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ARIZONA TAX RESEARCH ASSOCIATION

PROTECT OUR HOMES (Prop 100)

Summary of key provisions:

The initiative amends the Arizona Constitution to prohibit the following:

The state, any county, city, town, municipality or other political subdivision of the state, or any district created by law with authority to impose any tax, fee, stamp requirement or other assessment, shall not impose any new tax, fee, stamp requirement or other assessment, direct or indirect, on the act or privilege of selling, purchasing, granting, assigning, transferring, receiving, or otherwise conveying any interest in real property. This section does not apply to any tax, fee, or other assessment in existence on December 31, 2007.

ATRA Policy Concerns/Issues:

During a time when the state is looking for creative ways to raise revenues, this constitutional provision would proactively prevent state and local governments from imposing such a tax. Arizona is one of 13 states that do not currently levy a real estate transfer tax.

Additionally, this initiative would limit government from increasing the existing tax burden on real property owners that are already required to pay property taxes annually, impact fees on new construction, sales tax on the construction and materials under the transaction privilege tax (TPT) prime contracting classification, and the speculative builder tax under the Model City Tax Code.

Property Taxes

Arizona businesses rank 5th in the country in the amount they pay in property taxes. According to a recent study published by the Minnesota Taxpayer's Association, an industrial property owner paying taxes in Arizona with \$25 million in real property value and \$25 million in personal property carries a tax burden of approximately \$1.3 million. This annual tax liability results in a 2.529% effective tax rate (ETR), which is 1.039% higher than the national average of 1.490%.

Residential properties fare better than business properties in the same study. For a residence that is valued at \$300,000, the annual property tax liability is \$2,638 (ETR of 0.879%), ranking Arizona 38th. The national average ETR is 1.327%.

Development Fees

In state statute, counties and cities have the authority to assess development fees to offset the capital costs for water, sewer, streets, parks, public safety facilities or the cost of any service identified in an infrastructure improvements plan that is necessary for public services provided by the jurisdiction.

The only limitation on the amount of fees that may be assessed is that the fee must bear a reasonable relationship to the burden of capital costs imposed upon the county or municipality to provide additional necessary public services to the development. Fees are typically paid when construction permits are issued unless otherwise specified in a development agreement. The total revenue collected from development fees is unknown.

Transaction Privilege Taxes (TPT)

In addition to paying property taxes and impact fees, taxes are collected under the TPT prime contracting class. According to the prime contracting class, taxes are imposed on 65% of the prime contractor's gross receipts from a construction project.

The combined average TPT rate levied under the prime contracting class is 9.1%, with rates ranging from a low of 7.6% to a high of 11.3%. In FY 2007, total state tax collections under the prime contracting class amounted to \$1.1 billion, representing 20% of total TPT collections of all the classifications. Collections by classification are not available at the city level but assuming the same percentage relationship as the state, collections under contracting at the city level are estimated at \$477 million.

Speculative Builder Tax

The speculative builder tax is applied to the sale of "improved real property" that is sold prior to the completion of improvements or before the expiration of 24 months after the improvements are substantially completed.

The rate levied under the speculative builder tax is the same as the TPT retail rate levied by the city unless otherwise specified. The speculative

builder tax is triggered by the sale of the improved property and the rate is applied to 65% of the gross income from the business activity as a speculative builder.

The total amount collected under the speculative builder class is not known; however, the average city retail rate is 2.4%, with rates ranging between 1.5% and 4%.

Other Policy Considerations:

Proponents of the real estate transfer tax no doubt see it as an effective and simple way to garner significant tax revenue from taxpayers who are unable to avoid or escape the tax. From an administrative standpoint, the tax could probably be implemented with minimal fiscal compliance and administrative costs. However, ease of administration, coupled with the opportunity to raise significant revenue on major real estate transactions, are not the criteria that should lead to the implementation of the tax.

One of the key criteria for judging a state and local fiscal system is **efficiency**, which is defined as follows:

Avoid causing changes in economic behavior by keeping tax bases broad and marginal tax rates low. Tax individuals and businesses in relation to public services received, where appropriate.

Clearly, a real estate transfer tax in Arizona would be a new tax that is narrowly focused on a major transaction that has little relationship to public services received. In fact, any political attraction to the tax would be grounded in the fact that most citizens would not be impacted by the tax.

Another criterion for judging a state fiscal system is **stability**, which is defined as follows:

Employ a system that does not produce wide swings in expenditures or revenues in response to economic cycles.

For a variety of reasons, Arizona's state and local fiscal system has been volatile over the last decade. Some of that volatility is the result of predictable fluctuations in the economic cycle. However, Arizona's reliance on tax revenues from the real estate industry certainly adds to the degree of instability in our system. As noted above, state and local governments receive a considerable amount of revenue from the real estate industry. With the exception of property taxes, most of these sources of revenues show

significant fluctuation depending upon conditions in the real estate market. The addition of a real estate transfer tax would undoubtedly add to the volatility in our revenue system.

ATRA Position: Support