



The taxpayer's watchdog for over 70 years

ARIZONA TAX RESEARCH ASSOCIATION

2011 LEGISLATIVE PROGRAM

INTRODUCTION/STATE BUDGET

As has been the case for the last three years, this year's ATRA agenda was developed with recognition that the Legislature's highest priority for the session should be addressing the state's chronic budget deficit. Regrettably, despite the previous actions of the Legislature and Governor to both reduce spending and raise taxes, Arizona still faces one of the largest budget deficits in the country. The bottom line is Arizona's financial future, as well as our ability to attract business to our state, rests on state policymakers restoring fiscal stability.

For the sixth-straight year, ATRA will forward to the Governor and Legislature a laundry list of specific recommendations on budget reductions as well as improvements to the state's fiscal management. ATRA's budget recommendations have been expanded to take into account the severity of the state's budget crisis. Clearly, further reductions to on-going spending need to be achieved. To date, on-going general fund spending has been reduced \$1.1 billion from the high-water mark of \$10.6 billion in FY09. Taxes have been increased over \$1.1 billion.

In 2010, ATRA supported Governor Brewer's call for a temporary increase in the state sales tax. ATRA's decision to support a major tax increase during a recession was very difficult. However, ATRA believes the structural deficit needs to be closed in a straight forward manner. Budget gimmicks that avoid the tough but necessary decisions to reduce the deficit only serve to further weaken Arizona's financial future.

ATRA's 2011 budget recommendations will again encourage state leaders to maximize their authority to manage the state's budget crisis. Simply put, this crisis cannot be resolved while simultaneously adhering to stipulations from the federal government to spend money Arizona does not have or strict interpretations of the limitations on the state's budget authority through voter initiatives. *(A detailed list of ATRA's updated budget recommendations will be made available in January 2011.)*

TAXATION

Despite the fact that Arizona taxpayers have already been saddled with statewide increases in property and sales taxes, there will continue to be pressure to increase taxes further. Many of the efforts to increase taxes will be pursued under the banner of "tax reform" or "closing loopholes."

ATRA has consistently cautioned policymakers to first **Do No Harm** when making changes to the state's tax system. Any increase in taxes should avoid aggravating existing problems in

Arizona's state and local tax structure. To that end, state policymakers should avoid, and ATRA will strongly oppose, further increases in business property taxes to close the deficit.

Property Tax

Prevent further increases in property taxes. Following a ten-year streak of decreases in the state average property tax rate, Arizona property taxpayers saw a 47-cent increase in 2010. Despite widespread recognition that Arizona's business property taxes are a major impediment to economic development, there is considerable pressure at the Capitol to increase property taxes as well as increase access to the property tax for local governments.

In addition to the imposition of the state equalization rate in 2009, the Legislature and Governor dramatically expanded the K-12 schools access to the property tax base through a 50% increase in the override authority. Regrettably, those tax increases have undermined some of the progress that has been achieved to reduce business property taxes.

ATRA will oppose efforts to increase both state and local property taxes. In addition, ATRA will advocate for the continued compliance with the state's Truth-in-Taxation (TNT) law. Since its passage in 1998, the state has consistently complied with TNT. In tax year 2010, the TNT law called for an increase in the qualifying tax rate (QTR). However, adherence to the TNT law is an important principle that will benefit taxpayers over time.

Undoubtedly, the budget deficit creates more of a threat for non-compliance with the TNT law. A number of tax increase packages have been developed in recent years that have included calls for increases in the QTR. A JLBC list of options from 2010 contained a recommendation to increase the QTR for K-12 schools to \$4.25, an estimated \$625 million property tax increase.

Property Tax Reform. ATRA has led the effort to reform Arizona's property tax system and reduce the disparity in tax treatment between business and residential property. As the result of previous ATRA-backed legislation passed in 2005 and 2007, the effective tax rate on business properties has improved from 3rd highest in the country to 15th according to the most recent statistics from the Minnesota Taxpayers Association. However, Arizona's policy that shifts taxes from residential property to business continues to be the number one tax impediment in attracting new industry to Arizona.

- **Assessment Ratio Reductions** - ATRA will pursue reductions in the class one assessment ratio from 20% to 19% in 2012 and 18% in 2013. These reductions will also be accompanied by a reduction in the class 2 assessment ratio from 16% to 15% in 2012.
- **Full Cash Value Limitations** – ATRA will support a constitutional amendment for the 2012 general election ballot to limit the annual growth in locally assessed valuations to 5%.

- **County-wide Secondary Levy Limits** – ATRA will pursue legislation to place levy limitations on the following countywide special districts: Library Districts, Public Health Services Districts, and Jail Districts. These countywide special district levies should be limited to the same percentage growth as the annual increase in the county’s primary levy limit.
- **Sunset of Enterprise Zone Program** – ATRA will support the scheduled sunset of July 1, 2011, of the property tax incentives that are part of the state’s enterprise zone program.

Corporate Income Tax

- **Elective Service Sales Factor** – ATRA will support an amendment to the corporate income tax sales factor allocation to allow multi-state service companies the option to tax services at the location of the customer vs. the location of the income producing activity.
- **Net Operating Loss Carryforward** – ATRA will pursue legislation that extends the current five-year limit on net operating loss carryforwards to 20 years for losses arising in tax years beginning from and after 12/31/2010.

Sales Tax

- **City Sales Tax Reform** – Arizona businesses are burdened with arguably the most complicated sales tax system in the country. Much of that burden is grounded in Arizona’s independent municipal sales tax structure that allows cities to levy taxes on a different tax base than the state as well as collect and audit those taxes independently of the state. ATRA will pursue legislation to reform the sales tax code and create greater uniformity between the state and city sales tax bases. Specifically, the proposal will allow cities to continue to tax the major categories that differ from the state (i.e. food, commercial leases, residential rentals, and advertising). Those city options would become part of state law and cities would be preempted from expanding to other areas without amending state statute.
- **Prohibit cities from contracting with a non-government third party for the collection of taxes and contingent-based audits.** Historically, most Arizona cities and towns have relied on the Arizona Department of Revenue for the collection of their local sales taxes. Over the years, many of Arizona’s larger cities created their own tax departments for the collection and audit of city sales taxes. Regrettably, the Arizona League of Cities and Towns has engaged an out-of-state firm to begin contracting with cities that are currently in the state’s collection program for both the collection and auditing of their local sales tax.

In addition to being extremely bad public policy, ATRA believes that cities do not have the legal authority to contract out their tax and collection powers to a private company. ATRA will pursue legislation to make clear that cities and towns do not

have the authority to contract out their tax and collection powers to a third party for – profit entity.

- **Require the Arizona Department of Revenue to maintain the official version of the Model City Tax Code and make it available on the Department’s website.** Currently, the Model City Tax Code is maintained by a private entity, the League of Arizona Cities and Towns. ATRA believes that an accurate and up-to-date version of the Model City Tax Code should be maintained by the state and be available on the DOR website.
- **Oppose the wholesale expansion of the sales tax base.** Arizona’s on-going budget deficit has led to numerous recommendations to dramatically raise sales taxes through the wholesale elimination of most exemptions and deductions that currently define Arizona’s transaction privilege tax (sales tax) base. The advocates for sweeping expansion of the sales tax base ignore that Arizona already has a very broad sales tax base and eliminating many of the exemptions and deductions would result in double taxation of many business inputs.

Public Finance/Other

- **Taxpayer Information Rulings; Unclaimed Property** – ATRA will pursue legislation to extend the current law that allows taxpayers to seek tax guidance from the Department of Revenue for sales and income tax issues to unclaimed property tax issues.
- **Taxpayer Bill of Rights; Extensive Taxpayer Misunderstanding** – ATRA will pursue legislation to narrow the Department of Revenue’s current position regarding the definition of “affected class” for purposes of determining if there has been an extensive misunderstanding of the tax laws.
- **Public Pension Reform** – As was the case in the 2010 session (HB2389), ATRA will support reforms to each of Arizona’s four defined benefit retirement plans. Those reforms are currently being developed in cooperation with legislative leadership.
- **Public Health Services Districts** – ATRA will pursue legislation that would require a county board of supervisors to receive voter approval prior to creating a Public Health Services District.
- **Fire District Assistance Tax** – ATRA will pursue legislation capping the maximum fire district assistance tax distributed to any district at \$300,000.
- **US Census Bureau Reporting** – ATRA will pursue legislation to transfer Arizona’s reporting of public finance/tax information to the U.S. Census Bureau from ASU to JLBC.