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ARIZONA TAX RESEARCH ASSOCIATION

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LONG-TERM ATRA REFORM GOAL REACHED IN SB1093

For decades, ATRA has led the Arizona business community's effort to reform Arizona's property system. The 2022 legislative session was highlighted with the achievement of one of the organization's long-term goals: the reduction of the business property assessment ratio to 15%. Over the last 30 years, every major study of Arizona's tax system has pointed to a myriad of problems associated with Arizona's property tax classification system that places a higher reliance on business property taxes than other classes of property.

The most notable policy challenge associated with the high assessment ratio on Arizona businesses was the high effective tax rates that significantly limit Arizona's economic development opportunities with businesses looking to locate here. For years, Arizona's business taxes ranked in the top five nationally.

Frustration with high business property taxes resulted in some policymakers trying to side-step the underlying problem by recruiting companies through targeted property tax breaks. ATRA consistently argued against this policy path as the answer to the problem and, along with the broader business community, pushed for reforms for all Arizona businesses.

In addition to passage of SB1093 reducing the class one assessment ratio, ATRA and the business community

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Court Pulls Flat Tax Referral From Ballot

For the second time in recent months, the Arizona Supreme Court handed Arizona taxpayers a major victory with its decision to remove Prop 307 from the November General Election ballot. Prop 307 was an effort by the teacher's union and Stand for Children to refer to the ballot the Legislature's major income tax reduction from the 2021 session.

Following its passage in 2021, opponents successfully circulated petitions to refer sections 13 and 15 of SB1828. Those provisions created a phased-in flat personal income tax of 2.5%. Last year's budget indicated that the fully phased-in impact (Fiscal Year 2025) would reduce individual income taxes $1.5 billion annually.

The Arizona Free Enterprise Club (AFEC) filed a legal challenge to the referendum in July 2021 in Maricopa

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County Superior Court arguing that the tax relief was constitutionally protected from referendum. The case pivoted on the interpretation of the constitutional limitation of the citizen's right to refer the actions of the State Legislature. Article IV, part I (3) of the Arizona Constitution that established the power of citizen referendum also limits that authority by precluding "laws immediately necessary for the preservation of the public peace, health, or safety, or **for the support and maintenance of the departments of the state government and state institutions.**"

AFEC argued that the 1992 Court of Appeals decision in *Wade v. Greenlee County* that ruled that a tax increase was not referable because it was for "support and maintenance of the departments of state government and state institutions" also applied to tax reductions.

In December, 2021 Maricopa County Superior Court Judge Cooper rejected the AFEC argument in a ruling that mostly dismissed the court's reasoning in *Wade* while simultaneously arguing there should be a legal distinction between tax increases and decreases when considering the citizens limits on referendum power.

On January 5, 2022 AFEC appealed the Superior Court decision to the Arizona Supreme Court arguing that it "flies in the face of controlling precedent" established in *Wade v Greenlee County.*

Referendum backers reflexively attacked the Supreme Court's decision as being politically biased. However, considering the precedent set in *Wade,* any other decision from the Supreme Court would have set forth an extraordinary legal and policy dichotomy where state and local tax increases would be immune from voter referenda while tax reductions would not.

A one-sided decision that protected only tax increases from voter referenda would have created a number of potential policy challenges for taxpayers in the future. Article IV, part 1 (3) clearly allows citizens to refer separate sections of legislative acts. In fact, the teacher's union referral of SB1828 was limited to just sections of 13 and 15 of the act. Theoretically, a victory for the union in this case would have created the potential for referrals on portions of major tax reform legislation and not others. In the past, the Arizona Legislature has passed robust tax reform that included both tax increases and decreases in the same bill. Protecting only tax increases from referenda would allow some citizens to cherry pick only the tax reductions in a tax reform bill while others would be precluded from referring the tax increases.

The Supreme Court's decision to create equity between tax increases and decreases provides a rational policy balance between the two legislative actions. Avoiding the disconnect between tax increases and tax reductions will create considerably more clarity and less potential gamesmanship regarding future legislative acts that make comprehensive changes to the tax code.

ARIZONA TAX RESEARCH ASSOCIATION
Michelle Bolton……………………………Chairman
Kevin J. McCarthy……………………………President
Jennifer Stielow……………………………Vice President
Kathleen Farnsworth…………………Office Manager

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1814 W. Washington Street
Phoenix, Arizona 85007
(602) 253-9121

www.arizonatax.org

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were also successful this year in advocating for HB2822 that reduces the assessed value of newly acquired business personal property.

SB1093 Class One Assessment Ratio Reductions

Following passage of last year's tax package that reduced the assessment ratio on business property to 16% through 2025, Senator J.D. Mesnard sponsored SB1093 which drops the ratio further to 15% in 2027.

SB1093 Class 1 Property; SETR

Tax Year	Class 1 A/R	SETR
2026	15.50%	$0.3295
2027	15.00%	$0.2871

Like past class one assessment ratio reduction bills, last year's legislation was accompanied by an increase in the homeowner rebate and tax capacity was granted to Arizona's fire districts by increasing their tax rate cap. This year's legislation again granted fire districts rate relief and additional tax reductions were provided across the board by reducing the state equalization tax rate (SETR) in the last two years of the phase down.

Fire District Tax Rate Relief

Tax Year	Rate Cap
2021	$3.25
2022	$3.375
2023	$3.50
2024	$3.75

As was the case last year, a large business coalition joined forces to advocate for the change including: *Arizona Chamber of Commerce, Building Owners & Managers Association of Greater Phoenix (BOMA), Commercial Real Estate Executives for Economic Development (CREED), East Valley Chambers of Commerce Alliance, Greater Flagstaff Chamber of Commerce, Greater Phoenix Chamber, National Association of Industrial and Office Properties (NAIOP), National Federation of Independent Business (NFIB), and Tucson Metro Chamber.*

		Tax Year						
Class	**Description**	**1980**	**1985**	**1990**	**1995**	**2000**	**2011**	**2016**
1/1	Mines & Utilities	52%	34%	30%	29%	25%	20%	18%
2/1	Telecomm, gas, water, utility, pipeline	44%	34%	30%	29%			
3/1	Commercial/Industrial	25%	25%	25%	25%			
4/2	Vacant Land/Ag	16%	16%	16%	16%	16%	16%	15%
5/3	Residential Owner-Occupied	10%	10%	10%	10%	10%	10%	10%
6/4	Residential Rental	18%	17%	14%	10%	10%	10%	10%

The success in achieving greater equity for business property taxpayers comes after decades of consistent advocacy along with a recognition that policymakers, local governments, and other property taxpayers would only accept the reform in small increments over time.

In 1980, the centrally valued property (CVP) of mines and utilities were assessed as high as 52%, 44% for other CVP, and 25% for all locally assessed (LAP) commercial and industrial property. By 2000, the Legislature had successfully collapsed CVP and LAP into the same class and reduced the assessment ratio of mines and utilities to 25%. Even with the reduced assessment ratio, businesses still paid 2.5 times more in property taxes than residential property that is assessed at only 10%.

In 2005, the Legislature made the passage of business property tax reform a major priority and was successful in reducing the business assessment ratio from 25% to 20% over a ten-year period. To address concerns about impacts to residential property, lawmakers balanced each percentage decrease in the class one ratio with a percentage increase in the homeowner rebate from 35% to 40%. During the 2007 legislative session, the ten-year phase-down was accelerated four years to reach the 20% mark by 2011 instead of 2015.

SB1828 Tax Omnibus

Tax Year	Class 1 A/R	H.O. Rebate
2021	18.00%	47.19%
2022	17.50%	50.00%
2023	17.00%	50.00%
2024	16.50%	50.00%
2025	16.00%	50.00%

By 2011, Arizona's national business tax ranking had improved somewhat by dropping from the top five to 15th highest. During that legislative session, the Legislature enacted a recommendation from Governor Brewer that reduced the business assessment ratio to 18% over four years. The same measure included a reduction in the agricultural classification from 16% to 15% in tax year 2016 and again included another increase in the homeowner rebate.

Business Personal Property Valuation Reduction

Sponsored by Rep. Jeff Weninger, HB2822 reduces the compliance and tax burden associated with business personal property taxes by valuing property that is initially acquired during or after tax year 2022 at 2.5% of the acquisition price. The bill applies only to locally assessed personal property and not to the centrally valued personal property of utilities and mines, for example. Since the reduction applies only to newly acquired personal property, the reduction in the overall personal property tax base will be gradual as existing personal property is fully depreciated.

The business personal property tax is one of the most cumbersome taxes for businesses to comply. Businesses are required to annually report all of their personal property to the county assessor based on the type of property and the year in which the property is acquired for each business location. The county assessor then depreciates the personal property according to tables generated by the Department of Revenue to determine the taxable value. The level of compliance required to report and value personal property appears high compared to the revenue it generates, which is why various tax study committees over the years have recommended reducing the personal property tax as well as its full elimination.

In the early 90's, legislation was enacted to accelerate the depreciation of locally assessed commercial and industrial personal property, which was later expanded to include agricultural property and other types of business personal property. In 1996, the Legislature referred to the ballot a measure that was approved by voters to exempt the first $50,000 in personal property for commercial and agricultural businesses to alleviate the burden on small businesses. Due to a later statutory change in the inflation factor used to adjust the $50,000 exemption, that amount has now increased to $207,366 as of tax year 2022.

As a result of the various legislative changes over the last 25 years, the business personal property tax does not account for a significant amount of state and local property taxes. For example, in the early 2000's, the locally assessed personal property generated approximately $227 million in taxes, or 5.1% of the total tax base. Twenty years later, the taxes generated from the personal property tax have increased only 15% to $261 million, representing just 3% of the tax base.