

The Impact of *Wayfair* in Arizona

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The Impact of *Wayfair* in Arizona

On June 21, the United States Supreme Court rocked the state and local tax world with a decision that overruled their 26-year-old decision in the *Quill* case and may eventually permit state and local governments to collect as much as \$33 billion per year from remote vendors.

Is Arizona ready to collect its share of up to \$293 million per year?

The Impact of *Wayfair* in Arizona

Today's Presentation Addresses:

1. The State of the Law Before *Wayfair*
2. *Wayfair*'s Holding
3. *Wayfair*'s Impact on Arizona's State Tax System
4. *Wayfair*'s Impact on Municipal Taxes in Arizona

The State of the Law Before *Wayfair*

The United States Constitution grants Congress the power to regulate interstate commerce. When state legislation impacts interstate commerce in ways not addressed by Congress, courts rely on two primary principles to determine whether the state law is lawful: (1) state laws may not discriminate against interstate commerce, and (2) states may not impose undue burdens on interstate commerce.

The State of the Law Before *Wayfair*

In the 1977 *Complete Auto Transit* case, the Court outlined a four-part test to determine whether state taxes on transactions involving interstate commerce are lawful.

Under the test, the Court will sustain a tax so long as it (1) applies to an activity with a **substantial nexus** with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services the state provides.

The State of the Law Before *Wayfair*

In the 1992 *Quill* case, which until *Wayfair* was the most recent case interpreting the “substantial nexus” prong of the *Complete Auto* test for sales tax purposes, the Court reconsidered whether a taxpayer must establish physical presence in a state in order for the state to impose a use tax collection obligation on a remote seller.

The Court held that, for Commerce Clause (but no longer Due Process Clause) purposes, physical presence still was required.

Wayfair's Holding

In *Wayfair*, the Court overruled *Quill*'s physical presence requirement and determined that South Dakota's economic nexus statute, which requires \$100,000 in annual sales to in-state customers or 200 annual transactions with South Dakota customers, satisfies the substantial nexus prong of the four-part *Complete Auto* test used to gauge whether state taxes that apply to transactions in interstate commerce are permissible under the commerce clause.

Wayfair's Holding

After killing *Quill*, the Court remanded the *Wayfair* case to the South Dakota Supreme Court to ensure that the state's law does not otherwise discriminate against or impose undue burdens on interstate commerce — like by violating another prong of the *Complete Auto* test, for example.

Wayfair's Holding

When doing so, the *Wayfair* opinion highlighted three key features of South Dakota's tax system that it said "appear designed to prevent discrimination against or undue burdens upon interstate commerce." First, it has a safe harbor for those who only conduct limited business in the state. Second, affected business have no retroactive obligation to remit taxes. Third, South Dakota adopted the Streamlined Sales and Use Tax Agreement (SSUTA). These critical features of South Dakota's tax system are conspicuously absent from Arizona's.

Wayfair's Impact on State Taxes in Arizona

If Arizona wants to collect taxes from remote sellers, its Legislature will have to implement significant changes to its tax code and, like the South Dakota law upheld in *Wayfair*, they cannot be retroactive.

To begin, Arizona does not have a statute like South Dakota's that imposes a tax collection obligation on remote vendors that have at least \$100,000 in sales to customers in the state or engage in at least 200 transactions with customers in the state annually.

Wayfair's Impact on State Taxes in Arizona

In addition, the *Wayfair* opinion emphasized some SSUTA features that South Dakota adopted to reduce administrative burdens and compliance costs for taxpayers, including state-level tax administration, uniform definitions of products and services, simplified tax rate structures, uniform rules, and tax administration software provided by the state, the use of which immunizes sellers from audit liability.

Wayfair's Impact on State Taxes in Arizona

Arizona has not adopted the SSUTA or *any* of its features that were designed to reduce administrative and compliance costs for taxpayers. Worse yet, Arizona permits its municipalities to select from over 50 tax base options, which results in many tax base differences *between the 91 Arizona municipalities* that impose sales taxes *in addition to differences between each municipality and the state.*

Wayfair's Impact on State Taxes in Arizona

Perhaps the Council On State Taxation's April 2018 Scorecard on State Sales and Use Tax Administration best summarized the difference between South Dakota's sales tax system and Arizona's sales tax system when it awarded South Dakota an "A" and assigned Arizona a "D" on simplicity and transparency grounds.

Wayfair's Impact on State Taxes in Arizona

In addition to Arizona not having adopted the SSUTA and allowing its municipalities to select from over 50 tax base options, the state permits each of its municipalities to levy taxes under their own separate tax code. This alone makes Arizona's tax system one of the most burdensome, difficult, and expensive among the states for taxpayers to comply with.

Wayfair's Impact on State Taxes in Arizona

In sum, if Arizona wants to collect its share of taxes from remote sellers — recently estimated at up to \$293 million annually — its Legislature will have to implement significant tax code changes. However, Arizona's Republican-dominated Legislature and Gov. Ducey are unlikely to enact legislation to raise taxes.

Wayfair's Impact on State Taxes in Arizona

If Arizona chooses to level the playing field between local and remote vendors, that would be the perfect time to enact other important tax code changes that opponents have argued would cost the state too much money. For instance, the Legislature could specify which digital goods and services it wants to tax going forward, but at the same time acknowledge that digital goods and services were not subject to tax in the past.

Likewise, the state could dramatically simplify the way it taxes construction contractors by collecting taxes on building materials, like most other states do. After implementing these changes, if the state still is collecting more money on a net basis, one or more automatic triggers could kick in to reduce tax rates for all taxpayers.

Wayfair's Impact on Municipal Taxes in Arizona

The other 41 states impose municipal sales taxes under their state tax codes and distribute a portion of the taxes they collect to their municipalities.

Because municipal sales taxes in most other states are imposed under state tax codes, when those states have sufficient nexus to collect sales taxes from transactions in interstate commerce, the municipalities in those states receive a portion of the taxes the state collects.

Wayfair's Impact on Municipal Taxes in Arizona

Given the size of Arizona's municipalities and their autonomous taxing authority, while the world's largest remote vendors probably would trigger nexus in Arizona's largest cities (if they enact economic nexus ordinances) in a post-*Wayfair* world, most vendors probably still would not trigger nexus in most Arizona municipalities.

Accordingly, if Arizona municipalities want to benefit from the *Wayfair* decision, they should abandon their separate tax codes in favor of a single, state-wide tax code.

Wayfair's Impact on Municipal Taxes in Arizona

In fact, even if the cities are not ready to voluntarily abandon their separate tax codes but the State of Arizona wants to begin collecting taxes from remote vendors, it may have to force the cities to collect taxes under a single, simplified tax code because the courts probably would conclude that forcing remote vendors to collect and remit taxes under the state's existing tax system would unlawfully burden and/or discriminate against interstate commerce.

South Dakota v. Wayfair

Christie Comanita, Director of Research and State Compliance
Streamlined Sales Tax Governing Board, Inc.

South Dakota v. Wayfair - The Decision

- ▶ U.S. Supreme Court on June 21, 2018 issued its decision in *Wayfair* that overturned a physical presence requirement for sales/use tax collection
- ▶ Court specifically held:
 - ▶ “...the Court concludes that the physical presence rule of *Quill* is unsound and incorrect. The Court’s decisions in *Quill Corp. v. North Dakota*, 504 U. S. 298 (1992), and *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U. S. 753 (1967), should be, and now are, overruled.”
- ▶ “...the case is remanded for further proceedings not inconsistent with this opinion.”

South Dakota v. Wayfair - The Decision

- ▶ The Court only addressed the first prong of *Comptech Auto's (1977)* four prong test - the prong that requires a taxpayer have “substantial nexus with the taxing state” before the taxpayer can be subject to a state’s tax
- ▶ South Dakota’s \$100,000 in sales or 200 transactions held by the Court to be sufficient because “the seller availed itself of the substantial privilege of carrying on a business in South Dakota”

South Dakota v. Wayfair - The Decision

▶ *Wayfair* case is not final

- ▶ “Physical presence” is gone
- ▶ Remanded back to South Dakota to address “..whether some other principle in the Court’s Commerce Clause doctrine might invalidate the Act.”
- ▶ Supreme Court noted “...these issues have not yet been litigated or briefed, and so the Court need not resolve them here.”

South Dakota v. Wayfair - The Decision

▶ *Wayfair* case is not final

- ▶ Supreme Court Opinion indicated the following with respect to the Commerce Clause:

“Modern precedents rest upon two primary principles that mark the boundaries of a State’s authority to regulate interstate commerce. First, state regulations may not discriminate against interstate commerce; and second, **States may not impose undue burdens on interstate commerce...**”

- ▶ “...the Quill majority concluded that the physical presence rule was necessary to prevent undue burdens on interstate commerce.”

South Dakota v. Wayfair - The Decision

- ▶ Opinion indicated: “...Concerns that complex state tax systems could be a burden on small business are answered in part by noting that, as discussed below, there are various plans already in place to simplify collection...”

South Dakota v. Wayfair - The Decision

- ▶ Opinion identified three features in South Dakota law “...that appear designed to prevent discrimination or undue burdens upon interstate commerce.”
 - ▶ Safe harbor for those with limited business
 - ▶ No retroactivity
 - ▶ Member of Streamlined

South Dakota v. Wayfair - The Decision

- ▶ **Specific Items Noted in *Wayfair* Decision Related to Streamlined**
 - ▶ Standardizes taxes to reduce administrative and compliance costs
 - ▶ Single, state level administration
 - ▶ Uniform definitions of products and services
 - ▶ Simplified tax rate structures
 - ▶ “Other uniform rules”
 - ▶ Access to “sales tax administration software paid for by the state”
 - ▶ Audit protections

Questions?

Implementing the Decision

Fair, Efficient and Transparent Implementation

Streamlined Press Release

Streamlined Sales Tax Governing Board Responds to Supreme Court's South Dakota v. Wayfair Decision

June 21, 2018

Westby, WI – The Streamlined Sales Tax Governing Board released the following statement in response to the U.S. Supreme Court’s decision in South Dakota v. Wayfair, which grants states that have implemented certain simplifications the authority to enforce their sales tax laws on remote sellers:

“We applaud the U.S. Supreme Court’s decision in South Dakota v. Wayfair **removing the physical presence requirement and recognizing that South Dakota and similarly situated states have removed the “undue burdens” with which the Court was concerned in its 1992 Quill decision.** South Dakota and the other Streamlined member states recognized that if they wanted the authority to require remote sellers to collect and remit their state and local sales taxes, the “undue burdens” on interstate commerce needed to be removed. Through an **open and cooperative process** between the states and the business community, the Streamlined Sales and Use Tax Agreement was developed. This Agreement contains numerous simplification and uniformity requirements states must adopt to remove or reduce the undue burdens on all sellers. We understand that the work to implement this decision in a fair and efficient manner has just begun. As we have done over the last 18 plus years, we will continue to work with the business community to ensure that implementation of this decision is **fair, efficient and transparent for all taxpayers and administrable for sellers, purchasers and the states.**”

Implementing the Decision

- ▶ Streamlined Preparations
 - ▶ Uniform messaging
 - ▶ Impact of decision
 - ▶ What remote seller's need to do
 - ▶ Common questions
 - ▶ State contact information
 - ▶ ALL states
 - ▶ Implementation date
 - ▶ Individual State issues
 - ▶ Legislation needed?

Implementing the Decision

- ▶ Streamlined Preparations (cont'd)
 - ▶ Taxability Matrix
 - ▶ Taxable Services and Exemption Matrix
 - ▶ Rate and Boundary database
 - ▶ Outreach to Non-member States
 - ▶ Considering membership?
 - ▶ [State Guide to the Streamlined Sales Tax Project](#)

Implementing the Decision

**Other Issues to
Consider?**

Contact Information

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AZ K-12 Finance Reform

ATRA Outlook

2018



Topics

- Recent Spending, Trends
- Reform Goals
- Reform Frameworks
- Message to Policymakers



Trend: New Spending without Reform

- New spending has solved legal & political challenges
- State has committed to add more than \$1.3B without reforms
 - Ongoing, annual monies on top of population & inflation adjustments
- Prop 123: ~\$350M *Resolved Cave Creek lawsuit*
- DAA restoration: ~\$352M + \$ (Year 1 of 3 complete) *Hopes to solve Capital Facilities Lawsuit*
- 20x2020: ~\$600M (Year 1 of 3 complete) *Teacher Pay Issue*



What Impact Does 20x2020 have?

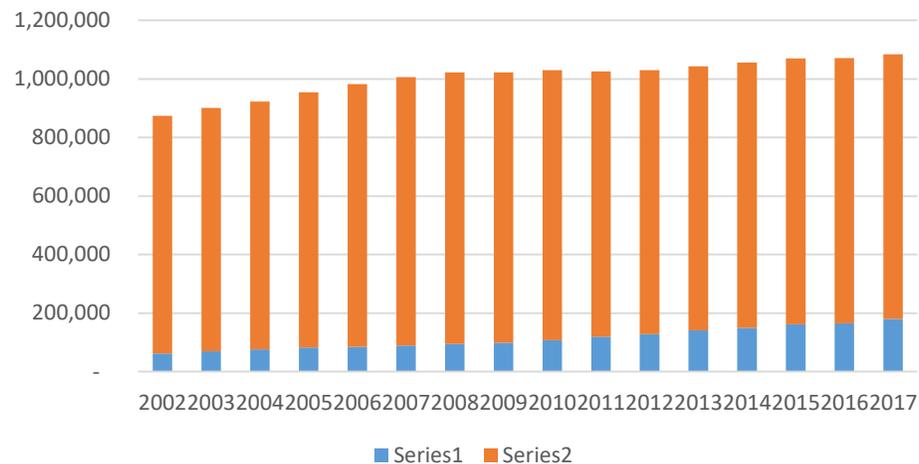
	State	Salary est (\$)	RANK (2019)	COLI	INDEX
1	D.C.	80,450	4	103	78,183
2	Michigan	65,825	11	90	73,383
3	Pennsylvania	69,139	10	102	67,783
4	Illinois	65,097	12	97	66,972
5	Ohio	59,896	21	92	64,892
6	Wyoming	61,699	16	96	64,538
7	New York	83,997	1	133	63,394
8	Georgia	57,507	23	91	63,334
9	Iowa	57,747	22	91	63,249
	United States	61,925	-	100	61,925
10	Massachusetts	81,693	3	133	61,469
11	Connecticut	76,421	5	126	60,796
12	Minnesota	60,397	19	100	60,578
13	Texas	55,066	28	91	60,379
14	New Jersey	73,574	6	122	60,356
15	Wisconsin	57,427	24	96	59,696
16	Arizona	56,662	26	96	59,269
17	Indiana	53,819	32	91	59,077
18	Kentucky	55,325	27	94	59,045
19	Nebraska	54,531	29	93	58,699
20	Arkansas	51,169	39	88	58,279
21	California	81,903	2	141	58,087
22	Nevada	60,428	18	105	57,716
23	Alabama	51,488	38	90	57,018
24	Tennessee	51,168	40	90	56,980
25	Rhode Island	70,249	9	124	56,836
26	Missouri	50,892	41	90	56,610
27	Kansas	50,678	43	90	56,184
28	Louisiana	52,790	35	94	55,921
29	Maryland	70,524	8	129	54,797
30	Alaska	71,571	7	131	54,510
31	Montana	54,158	30	100	53,942
32	Oklahoma	48,047	49	89	53,865
33	North Carolina	50,875	42	95	53,779
34	North Dakota	53,561	34	100	53,722
35	Mississippi	45,360	50	85	53,302
36	Washington	57,027	25	107	53,247
37	Idaho	48,945	47	92	53,086
38	Virginia	53,945	31	102	52,784
39	New Mexico	50,050	44	95	52,739
40	Florida	52,210	36	99	52,578
41	New Hampshire	60,081	20	115	52,245
42	South Carolina	51,754	37	100	52,014
43	Utah	49,757	45	96	51,993
44	Vermont	62,506	15	121	51,786
45	West Virginia	48,414	48	96	50,484
46	Oregon	64,053	13	129	49,539
47	Colorado	48,980	46	102	47,879
48	Maine	53,589	33	114	47,173
49	South Dakota	44,597	51	100	44,821
50	Delaware	63,630	14	156	40,867
51	Hawaii	60,946	17	188	32,367

- 20% increase over 3 years may move AZ average pay rank from #40 to #16
 - Using NEA data, AZ avg pay projects to ~\$56,600
 - This is adjusted for cost of living (COLI), unadjusted rank would be #26
 - Assumes every other state grows pay 2% in each of the 3 years (9% in aggregate)
- ERE costs remain a problem
 - Healthcare costs continue to eat into salary
 - ASRS costs 11.64% of salary for both teacher/employer
 - Discussions about creating a Defined Contribution option

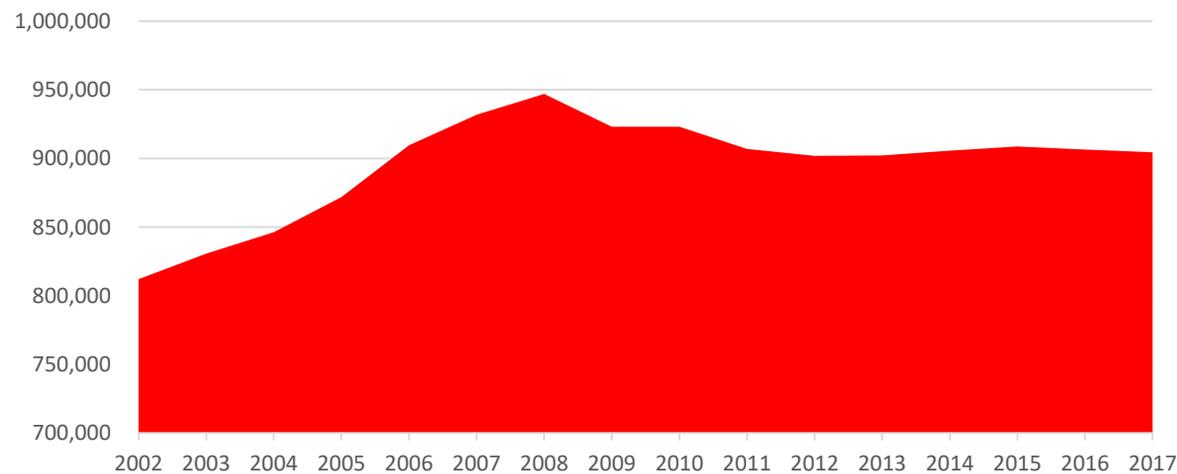


Student Demographic Trends

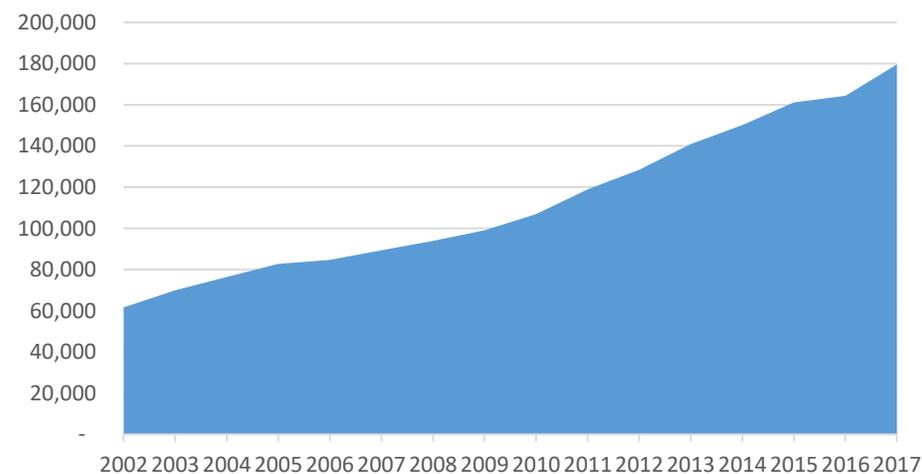
AZ K-12 ADM Count



District Growth



Charter Growth





School Finance problems are well documented

- Every blue ribbon committee has ID'd the problems
 - Nonformula and hold harmless monies which don't follow the student
 - Outdated 'weights' for SPED, small, rural, teacher experience
 - Charters get more State Aid while Districts access nonformula spending
 - Taxpayers inputs vary & students 'purchasing power' varies
- Regrettably, reform is difficult without large sums of new money to 'smooth' problems
 - i.e. Excess Utilities eliminated with passage of Prop 301
- A major overhaul will require significant political leadership
 - Even with new money, there will be resistance to reform
 - Perceived gains for some are viewed as threats, even if they're held harmless
 - Those with major advantages will fight to maintain them



Local Voter-Approved Tax Options for Districts

- All subject to voter approval
- Overrides
 - M&O may ask up to 15% of budget
 - \$477M statewide
 - 78% of pupils in a district with M&O override
 - Capital may ask up to 10% of budget
 - \$82M statewide
 - 25% of pupils in a district with Capital Override
- Bonds (debt for capital)
 - \$650M+ in debt service
 - 90% of pupils in district with bond program
- Combined: \$1.3B in FY19; **up 25% in 5 years**



Reform Goals for Taxpayers

- Improve the funding formula to create greater equity
 - Fairness issue: kids should be worth the same in the same system
 - Funding should follow student as much as possible
 - Only fair under an open enrollment system
- Eliminate the ‘Our outcomes are bad because of funding’ argument
 - Schools are competing for students on a level playing field
 - Parents will not accept this if system is fair
- Make system less ripe for litigation
 - Courts require adequate facilities for districts
 - Adequacy lawsuits far less successful; tough to prove
 - Funding must be equitable
 - Courts ruled charters and districts may be funded differently
 - State most liable in an equity lawsuit between districts



ATRA + Biz Community Goals

- Biz Community should not agree to a tax increase unless accompanied with significant reforms
 - Revenues from increased tax are used to ‘buy equity’
 - Not simply revenue on top of an inequitable system
- Any tax increase should do as little harm to tax system & economy
- The greater the new revenue, the more aggressive the reform
- Reforms should ideally be on both tax inputs and spending
- Working with business groups to formally support these principles



Frameworks for Reform

- Exchange
 - i.e. revamp SPED weights in exchange for nonformula funding phase out
 - i.e. new weight for small and isolated could replace Small School Adjustment
 - “Faster” reform but more controversial among schools; winners & losers
 - “Focused” reform will be described as ‘narrow’
- Dollar for dollar reform
 - A new formula dollar reduces a nonformula dollar, holding them harmless
 - Must be tracked individually because student count changes complicate
 - “Slower” reform but some LEAs have offered this as a viable path
 - May allow for broader reform



Revenue Options

- Sales Tax
 - Some pushing for an increase to Prop 301 with a ballot referral
 - Progressive groups suggested they would only support a small increase
 - Calls for expanding base (trickier with Prop 126 passing)
- Income Tax
 - Progressive groups calling for increased Personal & Corporate Income Taxes
 - Some suggested keeping the revenue generated from straight conformity
- Property Tax
 - Calls for boosting minimum QTR aka 'statewide QTR' or 'uniform rate'
 - Or increasing the current state rate (SETR)



Property Tax Reform

- First: Do no harm to our current property tax problem
 - AZ Biz Property Taxes rank high nationwide
 - Businesses are taxed on 18% while homeowners taxed on 10%
- Biz Community should reject property tax increases without reform
- Most K-12 formula inequities are paid by local property taxes



Message to Policymakers

- System was far more broken & difficult to fix in 1980 than today
 - Lawmakers forced a few districts to spend less while most got more
 - Heavily contested but the system was better off when complete
- Prop 301 last year proved a 2/3 vote is not impossible
- A modern reform will be hard but rewarding
 - Might take 2-3 years, political capital, and new money
 - Will be controversial and likely opposed by some
 - Could set the framework for decades to come
- 2019 could be a year for smaller, easier fixes
 - A grand effort which fails in 2019 would be counter productive



ARIZONA TAX RESEARCH ASSOCIATION

Questions?

ARIZONA TAX RESEARCH ASSOCIATION



Arizona Tax Research Association

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Arizona Education Finance Modernization

ACCELERATING ARIZONA'S PROGRESS

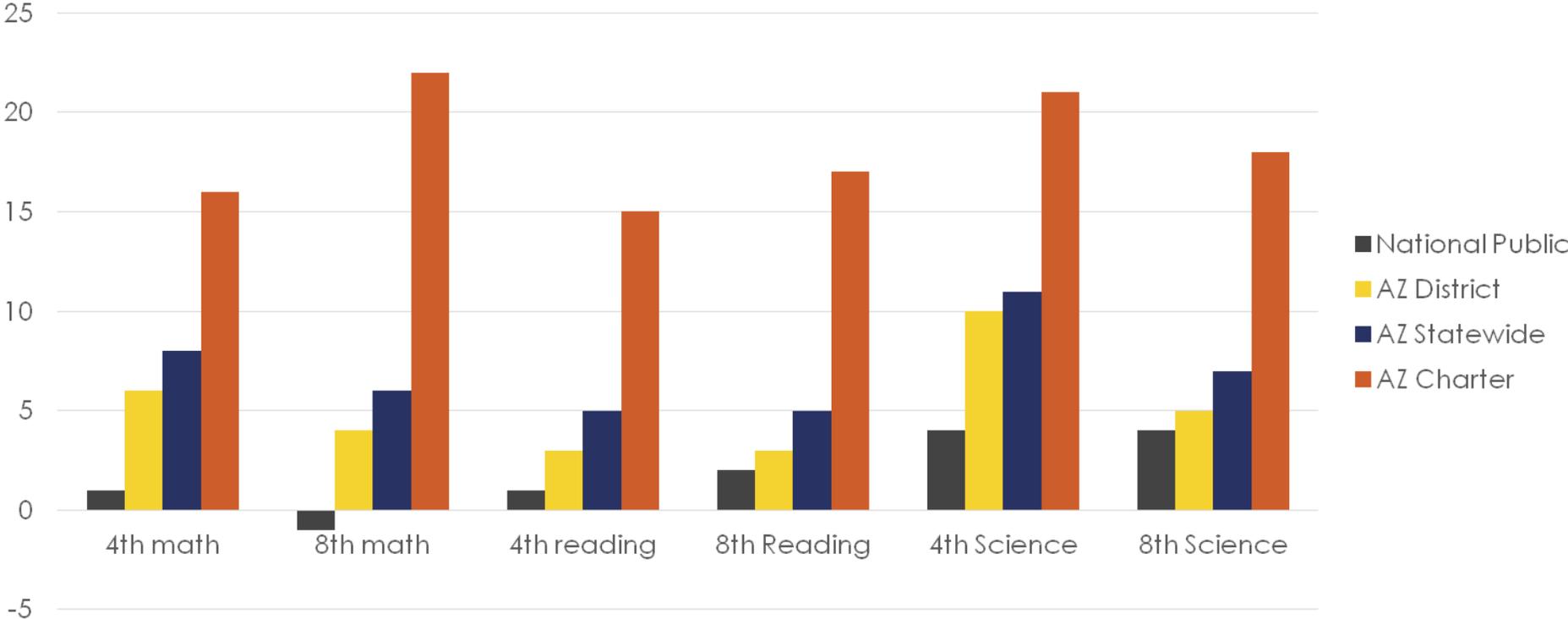


The **goal** of the Funding Formula must be to ensure all students have access to a **quality school**.

Arizona is making unprecedented **academic gains**. Finance formula changes will either accelerate this progress or thwart it.

National Assessment for Educational Progress (NAEP)

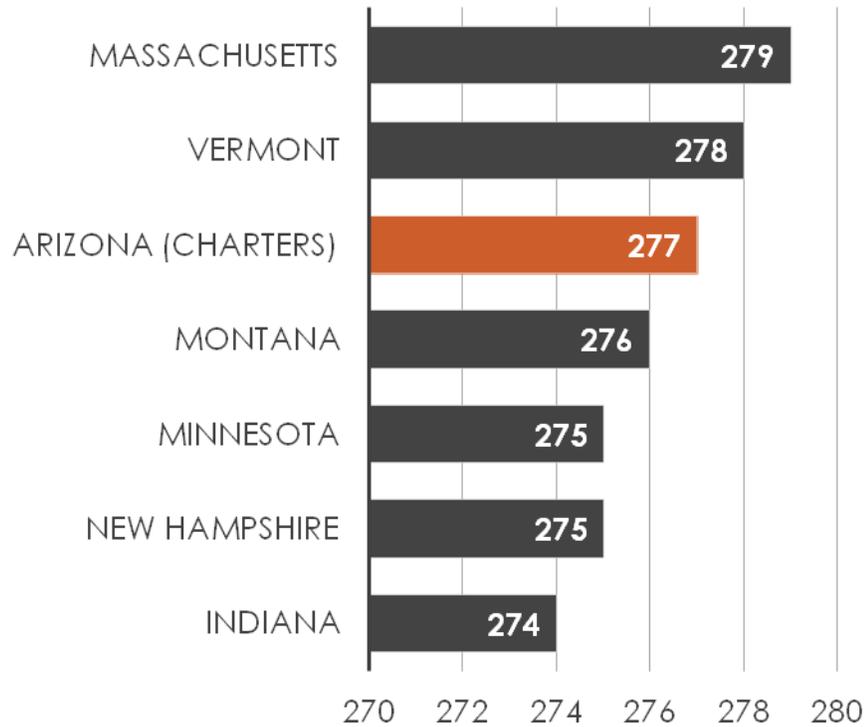
GAINS BY SUBJECT, 2009-2015



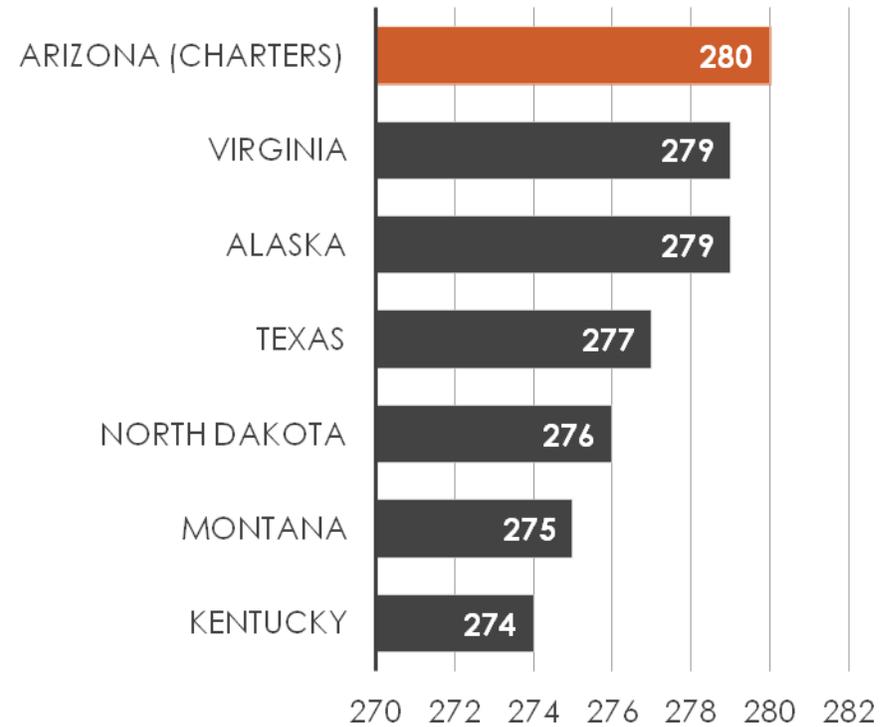
National Assessment for Educational Progress (NAEP)

Top 6 States & Arizona Charters 8th Grade Math Scores, 2015

Comparison of Scores for Free and Reduced Price Lunch Eligible Students



Comparison of Scores for Hispanic Students



We owe our gains to great
teachers in great schools,
chosen by families.



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What's Next?

Secure Teachers

- Keep the promise to fund higher teacher pay.
- Fully enact the school-based revenue and expenditure transparency laws that passed.
- Avoid funding mandates that detract from teacher funding.
- Empty schools directly impact the ability to pay teachers. Minimize facilities cost to maximize teacher pay.
- Defeat the "Pension Pac-Man" that currently reduces every teacher's salary by 24%.

Meet Demand for Great Schools

- Money for students and facilities should follow demand.
- Roughly 50% of Maricopa families don't attend their assigned schools. We should align tax revenues and burdens with student preferences vs geographic boundaries.
- The 1980 formula is student-based, but it did not contemplate open enrollment or charter schools.
- Failure to modernize will slow our hard won growth in quality.

Address the Big Risks

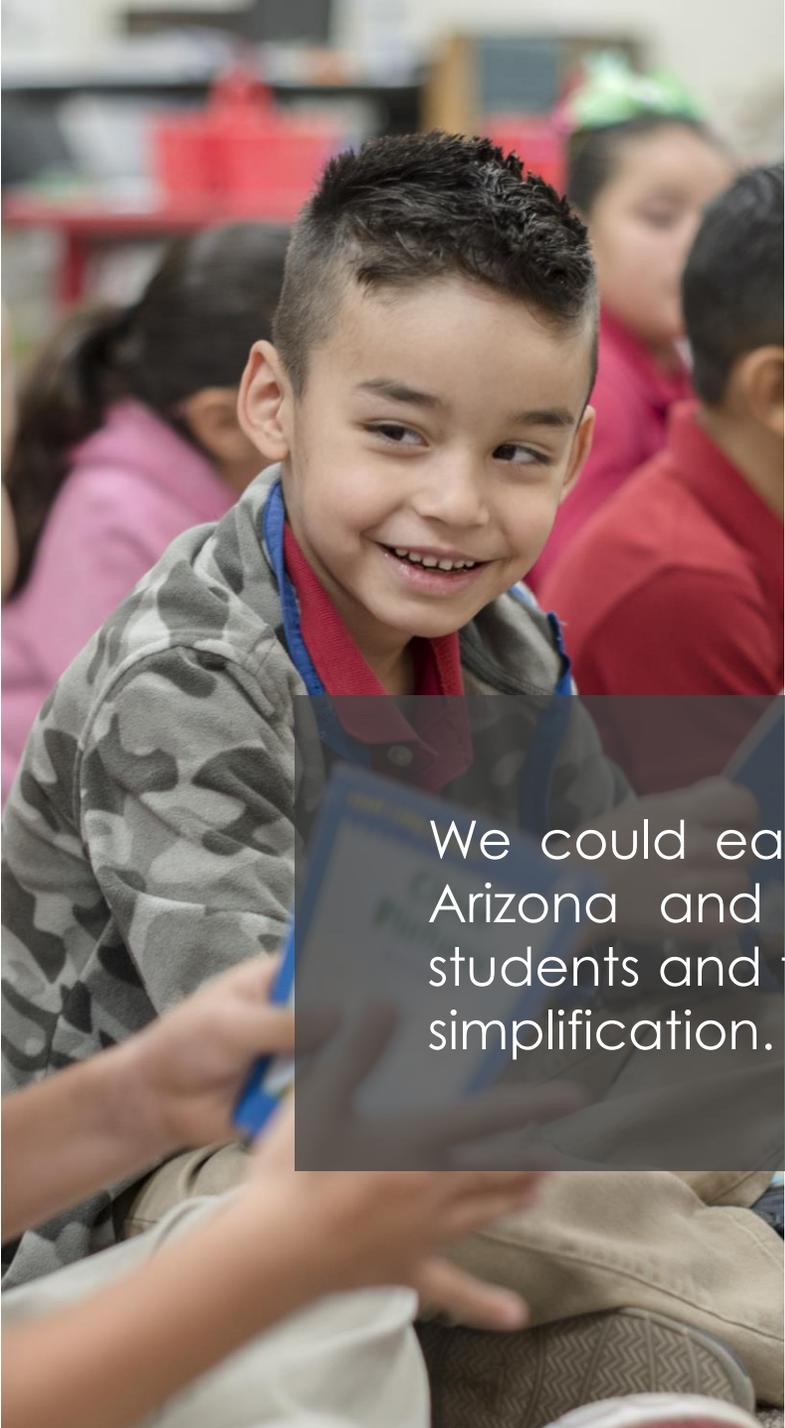
- Align facilities growth with student demand and school quality.
- Arizona currently has about 30% vacancy in its built school space. Empty schools should be easily available to quality schools that need to expand.
- The current pension plan reduces teacher pay by about 24% for a pension most will never see, and increases about 2% a year currently.

“Life is **really simple**, but we insist on making it complicated.”

-CONFUCIUS



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A young boy with short dark hair, wearing a grey camouflage-patterned hoodie over a red shirt, is smiling and looking towards the right. He is in a classroom setting with other children in the background.

This is the right
time to push for
the right thing.

We could easily accelerate the academic gains in Arizona and achieve a much greater equity for students and taxpayers through a modernization and simplification.



Income Tax Conformity

Speaker J.D. Mesnard



"Time running out for tax law change"

- Reporter Howard Fischer

“What would be simplest for Arizona taxpayers is for the state to conform to the new federal law on what is deductible. That’s been the practice now for years. But if Arizona adopts the new limits on federal deductions, that means higher taxes for many Arizonans who had been taking advantage of them.”



Is Howie Right?

What's the issue?



TAX CUTS & JOBS ACT

According to the Tax Foundation...



"Because the base-broadening provisions of the new federal tax law often flow through to states, while the corresponding rate reductions do not, most states will experience a revenue increase. The vast majority of filers will receive a tax cut at the federal level, but they could easily see a state tax increase unless states act to prevent one."

Tax Foundation (cont'd)

"For most states, the tax base [will] be broader after federal tax reform, forcing states to decide whether to keep the additional revenue to grow government, cut rates to avoid an automatic tax increase, or use the broader base to help pay down broader tax reform."

"States anticipating additional revenue should view this as an opportunity to make their tax codes more competitive. In the past, federal tax reform has initiated a round of state tax reform as well."

James Busby (attorney, CPA & Fellow of American College
of Tax Counsel:

"A potential tax preparer nightmare"

"...many are beginning to wonder whether the Legislature and Gov. Doug Ducey (R) will act to prevent [this] stealth \$300 million tax increase."

"will [Ducey] convene a special session after the election in November to address this important issue before the Legislature convenes as usual in January. Or will Arizona taxpayers and tax return preparers be forced to guess how to prepare, and then possibly amend, millions of tax returns?"

Bob Robb:

"The federal tax cuts will result in higher state tax collections."

"Now, the federal government reduced tax rates – bigly for corporations, modestly for individuals – to more than offset the expanded tax base. If the state doesn't change its rate, the result would be higher collections from the broader base."



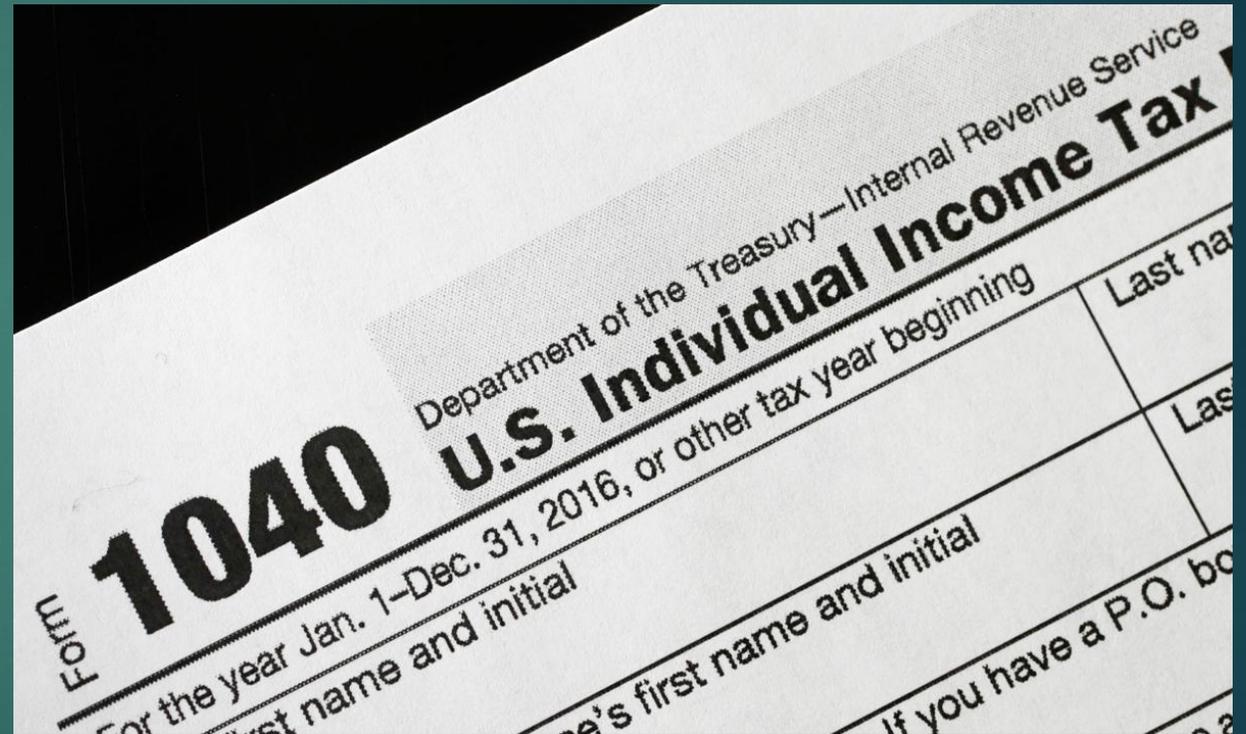
CNN Money:



"The more a state conforms to the features in the federal code, the more their residents could feel an impact at the state level. That is, unless their state makes changes."

Typically...

- ▶ Conformity is usually retroactive
- ▶ Conformity is usually assumed
- ▶ Conformity is usually not controversial



Overview:

- ▶ 2018 is different:
Major policy decision
- ▶ Implications for the
state and taxpayers



Why is this year different?



- ▶ December 2017, Congress overhauled the federal tax code.
- ▶ More taxable income because fewer deductions allowed.

Why is this year different?

- ▶ SALT
- ▶ Mortgage Interest
- ▶ Home Equity Loan Interest
- ▶ Other:
 - unreimbursed employee expenses
 - tax preparation fees
 - theft and personal casualty losses
 - other miscellaneous

TAX
DEDUCTIBLE
OR NOT ??



Does this mean the Feds raised
taxes?

The Feds offset the broadening of taxable income by reducing tax rates.



TAX BRACKETS FOR SINGLE FILERS

CURRENT LAW		FINAL PLAN	
10%	\$0 – \$9,325	10%	\$0 – \$9,525
15%	\$9,326 – \$37,950	12%	\$9,526 – \$38,700
25%	\$37,951 – \$91,900	22%	\$38,701 – \$82,500
28%	\$91,901 – \$191,650	24%	\$82,501 – \$157,500
33%	\$191,651 – \$416,700	32%	\$157,501 – 200,000
35%	\$416,701 – \$418,400	35%	\$200,001 – \$500,000
39.6%	\$418,401 or more	37%	\$500,001 or more
Standard deduction:	\$6,350	Standard deduction:	\$12,000
Personal exemption:	\$4,050	Personal exemption:	Eliminated

Why is this year different?

- ▶ Federal code is AZ starting point
- ▶ AZ has its own tax rates and brackets
- ▶ Applying broader tax base to current rates means increased tax payments.
- ▶ This issue unfortunately was not addressed last session.

Taxable income is over	Taxable income is not over	Tax rate
\$0	\$10,000	2.59%
\$10,000	\$25,000	2.88%
\$25,000	\$50,000	3.36%
\$50,000	\$150,000	4.24%
\$150,000	And over	4.54%

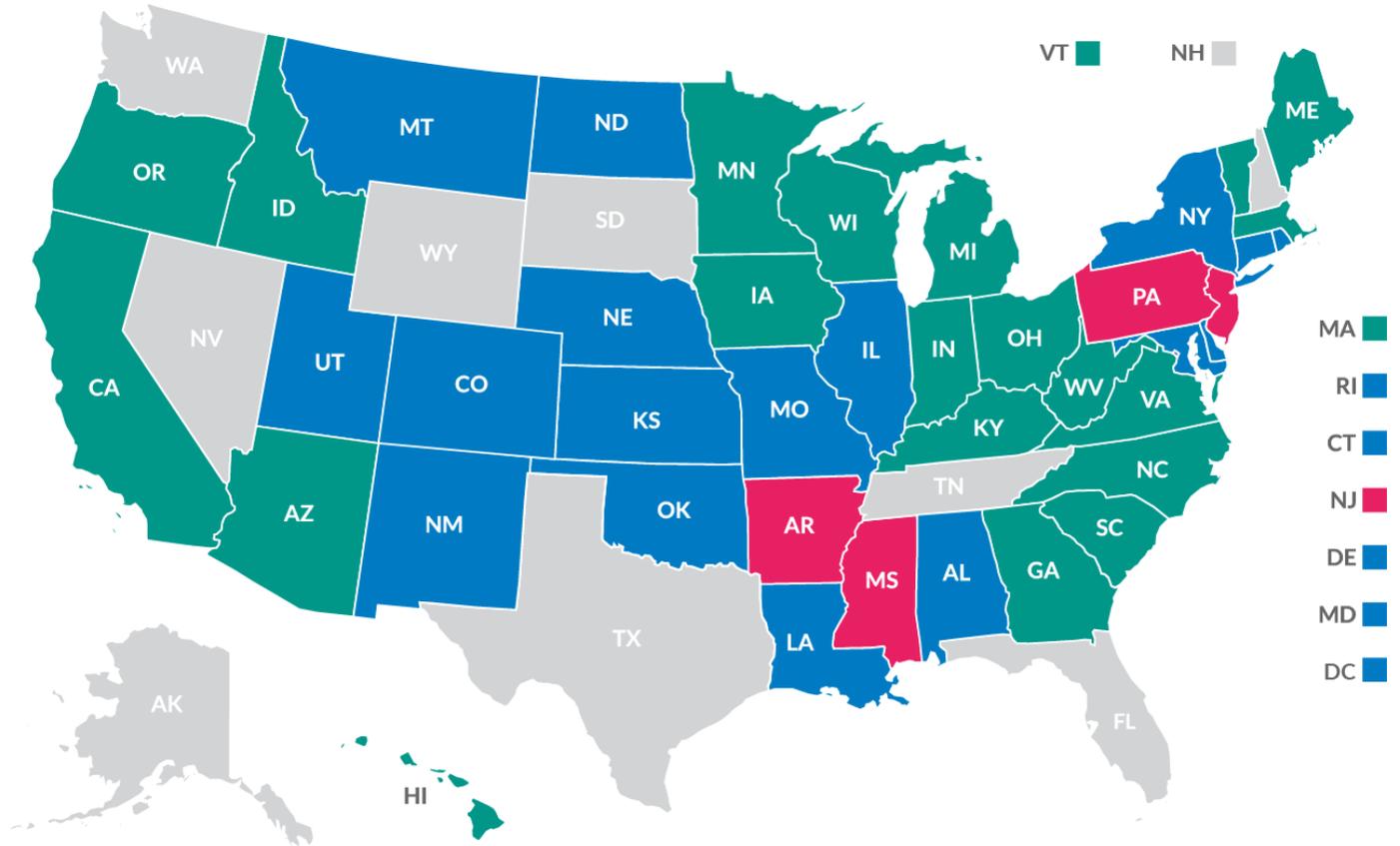
Delaying TY 2018 conformity to the 2019 legislative session has put the state in a difficult position:

- ▶ DOR has begun preparing its TY 2018 tax documents based on simple conformity.
- ▶ Arizonans will begin preparing their taxes assuming simple conformity.
- ▶ Legislators have been informed that any alterations to full conformity during the 2019 legislative session would leave little time for DOR to revise its TY 2018 tax documents.
- ▶ Tax software providers (TurboTax, etc) need to know what AZ will do to be ready by January 1.

What are other states doing?

- Static Conformity
- Rolling Conformity

Does Your State's Individual Income Tax Code Conform With the Federal Tax Code?



Note: States conform to the federal tax code on either a static or rolling basis. Static conformity means conforming to the Internal Revenue Code (IRC) as of a specific date, such as January 1, 2016. Rolling conformity means adopting IRC changes as they occur.
Source: Bloomberg BNA

- Rolling Conformity
- Static Conformity
- No Conformity (State Calculation)
- No Individual Income Tax

What are other states doing?

- ▶ Of the 18 states that have static conformity, only 3 states have not taken action on conforming to the federal tax changes.
- ▶ California, Minnesota (the Minnesota legislation was vetoed) and Arizona.

What have other states done?



– reduced corporate and income tax rates (highest bracket only) from 6% to 5.75% for all taxable years beginning in 2019 with a potential for a further reduction of 5.5%.



– adjusted income tax brackets and cut individual and corporate income tax by over \$200M.

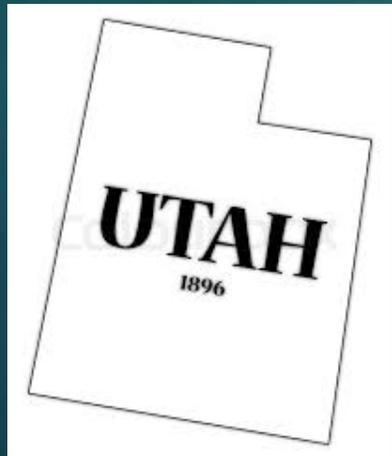


– reduced individual income tax rates beginning in TY 2019, several additional changes are contingent upon meeting revenue targets.

What have other states done (continued):

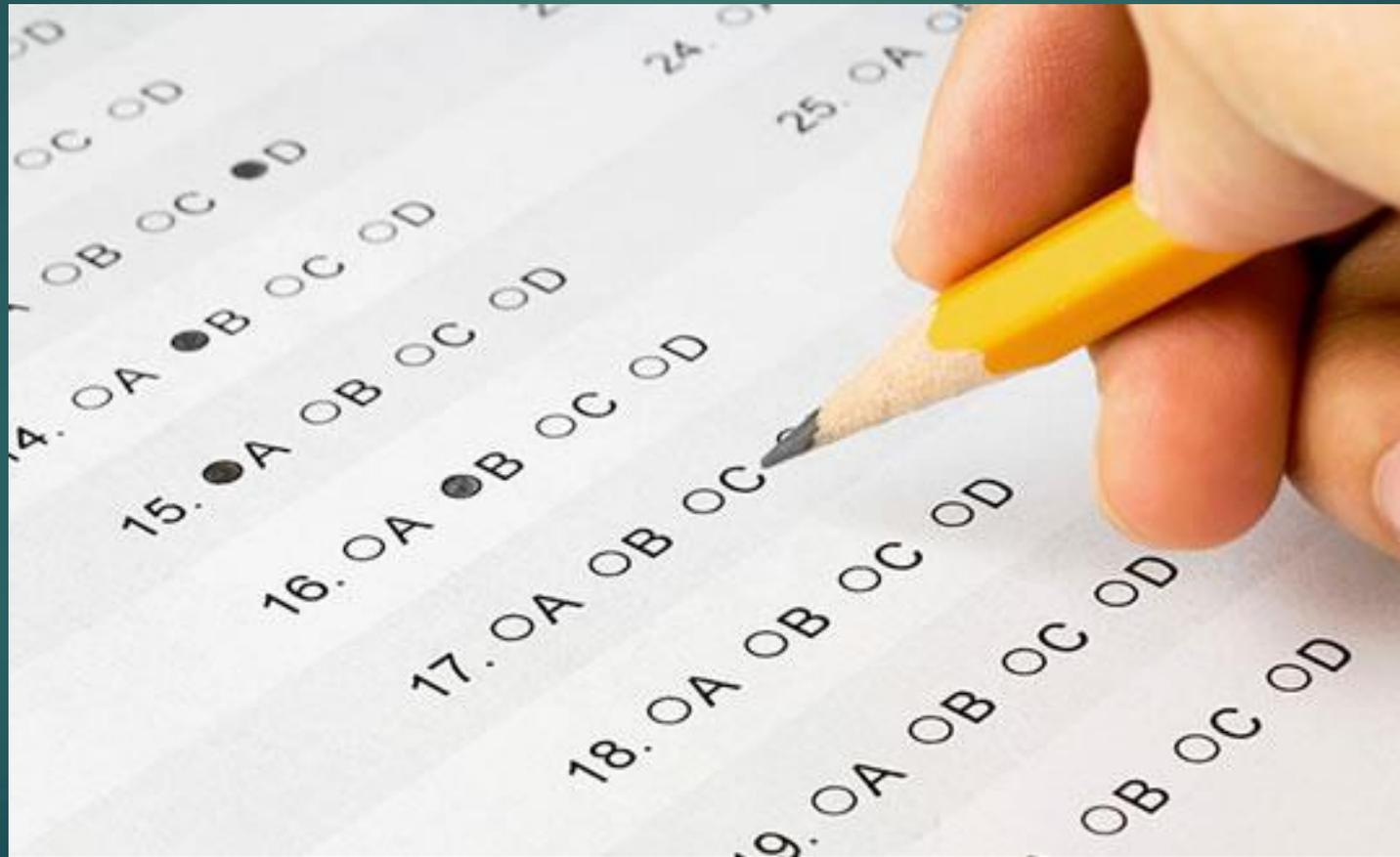


– estimated \$500 million in revenue offset by \$100 million worth of tax changes.



– permanently reduced the state's income tax rate to offset the additional revenue.

What should Arizona do and when should Arizona do it:



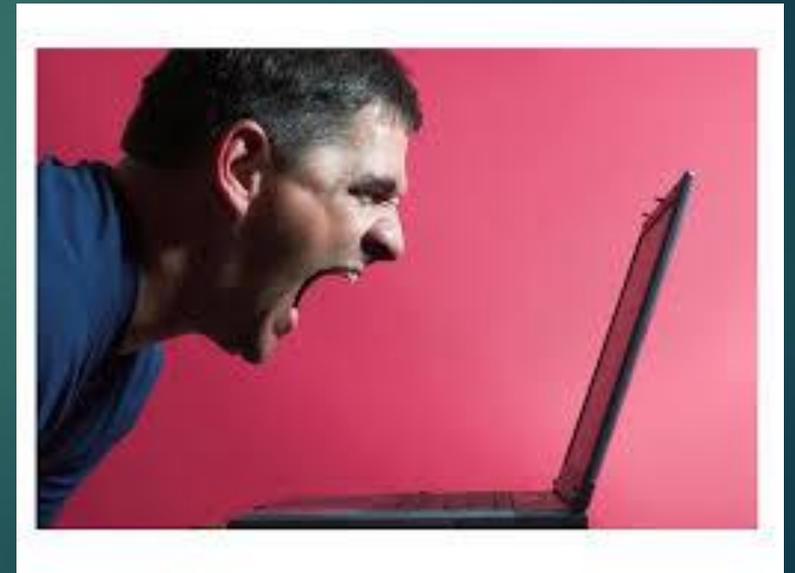
Option 1:

- ▶ Simple Conformity
- ▶ Pro: Easiest approach
- ▶ Con: Tax increase of \$174M to \$228M
- ▶ **NOTE: Taxpayers may owe money to the state because it is unlikely Arizona taxpayers have been withholding more state taxes during 2018**



Option 2:

- ▶ Conform with Reform
- ▶ Avoids a large tax increase on state taxpayers.
- ▶ Serious timing issue: May be a need for amended returns, upset taxpayers, and frustration with elected officials.



Reform Options...

- ▶ Tax Rates
- ▶ Tax Brackets
- ▶ Standard Deduction
- ▶ Exemption???

Option 3:

- ▶ No Conformity
- ▶ Pro: No tax increase
- ▶ Con: Taxes become much more complicated



What is best?

- ▶ Option 2: Conform with Reform
- ▶ Timing: ASAP



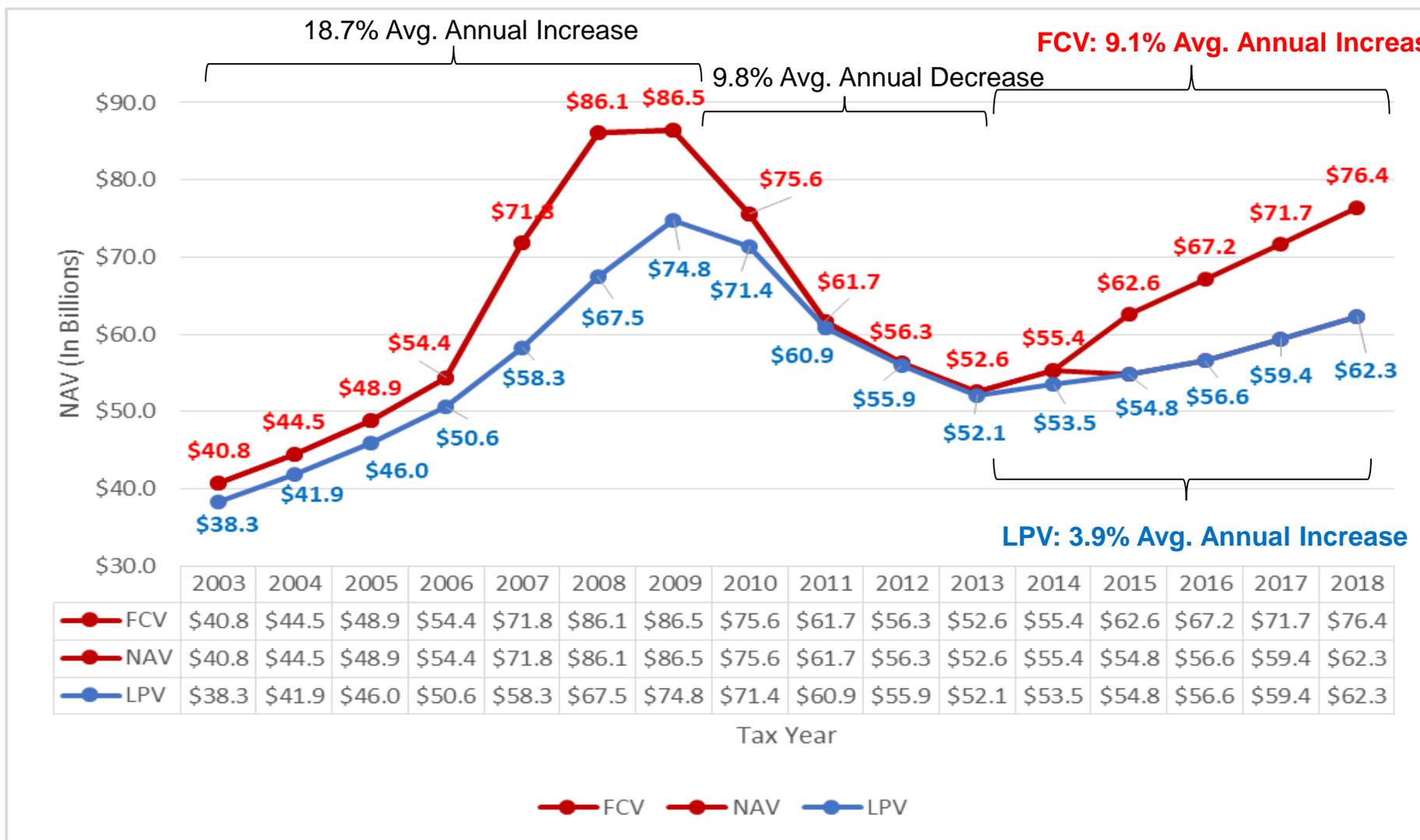


Major Tax Issues

- 1) Update on Arizona's property tax picture:
 - Good news – Stability in values and overall levies
 - Bad news – Historic problem of high business property tax lingers and increasing secondary taxes aggravating this problem (schools/fire districts)
 - Spread of government/non-profit use of tax exempt status for private development an increasing problem
- 2) Sales Taxes:
 - Wayfair v. South Dakota
 - Taxation of Digital Goods & Services
- 3) Income Taxes:
 - Federal Conformity



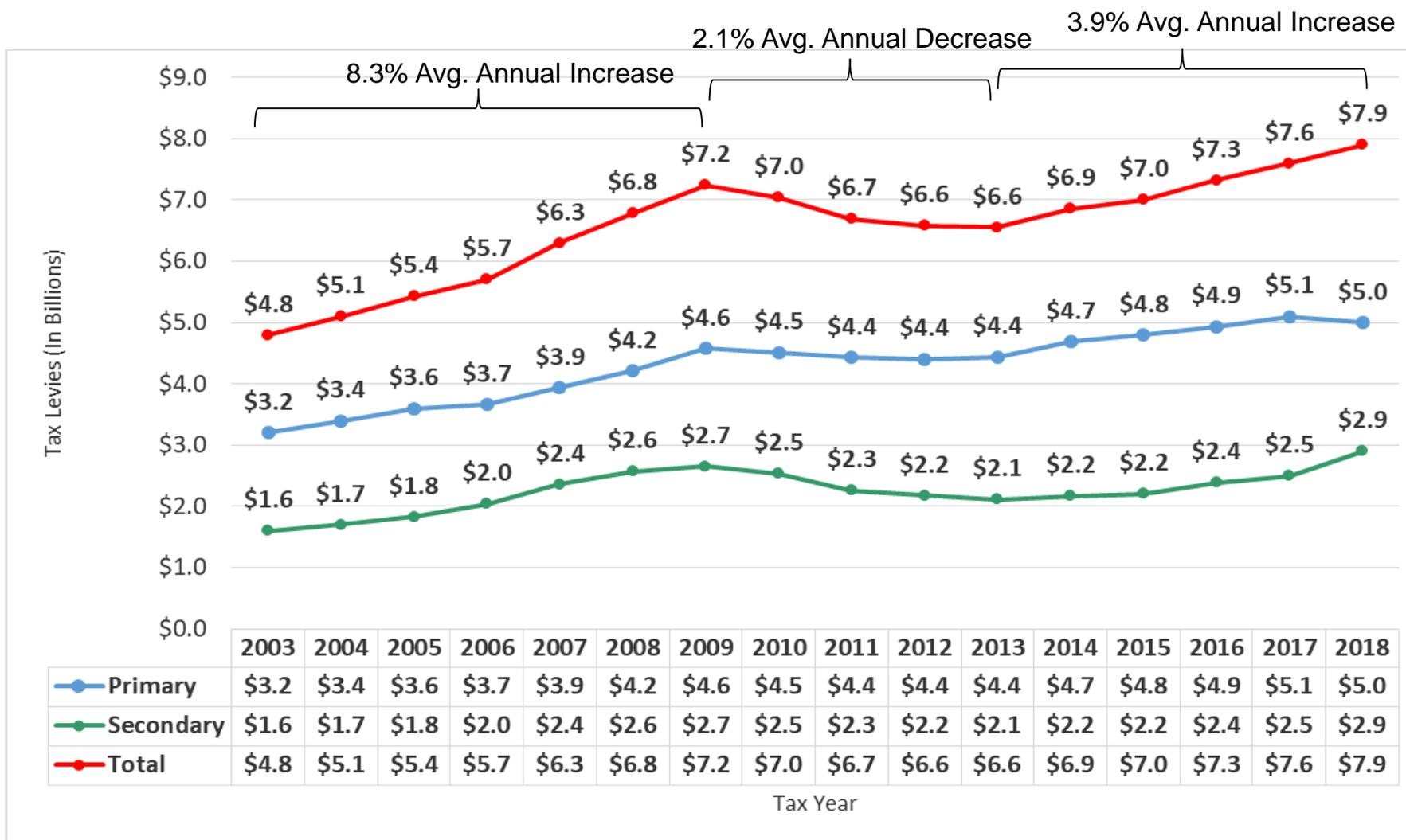
15-Year Property Values



The taxpayer's watchdog for over 75 years



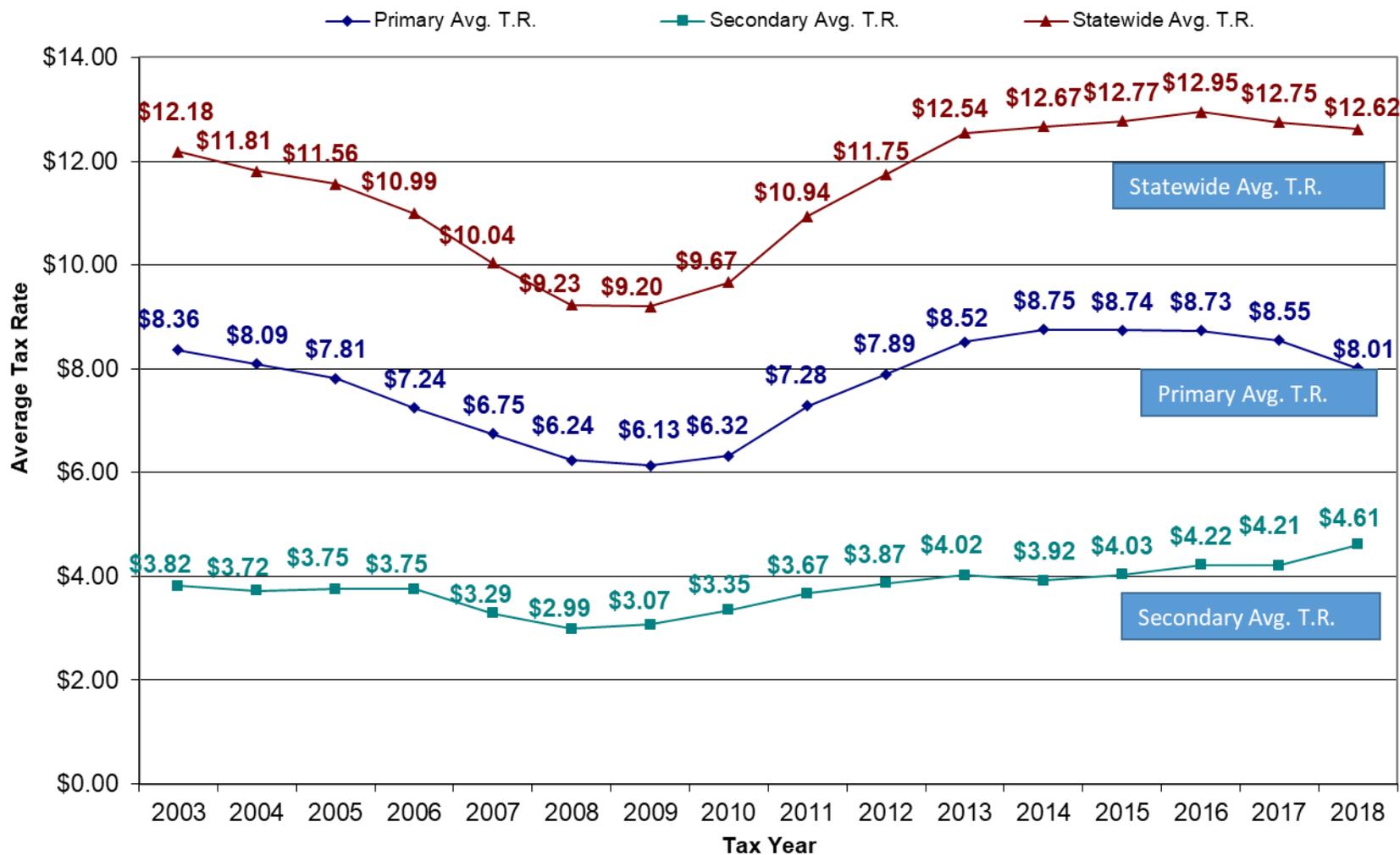
15-Year Property Tax Levies



The taxpayer's watchdog for over 75 years



Statewide Average Tax Rates





Residential vs. Industrial Property Rankings

Minnesota Study - Phoenix

Residential Property Taxes Payable 2017 \$150,000 Land and Building			
Rank	State	NET TAX	ETR
25	Arizona	\$1,885	1.257%
	<i>U.S. Average</i>	<i>\$2,182</i>	<i>1.455%</i>

Industrial Property Taxes Payable 2017 \$25,000,000 Land & Building \$12,500,000 Machinery & Equipment \$10,000,000 Inventories \$2,500,000 Fixtures			
Rank	State	NET TAX	ETR
8	Arizona	\$1,097,959	2.196%
	<i>U.S. Average</i>	<i>\$763,726</i>	<i>1.527%</i>

Statewide Average Tax Rate

Residential Property Taxes Payable 2017 \$150,000 Land and Building			
Rank	State	NET TAX	ETR
40	Arizona	\$1,335	0.890%
	<i>U.S. Average</i>	<i>\$2,182</i>	<i>1.455%</i>

Industrial Property Taxes Payable 2017 \$25,000,000 Land & Building \$12,500,000 Machinery & Equipment \$10,000,000 Inventories \$2,500,000 Fixtures			
Rank	State	NET TAX	ETR
23	Arizona	\$795,355	1.591%
	<i>U.S. Average</i>	<i>\$763,726</i>	<i>1.527%</i>



Current Property Tax Problem Areas

- Growing K12 secondary levies (bonds and overrides)
 - Dramatic increases in K12 budgets have led to significant increases in override levies. Secondary levy growth almost 25% over last 5 years
- Fire district levies have steadily increased over the years. Many districts struggling with huge PSPRS unfunded liability



Fire District NAV, Rates & Levy History

Statewide Totals	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
NAV	11%	16%	32%	28%	2%	-10%	-13%	-9%	-7%	-3%	9%	-3%	4%	5%
RATES	3%	-3%	-2%	-2%	1%	8%	7%	6%	2%	2%	1%	1%	1%	0%
LEVIES	13%	17%	25%	19%	1%	-2%	-7%	-2%	0%	0%	9%	4%	7%	5%

- 2005 - 2009, NAV doubled - \$6.4 Billion to \$12.8 Billion; Avg. T.R. dropped only 10 cents, from \$2.10 to \$2.00; Levies increased 77% to \$251 Million
- 2009 - 2013: NAV dropped 33% to \$8.6 Billion; Avg. T.R. up 46 cents; Levies down 11%
- 2013 - 2018: NAV up 11% to \$9.5 Billion; Avg. T.R. increased 21 cents to \$2.67; Levies increased 27%
- In 2018, One-half of 150 FDs levy a tax rate over \$3.00; One-third are at the \$3.25 cap
 - In 2009, 17 levied over \$3.00 and only 7 were rate capped
 - Some FDs have temporary voter-approved overrides to exceed cap
- FD rates now rival K12 avg. T.R. of \$3.72
- The answer to the FDs financial problems should not be to give them unlimited taxing power
- FD operations need to be more efficient (e.g. mergers, Joint Powers Authorities, voter-approved debt)

The taxpayer's watchdog for over 75 years

Government Shielding Private Property From Tax A Growing Problem



- Government's use of its tax exempt status to shield private development from taxation expands beyond cities use of GPLET
- ATRA effort last session to address current University leasing failed. Precedent for other governmental entities to follow
- Problem spreads to non-profit world. ASU Foundation/Skysong can be easily replicated to avoid paying Arizona's high business property taxes

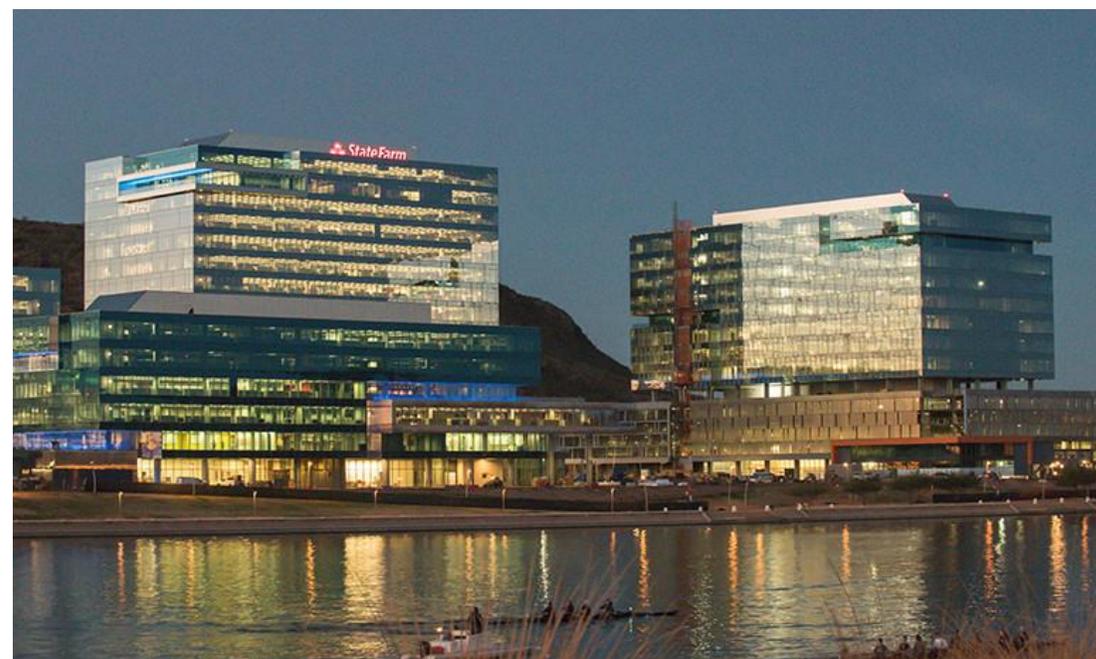


University/Nonprofit Taxation

SKYSONG



MARINA HEIGHTS



Who's Next??



Sales Tax Issues

- SCOTUS decision in *Wayfair v. South Dakota* should drive important and much needed administrative reforms in *Arizona*
- ATRA historical position: Internet should not be a tax free zone for **tangible personal property** sold online
- ATRA *Wayfair* principals:
 1. AZ needs a law to tax remote sellers. ATRA will oppose attempts to simply establish economic nexus through ADOR rule/policy
 2. AZ's law should be fair and administrable to sellers, purchasers, and state government
 3. AZ's law should be consistent with the SCOTUS decision and avoid litigation to the greatest extent possible
 4. The increased tax collections should be clearly acknowledged by state and local governments



Sales Tax Issues (cont.)

- Taxation of Digital Goods and Services:
 - ATRA and the business community's effort to create clarity in this area failed in the 2018 session
 - Despite the state's admission that the current statutory framework is unsatisfactory, state policymakers fumbled the effort to provide a clear and administrable law



Sales Tax Issues (cont.)

- Effort to fix this growing problem now complicated by litigation. As ATRA warned last year, lawsuits against the state are now piling up
- State contending this is the rental of tangible personal property. Court minute entry rejecting state motion to dismiss is strong
- Recognizing that courtrooms are a poor place to develop complicated tax policy, state policymakers should acknowledge the need for a clear law and lead on this issue. ATRA will again pursue a legislative response to this problem



Income Tax Issues

- Federal Conformity is a major looming problem
- Current law for tax year 2018 is an administrative nightmare
- As rapidly as possible the state should conform and adjust marginal rates to offset the tax increase
- Arizona's annual federal conformity rests on taxpayer confidence that the state will not absorb windfalls associated with major federal changes.