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ARIZONA TAX RESEARCH ASSOCIATION

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Legislature Debates Property Tax Relief

Against the backdrop of growing taxpayer unrest regarding skyrocketing property valuations, the Arizona Legislature continues to debate the best approach to protecting taxpayers from the increased taxes that are sure to follow. Responding to ATRA's recommendations, both Senate Finance Chairman Dean Martin (SB1289) and House Ways and Means Chairman Steve Huffman (HB2685) introduced similar measures that have each passed their respective houses. HB2685 and SB1289 provide roughly \$205 million in direct property tax relief through the elimination of the county education equalization rate. Further, each bill requires the counties, cities and community college districts to adopt their Truth-in-Taxation (TNT) rates for 2006. Beginning in 2007, these jurisdictions would be required to receive voter approval before exceeding their TNT rates two years in a row. (*For more information on ATRA's proposals, see the Jan/Feb 2006 NEWSLETTER.*)

Despite the fact that both bills have passed out of their house of origin, there are on-going disputes about how to best address both the short term issue of increasing property taxes as well as the long term structural reforms that will protect taxpayers in the future.

THE FOCUS ON PROPERTY VALUES: One of the first reactions of policymakers when they see county assessors dramatically increase valuations, as was the case in several counties this year, is to focus their energy on limiting annual increases in those values. In fact, this common response has become an annual exercise at the Capitol each year, with constitutional amendments introduced to limit valuation growth to 2% a year.

This session, the Senate passed SCR1025, which limits annual valuation growth to 2%, but the measure failed to get a hearing in the House. ATRA has consistently opposed further limits on valuation growth as the mechanism to control property taxes. As has been the case in previous years, SCR1025 does nothing to control the tax

rates of state and local government. In fact, severely limiting valuation growth alone will guarantee upward pressure in property tax rates.

The most significant policy problem caused by SCR1025 is that increasing tax rates, coupled with lower residential values, will cause a significant increase in the number of taxing jurisdictions with homeowners at the 1% constitutional cap. The Arizona constitution limits primary property taxes on homes to 1% of the full cash value. Currently, taxes above the 1% cap are shifted to the State of Arizona. (It is worth noting that an initiative filed by a group of taxpayers in Mohave County titled "Arizona Tax Revolt" limits both valuation increases to 2% as well as taxes owed at 1% of value.)

The second major policy problem with an acquisition-based valuation limit is that it will create major inequities among similarly situated properties. Arizona's property tax system is already famous for the inequities that exist as a result of the use of assessment ratios-adding to the inequities on the valuation side would be a step in the wrong direction.

FOCUS ON THE PROBLEM – TAXES, NOT VALUE ATRA's advocacy on this issue continues to focus on the fact that increasing property tax levies are the reason tax bills climb. Increased property values result in tax increases only if government levies are allowed to increase at the same rate. As the economy drives real estate values upward, policymakers at the state and local level need to be convinced to drive down tax rates in order to offset what otherwise will be significant tax increases. At a minimum, the Legislature and Governor need to lead by example and dedicate a significant portion of this year's tax relief to the property tax.

ATRA TO HONOR SENATOR KYL



The Arizona Tax Research Association will be honoring Senator Jon Kyl with ATRA's Taxpayer Watchdog Award for his years of dedicated service to taxpayers on Wednesday, May 31, 2006 at the Phoenix Country Club.

Senator Kyl was elected to the U.S. Senate in 1994 and re-elected in 2000, after having served four terms in the U.S. House of Representatives. Senator Kyl serves on the Senate Finance Committee, where he chairs the Subcommittee on Taxation and IRS Oversight, and on the Judiciary Committee, where he chairs the Subcommittee on Terrorism, Technology and Homeland Security.

Senator Kyl received the second highest ranking among U.S. Senators from the National Taxpayers Union (NTU) as well as a 100% rating from Americans for Tax Reform. In addition, Senator Kyl introduced legislation to make permanent President Bush's tax cuts of 2001 and 2003, as well as leading the efforts to reimburse states for the cost of providing federally mandated health care to undocumented immigrants and incarcerating criminal aliens.

LEGISLATIVE UPDATE

ATRA SUPPORTS

HB2712 tax decisions; distribution (Yarbrough) HB2712 is a recommendation by the ATRA Tax Practitioner's Committee that requires certain government agencies to provide tax decisions to the law libraries of Maricopa County, Arizona State University, University of Arizona, the State Law Library, and the Arizona State Library. The specified agencies are also required to publish tax decisions on their official web sites. An agency that does not have a web site has until January 1, 2008 to establish one. *Awaiting Senate Rules.*

SB1068 contractor sales tax; development fees (Martin) In an effort to prevent what ATRA considers to be double taxation, a transaction privilege tax (TPT) exemption is created under the prime contracting classification for development or impact fees paid to the state or a local government to offset governmental costs of providing public infrastructure, public safety and other public services to a development. *Awaiting House Rules.*

SB1206 schools; maximum property tax rate (Burns) This legislation caps a school district's primary property tax rate if the rate is 150% of the qualifying tax rate (QTR) and 50% of the residential properties in the district are at the 1% constitutional cap. Two years ago, when this legislation was first introduced, there were nine school districts that met the criteria – now there are 19 school districts that have primary property tax rates that exceed the QTR and 1% thresholds in SB 1206. Preventing these 19 school districts from increasing their primary property tax rates above their current levels would result in a cost savings to the state general fund because the state picks up the tax obligations for homeowners over the 1% cap. *Awaiting House Third Read.*

SB1217 S/E: Public health services district (Martin) County boards currently use their general fund revenues, which mainly consist of primary property tax levies and sales taxes, to provide services to taxpayers, including the funding of public health services. Under existing law that was enacted in 2000, a county board of supervisors has the ability to generate an additional funding source through the creation of a Public Health Services District (PHSD), either by a unanimous vote of the board or through voter approval, with the option to levy a secondary property tax or transaction privilege tax (TPT). To date, both Navajo and Yuma counties have made the decision to sidestep voters and create a PHSD. SB1217 would require a county board of supervisors to seek voter approval prior to creating the district. *Awaiting House COW.*

SB1065/HB2677 tax credit; research and development (Martin/Reagan) Increases the individual and corporate income tax credit allowed for excess qualified research expenses by increasing the credit from 20% to 30% if the excess expenditures are \$2.5 million or less. If the excess is over \$2.5 million, the credit increases from \$500,000 to \$750,000 plus 21% (up from 11%) of any amount exceeding \$2.5 million. *Awaiting Senate Rules/House Appropriations.*

SB1458 new tax interpretation; affirmative defense (Martin) Current statute provides an affirmative defense in any administrative or judicial action for retroactive assessment of tax, interest and penalties in the situation where the Department of Revenue (DOR) adopts a new interpretation or application under the transaction privilege tax (TPT) and other affiliated excise taxes that applies to a new or additional category or type of taxpayer and the change is not due to a change in the law. SB1458 expands that same protection to taxpayers to include all taxes administered by DOR. *Awaiting House COW.*

HB2372: post secondary ed; non credit courses (Knaperek) Creates new definitions for credit courses that would receive state funding. Tax dollars used by the community colleges or universities would be for courses that lead or prepare students for a qualified degree or certificate or are transferable to an accredited private or public college or university. *Failed on the House floor.*

SB1205: schools; transportation RCL; limited increases (Burns) This bill attempts to correct a serious flaw in the K-12 transportation formula that continues to generate funding, in perpetuity, for "ghost" students. Currently, about \$54 million in local property taxes are levied statewide, effectively funding students who are not being transported. The bill would not reduce the amount of funding a school district currently receives for transportation costs. A district's Transportation Revenue Control Limit (TRCL) may not increase if the existing limit is more than 120% of the Transportation Support Level (TSL). *Awaiting House Rules.*

SB1431: community colleges; nonresident county; tuition (Bee) SB1431 would redefine out-of-county reimbursement of students attending a community college from the unorganized counties of Santa Cruz, Geenlee, or Apache. It would simplify the statutory formula by dividing the community college's primary and secondary property taxes by the community college's FTSEs and then multiplying it by the number of unorganized county's FTSEs. *Failed in House Universities, Community Colleges, and Technology.*

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Property tax shell game is wearing thin

Kevin McCarthy
My Turn

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A debate among taxpayers regarding the most hated tax rarely changes minds. The current legislative session features a debate about whether to direct tax relief to property taxpayers or income taxes or possibly both.

Valid arguments can be advanced about the deleterious impact of most major taxes. However, the property tax historically has endured the wrath of taxpayers. Why? Because unlike other major taxes, the property tax is the object of a complicated annual shell game played by elected

officials that ultimately wears thin with those paying the tax.



Fed by dramatic growth in real estate prices, skyrocketing property-tax valuations in Arizona are stoking the flames

of a potential taxpayer revolt. In Mohave County, one of the first counties to send new valuation notices this year, taxpayers are forming to circulate an initiative that would place a tax limit similar to California's Proposition 13 in the Arizona Constitution. The initial meeting of the "Arizona Tax Revolt" packed the Bullhead City Council chambers in early February. A similar movement could surface in Maricopa County, where Assessor Keith Russell has sent out valuation increases for homeowners that average 51 percent.

At the heart of the property-tax shell game is the ambiguous and sometimes complicated relationship between property valuations established by the county assessor and the tax rates that result from budgets adopted months later. The foundation for a property-tax revolt is almost always built on significant increases in property valuations fed by a hot real estate market.

County assessors, fulfilling their legal obligation, increase values to reflect market conditions. Correctly, assessors proclaim that the valuation notice is not a tax bill and the final determination of taxes owed is based on the budgetary decisions of as many as 10 different taxing jurisdictions.

The Arizona Tax Research Association has consistently advocated measures that limit state and local government's ability to ride dramatic valuation increases to huge increases in their levies. Beginning in 1996, the association successfully pushed through the Legislature a series of Truth in Taxation, or TNT, provisions that require the state, counties, cities and community college districts to decrease tax rates to offset growth in valuations.

The good news is that the TNT law has been successful in mitigating property-tax increases at the state level. Since the law went into effect in 1999, state tax rates have decreased 14 percent. The bad news is that local governments (counties, cities and community colleges) have consistently adopted rates in excess of the TNT rates.

Current TNT laws require state and local governments that levy primary (levies for operating budgets) property taxes to provide public notice and majority vote of the governing body before raising taxes. The record suggests this

requirement has been a very low hurdle for local governments looking to turn valuation increases into tax increases. Most local governments easily garner the majority vote to exceed the TNT rate, and combine those votes with claims they are not increasing taxes because the tax rate is not increasing.

Clearly, the primary reason local governments continue to spin the "this is not a tax increase" story is that so many taxpayers still fall for it. Time and again, the strategy used to pass multimillion-dollar bond elections in Arizona is to soothe taxpayers by telling them it won't increase their taxes. The fact that those measures always rely on increasing property values, and therefore rising tax bills, never seems to resonate with voters.

If there is a silver lining to the dramatic growth in property valuations, it will be that taxpayers will become more knowledgeable about how government budgets, as well as bond and override elections, ultimately affect their property taxes. Instead of accepting the fantasy that all of the spending can be purchased for free, taxpayers will begin demanding greater accountability for those expenditures.

In the near term, taxpayers should demand that elected officials decrease tax rates in order to offset valuation increases. At the state level, Rep. Steve Huffman (HB 2685) and Sen. Dean Martin (SB 1289) have introduced bills to cut state property taxes as well as require local governments to receive voter approval before exceeding their TNT rates.

Whether it's the most hated tax or not, cutting property taxes now is a particularly good idea.

LEGISLATIVE UPDATE

ATRA OPPOSES

SB1074 S/E: enterprise zones; reauthorization (Huffman) The striker amendment to SB1074 extends the enterprise zone tax breaks, which include income, premium, and property, due to sunset on July 1, 2006. Expands the definition of “independently owned and operated” to allow at least 50% ownership interest to be held by another entity, more if the entity is family-owned or closely held, making it easier for more businesses to qualify for the program. The property tax breaks, which are made available to just a few qualifying companies located in enterprise zones, are bad policy and serve to exacerbate problems in Arizona’s property tax system by targeting relief to select businesses while shifting the burden onto other business taxpayers. *Awaiting House COW.*

HB2361 flood control districts; financing (Konopnicki) Allows a county flood control district to acquire real or personal property by

lease-purchase, lease and leaseback. Also allows a district to grant a mortgage or lien on its property, lease real or personal property in the district, either as lessee or lessor. Any lease-purchase agreement or lease-back agreement is binding on all future boards of directors until fully performed. This bill would allow county boards of supervisors to side-step the current voter approval process for debt financing for flood control districts. *Held in Senate Natural Resources & Rural Affairs.*

HB2702 Rio Nuevo; shared revenue (Huffman) The Rio Nuevo Multipurposes Facilities District tax increment financing project is extended from ten to forty years in which the district can receive millions in state transaction privilege tax (TPT) revenues. The district may use the revenue for the construction, operation, maintenance and repair within and adjacent to the district to serve any project within the district. ATRA believes that diverting state sales tax receipts from the state

general fund to finance this project makes all the state’s taxpayers participate in the funding of what is actually a local project. *Awaiting Senate Rules.*

HB2700 JTEDs; omnibus (Anderson) HB2700 requires the design of a joint technological education district (JTED) course to lead a student towards a specific career or vocation. It sets the average daily enrollment for students at both a charter school and JTED at 1.5 and increases the sum of average daily attendance and fractional enrollment at a school district and a JTED to 1.5 for satellite courses. It limits course offerings to students in grades 10-12. It also creates new requirements for intergovernmental agreements and new reporting requirements between a JTED and the Department of Education. *Awaiting Senate Appropriations.*