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ARIZONA TAX RESEARCH ASSOCIATION

NEWSLETTER

VOLUME 61
NUMBER 3

MARCH 2001

ATRA Chairman Dick Foreman appointed to Governor Hull's task force on education funding

Governor Jane Dee Hull's office announced this month that ATRA Chairman Dick Foreman is among the 24 appointments to the *Governor's Task Force on Efficiency and Accountability in K-12 Education*.

The task force is charged with conducting "a review of K-12 maintenance and operating budget issues to ensure that taxpayer dollars are being used in the most efficient manner."

Specifically, the task force will address the following topics:

- How schools can direct the maximum amount of federal, state and local funding for public education into the classroom, including a review of administrative costs and overhead and school district budget balance carry-forwards;
- How school districts can be unified, merged, consolidated or eliminated to lower administrative costs;

- How expenditures that are outside the revenue control limit are impacting the equality of M&O funding, and;
- How schools can establish teacher performance pay plans that are based upon individual and collective student achievement.

The task force will be chaired by Jack Henry of Sierra Blanca Ventures and current chairman of Greater Phoenix Leadership. The task force will also include civic and business leaders, as well as several members from Arizona's public school system.

The Governor has asked the task force to forward its initial recommendations by December 15, 2001.

House Ed rejects limits on capital overrides 5 to 5

The House Committee on Education voted this month to reject ATRA's proposal to place limits on capital outlay budget overrides. The 10-person committee was evenly split, 5 to 5.

Voting in favor of the limits were Representatives Gray, Anderson, Graf, Kraft, and Farnsworth. Opposed to the limits were Representatives Lopez, Norris, Pickens, Foster, and Carruthers.

Currently, voter-approved overrides to exceed the capital outlay revenue limit (CORL) are unlimited. This is in sharp contrast to the fact that there are limits on maintenance and operations (M&O) overrides and bonded debt capacity.

HB 2184 would have limited capital overrides to 15 percent of the district's revenue control limit.

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ATRA Vice President Michael Hunter (right) discussing small school district funding on KAET's *Horizon* with Mike Smith, Arizona School Administrators, and Host Michael Grant (See related article on page 4)

Sales tax grandfathering bills moving

HB 2345 & SB 1258 eliminate retroactive tax increase

On June 1, 2001, Arizona's state sales tax rate climbs from the current 5% to 5.6% as a result of the passage of Proposition 301 last November. While Prop. 301 addressed in detail how the roughly \$445 million in new revenue would be spent, it failed to grandfather, at the current rate, contracts and transactions in effect prior to June 1.

Grandfathering pre-existing contracts and transactions when sales tax rates are increased has become common practice in Arizona at the city and county level.

Last session, as the Education 2000 legislation was being prepared for debate in the House of Representatives, then Ways and Means Committee Chairman Bill McGibbon attempted to add language to ensure that the new sales tax would not apply retroactively. Representative McGibbon was told amendments would not be allowed on the floor and assurances were given that the problem would be addressed during the 2001 legislative session.

Early this year, several business groups united behind the effort to ensure that Prop. 301's sales tax increase would only be applied prospectively. The East Valley Chambers of Commerce, Arizona Association of General Contractors, National Federation of Independent Business, and others have joined ATRA in supporting House Bill 2345, sponsored by Representative Steve May, and Senate Bill 1258, sponsored by Senator Scott Bundgaard.

Prior to the session, most viewed passage of the grandfathering legislation as a technical cleanup issue that would receive quick legislative approval. Several issues have surfaced to prove those predictions overly optimistic.

First, while this is a simple issue to understand for businesses that **remit** sales taxes to the state, it is not as simple for those

that **pay** sales taxes. Customers know they will pay the current 5% sales tax on all transactions until June 1. However, the actual payments made on some transactions that occur prior to June 1 will not be made until **after** that date. For those businesses that remit sales taxes to the state on a cash basis (when the money is received), they will owe the higher sales tax if the money is received after June 1 regardless of when the transaction occurred.

**“An honorable
government would not
take taxes to which
it is not entitled.”**

Representative Steve May

Second, and most importantly, the Governor's office has strongly opposed ATRA's efforts to resolve the problem. Labeling it another "alt-fuels debacle," the Governor's staff has created the specter of a rush of long term contracts being entered into prior to June 1 in order to avoid paying the increased sales tax. Worse, they have further confused the issue by suggesting that businesses were attempting to side step a liability that is actually owed.

ATRA has responded to some of the Governor's concerns by adding two amendments that narrow the transactions that would be grandfathered at the existing sales tax rate. First, contracts entered into prior to June 1 that provide for a pass through of the increased sales tax would be required to do so. Second, transactions and contracts grandfathered at the existing rate would be provided that protection until only December 31, 2001. After December 31,

2001, all sales tax payments, regardless of the date of contract, would be required to pay the higher rate.

Both HB 2345, which pass the House 36 to 17, and SB 1258, which passed the Senate 24 to 6, have received strong bipartisan support. Along with Senator Bundgaard, Senators Ramon Valadez and Jay Blanchard were strong advocates for SB 1258. Fortunately, the majority of the legislature supports Representative May's perspective on the bill.

In explanation on the House floor that the bill simply ensured that taxpayers would only pay those taxes that are legally owed to the state, Representative May appropriately noted, "An honorable government would not take taxes to which it is not entitled."

SB 1178 limiting wayward program goes to Governor

ATRA's bill ensuring that no more districts will participate in a wayward energy savings program is on the Governor's desk after passing the Senate 29 to 0 and the House 47 to 12.

The program's purpose was to provide an incentive to districts to engage in energy savings behaviors to decrease taxes for excess utilities. One half of documented cost savings could be spent in the district's M&O budget with the other half decreasing taxes.

During its two years in existence, several districts claiming a cost savings were ineligible because tax levies simultaneously increased for excess utilities. Other eligible districts appear to have claimed more than the law allows.

ARIZONA TAX RESEARCH ASSOCIATION

Dick Foreman.....Chairman
Kevin J. McCarthy.....President
Michael E. Hunter.....Vice President
Jennifer Schuldt.....Senior Research Analyst
Carmen Florez-Lucero.....Office Manager

Published monthly except July & August by the Arizona Tax Research Association, a nonprofit organization, whose purpose is to promote efficiency and economy in Arizona government and reductions at all levels. Permission to reprint is granted to all publications giving appropriate credit to the Arizona Tax Research Association.

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

FAX (602) 253-6719

www.arizonatax.org
atra@arizonatax.org



HB 2527 EXPANDS ENTERPRISE ZONE TAX BREAKS

Cities oppose reform while supporting targeted tax breaks

Recognizing that Arizona's high business property taxes place them at a competitive disadvantage in economic development efforts, city representatives, along with the Arizona Department of Commerce (ADOC), are seeking a continuation and expansion of the current property tax breaks in the enterprise zone law.

Arizona's enterprise zone law provides that qualifying businesses receive an 80% reduction in the assessment ratio (from 25% to 5%) on value for primary property tax purposes. The higher assessment ratio on business property (25%) compared to homes (10%) leads to considerably higher taxes on business property in Arizona.

Ironically, cities recognize the effects that the disparate assessment ratios have on business property taxes yet oppose any fundamental reforms to the classification system. City representatives have strongly opposed two bills this session that attempt to make modest reform to the property tax system. SB 1097 and HB 2131 would have established, on a prospective basis, a single assessment ratio for all classes of property. Both bills have been stopped for the current session.

Legislation enacted in 1989 marked the inception of the enterprise zone program and has provided healthy tax breaks for qualifying businesses. Businesses that qualify for the program can benefit through income tax credits and a reduction in property taxes.

HB 2527 extends the program another five years beyond the current termination date of July 1, 2001, and broadens the criteria in qualifying businesses, furthering the inequities within the property tax system.

ADOC has the authority to certify proposed enterprise zones that encompass distressed areas having an average annual poverty rate or unemployment rate that is 150% of the state rate.

Under the current law, a small manufacturing company, which is defined as a minority or woman-owned business with less than 100 employees that is involved in the process of producing or manufacturing products, may qualify under the program for a property tax reduction as long as the company invests a minimum of \$2 million in fixed assets.

The statute outlining the enterprise zone program was amended in 1996 to reduce the assessment ratio from 25% to 5% on the primary value for five years for qualified businesses, resulting in a property tax reduction of more than 50%. Prior to the 1996 amendment, the assessment ratio was reduced from 25% to 5% on both the secondary and primary values for 10 years for qualifying businesses, resulting in an 80% reduction in property taxes.

According to ADOC, 11 companies are grand-fathered under the previous law, allowing these companies to receive the tax break on both the primary and secondary taxes for 10 years.

HB 2527 extends the enterprise zone program another five years, through June 30, 2006, and allows ADOC to form six new zones a year, not including the renewal of existing zones. To date, ADOC has certified 26 zones throughout the state. Out of the 26 zones, only 22 are considered active, with eight of the zones encompassing entire counties. Within these zones, less than 35 companies currently qualify for income tax credits and property tax reductions.

According to the Department of Revenue's (DOR) *Preliminary 2000 Report on Enterprise Zone Credits in Arizona*, a mere 23 businesses qualified for \$2.3 million in property tax savings in 1999. Total property tax savings for all businesses qualifying for the program between 1995 and 1999 amounted to \$8,059,792.

For example, Corella Electric Wire qualified for the tax break previous to 1996 when the 5% assessment ratio applied to both the secondary and primary property taxes. As a result, Corella paid only \$68,109 in property taxes in 1995 with the credit.

If Corella had not received the credit, their tax bill would have been \$340,544. With the credit, the company saved \$272,436 in property taxes. According to the report, Corella was the main recipient from the program, saving a total of \$2.7 million over a five-year period, and they will continue to benefit from the program through 2005.

HB 2527 also provides that a business no longer be required to show a profitable history prior to the application date to qualify for the program. In addition, the investment requirement, which was previously set at \$2,000,000 for all businesses, will be tiered, ranging from \$500,000 to \$2,000,000, depending on county or city population levels within the zone.

The Department of Commerce contends that loosening the restrictions on a businesses' performance and reducing the investment requirements will allow more businesses to qualify for the program, providing an incentive for companies to relocate to distressed cities, such as Gila Bend or Williams, and ultimately, help to revive a stagnant or deteriorating economy.

Jennifer Schuldt

Senate version of small school district tax bill fails in House Approps

House version still alive in Senate

The House Appropriations Committee failed to pass SB 1414, Senator Verkamp's effort to provide continued access to local property taxes for Grand Canyon Unified and other school districts that, since fiscal year (FY) 1998-1999, no longer qualify for the small school district exemption. A narrow majority (8 of 15) voted to defeat the measure.

The bill is nearly identical to HB 2183 which passed in the House earlier this month by a vote of 33 to 17, with 10 not voting. HB 2183 is slated to be heard next in Senate Education where it will likely be amended to address concerns about the absence of voter-approval requirements for selected districts to achieve budget overrides.

The bill, in its current form, has two parts. The first part of the bill amends A.R.S. §15-481 and enhances the voter-approved overrides available to school districts with

relatively small student counts. This statutory change would treat all districts of similar size equitably. ATRA is not opposed to this section of the bill, despite the likelihood of it resulting in considerable increases in secondary property taxes.

The second section, however, will authorize property tax increases without voter approval for small but growing school districts that become disqualified for the exemption from their budget limit under A.R.S. §15-949.

What's more, it creates that authority for only those school districts that lose the exempt status after FY 1998-1999.

In other words, districts with similarly small student populations that either never qualified for the exemption or lost eligibility prior to the cut-off date will be treated differently under state law than those who

happen to qualify for the non-voter-approved overrides under the second section of the bill.

ATRA has been supportive of an amendment that removes the section of the bill extending access to non-voter-approved overrides and leaves in tact the provisions of the bills relating to enhanced voter-approved overrides for all school districts with relatively small student populations.

Even if voter approval requirements were put in place for the section of the bill amending A.R.S. §15-949, ATRA would remain opposed to the bill because it would continue to carve out special treatment for selected school districts.

Irrespective of the outcome of this legislation, without substantive reforms, the small school issue will remain one of the most significant problem areas in public school finance.

Michael Hunter