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ARIZONA TAX RESEARCH ASSOCIATION

NEWSLETTER VOLUME 65 NUMBER 4 MAY 2005

PROPERTY TAX REFORM SIGNED INTO LAW

Following a veto earlier in the legislative session, the much discussed and debated property tax reform measure finally secured Governor Napolitano's signature on May 20, 2005. The bill signed by the Governor (HB 2779) was identical to the version vetoed back in March.

The passage of the property tax reform bill marks the most significant progress in decades to address Arizona's inequitable property tax burden. Numerous studies of Arizona's tax system have focused criticism on Arizona's property tax classification system that shifts taxes from one type of property to another through the use of varying assessment ratios. The highest assessment ratio is placed on business property causing it to pay two and half times the taxes of residential property assessed at 10%.

This year's victory will create meaningful tax reductions and the resultant expansion of capital across our state for job creation and wage improvement.

Representative Steve Huffman

For several years, ATRA has led the business community's efforts to create greater equity and accountability in Arizona's property tax system. HB 2779 is the culmination of a two-year effort that focused solely on a phased reduction in the assessment ratio on class one (business) property.

This is a historic day for Arizona. For a quarter of a century, business owners have sought relief from Arizona's high business property taxes.

Senator Dean Martin

After considerable debate and compromise with legislators and local government representatives, the final version of HB 2779 reduces the assessment ratio on class one property from 25% to 20% over a ten- year period starting in 2006.

The other important feature of the measure is an increase in the current homeowner's rebate from 35% to 40%. A new feature added to this year's reform effort, the increase in the homeowner rebate became necessary to assure lawmakers that the phased reduction in business taxes would not have major adverse effects on residential properties.

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J. ELLIOTT HIBBS RECEIVES ATRA GOOD GOVERNMENT AWARD

Former Arizona Governor Jane Hull congratulates J. Elliott Hibbs on receiving ATRA's Good Government Award

The Arizona Tax Research Association (ATRA) presented J. Elliott Hibbs with the *ATRA Good Government Award* at a luncheon held in his honor at the Phoenix Country Club. Hibbs is retiring from a 21-year career in state government.

Since 1991, ATRA has annually recognized an outstanding individual whose work in the public sector is characterized by a strong and consistent effort to spend taxpayer dollars wisely and promote government that is efficient, open and accountable.

Gretchen Kitchel, chairman of ATRA's Board of Directors, presented Elliott with the Award.

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GOOD GOVERNMENT

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"This year's presentation of the ATRA Good Government Award is truly special as we are provided the opportunity today to not only honor Elliott Hibbs with the Good Government Award but also to thank him for his many years of service in state government" said Kitchel.

Over the last two decades no state employee has garnered the widespread respect that Elliott has. Whether it was Governors, the Legislature, state employees, or the business community, everyone that interacted with him shared the same impressions. As Richard de Uriarte's tribute to him in *The Arizona Republic* noted, he truly defines the words "public servant."

Elliott was brought to Arizona in January of 1980 by then Governor Bruce Babbitt to direct the Department of Revenue. His success in turning around a troubled agency launched a 21-year career in state government where he also served as a Governor's Fiscal Advisor, the Director of the Department of Administration, Chief of Operations for the Arizona State Senate as well as Deputy Director of the Department of Economic Security.

ATRA Board Chairman Gretchen Kitchel and Russell Smoldon present Elliot Hibbs with the ATRA Good Goverment Award

Elliott's trademark was improving the efficiency of state agencies by setting the strategic direction of the agency and then measuring its performance to ensure progress. At the Department of Revenue, the time to issue tax refunds was reduced from 13 to three weeks and deposits reduced from five days to one day.

The quiet and consistent manner with which Elliott approached his work was well suited for his work at the Department of Administration where it is often said the goal is to have no one talking about the agency. While not headline grabbers, he took seriously his responsibility for improving the state's financial management. His efforts led to the first ever clean opinions on the state's comprehensive financial report.

Elliott also served as the Executive Director of ATRA from 1988 to 1991. In addition to his strong management skills, Elliott was also recognized as a bit of a tax policy wonk who really knew his stuff on tax matters.

In addition to honoring Elliott with the ATRA Good Government Award, we are also very proud to announce that he has graciously agreed to lend his name to this award in the future. In deciding to honor Elliott with the Good Government Award, the ATRA Board of Directors also thought it was a great opportunity to not only memorialize his outstanding service but also illustrate its purpose in the future by adding his name to it. So, beginning in 2006, future recipients of this award will receive the ATRA J. Elliott Hibbs Good Government Award.

Congratulations Elliott!

ATTENTION ATRA MEMBERS

ATRA staff is in the process of scheduling county and community college budget review meetings.

Look for communication soon regarding these opportunities to learn more about local government taxation and spending plans for the upcoming fiscal year.

Contact Jennifer Schuldt (counties) or Michael Hunter (community colleges) at 602-253-9121 for meeting schedules and other budget information.

ARIZONA TAX RESEARCH ASSOCIATION
Gretchen Kitchel....................Chairman
Kevin J. McCarthy ....President
Michael E. Hunter ....Vice President
Jennifer Schuldt ....Senior 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 Reseach 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

PROPERTY TAX REFORM

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Senate Finance Committee Chairman Dean Martin and House Ways and Means Committee Chairman Steve Huffman each made the passage of business property tax reform a major priority for the session. Each played key roles in their respective houses to ensure that business property tax reform remained a top priority through the entire session.

Senator Martin noted the significance of the legislation in stating "This is a historic day for Arizona. For a quarter of a century, business owners have sought relief from Arizona's high business property taxes. This year we passed it, not once but twice!"

Representative Huffman, who for two years advocated business property tax relief through a straightforward reduction in class one assessment ratios, said "This year's victory will create meaningful tax reductions and the resultant expansion of capital across our state for job creation and wage improvement. The success of the broad coalition of supporters, including ATRA, that came together to achieve this reform also creates a model for future endeavors."

In tax year 2006 (FY 2007), the assessment ratio will be reduced a half percent to 24.5% while the homeowner rebate will increase a full percentage point to 36%. Providing a full percentage increase in the homeowner rebate for the first five years "front loads" the homeowner relief in the bill.

The Joint Legislative Budget Committee (JLBC) estimates the first year general fund cost for the increased rebate at $12.3 million. The estimated total cost when fully implemented in 2011 is $82.2 million.

TWO MORE SUCCESSES FOR TAX PRACTITIONERS BILLS

SB 1171 MANAGED AUDIT AGREEMENTS

As a result of the Governor's signature on SB 1171, the Department of Revenue (Department) will have the opportunity to enter into managed audit agreements with taxpayers. Sponsored by Senate Finance Chairman Dean Martin, the new program will free up government resources by allowing the taxpayer to conduct a "self-audit" under a managed audit agreement with the Department.

A managed audit agreement is initiated at the taxpayer's request, in which the taxpayer will audit certain business activities and types of taxes for a specified period of time based on the negotiated agreement. The types of taxes that may be included under the managed audit include transaction privilege tax, local excise tax, use and luxury tax. Corporate income taxpayers become eligible for the program beginning January 2007.

Once the audit is completed, the taxpayer submits the findings to the Department, subject to review. The incentives for the taxpayer include the abatement of penalties and interest in the case a deficiency is assessed by the Department if the taxpayer pays the total assessment within 45 days.

SB 1185 USE TAX PERCENTAGE-BASED REPORTING METHOD

Also signed by the Governor was SB 1185, which implements a use tax percentage-based reporting method. Sponsored by Senator Karen Johnson, this piece of legislation will allow the Department to authorize a taxpayer that holds a use tax direct payment permit to use this method for determining use tax payments. All taxpayers become eligible for the program after taxable periods beginning June 30, 2007.

Taxpayers are currently required to file returns with the Department based upon actual purchases that are subject to use tax, which can be very costly from a taxpayer resources standpoint. The approval by the Department to use this method is valid for up to four years as long as there is no change in law or administrative rule, the taxpayer's business operations, or as long as the taxpayer does not commit a fraudulent act, malfeasance, or misrepresents material facts.

Jennifer Schuldt

CHANGES IN CLASS 1 ASSESSMENT RATIOS AND HOMEOWNER'S REBATE

Tax Year	Class 1	Homeowner's Rebate %	Homeowner's Rebate Cap
2005	25.0%	35%	$500
2006	24.5%	36%	$520
2007	24.0%	37%	$540
2008	23.5%	38%	$560
2009	23.0%	39%	$580
2010	22.5%	40%	$600
2011	22.0%	40%	$600
2012	21.5%	40%	$600
2013	21.0%	40%	$600
2014	20.5%	40%	$600
2015 & thereafter	20.0%	40%	$600

GOVERNOR SIGNS SALES FACTOR BILL

On May 20, Governor Napolitano signed HB 2139, a measure that was championed by Representative Steve Huffman to change the corporate income tax allocation factors. HB 2139 will ultimately provide multi-state corporations the ***option*** of using an 80% sales factor apportionment formula in the calculation of corporate income tax liability.

The current structure for the apportionment of multi-state corporate income is three-tiered, allocating a percentage to property, payroll, and sales. Existing law calls for using a 50% sales factor, with 25% allocated to payroll and property each.

Corporations that might see higher tax liabilities as a result of the increasing sales factor will be allowed to continue to calculate Arizona income tax liability using the current 50/25/25 apportionment.

Responding to concerns that major corporate investments would not materialize following the passage of the bill, proponents agreed to a provision requiring $1 billion in capital investments to be made for the change to take effect. In addition, the bill contains extensive reporting requirements to measure the effectiveness of the program. Final negotiations on the bill also decreased the sales factor weight from 100% to 80%.

Although most states originally taxed multistate corporate income by equally weighting property, payroll, and sales, many states are now moving toward allowing a greater weight to sales in an effort to encourage business to expand payroll and property in their state.

Jennifer Schuldt

APPORTIONMENT FORMULA CHANGES ALLOWED BY HB 2139

Tax Year	Formula
2006	Income x 50% (sales) + 25% (property) + 25% (payroll)
2007	Income x 60% (sales) + 20% (property) + 20% (payroll)
2008	Income x 70% (sales) + 15% (property) + 15% (payroll)
2009 & thereafter	Income x 80% (sales) + 10% (property) + 10% (payroll)