

# ATRA’s 2019 LEGISLATIVE REVIEW

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**The ATRA Legislative Policy Committee meets every Friday during the legislative session to review the impact of all proposed legislation on taxpayers and Arizona's public finance system. ATRA coordinates its advocacy efforts in the Legislature on important public finance and tax bills. Through testimony in committees and dissemination of information to legislators, ATRA serves as the only statewide taxpayer advocate at the Legislature.**

**The ATRA staff would like to express our gratitude to the members of ATRA's Legislative Policy Committee and Chairman Michelle Bolton for their guidance and effort during the 2019 legislative session. Special appreciation also goes out to members of ATRA's Tax Policy Committee whose knowledge, under the leadership of Chairman Bill Molina, has consistently proven to be indispensable to this organization's success during the legislative session and throughout the year.**

**During the First Regular Session of the 54<sup>th</sup> Legislature, 1,418 bills and resolutions were introduced. Of the 1,318 bills introduced, 320 passed and were signed while 11 were vetoed by the Governor. Twenty-six of the 100 resolutions introduced were adopted by the Legislature. This document summarizes key legislation ATRA supported, opposed, and monitored.**

**Additionally, ATRA would like to thank ATRA board member Steve Trussell, Executive Director of Arizona Rock Products Association, and his staff for graciously hosting the Legislative Policy Committee meetings.**

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## HIGHLIGHTS OF THE 2019 LEGISLATIVE SESSION

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This document summarizes key legislation ATRA actively supported, opposed or monitored during the First Regular Session of Arizona's 54<sup>th</sup> Legislature. Many ATRA sponsored bills as well as legislation ATRA advocated for passed and were signed by the Governor and all legislation ATRA opposed failed.

ATRA staff advocated for significant reforms in the areas of Transaction Privilege Tax and Individual Income Tax while also supporting improvements to the property tax. ATRA opposed several legislative proposals that would have damaged the state's public finance system or decreased government transparency.

The major legislative issues where ATRA played a key role included the following measures:

- ATRA successfully defeated a rushed and incomplete effort in HB2702 to implement an economic nexus law in order to apply sales taxes (TPT) on remote sellers. Stopping HB2702 allowed ATRA to drive a more sensible reform in HB2757, which for the first time in state history, created a state retail sales tax base that includes all localities. This municipal preemption allows the state to have a uniform base of taxes on retail sales so taxpayers do not have to suffer the burden of determining whether a product is taxable in each of Arizona's 91 cities. HB2757 included several reforms and protections for remote sellers, allowing Arizona to present a more simplified sales tax system that is less likely to invite a legal challenge on the grounds that its taxation violates interstate commerce.
- In addition to the *Wayfair* law, HB2757 included reforms to the individual income tax which conformed Arizona to the new federal code following the federal Tax Cuts and Jobs Act. After the Governor vetoed an effort that would have made small rate cuts to adjust for the base expansion, HB2757 went a step further by leveraging new state revenues to not only increase standard deductions while slightly reducing rates but to also eliminate a tax bracket, going from five to four.
- For the second year in a row, ATRA led a broad coalition of business groups to define in law the tax base for software and digital goods while exempting services provided digitally. However, lawmakers failed to pass SB1460 with opposition from cities citing exaggerated fiscal impacts.
- ATRA sponsored an effort in SB1334 to clarify the machinery and equipment sales tax exemption under independent functional utility following a flawed DOR ruling. Through stakeholder meetings with DOR, it was agreed the ruling could be restructured to adopt the historical meaning. With the bill made moot, it was held by the sponsor.
- Following the recent decision of several county treasurer's to discontinue mailing property tax statements to property owners with mortgages, ATRA led the successful effort in SB1033 requiring county treasurer's mail property tax statements to all taxpayers.
- ATRA was successful in its advocacy for SB1248, which requires all county assessors to apply Rule B in a uniform manner across the state when there are significant modifications to real property.

All bills ATRA actively opposed during the legislative session failed to pass and the following are a couple of examples:

- A proposal was introduced in both chambers to refer to the voters a proposal to raise the 0.6% sales tax for education to a full penny and change the current formula. ATRA was one of the few opponents, on the grounds that the new dollars did not come with any taxpayer reforms. SCR1001 and HCR2024 passed out of education committees but did not receive floor votes on either side.
- ATRA opposed an effort to rename school district override elections to "local support" in an effort to obfuscate the ballot language. ATRA opposed HB2304 in the House Education committee, where it failed on a bipartisan vote.

# LEGISLATION LISTED BY BILL NUMBER

## LEGEND FOR ATRA'S POSITION:

S = Supported    O = Opposed                      FA = Favorably Amended                      M = Monitored

| BILL NUMBER, SHORT TITLE, AND PRIMARY SPONSOR |  | POSITION | FINAL STATUS/<br>CHAPTER #           | PAGE |
|---|--|----------|--------------------------------------|------|
| HB2042  | S/E: statute of limitations; income tax (Petersen)           | M        | <a href="#">Chapter 48</a>           | 11   |
| HB2095  | property taxes; agricultural classification; payments (Cook) | S        | <a href="#">Chapter 49</a>           | 6    |
| HB2097  | personal property; reporting; exemption (Cook)               | S        | <a href="#">Chapter 225</a>          | 6    |
| HB2109  | county transportation excise tax (Shope)                     | M        | <a href="#">Chapter 50</a>           | 12   |
| HB2241  | JLAC; political subdivisions; investigation (Kern)           | S        | <a href="#">Chapter 209</a>          | 6    |
| HB2304  | school districts; overrides; ballot question (Udall)         | O        | Failed House WM                      | 8    |
| HB2360  | TPT; estimated payments; liability threshold (Toma)          | M        | <a href="#">Chapter 290</a>          | 12   |
| HB2367  | limited audit review; electronic portal (Toma)               | FA       | <a href="#">Chapter 169</a>          | 10   |
| HB2373  | tax corrections act of 2019 (Toma)                           | FA       | <a href="#">Chapter 203</a>          | 10   |
| HB2445  | TPT; residential rentals; notice (Griffin)                   | S        | <a href="#">Chapter 53</a>           | 7    |
| HB2493  | appraisal methods; solar energy devices (Cobb)               | M        | <a href="#">Chapter 291</a>          | 12   |
| HB2563  | education funding; use tax; TPT (Udall)                      | O        | Held House Rules                     | 8    |
| HB2672  | vacation rentals; short-term rentals; regulation (Kavanagh)  | FA       | <a href="#">Chapter 240</a>          | 10   |
| HB2677  | JLAC; auditor general (Kern)                                 | S        | Vetoed                               | 9    |
| HB2686  | business licensing requirements; web portal (Weninger)       | S        | <a href="#">Added to FY20 Budget</a> | 7    |
| HB2702  | TPT; marketplace facilitators; nexus (Toma)                  | O        | Held House Rules                     | 7    |
| HB2734  | NOW: prime contracting; study committee (Cobb)               | S        | Held in Senate                       | 9    |
| HB2757  | tax provisions; omnibus (Toma)                               | S        | <a href="#">Chapter 273</a>          | 7    |
| HCR2024                                       | TPT and use tax; education (Udall)                           | O        | Held House Rules                     | 8    |
| SB1019  | S/E: TPT; over the top (S Allen)                             | M        | <a href="#">Chapter 189</a>          | 11   |
| SB1033  | property tax statements; mortgaged property (Leach)          | S        | <a href="#">Chapter 167</a>          | 5    |
| SB1080  | TPT; use tax; education (Allen S)                            | O        | Held Sen 3rd Rd                      | 8    |
| SB1101  | schools; calculated opportunity index (Carter)               | M        | Held in Approps                      | 11   |
| SB1161  | S/E: school facilities; revisions (Leach)                    | S        | <a href="#">Chapter 247</a>          | 5    |
| SB1235  | possessory improvements; government property (Mesnard)       | S        | <a href="#">Chapter 249</a>          | 5    |
| SB1248  | property taxes; valuation; property modifications (Leach)    | S        | <a href="#">Chapter 306</a>          | 5    |
| SB1256  | school districts; procurement practices; auditors (Gray)     | M        | <a href="#">Chapter 85</a>           | 11   |
| SB1334  | independent functional utility (Mesnard)                     | S        | <a href="#">Fixed in Rule</a>        | 6    |
| SB1366  | commerce authority; data centers (Mesnard)                   | M        | Held House Rules                     | 11   |
| SB1451  | statewide ballot measures; circulators; procedures (Leach)   | S        | <a href="#">Chapter 315</a>          | 6    |
| SB1460  | TPT; digital goods and services (Ugenti-Rita)                | S        | Held Sen COW                         | 9    |
| SCR1001                                       | education; TPT; use tax (Allen S)                            | O        | Held Sen 3rd Rd                      | 8    |

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## PASSED LEGISLATION ATRA SUPPORTED

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### **SB1033 tax statements; property owner (Leach)**

**Chapter 167**

SB1033 requires Arizona's fifteen county treasurers mail property tax statements to all property owners, including those with mortgages. Prior to this legislation, county treasurers were only required to communicate property tax bills to mortgage companies and had the *option* to mail the statements to the property owners as well. However, in recent years, the number of treasurers that were opting not to mail the statements began to grow, including Arizona's largest county, Maricopa. Consequently, taxpayers with mortgages were not notified of their property tax burden until it was communicated by their mortgage company months later. ATRA advocated for this legislation because the property tax statement serves as an important educational tool that reflects the final decisions made by the various taxing jurisdictions during the budgeting process. *See ATRA position paper in Appendix.*

### **SB1161 S/E: school facilities; revisions (Leach)**

**Chapter 247**

The section of law related to requiring districts to account for vacant or partially used district space is rewritten and has several new reporting requirements. State law already requires school districts report to the School Facilities Board (SFB) their vacant and unused space, the report is notoriously incomplete due to a lack of district reporting. Naturally, districts are hesitant to encourage competition in their vacant or unused facilities.

SB1161 makes it both the duty of SFB as well as the Department of Administration to produce a more robust report. They will annually publish a publicly available list of vacant and underutilized space suitable for use by *any* school (instead of *charter* school). Buildings used for special education, magnet schools, career and technical education, preschool, or facilities less than five years old will not be counted as partially used buildings, except these exceptions cannot exceed 25% of a districts total school building space. Buildings considered "partially used" must be at least 4,500 unused square feet. Vacant buildings are those that have been vacant and unused for two years or more. Districts may dispose of district space without a public vote if the space has been vacant for three years.

Nonvoter approved lease agreements (as lessee or lessor) may last up to 20 years from 15 years, while retaining the exemption against constructing new district school facilities, which must be voter approved unless all payments come from unrestricted capital monies. At the end of a district lease with a charter operator, a district has the option to increase rent for the space but must provide a public rationale. The bill also authorizes governing boards the authority to enter into partnerships with a charter school, another school district or a military base, (although this may not be a change but a clarification).

### **SB1235 possessory improvements; gov. property; assessment (Mesnard)**

**Chapter 249**

Requires Interests on Possessory Improvements (IPI) located on federal, state, county or municipal property to be valued using standard appraisal methods and that the Limited Property Value (LPV) be calculated the same as all other real property. Currently, IPI's are valued as personal property, and therefore, are taxed at their Full Cash Value (FCV).

### **SB1248 property taxes; valuation; property modifications (Leach)**

**Chapter 306**

As introduced in the Senate, SB1248 would have set the "Rule B" threshold at 20% when property is modified by new construction, destruction or demolition. Modifications pertaining to tenant improvements would not trigger a Rule B calculation whereas current statute is silent, and therefore, has caused a lack of uniform treatment across the state. The Rule B percentage is applied to a property's FCV to determine the Limited Property Value (LPV) in cases when property has been significantly modified under the aforementioned circumstances. The current threshold is set only in DOR guideline at 10%; however ultimately, it's up to the county assessor's discretion. Unfortunately, leaving the decision up to the

discretion of the county assessors has led to disparate treatment among property taxpayers throughout the state. Following opposition by the county assessors that believed 20% was too high and that tenant improvements should not be excluded, the bill was amended to remove the language pertaining to tenant improvements and the threshold was reduced to 15%. Having the percentage in statute rather than DOR guideline will require all county assessors to apply Rule B uniformly for all property taxpayers. *See ATRA position paper in Appendix.*

**SB1334 independent functional utility; deduction (Mesnard)**

**DOR Amended PTR**

SB1334 attempted to clarify that the nonpermanent attachment of exempt machinery and equipment (M&E) to real property maintains its exempt status. This legislative proposal was developed by ATRA's Tax Policy Committee in response to an incorrect DOR Private Taxpayer Ruling (PTR) that, if left unaddressed, would have undermined Arizona's M&E exemption. The DOR ruling stated that merely bolting exempt M&E to a concrete slab would render the labor associated with the installation of that exempt M&E taxable. Fortunately, after much discussion with DOR officials, the agency agreed to amend the ruling to correctly reflect the law. As a result of DOR's commitment, ATRA requested the bill be held in committee. *See ATRA position paper in Appendix.*

**SB1451 statewide ballot measures; circulators; procedures (Leach)**

**Chapter 315**

SB1451 makes several changes to the initiative and referendum process. The bill requires all paid circulators and all out-of-state circulators for statewide initiative and referendum measures register with the Secretary of State (SOS) and provide their contact information and a signed, notarized affidavit. The SOS will assign them a circulator registration number which they must include on each signature sheet. Registered circulators must not have a civil or criminal penalty imposed for election fraud within five years, not have been convicted of treason or a felony without their civil rights restored, or not have ever been convicted of fraud, forgery or identity theft. There were several other smaller changes.

**HB2095 property taxes; agricultural classification; payments (Cook)**

**Chapter 49**

Amidst the state adopting a new Drought Contingency Plan were concerns that agricultural properties would lose their agriculture property tax classification because of a state-imposed reduction in water, putting them in a less favorable classification of vacant land. The exception for fallowed land was expanded to include properties that experience a *partial* reduction in water from an irrigation or water district. Late in the process the bill was amended to allow a county treasurer to enter into a payment plan with a taxpayer over delinquent business personal property taxes of more than \$1,000 but may not charge more than \$150 in administrative or processing costs.

**HB2097 personal property reporting; exemption (Cook)**

**Chapter 225**

In 1996, voters approved a constitutional amendment that exempted the first \$50,000 in personal property Full Cash Value (FCV). The exemption was intended to alleviate the administrative burden on small business taxpayers. Following the constitutional amendment, the Legislature enacted a law that removed the requirement for these small businesses to annually report their exempt personal property. Despite the clarity in current law, one county assessor began to deny the exemption to businesses who followed the law and did not report their exempt property. HB2097 further clarifies that taxpayers are not required to report their exempt business personal property to the county assessor.

**HB2241 JLAC; political subdivisions; investigation (Kern)**

**Chapter 209**

HB2241 requires each political subdivision subject to a constitutional expenditure limitation comply with the uniform expenditure reporting system, instructions and forms prescribed by the Office of the Auditor General (OAG). The OAG may notify the JLAC and the Attorney General (AG) if any political subdivision does not comply and the AG may file a petition for special action in any court of competent jurisdiction to compel any political subdivision to comply. The AG may apply for injunctive relief in any court of competent jurisdiction to enjoin any political subdivision from violating these requirements.

**HB2445 TPT; residential rentals; notice (Griffin)**

**Chapter 53**

HB2445 requires cities and towns notice by first class mail any new or increased rate of tax at least sixty days before the effective date of the rate change. The notice is required to be sent to each residential transaction privilege tax (TPT) licensee and to the address of each residential rental property. The intent is to give proper notification to renters and lead time for landlords to adjust tenant charges.

**HB2686 business licensing requirements; web portal (Weninger)**

**Included in State Budget**

As adopted in the state budget with a \$1 million appropriation, the Department of Administration will coordinate with the Arizona Commerce Authority to create a web portal that services as a ‘Business One-Stop’ that combines several state functions to simplify the creation of businesses and corporations. Currently, the Business One Stop is a website complete with links to other state agencies. The intent of the appropriation is to imbed functionality so the processes such as filing with the Secretary of State, Corporation Commission, and the Department of Revenue are streamlined.

**HB2757 tax provisions; omnibus (Toma)**

**Chapter 273**

The tax omnibus bill that was passed alongside the state budget had two major provisions: it conforms Arizona’s income tax code to the federal code post Tax Cuts and Jobs Act (TCJA) and implements an economic nexus law to require remote sellers collect and remit Arizona TPT. As passed, the bill retroactively conforms tax year 2018 to the new federal tax code, which was scored as a \$155 million tax increase to state coffers. This revenue was leveraged in the budget as a one-time payment towards state debt incurred during the recession. The debt reduction saves the state \$24 million through the life of the debt service. For tax year 2019, the state similarly conforms to the latest federal code and the \$217 million revenue increase associated with 2019 conformity is leveraged to make changes to the income tax code, to include higher standard deductions of \$12,200 (single) and \$18,400 (married) to match the new federal system. The bill also dissolves one income tax bracket, going from five to four total brackets and shaves rates by small amounts. Finally, it added a dependent tax credit and an “above the line” charitable deduction for filers electing to use the standard deduction. The reform eliminates the personal and dependent exemptions.

The bill also requires remote sellers and marketplace facilitators remit Arizona TPT, responding to the SCOTUS *Wayfair* ruling, which dropped the physical presence nexus requirement. HB2757 creates a statutory retail base, preempting localities from changing the base of tax without amending state law. The taxability and definitions of retail goods will be uniform between the state and localities for the first time in Arizona history. There were several reforms and technical adjustments to implement this law. All told, the revenue package was scored as neutral, except at the local level, where K-12 schools, cities and counties benefit greatly from new sales tax obligations. *See ATRA position paper in Appendix.*

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**FAILED LEGISLATION ATRA OPPOSED**

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**HB2702 TPT; marketplace facilitators; nexus (Toma)**

**Held in House Rules**

When the Supreme Court eliminated the physical presence test in *Wayfair v. South Dakota*, allowing states to apply an economic nexus standard and thus impose their sales taxes on remote sellers, ATRA welcomed the decision. ATRA called on policymakers to immediately begin the necessary work to address this complex issue. ATRA recommended a study committee in 2019 to address the many issues involved from policy to implementation. Other states with complex sales tax systems like Colorado, Alabama, and Louisiana have created task forces to study this issue. Several national groups have warned these states

against hastily crafted economic nexus laws which create undue burdens on remote sellers, lest they result in litigation. HB2702 was a rushed effort which created an economic nexus and marketplace facilitators nexus law without sufficient reforms to make the law less vulnerable to such litigation. In particular, the bill did not create a uniform base of tax between the state and localities, only referring to a uniform retail base by reference, the definition of which would effectively be controlled by the cities themselves. This would have the effect of creating distinct tax bases between goods sold online versus those in traditional stores, creating more chaos for taxpayers and possible equal protection violations.

Several business groups opposed HB2702 and asked lawmakers to go back to the drawing board, resulting in the scrapping of HB2702. A group of local tax lawyers and several national experts warned lawmakers their approach was insufficient to meet the demands of the *Wayfair* case and would likely result in litigation. ATRA also argued the significant tax increase associated with an economic nexus law should be acknowledged. A renewed effort began late in the session to create an economic nexus law which ATRA worked on, see HB 2757. *See ATRA position paper in Appendix.*

**HB2304 school districts; overrides; ballot question (Udall) Failed in House Education**

A bill that has been introduced several times in the past, HB2304 sought to water down the “ballot question” for K-12 district overrides from “Budget Increase Yes/No” to “Local Support Yes/No”. In ATRA’s opinion, the school lobby already maintains a favorable advantage in override questions because they do not mention the word “tax” when the operative function of a school override is an additional property tax. In addition, when districts are simply extending their current override, the question is a cozy “Override Continuation Yes/No”.

ATRA opposed this effort because it is an inappropriate ballot question for K-12 budget overrides. As the place where the voter marks their vote, it’s important that it remain legitimate. To opt for a most obscure “local support” not only clouds the meaning of the question, it delegitimizes the point of voter approval. The truth is property taxpayers “locally support” school districts whether they approve overrides or not, through two property taxes in the State Equalization Tax Rate and the Qualifying Tax Rate, making this option most inappropriate as it suggests that a ‘No’ vote means the voter intends to provide no “local support”. ATRA argued in committee that if any change should be made, it should be the addition of a mention that it is a property tax question, as in “Additional Property Tax for Budget Increase, Yes/No.”

**HB2563/SB1080/SCR1001/HCR2024 TPT use tax; education (Udall/S Allen) Held in Each Chamber**

Companion bills in the House and Senate along with accompanying ballot referrals would ask voters to raise the current 0.6% sales tax for education to 1% and revise the appropriation formula. The existing formula sends roughly \$623 million total to K-12 education, \$83 million to Universities and \$25 million to community colleges, although it is rather complex and has several buckets. As amended on the floor on both sides, the bill would eliminate most of the buckets and simply give 75% of the money to K-12 with far fewer restrictions, 20% to Universities and roughly 5% to community and tribal colleges. K-12 would receive just shy of \$300 million in new funds. Universities and community colleges would receive \$140 million and \$32 million respectively in new revenue.

ATRA opposed this sales tax increase primarily because it lacks reforms to the school finance system. Further, the bill watered down the existing Classroom Site Fund by removing the performance pay provision, suggesting all teacher pay be based on a traditional pay scale. Finally, the dilution of the Prop 301 formula, by putting so much revenue in the higher education buckets, added only a fractional amount of money for K-12, eliminating the ability to derive reforms from the funding increase. *See ATRA position paper in Appendix.*

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## FAILED LEGISLATION ATRA SUPPORTED

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### **SB1460 TPT; digital goods and services (Ugenti-Rita)**

**Held in Senate**

Following a 2017 legislative study committee which found the state lacks statutory authority to tax digital goods and services, the legislature attempted a legislative fix in 2018 to provide the state the legal authority to tax digital goods and exempt digital services. When that effort failed, the coalition of businesses and business groups helped construct a modified effort for 2019 in SB1460. In addition to having a slightly broader scope of taxable goods, the 2019 version did not address the taxation of data center services, an area of past controversy. The bill established definitions for software, digital goods, and digital services in a new classification of TPT. It made licensed prewritten software and all digital goods subject to TPT, regardless of transfer method. Licensed software is software where the user has the right to electronic transfer; in essence the user has a right to a full copy as opposed to remote access. For digital goods, such as ebooks, movies, television shows and audio files, they are taxable if transferred electronically or accessed remotely. Though this made streaming audio and video taxable, there were exemptions for scheduled programming, such as live linear broadcast, which have never been subject to TPT.

Similar to the year prior, The League of Cities and Towns produced a fiscal analysis saying it would cost the state \$60 million. This was after their claim in March of 2018 it was \$200 million followed by a quick recalculation dropping it to \$120 million. Ultimately the Department of Revenue estimated the fiscal impact was \$33 million to the state. A League of Cities amendment would have made all digital goods and services subject to tax with the exception of a cynical compromise to exempt a few targeted industries lobbying the bill. The bill passed Senate Finance but was held on the Senate floor. Despite mounting lawsuits against the state's tenuous legal position, lawmakers were not moved to address the problem, leaving Arizona without a law on the taxation of these products. *See ATRA position paper in Appendix.*

### **HB2677 JLAC; auditor general (Kern)**

**Vetoed**

HB2677 would have required officers of any state agency, board, commission, department, institution, program advisory council or committee or political subdivision of this state to afford reasonable and needed facilities for the Office of the Auditor General (OAG) staff and make records available. Specified that any officer or person who knowingly fails or refuses to allow access and examination or otherwise knowingly obstructs or misleads the OAG in the execution of the OAGs duties is guilty of a class 2 misdemeanor. For a county or community college district that is required to comply with the federal single audit requirements, audits must include compliance audits of financial transactions and applicable accounts and audits must be conducted in accordance with generally accepted governmental auditing standards, among other requirements. Requires the OAG to conduct an audit of a county transportation excise tax every five years instead of ten years. The Governor's veto message simply stated that the measure "may have unintended consequences."

### **HB2734 NOW: prime contracting; study committee (Cobb)**

**Held in Senate**

In response to a recently published study that reported noncompliance under Arizona's prime contracting class could be as high as \$1 billion in lost tax revenues, Rep. Cobb advanced HB2734 to create a prime contracting study committee. Rep. Cobb's efforts stem from years of disagreement between the business community and the League of Arizona Cities and Towns regarding the level of noncompliance resulting from the administrative complications of the prime contracting class. The study committee proposed under HB2734 would be tasked with analyzing the legal framework and examining best practices from other states and policy experts on the taxation of prime contracting to reduce the noncompliance under Arizona's prime contracting law. Although the bill passed unanimously out of the Ways & Means Committee and the entire House, the bill was never assigned a hearing in the Senate.

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## LEGISLATION ATRA FAVORABLY AMENDED

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### **HB2367 limited audit review; electronic portal (Toma)**

**Chapter 169**

As introduced, HB2367 would have allowed DOR to conduct limited scope audits of taxpayers based on information received from a third party (undefined). Additionally, the bill would have allowed DOR to request records from a taxpayer in support of the taxpayer's filed return and propose a tentative amount of tax, penalties and interest, in response to the third party information. The taxpayer would have at least 15 days to respond to the request to submit additional data to substantiate or resolve any discrepancies in their return. Failure to respond to DOR's request within the 15 days would allow the taxpayer to be assessed tax, penalties and interest. Further, a limited scope audit would not preclude DOR from conducting subsequent audits. ATRA opposed the bill as introduced for several reasons, but mainly because it failed to protect taxpayers by allowing DOR to subsequently audit the same taxpayer multiple times for the same tax periods.

ATRA worked with DOR throughout the session to produce a bill that allowed DOR flexibility to clear up discrepancies with taxpayers, but would not minimize the current protections provided to taxpayers. In its final version, HB2367 allows DOR to conduct a limited scope review of a filed individual income tax return if a discrepancy is reported based on information received by an employer. The bill allows DOR to request information from the taxpayer and to propose a tentative amount of taxes, penalties and interest based on the additional information; however, the taxpayer would have at least 30 days to respond. A limited scope review can only be conducted once per tax year per taxpayer and is not considered to be an initial "audit contact" under specified circumstances. Additionally, beginning January 1, 2019, DOR may issue deficiency assessments to individual income taxpayers through an electronic portal in lieu of mail with written consent from the taxpayer.

### **HB2373 tax corrections act of 2019 (Toma)**

**Chapter 203**

HB2373 is the annual tax corrections bill that is intended to provide technical clarifications to existing statutes. However, as introduced, HB2373 included substantive changes that ATRA recommended be removed as they deserved a larger policy discussion. Specifically, DOR was attempting to accelerate their ability to issue deficiency assessments via an electronic portal and to expand the definition of nonaudit adjustments, both of which were considered to be substantive changes and thus required more debate (some changes were later adopted under HB2367). The bill was also amended to remove a significant change that would have expanded the denominator in the sales factor calculation for determining the threshold for taxpayers in obtaining market-based sourcing treatment under the corporate income tax sales factor formula.

### **HB2672 vacation rentals; short-term rentals; regulation (Kavanagh)**

**Chapter 240**

HB2672 addresses the regulations by cities and towns on short term, vacation rentals. ATRA's involvement in the legislation pertained strictly to the proposed expansion of confidential taxpayer information that DOR and the League of Arizona Cities and Towns were attempting to access. Specifically, language was added to the bill that would have allowed confidential taxpayer information be released to "any other law enforcement agency" (currently only applies to the Attorney General) in a proceeding involving tax administration. Another provision would have allowed a county, city or town tax official to "rediscover" confidential TPT information to nonelected officials in other units within the jurisdiction if they determine there is a legitimate business need to do so. To remove ATRA's opposition, sponsor Rep. Kavanagh agreed to remove those provisions from the final version of the bill.

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## SELECTED LEGISLATION ATRA MONITORED

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### **SB1019 TPT; over the top (S Allen)**

**Chapter 189**

SB1019 added an exemption to the telecommunications classification of Transaction Privilege Tax (TPT) for Over-The-Top (OTT) services, defined as audio or video programming that is comparable to linear or live programming, to include bundled on-demand programming. These services are not subject to TPT as distributed historically via cable or phone line. This exemption applies to distribution technology such as the internet or cellular data. It further preempts cities from adding a local tax on OTT.

The bill further added a clarification to the TPT sourcing statute by stating that when a seller receives an order outside the state of Arizona, they may source the TPT to the billers (or lessees) address if there is no shipping address available, which was a clarification of existing practice.

### **SB1101 schools; calculated opportunity index (Carter)**

**Held in House Appropriations**

SB1101 added a wrinkle to the existing public school finance formula which adds funding for districts and charters with schools that have more than the statewide average for poverty, measured by qualification for federal free or reduce lunch (FRL). A weight of .059 is added for this index, which is measured as the differential between each schools FRL rate and the statewide average, so funding is increased based on concentration of poverty. Recipients of the funding submit a report to the Legislature demonstrating the academic gains of pupils in these schools, using assessments aligned to state standards. As amended in the Senate, the bill reduced any monies levied in relation to Desegregation or compliance with the Office of Civil Rights on a fifty cent to each dollar ratio, although there were discussions of amending it back to a dollar for dollar reduction in the House, an amendment ATRA supported. Cost to the State GF was an estimated \$36M with a \$2.7M local property tax impact in non-state aid districts.

### **SB1256 school districts; procurement practices; auditors (Gray)**

**Chapter 85**

SB1256 removed two provisions from law introduced in the 2018 budget, one that required low-bid procurement for all district school procurement and one that required districts rotate auditors every three years and that the audit firm also not be a financial consultant to the district. The bill also added a pilot program where one medium sized district and two small districts with ongoing alternative delivery procurements will receive technical assistance and consulting from the School Facilities Board.

### **SB1366 commerce authority; data centers (Mesnard)**

**Held in House Rules**

Adjusts the data center tax relief program to clarify the exemption for equipment purchases, which were meant to emulate machinery and equipment exemptions enjoyed by manufacturers. In addition to servers, networking equipment and other physical equipment, enabling software was also exempt. Following a dispute over the definition of enabling software, SB1366 removed the term enabling and defined the software exempt from tax from certain data centers as any software purchased or licensed to support, maintain or use in any aspect of a computer data center or its computer data center equipment, including software that affects operations, networking, operating systems, data storage and manipulation, cloud computing, automation, virtualization, management, security and other uses.

### **HB2042 income tax; statute of limitations (Petersen)**

**Chapter 48**

In most cases, the statute of limitations in which a taxpayer may be audited by DOR is four years. Under current law, however, DOR may issue a deficiency assessment at any time in the case of failure to file a return. As enacted, HB2042 authorizes DOR to issue a deficiency assessment or begin a proceeding in court at any time in the case of failure to file an income tax or withholding tax return *if* it is shown that the failure was due to an intent to evade tax. Otherwise, DOR has seven years to file a deficiency assessment if a taxpayer fails to file a report for income tax or withholding tax.

**HB2109 county transportation excise tax (Shope)**

**Chapter 50**

Doubles the existing half-cent transportation excise tax rate that may currently be levied to support a regional transportation authority. The total tax rate levied under this section and the existing half-cent authority to fund county roads cannot exceed one-cent.

**HB2360 TPT; estimated payments; liability threshold (Toma)**

**Chapter 290**

Under current law, a business entity with an annual total tax liability greater than \$1 million is required to file an estimated TPT payment in June. HB2360 increases the threshold to \$1.6 million in 2020, \$2.3 million in 2021, \$3.1 million in 2022, \$4.1 million in 2023 and each year thereafter.

**HB2493 NOW: appraisal methods; solar energy devices (Cobb)**

**Chapter 291**

Solar energy devices, grid-tied photovoltaic systems and any other device or system designed to produce solar energy primarily for on-site consumption characterized as personal property is valued annually at its taxable original cost less depreciation. The depreciation schedule is based on a ten-year life and is 3% of the scheduled depreciated value for the first three years, 4% in the fourth year, 5% the fifth year, 6% the sixth year, 8% the seventh year, 11% the eighth year, 24% in the ninth year, and 100% of the scheduled depreciated value in the tenth year. The “taxable original cost” is defined as the original cost minus renewable energy equipment investment tax credits, production tax credits or cash grants in lieu of investment tax credits. Requires solar equipment that was valued prior to this act be recalculated and any excess tax be refunded to the taxpayer.

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**PASSED LEGISLATION ATRA OPPOSED**

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*None*

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# ARIZONA TAX RESEARCH ASSOCIATION

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## 2019 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 that the Fiscal Year (FY) 2020 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.

For the first time in many years, strong economic growth has driven state tax collections above budgeted estimates for two fiscal years, dramatically improving the state's fiscal condition. The Joint Legislative Budget Committee (JLBC) is estimating that lawmakers will have access to more than \$900 million in one-time revenues for the FY 2020 budget. It is imperative that Governor Ducey and lawmakers carefully distinguish between appropriations that create on-going expectations from obvious one-time expenditures like capital outlays and debt retirement.

ATRA will provide updated state budget recommendations to the Legislature after the JLBC and the Office of Strategic Planning and Budgeting (OSPB) have submitted their recommendations for the FY 2020 budget.

### **Taxation**

**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, 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%.

**Prevent greater access to the property tax.** For the 2019 session, ATRA will oppose efforts on the part of Arizona State and 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 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 2019 session, ATRA will pursue the following legislation:**

**Prospectively apply GPLET to Board of Regents; Community Colleges; and School Districts (Senator Vince Leach)**

There presently is not a mechanism in law to tax possessory interests on government-owned property other than for cities, counties and some special districts who are subject to GPLET. Arizona’s universities, through the Arizona Board of Regents, 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. Instead they have mostly become a tax-free zone.

The most curious case has occurred at Arizona State University (ASU), where 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 that is counterproductive for state and local governments and bad for taxpayers.

The legislation will seek to prospectively apply the existing GPLET law to the Arizona Board of Regents, community college districts, and school districts.

## **Mailing Property Tax Bills to Mortgagees (Senator Vince Leach)**

ATRA will pursue legislation requiring all county treasurers to mail a statement reflecting the current property bill to every mortgagee. There is currently no statutory requirement for County Treasurers to mail property tax bills to mortgagees. Fortunately, nine of the fifteen counties currently mail property tax bills to all taxpayers and mortgage companies. ATRA believes this critical information should be made available to taxpayers in every Arizona County.

## **Sales Tax**

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

Following a 2017 Ad Hoc Joint Legislative Study Committee which recommended statutory updates to make clear what is taxable in the digital space, ATRA will again pursue legislation in 2019 to update Arizona's tax code related to the taxation of Digital Goods and Services (DGS). Existing sales tax laws deal with tangible property. The application of sales taxes to *intangible* products purchased over the Internet has gripped states across the country who struggle to make clear distinctions between taxable and nontaxable purchases. Arizona has yet to define these taxes in law and can draw from nationwide best practices.

In the absence of clearly defined laws, the Arizona Department of Revenue has taken the aggressive stance through audits that any transaction occurring on the Internet that involves software is subject to Transaction Privilege Tax (TPT), typically through the rental of personal property classification. Given that all digital transactions leverage software in one form or another, this can only mean that every exchange via the Internet is taxable, regardless of whether or not it clearly is a service. Interestingly, Arizona is the only state to attempt to tax digital services such as remotely accessed or cloud software without a state law on the taxation of software generally.

A fair resolution to this process would be to tax products which mirror analog goods or amusements, which are typically subject to tax in Arizona, and exclude those which most closely reflect services. The proposed legislation will make licensed software, digital goods, and streaming products subject to tax while excluding digital services, defined as remotely accessed software. The taxable products will not be dependent on a particular delivery or purchase model.

Arizonans deserve to know their tax obligations. With lawsuits mounting, the state's liability for taxing without authority is growing. This legislation will bring Arizona into compliance with the federal Internet Tax Freedom Act, which among other things prohibits states from taxing products provided electronically that are not similarly treated in their analog form. Importantly, it will provide clarity to the business community who presently is in the untenable situation where they cannot possibly know which products are subject to tax.

## **Taxing Remote Sellers**

On June 21, 2018, the United States Supreme Court in the *Wayfair v. South Dakota* case, reversed its 1992 *Quill* decision that required a physical presence for a state to impose a sales tax obligation on a remote seller. In the ruling, the Supreme Court said key features of South Dakota's system removed or addressed undue burdens upon interstate commerce. South Dakota's state and local sales tax code, over a period of several years, was simplified to address the Supreme Court's concerns regarding undue burdens placed on remote sellers. Unfortunately, Arizona's state and local sales tax code remains one of the most administratively complex in the country — well short of the Supreme Court's requirements set forth in the *Wayfair* decision.

ATRA will support the creation of a legislative study committee to analyze and recommend changes to Arizona's state and local sales tax system necessary for Arizona to begin taxing remote online sellers.

## **Independent Functional Utility**

Like most states in the country, Arizona provides a sales tax exemption for machinery and equipment (M&E) used in manufacturing, mining, utility, and telecommunications. Arizona businesses have struggled for years with state auditor's efforts to complicate and undermine this important exemption by attempting to tax the labor associated with the installation of the exempt equipment through the prime contracting tax. State policymakers have attempted to address this problem in prior legislation. The most recent attempt to provide clarity regarding the tax treatment on the installation of exempt M&E was HB2535 in 2013. HB2535 established that the labor for the installation of exempt machinery and equipment was deductible if the equipment had "independent functional utility." The independent functional utility test clearly established that the exemption was not lost if the labor was associated with assembling the M&E or stabilizing it through bolting or burying it. The Legislature's support for protecting the M&E exemption was reflected in the unanimous support for HB2535.

Regrettably, private letter rulings from the Arizona Department of Revenue are again attempting to narrow the exemption. Those rulings are in direct conflict with the 2013 law — denying the labor exemption for equipment being attached to real property for purposes of stabilization.

ATRA will pursue legislation to clarify the tax treatment for the installation of exempt M&E and the legislative intent of the 2013 law.



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## ARIZONA TAX RESEARCH ASSOCIATION

### **ATRA Applauds HB2757, Budget Tax Plan**

#### Leveraging new revenues for reform is smart policymaking

Making changes to the tax code is never easy and opportunities for revenue neutral reform are rare. With two major revenue producing tax law changes available, state lawmakers and the Governor have elected to make prudent use of that revenue with modest tax reform.

#### *Conformity*

When the federal government expanded the personal income tax base and lowered rates, it became necessary for states who conform their income tax code to the federal code to decide what to do about this expanded base of tax. The reform proposal in the budget offers several advantages and is consistent with the philosophy in the federal Tax Cut and Jobs Act (TCJA). TCJA doubled the standard deduction and many will no longer itemize their deductions as a result. An estimated 90% of taxpayers will use the standard deduction for their federal tax filings. Leveraging the same philosophy, higher standard deductions at the state level will mean taxpayers need not recreate a Federal Schedule A. The state filing will be simplified for the vast majority of taxpayers.

Importantly, “this conform with reform”, which also reduces the income tax brackets from five to four, keeps the faith with taxpayers that the income tax conformity process will not be used as a backdoor tax increase. Each year the state conforms to the federal code with little fanfare, despite its significance. If taxpayers could not rely on state lawmakers to fairly acknowledge when there is a tax increase as a result of conformity, there would be a renewed effort to permanently decouple from the system.

#### *Wayfair*

ATRA has long supported the notion of applying TPT (sales) taxes on sales conducted but warned of the legal hazards. While the introduced bill did not go nearly far enough to make Arizona’s sales tax system fair for remote sellers, who must figure out the sales tax based on the destination of each product sold, the final product goes a long way towards simplifying Arizona’s retail TPT. The state is making the necessary change of creating a statutory retail base, so taxpayers nationwide can trust there is one code housed at the state level, meaning the taxability and definitions of retail goods is uniform. Between this major change and the 2013-14 reforms, which consolidated collection, remittance, and audit at the state level, Arizona will be able to present a sales tax system that is easier to comply with and is less liable in a legal challenge.

**Finally, it is appropriate to acknowledge the revenue windfall associated with this change, as both individuals and businesses will certainly pay more TPT going forward. By using this revenue increase as part of a tax reform package, a good faith effort has been made to give the money back to taxpayers.**



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## ARIZONA TAX RESEARCH ASSOCIATION

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### **ATRA SUPPORTS SB1033**

### ***Require County Treasurer's mail property tax statements to ALL property owners***

Arizona's property tax system is one of the most complicated in the country, and therefore, taxpayer education is imperative.

The County Assessor annually determines both the Full Cash Value (FCV) and the Limited Property Value (LPV), and no later than March 1<sup>st</sup> each year, is required to mail the property notice of valuation (NOV) to all property owners.

During the budget process, local governments make taxing and spending decisions to determine their annual budgets. Counties, in particular, go to great lengths to educate taxpayers how much of their tax bill is levied by the various taxing entities. More importantly, local taxing jurisdictions are required to publish notice and hold Truth-in-Taxation (TNT) hearings when they intend to increase property taxes.

Once those budgeting decisions are made, tax rates and levies are adopted in August. The County Treasurer is then responsible for collecting the applicable taxes after applying the adopted tax rates to all taxable values. The tax statement is the only place a homeowner sees the "homeowner rebate" where the state pays 48% of the K12 primary property tax obligation.

Currently ten of the fifteen counties mail property tax statements to every property owner. The other five counties, however, do not mail statements to owners of mortgaged property. Instead, they only communicate how much in property taxes is due to the mortgage company. Consequently, the property owner is never notified of their property tax liability.

The property tax statement serves as an important educational tool in that it reflects the final decisions made by the various taxing jurisdictions during the budgeting process. It should be a minimum expectation that all property taxpayers receive a property tax statement.

***ATRA ASKS LAWMAKERS TO VOTE YES ON SB1033!***



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# ARIZONA TAX RESEARCH ASSOCIATION

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## **ATRA SUPPORTS SB1334**

### ***Protect Arizona's Machinery & Equipment Exemption***

During the 1996 legislative session, the Legislature enacted legislation to reverse a court decision that would have done immeasurable harm to economic development in Arizona. The passage SB1280 was critical following the ruling in 1995 by the Arizona Court of Appeals in *Brink Electric Construction Co. v. Arizona Department of Revenue*, which at the time, changed the longstanding policy of the Arizona Department of Revenue (ADOR) regarding the tax treatment of the installation of exempt machinery and equipment (M&E) that did not become permanently attached to real property. Despite an existing ADOR regulation that required M&E become permanently attached, the Court of Appeals dismissed the permanent attachment test and concluded it was taxable contracting as long as the M&E remains "until the purpose to which the realty is devoted is accomplished."

Left unchanged, Arizona would have been the only state in the country that exempted the purchase of M&E from the retail sales tax only to turn around and tax the installation costs of those items in new facilities through the contracting tax. Considering the significant costs associated with the installation of M&E for capital intensive manufacturers, this tax would have become a major impediment to economic growth in Arizona. In its final form, SB1280 exempted from the prime contracting tax the costs associated with installing, assembling, repairing or maintaining M&E that is also exempt from the TPT retail class that does not become "permanently attached" to the real estate.

The passage of SB1280 in 1996, which was clearly intended to return to a pre-*Brink* status in law, capped a long and pronounced battle between taxpayers until 2012 when ADOR advanced a TPT ruling under prime contracting that reflected the holding of *Brink Electric*, completely ignoring the Legislature's actions under SB1280 in 1996 to overturn that decision. In the proposed ruling, ADOR stated that simply bolting down exempt M&E into a concrete base was considered permanently attached and therefore subject to TPT under the prime contracting class.

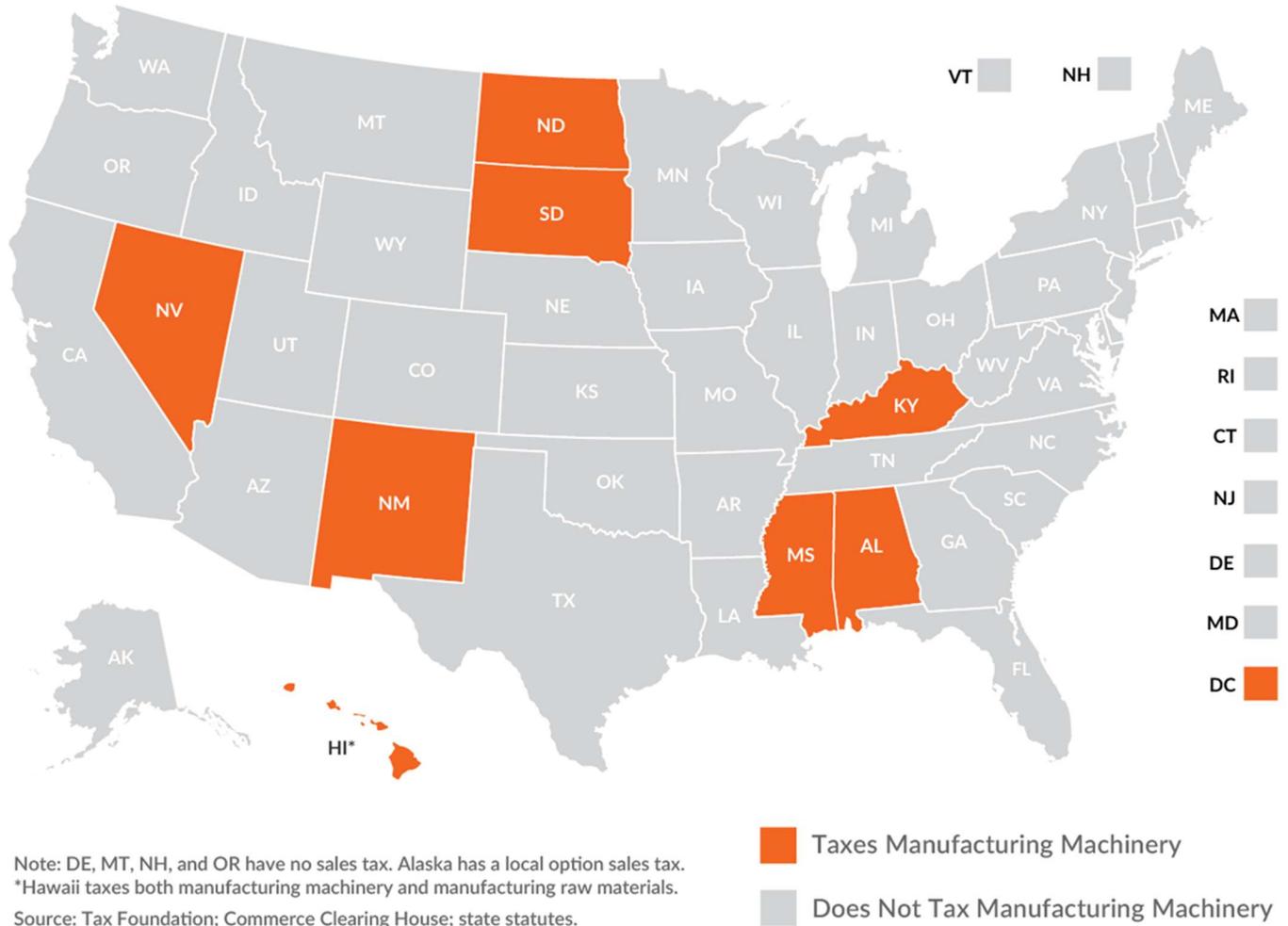
The most recent attempt to provide clarity regarding the tax treatment on the installation of exempt M&E was HB2535 in 2013. HB2535 established that the labor for the installation of exempt machinery and equipment was deductible if the equipment had "independent functional utility." The new independent functional utility test was a joint effort between ATRA and ADOR to clearly establish that the exemption was not lost if the labor was associated with assembling the M&E or stabilizing it through bolting or burying it. The Legislature's support for protecting the M&E exemption was reflected in the unanimous support for HB2535.

Regrettably, private letter rulings from ADOR are again attempting to narrow the exemption. Those rulings are in direct conflict with the 2013 law – denying the labor exemption for equipment being attached to real property for purposes of stabilization.

SB1334 is an attempt to reverse ADORs latest effort to change the longstanding treatment of the installation of exempt M&E under the prime contracting class. SB1334 removes the requirement that connections to real property be “nonpermanent” in order to maintain the legislative intent of past legislative enactments that sought to preserve the M&E exemption.

## Does Your State Tax Manufacturing Machinery?

Sales Taxes on Manufacturing Machinery, 2019



# DIGITAL GOODS & SERVICES COALITION

## SUPPORTS SB1460

### Make Clear in Law the Taxation of Digital Goods & Services

- AZ presently lacks statutory clarity in its taxation of digital goods and services
- AZ only has one adopted rule, taxing prewritten software delivered by any means (R15-5-154B)
- AZ has no laws or rules related to Digital Goods or Digital Services, only private taxpayer rulings
- Private letter rulings arbitrarily making some SaaS/Cloud products taxable is untenable
- Lack of clarity is an economic impediment, creating uncertainty & restricting capital investment

#### WHAT DOES THE BILL DO?

- Codifies the 2005 rule taxing prewritten software
- Licensed prewritten software is taxable regardless of provisioning method
- Digital goods are taxable regardless of provisioning
- Excludes digital services from tax
- Makes the tax uniform between state & city level
- Similar philosophy as 2018 bill

#### WHAT IS A DIGITAL GOOD?

- Nationally accepted definitions for consumer digital products
- Audiovisual works
- Audio Works
- Books, Articles, Periodicals
- Visual Works (still images)

*-The Legislature can determine what is taxable or the courts may determine NONE of it is*

*-At least 5 separate legal challenges to ADORs position have been filed*

From the Superior Court's December denial of DOR's motion to dismiss in *Netflix v ADOR*:  
 "Even if, as a matter of law, Plaintiff's business receipts are derived from "tangible personal property," it is not clear that they are taxable under A.R.S. §42-5071. In order to be so, the receipts must be from the lease of rental of the property. In order to so qualify, the taxpayer's customer must have "exclusive use and control" of the property for a time period. **On this issue, Plaintiff has pled facts which, if true, would allow a conclusion that its property is not rented or leased.**" TX 2018-000073

"Finally, in order to be taxable under A.R.S. §42-5071, the Plaintiff's business activity must, in their essence, not be in the nature of a service. Again, on this issue, Plaintiff has plead fact which allow a conclusion that its activity is more of a service that it is a lease or rental of personal property."

*The Courts may agree streaming goods are services, which then requires a Constitutional amendment to make them taxable in the future. This bill deems them goods in law and subject to tax.*

## ORGANIZATIONS IN SUPPORT OF SB1460

|                                  |                                      |
|----------------------------------|--------------------------------------|
| Amazon                           | Goldwater Institute                  |
| American Airlines                | Homebuilders Assn of Central AZ      |
| Americans for Prosperity         | Intel                                |
| Arizona Chamber of Commerce      | IO Data Centers                      |
| Arizona Mortgage Lenders Assn    | Iron Mountain Data Centers           |
| Arizona Public Service           | Microsoft Corporation                |
| Arizona Tax Research Association | National Fed of Independent Business |
| Arizona Technology Council       | ON Semiconductor                     |
| AT&T                             | Phoenix Chamber of Commerce          |
| ADP                              | Salt River Project                   |
| Baselayer Technology             | Southwest Cable Communications Assn  |
| Comcast                          | T-Mobile                             |
| Council on State Taxation        | Tucson Metro Chamber of Commerce     |
| Cox Communications               | University of Phoenix                |
| Cox Automotive                   | UNS Energy Corp.                     |
| Dish Network                     |                                      |
| East Valley Chambers of Commerce |                                      |
| Freeport McMoRan                 |                                      |
| GoDaddy                          |                                      |

### WHAT ABOUT OTHER STATES?

- 33 states tax prewritten software (delivered electronically)
- 27 states tax digital goods
- 23 states tax video streaming
- 4 states tax SaaS/remote software
  - 13 have attempted via rule
  - 25 have exempted via rule
  - 4 states exempted in law

### WHY NOT TAX ALL DIGITAL PRODUCTS?

- Taxing services provided online is unfair and likely against federal law (ITFA)
- Under Prop 126, would require a Const. amendment
- Very few states tax cloud services or remotely accessed software; such a move would make AZ economically uncompetitive
- NCSL has advised states not to tax SaaS/Remotely Accessed software. Just 4 states have done so.

### DOES ARIZONA GAIN OR LOSE MONEY?

- Current position of the State is under litigation; this bill shores up the state's position
- DOR does not separately account for digital goods so it's impossible to know precisely
- Licensed prewritten software has been & continues to be taxable
- Some but not all providers of digital goods already collect and remit
- A few "cloud service" or SaaS companies began collecting while many never have; some have since stopped collecting or have brought legal challenges against the state
- Entire tax base for all rentals of personal property is ~\$213M & hasn't grown much in decades; if the state is collecting on digital services, the amount is likely fractional



## **ATRA SUPPORTS SB1248**

### ***Require County Assessors apply Rule B consistently among all taxpayers across the state!***

As amended in Senate COW, SB1248 would require all fifteen county assessors to calculate the Limited Property Value (LPV) in a consistent manner in cases of new construction, demolition, and when there are other significant changes in property characteristics. In these situations, a “Rule B” calculation (Percentage of LPV to the Full Cash Value (FCV) of similar properties) is applied to the FCV to determine the new LPV.

Applying Rule B will typically cause a substantial increase in property taxes so it is important that Rule B is applied as intended- in situations when there is a significant change in a property’s market value as a result of significant changes in property characteristics, or there is a change in property use (residential property is converted to commercial use, for example).

Currently, there is no guidance in statute- only a Department of Revenue guideline that suggests County Assessors apply “Rule B” when the Full Cash Value (market value) increases by 10% or more, *or at the discretion of the County Assessor*. First, the 10% threshold is arguably too low, and as introduced, SB1248 would have allowed a more reasonable threshold of 20%. Second, allowing assessor’s to ignore the 10% threshold and instead use their “discretion” has led to an inconsistent application of Rule B across the state.

SB1248 was amended in Senate COW to address many of the assessor’s concerns they testified to in the Finance Committee, as well as reduce the Rule B threshold to 15%. The 15% threshold is a reasonable threshold that more closely reflects the intent that Rule B be applied only when there is a significant change to property, and more importantly, that Rule B be applied in a consistent manner among all taxpayers across the state.



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# ARIZONA TAX RESEARCH ASSOCIATION

## ATRA OPPOSES SCR1001/HCR2024/HB2563/SB1080

The proposed “full penny” TPT (sales) tax increase proposal is poor public policy for three distinct reasons: the tax increase provides no necessary education reforms, it undermines the Classroom Site Fund, and unnecessarily dilutes the K-12 share.

A full penny sales tax could raise a conservative \$1.2 billion ongoing. The following is a breakdown of a before and after using FY2019 JLBC data.

|   | FY2019         | Penny Tax Proposed |                |                   |
|---|----------------|--------------------|----------------|-------------------|
| SFB Debt Service  | \$ 64,119,600  |                    |                |                   |
| Universities  | \$ 82,587,800  | \$ 222,743,900     |                |                   |
| Community Colleges  | \$ 24,647,000  | \$ 55,585,975      |                |                   |
| Tribal Assistance   | \$ 796,600     | \$ 2,000,000       |                |                   |
| Additional School Days  | \$ 86,280,500  | \$ 86,280,500      |                |                   |
| School Safety   | \$ 7,800,000   |                    |                |                   |
| Character Grants  | \$ 200,000     |                    |                |                   |
| SAIS  | \$ 7,000,000   |                    |                |                   |
| Failing Schools Fund  | \$ 1,500,000   |                    |                |                   |
| Income Tax Credit   | \$ 25,000,000  |                    |                |                   |
| Classroom Site Fund   | \$ 456,419,800 | \$ 835,289,625     |                |                   |
|   |                |                    | <b>Delta</b>   | <b>% increase</b> |
| K-12 Total  | \$ 623,319,900 | \$ 921,570,125     | \$ 298,250,225 | 48%               |
| Universities Total  | \$ 82,587,800  | \$ 222,743,900     | \$ 140,156,100 | 170%              |
| Comm College Total  | \$ 25,443,600  | \$ 57,585,975      | \$ 32,142,375  | 126%              |
| <b>Source:</b> JLBC; ATRA estimations using JLBC data + new formula |                |                    |                |                   |

### Penny Tax Proposal Includes No Education Spending Reforms

For decades, education leaders have sought to reform uneven policies such as arcane hold harmless formulas, which allow the same pupil to draw different funding depending on which school they enroll. This is unfair and likely unconstitutional. There is widespread agreement that bringing equity to Arizona’s school system will cost money. **The conclusion of the two-year Classrooms First Council was that while reforms are necessary, they will not be achieved without new funding.** To bypass another opportunity at reform is a critical misstep. Opportunities for tax increases are rare and should include something for everyone, including taxpayers. Taxpayers deserve a system that is fairer and less susceptible to lawsuits. Parents deserve a system where their pupil is worth roughly the same no matter the public school they attend. This proposal simply adds money to an outdated and outmoded finance system.

## Proposal Removes Performance Funding

One of the major selling points in Prop 301 was the addition of performance based funding for teachers. Lawmakers proposed and voters approved a portion of Classroom Site Fund dollars be set aside for performance based bonuses. **Removing this feature signals a return to bureaucratic teacher pay**, where teachers are paid only according a traditional pay scale. Teachers should be acknowledged and rewarded for making gains in student achievement, not saddled with a one-size-fits-all pay scale.

## New Formula Dilutes the K-12 Share

The new formula adds to K-12 schools just shy of \$300 million more than they would get from the existing formula (this accounts for maturing SFB debt service, which adds to the Classroom Site Fund at the end of 2020). **A sales tax increase which moves Arizona near the top of the nation in total rates should buy more than a 2.9% bump in K-12 noncapital funding** (using JLBCs FY19 \$10.2B estimate). While it's understandable that advocates want to "spread the money" to all public education, it's hard to argue university and community college needs require 170% and 126% increases in their sales tax funding.

With Prop 123, the 20x2020 plan, and District Additional Assistance restoration, **the state has committed \$1.3+ billion to K-12 education in the last several years without any finance reform**. This doesn't account for increases in population and inflation funding, School Facilities Board increases and other new funds. This <\$300M increase to K-12, which amounts to roughly 63% of new available funds, amounts to less than \$265 per pupil statewide and creates little opportunity for reform.

## The Juice Isn't Worth the Squeeze

Convincing taxpayers to open their wallet is always a challenge. They should be respected enough to offer reforms which improve Arizona schools, not simply add funds. Among other reforms, Prop 301 phased out expensive and unequal Excess Utilities fund. This one-cent sales tax plan lacks reform, sends the wrong message to teachers and won't solve budgetary challenges for schools.



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# ARIZONA TAX RESEARCH ASSOCIATION

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## **ATRA OPPOSES HB2702**

*"Without first simplifying Arizona's tax system, HB 2702's economic nexus provisions probably would not survive a Constitutional challenge."*

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When the Supreme Court eliminated the physical presence test in *Wayfair v. South Dakota*, allowing states to apply an economic nexus standard and thus impose their sales taxes on remote sellers, ATRA welcomed the decision. We called on policymakers to immediately begin the necessary work to address this complex issue. With nothing accomplished during 2018, ATRA recommended a study committee to address the many issues involved from policy to implementation.

### **HB2702**

A late introduced bill to create economic nexus fails to address all the necessary simplification and implementation issues. Clearly, the Department of Revenue has not been involved until the last few days. This alone should worry lawmakers.

Thus far, a limited stakeholder process resulted in proponents conceding the bill needs to be completely rewritten.

### **Litigation Threat**

HB2702 proponents provided a legal opinion arguing sales tax simplification is unnecessary and the state should ignore threats of litigation. They suggest the substantial effort states like South Dakota have undergone to simplify their systems, which the Court argued were reasonable efforts to ease burdens on remote sellers, were actually unnecessary and can be ignored.

In ATRA's legal opinion, formed by several of the top state and local tax attorneys in the state, Arizona must simplify its sales tax system considerably in order to not run afoul of the commerce clause and undue burden concerns in *Complete Auto*.

Several national organizations have written on the topic: the Tax Foundation wrote that Arizona must not proceed without addressing simplification, the Council on State Taxation graded Arizona a D on sales tax administration, NetChoice and the American Legislative Council argue HB2702 creates undue burdens on remote sellers in violation of the Commerce Clause.

### **What about all the other states?**

Pointing out that 35+ states have moved on the Wayfair decision provides no context to the broader issue. 23 states are members of the Streamlined Sales and Use Tax Agreement (SSUTA) like South Dakota and have already accomplished years of reforms to prepare for this moment. Most other states already had laws on the books related to remote nexus, meaning the issue had been debated and discussed prior to the decision. Arizona did not have a remote seller nexus law on the books and starts from scratch.

States with similarly complex sales tax laws as Arizona have undergone year's long efforts to address their challenges. These state led task forces and commissions should serve as both a warning and a guidepost.

### **ALABAMA**

After years of study, Alabama created Simplified Sellers Use Program (SSUP)

- SSUP provides single registration, online pay portal, single base
- One tax rate for all remote sales (8%) shared between state & localities
- Provided remote sellers 3 months to comply AFTER DOR was ready

### **LOUISIANA**

Louisiana created "Sales and Use Tax Commission for Remote Sellers"

- Will create a uniform base for remote sellers, single point registration
- Has delayed mandatory collection until work is complete (targeting 2019)
- Single rate of 8.45% shared between state & localities

### **COLORADO**

After years of study & implementation, created a 2-yr grace period (through May '19)

•CDOR is "making a concerted effort to bring consistency and fairness to sales tax laws for both in-state and out-of-state retailers."

- Certified 5 databases for rate lookup, created hold harmless provisions
- Approved CSPs allow online payment through a portal

### **ATRA's Position:**

Arizona's TPT system should be simplified in a manner that meets the demands of the Wayfair decision and makes it both simple and fair for remote sellers to comply. In addition to keeping Arizona out of unnecessary litigation, it is good public policy. In a

rush to enact this policy and reap windfall from the new tax revenue, HB2702 proponents are trying to convince you good tax policy is irrelevant.

**Uniformity:** The tax classifications Arizona intends to apply to remote sellers need to be uniform between state and municipalities. HB2702 fails on this front. Proponents offer a half measure which insists by reference to the model city tax code that imagines remote sellers complying with a uniform base at the state level as it relates to city taxes, effectively creating yet another base of taxation specific only to remote sellers.

**Implementation:** DOR must be ready to implement and administer a remote seller law before it becomes the law of the land. There needs to be software available for taxpayers to use, a reliable taxability matrix, and enough lead time for remote sellers to apply for licenses and "code/map" their products to Arizona's laws.

**Tax Increase:** Taxpayers should get reform in recognition for the GAO estimated \$190 million to \$293 million tax increase this imposes, and not simply be a windfall for state and local governments. The JLBC Fiscal Note only addresses state revenues and does not estimate county and municipal tax increases associated with going from Use Tax to TPT, which will be as high as 5% on transactions in some areas. This chart shows the difference in rates in each city between Use Tax and TPT.

A deliberative process would provide policymakers the opportunity to settle on a reasonable estimate of the increased taxes paid by individuals and businesses.

Opportunities for reform are difficult to find and new revenue provides a window for that opportunity. Lawmakers should not hastily pass a bill that closes that window.