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ARIZONA TAX RESEARCH ASSOCIATION

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OKLAHOMA LEGISLATURE BANS FOR-PROFIT TAX COLLECTORS

Tulsa/RDS Contract in Limbo

Tulsa city officials had recently signed a contract with Revenue Discovery Systems (RDS) to "enhance" its revenue collections, which would take effect July 1, 2010; however, that contract seems to be in question since the Oklahoma Legislature passed legislation in late May to require all Oklahoma cities to contract with the State Tax Commission to administer their tax collections, thereby prohibiting cities from contracting with a for-profit company for those same services.

During the 2010 legislative session, ATRA advocated for legislation (HB2512 and HB2508) that would have prohibited cities and towns from contracting with a third-party company for the collection, administration or processing of transaction privilege or affiliated taxes levied by a city or town. The legislation would have also prohibited cities from employing third-party auditors on a contingent-fee basis. To date, RDS has contracted in Arizona with the City of Bullhead City. As the legislation was making its way through the process, ATRA argued that allowing cities to contract with a private company to conduct their tax collection function posed many problems, including increasing the administrative burden on taxpayers, especially on small businesses.

The excuses used by Tulsa to justify contracting with RDS are the same ones that have been recently cited by the League of Arizona Cities and Towns and other city officials. For example, Tulsa officials believe that a private company can administer the collection of sales taxes more efficiently than the state, and that as a result, the city will receive additional tax revenues. However, the truth is that the "additional" sales tax revenue will largely be realized through increased audits. As HB2512 and HB2508 were moving through the

See **Oklahoma** page 2

ATRA BOARD VOTES TO SUPPORT PROPOSITIONS 301 AND 302

At its June meeting, the ATRA Board of Directors voted to support two important ballot propositions on the November 9th general election ballot. Both measures provide vital revenues to shore up the Fiscal Year (FY) 2011 budget that begins July 1st. The FY 2011 budget anticipates $124 million from the successful passage of Prop 301 and $324 million from Prop 302. Both propositions give Arizona voters the opportunity to revisit ballot measures that were approved in 1998 and 2006.

Arizona voters are being asked to vote on these two fiscal issues because of the requirements of the Voter Protection Act (Prop 105) passed in 1998. That initiative placed strict limits on the Legislature's ability make changes to voter approved initiatives. So while the majority of the Legislature approved redirecting these revenues to help plug a massive general fund budget deficit, voter approval for the change is still required.

If approved by the voters, Proposition 302 will redirect the proceeds from the 80 cents a pack tobacco tax increase that was approved by the voters in Proposition 203 in 2006. Since 2006, those tobacco tax revenues have been earmarked to the early childhood development and education fund. Proposition 301 would redirect that funding to the state general fund for the purposes of funding health and human services for children. In addition to reverting the current balance of $324 million in the fund, Proposition 302 will direct the future proceeds of the 80-cent tax (estimated at $140 million annually) to the state general fund.

ATRA opposed Prop 203 in 2006, arguing that the continued practice of special interest groups skirting the state budgeting process through "ballot box budgeting" was bad public policy. ATRA has consistently argued that ballot box budgeting overrides the responsibility of the Legislature and handcuffs policymakers' ability to respond to the state's changing demands. Clearly, the devastating effects of the recession on state and local government budgets reinforces that ATRA has been right all along about the negative impacts that ballot box budgeting has on the state's budgeting process.

In opposing Proposition 203 in 2006, ATRA cautioned that the significant increase in the cigarette tax would have deleterious effects on the programs that were currently being funded by tobacco taxes. As ATRA reported in detail in the April 2009 *Newsletter,* the state general fund and two funds earmarked for low income health care have experienced close to $60 million in reductions as a result of Proposition 203.

See **Propositions** page 2

OKLAHOMA, *Continued from page 1*

legislative process, lobbyists for RDS argued that the for-profit company has no intention of conducting audits for Arizona cities. However, when HB2508 was heard in the Senate Finance Committee, Rep. Nancy McLain testified that RDS in fact has every intention of auditing taxpayers. McClain, who represents the City of Bullhead City, led the opposition against ATRA's bill.

ATRA believes the concept of for-profit tax collectors and auditors is one of the worst developments in tax policy in many years. RDS is also trying to set up shop in Georgia, where legislation has been considered to preempt their activity. The Directors of the Department of Revenue, in both Arizona and Georgia, have both openly criticized these arrangements, claiming the obvious conflict of interest when compensation of auditing and collecting services is based on the amount of revenues collected, in addition to the different interpretations of the law that can result, particularly when one of the authorities is motivated by monetary gain.

PROPOSITIONS, *Continued from page 1*

If approved by the voters, Proposition 301 would transfer the remaining monies in the Land Conservation Fund ($124 million) to the state general fund. The Growing Smarter Act of 1998 required the Legislature to annually appropriate $20 million from the state general fund to the Public Conservation Account for FY 2001 through FY 2011. If voters approve Proposition 301, the remaining balance of $124 million will be transferred to the state general fund as one-time revenue for the FY 2011 budget.

In voting to support both of these measures, the ATRA Board of Directors noted that even with their passage, the state faces another cash shortfall in FY 2011 of roughly $370 million. If Propositions 301 and 302 fail, that cash shortfall will skyrocket to over $800 million and require further tax increases and/or budget cuts to close that deficit.

Proposition 100 Passes

Structural Deficit Still at $1.7 billion for FY11

Arizona voters overwhelmingly approved a temporary 1% increase in the state sales tax on May 18th. ATRA supported Proposition 100, arguing that the temporary tax was a necessary tool to manage the state's on-going budget crisis over the next three years.

The major challenge now facing policymakers is to ensure that the temporary sales tax revenues are not used to fund on-going spending over the next three years that cannot be sustained when the tax sunsets in Fiscal Year 2014. Upon the passage of Proposition 100, ATRA President Kevin McCarthy stated, "ATRA views the temporary tax as a management tool that will hopefully decrease the use of damaging budget gimmicks over the next three years. However, this tax has to be combined with further budget cuts over the next three years to ensure a balanced budget in Fiscal Year 2014."

As the graph on page 3 reflects, the state's structural deficit for FY 2011 currently stands at $1.7 billion after the passage of Proposition 100. According to estimates from the Joint Legislative Budget Committee (JLBC), the state should anticipate structural deficits during each of the three years the temporary tax is in place unless there are further budget reductions. The JLBC estimates a structural deficit of $1.1 billion when the temporary tax sunsets in FY 2014. (Actually the FY 2014 structural deficit could easily be much higher than the JLBC estimate, which uses 7% to 9% revenue growth over the three years)

In addition to what has become a chronic structural deficit, Arizona policymakers already face a cash deficit as the state's new fiscal year begins on July 1st. The state will open the FY 2011 budget with a shortfall from the FY 2010 budget of $368 million. As discussed in greater detail in the article on page 1 highlighting ATRA's support for Propositions 301 and 302, the FY 2011 cash deficit could get considerably worse if voters reject those two propositions. Further, if the federal government fails to appropriate the $400 million in temporary federal matching funds Arizona is counting on in FY 2011, the cash deficit could exceed $1.2 billion.

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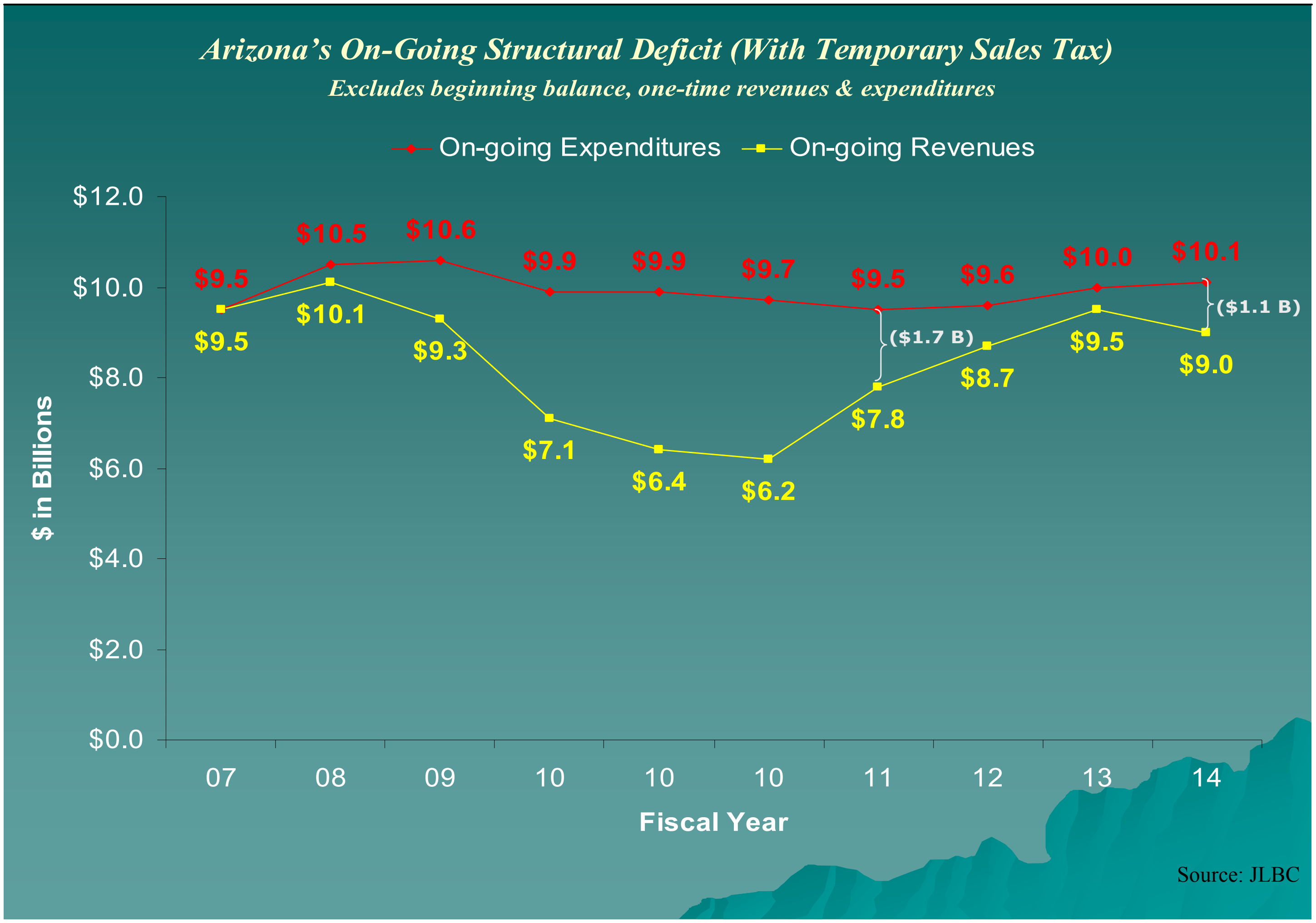

LAWSUIT INCREASES PIMA COUNTY TAXES

During the 2009 legislative session, ATRA successfully advocated for a bill that eliminated the potential for merging fire districts to draw down excessively higher fire district assistance tax (FDAT) revenues in comparison to other fire districts. The FDAT is a property tax levied on taxpayers countywide to support the operations of all fire districts located within county boundaries. The tax rate is capped at $0.10 per $100 of assessed value and each fire district receives an amount equal to 20% of the property taxes levied by each fire district, not to exceed $300,000 for any single district, with one exception: merged districts. In order to not discourage fire districts from merging, the amount of FDAT to be distributed to a newly merged district (prior to the 2009 legislation) was equal to the amount of FDAT that each district received in the year prior to the merger. There exist only a few fire districts that exceed the $300,000 FDAT cap, and prior to tax year 2009, the largest distribution to a merged district amounted to around $550,000. No fire districts have ever abused the FDAT merger law, that is, until Heritage Hills, North Ranch Linda Vista, and La Canada fire districts merged to form Mountain Vista Fire District (MVFD).

As part of the merger agreement, each of the three Pima County fire districts agreed to artificially inflate their local property tax levies enough to increase each district's FDAT distribution to $300,000 in the year prior to the merger in order to guarantee that the newly merged district would receive $900,000 in total FDAT revenue. That meant that each district had to deliberately increase its levy to $1.5 million, which resulted in a collective increase of $2.8 million (160%) to local property taxpayers of the three districts. On top of the additional $2.8 million levied on the local property taxpayers, taxpayers countywide were required to pay an extra $550,000 in FDAT as a result of the newly merged MVFD, amounting to an overall property tax increase of approximately $3.4 million.

In response to the abuse of the FDAT merger law by MVFD, Representative Steve Yarbrough, then House Ways & Means Chairman, agreed to sponsor HB2285, which eliminated the ability of merging fire districts to game the system in the future. The

See **Pima County** page 4

PIMA COUNTY *Continued from page 3*

new law capped a merged fire district's FDAT distribution to the sum of the average amount received by each district over the three years prior to the merger. In the bill, a retroactivity clause was included to require that all districts that merged after December 31, 2007 would be subject to the new law. If this law were in effect prior to the MVFD merger, the new district would receive an amount in FDAT that is closer to $500,000, similar to other merged districts, rather than $900,000.

In November 2009, MVFD filed a lawsuit against the Pima County Board of Supervisors, stating that the retroactivity clause was unconstitutional since they would be the only district affected by the new law. The Pima County Superior Court judge struck down the retroactivity language, agreeing with Mountain Vista that the retroactivity clause was unconstitutional. It's not known how strongly Pima County defended the language in HB 2285; however, the Board of Supervisors voted 5-0 to enter into a Stipulated Motion for Judgment regarding the unconstitutionality of the retroactivity clause. As a result of the court ruling, Pima County property taxpayers will continue to provide MVFD with an annual $900,000 subsidy. To put this in perspective, although the total property value in MVFD in tax year 2009 accounted for just 2.7% of the total property value in Pima County, the $900,000 received in FDAT by the district accounted for 23% of the total FDAT levied on property taxpayers in Pima County.

The MVFD merger has shined a light on the flaw in the FDAT merger statute. It was a mistake for lawmakers to ever allow any single district to exceed the $300,000 FDAT cap and ATRA will propose a remedy to the loophole during the next legislative session.