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ARIZONA TAX RESEARCH ASSOCIATION

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Tax and fiscal policy reform on the horizon?

As the 2nd Regular Session of the 45th Legislature winds down, two bills resulting from recommendations adopted last January by the House Ad Hoc Committee On Tax Policy For The New Economy should receive final approval.

One of the bills, **HB 2178**, reflects several of the Committee's long-term goals, such as establishing the Tax Reform for Arizona Citizens and the Arizona Fiscal Accountability Committees, expanding the duties of the Joint Legislative Budget Committee (JLBC), and requiring state participation in the multistate Streamlined Sales Tax Project (SSTP).

The Tax Reform for Arizona Citizens Committee, established under HB 2178, will be responsible for studying Arizona's fiscal policy. The Tax Reform Committee is required to consider the expansion of state resources and economic development strategies, as well as state and local tax policies, to include counties, municipalities, school districts, and special taxing districts, to ensure that current policies are adequate, equitable, competitive, and consistent with economic development strategies.

The Tax Reform Committee will develop a comprehensive report recommending a strategy for transitioning to an appropriate tax structure for state and local jurisdictions.

The committee will include four representatives from the Senate and House, one person from the general public, incorporated cities and towns, counties, school districts, along with a representative from a statewide taxpayer organization, and two representatives from the business community.

The Arizona Fiscal Accountability Committee, also established under HB 2178, will be responsible for studying current state and local expenditure policies, which will include the consideration of integrating services and eliminating duplicate programs where needed.

The Fiscal Accountability Committee is also charged with determining whether savings can be achieved through the privatization of services, the realignment of services between state and political subdivisions, and the elimination or streamlining of duplicative programs at the state level.

Committee representatives will include four representatives from the Senate and House, one person representing the general public, school districts, community colleges, a major state agency, one representative from a statewide taxpayer association, and two representatives from the business community.

Both committees are required to submit status reports by December 31, 2002, and a final report by September 15, 2003, outlining each committee's recommendations.

The ad hoc committee's recommendations from last January also included expanding JLBC's oversight concerning tax and revenue issues, duties that were previously assigned to the repealed Joint Legislative Tax Committee.

As a result, HB 2178 adds to JLBC's current responsibilities the requirement to analyze the state tax structure, tax burdens on individuals and businesses, and tax incentives for existing and prospective businesses. JLBC will also be required to

See **TAX & FISCAL POLICY**, page 3.

McCarthy appointed to School Facilities Board

Governor Jane Dee Hull announced on May 13 that she is appointing ATRA President Kevin McCarthy to serve on the Arizona School Facilities Board (SFB).

The SFB was created in 1998 to take primary responsibility for school district capital needs as part of the Students FIRST legislation responding to the Supreme Court decisions in *Roosevelt v. Bishop* and *Hull v. Albrecht*.

McCarthy will be taking the seat on the nine person board statutorily intended for a "private citizen who represents an organization of taxpayers."

The SFB oversees three main aspects of school district capital facilities: deficiencies correction, building renewal, and new school facilities.

BOND ELECTION PAMPHLETS TO PROVIDE MORE INFO

In an effort to provide more information to taxpayers, **HB 2443** was passed to require government entities to provide more detailed information in bond election pamphlets.

Current law requires bond election pamphlets to include the estimated tax rate impact on the average assessed valuation of residential and commercial property.

HB 2443 expands the law to require bond election pamphlets to show the estimated tax levy impact on residential, commercial, and agricultural properties, not just the tax rate impact.

The bill also requires pamphlets to show the projected average annual cost over the life of the bond, including the breakdown of principal and interest.

HB 2443, supported by ATRA, was introduced on behalf of the Maricopa County Assessor's Office.

Legislature reaffirms: schools are not allowed to purchase computers with bonds

Intent of new impact aid revenue bonds gets turned upside down

The Arizona State Legislature has passed a measure intended to ensure that school districts stop using general obligation (G.O.) bonds to purchase computer hardware.

HB 2165, sponsored by Representative Linda Gray, will hopefully put an end to any claims from school districts that the law is ambiguous on the issue.

Students FIRST legislation, passed in 1998, prohibited school districts from using bond debt to purchase "soft capital items or other items whose useful life is less than the average useful life of the bonds issued." The 1998 law further asserted that "bond proceeds shall not be expended for items whose useful life is less than five years."

Such "soft capital" expenditures would be allowed from schools capital outlay revenues or from the "soft capital allocation" created specifically for such needs. In addition, districts could use voter-approved capital outlay overrides to pay for items with such a short shelf-life. Elsewhere in statute the 1998 law provided examples of soft capital: "short-term capital items . . . such as technology, textbooks, library resources, instructional aids, pupil transportation vehicles, furniture and equipment."

Since 1998, despite this prohibition, at least some districts have nevertheless purchased computer hardware with the proceeds from 20-year bonds. The House Education Committee even heard testimony from a district superintendent that HB 2165 would disrupt plans to purchase not only computers but "palm pilots" for students.

One can only hope HB 2165, signed by the Governor on May 9, will resolve this matter.

Continued skepticism, however, remains warranted as demonstrated by the case of impact aid revenue bonds.

THE CASE OF IMPACT AID REVENUE BONDS

Last year, the Legislature passed HB 2440 allowing school districts to leverage their federal impact aid to service the repayment of revenue bonds for capital projects above the state's capital facility standards.

An ATRA amendment, sponsored by Representative Gray, prohibited districts that issued such "impact aid revenue bonds" from also issuing G.O. bonds. ATRA viewed this bill, as amended, as providing a rare opportunity to provide relief to taxpayers in districts that include significant portions of untaxable tribal lands.

A couple of districts, aided by their financial advisors, interpreted the new law, contrary to its intent, as providing an opportunity to heap higher burdens on property tax payers and gain access to even more debt-financed capital.

Thus, A.R.S. §15-1021, dealing with G.O. bonds, includes the following provision: "A school district shall not authorize, issue or sell bonds pursuant to this section if the school district has any existing indebtedness from impact aid revenue bonds . . ."

The intent was clearly to have districts choose which type of bonds would best suit their situation.

Prohibiting districts from using both G.O. bonds and impact aid revenue bonds was not only to address property taxpayer issues. It also was intended to help maintain the spirit of Students FIRST, which attempted to limit local access to debt-financed capital.

Indian Oasis-Babaquivari Unified, the main proponents behind HB 2440, held an election for impact aid revenue bonds last November, as anticipated. So did Red Mesa Unified.

A couple of districts, aided by their financial advisors, interpreted the new law, contrary to its intent, as providing an opportunity to heap higher burdens on property tax payers and gain access to even more debt-financed capital.

Tuba City Unified, like Indian Oasis and Red Mesa, also held an election for impact aid revenue bonds. However, their election also obtained approval for more G.O. bonds which they intended to issue first, maximizing their debt capacity and secondary property tax rate. They would then issue the revenue bonds once they had maximized the use of G.O. bonds.

Similarly, Ganado Unified obtained approval for G.O. bonds and will likely seek approval for impact aid revenue bonds at a later date.

This is just one of several reasons ATRA maintains its skepticism concerning prospects for tax relief associated with Students FIRST and related legislation.

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TAX & FISCAL POLICY

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implement a fiscal analysis system based on assumptions estimating the probable behavioral responses of taxpayers and businesses regarding bills introduced in the legislature that involve proposed changes to the tax laws.

In addition, the Committee's report acknowledged the need to simplify and modernize the state sales tax system. Although Arizona is currently considered an "observer" to the Streamlined Sales Tax Project, HB 2178 codifies the requirement for the state to participate in the nationwide project.

HB 2186 addresses short-term recommendations from the Ad Hoc Committee on Tax Policy relating to Arizona's income tax structure by establishing the **Joint Legislative Income Tax Credit Review Committee**.

This committee is required to determine the original purpose of existing income tax credits and establish a standard for evaluating and measuring the success or failure of those credits. The criteria for evaluating these credits may include determining the history, rationale, and estimated revenue impact of the credit, whether the credit has provided a benefit to the state, and whether it is unnecessarily complex in its application, administration, and approval process.

In addition, any new individual or corporate income tax credits are to be reviewed five years after its enactment and the legislation is required to include a purpose clause explaining the rationale and objective of the tax credit.

The committee, which will be made up of five members from both the House Ways and Means and Senate Finance Committees, is required to follow an income tax credit review schedule and must report its findings by December 15 in the year in which the tax credit is reviewed. Finally, the bill restricts the legislature from enacting any new tax credits until the committee files its first report.

Both HB 2178 and 2186 have cleared conference committee and are currently awaiting final read.

Jennifer Schuldt

Senior property valuation freeze goes back to voters with HCR 2038

Voters will have a second opportunity to vote on the Senior Property Valuation Protection Program. Proposition 104 was passed by the voters in the 2000 general election to allow property owners, who are at least 65 years of age meeting certain income requirements, to apply with the assessor to have their full cash value frozen on their primary residence for up to three years.

HCR 2038 was introduced this session as a result of the confusion surrounding implementation of the program among the 15 county assessors. Immediately following the passage of Prop 104, questions surfaced regarding the maximum income in which taxpayers can earn and still qualify under the program.

The main discrepancy in implementing the program is in the language addressing the maximum income that a senior can qualify under the program, which is 400% of the supplemental security income (SSI) benefit for an individual and 500% of the SSI benefit for a couple, or two or more persons, as established by section 1611 of the Social Security Act.

However, the sponsors of Prop 104 inadvertently failed to recognize that SSI benefits are calculated differently for individuals than for couples. This resulted in a higher income level of \$47,760 in 2001 for couples, which apparently was not the original intent of the bill.

HCR 2038 clarifies the language so that the maximum income that a couple can earn and still qualify under the program is calculated based on 500% of the individual SSI benefit, which would have resulted in a maximum income level of \$31,800 for couples in 2001.

HCR 2038 also establishes filing requirements for the program, which were not provided in the original measure. The new language requires taxpayers to file an application with the county assessor on or before September 1 and the assessor must respond by December 1. If the taxpayer fails to file the application by the deadline, the application will be processed for the following year.

Voters will have an opportunity to vote on HCR 2038 at the next general election.

Jennifer Schuldt

No tax break for conservation easement properties

HB2106, a bill that would have reclassified conservation easement properties from property class 2, assessed at 16%, to class 6, which is assessed at only 5%, failed the House Natural Resources and Agriculture Committee by a 2-3-3 vote.

ATRA opposed the bill and testified during the NRAE Committee that a conservation easement is a voluntary decision of the property owner and that the owner already benefits in the form of a lower tax burden as a result of the reduced value due to the property restrictions of the easement.

More importantly, adding another group of taxpayers to class 6 only creates more inequity within the property tax system and frustrates efforts to reform it.

COUNTY BUDGET MEETINGS BEING SLATED

ATRA staff has begun setting meetings with county government representatives to go over tax and spending changes in proposed budgets for fiscal year 2002-2003.

Although scheduling is only now in the preliminary stages, the meetings will be taking place in June and July. Counties normally adopt their budgets in July and August.

If you would like to participate in any of the county budget meetings or wish to ensure that you are on appropriate contact lists for schedules and other information, please contact Jennifer Schuldt at 602-253-9121 or by email at jschuldt@arizonatax.org.

April 25 Marks Arizona's Tax Freedom Day in 2002

Tax Freedom Day, a "tax barometer" that measures total federal, state, and local tax burdens over time, took place for the average American taxpayer on the 117th day, or April 27 in 2002. Tax Freedom Day represents the calendar date on which the average taxpayer finally earn enough money to pay off their total tax bill for the year, as reported by the Tax Foundation.

The National Tax Freedom Day was April 29 in 2001 and May 1 in 2000.

According to the report, economists have attributed the decline in the overall tax burden over the last two years to federal tax cuts in 2001 and 2002, accompanied by slow growth following the 2001 recession.

The two-year decline follows an eight-year climb in the National Tax Freedom Day. Since 1992, Tax Freedom Day has appeared later every year for eight years, with American's achieving tax freedom on April 19 in 1992, increasing to May 1 in 2000, requiring American taxpayers to work 12 extra days over that time.

According to the report, the main reason for the increased tax burden over the last decade was the rapid growth in federal tax collections.

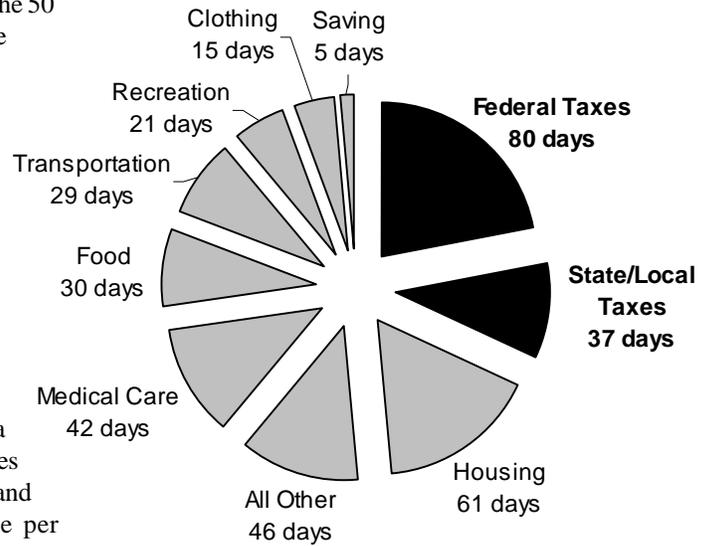
Arizonan's, by comparison, worked 115 days before celebrating their Tax Freedom Day on April 25, three days earlier than last year, ranking 18th out of the 50 states. The state with the highest ranking tax burden, according to the Tax Foundation, was Connecticut, whose Tax Freedom Day doesn't appear until May 14.

The Tax Foundation, a Washington, DC government watchdog organization, calculates Tax Freedom Day by determining per capita federal, state and local taxes for everyone in the U.S. and then divides that by the per capita U.S. income.

This percentage is then translated into calendar terms by multiplying it by 365 days. The same method is used to compute Tax Freedom Day for each state.

Based on the report, a typical taxpayer in Arizona can expect to have 31.7% of their income to go toward taxes: 21.6% to the federal government and 10.1% to state and local governments.

Number of days Americans work for taxes compared to other budget items



Source: Tax Foundation, Washington D.C.

The report also measures the price of government against the price of other important categories of consumer spending. The pie chart above shows that Americans will work longer to pay for government (117 days) than they will for food, clothing, and shelter combined (106 days).