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ARIZONA TAX RESEARCH ASSOCIATION

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2015 LEGISLATIVE SESSION A HUGE SUCCESS

Major Victories for Taxpayers; Zero Bad Bills Survive Short Session

The First Regular Session of the 52nd Legislature completed its work on April 3rd in what was a historically brief session lasting just 81 days; the shortest in 50 years. It wasn't for a lack of work; the Legislature passed 344 bills. Among those were a number of excellent pieces of legislation which serve to continue to improve the landscape of tax and finance policy in Arizona. Key progress was made in the areas of transaction privilege tax simplification, truth-in-taxation, bond election transparency, the use of public funds in elections, and promotion of good-government practices.

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Colleges Adjust Student Counts

Pima, Graham Continue to Exaggerate

After receiving significant attention during the 2015 legislative session, most Community College Districts (CCDs) brought their FY2016 student count estimations down to more realistic levels. Estimates from the CCDs sent to the Economic Estimates Commission (EEC) set the constitutional expenditure limit authority for the CCDs. High estimations in student counts—particularly in recent years, drove increased budget capacity. ATRA discussed the issue at length in the May 2014 and June 2013 newsletters.

The initial estimates made to the EEC in January saw only a 3% reported decline statewide in full-time student

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School Finance Equity; Everyone to the Top?

A March 13 article in *The Arizona Republic* highlighted the top ten Phoenix K-12 school districts for average teacher salary. Everyone loves a top ten list and those who follow Arizona school finance are not surprised to see wide discrepancies in teacher pay across Phoenix schools.

Arizona school finance is a complicated labyrinth but the original design envisioned a system where all districts would have roughly the same amount of per-pupil funding. Those tracking the Desegregation/Office of Civil Rights (Deseg/OCR) debate in the Arizona Legislature know full well how Phoenix Union teachers on average earn 55% more than Buckeye Elementary (\$58k versus \$35k).

Five of the top ten Phoenix area School Districts (SDs) for teacher pay avail themselves to the Deseg/OCR funding loophole. (ATRA explained the genesis of this program in the August and November 2014 newsletters). Senator Debbie Lesko's SB1371 sought a five-year phase out of these funds for OCR districts and a 10-year phase out for the two Deseg districts (see the ATRA January 2015 newsletter). The bill passed the Senate Finance committee but stalled on the Senate floor. Naturally, there was significant resistance from the few benefitting SDs while the rest of the education community was largely silent on the issue.

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Below are the major bills ATRA advocated for or against during the session. A complete listing of the bills tracked can be found on the Good Bill/Bad Bill List at www.arizonatax.org

ATRA BILLS

HB2538 special districts; truth in taxation (Mitchell) Included in ATRA's 2015 Legislative Program was a proposal to increase the transparency for local governments proposing to increase the property taxes of countywide special taxing districts. Unlike the current truth in taxation (TNT) requirements that are required for increases to the operational levies of counties, community colleges, cities and towns, there is currently no requirement that applies to increases to the operational levies of countywide special taxing districts. HB2538 fixes that inconsistency by extending the TNT requirements to the operational levies of countywide special taxing districts, specifically library districts, flood control, public health services, and jail districts. Although there was no opposition, the bill passed with a partisan vote in both chambers. The new TNT requirements go into effect for FY 2017. *Chapter 128*

SB1066 Political subdivisions; financial audit reports (Pierce) As a result of negotiations with local government representatives, SB1066 was amended in the Senate to extend the financial audit filing deadline for local governments to nine months and to require that financial audits be posted to the entity's website for at least 60 months. Failure to file the audit prior to the adoption of the subsequent year's budget requires the entity to submit a form as prescribed by the Auditor General with the adopted budget. Identical language was advanced as a strike-everything amendment under HB2617; however, the bill was further amended on the Senate floor to include other provisions unrelated to the original purpose of the legislation. *Signed by the Governor.*

HB2613 political activity; public resources; limitation (Petersen) HB2613 prevents local governments from using public funds to amplify their "district focused" advertising from the call of a tax question election through election day. The bill provides clear language for jurisdictions to follow so their advertising won't be judged as electioneering and a misuse of public funds. The bill exempts routine district business provided it is germane to their function and "maintain[s] the frequency, scope and distribution consistent with past practices or are necessary for public safety." *Signed by the Governor.*

HB2109 ballot; form; secondary property taxes (Petersen) HB2109 adds seven words to all general obligation bond election official ballot questions: "...to be repaid with secondary property taxes." This transparency bill provides the language to meet the current statutory requirement that the repayment mechanism for bonds be included on the official ballot question. *Chapter 48*

SB1371 schools; desegregation; OCR; funding; phase-out (Lesko) SB1371 was designed to phase out Desegregation and Office of Civil Rights (OCR) funding over 10 and 5 year periods, respectively. The 19 school districts currently using the authority spend a combined \$211 million annually in perpetuity, which represents the largest affront to equity in Arizona K-12 school finance. *Held in Senate COW.*

HB2442 community college expenditure limits; recalculation (Olson) As amended, the bill called for legislative oversight of the student count estimations provided by community college districts for the purposes of setting constitutional expenditure limits. The estimates would be approved by the Joint Legislative

Budget Committee prior to the EEC setting the expenditure limits for the upcoming fiscal year. *Held in House COW. A community college study committee on the issue was amended to HB2414, which was signed by the Governor.*

OTHER GOOD BILLS

SB1446/HB2590 TPT Reform; contractors (Lesko/Fann) The 2015 TPT contracting reform clean-up bill provides additional clarity to complete the historic 2013 TPT simplification effort, particularly regarding maintenance, repair, replacement, and alteration (MRRRA) projects. The bill serves as another step towards the goal of simplifying compliance and collection of TPT. *Chapter 4*

HB2147 TPT; municipal tax; pole attachment (Olson) Provides a TPT exemption for leasing or renting space for utility pole attachment under the personal property rental classification. The legislation reverses the improper application of a tax court ruling and restores the long-standing treatment of joint pole usage agreements under TPT. *Chapter 72*

HB2615 illegal tax levies; review; notice (Ackerley): As passed, the bill requires the Property Tax Oversight Commission to review the secondary property tax levies of all counties, community college districts, and cities and towns for the purposes of complying with statutory and constitutional laws. Additionally, the bill transfers responsibility of the state and local report of bonded indebtedness from the Arizona Department of Revenue to the State Treasurer. *Chapter 221*

HB2653 tax liens; delinquency; partial payments (Olson): Under current law, only Maricopa County property owners are required to pay a 16% interest rate to redeem their property tax liens whereas property owners in all other counties are only required to pay the lower bid rate. The difference in the 16% interest rate and the bid rate is deposited in the Maricopa County Elderly Assistance Fund (EAF) to pay down the school property taxes for taxpayers that qualify under the Senior Valuation Freeze program. HB2653 eliminates the 16% interest rate penalty on Maricopa County property owners and requires the county to utilize the existing fund balance to fund the EAF. ATRA supported the elimination of a funding source that is derived from a punitive penalty on property owners that can't afford to pay their taxes to pay down the taxes of others. *Awaits executive action.*

BAD BILLS

HB2253 Property tax assessments; one-year cycle (Mitchell) HB2253 was a proposal advocated by the Maricopa County Assessor that would have dramatically disrupted the coordination that exists in the current property valuation and budgeting calendar. HB2253 faced overwhelming opposition from taxpayers and the Arizona business community. The current property valuation and tax calendar that runs approximately 18 months provides ample time for county assessors to mail the notices of valuations to property owners, for those values to be appealed to address any errors or inaccuracies, and for county assessors to deliver the finalized property tax roll to state and local governments to set tax rates during the budget process in the following year. The proposal under HB2253 combined the valuation and tax calendar into one year, mainly by reducing the appellate process for taxpayers and by pushing the date in which values are finalized to the same day in which tax rates are adopted in mid-August. Among many other problems, HB2253 would have required state and local government to develop and adopt budgets using tentative property values that had not completed the appeals process. The current calendar that properly aligns the valuation process before the budgeting process and provides final values to all

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equivalent (FTSE) counts despite over-estimations of 17% in FY2012 and roughly 20% in both FY2013 and FY2014. Actual FTSE for FY2015 will be available in October this year.

However, after committee hearings for HB2442 (see January newsletter) which sought to provide legislative oversight of FTSE estimations, colleges reduced their FY2016 FTSE by a combined 6% statewide.

In particular, Maricopa CCD revised its FY2016 FTSE estimate from 86,000 to 81,000 and appears to be far closer to reality considering their FY2014 actual count was 78,454.

Necessary FTSE estimate adjustments from FY2015 to FY2016 were made by Cochise (20%), Gila (5%), Pinal (4.5%) and Navajo (2.5%).

One of the remaining exaggerators is Pima CCD, who proposed the same FTSE estimate in FY2016 as FY2015 at 23,000 pupils. Their FY2014 actual was just 17,963 which represented a 30% over-estimation in that year. It is highly unlikely they have witnessed a massive turnaround in student count given local and statewide trends in attendance. Pima is one of the two CCDs to receive zero state general fund monies in FY2016 (a \$7.7 million cut) and certainly has some unique fiscal challenges ahead. They have already raised tuition by 7% and indicated they will raise their property tax levy by their maximum allowed (2% plus new construction).

The other is Graham CCD, who also did not alter their FY2016 estimate from FY2015 at 3,350 FTSE. They had just 2,765 FTSE in FY2014 and reportedly are not experiencing an attendance increase. Their 3,350 estimate is a drop from FY2014 of 3,850 which was the result of a technical recalculation of the base pupil level from the removing pupils from Gila Pueblo, which had the net effect of increasing their FY 2015 expenditure limit and was not in recognition of declining enrollment.

The FY2016 total FTSE estimate from all colleges is 137,016 which is just 6.97% above the actual count for FY2014 and is a positive trend towards meeting constitutional obligations.

-Sean McCarthy

| FTSE CCD | 2013 | | % over | 2014 | | % over | Initial | | % '15 to '16 | Final | | % '15 to '16 |
|--------------|----------------|----------------|--------------|----------------|----------------|--------------|----------------|----------------|--------------|----------------|--------------|--------------|
| | EEC | Actual | | EEC | Actual | | 2015 EEC | 2016 EEC | | 2016 EEC | | |
| Cochise | 10,000 | 7,766 | 28.8% | 9,000 | 7,221 | 24.6% | 7,900 | 6,300 | -20.3% | 6300 | -20.3% | |
| Coconino | 2,250 | 2,099 | 7.2% | 2,100 | 2,092 | 0.4% | 2,100 | 2,091 | -0.4% | 2091 | -0.4% | |
| Gila | 1,150 | 703 | 63.6% | 950 | 785 | 21.0% | 950 | 900 | -5.3% | 900 | -5.3% | |
| Graham | 3,750 | 3,107 | 20.7% | 3,850 | 2,765 | 39.2% | 3,350 | 3,350 | 0.0% | 3350 | 0.0% | |
| Maricopa | 94,350 | 81,218 | 16.2% | 94,350 | 78,454 | 20.3% | 88,500 | 86,000 | -2.8% | 81000 | -8.5% | |
| Mohave | 4,338 | 2,987 | 45.2% | 4,200 | 2,919 | 43.9% | 3,200 | 3,200 | 0.0% | 3150 | -1.6% | |
| Navajo | 2,400 | 1,962 | 22.3% | 2,200 | 1,825 | 20.5% | 2,000 | 1,950 | -2.5% | 1950 | -2.5% | |
| Pima | 26,000 | 19,514 | 33.2% | 23,500 | 17,963 | 30.8% | 23,000 | 23,000 | 0.0% | 23000 | 0.0% | |
| Pinal | 5,500 | 4,822 | 14.1% | 5,770 | 4,354 | 32.5% | 5,500 | 5,500 | 0.0% | 5250 | -4.5% | |
| Santa Cruz | 325 | 218 | 49.1% | 320 | 254 | 26.0% | 325 | 288 | -11.4% | 325 | 0.0% | |
| Yavapai | 4,200 | 3,984 | 5.4% | 4,175 | 4,002 | 4.3% | 4,050 | 4,000 | -1.2% | 4000 | -1.2% | |
| Yuma/La Paz | 5,828 | 5,537 | 5.3% | 5,750 | 5,451 | 5.5% | 5,767 | 5,648 | -2.1% | 5700 | -1.2% | |
| Total | 160,091 | 133,917 | 19.5% | 156,165 | 128,085 | 21.9% | 146,642 | 142,227 | -3.0% | 137,016 | -6.6% | |

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Senator Steve Farley (D-Tucson) was sharply critical of ATRA's approach to addressing the inherent unfairness and inequity stemming from Deseg/OCR. Alternatively he suggested raising all other SD budgets to match the Deseg/OCR SDs instead of phasing out the provision. Every district receiving Deseg/OCR is capped at varying levels and one must assume the Senator meant raise all districts to the high watermark, which is Phoenix Union who receives roughly \$2,000 per student from this mechanism. In order to phase out Deseg/OCR as Senator Farley envisions, the state would need to increase the K-12 general fund budget by roughly two billion dollars per year, a 22% increase to the state general fund. This option would require the largest tax increase in state history. The sticker shock serves to highlight the massive inequity the Deseg/OCR program creates.

A two billion dollar tax increase would require an estimated two-cent statewide sales tax increase. According to the *Tax Foundation's 2015 Facts and Figures*, Arizona ranks #11 in the country for highest average sales tax rates at 8.17%. A 2% statewide sales tax increase would move Arizona to #1, by far the highest average sales tax rate in the country. The statewide sales tax base could be expanded to include food, for example, which would be politically unpopular but would generate a small portion of the required increase.

A statewide property tax sufficient to generate two billion dollars would require a \$3.7354 increase on primary property taxes, taking the statewide primary property tax rate average to \$12.49 and \$16.41 in total. This would move the majority of Arizona homeowners above the constitutional 1% primary property tax cap, which would create a significant financial impact on the state general fund and subsequent cuts to local governments who would be forced to offset the impacts of the cap. A corporate income tax rate to cover the amount would require a 380% increase in rates. Finally, \$2 billion could be raised by increasing personal income tax rates roughly 58%. All of these estimations assume zero loss due to diminishing returns on higher rates.

So the question remains: what to do with this vestige of the past that presently creates massive inequities for districts and taxpayers?

In addition to higher teacher pay, SDs with Deseg/OCR can afford smaller class sizes, additional support staff, nicer facilities, etc. In an environment where SDs compete for students, this inequity becomes more questionable and constitutionally unsound.

If lawmakers lack the political courage to remove the Deseg/OCR provision, then at a minimum it should become a part of the school finance formula so that it is equalized in the same manner as the rest of the school finance expenditures lawmakers deem justified. By taxing for this item separately outside the formula, on top of the qualifying tax rate, means local taxpayers are liable alone. It serves to inoculate the state from addressing the validity of the expenditures. Once equalized in the formula, the program would not serve as an additional property tax, which presently generates some of the highest rates in the state.

It is widely accepted that it has been too long since Arizona performed a comprehensive overhaul of K-12 school finance. There certainly have been many landscape changes since the last major effort in 1980 such as open-enrollment, charter schools and a variety of lawsuits both settled and pending. An overhaul should address both district and taxpayer equity issues to ensure fairness on all fronts. At the top of the reform agenda should be addressing the Deseg/OCR levies.

Phoenix Union High School District receives ~\$2,000 per pupil from this mechanism. To bring all other districts to this level would cost \$2 billion annually.

-Sean McCarthy

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state and local governments on February 10th each year. Those final values allow state and local government to comply with a host of budgeting and truth in taxation statutes that are critical for taxpayer's involvement in the budgeting process. *Held in Senate Finance.*

HB2406 Fire District Tax; Overrides (Stevens) HB2406 would have extended the current period of temporary tax overrides for fire districts (FDs) to exceed the current \$3.25 tax rate cap from five years to eight years. In addition, the temporary override would no longer be subject to the 5% levy limit and all FDs would have the ability to seek the temporary override, not only those districts that experience a 20% decline in property values over two consecutive years. ATRA testified in opposition to the bill in the House Ways & Means Committee, and as a result, the bill was held. However, this issue will be discussed over the interim since a fire district study committee (HB2162) was approved by the Legislature and signed by the Governor.

HB2333 tax credit; research activity; refunds (Fann) HB2333 would have increased the existing refundable income tax credit cap for increased research and development activity from \$5 million to \$15 million over the next four years. ATRA has consistently opposed refundable tax credits since they become the first draw on state revenues, ahead of funding for schools, health care, prisons, etc., and expansion of the program further exacerbates that bad policy. *Held in House Rules.*

HB2412 renewable energy credit; refundable; cap (Stevens) HB2412 was another effort to create a refundable tax credit but this time for an existing tax credit. Although part of the measure sought to reduce the production tax credit cap on renewable energy from \$20 million to \$18 million, it also designated 80% of any unused credit as refundable. *The bill never received a hearing.*