Taxpayers prevail: Navajo County in violation of constitutional levy limit

Arizona Supreme Court denies review of Navajo County v. PTOC

by Michael G. Galloway
Quarles & Brady Streich Lang, LLP

On March 20, 2003, the Arizona Supreme Court declined to review the case of Navajo County v. Property Tax Oversight Commission. That effectively ended any appeal of the PTOC’s conclusion that part of Navajo County’s 2000 property tax increase was a violation of the levy limits of Art. IX, § 19 of the Arizona Constitution.

The levy limits generally restrict governmental bodies to 2% annual property tax increases, plus allowable increases for new construction.

Arizona counties are required to provide health care treatment for indigent residents. From 1994 through 1999, several hospitals, medical care providers and ambulance companies brought 19 lawsuits against Navajo County seeking payment for medical services for persons alleged to be indigent. The amounts claimed were over $2.5 million but in late 1999, the County settled all of the suits for $275,000. It did not include the $275,000 in calculating its maximum property tax levy for 2000.

The PTOC, which is responsible for monitoring governmental compliance with the levy limits, held that this was illegal and

If the Court had ruled for Navajo County, a major loophole would have been created for most governmental entities in Arizona. The only requirement would be to somehow convert governmental obligations into “involuntary” litigation payments.

Navajo County argued that its settlements were as involuntary as tort judgments, or the Maricopa County tax refunds, contending that as long as the obligation arose from litigation of a claim against it, it was involuntary.

The Court disagreed, holding that the nature of underlying obligation also had to be considered. In Maricopa County, the exception for tax refunds was allowed because they resulted from litigation but also because they were unforeseeable obligations.

However, Navajo County’s ultimate payment of some indigent medical costs, while involuntary, was clearly foreseeable. It was a county function.

The Court noted that the County had a great deal of historical health care cost data from which it could have projected its future costs. The Court also pointed out that for years the County had numerous non-tax options available to cover the expenses.

Thus, to come under the levy limit exception, the obligation must be involuntary but also unforeseeable. Navajo County’s indigent health care responsibilities were

See Navajo County, page 4
Statewide average effective property tax rates reflect inequitable distribution of tax burden

Arizona’s statewide average effective tax rate (ETR) for tax year 2002 is 1.55%, same as the previous year. The table below reflects the ETRs on each of Arizona’s nine classes of property. Unlike most states, Arizona classifies property based on property use in order to shift the tax burden from one class of property to another. As a result, properties with higher assessment ratios carry a disproportionate share of Arizona’s property tax burden.

The ETR is calculated by dividing the total tax yield for each property class by the full cash value. For purposes of the calculation, exempt property is removed from the full cash value.

With a 25% assessment ratio, commercial and industrial properties, utilities, and mines (class 1), have the highest ETR in 2002 at 2.91%. Accounting for 23.5% of the state’s property value, class 1 properties pay 44.2% of the taxes. Railroads and airline flight property (class 5) have the second highest ETR at 2.42%.

The largest class of property, owner-occupied homes (class 3), has an ETR of 1.05%. Accounting for 58.6% of the state’s property value, class 3 properties pay 39.8% of the taxes. Taxes on owner-occupied residential properties are reduced as a result of the lower assessment ratio of 10%, as well as the 35% homeowner rebate provided by the state on school primary taxes. Additionally, total primary taxes for owner-occupied homes are capped at 1% of value.

Over the years, policymakers have created tax incentives for some taxpayers in an effort to circumvent high commercial property taxes. For example, class 6, which includes properties located in foreign trade and enterprise zones, are assessed at only 5% as opposed to 25%. Included in the same class are historic residential properties that are also assessed at 5%, instead of the 10% that is assessed on other residential properties.

Class 6 properties carry 0.95% of the state’s total value and pay 0.36% of total taxes. The ETR is 0.58%.

Rental residential properties that are restored as historic (Class 8) are also given a break in their property taxes. In this case, the portion of the property value that represents the cost to restore and rehabilitate the property is deflated by a one-percent assessment ratio. Class 8 reflects the lowest ETR in 2002 at 0.02%.

Possessory interests (class 9) are also assessed at 1% and shoulder the second lowest burden, with an ETR of 0.13%.

Assessment ratios explain most of the differences in ETRs across classes, but it is not the only determinant. ETRs will vary among different taxing jurisdictions depending on the level of tax rates.

Jennifer Schuldt

2002 statewide average effective property tax rates

<table>
<thead>
<tr>
<th>Class</th>
<th>Description</th>
<th>Assmt Ratio</th>
<th>Total Taxable</th>
<th>Percent of</th>
<th>Percent of</th>
<th>Effective Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Commercial, Industrial, Utilities, &amp; Mines</td>
<td>25%</td>
<td>$63,327,870,879</td>
<td>23.47%</td>
<td>$1,844,726,209</td>
<td>44.24%</td>
</tr>
<tr>
<td>2</td>
<td>Agricultural &amp; Vacant Land</td>
<td>16%</td>
<td>19,731,879,936</td>
<td>7.31%</td>
<td>317,242,001</td>
<td>7.61%</td>
</tr>
<tr>
<td>3</td>
<td>Owner-occupied Residential</td>
<td>10%</td>
<td>158,164,295,799</td>
<td>58.62%</td>
<td>1,658,758,696</td>
<td>39.78%</td>
</tr>
<tr>
<td>4</td>
<td>Rental Residential</td>
<td>10%</td>
<td>24,353,520,202</td>
<td>9.03%</td>
<td>306,948,518</td>
<td>7.36%</td>
</tr>
<tr>
<td>5</td>
<td>Railroad, Private car, airline flight</td>
<td>21%</td>
<td>1,096,016,250</td>
<td>0.41%</td>
<td>26,554,841</td>
<td>0.64%</td>
</tr>
<tr>
<td>6</td>
<td>Residential historic, Enterprise zones</td>
<td>5%</td>
<td>2,571,451,913</td>
<td>0.95%</td>
<td>15,025,509</td>
<td>0.36%</td>
</tr>
<tr>
<td>7</td>
<td>Commercial Historic</td>
<td>1%</td>
<td>20,497,803</td>
<td>0.01%</td>
<td>445,152</td>
<td>0.01%</td>
</tr>
<tr>
<td>8</td>
<td>Rental Residential Historic</td>
<td>1%</td>
<td>563,360,325</td>
<td>0.21%</td>
<td>109,584</td>
<td>0.00%</td>
</tr>
<tr>
<td>9</td>
<td>Possessory Interests</td>
<td>1%</td>
<td>1,451,157</td>
<td>0.00%</td>
<td>1,823</td>
<td>0.00%</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>$269,830,344,264</td>
<td>100.00%</td>
<td>$4,169,812,332</td>
<td>100.00%</td>
</tr>
</tbody>
</table>
Legislative update: one bad bill, one good

Two important public finance bills still moving through the process

Two of the most important public finance debates of this session involve bills that, at the time of this writing, are still moving through the legislative process. Senate Bill (SB) 1231, which ATRA opposes, will soon go to the Arizona State Senate for a final vote. House Bill (HB) 2357, which ATRA supports, is headed for a debate on the Senate floor.

ATRA OPPOSES SB 1231

SB 1231 (Cannell, Carruthers, Binder) provides a hospital district in a county with less than 45,000 people in which no more than 6% of the property is taxable, access to a voter-approved half-cent sales tax. This narrow language allows only the hospital district of La Paz County the privilege to levy a sales tax for the maintenance and operation of healthcare facilities.

Hospital districts are established for the maintenance and operation of healthcare facilities. Currently, hospital districts are given the authority to levy a secondary property tax and issue bonds, both of which require voter approval.

ATRA has argued that financing hospital districts through the secondary property tax makes sense from both a financial and administrative standpoint. In this instance, expanding access to the sales tax to special districts, specifically a hospital district in this case, sets a dangerous precedent.

The proponents of the bill argue that La Paz County levies some of the highest property taxes in the state and that there is not enough taxable property in the county to support the hospital district. The facts do not support their argument. La Paz actually ranks right in the middle when comparing the net assessed value (NAV) and average property tax rates of all fifteen counties, 7th and 8th, respectively.

Not long ago, Arizona sales tax rates were approximately 5% on average. Today those rates exceed 10% in some areas as the Legislature has granted greater access to the sales tax base. For instance, counties now levy a sales tax for transportation purposes, capital projects, construction and maintenance of jails, as well as general operations. In addition, some city sales tax rates now reach as high as 3.5%.

The Legislature should be extremely cautious about allowing greater access to the sales tax for any purpose. Arizona sales tax rates, and therefore collections, have climbed dramatically over the last decade. Arizona now ranks in the top five in sales tax collections nationwide according to the U.S. Census Bureau.

While the sales tax is unquestionably more popular than the property tax, there is a limit to how many government services we can expect the sales tax to fund.

A House version of this legislation, HB 2355, stalled in committee earlier this session. A similar Senate version, SB 1207, was defeated in the Finance Committee in February.

ATRA SUPPORTS HB 2357

HB 2357, sponsored by Representative Steve Huffman and several others, continues the current freeze on school district desegregation/OCR levies for M&O for an additional two years (until the end of FY 2006). It provides very modest relief for some taxpayers by restricting districts from levying these monies for capital expenses. It also puts into place new and important oversight provisions.

ATRA has been calling attention to the problems associated with these property tax levies for years.

Under state law, school districts may levy an unlimited amount of property taxes for an unlimited amount of time in excess of the state’s limits without voter approval if the district has either a court order of desegregation or an administrative agreement with the U.S. Department of Education’s Office for Civil Rights (OCR).

This exemption from the limits may continue even after the court order is lifted or the OCR agreement is no longer monitored. In addition, districts may also have multiple and overlapping agreements.

Nineteen school districts levy outside their budget limits for deseg or OCR. Two school districts are under court order to desegregate: Tucson Unified School District (TUSD); and Phoenix Union High School District (PUHSD).

The remaining districts have OCR agreements, most of which are no longer being monitored, allowing unlimited access to the property tax.

During FY 1990-1991, 10 districts levied $47.3 million under this provision. For FY 2001-2002, 19 districts levied $193.8 million. That represents nearly 310% growth over the 10-year period.

Despite the cap that HB 2550 placed on the 19 districts last year, the PUHSD increased their deseg levy bringing the statewide total to $196.1 million for FY 2002-2003.

Deseg/OCR levies are budget overrides requiring no voter approval that result in inequities in per-pupil expenditures and property tax burdens between districts.

Under this law, PUHSD has a 52.7% override of its revenue control limit that other districts do not have. Such inequities between districts cause non-deseg/OCR districts to be at a competitive disadvantage in teacher salaries compared to the 19 deseg/OCR districts.

These levies often result in high primary tax rates. One district’s primary rate is 292% higher than the equalized qualifying tax rate (QTR).

HB 2357 passed the House 37 to 23. Opponents of the bill, lead by Senator Slade Mead, succeeded in passing an amendment in the Senate Education Committee to gut the bill, removing several important provisions, especially those dealing with spending and property taxes.

However, the Senate Finance Committee passed a competing amendment that maintains the bill, with some corrections, as it passed in the House.

Thus the pending Senate floor debate will be over the two competing amendments.
ATRA's Tax Practitioners Committee formed a Streamlined Sales Tax Project (SSTP) subcommittee at its March meeting. The subcommittee is a result of legislation that was passed during the 2002 session to allow Arizona to become an “observer” state of the SSTP, which permits the state to join in discussions with other states.

The SSTP is an agreement created to simplify and modernize sales and use tax collection and administration among the states. ATRA's subcommittee will review the differences between Arizona's state and local sales tax bases and attempt to determine the impact that it will have on Arizona.

As of March 2003, 39 states and the District of Columbia are involved in the project out of the 45 states that levy sales and use tax.

Four states have already adopted the SSTP agreement, which include Kentucky, Utah, South Dakota, and West Virginia. However, the agreement does not go into effect until at least ten states with 20% of the total population of all states imposing a state sales tax have enacted the conforming legislation of the agreement.

For more information on the Tax Practitioners SSTP committee, contact ATRA staff at 602-253-9121.

Barb Dickerson
Chair, ATRA Tax Practitioners Committee