



The taxpayer's watchdog for over 60 years

ARIZONA TAX RESEARCH ASSOCIATION

NEWSLETTER

VOLUME 62
NUMBER 8

NOVEMBER 2002

Rep. Jeff Flake addresses ATRA's 62nd annual meeting



U.S. Representative Jeff Flake

ATRA's 62nd Annual Meeting luncheon featured a keynote address from U.S. Congressman Jeff Flake. Just re-elected to his second term in the House, Congressman Flake focused his remarks on the high expectations of Congress now that his party controls both the House and Senate.

While he cautioned against any expectation of significant tax cuts, he did

express hope that Congress will make the current phase out of the estate tax permanent as well as reduce the capital gains tax. He pointed out that if Congress employed dynamic scoring in their analysis of the fiscal impact of tax changes that there might be less resistance to tax changes that spur economic growth and ultimately more revenue for the federal government.

Rep. Flake also expressed his disappointment with Republican candidates who campaigned on a platform of not touching social security and opposing any privatization. "Americans need to be told the truth. This system is broken and some change needs to occur and privatization needs to be a part of the solution."

Finally, Congressman Flake addressed the considerable attention he has received as the leading voice to eliminate Arizona's so-called clean election law. While some are arguing for reform of the law, he intends to qualify an initiative in 2004 to have the entire process repealed.

Kinsall re-elected ATRA Chair



Kevin Kinsall

Kevin Kinsall, Manager of Governmental Relations for Phelps Dodge Corporation, was re-elected to a second term as Chairman of ATRA's Board of Directors at the 62nd annual meeting of the organization held on November 15, 2002.

Also elected as ATRA officers were Amy Barron Etkorn, *Advanced PCS*, first vice-chair; Larry Lucero, *Tucson Electric Power*, second vice-chair; Barbara Dickerson, *Deloitte & Touche*, third vice-chair; and individual member Dave Minard, as secretary/treasurer.

ATRA also elected 14 members to seats on the Board of Directors. Elected to terms on the Board expiring in 2007 were: Ray Aka, *Motorola*; Michael Green, *Fennemore Craig*; Kevin Kinsall, *Phelps Dodge*; David Minard, *individual*; Martin Shultz, *APS*; Mark Bare, *Motorola*; Russell Bowers, *Arizona Rock Products Assoc*; Jeff Dodson, *Boeing*; Edward Munoz, *Raytheon*; and Kate Baker, *Blue Cross Blue Shield*.

Elected to terms expiring in 2004 were: Robert Moroney, *Duke Energy*; Bas Aja, *Arizona Cattlemen's Association*; and Lori Daniels, *State Farm Insurance*. Individual member Allan Stanton was elected to a term expiring in 2003.

Inside . . .

Conferees given latest on state economy & budget, page 2

Expert panel reviews state tax system, page 3

Robert Robb on election results, page 4

Manny Lerma named ATRA's Member of the Year, page 4

Good Government Awards, page 5

ATRA Outlook Conferees given latest on state economy and budget

“Modest recession, modest recovery” says economist

The 2002 ATRA Outlook Conference program on November 15 included two timely and up-to-date presentations on the state economy and budget.

Elliott D. Pollack, president of an economic and real estate consulting firm based in Scottsdale, characterized Arizona’s economic condition as a “modest recession” and told conferees that the most likely scenario is for a “modest recovery” marked by “slow growth.”

Pollack noted that the economic outlook for the United States is favorable in inventory and sales, but that there is less pent-up demand in housing and auto sales than was experienced in previous recession recoveries. Nevertheless, business capital spending and consumer spending should recover slowly. The long-term outlook for the U.S. economy, he concluded, remains good.

The outlook for the greater Phoenix area, Pollack said, will benefit from the modestly positive U.S. outlook. The region is in an employment recession. However, the high-tech manufacturing recovery will be slow.

Furthermore, the commercial and residential real estate markets have already peaked and we will continue to experience a significant drop in commercial construction in 2002 and 2003.

Pollack also noted that the services sector in greater Phoenix are weak, especially tourism and business services.

Richard Stavneak, director of the Joint Legislative Budget Committee, briefed conference attendees on the current state of state revenues and spending.

Stavneak noted that, prior to one-time fund transfers, general fund revenues fell 6.1% in fiscal year (FY) 2002. Sales tax collections experienced a rapid drop in FY 2002 that was followed by a slow recovery in FY 2003 (a year-to-date change of 1.5% in FY 2003).

Meanwhile, income tax withholding has been declining faster than employment. The key driver for this has been recent decreases in high-paying jobs

Greater Phoenix Forecast 2001 - 2003

	<u>2001</u>	<u>2002</u>	<u>2003</u>
POPULATION	3.6%	2.7%	2.6%
EMPLOYMENT	1.1%	-1.0%	3.0%
HOUSING PERMITS			
SINGLE FAMILY	32,867	29,883	30,909
MULTI-FAMILY	7,201	5,843	5,384
PERSONAL INCOME	5.4%	4.0%	5.5%
RETAIL SALES	1.5%	2.0%	6.0%

Source: AZ DES; AZ Dept of Revenue; Elliott D. Pollack & Co.

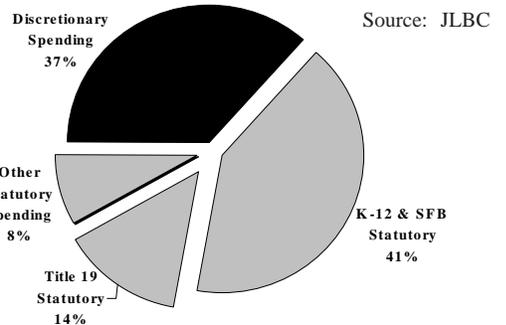
and increases in low-paying jobs. Individual income tax collections saw a record decline (-9.3%) in FY 2002 followed by a slow recovery.

Corporate income tax also experienced the largest percent drop in a decade, followed by stability in FY 2003 and FY 2004.

On the spending side, Stavneak explained that the general fund is \$6.2 billion of a \$16.5 billion total state budget. In the last decade, two areas have grown significantly as a percent of the general fund budget: K-12 (from 37.8% to 42.2%) and corrections (from 6.9% to 9.4%).

He further explained that only 37% of the general fund is defined as “discretionary” and that the remainder is either statutorily-required or voter protected.

Statutory Spending is 63% of General Fund Budget



**Total Statutory Spending:
\$3.6 Billion of \$6.2 Billion**

ARIZONA TAX RESEARCH ASSOCIATION
 Kevin Kinsall.....Chairman
 Kevin J. McCarthyPresident
 Michael E. HunterVice President
 Jennifer SchuldtSenior Research Analyst
 Carmen Florez-Lucero.....Office Manager

Published 10 times annually by the Arizona Tax Research Association, a nonprofit organization whose purpose is to promote efficiency and economy in Arizona government and reductions at all levels. Permission to reprint is granted to all publications giving appropriate credit to the Arizona Tax Research Association.

Serving Arizona’s taxpayers since 1940.

1814 W. Washington Street
 Phoenix, Arizona 85007
 (602) 253-9121
 FAX (602) 253-6719
 www.arizonatax.org
 atra@arizonatax.org



Expert panel reviews state tax system

ATRA dedicated a major portion of this year's Outlook Conference to a comprehensive overview of Arizona's state and local tax system.

With recurring state budget deficits and the establishment of the Tax Reform for Arizona Citizens Committee (TRAC), the talk of tax reform is in the air at the state capitol. Arizona's newly elected Governor, Janet Napolitano, has indicated an interest in expanding the state's sales tax base along with the appointment of a commission to review Arizona's fiscal system.

Kitty Decker, senior economist at the Arizona House of Representative's, and Steve Partridge, state and local tax attorney for Gallagher & Kennedy, joined ATRA president, Kevin McCarthy, on the tax panel.

The panel focused on the three major taxes in Arizona's state and local tax system: property, sales, and income.

OVERALL TAX COLLECTIONS

Kevin McCarthy kicked off the presentation with an overall view of Arizona's total tax collections, making a point of the fact that Arizona ranks average in overall tax collections according to the U.S. Census Bureau. Taking a closer look at

Arizona's tax structure shows that the transaction privilege tax (TPT), which some policymakers argue has a narrow tax base, generates the most in tax collections for the state at approximately 39%, followed by property taxes at 28.7%, and income taxes at 20.8%.

PROPERTY TAX

McCarthy's discussion of Arizona's property tax system noted that Arizona ranks average in total property tax burdens compared to other states. However, that statistic masks the property tax burden inequities between homeowner's and business owners in Arizona.

According to national rankings published by the Minnesota Taxpayer's Association for tax year 2000, Arizona homeowner's rank 31st in property tax burdens while industrial property owners in Arizona pay some of the highest taxes, ranking 3rd compared to other states.

Kevin also pointed out that overall per capita property tax burdens have grown 51.6% above inflation over the last two decades. The majority of that growth actually occurred between 1980 and 1990, prior to the enactment of truth in taxation (TNT) laws.

McCarthy closed his presentation by discussing a few of the top policy issues in the property tax system. A top issue facing policymakers continues to be the high tax burden on business owners. The 1% cap on homeowner taxes that has long been a concern is now a major state budget issue. The state budget picks up the tax for homeowners' tax in excess of 1% of value.

SALES TAX

Kitty Decker, senior economist in the House of Representatives, began the TPT portion of the conference by making note of the fact that Arizonan's pay some of the highest sales taxes, ranking 4th highest in the nation.

Decker focused considerable attention on media characterizations of Arizona's sales tax system as "loophole" ridden. She provided definitions and explanations regarding the differences between exemptions, exclusions, and incentives, making specific note that a loophole is simply an attempt to contradict the intent of a statute and is not specifically spelled out in law, which is the case with the exemptions that are currently on the legislative chopping block.

Decker also discussed the confusion among taxpayers due to the different tax bases, not only between the cities and the state, but also among the cities themselves. This is one problem that may be solved through the simplified sales tax program (SSTP); however, although Arizona is now an active participant in the program, she does not see Arizona conforming to the SSTP recommendations in the near future.

At \$5.7 million, the sales tax is Arizona's top revenue producer. Since 1980, state and local real per capita collections have climbed 53.4%. State and local sales tax rates have also climbed as counties have become frequent users of sales taxes to fund their needs.

2001 Effective Property Tax Rates

Class	Description	Effective Rate
1	Commercial, Industrial, Utilities, & Mines	2.90%
2	Agricultural & Vacant Land	1.66%
3	Owner-occupied Residential	1.05%
4	Rental Residential	1.25%
5	Railroad, Private car, airline flight	2.48%
6	Residential historic, Enterprise zones	0.59%
7	Commercial Historic	2.26%
8	Rental Residential Historic	0.02%
9	Possessory Interests	0.10%
Total		1.55%

See TAX PANEL on page 4

TAX PANEL

Continued from page 3

INCOME TAX

Steve Partridge wrapped up the tax presentation with a discussion on Arizona's income tax structure, presenting attendees with national rankings from the U.S. Census Bureau, which shows that Arizona's individual income taxpayers rank favorably over other states, ranking 38th out of 41 states and the District of Columbia.

In contrast, the corporate income, which is the most volatile of all taxes, showed a ranking of 15th nationwide. This is in spite of the corporate income tax rate cuts, which have been reduced from 9.3% in 1990 to 6.968% in 2001.

Partridge pointed out that real per capita personal income tax collections grew dramatically (105%) over the last two decades despite an almost 30% reduction in personal income tax rates. He noted that the largest percentage of the individual income tax (34%) comes from only 2% of filers, those making \$200,000 or more (see page 6).

In addition to the tax rate cuts, income taxpayer's received a gradual increase in income tax credits over the last ten years. Since 1993, the total number of corporate income tax credits increased by 14, while individual tax credits increased by 18, bringing the total income tax credits to 42.

Partridge also addressed the issue of federal conformity, which was one of the major topics of discussion during the 2002 legislative session. He explained the importance of Arizona conforming to Federal income tax laws since Arizona requires that the computation of income tax liability begin with federally adjusted gross income.

Partridge concluded by addressing the current issues under debate concerning the income tax structure. Discussions during the last legislative session included the increase in income tax credits over the last decade, which gave rise to the enactment of the Joint Legislative Income Tax Credit Review Committee.

The Committee is required to review various income tax credits over the next five years, beginning in tax year 2002, in order to determine the original purpose of the credits and whether or not the credits should be retained on the books.

Columnist Robert Robb shares his reflections on the election

Robert Robb, political columnist for The Arizona Republic, offered his perspective on the November 5 elections at ATRA's Outlook Conference on November 15.

Below is a sampling from his observations at the conference as they appeared in Robb's column in The Republic on November 17:

It didn't take Janet Napolitano long to adopt the definition of compromise Democrats in Washington have long advanced: Republicans acceding to the Democratic position.

Napolitano was elected with a plan for \$200 million in unspecified sales tax increases to balance next year's budget. Many Republican legislators were elected promising not to increase taxes at all.

Napolitano's proposed compromise: Republicans abandon their pledge and support her tax increases.

If Republicans don't go along with tax increases, Napolitano is already threatening to take the increases directly to the voters via an initiative, including a special election if necessary.

This is odd, since neither Napolitano nor voters can call a special election to consider a ballot measure. Only the Legislature has that power.

So, the earliest a Napolitano tax initiative could get before voters is November, 2004. That means it would be three budget cycles before any such increases could be fully implemented.

There is no path to higher taxes before then except through the Legislature.

Manny Lerma named Outstanding Member



Manny Lerma
ATRA's Outstanding Member, 2002

ATRA recognized Manny Lerma as this year's Outstanding Member at its Annual Membership Meeting luncheon. ATRA Chairman Kevin Kinsall presented the award.

Manny joined ATRA's Board of Directors and Executive Committee in 1992, representing Qwest Communications. "Right from the start," said Kinsall, "he has been one of ATRA's most reliable members."

"It is an extremely rare event when Manny is not present at an executive committee meeting. He is practically an institution at our Legislative Policy Committee meetings," Kinsall added.

"Though not the most vocal person in the room, Manny does not hold back when he has something to contribute on a matter of policy. And the organization always benefits from his experience, his balance, and his good judgment."

Good Government Awards go to R. Robert Jones and Eric Borst

2002 marks the 12th year that ATRA has recognized outstanding individuals whose work in the public sector is characterized by strong, continuing, and consistent efforts to spend taxpayer dollars wisely and to promote government that is efficient, open, and accountable.

ATRA solicits nominations from local governments and state agencies and these are reviewed by ATRA members and staff. This year, two nominations stood out above the others as obviously deserving of this award.



Dr. R. Robert Jones

The first award went to **Dr. R. Robert Jones**, superintendent of the *Madison Elementary School District*.

One of Jones' accomplishments most deserving of taxpayer recognition is his consistent and demonstrable stewardship of public resources. After a statewide, on-site assessment of every single public school facility in Arizona, Madison Elementary stood alone as the only district without a single deficiency. Under Dr. Jones' leadership, Madison has for the last decade carried out a systematic and methodical building maintenance program that, frankly, should be used as a model for all Arizona school districts.

Similarly, Dr. Jones' focus on academic achievement has resulted in consistently high marks and accolades. Madison is an extremely diverse district. Currently 43% of its students are at or below the federal poverty level. Two schools have poverty levels exceeding 80% of enrollment. Two schools have poverty levels less than 12% and the three remaining schools report 40% of their enrollment at or below the poverty level.

Despite such diverse demographics, including a growing population with limited English proficiency, not a single school was designated as underperforming by the Arizona Department of Education. In fact, their scores on state and national standardized tests continue to show steady increases. Madison's 8th graders, for example, can boast the highest combined AIMS scores in Maricopa County.

A significant part of this success is attributable to Dr. Jones' presence in this district. This does not mean his presence in the district office. Dr. Jones *inspects* what he *expects* and makes it a personal goal to visit every school, every day, collecting data. In fact, he logged over 1,000 school visitations in the 2001-2002 school year.

When Proposition 301 passed a couple of years ago, requiring a portion of the new revenue to be distributed to teachers based on performance, Madison was one of only a few districts that had already made significant progress toward the implementation of a performance pay plan.

ATRA also presented a Good Government Award this year to **Eric Borst**, budget coordinator for the Coconino County Community College District.

Borst has been employed by the college for the past eight years, starting as an administrative assistant before his promotion to his current position two and a half years ago. Borst's nomination is slightly different than most because it was initiated by ATRA staff.



Eric Borst

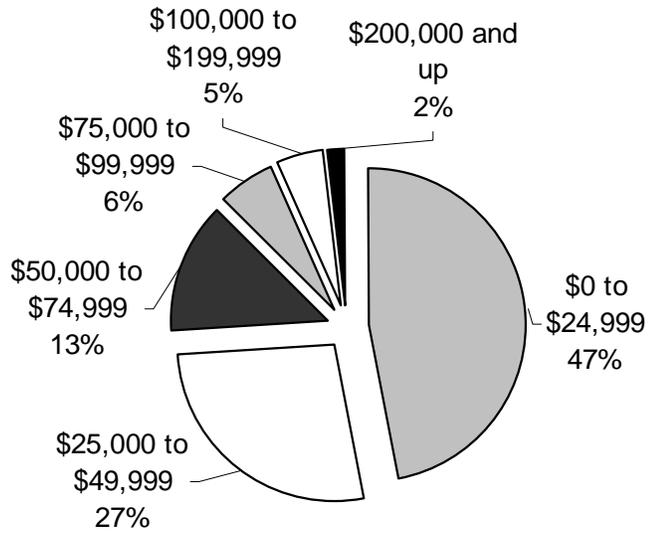
Annually, ATRA staff and members have an opportunity to meet with every one of Borst's counterparts throughout the state's community college system and other local government budget offices. It might not surprise you that not everyone is glad to see us. The fact is, we do occasionally encounter state and local government budget officials who truly would prefer that taxpayers simply pay their taxes, quietly and dutifully, and not ask any pesky questions about fiscal matters.

Eric Borst's attitude could never be described in such a way. When ATRA visits the college's administrative offices in Flagstaff during the budget development process, Borst's presentation of the budget is always straight-forward, matter-of-fact, and thorough. No shell games, no misdirection.

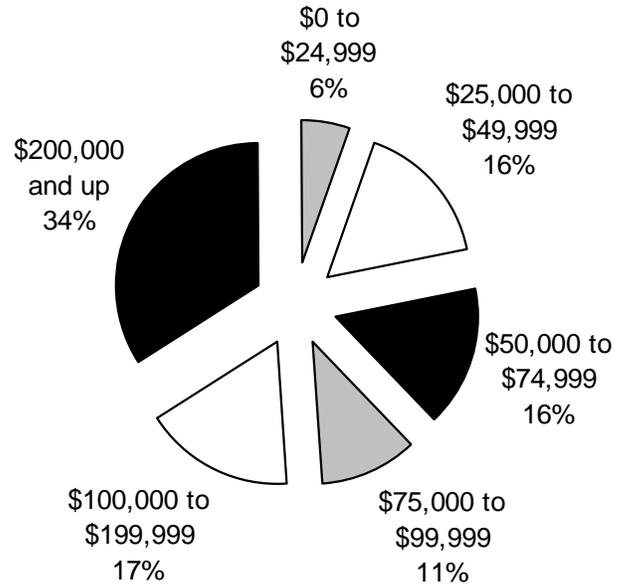
Borst's communication with ATRA continues throughout the year. By the time the budget meeting takes place, there usually aren't any surprises.

Borst's service to the taxpayers of Coconino County and the State of Arizona is a model for open, efficient, and accountable government.

% of Income Tax Filers by Category (1998)



Income Tax Liability by Category (1998)



Source: Arizona Dept. of Revenue