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ARIZONA TAX RESEARCH ASSOCIATION

NEWSLETTER VOLUME 72 NUMBER 3 MARCH/APRIL 2012

ATRA's Property Valuation Limit Heads to November 2012 Ballot

ATRA has long acknowledged that Arizona's property tax system is one of the most complex systems in the country and has consistently advocated for reforms to the system. Sponsored by Senator Steve Yarbrough, SCR1025 furthers ATRA's efforts to reform Arizona's property tax system. Rather than using two taxable values, ATRA's proposal eliminates the secondary net assessed value (SNAV), simplifying the taxation of property to only the primary net assessed value (*See Table 2 on Page 4*). In addition, the limited property value (LPV) will be limited to 5% annual growth. In a normal environment, eliminating the SNAV could have significant effects on local government budgets. However, since the statewide full cash value (FCV) and LPV are nearly identical, transitioning to taxing only the primary net assessed value will result in little or no loss in taxable value (*See Table 1 on Page 4*).

Under the current system, property is subject to tax on two sets of values: FCV and LPV. The Constitution requires that the FCV be reflective of the market value of the property, and therefore, there is no limit on its annual growth. In contrast, the LPV increases each year by 10% over the previous year or 25% of the difference between the current year FCV and the previous year LPV, whichever is greater.

ATRA's proposal will limit the taxation of property to only the LPV; therefore, all primary and secondary taxes will be levied against the LPV. However, the assessor will still be required to establish the FCV on the

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Other ATRA Legislation Makes it to the Finish Line

Two still in the pipeline

HB2608 Levy limits-auditing new construction (Chapter 124)

On or before February 10th of each year, the county assessor calculates the constitutional primary property tax levy limits and maximum tax rates for counties, cities, and community college districts. Statute requires that when these jurisdictions adopt their tax rates and levies in August, the values used in calculating those rates are the same values used to determine the constitutional levy limits. Some jurisdictions, however, adopt tax rates using "updated" values, leading to inconsistencies between primary and secondary values and between jurisdictions.

The problem with updating the values is that it changes the calculations that have been made to determine the constitutional levy limits of 2% plus growth, as well as the calculation used to determine a jurisdiction's adherence to the Truth-in-Taxation (TNT) laws. Changing the values in those calculations would result in a

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different rate. Therefore, those jurisdictions that are subject to the constitutional levy limits could unknowingly adopt a rate that exceeds the maximum tax rate under the constitutional levy limits and/or nullify the TNT publication that is required when notifying taxpayers of an impending property tax increase.

Additionally, new construction, a key feature of constitutional levy limits, has been the source of erroneous levy limit calculations in recent years. Discrepancies in new construction discovered throughout the state have raised questions about the accuracy of levy limits calculated by the county assessor.

HB2608, Sponsored by J.D. Mesnard, clarifies that local governments must use the February 10th values when adopting their tax rates and levies in August. The bill also allows the Department of Revenue to audit the value of new construction reported on the levy limit worksheets, which in turn will greatly increase the accuracy in the levy limit calculations for counties, cities, and community college districts.

HB2621 Transparency in local government budgets (Chapter 126)

Statute currently requires local governments to hold public budget hearings and publish their tentative and final budgets in a newspaper of general circulation. Building on these efforts to increase transparency, last year, the Legislature passed a bill to require counties and cities to post their budgets on their websites within seven days of adoption and maintain the budgets for five years. Sponsored by Rep. Debbie Lesko, HB2621 expands the posting requirements that currently apply to counties and cities to community colleges and fire districts.

The bill also mandates that cash balances be reflected in local government budgets. Despite Auditor General guidelines to the contrary, some local governments have argued that they do not have to reflect all of their cash reserves. HB2621 requires counties, cities, and community colleges to show all restricted and unrestricted cash balances in their budgets.

Lastly, the bill requires governments to include detailed personnel costs in their budgets. More specifically, the budgeted salaries, benefits, and retirement costs, in addition to the number of full-time equivalents, must be separately listed by fund type. This provision is important for taxpayers since personnel-related expenditures consume most of a jurisdiction’s budget.

HB2760 Transparency in bond & override elections (Chapter 129)

School districts hold elections for the approval of budget overrides and authorization to sell general obligation bonds. At least 35 days before the election is held, the county superintendent must publish and distribute a publicity pamphlet to each voter in the district. The pamphlet contains the estimates of the budget and the tax impacts of the proposed bond or override, as well as the pro and con statements on the question. The county superintendent also sets the deadline for taxpayers to submit statements in support or in opposition to the proposal. Currently, there is not a requirement for districts to provide notice to voters

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regarding the deadline to submit arguments.

As signed by the Governor, HB2760 requires a district holding a bond or override election to establish a deadline for submitting arguments for and against the proposed tax increase in a public meeting and to post the deadline either on the entity's website or in a newspaper of general circulation. The bill, sponsored by Rep. Justin Olson, increases the transparency in school district bond and override elections by allowing taxpayers the opportunity to weigh in on proposed tax increases.

SB1084 Corporate income tax—net operating loss (Held in the House)

Sponsored by Senator Michele Reagan, SB1084 would have extended the net operating loss (NOL) carryforward from five years to conform with the federal code of 20 years. Although the measure received unanimous support in the Senate, the bill was never assigned to a committee in the House. However, ATRA's NOL reform was included as part of the House tax package under HB2815, which currently awaits Senate Rules and the outcome of that bill is unclear at this time.

SB1279 Personal property—computer software (Awaits Final Read)

After much negotiation between ATRA and the Arizona Department of Revenue (ADOR), a compromise was finally reached regarding the taxation of computer software.

ATRA's proposal under SB1279 was prompted by a recent substantive change that ADOR made to the Personal Property manual that added "software" to the category of "computers," which as a result, would make all software subject to the personal property tax. This recent change in tax policy caused significant alarm to the business community, which has relied on the 1978 Arizona Court of Appeals case *Honeywell Information Systems, Inc. v. Maricopa County* that concluded that computer software is not subject to the tax since the Legislature had failed to create a mechanism to tax intangibles.

ADOR explained the change in the manual as a response to requests from county assessors who believed software to be taxable. ATRA's discussions with assessors revealed varying interpretations of the taxability of software.

Sponsored by Senator Steve Yarbrough, SB1279 attempts to distinguish between "operational" software and "application" software and makes clear that software necessary to operate personal and general purpose computers and the peripheral equipment is valued as part of the computer on which it is installed. All other software, whether canned or customized for a specific application, is not included in the value of personal property.

SB1279 was amended in conference committee and currently awaits final read.

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property and taxpayers will retain the ability to appeal the FCV if the owner does not agree with the value established by the assessor.

In addition, the annual growth in the LPV on all locally assessed property will be limited to 5%, and as is the case now, the LPV cannot exceed the FCV. Applying a reasonable limit to the taxation of property, rather than taxing the market value of property, will insulate taxpayers from dramatic tax increases as a result of major fluctuations in the real estate market. Had this measure been in place over the last decade, it

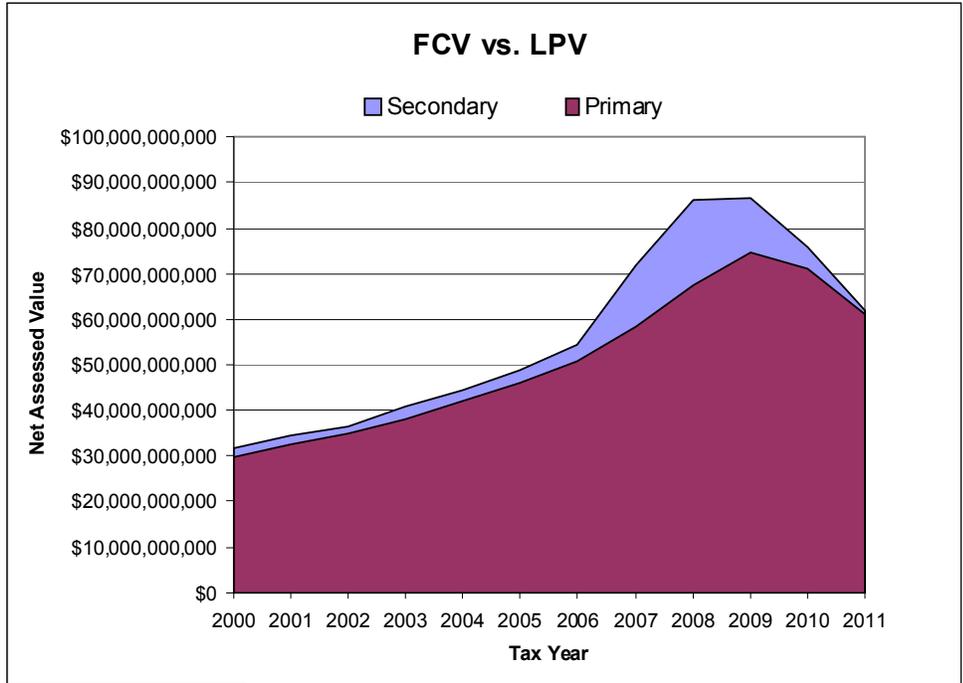


Table 1.

would have prevented \$33 billion in value from being added to the tax rolls that was ultimately removed as a result of the collapse of the real estate market.

If approved by the voters at the November 2012 general election ballot, the reforms provided under this measure will be effective for the 2014 valuation year.

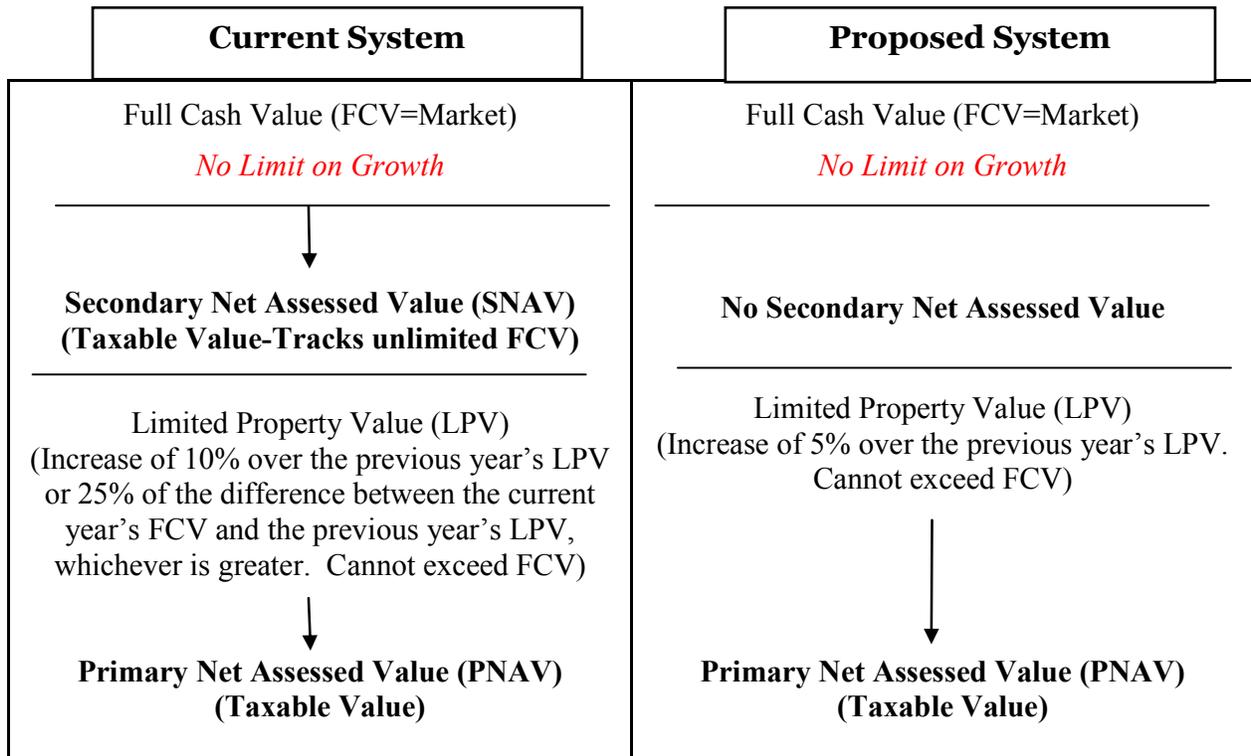


Table 2.