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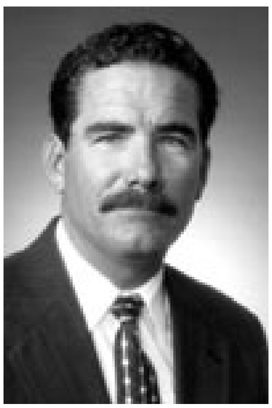
McCarthy Appointed to ASRS Board



Appointed by the Governor and confirmed by the State Senate, ATRA President Kevin McCarthy was one of three newly appointed members to the Arizona State Retirement System (ASRS) Board of Trustees. McCarthy is joined by Dennis Hoffman, an ASU professor of economics, and former gubernatorial deputy chief of staff for finance, Tom Manos.

McCarthy will serve a three-year term on the nine-member board that oversees the administration of ASRS. More specifically, the Board is responsible for prescribing investment goals, objectives and policies that are consistent in order to carry out the purposes of ASRS.

McCarthy currently serves on the Property Tax Oversight Commission. Previously, McCarthy served on the Debt Oversight Commission and the State School Facilities Board.

Legislature Adjourns With Mixed Results

For-Profit Auditors left to hunt Arizona businesses

The Arizona State Legislature adjourned sine-die on April 29th. Following a record length session in 2009, adjournment on the 109th day of the session came as welcome relief for everyone at the Capitol in 2010. As is almost always the case, the policy achievements of the 49th Legislature get a mixed review from a taxpayer's perspective.

Faced with another multi-billion dollar budget deficit, the Legislature and Governor Brewer were able to a pass a Fiscal Year (FY) 2011 budget in 65 days; considerable improvement over the last year's budget log jam that lasted well into the new fiscal year.

While the FY 2011 state budget still reflects a multi-billion structural deficit, it also marked the first meaningful progress by state policymakers to reduce state spending. However, Arizona's on-going structural budget deficit will continue to eclipse all other issues in Arizona for the foreseeable future.

See **Legislature** page 4

ATRA'S GPLET REFORMS FINALLY BECOME LAW

After three years of intense negotiations and in the final days of the 2010 legislative session, an agreement was finally reached between the business community and Arizona's cities to reform the government property lease excise tax (GPLET). As signed by the Governor, HB2504, sponsored by House Ways and Means Chairman Representative Rick Murphy, protects existing GPLET deals and reforms the GPLET law on a prospective basis. (For a full background and history on the GPLET law, please see the August 2009 *ATRA Newsletter*)

Grandfathering existing GPLET leases and agreements

Reforming GPLET immediately raised issues regarding the effect of any changes to the law on existing leases. For better or for worse, those deals were negotiated under the existing GPLET tax structure and there were many concerns regarding making major changes to those tax obligations.

After much discussion, consensus was reached to grandfather all leases and development agreements entered into before June 1, 2010. Additionally, the grandfathered development agreements can be amended within specific parameters, with the requirement that a lease be entered into within ten years.

See **GPLET** page 2

GPLET STRUCTURE

	EXISTING GPLET	NEW GPLET
Rate Structure/SF		
Office 1 flr	$1.00	$2.00
Office 2-7 flrs	$1.25	$2.30
Office 8+ flrs	$1.50	$3.10
Retail	$1.50	$2.51
Hotel Motel	$1.50	$2.00
Whse/Ind.	$0.75	$1.35
Residential	$0.50	$0.76
Other	$1.00	$2.00
Parking ($/space)	$100.00	$200.00
Term of rates	50 years-rate drops 20% every 10 years until it reaches zero	Rate adjusted annually by PPI for new construction indefinitely
Livable Area	Excluded areas such as banquet and meeting rooms, lobbies & stairwells	Includes all livable area
Central Business District (CBD) Definition	None	A single & contiguous geographical area w/in slum/blight, no larger than the > of 5% of total land area or 640 acres
Maximum Lease Term	None	25 years
GPLET Approval Process	None	Notification to all taxing entities 60 days prior to approval, economic fiscal benefit analysis 30 days prior & simple majority vote of board
Transparency	None	GPLET Lease to County Recorder, Treasurer, and DOR
GPLET Review	None	Auditor General (program review) in 2015 and JLBC (rate review) in 2016

GPLET, *Continued from page 1*

Central Business District Tax Abatement

Early on in the GPLET stakeholder meetings, all participants agreed that the most important issue for the cities was to maintain the eight-year abatement for property located within a single central business district (CBD). ATRA conceded on this issue but recommended that if the abatement incentive was going to remain in place, CBD needed to be defined and limited in scope since the area of some city CBD's were very significant in size. After much negotiation, the definition that was agreed upon specifies that each city can designate only one CBD and that the CBD boundaries must be a contiguous geographical area within a slum and blighted area. In addition, a CBD is limited to no larger than the greater of 5% of the total land area within the city boundaries or 640 acres.

Rate Structure

Determining a new rate structure was by far the most widely debated piece in reforming GPLET.

The longstanding disagreement over the GPLET rate structure has been grounded in a strong difference of opinion between ATRA and the cities regarding the original intent of GPLET. The cities argue that GPLET is an economic development tool that facilitates the use of their tax exempt status for economic development purposes. ATRA has long argued that GPLET was intended to limit the cities' ability to use their tax exempt status for private purposes.

As a result, the cities efforts were directed at keeping the rates as low as possible while ATRA advocated for rates that would reflect a tax liability under GPLET that would be closer to the tax liability if the property were listed on the property tax rolls. In the final compromise, most of the GPLET rates were doubled over their existing levels.

One stipulation that was included in the new rate structure addresses the disparity between property tax rates among the different cities. The City of Mesa argued that in order for GPLET to be a viable incentive for their city, the GPLET rate had to be lower than those in higher tax areas like Phoenix. To address this issue, the new GPLET rate structure provides that if the aggregate property tax rate of all jurisdictions in which the GPLET property is located is less than 90% of the countywide average property tax rate, the GPLET rate is reduced by 10%.

See **GPLET** page 3

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GPLET, *Continued from page 2*

Another important aspect of the existing rate structure that needed to be corrected was the provision that provided for a 20% drop in the GPLET rate every ten years until it reached zero in the fiftieth year. The new rate structure not only doesn't allow the rates to arbitrarily decrease to zero after fifty years, it requires that the rates be adjusted annually by the producer price index for new construction indefinitely.

Maximum term on GPLET leases

Another major reform sought by ATRA was a limit on the length of the GPLET lease. As previously stated, the current leases were not only allowed to be permanent, the entire tax obligation disappeared at fifty years. HB2504 will prospectively limit GPLET deals to a maximum of 25 years, including any abatement period, regardless of whether the lease is transferred or conveyed to subsequent prime lessees during that period. Upon expiration of the lease, the government lessor is required to convey the property to the prime lessee and the property is then placed on the property tax rolls.

Transparency or "Sunshine" Provisions

Much of the confusion surrounding GPLET is due to the fact that there is currently no requirement to publicly disclose any information regarding GPLET deals. In an effort to make these GPLET deals more transparent, several "sunshine" requirements were implemented under HB2504.

At least 60 days prior to approving a GPLET lease or development agreement, a government lessor must notify the governing bodies of the county, city or town, and school district. In addition, a government lessor must determine within the term of the lease or agreement that the economic and fiscal benefit to the state and local jurisdictions will exceed the benefits received by the prime lessee as a result of the agreement. Finally, the GPLET agreement must be approved by a simple majority vote of the governing body without the use of a consent calendar.

In addition, HB2504 includes reporting requirements such as requiring that the lease or memorandum of lease be recorded in the County Recorder's office within 30 days and the government lessor is required to submit a copy to the County Treasurer.

Furthermore, HB2504 adds accountability by requiring that all GPLET payments be made to the County Treasurer and that the Treasurer distribute the revenue to the appropriate jurisdictions rather than leaving that responsibility up to the government lessor. Finally, on or before February 15 of each year, the County Treasurer is required to submit a report to DOR and to all government lessors regarding all of the returns and payments received in the preceding calendar year.

GPLET Review

In order to ensure a legislative review of the GPLET reforms, both the Auditor General and the Joint Legislative Budget Committee (JLBC) are required to perform the following:

In 2015, the Auditor General is required to conduct and complete a special audit to determine whether GPLET "achieves the goal of providing, in lieu of an ad valorem property tax on possessory interests, a viable revenue stream for counties, cities, towns, school districts and community college districts in which government property improvements are leased for private commercial, residential rental and industrial purposes." Included in the areas to be considered under the audit are accountability, compliance, and the efficiencies in collecting and distributing the tax revenues.

By December 15, 2016, JLBC must conduct an analysis to determine the effectiveness of the GPLET rates. The analysis must include consideration of the total property tax revenues that would be produced if the property were listed on the tax rolls and the actual amount collected and distributed under GPLET to the various jurisdictions. The major piece under this analysis is that JLBC is required to determine and compare the average aggregate property tax levy per square foot for the various property types to the new GPLET rates.

Finally, a considerable amount of credit for the passage of the reforms should go to Senator Ken Cheuvront who has publicly criticized the inequities associated with the current GPLET law for several years.

Jennifer Schuldt

LEGISLATURE, *Continued from page 1*

The Good:

In addition to some positive progress on ATRA's strong recommendations on meaningful deficit reduction, the Legislature also passed a number of ATRA-backed bills that will benefit taxpayers. The following are the major bills backed by ATRA that were passed and signed by Governor Brewer:

SB1188 K-12 Primary Property Tax Oversight (Sen. Huppenthal). This bill provides for much needed oversight and accountability over the $2.4 billion in primary property taxes that are annually levied by K-12 school districts. Current statutes require county school superintendents to determine the amount of primary property taxes levied by each district. SB1188 extends oversight over these important school property tax rate calculations to the Property Tax Oversight Commission (PTOC) to ensure compliance. Currently, the PTOC has statutory oversight of the constitutional levy limitations of counties, cities and towns, and community colleges.

HB2287 County Accommodation School Tax Authority; Prohibition (Rep. Pratt). This measure prohibits a county accommodation school district from levying either primary or secondary property taxes. HB2287 also requires the Property Tax Oversight Commission to consider any property tax levied by a county in support of an accommodation school district to be part of the county's primary levy and subject to the county's constitutional levy limit.

The successful passage of this measure settles a dispute between ATRA and a few county school superintendents regarding their authority to levy property taxes.

HB2257 City/County Tax Limitation; 60 Day Notice (Rep. Antenori). This bill prohibits a county, city or town from levying or assessing any new or increased taxes or fees unless written notice is provided on the county or city website at least 60 days before the tax or fee increase is approved or disapproved by the governing body. Also requires the municipality or county to demonstrate that the new or increased fees are imposed pursuant to statute.

HB2504 Government Property Lease Excise Tax Reform (GPLET) (Rep. Murphy). The bill was the result of several years of work by ATRA staff and key legislators to reform Arizona's laws limiting cities ability to use their tax exempt status to shield private development from property taxation. A similar effort to reform this law had failed in the waning hours of the 2009 session (see August 2009 *ATRA Newsletter).* For a detailed summary of HB2504, please refer to page 1.

HB2389 Arizona State Retirement System Reform (Rep. Boone). As part of ATRA's State Budget recommendations for the last two years, ATRA recommended reforms to the state retirement programs. The employer costs for all of Arizona's public retirement systems have skyrocketed over the last decade, and unless reformed, will saddle taxpayers with unsustainable obligations in the future. The major provisions of HB2389 include: the normal retirement date (the sum of a member's age and years of total credited service) is increased from 80 to 85 for members hired after July 1, 2011; the monthly average of compensation calculation is increased from the highest 36 months to the highest 60 months for members hired after July 1, 2011.

The Bad:

HB2676 University Athletic Facilities District (Rep. Nichols). From a tax policy perspective, clearly one of the worst bills of the session created a new special taxing district created for the state universities. After failing to pass in the 2009 session, Arizona State University was successful in getting the Legislature to create a new special taxing district for the purpose of financing improvements on existing intercollegiate athletic facilities. The district would be created by the county board of supervisors and then governed by a board of directors that is established through an intergovernmental agreement between the county board and the Arizona Board of Regents.

Each of the three state universities is given the authority to establish a district within the contiguous exterior boundaries of property owned by the Board of Regents. The Regents are also allowed to expand the district by acquiring additional property.

Once formed, the otherwise tax exempt university property would be used for private development and the district would collect revenues from lessees of the property. The tax would be a new in-lieu property tax that would be calculated annually by the board of directors. The in-lieu property tax could not exceed the total property taxes that the property would have been subject to in the jurisdictions which it is located.

ATRA opposed this new special district as bad public and tax policy for two major reasons:

First, ATRA is strongly opposed to governmental entities using their tax exempt status as a means of promoting economic development. Shielding private development from the standard tax obligations that other businesses are liable for creates further inequities in Arizona's tax system. Ironically, HB2676 passed in the same session that the Legislature passed HB2504, which significantly reformed and limited the powers of city governments to use their tax exempt status to shield private property from taxation.

See **LEGISLATURE** page 5

LEGISLATURE, *Continued from page 4*

Second, this new district sets a dangerous precedent of allowing a special taxing district to deny equal access to the property tax base. The University Athletic Facilities District will not only be able to levy a tax, it will deny all other local governments' access to taxing that property.

As is the case with most tax increment financing type schemes, the property taxpayers end up being the biggest losers as a result of higher tax rates to schools, counties, and other local governments. In addition, as a result of the private property in a University District not being on the property tax roll, the state of Arizona will bear the burden of higher K-12 school state aid payments.

This new financing mechanism will certainly prompt other entities to seek similar treatment in the future. In anticipation of those efforts, the 50th Legislature would be better served by simply repealing this bad law in 2011.

And the Ugly:

HB2512 Municipal Taxes; Auditors and Collectors (Rep. Murphy). In a session where there was considerable discussion surrounding the impact of the state's tax system and structure on the economy and job growth, it was very disappointing that the Legislature rejected ATRA's bill to stop cities from contracting with for-profit tax collectors and auditors.

HB2512 would have pre-empted cities from entering into contracts with a third-party for the collection, administration or processing of transaction privilege or affiliated taxes levied by the city or town. It would also prohibit cities from employing third-party auditors on a contingent fee basis.

HB2512 failed on the House floor after receiving 30 out of the necessary 31 yes votes needed for passage. Support for the measure, as well as the opposition, was bi-partisan. Opposition to the bill was lead by Representative Nancy McClain, a Republican that represents the only city to have signed a contract with a for-profit company to both collect and audit its local sales taxes. Bullhead City officials explained that their contract with the firm Revenue Discovery Systems (RDS) was based on a laundry list of grievances with the Arizona Department of Revenue's city sales tax collection program.

Rep. McClain, along with other opponents to the bill, wrapped what is an extraordinarily bad tax policy in a policy that is generally supported by many policymakers: privatization. Despite the fact that most lawmakers were able to distinguish between governmental functions that are proper for privatization from those that are not, such as law enforcement and tax collection and auditing, the privatization argument provided ample cover for those looking to support the city position. Lawmakers supporting the privatization argument chose to look the other way when informed that the cities will not be openly bidding this contract to the lowest bidder. Rather, this vendor was hand-picked by the League of Arizona Cities and Towns and appears to be the only contractor that will collect and audit taxes on behalf of Arizona cities. In conjunction with their selection by the League for this exclusive contract, RDS has also agreed to kick back to the League a percentage of their revenues.

Opponents to the bill also used the standard rural vs. urban Arizona argument. Many major cities in Arizona have instituted their own tax departments and both collect and audit their own local sales tax. This is legal and HB2512 would not have stopped a city from creating its own local tax department. RDS lobbyists argued that small rural cities should have the same flexibility of the larger urban cities for local tax administration. Key rural republicans such as House Minority Whip Andy Tobin and seat-mate Rep. Lucy Mason both opposed the bill on what appeared to be simple rural vs. urban concerns. Clearly, rural lawmakers have legitimate concerns about economic development opportunities in their districts. To that end, it is difficult to understand how increasing the administrative burden for sales tax compliance could ever be viewed as something positive for small businesses in rural Arizona.

The only positive thing to come out of this very serious tax issue that threatens Arizona businesses is that state policymakers are again being exposed to the realities of Arizona's terrible state and local sales tax structure. Arizona is one of only three states that allows an independent municipal sales tax structure. Unlike most states, Arizona's system requires many businesses to maintain two sets of books for the payment of sales taxes. In addition to multiple points of contact for the payment of sales taxes, Arizona businesses are also faced with the potential administrative burden of audits from the state as well as municipal auditors.

The last major effort on the part of ATRA and key business organizations to pursue changes to Arizona's disastrous sales tax structure resulted in some limited improvements in 1999. Since that time, and until 2008, ATRA worked quietly behind the scenes, often through the leadership of the League of Arizona Cities and Towns, to make small but on-going improvements to the system through the Model City Tax Code. Regrettably, the League's decision to pursue the partnership with RDS over the strongest objections of ATRA and the business community brought an end to that era of cooperation. Ironically, that era of cooperation ultimately worked against the business community because a major tax policy problem in Arizona was taken off the radar screen for state policymakers.

It is clear that Arizona will crawl out of this prolonged recession that has seen Arizona businesses shed over 300,000 jobs. Certainly, efforts at the state capital regarding improvements and changes to the tax system that will encourage job creation will continue. In addition to addressing the high tax rates paid by Arizona businesses, those efforts should also address the enormous costs borne by businesses subjected to Arizona's unnecessarily complicated sales tax system.