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# ARIZONA TAX RESEARCH ASSOCIATION

## 2018 LEGISLATIVE PROGRAM

### **Introduction/State Budget**

ATRA's legislative program is developed each year with recognition that the Legislature and Governor's highest priority for the session should be passing a state budget that is not only balanced but is sustainable. The preeminent challenge facing state policymakers is ensuring the FY 2019 budget is structurally balanced – meaning ongoing spending does not exceed ongoing revenue and that one-time revenue (rainy day fund and cash balance) is not appropriated for ongoing spending.

ATRA will provide updated state budget recommendations to the Legislature after the Joint Legislative Budget Committee (JLBC) and the Office of Strategic Planning and Budgeting (OSPB) have submitted their recommendations for the FY 2019 budget.

### **Taxation**

#### **Property Tax**

**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 a result of previous ATRA-backed legislation passed in 2005, 2007, and 2011, steady progress has been made in reforming the underlying policies that drive Arizona's high business property taxes. That progress is the direct result of policymakers addressing the root cause of that problem: the shift of taxes from residential property to business through higher assessment ratios on business property.

Most legislative sessions include debates surrounding reforms to Arizona's tax code. ATRA believes any effort to reform Arizona's tax system should include further reductions to the class one assessment ratio with the ultimate goal of 15%.

In recent years state policymakers have struggled with the myriad of negative impacts associated with the 1% constitutional cap on homeowner primary property taxes. Pima County successfully challenged the 2015 legislation that shifted the state's responsibility to subsidize the 1% cap to local governments. As a result, the state's taxpayers are back on the hook for subsidizing the high tax rates of many local governments. In addition, the subsidy continues to incentivize those local governments to raise rates on non-residential taxpayers that are not protected by the cap. ATRA will support efforts to limit the state's exposure to 1% cap shifts from high tax jurisdictions while ensuring those changes do not result in spiraling tax rates in 1% cap jurisdictions.

**Prevent greater access to the property tax.** For the 2018 session, ATRA will oppose efforts on the part of Arizona local governments and special districts to increase access to the property tax base. Despite widespread recognition that Arizona's business property taxes are a major

impediment to economic development, there is considerable pressure each year at the Capitol to increase access to the property tax.

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 the TNT law. For the last four years, the Qualifying Tax Rate and the State Equalization Tax Rate have fallen as a result of the TNT law. While that rate has both risen and fallen with the fluctuations in the real estate market, ATRA believes adherence to the TNT law is an important principle that will benefit taxpayers over time.

**Targeted Property Tax Breaks.** For decades, ATRA has led the effort at the Capitol to oppose rifle-shot property tax breaks to specific industries. ATRA will continue to support policies that provide for equitable treatment among property taxpayers and oppose efforts that undermine that important policy principle.

***For the 2018 session, ATRA will pursue the following legislation:***

**Prospectively Close ABOR Tax-Free Zones (Representative Leach)**

Private improvements on public land are taxed via the Improvements on a Possessory Right (IPR) tax. However if the improvement is "leased back" to a governmental entity, there is no mechanism in law to tax that possessory interest except for Government Property Lease Excise Tax (GPLET), which only applies to cities, counties and some special districts. The Arizona Board of Regents through the Universities have begun aggressively using their tax-exempt status to enter the real-estate development business. For years this occurred primarily on university Research Parks, which were supposed to be areas where private business would work with the universities to bring research to market. For the most part, they have simply become a tax-free zone.

The most curious case has occurred at Arizona State, where normal university property was converted into the State Farm facility on Tempe Town Lake using a 99 year "lease back" arrangement. Instead of paying millions in property taxes to local governments including K-12 schools, the development pays a small tariff to ASU. Harvesting local government revenue to benefit University budgets is a policy which much be curbed.

The legislation will seek to prospectively deny development agreements for "lease back" deals on ABOR land except for legitimate university purposes. Private development may continue on campus, however they will be subject to tax like any other business. The bill will require legislative approval for increases in the footprint of the existing Research Parks.

**Reform of the GPLET Slum and Blight Designation (Representative Leach)**

Following the 2017 bill which made several reforms to GPLET, ATRA will seek legislation to reform the slum and blight provisions. These reforms were removed from the introduced version last session in an attempt to focus the debate and spend more time studying the issue. The 2018 effort will focus on bringing meaning to the public benefit of the property tax abatement in GPLET, which is the entire justification for the taxpayer subsidized incentive.

The legislation will require municipalities to revisit slum and blight designations every ten years (currently no limit). Each project will need to be publicly discussed by the governing body and appropriately linked to the resulting public benefit from blight reduction. Instead of relying

solely on existing definitions of slum and blight which are specious and vague, newer and clearer standards will be added which jurisdictions must use to justify the public benefit of the incentive.

### **Cap the K-12 Transportation Hold Harmless Tax (Representative Norgaard)**

The K-12 finance formula equalizes the cost of general fund budgets so property taxpayers and the state general fund share the burden. School districts are funded formulaically based on actual route miles driven for school and extracurricular activities. However, school districts may add an additional local property tax in order to spend at their historic high transportation budget. This currently costs taxpayers \$79 million per year and has grown substantially in the last several years. It is a significant source of inequitable spending as older districts which have contracted in size spend more per pupil than growing or younger districts as well as charter schools. It was recognized in the Governor's Classrooms First Council as one of the problem areas in school finance in need of reform.

The difference between the state formula and the hold harmless amount is known as the "Transpo Delta" which represents the amount local taxpayers pay in addition to normal K-12 taxes. This 2018 legislation proposes to cap that amount at current levels so the problem does not continue to exacerbate. Eventually the program ought to be phased out but a cap will limit the damage and improve the chances of larger reform efforts in the future.

### **Refine the K-12 Primary Property Tax Calculation (Representative Norgaard)**

In 2016 the Legislature passed HB2481 which simplified the way primary property tax rates are calculated for general fund budgets for K-12 school districts. The implementation of that bill began for FY 2018 and demonstrated that school rates became far more predictable and easier to understand. While the change has been rather successful, the first year of implementation highlighted a few limitations of the initial bill.

This year's proposal will ensure all nonformula programs are included in the additional tax rates to ensure the correct cash is levied by school districts. It will also clarify that K-8 and 9-12 budgets are calculated separately, which is the longstanding treatment. Finally it will provide County School Superintendents the ability to correct cash deficits which occurred legally by obtaining approval from the County Board of Supervisors.

## **Sales Tax**

### **Clarify Taxation of Digital Goods/Services (Representative Michelle Ugenti-Rita and Senator David Farnsworth)**

In recognition of the findings and recommendations of the Ad Hoc Joint Legislative Study Committee, ATRA will pursue legislation updating Arizona's tax code related to the taxation of Digital Goods and Services (DGS). The primary thrust of the bill will be to codify longstanding TPT treatment on digital goods where a user takes control of software or a digital good while halting the recent advance by the Department of Revenue to tax services provided digitally.

The legislation will define and clarify the difference between prewritten software and digital goods that have been taxable in administrative rule only versus DGS which are not and should not be taxable. The bill will make clear both nexus and sourcing rules to ensure taxpayer compliance is simple and understandable.

## **Prime Contracting**

For decades, Arizona's prime contracting tax has arguably been the most complicated, inefficient and controversial area of the sales tax code. The 2013 TPT reforms carved out service contractors doing maintenance, repair, and replacement on existing property. Those reforms were modified in 2014 and 2015 in an attempt to create greater certainty for contractors and tax agencies regarding the line between maintenance, repair, replacement, and alteration (MRRA) projects and prime contracting.

ATRA will support continued efforts to move toward the elimination of the prime contracting tax in favor of a tax on construction materials at retail in order to reduce the tax compliance burden on businesses and state and local governments.

### **TPT Audit Appeals – Direct Appeal to Tax Court**

A taxpayer that disagrees with a proposed audit assessment from DOR may appeal to the Office of Administrative Hearings (OAH). A taxpayer that is not satisfied with an OAH decision may appeal directly to the Director of the Department of Revenue or the Board of Tax Appeals (BOTA). BOTA decisions may further be appealed to Tax Court.

The current appeals process appears to be broken. Very few appeals to OAH are decided in the favor of taxpayers. Additionally, the process can be lengthy due to lack of deadlines and the requirement of OAH to follow procedural rules. ATRA will pursue legislation that will allow taxpayers to skip OAH and BOTA and appeal directly to Tax Court.

## **Public Finance**

### **Reform the Certificates of Necessity (CON) Approval Process (Rep. Carter)**

The Department of Health Services (DHS) is responsible for certifying public and private emergency medical service (EMS) providers through the CON process. It has been generally understood that entities seeking to either acquire a new or expand an existing CON area request approval from DHS through this process. However in recent years, fire districts have successfully argued to DHS that an expansion to their CON area should be automatic when they merge or consolidate.

During the 2017 session, legislation was advanced that ultimately resulted in the creation of an Ad Hoc study committee to evaluate the expansion of CON service areas. Following testimony from both public and private EMS providers, the study committee recommended that fire districts who merge or consolidate adhere to the existing CON process. ATRA will support legislation that furthers the study committee's recommendation and also applies to property that is annexed into fire district territory.