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ARIZONA TAX RESEARCH ASSOCIATION

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Sometimes you win . . .

Governor signs municipal sales tax refund legislation

Governor Janet Napolitano signed into law HB 2055, sponsored by House Ways & Means Chairman Steve Huffman, that creates uniformity with state law in the treatment of taxpayers regarding access to sales tax refunds as well as the accrual of interest on refunds and deficiency assessments.

Currently, the Department of Revenue serves as the sales tax collector for 77 cities in the state, which are referred to as "program" cities. Twelve cities that collect their own sales tax are referred to as the "non-program" cities and include Avondale, Chandler, Flagstaff, Glendale, Mesa, Nogales, Peoria, Phoenix, Prescott, Scottsdale, Tempe, and Tucson.

The 12 non-program cities currently have a different set of rules from the state and the program cities regarding refunding excess transaction privilege tax payments back to businesses. In addition, those 12 cities also employ a different set of rules for determining interest rates on deficiency assessments and refunds. The different rules and varying interpretations pose obvious problems for taxpayers. HB 2055 will create uniformity with state law, as well as the program cities, by requiring the following changes:

- ◆ Prohibits the tax collector from conditioning any refund to a taxpayer on a requirement that the taxpayer remit the refund to its customers. Since Arizona has a transaction privilege tax rather than a sales tax, the legal incidence for the tax is on the taxpayer – not the taxpayer's customers. This conforms to the treatment for refunds by both the state and program cities.
- ◆ Equalizes the non-program city interest rates on overpayments and deficiencies by conforming to the state. The state follows the IRS interest rate, which can fluctuate quarterly. The state's current rate of 5% is also followed by the program cities. Some non-program cities currently charge as high as 18% interest on deficiency assessments and offer as low as 1% interest on refunds.
- ◆ Requires the tax collector to issue an express written "denial" containing the grounds for the denial, plus express written notification of the appeal deadlines. This alerts the taxpayer that the appeal time limits have been triggered.
- ◆ Provides that additional information requested by the tax collector must be reasonably related to the refund claim. For instance, the tax collector is prohibited from requesting information that the taxpayer is not otherwise required to keep in its records under the recordkeeping requirements of the Model City Tax Code.

. . . and sometimes you lose

Governor vetoes deseg/OCR property tax reform

Governor Janet Napolitano vetoed a legislative effort to reform school district desegregation (deseg) funding. Introduced by House Ways & Means Chairman Steve Huffman, HB 2498 would have put into place reasonable reforms to deal with the authority 19 school districts have to levy unlimited property taxes.

HB 2498 passed the Arizona House of Representatives by a vote of 36 to 24. The vote in the Arizona State Senate was 19 to 10.

State law allows school districts to levy unlimited property taxes in excess of their budget limits, for an unlimited amount of time and without voter approval, if the district has either a court order to desegregate or an agreement with the U.S. Department of Education's Office for Civil Rights (OCR). These districts budgeted a total of \$193.5 million in FY 2004-2005.

This veto all but ensures property tax increases in these 19 school districts (a table listing these districts appears on page 5). Absent legislation to the contrary, other districts with OCR agreements may qualify for similar property tax hikes.

The Joint Legislative Budget Committee (JLBC) has estimated that deseg/OCR property taxes would increase by an estimated \$5.2 million in FY 2006 if the deseg/OCR levies are allowed to increase by 2% plus student growth. Approximately \$1 million of that would come from the state general fund to cover homeowner rebate costs. Labeled by proponents as a "soft" cap, this proposal is really no cap at all.

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Inside . . .

◆ *A snapshot of statewide debt, page 2*

◆ *2005 valuation growth reaches 10%, page 4*

A SNAPSHOT OF STATEWIDE DEBT

Jurisdiction	FY 1998-99	FY 2002-03	FY 2003-04	1-YR CHG	5-YR CHG
Counties	\$551,288,102	\$714,430,302	\$744,279,569	4.2%	35.0%
Cities/Towns	\$5,859,648,157	\$7,604,551,505	\$8,509,809,700	11.9%	45.2%
Comm Colleges	\$429,085,000	\$488,800,000	\$481,615,000	-1.5%	12.2%
Schools	\$4,233,499,085	\$4,019,381,000	\$3,889,602,972	-3.2%	-8.1%
Special Districts	\$1,424,803,668	\$1,053,304,378	\$848,877,203	-19.4%	-40.4%
State & Univ.	\$2,079,162,079	\$3,940,875,579	\$5,931,671,436	50.5%	185.3%
Other	\$3,557,128,136	\$3,815,548,736	\$3,189,457,176	-16.4%	-10.3%
TOTAL	\$18,134,614,227	\$21,636,891,500	\$23,595,313,056	9.1%	30.1%

Source: Arizona Department of Revenue

TOTAL STATEWIDE DEBT

Total statewide debt increased 9.1% in FY 2004 to \$23.6 billion, nearly \$2 billion more than total debt in FY 2003, according to the Department of Revenue's (DOR) latest report on state and local indebtedness. Since FY 1999, total statewide debt has grown just under \$5.5 billion, or 30.1%.

The DOR report is a compilation of data provided by the state's cities and towns, counties, community colleges, school districts, and other political subdivisions throughout Arizona. The debt report includes principal amounts only, excluding all interest payment obligations, and does not include \$6.3 billion in Industrial Development Authority debt, as well as \$571 million in lease purchase contracts.

STATE & UNIVERSITIES

State and university debt experienced the largest percentage increase of 50.5%, nearly \$2 billion, increasing from \$3.9 billion in FY 2003 to \$5.9 billion in FY 2004. A five-year analysis shows 185.3% growth, or \$3.9 billion, since FY 1999.

Not including amounts for refunding, the increase in the state and university category is largely the result of new bond issues for

ASU (\$103 million), NAU (\$31 million), U of A (\$255 million), and most notably, the School Facilities Board (\$489 million). State and university debt accounts for 25% of total debt statewide.

CITIES & TOWNS

Cities had the second largest increase in total debt of 11.9%, from \$7.6 billion in FY 2003 to \$8.5 billion in FY 2004. City debt accounts for the majority of total statewide

Top 10 Per Capita Debt	
City/Town	Per Capita Debt
Tolleson	\$6,164
Sedona	\$6,027
Williams	\$4,852
Scottsdale	\$3,009
Page	\$2,950
Phoenix	\$2,685
Cave Creek	\$2,678
Quartzsite	\$2,547
Oro Valley	\$2,075
Glendale	\$2,039

Source: Arizona Department of Revenue

Top 10 Outstanding Debt	
City/Town	Outstanding Debt
Phoenix	\$3,725,554,540
Tucson	\$860,150,437
Mesa	\$820,308,000
Scottsdale	\$654,539,232
Glendale	\$470,294,401
Chandler	\$283,375,571
Tempe	\$280,525,000
Gilbert	\$180,020,000
Yuma	\$160,023,520
Peoria	\$158,122,302

Source: Arizona Department of Revenue

debt at 36%. Between FY 1999 and FY 2004, city debt grew significantly, representing an increase of nearly \$2.7 billion (45.2%).

The largest percentage increases in city debt over the previous year occurred in Patagonia (2,518%), Eagar (820%), Yuma (116.4%), and Tolleson (107.4%). Not included in the report is the City of Goodyear's recent \$134 million bond election. The adjacent tables show the 10 cities with the most debt outstanding (above) and debt per capita (left).

See STATEWIDE DEBT, page 3

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STATEWIDE DEBT

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SCHOOL DISTRICTS

School district debt dropped 3.2% (\$130 million) to \$3.9 billion in FY 2004. Over the last five fiscal years, debt in this category dropped 8.1% (\$344 million). School district debt accounts for 16.5% of total statewide debt.

According to the report, Maricopa County schools have the most outstanding debt at \$2.8 billion and the largest per student debt of \$5,330.

The decrease in school district debt would be better news for property taxpayers if not for a recent surge in voter-approved bonds that may reverse the trend. The November 2004 election saw the approval of \$754 million in general obligation bonds, bringing the total of class B bonds authorized since Students FIRST was enacted to over \$1.9 billion.

COMMUNITY COLLEGES

Community college debt dropped slightly by 1.5% (\$7.2 million) in FY 2004. Community colleges hold the least amount of statewide debt at only 2% of total debt. However, community colleges have accumulated an additional \$52.5 million (12.2%) over the last five fiscal years.

Not reflected in the report is the recent passage of Maricopa and Arizona Western's (Yuma/La Paz) bond programs of \$951 and \$74 million, respectively, as well as the upcoming \$435 million bond election for Central Arizona College in Pinal County.

The Yavapai and Coconino college districts have the highest per student debt at \$13,859 and \$12,632, respectively. Of the 10 community college districts, Eastern Arizona is the only one not reporting any outstanding debt.

COUNTIES

Counties increased their debt obligations 4.2%, or \$29.8 million, bringing total debt to \$744.3 million in FY 2004. Total county debt increased nearly \$193 million (35%) since FY 1999.

In FY 2004, Pima County had the most outstanding debt of all the 15 counties at \$480 million and the largest per capita debt of \$527. Pima County will continue to hold the highest debt level position, particularly after the recent passage of the county's \$732 million bond program in May 2004. Graham County is the only county that is reported to be debt free.

Jennifer Schuldt

County Total for School Districts	Outstanding Debt	Per Student Debt*
Maricopa	\$2,786,178,000	\$5,330
Pima	\$603,959,972	\$4,873
Pinal	\$97,600,000	\$3,583
Mohave	\$68,990,000	\$3,159
Coconino	\$67,730,000	\$3,849
Yavapai	\$56,250,000	\$2,662
Yuma	\$49,110,000	\$1,526
Navajo	\$44,345,000	\$2,289
Cochise	\$32,035,000	\$1,728
Apache	\$26,215,000	\$1,987
Santa Cruz	\$17,600,000	\$1,930
Gila	\$15,325,000	\$1,960
Graham	\$9,625,000	\$1,830
La Paz	\$9,620,000	\$3,819
Greenlee	\$4,720,000	\$3,138

*Arizona Department of Education's 100th day average daily membership student count for FY 2003-04.

Source: Arizona Department of Revenue

Community College	Outstanding Debt	Per Student Debt
Maricopa	\$263,445,000	\$4,269
Pima	\$87,545,000	\$4,489
Yavapai	\$47,120,000	\$13,859
Central Arizona ²	\$30,865,000	\$8,456
Coconino	\$22,295,000	\$12,632
Mohave	\$11,675,000	\$4,389
Arizona Western ³	\$8,750,000	\$2,264
Navajo	\$8,640,000	\$3,260
Cochise	\$1,280,000	\$361
Eastern Arizona ⁴	\$0	\$0

²Central Arizona Community College serves Pinal County.

³Arizona Western Community college serves Yuma and La Paz Counties.

⁴Eastern Arizona Community College serves Graham County.

*The student population counts used to calculate per student debt are provided by the State Board of Community Colleges for FY 2002-03 for the expenditure limitation calculation.

Source: Arizona Department of Revenue

County	Outstanding Debt	Per Capita Debt
Pima	\$479,949,569	\$527
Pinal	\$36,375,000	\$180
Coconino	\$21,940,000	\$170
La Paz	\$3,345,000	\$161
Yuma	\$24,415,000	\$139
Greenlee	\$1,190,000	\$138
Apache	\$7,450,000	\$105
Cochise	\$9,250,000	\$73
Navajo	\$6,430,000	\$62
Mohave	\$7,835,000	\$46
Gila	\$2,415,000	\$45
Maricopa	\$136,270,000	\$40
Yavapai	\$6,375,000	\$34
Santa Cruz	\$1,040,000	\$25
Graham	\$0	\$0

Source: Arizona Department of Revenue



2005 Valuation Growth Reaches 10%

Last year, primary property net assessed values (NAV) in Arizona grew 9.3% (\$3.6 billion). This year, statewide primary NAV growth surpassed last year's increase with 10% value growth, resulting in total primary NAV of \$46.1 billion.

Four counties—Greenlee, Maricopa, Pinal, and Yavapai—experienced growth in excess of 10% for tax year 2005. The 19.3% growth in Greenlee County was mainly the result of an increase in existing centrally assessed property values.

Maricopa and Yavapai Counties experienced growth in existing property values, as well as new construction added to the tax roll, and the majority of Pinal County's growth, once again, was the result of new construction.

The dramatic growth in property values often translates into higher property tax revenues as many government entities adopt the same tax rates as the previous year.

For instance, with 9.3% valuation growth last year, 8 out of the 15 counties chose to increase property taxes above truth-in-taxation (TNT) limits, as well as 19 out of 48 cities, and 7 out of the 9 community colleges.

TNT laws require state and local governments to adjust

property tax rates based on changes in property valuations (excluding new construction) so that the only growth in the property tax levy is the result of new construction.

If jurisdictions choose to exceed the TNT limit and increase taxes over the prior year on existing property, they are required to notice taxpayers and hold a public hearing regarding the tax increase. If just the counties elect to levy the same rate as last year (up to the levy limit, if applicable), they will collectively raise taxes \$30 million in 2005.

Jennifer Schuldt

Net Assessed Valuation Growth by County, 2004 to 2005

County	2004	2005	Change	% Change
Apache	\$296,128,594	\$306,759,328	\$10,630,734	3.6%
Cochise	\$611,079,588	\$664,734,679	\$53,655,091	8.8%
Coconino	\$1,174,117,295	\$1,263,779,835	\$89,662,540	7.6%
Gila	\$365,997,563	\$387,715,727	\$21,718,164	5.9%
Graham	\$101,932,721	\$106,584,939	\$4,652,218	4.6%
Greenlee	\$160,123,797	\$190,973,104	\$30,849,307	19.3%
La Paz	\$141,588,228	\$142,746,979	\$1,158,751	0.8%
Maricopa	\$28,070,870,413	\$31,010,284,705	\$2,939,414,292	10.5%
Mohave	\$1,251,920,164	\$1,370,188,972	\$118,268,808	9.4%
Navajo	\$644,595,265	\$683,934,130	\$39,338,865	6.1%
Pima	\$5,412,550,080	\$5,868,143,484	\$455,593,404	8.4%
Pinal	\$1,061,148,994	\$1,212,971,458	\$151,822,464	14.3%
Santa Cruz	\$247,854,940	\$261,090,689	\$13,235,749	5.3%
Yavapai	\$1,676,029,540	\$1,877,847,425	\$201,817,885	12.0%
Yuma	\$658,763,396	\$707,027,499	\$48,264,103	7.3%
Total	\$41,874,700,578	\$46,054,782,953	\$4,180,082,375	10.0%

Data source: 2005 levy limit worksheets.

County	TAX YEAR 2004			TAX YEAR 2005			2005 LEVY USING 2004 TAX RATE (or up to levy limit)
	NAV	RATE	LEVY	NAV	TNT RATE	TNT LEVY	
Apache	\$296,128,594	0.3818	\$1,130,619	\$306,759,328	0.3765	\$1,154,971	1,171,207
Cochise	\$611,079,588	2.9373	\$17,949,241	\$664,734,679	2.8642	\$19,039,055	19,525,252
Coconino	\$1,174,117,295	0.4753	\$5,580,580	\$1,263,779,835	0.4578	\$5,785,342	6,006,746
Gila	\$365,997,563	4.4100	\$16,140,493	\$387,715,727	4.2906	\$16,635,393	17,098,264
Graham	\$101,932,721	1.7912	\$1,825,819	\$106,584,939	1.7836	\$1,901,086	1,909,149
Greenlee	\$160,123,797	0.7707	\$1,234,066	\$190,973,104	0.6427	\$1,227,439	1,252,020
La Paz	\$141,588,228	2.2500	\$3,185,735	\$142,746,979	2.2931	\$3,273,372	3,211,807
Maricopa	\$28,070,870,413	1.2108	\$339,882,099	\$31,010,284,705	1.1516	\$357,110,069	371,224,118
Mohave	\$1,251,920,164	1.7500	\$21,908,603	\$1,370,188,972	1.7014	\$23,312,319	23,978,307
Navajo	\$644,595,265	0.6316	\$4,071,264	\$683,934,130	0.6213	\$4,249,286	4,319,728
Pima	\$5,412,550,080	4.0720	\$220,399,039	\$5,868,143,484	3.9031	\$229,038,681	238,950,803
Pinal	\$1,061,148,994	4.5963	\$47,255,087	\$1,212,971,458	4.3777	\$53,099,918	55,751,807
Santa Cruz	\$247,854,940	3.3487	\$8,299,918	\$261,090,689	3.2883	\$8,585,518	8,743,144
Yavapai	\$1,676,029,540	1.7008	\$28,506,000	\$1,877,847,425	1.6014	\$30,071,299	31,938,429
Yuma	\$658,763,396	2.3180	\$15,270,136	\$707,027,499	2.3532	\$16,637,534	16,388,897
Total	\$41,874,700,578		\$732,638,699	\$46,054,782,953		\$771,121,282	\$801,469,677

Budgeted Desegregation/OCR Expenditures, FY 2005

District	FY 2005 Deseg Total	Deseg as % of RCL	TY 2004 Primary Rate	% of QTR	Estimated state cost thru 35% rebate
Tucson Unified*	\$62,461,811	26.1%	6.8278	180.3%	\$10,698,962
Phoenix Union	\$46,808,290	46.1%	3.0675	162.0%	\$3,975,170
Tempe Elementary	\$14,209,692	28.5%	2.8957	153.0%	\$1,042,660
Roosevelt Elementary	\$11,726,400	26.9%	6.1337	324.0%	\$1,211,413
Phoenix Elementary	\$9,818,256	31.3%	4.1879	221.2%	\$275,590
Mesa Unified	\$8,171,391	2.7%	4.4696	118.0%	\$1,502,809
Scottsdale Unified	\$6,752,458	6.3%	3.7696	99.6%	\$1,375,981
Washington Elementary	\$6,606,735	7.1%	2.7398	144.7%	\$997,511
Glendale Union	\$5,653,637	9.3%	2.3186	122.5%	\$890,534
Isaac Elementary	\$4,758,896	15.5%	5.2579	277.7%	\$371,840
Cartwright Elementary	\$4,140,780	5.8%	3.4152	180.4%	\$693,723
Amphitheater Unified	\$4,025,000	5.9%	4.5111	119.1%	\$731,794
Holbrook Unified	\$2,325,120	25.9%	3.8579	101.9%	\$142,866
Flagstaff Unified	\$2,086,634	4.2%	3.9883	105.3%	\$327,976
Wilson Elementary	\$1,792,823	34.9%	3.5351	93.4%	\$7,052
Window Rock Unified**	\$662,194	4.6%	0.0000	0.0%	n/a
Agua Fria Union	\$660,000	4.1%	3.3758	178.3%	\$127,556
Buckeye Elementary	\$510,000	9.4%	3.9725	209.8%	\$11,014
Maricopa Unified*	\$371,622	6.3%	6.1056	161.3%	\$62,833
Totals	\$193,541,739				\$24,447,282

* The total primary rate on TUSD taxpayers exceeds the constitutional one percent cap (by 43 cents within the city of Tucson). This results in an estimated additional \$5 million cost to the state general fund. Maricopa Unified receives \$212,127 from the state because it is \$1.17 over the cap.

** Window Rock does not have a property tax. The district's deseg spending is funded through federal (P.L. 874) dollars.

DESEG VETO

Continued from page 1

In her veto message, Governor Napolitano argues that the cap proposed in HB 2498 “entirely fails to account for student growth within those districts . . .” The suggestion that current deseg/OCR levies have some relationship to student growth does not withstand scrutiny. If such a relationship to student count existed, it would be reflected in the amount levied as a percent of a district’s revenue control limit, or RCL, the main component of which is student count. In fact, the variance in amounts levied from district to district as a percent of the RCL ranges from a high 46% in the Phoenix Union High School District to a low of almost 3% in Mesa Unified (see the table on page 5).

It is also noteworthy that while Tucson Unified levies more than any other district at \$62.5 million, that amount only represents 26% of the district’s RCL. Meanwhile, Wilson Elementary’s \$1.8 million levy is nearly 35% of their RCL.

In fact, growth in deseg/OCR levies is often associated with declines in student count. Everything else being equal, a school district experiencing a reduction in student count will also experience a reduction in budget capacity through the RCL. A district with authority to levy for deseg/OCR, however, often finds that property tax hikes are the path of least resistance to overcoming a budget shortfall.

Governor Napolitano also maintains that HB 2498 “allows for different expenditure

levels based not on need but on when the school district became subject to a desegregation order of administrative agreement.”

“It is doubtful,” she continues, “that such funding discrepancies would withstand judicial review, and we should not be passing laws that will lead to more litigation against the state and its school districts.”

Again, HB 2498 would not have resulted in “funding discrepancies” but would instead have prevented such discrepancies from getting worse.

Since HB 2498 provided that any justifiable increases for new or existing deseg/OCR expenditures would be subject to state appropriation, as is the case with most other special categories of K-12 funding, district revenue for such purposes would have been based on need. Additionally, future issues of this nature, in any district, would have been addressed through targeted state appropriations designed to solve problems on a district by district basis, or statewide if necessary.

The governor’s last point is that “Funding for compliance with desegregation orders and administrative agreements is an essential element of fully funding public education. Arizona should not shirk in its duties in this regard, and we must exercise care before making changes to schools’ desegregation budgets.”

Yet, under the current system, Arizona is shirking in its duties. To the extent these revenues are addressing cases where children’s civil rights have been violated, the State of Arizona has a responsibility to resolve these problem where they occur or, as may be the case, systemically across the state.

By leaving compliance costs almost entirely up to local property taxpayers, Arizona remains vulnerable to litigation on the grounds that the current funding mechanism violates the “general and uniform” clause of the Arizona Constitution.

Some extraordinarily high property tax rates result from the current system. Roosevelt Elementary levies less, for example, than Tempe Elementary does for OCR compliance. Yet Roosevelt’s primary tax rate is more than double what Tempe’s is. In fact, Roosevelt’s primary rate of 6.1337 per \$100 of assessed value is 324% of the qualifying tax rate (QTR), used to determine the local contribution and state revenue to fund school district budgets (see table on page 5).

As a result of the veto, school districts that run afoul of Federal civil rights laws will continue to be rewarded with unlimited property tax revenues and local taxpayers will remain exposed to higher tax burdens.

Michael Hunter