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ARIZONA TAX RESEARCH ASSOCIATION

NEWSLETTER VOLUME 68 NUMBER 3 APRIL 2008

# Governor Vetoes Property Tax Relief

### *Action could boost property tax initiatives in circulation*

Governor Napolitano vetoed HB2220 – a bill that would have made permanent the reduction on the state equalization rate passed in 2006. The veto came despite the widespread support of almost every major business and trade association in the state. The 2006 measure reduced the tax rate to zero for tax years 2006, 2007, and 2008.

In response to widespread taxpayer concerns with skyrocketing property valuations in 2006, state policymakers responded by reducing state level property tax rates as well as acting on measures to control local government tax rates.

The state level property tax relief was one prong of a three-prong strategy to attempt to manage a pending property tax crisis in 2006. In order to address skyrocketing property valuations and threats of property tax limitation initiatives, ATRA encouraged the Legislature to immediately address primary property taxes that were outside taxpayer control. In 2006, ATRA recommended that the Legislature take the following three steps:

**Provide tax relief:** The only way to protect taxpayers from significant increases when valuations climb is to reduce tax rates. ATRA recommended the elimination (not a three-year suspension) of the state equalization rate. This display of leadership on the issue was essential to asking local government to also participate in the second and third prong of the strategy.

**Stop the backfill:** To ensure that taxpayers would see the effect of the state property tax relief, local governments were prohibited from raising taxes above their Truth-in-Taxation levels.

**Proposition 101:** The Legislature referred to the ballot (and the voters approved) Proposition 101, which ensured that the levy limitations of counties, cities, and community colleges would limit future primary levies to 2% plus new construction.

Regrettably, in last minute negotiations with the Governor in 2006, the state tax relief changed to a temporary, three-year suspension of the state equalization rate. Ironically, now the pending tax increase in 2009 completely undermines the effort in 2006 to show property taxpayers that state policymakers were capable of showing sustained leadership on the issue.

The two tax revolt groups still circulating property tax limitation initiatives, Arizona Tax Revolt and Prop 13 Arizona, wasted no time in using the veto to boost their circulation efforts. Leaders of those efforts also pointed to the defeat of HB2586, an ATRA-backed measure to put limitations on some secondary property taxes, as further evidence that reasonable property tax policy may not succeed at the Capitol. (For further information on the defeat of HB2586, refer to the Feb/March 2008 *ATRA Newsletter*.)

The property tax increase that now awaits taxpayers in 2009 will be on top of increases that have occurred through the temporary reduction in the state rate. While property taxes increased at a lower rate as a result of the 2006 legislation, valuation growth still drove taxes higher for most property owners. Primary property taxes, the target of the 2006 legislation and Prop 101, only climbed 9.4% over the last two years. However, secondary taxes climbed 28% over the last two years.

# Primary Net Assessed Values Climb 16% Despite Drop in Housing Market

Despite Arizona's slowing housing market, total primary net assessed values grew by $9.3 billion to $67.6 billion in 2008, up from $58.3 billion in 2007. The $9.3 billion value growth represents an increase of 16% (5.4% of which is attributable to new construction), trumping last year's record growth of 15.2%.

Although the market values (secondary values) of residences are dropping, homeowner's should not expect their primary values to fall anytime soon. As prescribed by the Arizona Constitution, the primary value is increased each year until it reaches the secondary value. With the dramatic spike in home values from the past few years, it may be a few years before the primary value catches up to the secondary value.

Consequently, most homeowner's might be expecting to see their tax bills fall along with the market values of their homes. However, as a result of the continued growth in primary values, coupled with increasing secondary tax levies, most homeowners will see

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## What's inside…

# AZ Ranks 4th in the Nation in School Funding Increases

While analyzing the most recent 20 years of nationwide data (1986 to 2006), the American Legislative Exchange Council (ALEC) found that Arizona public schools received a greater funding increase than the schools of all but three other states in the union. In the fiscal year (FY) of 1986, the public schools of Arizona received funding that is equivalent to $2.7 billion when expressed in terms of the 2006 dollar. In FY 1996, Arizona schools spent the equivalent of $4.3 billion. Over the final ten years evaluated, funding increased to $6.5 billion. This amounted to a dramatic increase of 135% in inflation-adjusted funding for Arizona's public schools.

This record-setting funding growth naturally raises the question of how the increase compares to the population growth over the same time frame. From 1986 to 2006, Arizona's population grew from 3.3 million to 6.1 million—an increase of 86%. The inflation-adjusted funding growth significantly outpaced the increase in the population. As a result, the amount Arizona spends per student has also increased over the years ALEC analyzed. According to the ALEC publication, Arizona spent the 2006-equivalent of $5,131 per public-school student in 1986. In constant dollars, this figure increased to $5,729 in FY 1996 and $6,339 in FY 2006.

Interestingly, while the per-pupil funding level climbed 24% in real terms, the state's ranking in this measurement dropped from 35 in 1986 to 43 in 1996 and finally to 50 out of 51 in 2006. Juxtaposing the real increase in per-pupil expenditures with the corresponding decline in the state's ranking in this measurement raises important questions regarding the interpretation of this statistic. Those advocating greater increases in funding for education often cite Arizona's low ranking in per-student expenditures as

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| | FY 1986 Values* | | | FY 2006 Values | | | % Change | |
|---|---|---|---|---|---|---|---|---|
| States | Expenditures (in $1,000) | Expenditures Per Pupil | Rank | Expenditures (in $1,000) | Expenditures Per Pupil | Rank | Expenditures | Rank |
| Alabama | $3,552,881 | $4,842 | 40 | $5,164,406 | $7,486 | 43 | 45.36% | 40 |
| Alaska | $1,214,869 | $11,265 | 1 | $1,442,269 | $11,635 | 8 | 18.72% | 50 |
| **Arizona** | **$2,742,468** | **$5,131** | **35** | **$6,451,870** | **$6,339** | **50** | **135.26%** | **4** |
| Arkansas | $1,809,151 | $4,136 | 48 | $3,546,999 | $8,043 | 39 | 96.06% | 13 |
| California | $25,341,169 | $5,788 | 26 | $50,918,654 | $8,505 | 30 | 100.93% | 11 |
| Colorado | $3,493,577 | $6,256 | 19 | $5,994,440 | $8,265 | 35 | 71.58% | 27 |
| Connecticut | $3,674,643 | $7,838 | 7 | $7,080,396 | $13,239 | 4 | 92.68% | 14 |
| Delaware | $689,694 | $7,305 | 12 | $1,299,349 | $11,553 | 9 | 88.39% | 15 |
| D.C. | $752,726 | $8,792 | 3 | $1,023,952 | $14,322 | 3 | 36.03% | 42 |
| Florida | $8,509,392 | $5,294 | 32 | $19,042,877 | $7,655 | 40 | 123.79% | 6 |
| Georgia | $4,306,686 | $3,928 | 49 | $12,528,856 | $8,428 | 32 | 190.92% | 2 |
| Hawaii | $1,007,456 | $6,119 | 21 | $1,648,086 | $9,693 | 18 | 63.59% | 30 |
| Idaho | $900,023 | $4,319 | 45 | $1,618,215 | $6,642 | 49 | 79.80% | 18 |
| Illinois | $12,172,919 | $6,669 | 17 | $18,658,428 | $9,501 | 20 | 53.28% | 35 |
| Indiana | $4,840,916 | $5,007 | 37 | $9,108,931 | $9,463 | 22 | 88.17% | 16 |
| Iowa | $3,411,002 | $7,087 | 13 | $3,808,200 | $8,469 | 31 | 11.64% | 51 |
| Kansas | $2,443,880 | $5,873 | 25 | $3,718,153 | $8,556 | 29 | 52.14% | 36 |
| Kentucky | $2,796,306 | $4,350 | 44 | $4,812,591 | $7,611 | 41 | 72.11% | 26 |
| Louisiana | $4,508,100 | $5,669 | 27 | $5,554,766 | $9,125 | 25 | 23.22% | 47 |
| Maine | $1,023,565 | $4,834 | 41 | $2,056,266 | $11,310 | 10 | 100.89% | 12 |
| Maryland | $4,940,288 | $7,311 | 11 | $8,682,586 | $10,856 | 13 | 75.75% | 23 |
| Massachusetts | $7,127,411 | $8,547 | 4 | $11,357,857 | $12,566 | 7 | 59.35% | 33 |
| Michigan | $13,251,864 | $8,297 | 6 | $16,353,921 | $10,096 | 16 | 23.41% | 46 |
| Minnesota | $4,846,343 | $6,815 | 15 | $7,310,284 | $9,366 | 24 | 50.84% | 37 |
| Mississippi | $1,828,235 | $3,666 | 50 | $3,243,888 | $7,047 | 48 | 77.43% | 21 |
| Missouri | $4,190,760 | $5,234 | 33 | $7,115,207 | $8,337 | 34 | 69.78% | 28 |
| Montana | $969,339 | $6,322 | 18 | $1,193,182 | $8,823 | 26 | 23.09% | 48 |
| Nebraska | $1,604,165 | $6,005 | 22 | $2,512,914 | $9,426 | 23 | 56.65% | 34 |
| Nevada | $733,848 | $4,551 | 42 | $2,722,264 | $7,098 | 46 | 270.96% | 1 |
| New Hampshire | $868,416 | $5,304 | 31 | $2,021,144 | $10,562 | 14 | 132.74% | 5 |
| New Jersey | $9,305,733 | $8,403 | 5 | $19,669,576 | $15,155 | 1 | 111.37% | 7 |
| New Mexico | $1,428,698 | $5,067 | 36 | $2,554,638 | $8,407 | 33 | 78.81% | 19 |
| New York | $23,615,413 | $9,056 | 2 | $38,866,853 | $14,843 | 2 | 64.58% | 29 |
| North Carolina | $5,387,244 | $4,964 | 38 | $9,567,000 | $7,263 | 45 | 77.59% | 20 |
| North Dakota | $648,272 | $5,461 | 29 | $786,870 | $8,609 | 28 | 21.38% | 49 |
| Ohio | $10,583,280 | $5,901 | 24 | $17,167,866 | $10,034 | 17 | 62.22% | 32 |
| Oklahoma | $3,043,429 | $5,131 | 34 | $4,161,024 | $7,049 | 47 | 36.72% | 41 |
| Oregon | $3,296,548 | $7,337 | 10 | $4,458,028 | $8,681 | 27 | 35.23% | 43 |
| Pennsylvania | $12,636,906 | $7,548 | 8 | $18,711,100 | $10,990 | 12 | 48.07% | 39 |
| Rhode Island | $1,008,352 | $7,486 | 9 | $1,825,900 | $12,797 | 6 | 81.08% | 17 |
| South Carolina | $2,565,802 | $4,195 | 47 | $5,312,739 | $8,143 | 37 | 107.06% | 8 |
| South Dakota | $617,714 | $4,924 | 39 | $916,563 | $8,077 | 38 | 48.38% | 38 |
| Tennessee | $3,646,734 | $4,458 | 43 | $6,446,691 | $7,267 | 44 | 76.78% | 22 |
| Texas | $13,542,421 | $4,219 | 46 | $31,919,107 | $7,584 | 42 | 135.70% | 3 |
| Utah | $1,498,664 | $3,603 | 51 | $2,627,022 | $5,556 | 51 | 75.29% | 24 |
| Vermont | $573,560 | $6,227 | 20 | $1,177,478 | $13,102 | 5 | 105.29% | 9 |
| Virginia | $5,216,363 | $5,349 | 30 | $10,705,162 | $9,478 | 21 | 105.22% | 10 |
| Washington | $4,568,758 | $6,000 | 23 | $7,870,979 | $8,201 | 36 | 72.28% | 25 |
| West Virginia | $1,925,176 | $5,472 | 28 | $2,527,767 | $9,677 | 19 | 31.30% | 44 |
| Wisconsin | $5,192,051 | $6,762 | 16 | $8,435,359 | $10,364 | 15 | 62.47% | 31 |
| Wyoming | $691,515 | $6,850 | 14 | $863,423 | $10,999 | 11 | 24.86% | 45 |

*Inflation-adjusted figures: values represent the 1986 expenditure expressed in terms of the 2006 dollar.

Source: American Legislative Exchange Council



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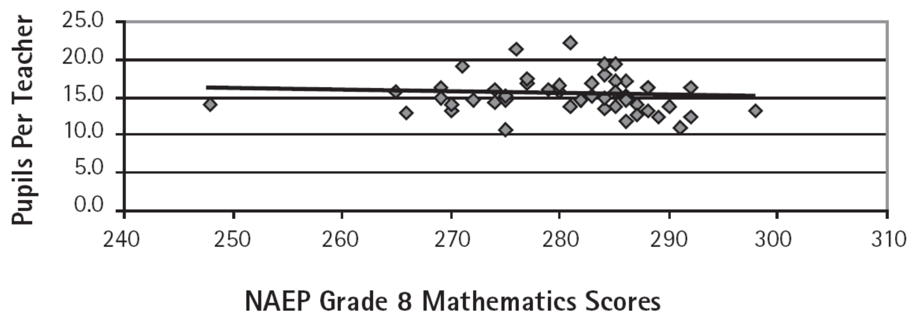
## SCHOOL FUNDING, *Continued from page 2*

evidence that Arizona currently under funds its schools. But consistently applying this logic would indicate that, despite a lower per-pupil-expenditure rate in 1986, Arizona schools were better funded at that time due simply to the higher ranking.

In reality, the per-student-expenditures ranking is merely a reflection of the state's ranking in student-to-teacher ratios. Arizona's rank in class size in the years evaluated by ALEC almost exactly mirrored the per-student-expenditures rank: 36 vs. 35 in 1986, 46 vs. 43 in 1996, and 50 vs. 50 in 2006. During these years, it was not skyrocketing class sizes in Arizona that led to the state's drop in this ranking; instead, it was the nearly universal decline in student-to-teacher ratios in each of the other states. The largest decline, 36.6%, occurred in Alabama where the ratio dropped from 20.2 to 12.8 students per teacher. The Rhode Island ratio declined 29.1% from 15.1 to 10.7 students for every teacher. Nationwide the number of students for every teacher declined 15.1% from 17.9 to 15.2. In contrast, Arizona held its student-to-teacher ratio nearly constant over the last 20 years. In 1986, there were 19.6 students per teacher in Arizona; in 1996, the ratio was the same; and in 2001, it rose only slightly to 19.8. In the last five years of the analysis, the ratio increased by 1.5 students to 21.3 per teacher.

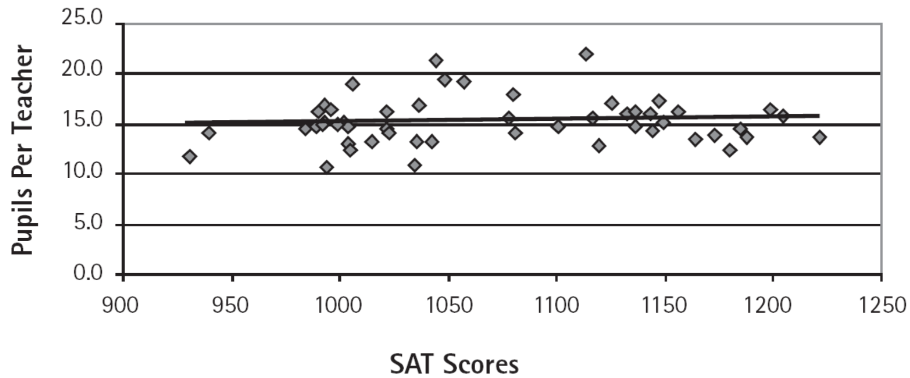
This nationwide trend towards class-size reductions came at a substantial cost to the 46 participating states. Avoiding this cost explains Arizona's drop in the per-pupil-expenditure ranking. As the ALEC analysis found no correlation between class size and educational achievement (see figures 3.1 and 3.2), this per-student-expenditure statistic that merely reflects the student-to-teacher ratio is a poor measurement of the educational opportunities available to the students of each state. Multiplying this statistic by each state's student-to-teacher ratio, however, controls for the differing class sizes and compares essentially the amount each state spends per class. When ranked in this manner, Arizona falls in the center of a bell-shaped, distribution curve with spending ($135,021) that exceeds the amount spent in 25 states and is lower than the amount of 24 others. Not surprisingly, this per-class ranking correlates closely with Arizona's ranking for average teacher salaries (see the May 2007 *ATRA Newsletter*).

**Figure 3.1 — NAEP Grade 8 Mathematics Scores and Pupils Per Teacher**




Source: American Legislative Exchange Council

**Figure 3.2 — SAT Scores and Pupils Per Teacher**




Source: American Legislative Exchange Council

In summary, the 20-year analysis ALEC published paints a detailed picture regarding the funding received by Arizona's public schools and how it compares to that of other states. That is, during a time of nationwide reductions in student-to-teacher ratios, Arizona's public-school system coped with explosive population growth; Arizona poured resources into the system at a record-setting rate; and in so doing, Arizona increased the real dollars spent per pupil, managed to stave off significant increases in the average class size, and maintained a per-class funding level that is well within the mainstream.

**Justin Olson**

## PRIMARY VALUES,

*Continued from page 1*

increases in property taxes when rates are set in August. To further aggravate homeowners who are seeing decreases in the value of their property and increases in the taxes, they now face a statewide property tax increase in 2009 as a result of Governor Napolitano's veto of HB2220 (See "Governor vetoes property tax relief," page 1).

**Jennifer Schuldt**

# ATRA Tax Practitioner's Committee Legislation on the Move

HB2692 is a measure recommended by the ATRA Tax Practitioner's Committee that maintains a taxpayer's right to seek guidance from the Department of Revenue (DOR) on an anonymous basis by means of a taxpayer information ruling (TIR). The legislation was introduced this session by Chairman of the House Ways & Means Committee, Representative Steve Yarbrough.

***Purpose of legislation***

This legislation is in response to the General Tax Ruling (GTR 07-1) issued by DOR on November 19, 2007. That ruling precluded the issuance of information letters to taxpayer representatives if the taxpayer is not disclosed. Instead, DOR will issue a "statement of general guidance," which provides only general advisory guidance. This ruling closes an avenue of tax advice that was previously available to taxpayers that wanted to remain anonymous.

DOR testified in opposition to the bill in the House Ways & Means Committee, stating some concerns regarding possible abuses of the system with allowing tax practitioner's the opportunity to seek tax guidance from DOR without disclosing the identity of the taxpayer. DOR's concerns were addressed with a House floor amendment (see ATRA/DOR compromise below).

***The history of "Information Letters"***

Prior to November 2007, taxpayers had the ability to request anonymous guidance through the taxpayer's representative by means of an "information letter." In this situation, a taxpayer representative would typically lay out the facts and legal arguments in the request, similar to that which would be required if a private taxpayer ruling (PTR) is requested, except that the taxpayer identity would not be disclosed and the ruling would not be published. The purpose of such requests was to secure a technical analysis and conclusion from DOR as to the tax treatment of a transaction or activity. In addition, unlike a PTR that would prevent the assessment of tax, penalty, and interest if DOR modifies or revokes the ruling at a later time, a taxpayer that received a ruling on an information letter could only have penalties and interest abated.

***ATRA/DOR compromise***

HB2692 continues the practice of allowing taxpayers to request tax guidance anonymously by means of a TIR through the taxpayer's representative. The House engrossed version of HB2692 is a compromise between DOR and ATRA and addresses all of the concerns voiced by DOR.

The level of work involved in preparing a request for a PTR is substantial and HB2692 requires the same amount of effort in preparing a request for a TIR. In addition, the waiver of tax, penalty, and interest, in the case that DOR changes its position on a ruling, only applies if the taxpayer's identity has been disclosed prior to the publication date of the TIR. On the other hand, if the taxpayer chooses to remain anonymous, the ruling is not binding on DOR for the abatement of tax, penalty, and interest.

A taxpayer may request that a ruling not be published at the time of the request if the taxpayer is concerned that its identity can be determined by publication of either a PTR or TIR despite redaction. If DOR determines that the ruling should be published, the taxpayer may withdraw its ruling request at that time and DOR is not to proceed with a ruling.

HB2692 currently awaits a Senate floor vote.

**Jennifer Schuldt**