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ARIZONA TAX RESEARCH ASSOCIATION

NEWSLETTER VOLUME 67 NUMBER 4 MAY 2007

Governor Signs Two ATRA Tax Practitioner Bills

Governor Napolitano signed into law two important measures recommended by the ATRA Tax Practitioner's Committee. SB1233, sponsored by Senator Leff, provides guidance for taxpayers filing an amended return with the Department of Revenue (DOR) and HB2627, sponsored by Representative Yarbrough, offers clarity under the transaction privilege tax (TPT) prime contracting class.

SB1233 recomputation of tax; final determination (Leff)

Under the current state income tax law, a taxpayer that is subject to a Federal audit which ultimately results in a change to the taxpayer's income is required to either file an amended return with DOR within 90 days of receiving a final determination by the Internal Revenue Service (IRS) or to file a copy of the final determination. However, "final determination" is not currently defined in statute and consequently, the confusion as to when the clock starts on the 90-day filing deadline impacts a taxpayer's statute of limitations. In some cases, this has resulted in multiple filings to DOR, which can be burdensome for both DOR and taxpayers.

SB1233 addressed this problem by providing that a "final determination" occurs when the appeal rights of both parties have been exhausted relative to the tax year in dispute. Partial agreements, jeopardy assessments, and other agreements are handled with the final determination so that only one amended return or notification is required. The Legislation also provides guidance in handling a final determination when the taxpayer has reached agreement with IRS but an audit of a flow-through entity may impact taxable income in the future.

In addition, any assessment that the taxpayer is required to pay or adjustment DOR is required to refund to the taxpayer is not payable until the final determination has been made, but the law does not preclude a taxpayer from making a prepayment of tax to stop the accrual of interest.

HB2627 prime contracting; property owners (Yarbrough)

Another beneficial piece of legislation to taxpayers is HB2627 regarding the clarification of TPT on owner/developers under the prime contracting classification.

Under the prime contracting class, a prime contractor, which is typically a contractor working directly for an owner of real property, is subject to tax on 65% of the gross proceeds from the activity of contracting.

Unfortunately, the current prime contracting statute creates confusion in a situation where an owner/developer is developing real property and accepts a contract for the sale of that property. Under a current DOR private taxpayer ruling, DOR's interpretation of the statute provides that the owner becomes a prime contractor at the time of acceptance of the contract for sale even when title to the property has not yet passed. This can result in excess TPT being paid than would be owed on the sale price of the property because the prime contractor owes TPT on its gross proceeds from its construction contract while the owner is being charged TPT on the sale price of the property. This scenario also causes confusion as to which party is subject to TPT and on what activity.

HB2627 rectified this problem by clarifying that an owner/builder is not taxable as a

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Arizona Ranks 11th in the Nation for Average Instructional Pay, 1st as Percent of Per Capita Income

A recent publication by the American Federation of Teachers (AFT) claimed that Arizona ranks 40th in the nation in average salary for public school teachers. Other statistics have indicated Arizona under funds education by comparing measures of states' per-pupil funding levels. Unions like AFT will understandably continue to advocate more funding for their members; but, in a state where 42% of the budget is spent on K-12 education, policymakers should base funding level decisions on a complete understanding of the data.

For years, Arizona has experienced tremendous growth (41.5% population growth from 1993-2003, second only to Nevada). This growth leads to full classrooms. On average, Arizona schools have 21.5 students enrolled per teacher, ranking Arizona 2nd highest in the nation for classroom size alongside states with similar growth trends. While larger class sizes may lead to additional work for teachers, studies by the RAND

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prime contractor unless that owner performs contracting activity after passage of title to a new owner of the property. Ultimately, this limits the TPT on the activity of prime contracting to 100%, eliminating the possibility of excessive tax collections that can occur under DOR's existing interpretation.

This legislation is retroactive to January 8, 1991 to restate the *SDC Management* Arizona Court of Appeals decision that precluded DOR from taxing an owner/developer unless that owner/developer actually acted as a contractor and performed contracting activities.

Jennifer Schuldt

Teacher Salaries, *Continued from page 1*

Corporation have failed to demonstrate any educational advantage in lower student-to-teacher ratios. Therefore, statistics that compare states' funding levels per student do not indicate any conclusions about the quality of education provided, but rather indicate the efficiency of the system providing that education. An education system with empty desks is more expensive per student than the capacity-filled classrooms found in areas of high growth. If policymakers' goals are to provide young Arizonans with the highest quality education possible while frugally spending the taxpayers' dollars, then a low price-per-student ratio should be lauded while other measures are consulted to evaluate the quality of the education.

The competitiveness of teacher pay, on the other hand, likely influences the quality of instruction received by public school students. As the education of Arizona's rising generation will greatly affect the state's future, the competitiveness of Arizona's schools to attract and retain quality instructors deserves attention. The AFT study of how well Arizona teachers fair compared to their counterparts in other states asks a valid question and one worthy of closer consideration. However, upon examining the nationwide data on teacher salaries, ATRA found that teacher pay in Arizona is likely more competitive than the AFT study implies.

While AFT is a leading nationwide union of education professionals, the organization is not the only distributor of information regarding our states' education systems. In fact, the National Education Association (NEA), which is the nation's largest professional employee organization, annually publishes exhaustive statistical information regarding each state's education system. The NEA publication provides a more positive assessment of teacher salaries in Arizona. According to NEA, Arizona ranks 27th in the nation for average teacher pay ($42,905). Ranking next to the median indicates that Arizona is not at a competitive disadvantage in attracting teachers to the state.

Furthermore, comparing the competitiveness of salaries in different states requires one to consider the costs associated with living in the respective economies and tax jurisdictions. For example, a teacher would not be enticed to leave Arizona to teach in California without a considerable wage increase. Comparing each state's average teacher pay expressed as a percent of the state's per capita income is a standard approach to account for wealth differences in the respective markets. On average, Arizona teachers earn 1.42 times more than Arizona's per capita income ($30,019). In terms of per capita income, Arizona teachers fair better than teachers in 31 other states.

Lastly, the measure of average teacher pay is also affected by the average experience level of the teacher workforce. High growth levels tend to decrease the average experience level of a teaching workforce. A less experienced teacher workforce is less expensive. Therefore, teacher pay scales in Arizona are likely competitive with pay scales in many of the states that report a higher average teacher pay. The higher average pay, in such a case, would be the result of a more tenured workforce; it would not be the result of more competitive salaries for individual teachers.

In addition to teacher salaries, NEA also collected data on the average pay given to all instructional staff. NEA defined instructional staff to include all of the following: teachers, consultants, supervisors of instruction, principals, guidance personnel, librarians, psychological personnel, and other instructional staff. The definition explicitly excludes administrative staff, attendance personnel, health services personnel, clerical personnel, and junior college staff. On average, Arizona workers who are considered instructional staff earn close to double (187%) the state's per capita income.

For average instructional staff salaries, NEA ranks Arizona 11th highest. When these salaries are evaluated as a percent of per capita income, Arizona ranks number one in the nation.

Enrollment growth, full-classrooms, cost-of-living differences, and variances in workforce experience levels will continue to impact statistics designed to describe education systems. While state-to-state comparisons of education funding provide important information, that information must be considered within the context of the many variables that affect those funding measures.

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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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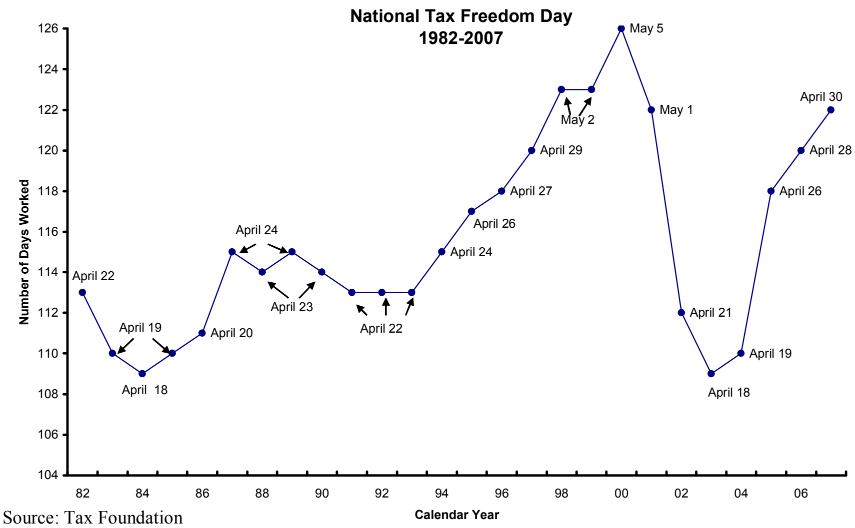
Adjusted Arizona Instructional Pay Ranks First

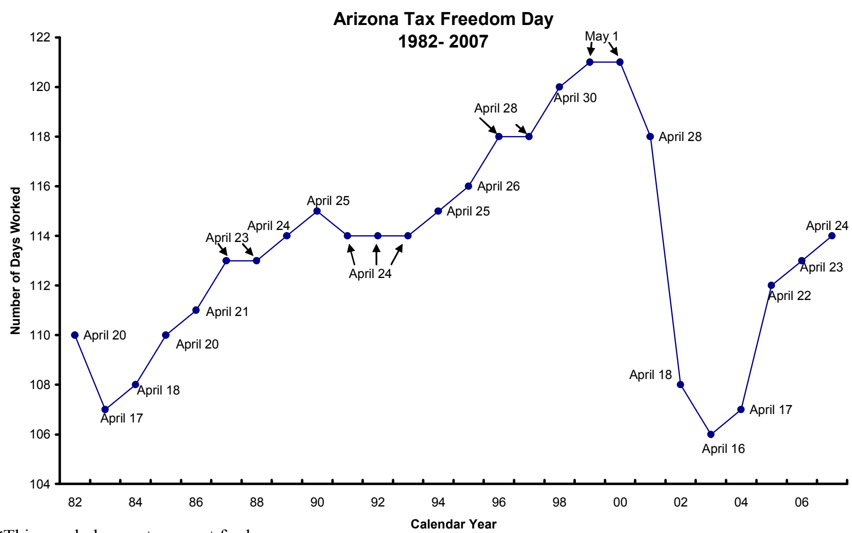
Rank	State	04-'05 Avg. Instr. Staff Salary (NEA)	Rank	State	% of Per Capita Personal Income
1	District of Columbia	$60,310	**1**	**Arizona**	**182.7%**
2	Connecticut	$59,431	2	Michigan	173.7%
3	New Jersey	$58,612	3	Louisiana	165.6%
4	Illinois	$57,989	4	Alaska	162.2%
5	California	$57,876	5	Illinois	159.9%
6	Alaska	$57,673	6	Rhode Island	159.1%
7	New York	$57,300	7	Arkansas	159.0%
8	Michigan	$56,973	8	Georgia	158.1%
9	Rhode Island	$56,196	9	Ohio	157.6%
10	Massachusetts	$56,006	10	Pennsylvania	156.8%
11	**Arizona**	**$54,836**	11	Oregon	156.8%
12	Pennsylvania	$54,795	12	California	156.7%
13	Maryland	$53,133	13	South Carolina	156.4%
14	Delaware	$52,480	14	Indiana	154.1%
15	Oregon	$50,628	15	Mississippi	151.7%
16	Ohio	$50,225	16	West Virginia	151.0%
17	Georgia	$48,889	17	Utah	150.9%
18	Minnesota	$48,518	18	Idaho	148.1%
19	Washington	$48,111	19	New Mexico	147.3%
20	Indiana	$48,026	20	Kentucky	145.3%
21	Wisconsin	$47,631	21	New York	143.4%
22	Hawaii	$47,575	22	Wisconsin	143.1%
23	Colorado	$46,052	23	Delaware	141.5%
24	Vermont	$45,994	24	Tennessee	141.3%
25	New Hampshire	$45,990	25	Maine	140.8%
26	Nevada	$45,797	26	Vermont	140.6%
27	Virginia	$44,401	27	North Carolina	139.6%
28	South Carolina	$44,245	28	Hawaii	137.9%
29	Tennessee	$43,744	29	Washington	135.6%
30	Texas	$43,500	30	Alabama	134.8%
31	Maine	$43,386	31	Texas	134.0%
32	North Carolina	$43,348	32	New Jersey	133.7%
33	Florida	$42,842	33	Montana	132.6%
34	Nebraska	$42,575	34	Iowa	132.4%
35	Arkansas	$42,412	35	Oklahoma	131.4%
36	Idaho	$42,168	36	Missouri	131.0%
37	Iowa	$41,945	37	Minnesota	130.1%
38	Wyoming	$41,930	38	Nebraska	129.3%
39	Utah	$41,233	39	Massachusetts	128.7%
40	Kentucky	$41,076	40	Nevada	128.1%
41	New Mexico	$41,071	41	Maryland	126.6%
42	Missouri	$40,911	42	Florida	126.0%
43	Louisiana	$40,838	43	Connecticut	125.4%
44	Kansas	$40,489	44	Kansas	123.2%
45	Alabama	$39,939	45	Colorado	122.8%
46	West Virginia	$39,897	46	New Hampshire	121.8%
47	Oklahoma	$39,359	47	North Dakota	120.9%
48	Montana	$38,485	48	Virginia	118.4%
49	Mississippi	$38,005	49	District of Columbia	114.2%
50	North Dakota	$37,915	50	Wyoming	112.4%
51	South Dakota	$35,313	51	South Dakota	108.6%
	United States	**$49,377**		**United States**	143.2%

April 24th Marked Arizona's Tax Freedom Day

April 24th marked the day that the citizens of Arizona had earned enough income to pay off their federal, state, and local taxes for the year, or otherwise known as Tax Freedom Day (TFD). Each state's TFD depends on its tax burden. Arizona's total tax burden this year was 31.3% of personal income compared with last year's 31.0%. Arizona's TFD is ranked 25th among the nation this year down from 24th in 2006. According to the Tax Foundation, in 1990 Arizona ranked 13th for the highest tax burden but has since seen a substantial decline due to tax cuts and income rising at a quicker rate than state and local tax collections. The decline has tapered off in the past few years.



Source: Tax Foundation



*This graph does not account for leap years

Arizona
State-Local Tax Burden Compared to U.S. Average
(1970-2007)

	State						U.S. Average		
Year	State-Local Tax Burden	State Rank	Federal Tax Burden	State Rank	Total Tax Burden*	State Rank	Average State-Local Tax Burden	Average Federal Tax Burden	Total Tax Burden*
1970	10.9%	11	21.3%	5	32.1%	3	10.0%	19.9%	29.9%
1975	11.7%	4	18.7%	29	30.4%	7	10.3%	19.1%	29.4%
1980	10.3%	12	20.5%	32	30.7%	23	9.5%	21.2%	30.7%
1985	10.6%	11	19.4%	27	30.0%	15	9.9%	19.9%	29.8%
1990	11.7%	5	19.7%	33	31.4%	13	10.3%	20.5%	30.8%
1995	10.9%	13	20.8%	22	31.8%	14	10.5%	21.0%	31.6%
2000	10.4%	25	22.8%	23	33.1%	21	10.5%	23.5%	34.0%
2005	10.6%	24	20.1%	20	30.7%	23	10.9%	20.6%	31.5%
2006	10.3%	30	20.7%	23	31.0%	24	10.8%	21.5%	32.3%
2007	10.3%	31	20.9%	22	31.3%	25	11.0%	21.7%	32.7%

1 is the highest for rankings

* May not add to total due to rounding.

Source: Tax Foundation calculations based on data from the Bureau of Economic Analysis, Department of Commerce

This year the national TFD was April 30th, two days later than in 2006. The top ten states that have the heaviest tax burden and the latest TFD are Connecticut (May 20), New York (May 16), New Jersey (May 10), Vermont (May 9), Rhode Island (May 9), Nevada (May 8), California (May 7), Washington (May 6), Massachusetts (May 6), and Minnesota (May 4). The states with the highest tax burden tend to be the most heavily taxed both at the federal level and at the state and local level. These top ten states clearly have a higher per capita income that results in the citizens paying the highest federal income taxes. They also have the highest state and local tax burden due to a combination of property, sales, and income taxes. The lowest tax burden states are (starting with the lowest) Oklahoma (April 12), Alabama (April 12), Mississippi (April 13), Alaska (April 13), Tennessee (April 15), New Mexico (April 15), Louisiana (April 16), South Dakota (April 16), Texas (April 19) and Idaho (April 19).

TFD is a given day in the year when the entire nation has earned enough to pay for its annual tax burden. TFD is calculated by dividing the total of all government taxes collected each year by the total income earned each year. The percentage that is derived from this equation is known as the "total tax burden." Analysts then use the total tax burden along with historical trends to project what the current year's tax burden will be. This projection is then converted from a percentage into days to determine the current TFD. TFD is based on a 365 day calendar and is not adjusted for weekends and holidays. The Tax Foundation, a Washington D.C. based tax research group, currently calculates and reports the TFD. The Foundation uses the tax and income data collected by the Department of Commerce's Bureau of Economic Analysis to make their calculations. The Foundation annually reports the tax burden, tax burden by type of tax, tax burden for each state, and compares tax payments to other consumer expenditures.

Courtney Baker

Maricopa Cities Plan Huge Property Tax Increases

In 2006, the Maricopa County Assessor rocked residential taxpayers with extraordinary increases in their valuations for the 2007 tax year. Driven by sharp increases in the real estate market, the notices in many instances reflected 60% growth in the secondary (full cash) value of the property. Because the growth in primary value is limited, those same residential taxpayers typically saw a 15% increase in their primary value. Following administrative and judicial appeals, those values are now being used to set local government budgets throughout the county for tax year 2007.

While residential taxpayers in Maricopa County can be assured that their taxes should not climb 60%, there is good reason to be nervous about increases well above the norm. For example, while property taxes levied by Maricopa County cities make up only 12% of the average tax bill, residential taxpayers in some valley cities could nonetheless see huge increases in that line item.

In most cases, primary property taxes for city taxpayers will climb but not at the same rate as the typical 15% increase in value. In November of 2006, voters approved an initiative advocated by ATRA (Proposition 101) that limited the annual growth in the primary levies of counties, community colleges, cities and towns to 2% plus new construction. As a result, the levy limits of cities in Maricopa County will force most primary rates down although not enough to entirely offset a 15% increase in the primary value.

Where city property taxpayers look to absorb the largest increases is in secondary taxes levied for debt service on general obligation bonds. Several

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Maricopa County Cities Secondary Values

TAX AUTHORITY	2006 Net Assessed Value	2007 Net Assessed Value	One Year Change: Change in Net Assessed Value	One Year Change: % Change in Net Assessed Value	One Year Change: % of New Property
APACHE JUNCTION	$1,184,199	$1,398,579	$214,380	18.1%	-4.3%
AVONDALE	$386,790,640	$583,884,953	$197,094,313	51.0%	14.5%
BUCKEYE	$193,594,069	$369,230,204	$175,636,135	90.7%	50.6%
CAREFREE	$139,471,214	$186,667,993	$47,196,779	33.8%	3.7%
CAVE CREEK	$134,790,676	$184,427,380	$49,636,704	36.8%	6.2%
CHANDLER	$2,114,887,174	$2,989,189,876	$874,302,702	41.3%	8.5%
EL MIRAGE	$126,977,544	$185,042,960	$58,065,416	45.7%	5.2%
FOUNTAIN HILLS	$397,380,162	$610,738,122	$213,357,960	53.7%	4.2%
GILA BEND	$61,727,966	$84,096,340	$22,368,374	36.2%	1.2%
GILBERT	$1,466,841,566	$2,370,221,717	$903,380,151	61.6%	15.0%
GLENDALE	$1,370,989,076	$1,827,019,187	$456,030,111	33.3%	3.0%
GOODYEAR	$494,913,013	$764,237,139	$269,324,126	54.4%	16.5%
GUADALUPE	$14,933,932	$17,060,514	$2,126,582	14.2%	5.4%
LITCHFIELD PK	$69,322,072	$93,805,517	$24,483,445	35.3%	4.7%
MESA	$3,083,070,290	$4,114,527,316	$1,031,457,026	33.5%	4.8%
PARADISE VALLEY	$659,474,210	$918,156,814	$258,682,604	39.2%	3.7%
PEORIA	$1,115,620,151	$1,642,187,476	$526,567,325	47.2%	9.5%
PHOENIX	$12,261,133,763	$16,068,816,500	$3,807,682,737	31.1%	5.6%
QUEEN CREEK	$155,318,930	$278,198,216	$122,879,286	79.1%	28.0%
SCOTTSDALE	$5,209,444,390	$7,243,823,228	$2,034,378,838	39.1%	2.9%
SURPRISE	$744,529,285	$1,194,242,583	$449,713,298	60.4%	15.6%
TEMPE	$2,006,703,332	$2,401,898,465	$395,195,133	19.7%	3.6%
TOLLESON	$161,146,393	$182,645,598	$21,499,205	13.3%	9.1%
WICKENBERG	$63,283,048	$87,620,074	$24,337,026	38.5%	9.0%
YOUNGTOWN	$32,811,079	$43,146,222	$10,335,143	31.5%	3.1%
COUNTY TOTAL	**$32,466,338,174**	**$44,442,282,973**	**$11,975,944,799**	**36.9%**	**6.4%**

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valley cities have no plans to reduce their debt service rate in an effort to soften what will certainly be large residential secondary tax increases. While the large increase in secondary net assessed values would normally drive down the debt service tax rate, some valley cities instead plan to pay off debt early with a huge tax increase this year. For example, the City of Gilbert, where most residential taxpayers saw 60% increases in their secondary value, has no plan to decrease their secondary tax rate of $1.15. City officials say the increase in valuations will allow the city to pay off debt early and free up capacity to sell more bonds to finance infrastructure improvements.

The City of Phoenix, which has levied an aggregate (primary and secondary) tax rate of $1.82 for several years, plans to do so again this year. The primary levy limit will drive Phoenix's primary rate down from $0.8453 to $0.8042. However, Phoenix plans to increase the secondary rate by a like amount in order to maintain the $1.82 overall rate. Residential taxpayers in Phoenix will actually see a higher city secondary tax rate applied to their higher 2007 values. Phoenix residential properties with valuation increases of 60% will see a 67% increase in their city secondary tax for bonds.

The City of Tempe also plans to leave its aggregate tax rate at $1.40 by transferring a mandated reduction in the primary rate to the secondary rate. Tempe's voter approved debt service requirements far exceed what they plan to levy with a $0.8895 rate. The City of Glendale plans to reduce its aggregate rate 10 cents from $1.72 to $1.62. If not for new bonds coming on line, Glendale taxpayers would have benefited from an almost 40-cent reduction in the secondary rate.

For years, city taxpayers have been coaxed into supporting ever increasing general obligation bond requests through the fiction that the bonds were not a tax increase. If there is a silver lining in the 60% increase in city bond taxes that some Maricopa homeowners will be hit with, it might be that the "no tax increase" shell game of bond campaigns will be a thing of the past.

Kevin McCarthy