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ARIZONA TAX RESEARCH ASSOCIATION

NEWSLETTER

VOLUME 64
NUMBER 2

FEB/MARCH 2004

TAX REFORM BILLS ADVANCE

Acting on recommendations from the Legislature's Tax Reform for Arizona Citizens (TRAC) Committee, both the Arizona House and Senate are advancing several pieces of legislation directed at improving Arizona's property tax system and corporate income tax structure.

The co-chairs of the TRAC Committee, House Ways and Means Chairman Steve Huffman and Senate Finance Chairman Dean Martin, introduced a series of bills and dedicated significant committee time to advocate for the changes.

Two major property tax reform bills cleared the Ways and Means Committee. HB 2263, which decreases the assessment ratio on class one property (commercial and industrial) from 25% to 24%, passed the House on a 35-25 vote and now awaits action in the Senate.

HB 2264, which prospectively changes the assessment ratios for future voter approved taxes for class one property from 25% to 20%, awaits a final vote in the House. Another TRAC recommendation that cleared the Ways and Means Committee was HB 2269, requiring cities, counties and community college districts to receive voter approval before increasing primary property taxes above their Truth-in-Taxation (TNT) limits.

Some local government lobbyists have opposed the property tax reform proposals, indicating a strong interest in maintaining Arizona's current property tax structure that heavily subsidizes the homeowner/voter. Local government lobbyists alternated between acting as taxpayer advocates in one hearing, concerned with increases in residential taxes if assessment ratios changed, and then in the next hearing protecting their ability to raise taxes on those same homeowners by opposing public votes on TNT increases.

The prospects for HB 2263 or HB 2264 in the Senate are in question since the similar measures did not clear the Finance Committee. However, in a recent letter to Representative Huffman, the League of Arizona Cities and Towns has communicated a change of heart on HB 2263: "The cities and towns of Arizona are cognizant of the disparity of the property tax burden among classes of property and the impact this disparity may have on economic development efforts. . . . After considerable discussion and consultation, the League will support H. 2263 as a reasonable and limited approach to addressing the disparity . . ."

An additional key TRAC recommendation making its way through the process is a change to the apportionment formula for the allocation of corporate income taxes for multi-state and multinational corporations.

While the TRAC recommendation was to allow the option for companies to choose a 100% sales factor allocation, HB 2270 provides for an optional increase in the sales factor to 70%. The optional increase in the sales factor would be phased in over a two-year period beginning with tax year 2005.

HB 2270 passed the House 40-20 and awaits a hearing in the Senate Finance Committee. The Finance Committee has already approved a similar bill, SB 1143, sponsored by Senator Thayer Verschoor.

Legislative Update

Legislators introduced over 1,200 bills and resolutions this regular session, among which numerous important bills affecting public finance and taxation have made their way into legislative committees. Inside this Newsletter is a selected list of noteworthy legislation ATRA is tracking.

ATRA SUPPORTS

HB 2160 schools; maximum property tax rate (Huffman) Caps the primary property tax rate in school districts in which homeowners with 50% or more of the value in the district are at the 1% cap and the primary tax rate is 150% of the qualifying tax rate (QTR), as determined by the Property Tax Oversight Commission (PTOC). There are currently nine districts that meet the criteria and would be affected by this legislation. The passage of this legislation would result in a cost savings to the state general fund. *The bill awaits Senate Rules.*

HCR 2011 voter approved expenditures (Konopnicki) Amends the Prop 105 constitutional provision to stipulate that if monies approved for specific purposes fail to fully fund that purpose, the Legislature may, by concurrent resolution and by a simple majority in each house, proportionately reduce the amount required in that fiscal year and that the reduced amounts constitute the base from which future allocations will be computed. Retroactive to monies appropriated on or after November 3, 1998. *The bill is slated to be heard soon in Senate Appropriations.*

SB 1150 study committee on state debt (Burns) Establishes the Study Committee on State Debt to study and quantify all current outstanding debt at the state level, including

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In Memorium

Genevieve Barc, who served for 36 years on ATRA's staff, passed away in California on March 9, 2004, at the age of 81.

Known among ATRA members for her institutional memory, Genevieve was hired originally as a temporary employee in 1950 and performed a multitude of functions as ATRA's office manager until her retirement in 1986.

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bonds, notes, certificates of participation, etc., and identify the source of financing for the current debt service. The Committee is required to review constitutional and statutory limitations relating to state debt and to make recommendations for changes to state debt limits and the process and oversight of state debt on or before December 31, 2004. Requires the Committee to gather national data rankings and compare Arizona's debt burden with other states. *The bill awaits Senate floor deliberations.*

SB 1274 taxpayer bill of rights; amnesty (Leff) Places a two-year limit on the length of an audit by the Department of Revenue (DOR). DOR is required to provide the taxpayer with a written explanation at the time a deficiency assessment is issued or at the time of a refund claim denial. Provides clarity to the definition of "affected class" when determining whether 60% of taxpayers have a misunderstanding of remitting taxes. Contains a clean-up provision from last session's tax amnesty legislation, which unintentionally created the potential that taxpayers who were audited and assessed additional tax by DOR after the filing of an amnesty application would lose all administrative and judicial appeal rights on subsequent audits. Such a denial of appeal rights could be considered an unconstitutional violation of the right to due process. *The bill passed the Senate 30 to 0 and now goes to House Ways & Means.*

HB 2306 repeal fire districts county reimbursement (Wagner) Rep. Bill Wagner, a former Bullhead City Fire Chief, has successfully moved legislation out of the House that would limit counties' ability to charge fire districts for "services" provided by the county. Current statute allows counties to recoup the costs of providing specific services to special districts. Some counties have elected to expand the interpretation of the statute to annually

charge special districts, on a per parcel basis, for basic county operational functions. HB 2306 attempts to limit the county charges to fire districts to the actual costs associated with organization, reorganization, boundary changes and election services. *The bill is headed for Senate Government.*

SB 1280/HB 2623 tuition organizations; corporate tax credit (Anderson/Yarbrough) Provides corporations with an income tax credit for contributions made to a school tuition organization that provides scholarships and tuition grants to children of low income families. *HB 2623 passed the House. SB 1280 is now headed for a Senate floor debate.*

SB 1293 prime contracting; design-build contracts (Martin) Excludes from the transaction privilege tax (TPT) prime contracting tax classification base the portion of gross proceeds of sales or gross income attributable to architectural or engineering services that are incorporated into a design-build contract. A design-build contract is defined as a process of entering into and managing a contract in which one party agrees to both design and build a structure, facility or other items specified in the contract. Itemized separately, architectural and engineering services are not currently subject to tax. *SB 1293 will soon be heard in Ways & Means.*

ATRA OPPOSES

HCR 2026 border cities expenditure limitation; population (Carruthers) In addition to the alternative expenditure limitations already in the constitution, HCR 2026 offers one more alternative. This new alternative will allow a border city or town with population of less than 35,000 to include 50% of the average daily border crossings in determining the city's population in their expenditure limit calculation. ATRA has argued that border cities currently have a

constitutional alternative that allows for a permanent adjustment to their expenditure base limit, but the city would have to ask voters for approval. HCR 2026 would allow a border city or town to sidestep voters and spend much more without offering any justification to voters, making the constitutional expenditure limits even more ineffective than before. *The resolution goes next to Senate Finance.*

SB 1099 municipal expenditure limitation; penalty waiver (Cannell) Waives all penalties that might be imposed against the City of Somerton for exceeding their expenditure limit for an undetermined number of years prior to FY 2004. An amendment adopted by Senate Finance limits the total penalty to \$100,000. *The bill goes next to the Senate floor.*

SB 1327 small school districts; budget limit (Bennett) A special override formula was created in 2001 to provide additional local property tax funds for small districts that are growing to large to qualify for the "small school district" exemption from their budget limits. This override starts at 65% and phases down as student counts climb. This bill is an effort to increase the override formula by another 20% to generate additional taxes. *The bill passed the Senate and awaits Education and Appropriations hearings in the House.*

SB 1395 schools; excess utilities formula (Hellon) Creates a new formula for school district utility spending. Prop. 301, approved by voters in 2000, requires the "excess utilities" statutes to expire in 2009. SB1395 represents an effort to shift current spending practices and inequities from the property tax to the general fund starting in 2007. *The bill awaits deliberations on the Senate floor.*

HB 2164 municipal annexation; petition (Huffman) The signing requirements under a petition for annexation is changed so that owners having half of the value of the real

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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.

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property and the personal property of gas, electric and telecommunications utilities is used to determine the signature requirements. *The bill was held in House Federal Mandates and Property Rights.*

HB 2526 solar electricity; property tax classification (Clark) A new program is established by the Department of Commerce to assist businesses in qualifying and applying for tax incentives for generating electricity from on-site solar energy devices. Once a business is certified, the real and personal property will be reclassified as class 2, assessed at 16%. *The bill goes next to the Senate.*

HB 2042 sales tax refunds; taxpayer's customers (Huffman) In the case of overpayment of TPT taxes, if a taxpayer collected taxes from customers under a separately stated itemization, a refund or credit is allowed only if the taxpayer provides proof satisfactory to the Department identifying each customer from which the excess taxes were collected and establish that the refunded or credited amount of tax will be returned to the customers within 60 days after receiving the refund or credit. *HB 2042 was held in House Ways & Means.*

HB 2427 fire district assistance tax (Jackson Jr.) Specifies that the fire district assistance tax (FDAT) also be distributed to municipal and volunteer fire departments as well as county fire districts and the distribution be based on 20% of the property tax levy or 20% of their adopted budgets. Requires that the board of supervisors establish a process for reviewing and approving municipal and volunteer fire departments for participation in the distribution of monies from FDAT. *The bill was held in House Utilities and Municipalities.*

SB 1178 school tax credit; classroom instruction (Leff) Changed the allowable use of public school tax credit revenues from extracurricular activities and character education to classroom instruction. *The bill failed in Senate Education.*

SB 1350 financial provisions; community colleges (Mitchell) Eliminated current limits on community college leases and lease-purchase obligations and doubled their revenue bonding capacity for classrooms. Also provided automatic statutory inflation adjustments to college finance formulas. *The bill was held in Senate Education.*

FAVORABLY AMENDED

HB 2100 schools; transportation support level (Boone) Increases transportation support level (TSL) funding by increasing the number of days in the formula from 175 to 180, starting in FY 2006. Representative Tom Boone sponsored an amendment to reduce the \$49 million-gap statewide between the TSL and the TRCL (transportation revenue control limit). In many districts, that gap between the two formulas results in highly burdensome local property tax rates. *The bill passed the House 41 to 18.*

HB 2103 school districts; bonds; overrides (Boone) Allows general obligation (G.O.) bonds to be spent on furniture and equipment, including computers for new facilities. The bill was amended to limit capital overrides to 75% of the districts soft capital allocation. *HB 2103 has passed the House and goes next to Senate Education.*

HB 2259 county treasurers; procedures (Huffman) The County Treasurer may request that a taxpayer with a property tax liability exceeding \$25,000 submit supporting documentation on multiple parcels, which may include the taxpayers name, parcel number and amount of tax for each parcel, on or before the due dates prescribed in current statute. Increases the recording fee on judgment deeds from \$10 to \$50 per parcel, with \$15 of that being directed into the Treasurer's fund. Specifies that a person in which a warrant is drawn may present a claim for the amount to the Board of Supervisors within one year after the warrant has been voided. Eliminates the property tax deferral program but grandfathers the current participants. Removes the six-month limit in which the sheriff may seize property for delinquent taxes. *HB 2259 goes next to Senate Rules.*

HB 2041 department of revenue; taxpayer confidentiality (Huffman) The list of authorized agencies to which the Department of Revenue (DOR) may disclose otherwise confidential taxpayer information is expanded to include the US Treasury Department for use in the state income tax levy program and in the electronic federal tax payment system. Allows DOR to provide social security numbers on any correspondence mailed to a taxpayer in an enclosed envelope as long as the social security number is not visible. *This bill goes next to a Senate Finance.*

House Ways & Means rejects ATRA proposal on taxpayer funded publicity pamphlets

Opting to stay with the current process, the House Ways and Means Committee killed an ATRA effort to try to clean up taxpayer financed publicity pamphlets for local government bond and override elections.

In an attempt to ensure that the pamphlets are used only to provide factual, unbiased information to the voters on a tax question, HB 2111, sponsored by Representative John Huppenthal, would have eliminated the inclusion of advocacy arguments in the taxpayer-financed documents.

ATRA argued in committee that, in the great majority of instances, the pro/con statements have become a one-sided opportunity for insiders to advocate for the tax increase. With deadlines for the submission of the pro/con statements sometimes months before the date of election, only local government officials, and those citizens that are prompted by them, submit statements for the pamphlet.

By the time the public debate heats up, the deadline is passed for those who might have a contrary view. Despite ATRA's demonstration that a random selection of 30 publicity pamphlets contained only one that included a con statement, the committee sided with local government lobbyists acting to protect that system.

House approves deseg/OCR reform bills

The Arizona House of Representatives passed four bills dealing with an area of school district finance that has been one of the most significant drivers of recent property tax growth in Maricopa and Pima Counties.

State law allows school districts to levy unlimited property taxes in excess of their budget limits — for an unlimited amount of time and without voter approval — if the district has either a court order or an agreement with the U.S. Department of Education's Office for Civil Rights (OCR). This exemption for budget and property tax limits may continue long after the court order has been lifted or the OCR agreement is no longer monitored.

Currently, 19 school districts utilize state law to levy taxes over their budget limit because they have a desegregation order or an OCR agreement. Specifically, only two districts are under court orders to desegregate: Tucson Unified and Phoenix Union. The remaining 17 districts are currently, or at least were at some point, under scrutiny by the OCR to remediate some claimed violation of civil rights. In other words, if a school district is accused of violating some student's civil rights, they are rewarded with unlimited access to the property tax base in perpetuity.

A 1990 special study by the auditor general found that "expenditures budgeted outside of the revenue control limits for desegregation programs are growing" and

that "some costs categorized as desegregation expenditures do not appear to be related to desegregation orders and agreements." During fiscal 1991, the year in which the auditor general's report was released, 10 districts levied \$47.3 million under this provision. For fiscal year 2002, 19 districts levied \$193.8 million, a 309.7 percent climb over the 10-year period.

Despite the report's recommendations that the Legislature take a more active role in strengthening accountability for desegregation programs, lawmakers had accomplished very little until 2002, when the Legislature capped deseg/OCR levies for a two-year period. That cap expires this year.

According to the Legislature's budget office, if nothing is done to extend the cap on deseg/OCR levies, tax increases could reach \$54 million statewide next year and \$72 million the following year.

Those potential property tax increases could cost the state general fund between \$4 million and \$12 million to compensate for the 35% homeowner rebate and the 1% constitutional cap on homeowner primary property taxes.

Deseg/OCR levies are unlimited budget overrides requiring no voter approval. In fact, some districts have used this taxation authority to compensate for the loss of revenue when overrides are rejected by voters, essentially saying to taxpayers, *You don't get to say no.*

These levies have been driving a wedge into school district and taxpayer equity, widening the gap every year in a public school system that is required by the Arizona Constitution to be "general and uniform." Disparities in tax burdens resulting from these desegregation levies can be severe, with some property owners paying tremendously higher tax rates than similarly valued property in an adjacent district.

Of the four bills dealing with deseg/OCR taxation, HB 2266, sponsored by Representative Steve Huffman, represents the most meaningful and long-term reform. This bill will cap desegregation and OCR property tax levies at their current level. Any justifiable revenue increase for new or existing expenditures for such deseg/OCR purposes will be subject to legislative appropriation.

HB 2268 extends the current two-year cap on deseg/OCR taxes for an additional two years.

HB 2265 eliminates the ability for districts to levy deseg/OCR property taxes for capital purposes. HB 2267 enhances and clarifies deseg/OCR reporting requirements.

If the Legislature does nothing this year, deseg/OCR taxation will go back on the path it was on prior to 2002. Pass or fail, no other legislation this session is likely to have a greater impact on local property taxes than HB 2266 or HB 2268.