous chemical with the identity of the hazardous chemical and with an appropriate hazard warning. Employers must ensure that all workplace containers of hazardous chemicals are similarly labeled, tagged or marked. In lieu of affixing labels to individual containers, an employer can provide notice of the presence of hazardous chemicals by posting signs or distributing written materials among employees. All labels and warnings must be legible and in English.

MATERIAL SAFETY DATA SHEETS

Under OSHA, employers must maintain a material safety data sheet (MSDS) for each hazardous chemical in the workplace. The MSDS must identify the specific chemical, the health hazards associated with the chemical, known precautions for safe handling and use of the chemical and first aid procedures. Employers must make the MSDS available to employees, union representatives and the Labor Department.

EMPLOYEE INFORMATION AND TRAINING

The OSHA Hazard Communication Standard requires employers to provide employees with information and training on hazardous chemicals in the workplace at the time of their initial employment and whenever a new hazard is introduced into the work area. Employees must be informed of any operations in their work area where hazardous chemicals are present and the location of the MSDS. Employee training must include discussions of available means to detect the release of hazardous chemicals, the physical and health hazards of the chemicals and the measures that employees can take to protect themselves.

WRITTEN HAZARD COMMUNICATION PROGRAM

OSHA requires employers to develop, implement and maintain at the workplace a written hazard communication program. The program must describe how the employer will satisfy the requirements relating to labeling, preparation of material safety data sheets and employee information and training.

EMERGENCY PLANNING AND COMMUNITY RIGHT-TO-KNOW ACT

The Emergency Planning and Community Right-to-Know Act (EPCRA) imposes reporting requirements on businesses that use hazardous chemicals. The reporting requirements are

intended to provide the public with important information on hazardous chemicals in their communities, to enhance community awareness of chemical hazards and to facilitate state and local emergency response plans. The reporting requirements under EPCRA fall into four categories, discussed below.

Emergency Planning Reporting

An owner or operator of any facility that has any "extremely hazardous substance" present in designated quantities must notify the state and local emergency planning commissions under EPCRA. The presence and location of additional quantities of specified substances must be reported within 60 days of the acquisition and the notification must include the name of a facility representative who can be contacted in the event of an emergency.

Chemical Inventory

Businesses are required to provide an annual inventory of certain chemicals under EPCRA. Any business that prepares a material safety data sheet in compliance with the OSHA Hazard Communication Standard must submit a list of all chemicals for which a material safety data sheet is required that are present at the facility in quantities greater than threshold reporting quantities at any one time during the year or the business must submit the actual material safety data sheet. Additionally, businesses must submit an annual chemical inventory report specifying the average daily amount of a chemical on the premises, the maximum amount present on any given day and the location of the chemicals. A business may be exempted from disclosing the identity of a specific chemical if it can establish that the disclosure would reveal a trade secret.

Emergency Notification

Under EPCRA, the owner or operator of any facility that produces, uses or stores any hazardous chemical defined under the OSHA Hazard Communication Standard must report the spill or release of any such chemical *outside* the facility. The report must be made to the National Response Center, the state emergency response commission and the local emergency planning committee. Two notifications are required: an initial notice and a follow-up notice. The initial notice may be by telephone and must include the identity and amount of the chemical released, the duration of the release and information regarding any health hazard created by the release. The follow-up notice must be in writing, must update the information previously submitted and must identify the actions taken.

Toxic Chemical Release Reporting

EPCRA requires every manufacturing company that has 10 or more full-time employees and that manufactures, imports, processes or otherwise uses any "toxic chemical" in an amount greater than the designated threshold amount during the calendar year, to submit annual reports of discharge of toxic chemicals into the environment during the preceding year.

Superfund Laws

IN GENERAL

Federal and state statutes, commonly referred to as "Superfund Laws," authorize government actions against responsible parties for reimbursement of cleanup costs and for damages to natural resources caused by the release of hazardous substances into the environment. The federal and state statutes also contain citizen suit provisions, which allow private parties in certain situations to bring claims against responsible parties for releases of hazardous substances into the environment. A "responsible party" can include a generator or transporter of the hazardous substance or any present or past owner or operator of a site from which hazardous substances are released.

Liability under the federal Superfund Law is joint and several. However, recent amendments to the state Superfund Law have eliminated joint liability. Joint liability means that each responsible party may be liable for the entire amount of cleanup costs and damages at a particular site, regardless of the responsible party's actual share of liability. Furthermore, liability is "strict," which means that a responsible party may be held liable without regard to fault. A purchaser of a site contaminated by a prior owner's operations may be liable no matter when or by whom the hazardous substances were disposed.

The Federal Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA), as amended in 1986, and most recently in 2002 by the Small Business Relief and Brownfield Revitalization Act (Brownfield Amendments), historically held that owners of property could be strictly liable solely by virtue of ownership of a property on which a "hazardous substance" had been released or was threatened to be released. Prior to the Brownfield Amendments, CERCLA excluded from liability those persons who could establish that the release or threat of release of hazardous substances was through an act or omission of a third party, with whom such party was not in a contractual relationship. Still, the potential existed that a landowner who did not cause or contribute to contamination on a property could have been liable for substantial cleanup costs under the prior law.

BONA FIDE PROSPECTIVE PURCHASER DEFENSE

In January 2002, Congress passed the Brownfield Amendments, which amended CERCLA to provide substantial liability limitations for landowners who qualify as: (1) bona fide prospective purchasers (BFPPs), (2) contiguous property owners or (3) innocent landowners. Under the new law, in order for a buyer to meet the statutory criteria for landowner liability protection, certain threshold criteria must be met and certain continuing obligations satisfied.

A purchaser of property after January 11, 2002 may qualify as a BFPP, even with knowledge of contamination, after performing all appropriate inquiry, provided the buyer satisfies the other criteria set forth in CERCLA § 101(40).[82] Specifically, in order to be a BFPP, a party must not be potentially liable or affiliated with any other person who is potentially liable for response costs. However, unlike the former law, the Brownfield Amendments provide an exception for a contractual relationship that is created by the instruments by which title to a property is conveyed or financed.

The BFPP provision of CERCLA provides landowner liability protection and limits EPA's recourse for unrecovered response costs to a lien on property for the increase in fair market value attributable to EPA's response action. Specifically, CERCLA § 107(r) provides a limitation on liability for a BFPP whose potential liability is based solely on the purchaser being an owner or operator of a facility and provided that the purchaser does not impede the progress of a CERCLA remedial action.

INNOCENT PURCHASER DEFENSE

An important defense to environmental liability where a site has been contaminated by another party's operations is the "innocent purchaser" defense. A party will not be liable under the federal Superfund Law if it can be established that

82 *Revitalizing Contaminated Sites: Addressing Liability Concerns*, U.S. Environmental Protection Agency, Office of Site Remediation Enforcement, at 7 (March 2011).

after "all appropriate inquiry," a purchaser had no reason to know about the presence of hazardous substances at the site prior to acquisition. Superfund laws are not explicit about the extent of inquiry required, but minimum inquiry probably would include site inspection, a full inquiry into any present and past uses of hazardous substances at the site, a title search of real estate records to determine prior owners and a review of regulatory agency records to determine whether enforcement action has occurred or is planned.

STATE SUPERFUND

Like Superfund, Arizona's Water Quality Assurance Revolving Fund (WQARF) statute also classifies an "owner" of contaminated property as a "responsible party." In addition, WQARF specifically exempts from liability a person who merely owns real property, unless that person: (1) was engaged in the business of generating, treating, storing or disposing of hazardous substances or waste at the site or "knowingly permitted" others to engage in such a business there; (2) permitted a person to use the facility for the disposal of a hazardous substance; or (3) "knew or reasonably should have known that a hazardous substance was located in or on the facility at the time rights, title or interests in the property was first acquired by the person" and "engaged in conduct by which he associated himself with the release."

A person is not a responsible party under WQARF "with respect to a hazardous substance that is located on or beneath

property that is owned or occupied by that person if the hazardous substance is present solely because it migrated from property that is not owned or occupied by that person and that person is not otherwise a responsible party."

Arizona's Superfund Law has a defense similar to the innocent purchaser defense available to purchasers of contaminated property who did not cause or contribute to a hazardous substance release.

National Environmental Policy Act

The National Environmental Policy Act (NEPA) establishes the national environmental policy and goals for the protection, maintenance and enhancement of the environment. NEPA implements this policy by requiring federal agencies to incorporate environmental considerations into their planning and decision-making processes. Federal agencies accomplish this task by preparing detailed Environmental Impact Statements (EIS) that assess the environmental impact of federal actions and alternative actions.

Certain categorical exclusions exist that may preclude the need for undertaking an EIS. If no categorical exclusion applies, a federal agency will prepare a written Environmental Assessment (EA) that determines whether or not the federal undertaking would significantly impact the environment. If the EA determines that there will not be such impact, it will issue a Finding of No Significant Impact. If the EA determines that there will be a significant impact, then the agency will proceed to prepare an EIS.

An EIS can be a lengthy and expensive undertaking, particularly if the proposed project is contested, controversial or will have a large impact on the environment. NEPA is frequently a consideration for new projects in Arizona given that the state has substantial quantities of land owned or managed by the federal government.

Endangered Species Act

Plans for future development could also be impacted by the requirements of the Endangered Species Act (ESA).

THE PROCESS FOR LISTING SPECIES AND DESIGNATING HABITAT

ESA protection extends to species listed by the U.S. Fish and Wildlife Service (U.S. FWS) as endangered, such as the desert tortoise. Once the species is listed, the U.S. FWS is generally required to designate land as "critical habitat" for the species. Generally, critical habitat may include only a portion of the geographical area occupied by the species at the time of listing, but it is the relevant land area that the U.S. FWS considers essential to the conservation of the species and which may require special protection. The designation also may include land not occupied by the species at the time of listing if the U.S. FWS believes that critical habitat protection is essential to conserve the species.

THE SECTION 7 CONSULTATION PROCESS

Section 7(a)(2) of the ESA imposes both substantive and procedural requirements on federal agencies and, in some cases, non-federal "applicants" whose actions may impact a critical habitat. Section 7(a)(2) requires federal agencies to ensure that "any action authorized, funded, or carried out by such agency… is not likely to jeopardize the continued existence of any endangered species or threatened species or result in the destruction or adverse modification of habitat of such species" which has been designated as critical. Thus, federal actions may not proceed if they would either jeopardize the existence of a listed species or destroy or adversely modify a listed species' critical habitat, unless an exemption is granted.

In addition, Section 7(a)(2) imposes a procedural obligation to "consult" with U.S. FWS to ensure that the federal action is not an ESA violation. U.S. FWS, and the federal agency proposing the action, must use the best scientific and commercial data available.

Section 7 technically applies to federal agencies and not to activities by non-federal entities. As a practical matter, however, a number of activities occurring on private land require some sort of federal permit or approval or have some other federal nexus that may trigger Section 7. Consequently, a federal agency proposing to issue a permit, easement or other land use approval to a private party must ensure that its action complies with Section 7.

Informal consultation is described in 50 C.F.R. § 402.13. Agency consultation may begin with an "informal consultation," an optional process in which the U.S. FWS and another federal agency determine whether formal consultation is required. The consultation process will end if the U.S. FWS and federal agency agree that the action will not adversely affect the species or critical habitat. During informal consultation, an action may be modified, or impacts mitigated, to avoid adverse impacts.

Formal consultation is detailed in 50 C.F.R. § 402.14. The federal agency is required to review its action and decide whether the action "may" affect a listed species or critical habitat. If the federal agency decides there might be some impact, the agency must enter into a formal consultation with the U.S. FWS. The consultation is required to be completed within 90 days, but can be extended for an additional 60 days. As noted, a formal consultation will not be needed if an informal consultation has been conducted and concluded with agreement that the action will not likely adversely impact the species or habitat.

Formal consultation requires U.S. FWS to evaluate both direct and indirect effects of the federal action on the species or critical habitat, including the effects of other activities that are interrelated or interdependent with the federal action and described in 50 C.F.R. §§ 402.02; 402.14(g)(3).

Biological opinion is covered in 50 C.F.R. § 402.14(g). If there is a formal consultation, the federal agency must complete

a biological opinion on whether the federal action is likely to jeopardize the continued existence of the listed species or to adversely affect a critical habitat, referred to as a "take" in the applicable regulations. If the agency finds a "take" will occur, it is required to impose "reasonable and prudent measures" necessary or appropriate to minimize impact to the species. These measures are known as an incidental take statement. If the agency finds no take will occur, the U.S. FWS may still provide discretionary conservation recommendations to aid the agency to reduce or eliminate impacts agency action may have on listed species.

THE ARIZONA NATIVE PLANT ACT

The Arizona Native Plant Act (Native Plant Act) sets forth procedures for protecting certain groups of native Arizona plants from vandalism, theft, over-depletion and unnecessary destruction. Although the Native Plant Act does not expressly prohibit the destruction of protected native plants, it does impose some procedural hurdles to encourage and facilitate prospective land developers to salvage native Arizona plants to the greatest extent feasible.

The Native Plant Act applies to native plants growing on public as well as private land. The protected group of native plants includes:

> any plant or part of a plant, except, unless specifically included, its seeds or fruit, which is growing wild on state land or public land

> or on privately owned land without being propagated or cultivated by human beings and which is included by the director on any of the definitive lists of protected categories of protected native plants ….

The Native Plant Act does not apply to existing canals, laterals, ditches and electrical transmission and distribution facilities. Normal and routine maintenance of improvements that may cause the incidental or unavoidable destruction of native plants are also exempt from the Native Plant Act's provisions.

Renewable Energy

Given the significant amount of sunshine and large expanses of undeveloped land, Arizona desires to be the top provider of solar and renewable energy in the world. The state has undertaken several important initiatives to promote renewable energy growth, particularly for solar power. In addition to the initiatives and incentive programs described below, it is likely that further programs will be undertaken to encourage renewable energy growth within the state.

RENEWABLE ENERGY TAX BENEFITS

Non-residential entities that install solar or wind energy devices are subject to a 10 percent Arizona tax credit, up to a maximum of $25,000 per building. Additionally, a separate

tax credit is available for renewable energy that is calculated based on the wattage of renewable energy produced.

STREAMLINED ZONING AND FEE REDUCTIONS FOR SOLAR INSTALLATIONS

A.R.S. §§ 9-468 and 11-323 require municipalities and counties to streamline permitting procedures for the installation of solar photovoltaic systems and also limit the fees that a local government can assess for such devices. Importantly, these statutes create consistent permit requirements to prevent major variations among Arizona's cities and counties. Likewise, the statutes also prevent cities and towns from assessing permitting fees that exceed the actual cost of permit issuance.

RENEWABLE ENERGY SOURCING REQUIREMENTS

Numerous businesses are rushing to Arizona to develop large-scale sources of renewable energy given recent requirements that Arizona utilities produce or obtain a set percentage of their energy from renewable sources. This required percentage increases annually, with the requirement that Arizona utilities obtain 15 percent of their output from renewable sources by 2025.

Practical Tips

ENVIRONMENTAL ASSESSMENTS AND ALLOCATION OF LIABILITIES

The acquisition of real property or an existing business normally should be preceded by an environmental assessment of the property and/or business. Environmental assessments serve at least two important purposes. First, environmental assessments identify liabilities that may significantly affect the economic viability of an acquisition. Cleanup costs, expenses and delays in planned operations may make the acquisition economically unattractive. Further, knowledge as to whether operating permits are transferable is important if the business will continue to be operated in the same fashion after acquisition. Second, the prospective purchaser may be able to take advantage of the innocent purchaser defense under the Superfund Laws, as noted above, if proper due diligence (typically in the form of an environmental assessment) is undertaken.

The parties to a transaction also typically should address the possibility and allocation of environmental liabilities in their agreement through appropriate representations, warranties and indemnities.

TRANSFERS OF PERMITS

Changes in ownership or control of an Arizona business frequently require amendments to environmental permits to "transfer" the permit to the new business. Unfortunately, transfer requirements and procedures vary from permit to permit. Further, some permits must be transferred prior to any change in ownership or control while others must occur following the restructuring. Consequently, prior to engaging in any restructuring or the purchase or sale of a business, a party should plan ahead to ensure that all environmental permits are properly transferred and amended to maintain compliance with the law.

DUE DILIGENCE REQUIREMENTS FOR TRANSACTIONS

Given that most liability for environmental harm is not restricted by any form of statute of limitations, buyers of a business should carefully evaluate the method of acquisition—such as through a stock purchase or asset purchase—to determine whether the buyer will assume a previous parties' known or unknown environmental liabilities.

LITIGATION ISSUES

Given Arizona's unique environment, businesses that intend to use significant amounts of water or emit a large quantity of pollutants into the air are likely to draw attention from state and national environmental interests groups. Further, Arizona businesses should note that Arizona state courts have unique discovery rules that differ from most other states and the federal court system by requiring the disclosure of all information pertaining to a case—good or bad—to an opposing party.

Although Arizona is a comparative fault state, whereby a party is ordinarily only liable for its proportion of fault, many state and federal environmental laws utilize joint and several liability. Under joint and several liability, a party may be deemed liable regardless of whether it is at fault and regardless of its proportion of liability.

ADEQ is authorized to inspect permitted facilities under the applicable environmental program. To ensure compliance with state environmental law, ADEQ utilizes a variety of enforcement mechanisms, ranging from informal compliance tools to formal enforcement through civil and criminal proceedings. The ADEQ Compliance and Enforcement Handbook outlines ADEQ's various enforcement policies and enforcement mechanisms.

ADEQ's Compliance and Enforcement Handbook also outlines how it calculates penalty amounts for parties willing to settle with the agency for alleged environmental violations. The settlement amount is calculated by assessing a multitude of factors, including the seriousness of the violation; any history of repeat violations; any history of non-compliance with other state, federal and local environmental laws; the party's refusal to comply with ADEQ directives; the duration of the violation; good faith efforts to comply; fault attributable to a third party; the economic impact on the violator as a deterrent to future improper conduct, the party's ability to pay and ADEQ's likelihood of success in the matter. Violators may also be permitted to conduct a "Supplemental Environmental Project" that benefits the local environment to mitigate any penalty.

Water Rights

Karlene E. Martorana and L. William Staudenmaier

Much of Arizona is arid. As a consequence, Arizona has developed an extensive system of statutes and regulations for allocating water among competing users. These laws are widely recognized as a fair and effective means of managing Arizona's water resources.

Most who need water in Arizona will have little involvement with Arizona's water laws. Those who locate industrial, commercial or residential developments within metropolitan areas of Arizona usually will find fully developed water supplies and delivery systems. Hooking up to a water line and paying a usage fee to the municipal water company will be all that is required. But water rights can be an important element in certain types of real estate purchases or industrial ventures, especially in the smaller metropolitan areas of Arizona. Agricultural, commercial or industrial developments locating in rural or undeveloped areas may find that the availability of water is a key factor in the successful development of these types of properties.

Types of Water Rights in Arizona

Water rights in Arizona are classified into three broad categories: (1) rights to use surface water, such as the water in streams, rivers, lakes, ponds and springs; (2) rights to use groundwater; and (3) contractual rights to water.

While each of these categories is discussed below, it must be remembered that in Arizona, the nature of a "water right" is defined by the courts and by Arizona's legislature. As our courts or the legislature resolve conflicts between competing water users, the nature of such water rights may be altered or restricted as to use.

SURFACE WATER RIGHTS

Doctrine of Prior Appropriation

In the arid western United States, early miners, irrigators, settlers and pioneers found that streams, rivers and lakes were sparse. These early water users often claimed surface water under an informal process that had previously been used to claim minerals under mining laws. A water user would "stake a claim" to surface water by diverting it from its source and applying it to some beneficial use—usually mining, irrigation or domestic consumption. This informal process became known as the Doctrine of Prior Appropriation.

Arizona, like certain other western states, follows the Doctrine of Prior Appropriation. Under this doctrine, the first person to divert and beneficially use surface water acquires a "prior right" or "senior right" to the water necessary to continue his or her beneficial use. An appropriator with a senior right is entitled to have his or her right protected from interference by subsequent water users with "junior rights." For example,

a water user who appropriated water in 1950 is entitled to protection against a person who initiated a water use from the same source in 1991. Thus, the Doctrine of Prior Appropriation translates into "first-in-time is first-in-right."

The Administrative Process for Acquiring Surface Water Rights

During the final 20 years of the 1800s, most western states adopted a water code of some sort in which the Doctrine of Prior Appropriation was legislatively reduced to an administrative process. The territorial and state legislatures enacted statutes to formalize the Doctrine of Prior Appropriation. Statutes varied widely from state to state, but often the enactments of one state were subsequently adopted by another state. In 1919, Arizona enacted its surface water code based on Oregon's code.

Despite the variation from state to state, most statutory schemes based on the Doctrine of Prior Appropriation require a person who desires to appropriate surface water to first file an Application to Appropriate with the applicable state agency. In Arizona, this agency is now the Arizona Department of Water Resources (ADWR).

After the application is filed, ADWR issues a Permit to Appropriate under which an applicant is entitled to construct the diversionary facilities necessary to put the surface water to beneficial use. Once the facilities have been constructed and the water has been applied to beneficial use, ADWR issues yet another document recognizing, at least on an administrative level, the validity of the appropriation. In Arizona, this document is referred to as a Certificate of Water Right.

Registration of Certain Types of Surface Water Rights

Arizona's 1919 Surface Water Code did not, however, provide a mandatory, statewide system for registering surface water rights based on uses initiated prior to 1919. Water rights that had been acquired before 1919 were not subject to the Surface Water Code's requirement that a water user first file an application to appropriate surface water. Therefore, no database of the water rights that had been perfected or vested prior to June 12, 1919 existed. To deal with specific problems in determining conflicting rights to surface water, Arizona's legislature enacted a law that required those who claimed such pre-1919 water rights to register these types of claims with the appropriate state agency.

A similar registration scheme required stockpond owners to register their water rights claims. A stockpond is a small surface water impoundment that stores water solely for watering livestock or wildlife. Generally, stockpond water rights are of limited value to large industrial water users and real estate developers.

General Stream Adjudications

In the mid-1970s, major surface water users initiated adjudications in two major river systems in Arizona: the Gila River and Little Colorado River Systems. General stream adjudications or judicial proceedings in the state courts determine

the nature, extent and relative priority of surface water rights in an entire river system.

Under the current law, it is unclear exactly what claims fall within the scope of a general stream adjudication. In many cases, groundwater may be hydrologically connected to surface water flow. Such water is known to be subflow and for purposes of adjudicating water rights will be treated as surface water. The extent of subflow continues to be a key element of litigation in the adjudications. Because the extent of subflow remains uncertain, many ground water users in Arizona have filed statements of claimant in the adjudications to protect their water rights should the water they are using be determined to be subflow. Many water rights may be affected by the outcome of this litigation.

Indian tribes with reservations in Arizona have asserted significant claims to water. It was hoped that in these adjudications, the Arizona courts would determine the nature and extent of these claims. However, the adjudications have become extremely complex and protracted. Rather than adjudicate their water rights, many Indian tribes have settled their water rights claims as to other water users in the state.

GROUNDWATER RIGHTS

"Groundwater" means water found under the surface of the earth regardless of the geologic structure in which it is standing or moving. As explained above, Arizona simply does not have enough surface water to meet demand. As a result, numerous water users in Arizona drilled wells and then pumped groundwater from highly productive aquifers. Municipalities and mining companies usually drilled wells to tap aquifers already pumped by agricultural groundwater users. As a result, groundwater levels declined and pumping costs increased; these increased costs led to protracted litigation.

To resolve these disputes, Arizona passed the 1980 Groundwater Management Act. The Groundwater Management Act governs the use of groundwater in active management areas (AMAs), which include most of the metropolitan areas of Phoenix, Prescott and Tucson, as well as the upper Santa Cruz Valley (near Nogales, Arizona) and Pinal County in central Arizona.

Groundwater Rights in AMAs

Pursuant to the Groundwater Management Act, ADWR adopted management plans for each AMA that require all groundwater uses in an AMA to gradually implement conservation measures to reach certain management goals. For example, in the Phoenix, Tucson and Prescott AMAs, groundwater usage is to be managed to achieve "safe-yield" by the year 2025. Safe-yield is a long-term balance between the annual amount of groundwater withdrawn and the annual amount of natural and artificial groundwater recharged or replenished in the same AMA. The management goals for the Pinal and Santa Cruz AMAs are similar to the goal of safe yield, although other management objectives are also recognized.

Within an AMA, to legally pump groundwater, a person must have a grandfathered right, a withdrawal permit or a service area right, unless the use is for domestic purposes and is less than 35 gallons per minute. There are three types of grandfathered rights: irrigation grandfathered rights, type 1 rights and type 2 rights. A property owner who used groundwater for agricultural irrigation on a particular parcel of land during the five-year time period before January 1, 1980 acquired an irrigation grandfathered groundwater right. The grandfathered irrigation right entitles the owner of the property or the owner's successors, to continued use of groundwater on that property for agricultural irrigation. A type 1 right is created when land is permanently retired from farming and used for a non-irrigation purpose. Type 1 rights can only be conveyed with the land. A type 2 right, also based on historical irrigation, can be used for non-irrigation purposes. A type 2 right is the most flexible grandfathered right because it can be sold or leased separate from the land. If a property owner does not have a grandfathered right, the owner nevertheless may be entitled to a groundwater use under a withdrawal permit issued by ADWR. In addition, service area rights allow municipalities to withdraw water to serve their customers.

Groundwater Rights Outside AMAs

Outside of the AMAs, there are areas where property owners are prohibited from using groundwater to irrigate new tracts of land. These areas are designated as irrigation non-expansion areas (INAs). In INAs, groundwater usage for agricultural uses cannot increase. There are, however, no restrictions in INAs prohibiting new uses of groundwater for nonagricultural purposes.

The use of groundwater outside of INAs and AMAs is governed by the doctrine of reasonable use. Under this doctrine, a property owner is authorized to withdraw and use groundwater on the owner's property for all "reasonable" purposes. There may also be limitations on the transportation of groundwater away from the basin from which it is withdrawn.

CONTRACTUAL WATER RIGHTS

Rights to water also may be established under contract, such as when an owner of property enters into a contract with a municipality or a private water company to obtain water. Often, developers in Arizona will have to negotiate the terms and conditions of water service with a private water company or a municipality. If the entity that supplies the water is a private water company, then such water service contracts typically must be approved by the Arizona Corporation Commission (ACC), the state agency that regulates private companies that supply utility services in Arizona.

In addition, various water suppliers have entered into water service contracts to acquire water from the Central Arizona Project (CAP), a technologically-advanced aqueduct system that transports water from the Colorado River to water users in central and southern Arizona. Other water users may enter

into contracts to receive reclaimed water, water that has been used and treated for re-use.

The Central Arizona Project

The CAP is an aqueduct system consisting of canals and an expanded storage facility (New Waddell Dam) through which Colorado River water is imported from Lake Havasu (on the Colorado River) to the Phoenix and Tucson metropolitan areas, as well as various irrigation districts and Indian tribes along the aqueduct system. It has a capacity of approximately 1.5 million acre-feet per year.[83] The CAP was constructed by the U.S. Bureau of Reclamation under the authority granted to the Secretary of Interior in the Colorado River Basin Project Act of 1968, which authorized federal funding of this project.

The CAP is now operated by an Arizona political subdivision, the Central Arizona Water Conservation District (CAWCD). The CAWCD is responsible for repaying to the United States a portion of the construction cost of the CAP, as well as operating and maintaining it. Payments to the United States are made with funds acquired by CAWCD from three sources: property taxes levied on taxable real property within Maricopa, Pinal and Pima Counties; water service charges to all CAP water users, including those municipalities and private water companies that have contracted for CAP water but have not received delivery of such water; and the sale of surplus electrical power from several facilities that were constructed to

83 www.cap-az.com (Central Arizona Project).

generate electrical power for pumping Colorado River water through the CAP aqueduct system. In order to receive CAP water, municipalities, irrigation districts and other types of non-Indian water users enter into three-party contracts between the water user, the CAWCD and the U.S. Bureau of Reclamation. Indian tribes contract directly with the Secretary of the Department of Interior.

Reclaimed Water

Reclaimed water has become an important water conservation tool in Arizona. Reclaimed water is commonly used to irrigate golf courses, parks, cemeteries and for industrial purposes. The level of treatment wastewater receives dictates how the reclaimed water can be used. The use of reclaimed water is expected to increase in order to meet Arizona's growing demand for water.

Special Water Issues Affecting Land Acquisitions

Because of the importance of water, a prospective purchaser of real property in Arizona should conduct a thorough investigation of all applicable water rights that might either be legally appurtenant to the land to be acquired or, alternatively, required for future development. This investigation usually is made during a due diligence or feasibility review period that is provided for in most purchase agreements for major real estate transactions. If the property is in a metropolitan area, the investigation may involve no more than confirmation of

the availability of water and terms of water service from the local municipality or water company. If the property is located outside the area served by a municipality or private water company, or if the property includes existing wells or other water sources, the purchaser must make a more comprehensive analysis of water availability.

REVIEW OF TITLE REPORT AND SURVEY

Most water rights are appurtenant to specific parcels of real property. The ability to acquire water rights may depend on the geographic location of the real property—often the types of water rights that might be appurtenant to a tract of real property vary from location to location within Arizona. For example, irrigation grandfathered groundwater rights, as discussed above, exist only within the AMAs or INAs. Thus, farmland outside of an AMA or INA lacks such rights. If the real property is served with water from a commonly owned well or irrigated with water received from some surface water source, then the contractual arrangements under which such water is used often will be referenced in a title report.

If the real property to be acquired is of significant acreage, a prospective purchaser may elect to have the property surveyed to determine the existence of wells, ponds and similar water sources; this will aid in the evaluation of what water rights will actually be acquired in connection with the acquisition of the real estate. Close review of all such title reports and surveys is essential.

Warranties

A seller of property usually makes warranties of title to the purchaser, but sellers rarely make warranties relating to water rights because, as noted above, the outcome of the general stream adjudications may affect existing rights to both surface water and groundwater. Sellers are often unwilling or unable to make unqualified warranties regarding the validity of water rights.

Post-Acquisition Documentation

If real property includes appurtenant water rights, documents should be prepared and filed with ADWR to reflect the transfer of water rights from seller to buyer. Claims to water rights in the adjudication and well ownership should also be transferred. In many cases, the documentation can be submitted using forms available from ADWR. In addition to updating ADWR's records, water rights are also typically transferred by quit claim deed.

Special Water Issues Affecting Land Development

ASSURED WATER SUPPLY REQUIREMENTS

A purchaser who acquires property within an AMA and who intends to subdivide the property into six or more lots or parcels is required to demonstrate to ADWR that an assured water supply exists for the proposed subdivision before splitting the property into lots. Demonstration of an assured water supply requires a showing that enough water is physically and legally available to meet the demands of the subdivision for a 100-year period. Additionally, projected groundwater use must be consistent with the management plan and the developer must show financial ability to construct the water delivery system. Similar requirements apply to the subdivision of real property located outside of the AMAs, although, in such cases, the limitations on sub-dividing real property if adequate supplies of water are not available are somewhat more relaxed.

WATER SERVICE PROVIDERS

A person seeking to subdivide real estate in an area that lacks water service also may have to create a water service provider to build and operate the water service infrastructure. There are several alternatives for water providers, but two options commonly are considered—a developer might form a private water company or form a domestic water improvement district. Both alternatives involve additional expense and require various governmental approvals, but these alternatives may be the only way to develop a tract of real property in areas where no water service provider is available.

Formation of a Private Water Company

In some cases, a developer may elect to form a private water company. Sometimes several developers will join to form a water company to serve a number of developments. Formation of a water company is a complicated process that may take significant time to complete. Approval must be obtained from the ACC, which will grant the water company a certificate of convenience and necessity (CC&N). CC&Ns allow the water companies to serve customers in a specific geographic area. Additionally, a water company must obtain a franchise from the county or municipality in which it proposes to operate. If the water company conducts business within the boundaries of a municipality, the grant of a franchise requires approval of the municipality's voters. Furthermore, a water company that proposes to operate within an AMA must satisfy conservation requirements imposed by ADWR. Approvals also are required from state and local health and environmental departments.

Formation of a Domestic Water Improvement District

An alternative to the formation of a private water company is the formation of a domestic water improvement district to construct or to acquire an existing water system. Every landowner within such a district pays assessments that are used to pay the costs and expenses of the district. In some cases, a district has the capacity to issue bonds and the proceeds from the bond sale are used to construct water service facilities. There are extensive requirements for the formation of such districts, including obtaining the approval of the Board of Supervisors of the county in which the district is located and sometimes obtaining the approval of other districts that operate in the same geographical area.

Federal Income Taxation

Geoffrey L. Gunnerson, William A. Kastin, Bahar A. Schippel and Carlene Y. Lowry

This chapter deals with certain federal income tax considerations relevant to foreign individuals and entities investing or doing business in the United States.

I. Taxation of Foreign Individuals

The federal income taxation of a foreign individual depends, almost entirely, on whether that foreign individual is properly treated as either a "U.S. resident" or a "nonresident." That determination is discussed in Part I.A. Once that determination is made, Part I.B addresses certain general federal income tax rules applicable to foreign individuals taxed as U.S. residents and Part I.C addresses certain federal income tax rules applicable to foreign individuals taxed as nonresidents. Parts II and III briefly address the federal income tax rules applicable to doing business in the United States by way of a corporation or partnership, respectively. Finally, Part IV briefly addresses certain general federal tax rules that may apply to individuals, corporations and partnerships doing business in Arizona.

A. DETERMINATION OF STATUS AS A U.S. RESIDENT

A foreign individual who is a U.S. resident is often times referred to as a "resident alien," and is treated as such if he or she meets one of the following two tests for the calendar year.

1. The Green Card Test

A foreign individual is classified as a resident alien if he or she is in the United States by way of an immigrant visa (a green card) and the individual's green card status has not been rescinded or abandoned. Unlike the substantial presence test, discussed below, the length of time during which the individual is in the United States is irrelevant in determining whether the individual is a resident alien pursuant to the green card test.

2. The Substantial Presence Test

Alternatively, pursuant to the substantial presence test, a foreign individual is classified as a resident alien if he or she is physically present in the United States (i) for at least 31 days during the current year and (ii) 183 days during the three-year period that includes the current year and the immediately preceding two years.

There are special rules applicable for the manner in which days are counted for these purposes. Specifically, to satisfy the 183-day requirement, you count (i) all the days the individual was present in the United States during the current year, (ii) one third of the days the individual was present in the United States during the first year before the current year and (iii) one sixth of the days the individual was present in the United States during the second year before the current year. In addition, you do not count certain days (e.g., days during which the individual was in transit between two places outside of the United States and days the individual was prevented from

leaving because of a medical condition that arose while in the United States).

In addition, certain individuals do not count those days during which they were in the United States as an "exempt individual." For example, an exempt individual may include (i) an individual temporarily present in the United States as a foreign government-related individual and (ii) certain teachers, trainees and students in the United States and in compliance with specified visas (e.g., J, Q and F visas).

Even if a foreign individual meets the substantial presence test, such foreign individual may be treated as a "nonresident alien" if he or she (i) is present in the United States for fewer than 183 days during the current calendar year, (ii) maintains a tax home in a foreign country during the year and (iii) has a closer connection to that country than to the United States (collectively commonly referred to as the "Closer Connection Exception").[84] In applying the Closer Connection Exception, factors taken into consideration include the locations of the individual's family and business, location of bank accounts and the individual's social, political, cultural and religious affiliations. An individual who otherwise satisfies the substantial presence test must file a statement justifying the claim to the Closer Connection Exception. The statement must be

84 This exception to being classified as a resident alien only applies to foreign individuals who would be classified as a resident alien under the substantial presence test. The exception does not apply to foreign individuals who are classified as resident aliens under the green card test.

filed with the Internal Revenue Service (IRS), the principal enforcement agency of the U.S. tax laws. Alternatively, if a foreign individual satisfies the substantial presence test, but does not come within the Closer Connection Exception, such foreign individual may still be treated, for tax purposes, as a nonresident alien under the "tie-breaker" rules set forth in a tax treaty between the United States and such individual's country of residency.

3. Dual Status Years

Special rules govern the first and last year in which a foreign individual is classified as a resident alien.

a) Initial Year as a Resident Alien

A foreign individual who is classified as a resident alien is regarded as a resident alien only for the portion of the calendar year that begins on such resident alien's "residency starting date."

If a foreign individual is classified as a resident alien during the calendar year pursuant to the green card test, then such person is generally considered a resident alien for the entire year.

If a foreign individual is classified as a resident alien for any calendar year pursuant to the substantial presence test, then such person's residency starting date is generally the first day he or she is present in the United States during that calendar year. Thus, a foreign individual may be taxed as (i) a nonresident alien for a portion of a calendar year and (ii) a resident

alien for the remainder of that year, a year sometimes referred to as a "dual status" year. An exception to this rule arises if the individual was classified as a resident alien at any time during the preceding calendar year. If an individual is classified as a resident alien in the immediately preceding calendar year and, pursuant to the substantial presence test, such individual is considered a resident alien in the current year, then such person's residency starting date is January 1 of the current year.

b) Final Year as a Resident Alien

In general, if a foreign individual is classified as a resident alien in one year, but is not classified as a resident alien during any part of the following year, then such person ceases to be a U.S. resident on his or her "residency termination date." In general, a resident alien's residency termination date is December 31 of the last year during which such individual qualified as a resident alien. However, a resident alien may qualify for an earlier termination date in certain circumstances. For example, under certain circumstances, if the individual is a resident alien pursuant to the green card test, then his or her residency termination date is the first day of the year that such individual is no longer a lawful permanent resident. Similarly, under certain circumstances, if the individual is a resident alien pursuant to the substantial presence test, then his or her residency termination date is the last day in the year that he or she was physically present in the United States.[85]

B. TAXATION OF RESIDENT ALIENS

A foreign individual who is classified as a resident alien for federal income tax purposes is taxed in the same manner as a U.S. citizen. Accordingly, the individual's income earned worldwide (as opposed to being limited to the individual's income earned from within the United States) is subject to U.S. taxation. In general, ordinary income is taxed at graduated rates, currently ranging from 10 to 35 percent.[86] This rate generally applies to rents, royalties, interest and compensation for personal services performed. Currently, the maximum U.S. federal long-term capital gains rate is 15 percent. This rate generally applies to gains from the sale of capital assets held for more than 12 months. The United States, unlike certain other countries, does not permit a capital gains tax adjustment in the tax basis of a capital asset to fair market value upon arrival; as such, all appreciation in the value of capital assets, including the appreciation accumulated prior to arrival in the United

85 In order to establish a residency termination date, the individual must file with the IRS, together with such individual's tax return, a statement, dated and signed under penalties of perjury, providing, among other things, sufficient facts respecting such person's termination of status as a lawful permanent resident.

86 The tax rates referred to throughout this chapter were in effect as of January 2012. However, tax rates may change and new taxes may be imposed as a result of legislation arising subsequent to the drafting of this publication.

States, is potentially subject to U.S. tax upon the disposition of such capital asset.

In many instances, classification as a resident alien will result in greater U.S. taxes than if the individual were classified as a nonresident alien. However, there are circumstances in which a resident alien pays lower taxes than a nonresident alien. For example, a resident alien may pay lower taxes than a nonresident alien because the resident alien is able to claim various deductions that reduce taxable income or may be able to claim a credit for certain taxes paid to foreign countries.

Special rules apply to resident aliens and U.S. citizens alike in determining U.S. taxable income arising from foreign holdings. For example, ownership in certain foreign corporations may result in a "deemed" dividend on which U.S. taxes must be paid, even though a dividend is not actually received by the taxpayer. This could occur, for example, with respect to a resident alien's ownership in a "controlled foreign corporation" (CFC). A CFC is a foreign corporation of which more than 50 percent, by vote or value, is owned by U.S. shareholders. For purposes of that definition, U.S. shareholders are defined as U.S. citizens, resident aliens, corporations, etc. that own, directly or indirectly, at least 10 percent of the voting stock of such foreign corporation. As another example, ownership of "foreign personal holding companies" or "passive foreign investment companies" can also result in unanticipated U.S. income tax liabilities arising from such holdings, in some instances, even if no cash is actually received from such companies. Additional tax and information returns must also be filed with respect to such foreign corporate holdings. In some instances, a timely election may reduce certain adverse tax implications associated with such holdings. Foreign individuals who are classified as resident aliens for U.S. tax purposes should be mindful of how these rules could apply to such individual's non-U.S. holdings and investments.

C. TAXATION OF NONRESIDENT ALIENS

In general, there are two sets of federal income tax rules applicable to nonresident aliens—one set of rules applicable to passive investment income (discussed in Part I.C.1) and another set of rules applicable to income "effectively connected" with the conduct of a trade or business in the United States (discussed in Part I.C.2).

1. Investment Income

Investment income (sometimes referred to as "fixed or determinable annual or periodic income" or FDAP) earned from U.S. sources by a nonresident alien is generally taxed in the United States at a flat tax rate of 30 percent. The tax is generally collected by withholding at the source and applies to the gross amount of the investment income. The amount of investment income subject to federal income taxation is computed without any deductions. Investment income is income not effectively connected with a U.S. trade or business and includes interest, dividends, rents and royalties. Investment income earned from foreign sources by a nonresident alien is

not subject to U.S. taxation. In this respect, whether the income is "U.S.-sourced" or "foreign-sourced" is important for determining whether such income is subject to U.S. income tax and withholding. Below is a brief summary of certain types of investment income and the manner in which such income is sourced.

a) Interest

In general, interest paid by a U.S. borrower to a foreign lender is treated as U.S. source investment income. As such, it is subject to the 30 percent tax and corresponding withholding rules mentioned above.

Not all interest earned from U.S. sources is subject to such treatment. For example, neither (i) interest payments arising from deposits with U.S. banks nor (ii) "portfolio interest" are subject to these U.S. tax and withholding rules. Portfolio interest generally includes interest that accrues from an obligation issued in registered form.[87] However, in general, portfolio interest does not include either contingent interest or interest paid to a non-U.S. payee that owns 10 percent or more of the U.S. payor.

b) Dividends

In general, dividends paid by a U.S. corporation are treated as U.S. source investment income. As such, it is subject

87 Portfolio interest also applies to certain interest accrued from debt instruments issued in bearer form prior to March 18, 2012.

to the 30 percent tax and corresponding withholding rules mentioned above.

c) Rents and Royalties

Rental income that is not effectively connected with a U.S. trade or business is U.S. source investment income if the property producing the rent is located in the United States. Royalties from the licensing of intangible property, such as patents, copyrights, secret processes, good will and similar properties are treated as U.S. source income if the intangible property is used in the United States. As such, both types of investment income are subject to the 30 percent tax and corresponding withholding rules mentioned above.

d) Disposition of Investments

In general, assets that generate investment income may qualify as capital assets. A nonresident alien's gain arising from the disposition of a capital asset will often, but not always, be exempt from U.S. taxation. There are, of course, exceptions to this general rule. For example, dispositions of U.S. real property (including U.S. property held indirectly through a U.S. entity) is subject to a special set of rules, discussed below, subjecting such transactions to both U.S. tax and withholding rules. Another exception arises when, in certain instances, the disposition of a capital asset gives rise to ordinary income. In that case, such ordinary income will be subject to the 30 percent tax and withholding rules discussed above.

e) Tax Treaties and Certain Forms

The United States has entered into income tax treaties with numerous foreign countries. If applicable, the rules set forth in the treaties can reduce the U.S. taxation and withholding rates otherwise applicable to the U.S.-sourced investment income discussed above. For example, some treaties may reduce or eliminate the 30 percent tax applicable to dividend income.

In connection with investing in the United States and receiving payments of investment income, a nonresident alien may be required to submit to the U.S. payor an IRS Form W-8BEN, certifying under penalties of perjury that the payee is, in fact, a nonresident alien.

2. Trade or Business Income

a) General

As mentioned above, a nonresident alien's U.S.-sourced investment income is subject to a 30 percent tax and withholding rate, which applies to the gross amount of such investment income. By contrast, a nonresident alien's income that is effectively connected with a U.S. trade or business is taxed on a net basis at graduated rates. Thus, certain expenses associated with the trade or business can be claimed as a deduction to offset the amount of income subject to tax. The rates of taxation vary between 10 and 35 percent, similar to the rates applicable to U.S. citizens and resident aliens. Although most effectively connected income is derived from U.S. sources, a nonresident alien may be taxed on certain foreign source income if such foreign source income is effectively connected with a U.S. trade or business.

There are no specific guidelines for determining whether a nonresident is considered to be engaged in a U.S. trade or business. The most important factor is the "continuity and regularity" of activities carried on in the United States. The number of transactions and the nature and kind of undertakings carried on are important criteria. For example, isolated sales or "net leases" by a foreign person (leases that do not compel the nonresident alien to provide any services in connection with the leased property) to only one tenant may not be considered a U.S. trade or business. As another example, trading in securities or commodities, through brokers or for one's own account, also may not constitute a U.S. trade or business. However, the purchase and sale of goods and the regular solicitation and advertising of sales in the United States are both activities regarded as engaging in a U.S. trade or business.

Even if a nonresident alien is not directly engaged in a U.S. trade or business, the nonresident alien may be deemed to be engaged in a trade or business as a result of the activities of others. For example, activities engaged in by a partnership (foreign or domestic) in which the nonresident alien is a partner are attributed to the foreign partner. Similarly, activities engaged in by an agent on behalf of a nonresident alien may be attributed to the nonresident alien.

Compensation for the performance of personal services in the United States is treated as income effectively connected with a U.S. trade or business. A limited exception applies for certain nonresident aliens performing services in the United States for a relatively short period of time, i.e., up to 90 days and who earn less than $3,000 for such services. Additional exceptions to this general rule may also be available pursuant to an applicable income tax treaty.

b) Tax Treaties and Certain Forms

As mentioned previously, the United States has entered into income tax treaties with numerous foreign countries. Even if income is effectively connected with a U.S. trade or business, many treaties exempt such income from U.S. taxation if the nonresident alien does not have a "permanent establishment" in the United States. The definition of a permanent establishment varies from treaty to treaty, but is often defined as an office, branch, factory or similar facility in the United States. A permanent establishment generally does not include a storage facility. A tax advisor can help nonresident aliens determine whether their U.S.-related operations rise to the level of a permanent establishment under the applicable U.S. income tax treaty.

In connection with engaging in a trade or business in the United States and receiving payments of income in connection with such trade or business, a nonresident alien may be required to submit to the U.S. payor an IRS Form W-8ECI, certifying under penalties of perjury that the payee is in fact a nonresident alien and that the income received from the payor will be treated by the nonresident alien as effectively connected income.

c) United States Real Property Interests

A special set of rules generally applies to the taxation of income relating to a U.S. real property interest.

U.S. source rental income could be taxed either as (i) investment income, in which case the gross amount of such rental income would be subject to the flat 30 percent rate of tax (discussed above in Part I.C.1.c) or (ii) effectively connected with a U.S. trade or business, in which case the net amount of such rental income (i.e., after reduction for rental expenses, including depreciation deductions) would be subject to tax at graduated rates. Whether rental income is properly taxed as investment income or effectively connected income depends on the facts and circumstances of each case, taking into account the various landlord-related services provided by the nonresident alien or the nonresident alien's agents. If the nonresident alien prefers to claim rental expenses as deductions and subjects the net rental income to tax at graduated rates, then he or she may elect to treat the rental income as effectively connected with a U.S. trade or business. The election, if made, applies to all rental income from U.S. real property earned by the nonresident alien and remains in effect for all subsequent

taxable years unless permission to revoke the election is granted by the IRS.

Special rules apply to the gain or loss associated with the taxable disposition of a U.S. real property interest. In general, those rules provide that regardless of whether the ownership and operation of the U.S. real property constitute a trade or business, gain or loss associated with the taxable disposition of such U.S. real property interest is treated as income effectively connected with a U.S. trade or business.

In addition, to ensure that nonresident aliens pay tax on any gain arising from the disposition of a U.S. real property interest, special withholding rules generally provide that the purchaser or transferee of a U.S. real property interest from a nonresident alien transferor must withhold 10 percent of the amount realized by the nonresident alien with respect to such transfer. Because the 10 percent withholding rate is applied to the "amount realized" on the sale, as opposed to the gain from the sale, it is possible that the amount withheld will be greater than the tax ultimately due with respect to the sale. Careful planning, well in advance of a disposition of a U.S. real property interest, may reduce the amount required to be withheld in connection with the transfer. If less tax is withheld than the non-U.S. transferor's tax liability, then the transferor must pay the additional tax due upon filing its U.S. tax return. Alternatively, if more tax is withheld than the non-U.S. transferor's tax liability, then the non-U.S. transferor may file a claim for refund.

For these purposes, a U.S. real property interest includes direct and indirect ownership of real property in the United States. In general, stock in a U.S. corporation generally constitutes a U.S. real property interest if, at any time during the five-year period preceding the nonresident alien's disposition of the stock, the corporation held U.S. real property worth 50 percent or more of the fair market value of the corporation's total assets. However, there are some exceptions to this general rule. For example, publicly traded stock of a U.S. corporation does not constitute a U.S. real property interest connected with a U.S. trade or business unless a foreign individual directly or indirectly owns more than 5 percent of the corporation's stock.

II. Taxation of Corporations

The federal income taxation of corporations depends on whether the corporation is a U.S. corporation (also referred to as a domestic corporation) or a foreign corporation. In general, the corporation's "place of incorporation" determines its status for federal income tax purposes. As such, a U.S. corporation is a corporation created or organized in the United States. And, unless an election is made to be treated as a U.S. corporation, a corporation created and organized outside of the United States is a foreign corporation.

A. TAXATION OF UNITED STATES CORPORATIONS

A United States corporation is taxed on its income earned worldwide. Generally, a U.S. corporation is taxed on its income

at graduated rates between 15 and 35 percent and there is no preferential rate for capital gains as there is for individuals.

In addition to the income tax paid by the corporation on its worldwide income, shareholders of a corporation are subject to tax on dividends distributed or deemed to be distributed, from the corporation. The federal taxation of those dividends depends, in part, on whether the shareholder is taxed as a resident or nonresident alien. As a result of both the corporate level tax and the shareholder level tax, corporate profits are generally subject to two levels of taxation.

Certain U.S. corporations may avoid the imposition of corporate level taxes by making a special election under Subchapter S of the federal income tax code. In lieu of taxes payable by the S corporation, only the shareholders of the corporation pay taxes on income earned by the corporation. A corporation can make this election only if, among other requirements, its shareholders meet certain eligibility requirements and the number of permissible shareholders does not exceed 100 (subject to certain exceptions that increase the number of permissible shareholders when the shareholders are members of the same family). As a general rule, nonresident aliens, corporations, partnerships and many types of trusts are not eligible S corporation shareholders.

B. TAXATION OF FOREIGN CORPORATIONS

Foreign corporations are taxed in a manner similar to the taxation of nonresident aliens. A foreign corporation's gross investment income is subject to U.S. tax and withholding at the source at the generally applicable flat rate of 30 percent, except as may be reduced by an applicable tax treaty.

A foreign corporation's net income effectively connected with its U.S. trade or business is not subject to withholding. Instead, except as may be provided by an applicable income tax treaty, such net income is taxed at graduated rates, similar to the taxation of U.S. corporations. In addition to the tax on net income effectively connected with a U.S. trade or business, a foreign corporation that directly engages in a U.S. trade or business may be liable for the "branch profits tax."

The branch profits tax subjects a foreign corporation that directly engages in a U.S. trade or business to U.S. taxes roughly equivalent to those that would be payable by a foreign corporate shareholder if the U.S. trade or business were incorporated as a U.S. subsidiary of such foreign corporation. When a foreign corporation is engaged in a U.S. trade or business through a U.S. subsidiary, income generated by the U.S. subsidiary is taxed twice. First, the U.S. subsidiary is subject to a U.S. corporate level tax; and second, dividends from the U.S. subsidiary to its foreign corporate shareholder are generally taxed at the flat rate of 30 percent on the U.S. source investment income. Without the branch profits tax, a foreign corporation doing business directly in the United States (as opposed to doing business through a U.S. subsidiary) would be subject to a U.S. corporate level tax on net income effectively connected with a trade or business, but because the earnings of

the foreign corporation when repatriated abroad would merely be transferred and would not be paid out as dividends, there would be no second shareholder level tax or withholding. To eliminate the distinction between the two structures, the branch profits tax imposes a tax on the amount deemed to be repatriated abroad by the U.S. branch. The amount deemed to be repatriated is intended to approximate the difference between the profits earned by the branch and the amount of branch profits reinvested in branch operations. Unless reduced by treaty, the tax is imposed at a rate of 30 percent. A similar tax is imposed on interest received by a foreign corporation from a U.S. branch.

III. Taxation of Partnerships

United States tax rules govern the characterization of an entity as a partnership or corporation for U.S. income tax purposes, notwithstanding the characterization of that entity under foreign law.

In general, unlike corporations, which are subject to corporate level taxes, partnerships do not incur U.S. federal income tax liability. Instead, the U.S. federal income tax liability falls on the partners of the partnership. Each partner of the partnership is required to take into account his or her respective distributive share of the partnership's net income or loss, as well as his or her respective distributive share of certain specially characterized items (e.g., capital gain), in computing such partner's income tax liability. In general, the activities of a

U.S. partnership are attributed to its foreign partners. For example, if a U.S. partnership (or an entity taxed as a partnership for U.S. tax purposes, such as a multi-member limited liability company) is engaged in a U.S. trade or business and has a fixed place of business in the United States, then a foreign partner of that partnership is itself treated as being engaged in a U.S. trade or business and as having a fixed place of business in the United States.

A U.S. partnership generally must withhold, on a quarterly basis, 35 percent of a foreign partner's distributive share of the partnership's income effectively connected with a U.S. trade or business. When the foreign partner later files its U.S. tax return (e.g., IRS Form 1040NR) with respect to such effectively connected income, the foreign partner may claim, as a credit against its U.S. tax, the U.S. federal income tax withheld by the partnership. If more tax is withheld relative to the foreign partner than is owed by such foreign partner, then, in most instances, such foreign partner may file a claim for a refund. The tax rules applicable to partnerships are terribly complex. A professional tax advisor can provide advice on any applicable U.S. federal income tax consequences to individuals, partnerships and corporations seeking to invest in a partnership or do business in the United States through a partnership.

IV. Additional Tax Considerations

A. TRANSFER PRICING

Transactions between foreign taxpayers and "related parties" under "common control" are closely scrutinized by the IRS. The principal purpose of such scrutiny is to ensure that the corporations deal with each other at arm's length and do not unreasonably inflate or reduce the costs of goods and services performed between the two in an effort to shift income artificially from one entity to the other for tax advantage. The IRS has extensive authority to reallocate income and deductions among related parties if it determines that arm's length dealing has not occurred.

B. DISCLOSURE AND RECORD KEEPING REQUIREMENTS

1. Foreign Bank Account Reporting

Separate and apart from the federal tax liabilities arising from foreign holdings, there are annual disclosure requirements applicable to resident aliens, U.S. partnerships and U.S. corporations, which may apply to a foreign individual or business entity in connection with doing business or investing in the United States. In general, these rules apply if: (i) the individual or entity has a financial interest in, or has signature authority over, a foreign financial account (e.g., a bank account, brokerage account, certain mutual funds and retirement accounts) and (ii) the aggregate value of all such foreign financial accounts exceeds $10,000 at any time during the calendar year. In such a case, the individual or entity may be required to report the foreign financial account to both the IRS and the U.S. Treasury Department, even if the account produces no taxable income (e.g., no interest income).

In general, this disclosure obligation is satisfied if the applicable party both checks the appropriate box on its U.S. federal income tax return and files TD F 90-22.1 (Report of Foreign Bank and Financial Accounts, commonly referred to as the FBAR). The FBAR is filed separately from the applicable party's U.S. federal income tax return and must be received by the U.S. Treasury Department on or before June 30 of the year immediately following the calendar year being reported. Unlike tax returns, there is no extension for filing the FBAR.

Failure to meet this annual disclosure obligation could subject the applicable party to (i) criminal charges including, but not limited to, charges related to tax evasion, filing a false return and failure to file an income tax return, (ii) criminal penalties for failing to file the FBAR, and (iii) civil penalties including but not limited to (a) a penalty for willfully failing to file the FBAR, in an amount equal to the greater of $100,000 or 50 percent of the total balance of the foreign account;[88] (b) a penalty for failing to file a tax return in an amount equal to 5 percent of the balance due, plus an additional 5 percent for each month during which failure continues, not to exceed 25 percent; and (c) in the case of fraud, a penalty in an amount

88 Or, in the case of *non-willful* violations, a penalty of not more than $10,000 per violation.

equal to 75 percent of the unpaid tax. In the case of corporate entities subject to these rules, officers and directors may also be subject to penalties for corporate non-compliance.

2. Disclosure and Record Keeping Requirements on Certain Corporations

The federal tax code imposes disclosure and record keeping requirements on corporations used by foreign persons for investment or business in the United States. The disclosure and record keeping requirements apply to any "reporting corporation" that is either a foreign corporation engaged in business in the United States is a U.S. corporation that has at least one "foreign person" who directly or indirectly owns at least 25 percent of the vote or value of the corporation's stock. A "foreign person" includes a nonresident alien or foreign corporation.

A reporting corporation must file an annual return that discloses the name, business, principal business location and country of incorporation or residence of any related party who engaged in one or more transactions with the reporting corporation during the year. For these purposes, "related party" is defined very broadly.

In addition to maintaining all records necessary to determine its correct U.S. tax liability, a reporting corporation must also maintain all records necessary to establish the correct tax treatment of any "related party" transaction.

The disclosure and record keeping requirements for reporting corporations are complex and include exceptions for certain small corporations, e.g., a reporting corporation with less than $10,000,000 in U.S. gross receipts for a taxable year. Failure to comply with the disclosure and record keeping requirements could subject the reporting corporation to sanctions for non-compliance.

3. Tax Treaties

As mentioned throughout this chapter, the benefits of tax treaties entered into by the United States and certain treaty countries may be available to foreign nationals of, and foreign corporations organized under, the laws of such treaty countries. For example, tax treaties may reduce (or eliminate) the otherwise applicable U.S. withholding applicable to dividends or similar investment income payable by a U.S. payor to a foreign payee. Resident aliens, nonresident aliens and foreign corporations doing business or investing in the United States and Arizona should carefully consider how the provisions set forth in the applicable tax treaty impacts their particular circumstances.

State and Local Taxation

Craig R. McPike

The State of Arizona and various local governments impose taxes in connection with income, investments and business operations in Arizona. This chapter outlines several of the most significant state and local taxes in Arizona, beginning with taxes levied only by the state, such as state individual and corporate income taxes and estate taxes. The next part of this chapter deals with taxes that may be levied by the state, its counties and its municipalities, such as the transaction privilege (sales) tax and taxes on real and personal property.

Income Taxation of Individuals

Two different classifications govern state income taxation of individuals. One applies to "Arizona residents," the other to "Arizona nonresidents."

DETERMINATION OF RESIDENT STATUS

An individual is classified as an Arizona resident for state income tax purposes if such individual is in the state for other than a temporary or transitory purpose or is domiciled in Arizona. An individual is considered to be domiciled in Arizona if present in the state with the intent to remain in the state permanently. An individual who spends more than nine months of a year in the state is presumed to be an Arizona resident for that year, but evidence that the individual is in the state for a temporary or transitory purpose can overcome the presumption. An individual is classified as an Arizona nonresident if he or she is not classified as an Arizona resident under either of the above two tests.

TAXATION OF ARIZONA RESIDENTS

An individual classified as an Arizona resident for state income tax purposes is taxed by the state on the individual's income worldwide. The income tax rates range from 2.59 to 4.54 percent of taxable income.

TAXATION OF ARIZONA NONRESIDENTS

An individual classified as an Arizona nonresident for state income tax purposes is taxed by the state only on income earned from sources within the state. The income tax rates for a nonresident are the same as for a resident.

SIMILARITIES TO FEDERAL TAXATION

The income tax in Arizona is imposed on "Arizona taxable income." For residents, an individual's Arizona taxable income is the individual's federal adjusted gross income, modified by certain additions and subtractions. Two of these modifications relate to interest income. First, interest received on obligations issued by any state or municipality, although excluded from federal taxable income, is included in Arizona taxable income unless paid by the State of Arizona or by an Arizona municipality. Second, interest received on U.S. government obligations, such as savings bonds and treasury bills, although included in federal taxable income, is not subject to tax by Arizona or any other state. Many other modifications exist.

Income Taxation of Corporations

IN GENERAL

Arizona currently taxes 6.968 percent of the taxable income of corporations or $50, whichever is greater. Recently enacted legislation will cause this rate to decrease over a three-year period, to 6.5 percent in 2014, then to 6 percent in 2015 and finally to 5.5 percent in 2016. Except for corporations that derive income attributable to business activities in more than one state, a corporation's Arizona taxable income is determined by reference to the corporation's federal taxable income, with certain adjustments.

MULTI-STATE ACTIVITIES

If a corporation has income attributable to activities in more than one state and more than one state imposes a corporate income or similar tax, the corporation's aggregate income must be "apportioned" among the states. Only the amount properly apportioned to Arizona is subject to the Arizona corporate income tax.

For purposes of apportioning "business income," Arizona uses the three-part formula method of the Uniform Division of Income for Tax Purposes Act. Under this method, business income is generally apportioned among the states on the basis of three factors: the relative value of the corporation's real and personal property in Arizona as compared to the value of the corporation's property nationwide (the property factor); the relative amount of compensation paid by the corporation in Arizona as compared to the amount of the compensation paid by the corporation nationwide (the payroll factor); and the relative amount of sales made in Arizona as compared to the amount of the corporation's sales nationwide (the sales factor). Under Arizona law, a taxpayer may annually choose one of two options for weighting these factors. The first option is to weight the sales factor at 50 percent of the formula and to weight the property factor and the payroll factor each at 25 percent of the formula. The second option currently is to weight the sales factor at 80 percent of the formula and to weight the property factor and the payroll factor each at 10 percent of the formula. Arizona is in process of converting to a complete sales-factor approach for the second option—by 2017, the second option will be 100 percent sales factor.

Nonbusiness income, which is income received by the corporation outside the regular course of its trade or business, is allocated under different rules. Dividends and interest received by a corporation are allocated to the state of the corporation's commercial domicile. Income from real property rentals is allocated to the state where the real property is located. Patent and copyright royalties are generally allocated to the state where the patent or copyright is used.

Multi-State Corporations Involving Related Corporations

Multi-state corporations that are part of an affiliated group of corporations may elect to aggregate their income in a consolidated return for apportionment to Arizona. Once elected, an affiliated group must continue to file consolidated returns unless the Arizona Department of Revenue consents to a change. Even if an election is not made, the Arizona Department of Revenue may require a consolidated return to clearly reflect income. In order to file a consolidated state income tax return, multi-state corporations must file a consolidated income tax return at the federal level.

Estate Taxation

The death of an individual may have estate tax implications under Arizona law. Different tests govern depending on whether the individual is an "Arizona resident" or an "Arizona nonresident."

DETERMINATION OF RESIDENT STATUS

The location of an individual's "domicile" is determinative of such individual's estate status for Arizona estate tax purposes. An individual's estate is classified as an Arizona resident estate if the individual was domiciled in Arizona at the time of death; otherwise, the estate is classified as an Arizona nonresident estate. An individual is considered to be domiciled in Arizona if present in the state with the intent to remain permanently.

ESTATE TAXATION OF RESIDENT ESTATES

Arizona imposes its estate tax on a resident estate in an amount equal to the maximum credit for state death taxes allowed for federal estate tax purposes. The specific amount of such federal credit is prescribed by a table, which can be found at 26 U.S.C. § 2011(b).

ESTATE TAXATION OF NONRESIDENT ESTATES

Arizona imposes its estate tax on a nonresident estate in an amount equal to a portion of the maximum credit for state death taxes allowed for federal estate tax purposes. The Arizona estate tax equals the portion of the federal credit, found at 26 U.S.C. § 2011(b), that corresponds to the portion of the total value of the estate that is attributable to Arizona. Estate property that is attributable to Arizona includes real property located in Arizona and tangible personal property that has an "actual situs" in Arizona.

Transaction Privilege (Sales) Taxes

The State of Arizona, most municipalities, certain counties and various Indian tribes, impose a "transaction privilege" tax, similar to a "sales" tax that other states impose. The tax is imposed on the privilege of engaging in certain specific business activities, including retail sales, transportation, utilities, telecommunications, publication, job printing, private car line, transient lodging, amusements, restaurant, membership camping, mining, personal property leasing, real property leasing, contracting and owner/builder sales. The tax is imposed on the person who engages in the taxable business activity. The person who engages in the business is permitted to pass the tax through to the customer, if the tax is separately stated on the invoice or receipt.

Any person wishing to engage in a business covered by one of the statutory taxable classifications must first obtain a license from the state and the particular municipality in which the business is to be operated. In most instances, a monthly tax return is required and is submitted to the particular taxing jurisdiction with payment of the tax owed. Certain cities rely on the Arizona Department of Revenue for collecting and remitting the tax to the cities, while other cities completely administer their own tax program, with a completely separate licensing process.

The tax base is the gross income or gross proceeds from the business activity. The rate of tax imposed by the state is currently 6.6 percent for most categories of taxable activities, though this rate will decrease to 5.6 percent in 2013, after expiration of a 1 percent temporary increase and assuming that a ballot initiative intended to make permanent this temporary increase ultimately is not successful. Municipal tax rates vary, but generally range from 1.5 percent to 4 percent. Additionally, most counties impose a tax of .25 percent to 1.5 percent on most taxable business activities. Various tax exemptions and deductions, typically specific to the business activity being taxed, may be utilized to reduce or eliminate some or all of the tax liability.

One of the most notorious of all transaction privilege taxes is the city-level speculative builder tax. This tax generally applies to the sale of improved real property if the seller caused the improvements to be made to the property. In essence, this tax is a disguised real estate transfer tax applicable to certain transfers of improved real property. In addition, Arizona's state and local tax system operates very differently with respect to taxes imposed on the construction industry, as the tax is based on the proceeds an owner pays to its contractor, with the materials purchased by the contractor for use in the project being exempt from the retail tax.

Real Property Taxes

All levels of government, including state, county and local jurisdictions, have the authority to impose taxes on real property. The counties are primarily responsible for property tax assessment and collection for most property.

The tax is determined by the use of the property and its value. Real property is classified into one of several use categories, including, but not limited to, commercial and industrial, owner-occupied residential, rental residential and agricultural. The use or class of the property determines the percentage of the property's value that is subject to tax. Each parcel is assigned a primary "limited" value and a higher secondary "full cash" value. The taxes assessed against the taxable portion of

the property's limited value are used for the general maintenance and operation of counties, cities, towns, school districts, community college districts and the state. Taxes assessed against the taxable portion of the property's full cash value are used for specific purposes, such as the funding of bonds, budget overrides and special assessment districts. Increases in a property's limited value are governed from year to year by the Arizona Constitution and by statute. There is no limit on the amount that a property's full cash value can increase from year to year and the property's full cash value is intended to reflect the property's fair market value. An administrative and a judicial appeal process are available for property owners to dispute a property's valuation or classification.

Personal Property Taxes

Personal property used for a commercial purpose also is subject to taxation in Arizona. Although there are exceptions, most commercially owned personal property is subject to tax. The owner or person in control of personal property subject to tax is required to file with the local county assessor a report of all taxable personal property, with values if requested by the county assessor, by April 1 each year. If no report is filed, the county assessor can estimate the property and its value. After receiving the property report, the county assessor will then assign a depreciated market value to each item of personal property. An accelerated administrative appeal process is available for challenging the valuation or classification assigned by the particular county.