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ARIZONA TAX RESEARCH ASSOCIATION

NEWSLETTER

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ATRA Board Takes Action On Three Initiatives...

Proposition 101

Support Reasonable Property Tax Limits

The Taxpayer Protection Act of 2006 (Prop. 101) would require a recalculation of the constitutional levy limits for counties, cities, towns, and community colleges that voters first approved in 1980. The limits allowed these jurisdictions to grow their previous year's primary levies by 2%, plus new construction. If passed, Prop. 101 would eliminate more than $186 million in primary property tax levying capacity that currently exists.

Over the last 25 years, the capacity to levy primary property taxes has outpaced actual levies for a variety of reasons. When the levy limits were first put into place in 1980, the expectation was that tax rates would decrease slightly each year. However, the maximum tax rates in some jurisdictions' levy limits have grown dramatically, particularly for those jurisdictions that were initially levying a higher rate when the limits were first implemented. Excess capacity has also been created through new construction that is brought into the levy limit using the maximum rate as opposed to the current rate levied by the jurisdiction. Some jurisdictions now have maximum tax rates that are 150% or higher than their current primary rates.

Another reason for the growth in the levy limit capacities, at least for counties, has been the ability to levy a sales tax. The Legislature granted all counties, except Maricopa, the authority to levy a ½-cent sales tax without a public vote. The growth in their levy limit capacities increased noticeably after the jurisdictions began levying a sales tax to subsidize their general funds.

As the table below shows, the counties were either at or near their levy limits in tax year 1989, which was eight years after the levy limits were implemented and prior to the counties ability to levy a sales tax. In 1995, after the counties were provided the authority to levy a sales tax to subsidize their general fund, the levy limit capacity had grown by nearly $82 million.

Prop. 101 ensures that local governments intending to raise taxes beyond reasonable limits should be required to seek voter approval.

For more information on ATRA's ballot initiative positions, visit www.arizonatax.org

Proposition 106

Oppose Deferring Major Public Policy to an Appointed Board

Prop. 106 is an effort to set aside over 690,000 acres of state trust land as well as significantly change the current management of Arizona's state land trust. The following are the key provisions:

Conservation Reserve

This initiative creates a Conservation Reserve of approximately 694,000 acres consisting of *Educational Reserve Lands*, *Permanent Reserve Lands*, and *Provisional Reserve Lands*, all which have various restrictions on their use.

Educational Reserve Lands may be conveyed for research and education and the development on these lands are not limited. *Permanent Reserve Lands* may be conveyed to a county, city or town or to a "qualified party" if the land is located in the vicinity of a state park or wildlife area. *Provisional Preserve Lands* may be conveyed to a qualified party, agency of the United States or nonprofit organization that is organized for the purpose of conservation if the true value is provided through monetary

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COUNTY LEVY LIMIT CAPACITY

	TY 1989			TY 1995			TY 2005		
County	Levy Limit Capacity	Adopted Tax Rate	Max Tax Rate	Levy Limit Capacity	Adopted Tax Rate	Max Tax Rate	Levy Limit Capacity	Adopted Tax Rate	Max Tax Rate
Apache	(76,211)	0.1522	0.1711	0	0.2555	0.2555	73	0.4598	0.4587
Cochise	0	2.8407	2.8407	(1,965,517)	3.0309	3.5106	(8,840,972)	2.9373	4.2673
Coconino	0	0.4285	0.4285	(478,826)	0.4008	0.4659	(358,913)	0.4753	0.5037
Gila	42,683	3.8368	3.8444	(3,465,761)	3.4500	4.7486	(7,113,806)	4.4100	6.2448
Graham	(151,827)	2.1992	2.4538	(726,862)	1.8968	1.8353	(1,750,444)	1.7912	3.4335
Greenlee	12,714	0.2230	0.2230	(127,587)	0.1652	0.2211	0	0.6556	0.6556
La Paz	0	2.2759	2.2759	(610,446)	2.3720	2.9796	(2,184,743)	2.2500	3.7805
Maricopa	0	0.9426	0.9426	(14,361,887)	1.1580	1.2669	0	1.1971	1.1971
Mohave	(24,934)	1.8423	1.8475	(1)	1.7454	1.7454	(2,874,653)	1.7500	1.9616
Navajo	(1,002)	0.3682	0.3683	(3)	0.5071	0.5071	0	0.6337	0.6337
Pima	(1,218,457)	3.7068	3.7476	(45,258,161)	3.5137	4.9593	(38,976,394)	4.0720	4.7233
Pinal	(214,644)	4.5839	4.4760	(10,989,475)	4.2567	6.0358	(45,625,839)	4.4532	8.2429
Santa Cruz	(118,169)	3.0188	3.1241	(960,124)	2.6485	3.2222	(486,934)	3.3487	3.5352
Yavapai	0	2.1773	2.1773	(1,532,368)	1.9413	2.1261	(6,369,087)	1.7008	2.0400
Yuma	76,860	1.9749	1.9794	(1,467,698)	1.9200	2.2672	(2,986,811)	2.2315	2.6565
TOTAL	**(1,672,987)**	**2.0381**	**2.0600**	**(81,944,716)**	**1.9508**	**2.4098**	**(117,568,523)**	**2.1577**	**2.9556**

PROPOSITION 106

Continued from page 1

or non-monetary forms of consideration.

Board of Trustees

The initiative creates a seven-member Board of Trustees that are appointed by the Governor and confirmed by the Senate to oversee the management of state trust land as well as the distribution of the Conservation Reserve lands.

Changes To Current Process For Disposition Of State Lands

The Board will be given the authority to prescribe a method for determining highest and best bid. Sale to the highest bidder will no longer be a requirement for public or private rights-of-ways and will have the authority to grant rights-of-ways for non-monetary considerations.

Plans for the use of state trust lands are required to be done in conjunction with the county, city or town in which they are located, in accordance with all applicable ordinances, rules and regulations of the jurisdiction.

The Board will be allowed to designate any part of the state trust land for conservation purposes to an agency or political subdivision of the state if the monetary or non-monetary consideration for all of the trust land that is subject to the plan is at least equal to the true value of the land.

Trust Land Management Fund

Provides the Board of Trustees the authority to transfer state trust land monies into a Trust Land Management Fund based on specified criteria. The initiative prescribes that the Management Fund can only be used to supplement funding for the administration and management of state trust lands provided by the Legislature.

ATRA'S POLICY CONCERNS:

Earmarking Revenue

For decades, ATRA has expressed concerns about earmarking revenues outside the appropriations process through what is commonly referred to as "ballot box budgeting." Conserving Arizona's Future is one of many in a long line of initiatives that have been placed before Arizona voters in an attempt to guarantee funding for a program or agency that receives annual funding from the Legislature.

Every interest group that receives annual state general fund appropriations would opt for guaranteed funding levels. However, earmarking revenues and creating dedicated funding mechanisms does significant damage to the state's ability to do comprehensive budgeting and handcuffs state policymakers' ability to readjust budget priorities over time.

Regrettably, determining state budget priorities at the ballot box has become so commonplace in Arizona that much of the flexibility to annually develop a state budget has been stripped from the Legislature.

Deferring Major Public Policy To An Appointed Board

In recent years, it has become increasingly popular to combine efforts to earmark funding outside the state's appropriations process with the creation of an appointed board to oversee the management of those funds. The creation of the board, in this instance the Board of Trustees, accomplishes two goals: First, after side-stepping the Legislature, it creates the impression that the board will fill the fiduciary responsibility of providing on-going oversight of the agency and funds. Second, the appointed board allows the proponents to dictate and control the membership of the board through a narrow set of criteria for participation.

Conserving Arizona's Future would transfer authority and management over Arizona's 9.3 million-acre state land trust and some of the two billion dollar permanent fund to an appointed body. Such a significant grant of policy making authority, as well as appropriation powers, should not be vested in an appointed board.

Proposition 203
A Fiscal Hazard Arizonans Should Avoid

The Arizona Early Childhood Development and Health Initiative, Prop. 203, is a vehicle to increase tobacco taxes from \$1.18 to \$1.98. Four years in the making, First Things First is an organization formed to spearhead the initiative's qualification for the 2006 ballot and is headed by Nadine Mathis Basha. According to its estimates, the 80-cent tax increase will raise \$150 million *in perpetuity* which will be used specifically for services to improve the health and school readiness of children, ages 0-5 years old.

If it receives approval in November, it will be Arizona's third tobacco tax increase in a dozen years. It would create an Early Childhood Development and Education Board, composed of nine members appointed by the Governor and confirmed by the Senate to serve six-year staggered terms. The initiative also authorizes the construction of regional partnership councils, as deemed necessary, to form around the state. The councils are given the task of performing needs assessment for their communities, reporting back to the Board which then acts as the appropriator and provides them funding.

The Board is allowed to raise money from other sources such as individuals, corporations, and foundations, but a majority of its funding is expected to be gained through the tobacco tax increase.

It is at this point that ATRA raises concerns on the propriety of relying on this tax for its full funding.

For decades, ATRA has expressed its concern that the Legislature and Governor are not being allowed to fully perform its fiduciary duties due to the practice of earmarking revenues outside the appropriations process or otherwise known as "ballot box budgeting."

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PROPOSITION 203

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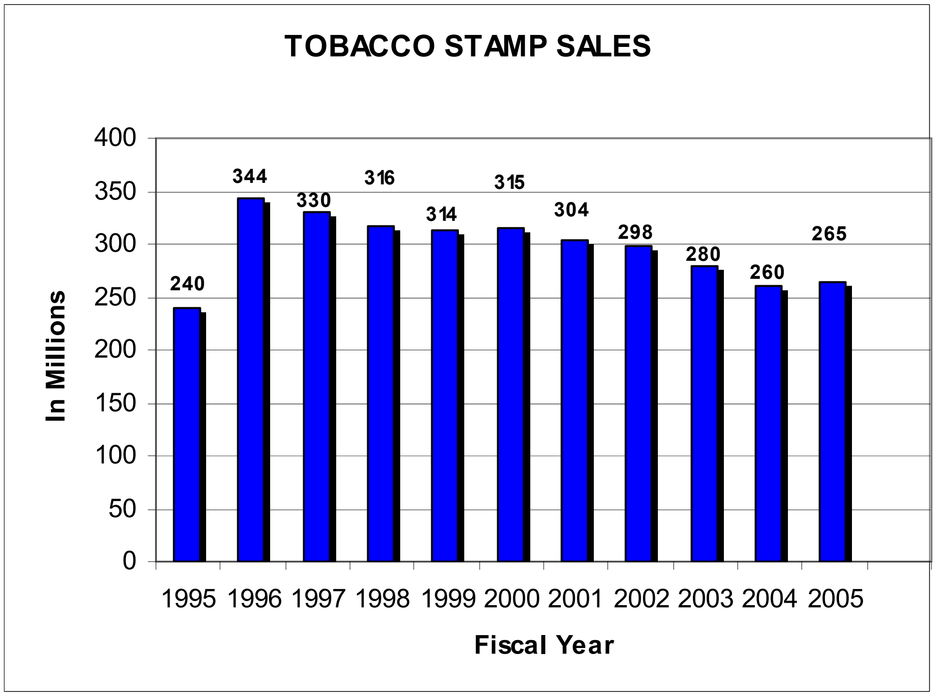

Another concern rises from the fact that tobacco taxation is a declining revenue source. Fewer Arizonans are smoking, as measured by the Center for Disease Control - 23.1% in 1996 to 18.6% in 2004. Cigarette consumption is expected to decline 1.5% annually regardless of any tax changes and the National Association of Attorneys General announced that fewer cigarettes were sold this year since 1950.

Finally, the tax increase will cause tobacco patrons to search for alternative methods to purchase cigarettes and other products. The most prevalent method is through the Internet, in which Philip Morris USA estimates nearly 1,000 sites are in existence to purchase cigarettes for a reduced price. Indian reservations, neighboring low tax states, and purchasing duty-free products through Mexico are also avenues that can be used to avoid the tax.

Ballot Box Budgeting

Over 50% of the budget is now outside the Legislature's control and therefore policymakers are handcuffed in their ability to respond to the state's changing demands. Also, due to the passage of Prop. 105 in 1998, statutory initiatives are the equivalent to constitutional amendments, further hamstringing the Legislature.

Moreover, during the appropriations process, budget items and programs are provided oversight and review in the Legislature. The nine-member Board does not contain any type of mechanism in which its unelected political appointees will be held accountable or responsible. In case of improprieties, as was experienced in California with the resignation of Rob Reiner from the First 5 California Children and Families Commission, the Board's appointees would be largely insulated from scrutiny.

Declining Revenue Source

The first major tobacco tax increase was in 1994 with the passage of Prop. 200. It increased taxes by 40 cents, from 18 to 58 cents. Called the Tobacco Tax and Health Care Act, it directed funds to the Medically Needy Account for the Arizona Health Care Cost Containment System (AHCCCS), the Health Education Account, the Health Research Account, and the Corrections Fund.

Eight years later, in 2002, Prop. 303 passed and increased the tobacco tax by 60 cents to $1.18 and created the Tobacco Products Tax Fund. This also "reauthorized" Prop. 200 by extending Prop. 105's protection to it.

The General Fund experienced a 11% decline between FY1991 and FY2005. The Corrections Fund was held harmless following the passage of Prop. 200 until FY2005 where it experienced a drop. The Tobacco Tax & Health Care Fund, as measured from FY1996 to FY2005, experienced an 11.8% decline.

For the purposes of generating a conservative figure, a 2% decline in demand was applied in ATRA's analysis. When measured against the expected tax receipts, nearly $40 million will be lost and its effects will be felt across the Tobacco Tax and Health Care Fund, the Tobacco Products Tax Fund, and the Corrections Fund.

An anomaly was discovered in the analysis of the data. There is a general decline between FY1996 to FY2004 in per capita stamp sales. However, in FY2005, there is an increase of over $10 million in total collections. This is due to the Legislature appropriating $900,000 for increased enforcement of the state's tobacco taxation laws.

The state's increased population over the last 15 years has not produced an increase in tobacco users. The population of the state grew 61.2% between 1990 and 2005 but the per capita sales declined 42.3% between 1996 and 2005.

Proponents of Prop. 203 have not attempted to disguise their efforts as an attempt to eliminate smoking. Instead, they have used the years since Prop. 303 trying to identify a revenue source. Higher sales, income or alcohol taxes did not bode well with the public and thus cigarette taxes were targeted because, according to a Prop. 203 spokesman, "they are the avenue of least resistance."

Tax Avoidance

While increasing tobacco taxes leads some patrons to purchase tobacco products over the Internet, since March 2005, web sites no longer accept credit cards. Instead, personal checks and money orders must be used.

Arizona identifies its cigarettes through a three-stamp system. Blue is for the general public, red is for Indian

See **Proposition 203**, page 5

The following are the arguments submitted by ATRA for publication in the official publicity pamphlet.

ARGUMENT FOR PROPOSITION 101

The Arizona Tax Research Association (ATRA), Arizona's only statewide taxpayer organization, strongly supports Proposition 101. In an effort to ensure that skyrocketing property valuations do not translate into huge property tax increases, Proposition 101 will ensure that reasonable limits are placed on local government property tax levies. The Taxpayer Protection Act of 2006 will limit the growth in annual operating property tax levies of counties, cities, towns, and community college districts to two percent. These jurisdictions would receive growth in excess of two percent for any taxes attributable to new construction.

In 1980, Arizona voters placed constitutional property tax limits on counties, cities, towns, and community colleges of two percent plus any growth in the tax base attributable to new construction. For 26 years, these limitations have served taxpayers relatively well. However, for some jurisdictions, their maximum levy limit capacity greatly exceeds their actual operating levies. In some instances, these jurisdictions could dramatically raise property taxes without the consent of the voters.

The Taxpayer Protection Act of 2006 will ensure that voter approval will be required for any county, city, town or community college district to raise property taxes in excess of two percent over their levies in 2005. While Proposition 101 will reduce the non-voter approved levy **capacity** of these jurisdictions by $186 million, it will not force any jurisdiction to reduce taxes below existing levels.

History tells us that when property valuations increase, property taxes often climb along with them. By ensuring that all jurisdictions' levies are capped at their current levels, Proposition 101 will protect property taxpayers when the valuations climb.

ARGUMENT AGAINST PROPOSITION 106

The Arizona Tax Research Association (ATRA) opposes Proposition 106. In an effort to set aside certain lands in the state land trust, as well as dramatically change the current management of our state land trust, this initiative implements two policies which ATRA opposes.

In an effort to dramatically change the current management structure of the state land trust, Proposition 106 creates a seven member Board of Trustees. These individuals, who would be appointed by the Governor, would be given sweeping authority over the 9.3 million acres state land trust as well as the distribution of lands in the Conservation Reserve. In addition, this appointed Board would have the authority to transfer state land trust monies primarily used for the benefit of public schools to a new Trust Land Management Fund.

For decades, ATRA has expressed concerns about earmarking revenues outside the appropriations process through what is commonly referred to as "ballot-box budgeting."

Proposition 106 is another in a long line of initiatives that have been placed before Arizona voters in an attempt to guarantee funding for a program, agency, or special interest group. Clearly, every group that receives annual State General Fund appropriations would opt to receive guaranteed funding from sources other than the State General Fund. However, earmarking revenue and creating dedicated funding mechanisms does significant damage to the state's ability to do comprehensive budgeting and handcuffs state policymakers ability to readjust budget priorities over time.

ATRA encourages Arizona voters to reject a proposal that would give an appointed board sweeping powers over the state land trust as well as the authority to transfer monies from the permanent fund.

ARGUMENT AGAINST PROPOSITION 203

The Arizona Tax Research Association (ATRA), Arizona's only statewide taxpayer organization, opposes Proposition 203. The effort on the part of special interest groups to use the initiative process to receive guaranteed and permanent funding for their programs is bad public policy and should be rejected.

Arizona's state budget problems have been well documented over the last decade. The challenges state policymakers face developing an annual budget is significant. The budgeting process has been complicated by the effect of previous initiatives that earmark funding to special interests and tie up revenues that would otherwise be used to fund our K-12 schools, universities or other state programs. Further, earmarked funding escapes the annual scrutiny of the budget process.

Proposition 203 earmarks the new revenue directly to an appointed board who will exercise sole authority to appropriate the monies to "regional partnership councils."

The proponents suggest that their dramatic tax increase will raise roughly $150 million to fund the new programs. What they do not disclose is the negative impact this huge tax increase will have on existing programs that currently receive funding from existing tobacco tax collections. The following recipients of tobacco tax revenues will most assuredly see real losses in funding: State General Fund; Corrections Fund; Health Care for Medically Needy; Health Education and Research for Tobacco Prevention. In fact, State General Fund revenues from tobacco taxes have declined 20 percent since Arizona's first major tobacco tax increase in 1994.

If successful, Proposition 203 will propel Arizona tobacco taxes to the fourth highest in the nation. At a tax rate of $1.98 per pack, the incentive for smokers to evade this tax through purchases on the Internet or the black market will increase substantially and lead to further declines in **taxable** cigarette sales.

Proposition 203

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Reservations, which sell cigarettes to the general public, and green is for Indian Reservations, which sell to their tribal members.

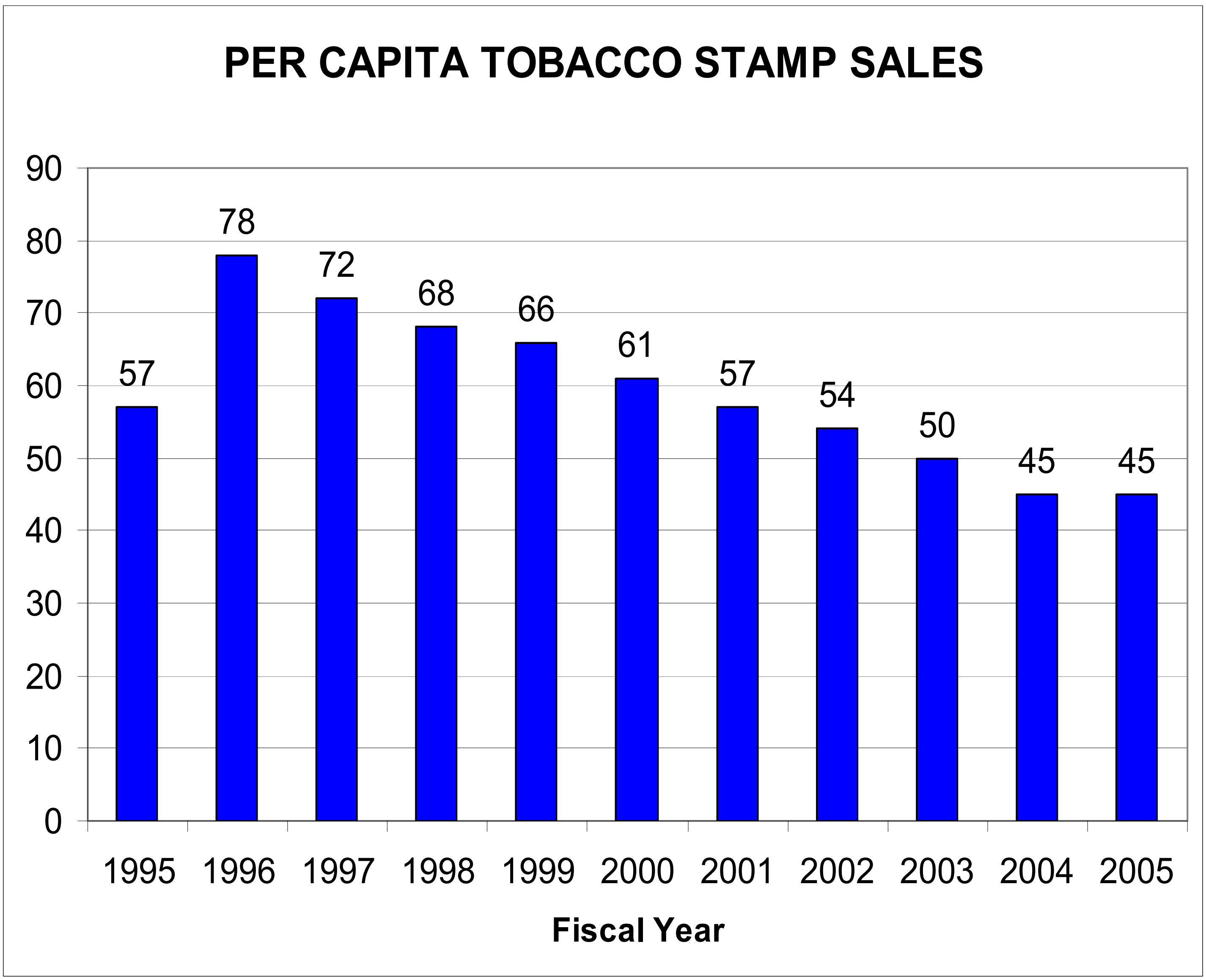
The passage of Prop. 200 and Prop. 303 added to the complexities of the current Indian Reservation taxation system.

Based on previous experiences with Prop. 200 and Prop. 303, ATRA predicts the state will see a reduction in the taxable sales of cigarettes. In order to estimate the anticipated reduction from this 80-cent increase, economists use elasticity of demand projections. In this case, it was found that for every 1% increase in the price of cigarettes, there will be a range of 0.2% to 0.8% decrease in cigarette sales.

In the Joint Legislative Budget Committee's (JLBC) Prop. 203 fiscal analysis, the average Arizona retail price of a pack of cigarettes is $4.30 and increasing the tax by $0.80 would generate an 18.6% increase in the price of cigarettes. Thus applying the 18.6% increase to a JLBC elasticity estimate rate of 0.4%, the tax increase is estimated to decrease cigarette consumption by 7.4% annually. With these estimates, the adjusted actual FY2005 collections declines $21 million.

JLBC also states that the current recipients are estimated to receive $305 million from tobacco tax revenues in FY2007 and FY 2008 but Prop. 203 would reduce those amounts by $13.2 million and $22.7 million, respectively.

Finally, it is important to note that Arizona's share of the Master Settlement Agreement has declined, as this will have an impact on AHCCCS. The share declined due to the major tobacco companies demonstrating that there had been a reduction in the use of its product.



Source: Joint Legislative Budget Committee

Effect of Proposition 203 on Current Revenues

	Current Estimated Revenue	Change in Revenue as a Result of Tax Increase	Estimated Revenue Under Proposition 203
General Fund			
FY2007 [1]	$40,870,000	($1,774,200)	$39,095,800
FY2008	$40,870,000	($3,041,500)	$37,828,500
Corrections Fund			
FY2007 [1]	$6,405,000	($278,100)	$6,126,900
FY2008	$6,405,000	($476,700)	$5,928,300
Tobacco Tax and Health Care Fund			
FY2007 [1]	$109,495,000	($4,753,300)	$104,741,700
FY2008	$109,495,000	($8,148,500)	$101,346,500
Tobacco Products Tax Fund			
FY2007 [1]	$148,230,000	($6,434,800)	$141,795,200
FY2008	$148,230,000	($11,031,100)	$137,198,900
TOTAL			
FY2007 [1]	$305,000,000	($13,240,400)	$291,759,600
FY2008	$305,000,000	($22,697,800)	$282,302,200

1/ Assumes tax increase will take effect December 1, 2006

Source: Joint Legislative Budget Committee