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ARIZONA TAX RESEARCH ASSOCIATION

NEWSLETTER

VOLUME 61
NUMBER 1

JANUARY 2001

Spending & tax increase bills on the rise

The 45th Legislature convened its first session amid a plethora of bills to increase state spending and taxes. While bills creating new programs or increased appropriations for existing programs are commonplace at the State Capitol, both the volume and the appropriation demands have increased markedly this year. Proposed legislation increasing taxes on Arizona businesses and individuals has been rare in recent memory. However, this session several bills have been introduced that increase sales and income tax liabilities through an expansion of the sales tax base or the elimination of tax credits.

While some of the spending bills introduced reflect appropriations that are already in the budget recommendations, many create new programs for state and local governments. The Joint Legislative Budget Committee recommends \$1,416,216,900 in new general fund spending for the biennium. That recommended 22 percent increase in the general fund budget includes the added revenue from the recently approved 0.6 percent sales tax earmarked for education.

Through the end of January, Arizona Legislators had introduced bills calling for \$1.2 billion in new spending for fiscal year (FY) 2002 and \$1.6 billion for FY 2003. Legislators have introduced 155 bills that directly increase spending in one form or another. The numbers would be even higher if all bills calling for increased spending through program enhancements or benefit increases were considered. As introduced, some bills fail to reflect the appropriation that would be necessary for implementation.

Also not included in the above totals is a noticeable increase in the number of bills directed at increasing retirement benefits for public employees. Forty-two retirement bills have been introduced this session. Despite the fact that these bills can have a significant

impact on state and local governments, they often move through the committee process without fiscal notes.

For the first time in almost a decade, taxpayers are on alert at the Capitol as a result of several bills that have been introduced to increase taxes. The House Ways and Means Committee Chairman Steve May has introduced a number of bills targeting individual and corporate income taxes for repeal or sunset. Representative Henry Camarot's House Bill 2495 turns the state transaction privilege tax system on its head by making almost all business transactions subject to the sales tax. Senate Finance Chair Scott Bundgaard had also expressed an interest in pursuing legislation that expands the sales tax to activities currently not subject to the tax.

While most of the efforts to expand the sales or income tax base claim an interest in maintaining revenue neutrality, all would result in increased tax liabilities for those taxpayers whose tax treatment has changed.

Senate finance kills truth in taxation bill

Following testimony from a city representative that Arizona's Truth in Taxation (TNT) laws are too difficult to understand and that the "punishment doesn't fit the crime," the Senate Finance Committee killed a measure that simply required that local governments comply with the existing law.

Arizona statutes require counties, cities and towns, and community colleges to calculate a TNT rate that offsets the growth in value of property that was subject to tax in the previous year. That rate is then applied to the current year's total net assessed value to determine the TNT levy limit. Simply put,

Senate Ed panel rejects phase down of school district excess utilities

The State Senate's Committee on Education rejected SB 1179 by a 3 to 4 vote which would have capped and phased out school district authority to levy property taxes outside district budget limits for statutorily defined "excess utilities." Senator Bennett sponsored the legislation on ATRA's behalf.

Among the measures specifically put to voters in Proposition 301 was a termination of excess utilities after fiscal year (FY) 2008-2009. The ballot measure stopped short, however, of capping and phasing out the expenditures.

Despite testimony from school district representatives that "prudent" administrators would begin to implement some sort of phase down, it is apparent that the real strategy by opponents of SB 1179 is to allow districts to levy increasing amounts under the excess utilities exemption despite the pending termination, thus creating a crisis in 2009.

Senators Bennett, Petersen, and Smith voted in favor of the bill. Senators Aguirre, Jackson, Lopez, and Hartley voted to defeat SB 1179.

TNT requires local governments to offset valuation growth (excluding new construction) with commensurate changes in tax rates.

Presented with a choice between dealing, on the one hand, with the ever increasing property taxes and, on the other, with the reluctance of local governments to do basic math, four committee members gave the nod to local governments. Voting against SB 1259 were Senators Valadez, Brown, Cummisky, and Blanchard. Supporting taxpayers were Senators Bundgaard, Bennett, Cirillo, and Daniels.

State comm college board adopts dual enrollment rule

At its January meeting the State Board of Directors for Community Colleges of Arizona (SBDCCA) adopted a revised version of R7-1-709, a state regulation intended to place moderate restrictions on "dual enrollment" between public high schools and community colleges.

Although ATRA staff testified in opposition to the rule, ATRA's comments to the SBDCCA recognized that the rule does put in place more restrictions than currently exist and that taxpayers would benefit by the presumed reduction in redundant funding for the simultaneous high school and community college student counts.

Most of the recent changes to the rule were a result of pressure on the colleges from ATRA, the Governor's budget office, as well as from their own faculty. The debate came to a head during last summer's Joint Legislative Committee on Dual Enrollment where R7-1-709 became the vehicle for committee recommendations. (See the October 2000 *ATRA Newsletter*: "Four-corner stall by comm colleges on dual enrollment," page 4.)

Entitled "Community College Classes Offered in Conjunction with High Schools," R7-1-709 officially allows college courses to be offered to high school students at the high school during the school day through a contract or intergovernmental agreement.

However, all public high school students must be enrolled in a full-time instructional program in addition to any college courses. Currently, a full-time instructional program is a minimum of four hours. High school seniors who can meet graduation requirements with less than a full-time instructional program are exempt from this

restriction. In addition, high school freshmen and sophomores may make up as much as 25 percent of the total students enrolled by a college in dual enrollment courses.

The rule states that all dual enrollment courses must have been "evaluated and approved through the official college curriculum approval process . . . , be at a higher level than taught by the high school, [and] be transferable to an Arizona public university or applicable to an established community college occupational degree or certificate program." Physical education classes will no longer qualify for dual enrollment.

Community colleges and high schools will continue to count each dual enrollment student's time in class for both K-12 and community college funding as if that student were actually two students.

ATRA's opposition to R7-1-709 was based primarily on the fact that, despite the restrictions, community colleges and high schools will continue to count each dual enrollment student's time in class for both K-12 and community college funding as if that student were actually two students. ATRA has argued that Arizona is facing enormous challenges funding its burgeoning growth in student populations. Asking taxpayers to pay twice for the same service is wrong.

Other concerns shared by ATRA, but raised most articulately by community

college faculty, involved the quality of dual enrollment programs. For example, the proposed rule provides for no objective standards to determine college readiness. The rule, in fact, explicitly circumvents minimum college entrance examination scores established in another SBDCCA regulation on the admission of students under the age of eighteen. Several community college faculty members have spoken out against current dual enrollment practices and quality concerns that emerge when students are expected to perform at a level for which they are not emotionally or academically prepared.

ATRA staff also expressed concern that SBDCCA has neither the staff nor the institutional authority to properly enforce the restrictions proposed in R7-1-709.

The Governor's budget office has recommended for the last two years that community college student counts associated with dual enrollment be valued at 20 percent of a full time student equivalent (FTSE) for state aid purposes. ATRA will continue to be supportive of efforts in the state's budget negotiations to recognize and compensate for the dual funding.

In the meantime, Representative John Huppenthal, Representative Linda Gray, and Senator Ken Bennett have sponsored legislation on ATRA's behalf that will help the state deal with this growing component of taxpayer funding for public education. HB 2540 would require the Auditor General to certify separately, as is currently done with other categories, any FTSE where a student is enrolled in a course for both high school and college credit simultaneously.

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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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Arizona sales tax reliance high

Discussions regarding Arizona's reliance on sales taxes, as well as the adequacy of the sales tax base, continue at the Capitol.

The following information has been requested many times in recent weeks so we are passing it along for those following the debate.

As ATRA has pointed out, Arizona's current 5.0 percent sales tax rate is about average nationally: Thirteen states have the same rate while 16 are higher and 15 are lower.

However, even with an average state sales tax rate, Arizona has consistently ranked near the top ten nationally in sales tax collections.

In fiscal year 1996, the most recent national data available, sales tax revenue accounted for 49.6 percent of the "big three" revenues (sales, property, and income) in Arizona, ranking us 17th nationally.

Arizona taxpayers paid \$1,025 in sales taxes per capita, ranking Arizona 11th.

State and local taxes collected in FY 1996 represented 5.25 percent of Arizona's personal income. Only eight states had higher percentages than Arizona.

As ATRA has consistently pointed out, isolated national rankings can be misleading if one does not take into consideration the differences between tax systems. For example, relative reliance on the sales tax could be influenced by reliance on property or income taxes.

Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming have no personal income tax.

Nevada, Texas, Washington, and Wyoming have no corporate income tax, while South Dakota's corporate income tax applies only to financial institutions.

Alaska, Delaware, New Hampshire, Montana, and Oregon have no state general sales tax.

SALES TAX RELIANCE, FY 1996

State	Sales Taxes per Capita	Rank by \$	Sales Taxes as % of three-tax revenues	Rank by %	State & Local taxes as % of personal income	Rank by %
Alabama	\$914	22	59.6	7	4.79	15
Alaska	\$394	46	26.0	45	1.65	47
Arizona	\$1,025	11	49.6	17	5.25	9
Arkansas	\$924	20	54.8	12	5.16	11
California	\$968	14	41.5	24	4.06	24
Colorado	\$905	24	40.4	26	3.85	30
Connecticut	\$1,201	6	35.1	34	3.78	31
Delaware	\$340	48	20.4	47	1.31	49
Florida	\$1,221	4	59.8	6	5.38	8
Georgia	\$928	17	43.0	21	4.36	20
Hawaii	\$1,683	3	55.3	11	6.83	3
Idaho	\$724	42	39.7	27	3.92	27
Illinois	\$926	18	37.5	29	3.68	35
Indiana	\$651	44	32.4	37	3.06	43
Iowa	\$786	35	35.9	32	3.77	32
Kansas	\$904	25	40.9	25	4.15	23
Kentucky	\$827	31	44.8	20	4.41	19
Louisiana	\$1,067	9	64.8	5	5.63	6
Maine	\$754	37	31.3	38	3.76	33
Maryland	\$742	39	29.3	44	2.84	44
Massachusetts	\$649	45	23.1	46	2.32	45
Michigan	\$873	27	39.2	28	3.67	36
Minnesota	\$990	12	35.9	33	4.17	22
Mississippi	\$979	13	57.7	8	5.91	5
Missouri	\$909	23	46.5	18	4.19	21
Montana	\$307	49	18.9	49	1.68	46
Nebraska	\$848	28	36.7	30	3.98	26
Nevada	\$1,733	1	76.0	1	7.44	1
New Hampshire	\$369	47	19.1	48	1.46	48
New Jersey	\$926	19	29.6	43	3.12	41
New Mexico	\$1,216	5	65.1	4	6.79	4
New York	\$1,067	10	30.3	41	3.87	29
North Carolina	\$835	30	42.2	22	4.03	25
North Dakota	\$928	16	51.4	14	5.00	13
Ohio	\$772	36	33.9	36	3.43	37
Oklahoma	\$837	29	52.2	13	4.53	17
Oregon	\$231	50	12.5	50	1.09	50
Pennsylvania	\$750	38	36.1	31	3.18	40
Rhode Island	\$792	34	31.2	39	3.32	38
South Carolina	\$732	40	41.8	23	3.88	28
South Dakota	\$950	15	55.5	10	4.87	14
Tennessee	\$1,142	7	71.9	2	5.49	7
Texas	\$1,079	8	57.5	9	5.20	10
Utah	\$893	26	45.4	19	5.02	12
Vermont	\$688	43	29.7	42	3.27	39
Virginia	\$728	41	34.7	35	3.06	42
Washington	\$1,689	2	66.7	3	7.24	2
West Virginia	\$816	32	50.2	16	4.61	16
Wisconsin	\$815	33	30.5	40	3.69	34
Wyoming	\$921	21	50.4	15	4.46	18
50 states	\$938		41.2		4.08	
DC	\$1,463		36.3		4.28	
United States	\$939		41.1		4.08	

Source: Census Bureau data as published in K.A. Hovey & H.A. Hovey's *CQ's State Fact Finder 2000*, Washington, DC: Congressional Quarterly Press.

HB 2477 will allow corporate income taxpayers to select apportionment method

Governor Jane Hull dedicated a portion of her state of the state message advocating for a change in Arizona's corporate income tax. Following reductions in the corporate tax rate from 9.0 percent to 6.9 percent, Governor Hull is now focused on changing the apportionment formula that guides the tax treatment of multi-state corporations.

The current structure for the apportionment of multi-state corporate income is three-tiered, allocating a percentage to property, payroll, and sales. Arizona's current formula is:

$$\text{Income} \times [25\%(\text{property factor}) + 25\%(\text{payroll factor}) + 50\%(\text{sales factor})]$$

To implement the Governor's recommendation, State Representative Steve Huffman has introduced House Bill 2477. HB 2477 provides for a second method for allocating the income of a multi-state corporation. This second method increases the weight of the sales factor and decreases the weight of the property and payroll factors for tax years 2002 through 2005, at which time multi-state corporations can elect to

weight their entire tax burden on sales.

The formula for each tax year would be as follows:

Tax Year 2002

$$\text{Income} \times [15\%(\text{Property Factor}) + 15\%(\text{Payroll Factor}) + 70\%(\text{Sales Factor})]$$

Tax Year 2003

$$\text{Income} \times [10\%(\text{Property Factor}) + 10\%(\text{Payroll Factor}) + 80\%(\text{Sales Factor})]$$

Tax Year 2004

$$\text{Income} \times [5\%(\text{Property Factor}) + 5\%(\text{Payroll Factor}) + 90\%(\text{Sales Factor})]$$

Tax Year 2005

$$\text{Income} \times \text{Sales Factor}$$

The concept of "superweighting" the sales factor is not new at the Arizona legislature. However, previous efforts to increase the sales factor were complicated by the fact that some corporations tax liabilities increase as a result of the change to the apportionment formula. To solve the problem, Governor Hull has recommended, and HB 2477

includes, a provision that maintains the current formula and allows corporations to elect into the new superweighted sales formula.

While most states originally taxed multi-state corporate income by equally weighting property, payroll and sales, the majority of states now give greater weight to sales in an effort to encourage business to expand in-state payroll and property in their state. This change in corporate tax policy takes on an added importance in Arizona where business tax burdens are above average nationally and property taxes in particular are some of the highest in the country.

Both the Executive and the Legislative budget recommendations make room for tax reductions. In addition to the sales factor change, Governor Hull also recommends reducing the insurance premium tax from 2.0 percent to 1.7 percent and further reductions in the vehicle license tax.

Jennifer Schuldt