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ARIZONA TAX RESEARCH ASSOCIATION

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ATRA'S LEGISLATIVE AGENDA OFF TO A GOOD START

The 2007 legislative session is off to a fast start and some of ATRA's key issues have already cleared important hurdles. Two major issues that top ATRA's 2007 legislative agenda are property tax reform and property tax rate relief. Both issues attempt to address unfinished business from the work of the Legislature in 2006.

PROPERTY TAX REFORM

The 2005 legislative session was highlighted by the passage of a significant property tax reform measure (HB2779). HB2779 followed two major studies of Arizona's tax system that called for changes in the property tax system to deal with the extraordinarily high taxes on business property in Arizona. As passed, the 2005 legislation called for a reduction in the assessment ratio of business property (class one) from 25% to 20% over 10 years beginning in tax year 2006.

While the 2005 tax reform bill was clearly a major move in the right direction, ATRA believes that the policy problem of high business property taxes

demands a more timely response than the 10-year phase down. To that end, ATRA is advocating that the 10-year phase down be shortened to six years. Senate Finance Committee Chairman Jim Waring (SB1028) and House Ways & Means Chairman Steve Yarbrough (HB2400) both introduced bills to accelerate the phase down. Both bills have cleared their initial hurdles, passing out of the House Ways & Means and Senate Finance Committees. *(For more information on HB2400 & SB1028, see article on page 3).*

PROPERTY TAX RELIEF

A major issue of the 2006 legislative session is concerned with the significant increases in property taxes that could result from dramatic growth in real estate values. ATRA argued that without some legislative action to prevent it, those property valuation increases would result in large property tax increases. Lawmakers responded favorably to a three-pronged strategy of property tax relief at the state level, preemption of local governments from increasing property taxes in 2006, and ensuring protections from primary property tax increases in 2007 and beyond.

Lawmakers responded by reducing the county education equalization rate (now titled the "state equalization rate") from 43 cents to zero. In addition, lawmakers passed session law that preempted local governments from raising primary property taxes for 2006. Lastly, they referred a constitutional amendment (Proposition 101) to ensure that the primary property taxes of counties, cities and towns, and community college districts be limited to 2005 levels (plus inflation and new construction).

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Jennifer Schuldt Named ATRA Vice President



The Arizona Tax Research Association (ATRA) Board of Director's announced at its December meeting the promotion of Jennifer Schuldt to the position of vice-president.

Jennifer has been a senior research analyst for ATRA since November of 2000. Jennifer has served as a specialist in county and municipal government finance as well as state and local property, sales and income taxation. Jennifer brought 12 years of property tax and assessment experience when she joined ATRA in 2000.

In announcing her promotion, ATRA Chairman Gretchen Kitchel said, "In her six years at ATRA, Jennifer has truly distinguished herself as an expert in state and local taxation and is very deserving of the promotion to vice-president."

ATRA President Kevin McCarthy said, "Jennifer's promotion is well deserved and it sends a message to our members about the significant contribution she makes in furthering ATRA's mission. While much of it is behind-the-scenes, Jennifer's hard work is a part of every aspect of ATRA's operation and her promotion will provide even greater opportunities for ATRA to benefit from her talents."

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The Arizona Legislature and Governor Napolitano deserve credit for responding to the threat of increasing property taxes during the 2006 session. However, by only reducing the state equalization rate for three years, they sent the wrong message to property taxpayers. Instead of a strong message that state policymakers recognized the huge valuation increases and responded with rate reductions, the lasting message is that the state plans a significant tax increase in 2009. Simply put, making the tax cut temporary completely undermines the argument that state leaders are managing this crisis in a meaningful way.

Senator Jim Waring (SB1027) and Representative Steve Yarbrough (HB2401) have both introduced bills to repeal the scheduled tax increase in 2009. Those bills have also cleared the Ways & Means and Finance Committees.

SECONDARY PROPERTY TAX REFORMS:

The majority of secondary property taxes are voter-approved overrides and debt service levies for voter-approved general obligation bonds. For the most

part, these levies have some limitations on growth and theoretically tax rates should fall when valuations increase dramatically. However, there are areas in the secondary property tax that need reform if taxpayers are to be protected from significant tax increases when valuations climb.

Representative Steve Yarbrough has introduced the secondary property tax reform legislation to do the following:

- Establish levy limits for the County Flood Control District, County Library District, and County Public Health Services Districts. These countywide special districts will have their secondary levies limited to the same annual percentage growth of the county's primary levy limit. The county primary levy limit is annually increased by 2% plus growth allowed for new construction. In recent years, the average annual growth in the primary levy limits has typically been 7%.
- Change the basis for the levy of taxes for voter-approved school overrides from 10% of the district's current revenue control limit (which fluctuates annually) to a fixed levy through the life of the override. The

initial override request would be capped at 10% of the revenue control limit of the district in the year of approval.

GENERAL TAXATION:

Prime Contracting. Senator Ken Chevront is sponsoring SB1545 on behalf of the ATRA Tax Practitioners Committee. The measure clarifies the definition of a prime contractor to ensure that the tax is not applied to more than 100% of the contract amount.

Final Determination. Senator Barbara Leff is sponsoring SB1233, also on behalf of the ATRA Tax Practitioners Committee. The bill defines "final determination" in order to clarify when the 90-day deadline begins when filing an amended appeal with the Department of Revenue. This bill has cleared the Senate Finance Committee.

Affiliated Leasing Exemption. The final bill recommended by the Tax Practitioner's Committee addresses the current inequity that exists in the TPT commercial lease and tangible personal property lease exemptions to affiliated entities. Senator Waring is sponsoring this legislation.

Key Dual Enrollment Recommendations Sidelined

Last month the Ad Hoc Committee on Dual Enrollment proposed multiple recommendations to amend the dual enrollment statutory guidelines. The interim committee's proposals included new qualifications for dual enrollment courses, changes to admission requirements, uniform intergovernmental agreements (IGAs), more oversight, and a 50% reduction in redundant taxpayer funding.

As introduced, SB1068 (Sen. Linda Gray) would have implemented each of the committee's recommendations. Specifically, to qualify as a dual enrollment class under SB1068, a college level course offered on a high

school campus would need to be more rigorous than a similar high school course. The course would need to lead toward completion of a degree or toward a specific career. The corresponding community college and school district boards would each need to certify the compliance with these qualifications. And finally, the course would need approval from a state oversight agency.

SB1068 also contained the changes proposed to admission requirements. Current statute allows community colleges to admit students under the age of 18 if they achieve a specified score on the SAT or the ACT. However, the statute also allows colleges to waive this

requirement on an individual basis. In order to ensure that all dual enrollment students are adequately prepared for college level work, SB1068 would require a specified score for either the SAT, the ACT, or the PSAT from all students less than 18 years of age.

In order to establish uniform and consistent agreements between the different community colleges and K-12 school districts, SB1068 would have implemented the committee's proposed changes to IGAs. Under SB1068, the community colleges would have been required to cooperatively submit for approval a template IGA to a state

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ARIZONA TAX RESEARCH ASSOCIATION
Gretchen Kitchel.....Chairman
Kevin J. McCarthy.....President
Jennifer Schuldt.....Vice President
Justin Olson.....Research Analyst
Courtney Baker.....Research Assistant

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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



Two Bills Move to Accelerate Reduction in Business Assessment Ratios

In 2005, legislation was enacted with HB2779 to reduce the assessment ratio on business property (class 1) from 25% to 20% over ten years, up from five years as originally introduced. To offset the shift to residential taxpayers, the homeowner rebate was increased from 35% to 40% for the first five years of the reduction.

The passage of this property tax reform measure was the most significant step that Arizona had made in decades to address the state's inequitable property tax system. Arizona's classification system shifts taxes from one type of property to another by applying various ratios to the different classes of property based on property use. Business property, which carries an assessment ratio of 24.5% (tax year 2006), is the highest among all of the property classes. Businesses carry more than 2.5 times the property tax burden as owner occupied residential property (class 3), which is assessed at only 10%.

Arizona's 2006 effective tax rates show that the property tax burden on commercial and industrial property (2.44%) is 2.65 times higher than residential (0.92%) (See ETR table, on page

4). In fact, although commercial property accounts for only 21% of the total value for all classes of property, the tax burden on class 1 is nearly double at approximately 40%.

The Minnesota Taxpayers Association produces an annual property tax study that compares the tax burden on major industrial and residential property. For tax year 2005, Arizona homeowners rank in the bottom half nationally (38th) while industrial property ranks fourth.

Two bills have been introduced this legislative session by the tax chairs, SB1028 and HB2400, to accelerate the reduction in the assessment ratio for businesses from a 10-year phase-down to six years. With successful passage, the assessment ratio will be reduced from 23.5% to 23% beginning in tax year 2008, and 1% each year until 2011 when the assessment ratio for businesses will reach 20%. HB2400, sponsored by Ways & Means Chair Representative Yarbrough, awaits a House Appropriations Committee meeting and SB1028, sponsored by Senate Finance Chair Senator Waring, awaits floor debate.

Residential Property Taxes Payable 2005 \$150,000 Land and Building

Rank	State	NET TAX	ETR
38	Arizona	1,561	1.041%
	AVERAGE	2,048	1.365%

Industrial Property Taxes Payable 2005 \$25,000,000 Land and Building \$12,500,000 Machinery and Equipment \$10,000,000 Inventories \$2,500,000 Fixtures

Rank	State	NET TAX	ETR
4	Arizona	1,386,247	2.772%
	AVERAGE	795,687	1.591%

Source: Minnesota Taxpayers Association

Dual Enrollment, *Continued from page 2*

oversight agency. The agreement would specifically identify the financial and academic responsibilities of each party to the contract.

Most importantly, SB1068 would have reduced the redundant funding for dual enrollment courses. If a dual enrollment course is taken on a high school campus during regular school operating hours and taught by a high school employee then the state would only pay the college 50% of the payment made per student for traditional college courses.

Unfortunately, when the bill came before the Senate Education Committee, representatives from various community college districts voiced general opposition to the bill and support for the status quo. The committee amended the bill and the majority of the reforms described above were removed or nullified. The amendment removed the "more rigorous" qualification from the definition of a dual enrollment course. The amended version of the bill accepts a passing score on the AIMS test in place of a score on one of the college

admissions tests. The amendment also removed the new requirement for a state oversight agency to review and approve dual enrollment programs. And finally, the 50% reduction in state funding was replaced by a 25% reduction in the student's tuition "if applicable."

Therefore, in its current form, SB1068 will do nothing to ameliorate ATRA's concern of dual taxpayer funding when educating Arizona high school students through dual enrollment programs.

2006 Effective Tax Rates Including Fire and Flood Control Districts

Class	Total Taxable Full Cash Value	Percent of Total	Description	Total Yield	Percent of Total	Effective Rate
1	86,634,673,011	21.07%	Commercial, Industrial, Utilities, & Mines	2,111,348,298	39.77%	2.44%
2	31,972,041,127	7.77%	Agricultural & Vacant Land	437,306,341	8.24%	1.37%
3	251,178,576,879	61.08%	Owner-occupied Residential	2,304,764,667	43.41%	0.92%
4	37,878,963,302	9.21%	Rental Residential	411,038,786	7.74%	1.09%
5	1,396,524,613	0.34%	Railroad, Private Car, Airline Flight	32,301,894	0.61%	2.31%
6	2,131,510,807	0.52%	Residential Historic, Enterprise Zones	11,975,551	0.23%	0.56%
7	28,325,074	0.01%	Commercial Historic	514,928	0.01%	1.82%
8	2,970,378	0.00%	Rental Residential Historic	37,355	0.00%	1.26%
9	16,854,284	0.00%	Possessory Interests	10,488	0.00%	0.06%
Total	411,240,439,475	100.00%		5,309,298,309	100.00%	1.29%

Source: Arizona Tax Research Association