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ARIZONA TAX RESEARCH ASSOCIATION

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ATRA Property Tax Recommendations Signed

Tax Cuts Highlight Budget Agreement

When the Legislature and Governor Napolitano finally came to an agreement on the Fiscal Year (FY) 2007 budget, it included the largest single year tax cut in state history. Signed into law on June 21, 2006, House Bill (HB) 2876 will provide approximately $370 million in property and income tax relief in FY 2007. The package will provide an estimated $1.5 billion in tax relief over the next three years.

The tax package includes recommendations made by ATRA in November 2005. With property valuations skyrocketing, and with initiatives threatening to dramatically change Arizona's property tax system, ATRA recommended that the Legislature reduce property tax rates as well as prohibit local governments from increasing property tax rates this year. ATRA also recommended that the local governments be required to seek voter approval before increasing primary property taxes in the future.

Led by House Ways and Means Chair Steve Huffman and Senate Finance Chair Dean Martin, the Legislature settled on the ATRA recommendations after considerable debate regarding the best way to prevent the dramatic increases in property values from translating into equally high property tax increases. The following are the key provisions of the property tax package:

Equalization Rate Reduction

ATRA argued that the most effective way to ensure that valuation increases will not result in tax increases was to reduce tax rates. To that end, ATRA advocated a reduction or elimination of the county education equalization rate which is currently set at $0.4358 per $100 of net assessed value for FY 2006. HB2876 reduces this tax rate to zero for the next three tax years and brings the rate back in Tax Year (TY) 2009 under the new name of "state" equalization rate. According to the Joint Legislative Budget Committee (JLBC), dropping the equalization rate to zero will result in an estimated total savings for taxpayers in the amount of $215 million for FY 2007.

Limiting Primary Property Tax Levies in TY 2006

A major concern when the state reduces property taxes is that local governments will backfill into the tax cut by increasing their rates. ATRA proposed and the Legislature adopted for TY 2006 all counties, cities, towns, and

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U.S. Senator Jon Kyl Receives ATRA Watchdog Award

(From left to right) Russell Smoldon, Senator Jon Kyl, Gretchen Kitchel, ATRA Chairman, and Larry Lucero, ATRA Vice-Chair.

The Arizona Tax Research Association (ATRA) presented U.S. Senator Jon Kyl with ATRA's 2006 Watchdog Award at a luncheon held in his honor on May 31 at the Phoenix Country Club.

The award was presented to Senator Kyl by Salt River Project Government Affairs Manager Russell Smoldon in recognition of what Smoldon called "a courageous and principled stance to return taxpayer dollars to those who earned them. Washington's appetite to spend, spend, spend is nearly insatiable and while Senator Kyl has assumed a lonely and

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community college districts be prohibited from raising primary property levies more than two percent, excluding new construction, over the 2005 levies.

Voter Approval to Raise Property Taxes

In order to address future growth in primary property taxes, ATRA's third proposal required counties, cities, towns, and community college districts to receive voter approval before raising levies beyond the two percent plus new construction threshold. This provision will become law if it is passed by the voters at the November general election. The Legislature referred to the ballot HCR2056, dubbed the Taxpayer Protection Act, which requires a recalculation of the base constitutional levy limits.

In 1980, the voters of Arizona approved a measure to limit primary property tax growth for counties, cities, towns, and community college districts to two percent on existing properties over the previous years' tax levy plus new construction.

County	1989 MTR	2005 MTR	Difference
Apache	0.1711	0.4587	0.2876
Cochise	2.8407	4.2673	1.4266
Coconino	0.4285	0.5037	0.0752
Gila	3.8444	6.2448	2.4004
Graham	2.4538	3.4335	0.9797
Greenlee	0.2230	0.6556	0.4326
La Paz	2.2759	3.7805	1.5046
Maricopa	0.9235	1.1971	0.2736
Mohave	1.8475	1.9616	0.1141
Navajo	0.3683	0.6337	0.2654
Pima	3.7476	4.7233	0.9757
Pinal	4.4760	8.2429	3.7669
Santa Cruz	3.1241	3.5352	0.4111
Yavapai	2.1773	2.0400	-0.1373
Yuma	1.9794	2.6565	0.6771

Single Filer	Tax Year 2005	Tax Year 2006	Tax Year 2007
If taxable income is:	The tax is:		
0 - $10,000	2.87%	2.73%	2.59%
$10,001 - $25,000	$287 + 3.2% of excess > $10,000	$273 + 3.04% of excess > $10,000	$259 + 2.88% of excess > $10,000
$25,001 - $50,000	$767 + 3.74% of excess > $25,000	$729 + 3.55% of excess > $25,000	$691 + 3.36% of excess > $25,000
$50,001 - $150,000	$1,702 + 4.72% of excess > $50,000	$1,617 + 4.48% of excess > $50,000	$1,531 + 4.24% of excess > $50,000
$150,001 and over	$6,422 + 5.04% of excess > $150,000	$6,097 + 4.79% of excess > $150,000	$5,771 + 4.54% of excess > $150,000

Joint/Head of Household	Tax Year 2005	Tax Year 2006	Tax Year 2007
If taxable income is:	The tax is:		
0 - $20,000	2.87%	2.73%	2.59%
$20,001 - $50,000	$574 + 3.20% of excess > $20,000	$546 + 3.04% of excess > $20,000	$518 + 2.88% of excess > $20,000
$50,001 - $100,000	$1,534 + 3.74% of excess > $50,000	$1,458 + 3.55% of excess > $50,000	$1,382 + 3.36% of excess > $50,000
$100,001 - $300,000	$3,404 + 4.72% of excess > $100,000	$3,233 + 4.48% of excess > $100,000	$3,062 + 4.24% of excess > $100,000
$300,001 and over	$12,844 + 5.04% of excess > $300,000	$12,193 + 4.79% of excess > $300,000	$11,542 + 4.54% of excess > $300,000

However, over the last 25 years, the capacity to levy primary property taxes has outpaced actual levies for a variety of different reasons. First, as the table above reflects, the maximum tax rates in the levy limits have climbed considerably since 1989, creating unused capacity. Second, some jurisdictions experienced explosive growth in property values associated with new construction.

However, the primary reason for the excess capacity is that jurisdictions with unusually high property tax rates have experienced tremendous growth in their primary levy limit capacities as opposed to jurisdictions with lower rates. The capacity grows at an even greater rate with the dramatic growth in new construction throughout the state.

For example, in TY 2005, Maricopa County levied a primary property tax rate of $1.1971 per $100 of net assessed value. Pinal County, which incidentally levies the highest primary property tax rate of the 15 counties and has been experiencing the highest percentage in new construction, levied a rate of $4.4532 in the same year. The dramatic difference in the rates between the two counties has created a disproportionate growth in the levy limit capacity since every dollar of new construction creates an equal rate of change in the capacity. Creating further levy limit capacity for Pinal County is the fact that new construction is brought into the levy limit at the maximum tax rate and not the rate currently levied. For Pinal County, the maximum allowable tax rate in their levy limit for 2005 was $8.2429 per $100 of net assessed value, providing almost seven times the levy capacity for each dollar of new construction that Maricopa County receives. The adjacent table shows

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the percentage of new construction for the two counties and the resulting growth rate in the constitutional levy limit for each.

Lastly, with the ability to levy a sales tax, many counties and cities have been able to generate additional revenues without increasing their primary property tax rates. Prior to the county's ability to levy a sales tax, there existed only $936,000 in primary levy capacity in 1989. In TY 1995 however, when the majority of counties had already begun levying a sales tax, the capacity grew over $81 million. By TY 2005, the counties capacity to levy higher primary taxes without voter approval rose to over $117 million. If passed by the voters this November, the 2006 Taxpayer Protection Act will eliminate approximately $181 million in potential tax levying capacity.

Tax Year 2005	Maricopa	Pinal
New Construction	$1,496,021,274	$133,514,582
% of NAV	4.8%	11.0%
Tax Year 2006		
New Construction	$1,700,968,520	$191,900,968
% of NAV	5.0%	13.0%
2005 Levy Limit	$371,224,118	$99,984,028
2006 Levy Limit	$398,725,245	$117,270,762
1-yr levy limit growth	**7.4%**	**17.3%**

Individual Income Tax Cuts

HB2876 also included a major reduction in personal income taxes. Taxpayers will benefit from a 10% cut in their individual income taxes over the next two years, with a five percent drop per year. As a result, it is estimated that approximately $155.5 million will be retained by taxpayers in FY 2007 and $333.6 million in FY 2008.

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somewhat unpopular mantle, in the end, taxpayer's rights have been safeguarded because he made the choice to do what is right."

"Senator Kyl has consistently been rated among the most fiscally responsible and taxpayer friendly members of Congress, and as you know all too well - taxpayers need a friend in Congress!" Smoldon said. "The National Taxpayers Union has named the Senator a 'Taxpayer Friend;' Americans for Tax Reform gives him a solid 90 percent ranking; Citizens Against Government Waste calls him a 'Taxpayer Hero' and ranks him first among his peers. In fact, the Senator has received that group's top ranking every year since 1997. And the National Federation of Independent Businesses awarded Jon Kyl their 'Guardian of Small Business Award.'"

ATRA President Kevin McCarthy said the award was a token of the organization's gratitude for the Senator's undaunted work on behalf of taxpayers. "The fight against pork barrel spending is difficult and often thankless work, so ATRA wanted to take this opportunity to express our appreciation for Senator Kyl's diligent opposition to the wasteful and frivolous spending of taxpayers' dollars," said McCarthy.

"Whether he is championing the extension of President Bush's tax cuts, advancing the landmark Arizona Water Settlement Act, or advocating for a strong national defense, it is widely acknowledged that he is indispensable in Congress for statecraft. The Senator has also been a leader in permanently lowering dividend and capital gains tax rates, making individual rate reductions permanent, and in eliminating the death tax."

Accepting the award, Senator Kyl said, "I am proud to be leading the Congress in the fight against wasteful spending. I am honored to receive this wonderful award and will continue advocating fiscal responsibility and lower taxes in Washington for all Arizona taxpayers while working to see that their tax dollars are being used efficiently."

SB1205 Reforms Flawed K-12 Formula

Transportation funding for ghost students limited

A victory was handed to local property taxpayers after Governor Napolitano signed Senate Bill (SB) 1205, an ATRA recommendation to reform a flawed school transportation funding formula.

Sponsored by Senator Bob Burns, SB1205 prohibits increases in the school district's transporation revenue control limit (TRCL) if the calculated amount exceeds 120% of the transportation support level (TSL). The TSL formula was also changed by increasing the school day multiplier to 180 days (from 175). It is now calculated by multiplying the average bus miles per eligible student by the state support level per route mile and a 180-school day calendar.

Both formulas were created by the State Legislature in 1980 but since then, this "hold harmless" funding mechanism has resulted in the TRCL outpacing the TSL by approximately $54 million in Fiscal Year (FY) 2005. Essentially, this is an amount that is calculated to transport students who do not exist.

The mechanism affects property tax rates because the state's equalization formula recognizes only the TSL. School districts' adopted budgets, however, include the TRCL. Therefore, the $54 million to transport ghost students is falling mostly to local property taxpayers, even causing some of the highest property tax rates in the state.

The TRCL is calculated by adjusting the previous year's TRCL by the growth in the TSL. In other words, if the TSL formula results in more funding, the TRCL grows by the same amount. Even if the TSL decreases, the TRCL remains the same, resulting in a growing disparity between the two formulas.

JLBC estimated that the gap between the two will cost the General Fund approximately $12 million through additional state aid in recognition of the one-percent cap and the 35% rebate for owner occupied homes. It was further estimated that the cost to the General Fund would continue to grow by another $1 million if SB1205 was not signed into law.

It is important to note that SB1205 will not reduce the TRCL amount in any school district - it simply caps the TRCL from growing until the difference between the two formulas returns to a reasonable level. To accommodate transportation costs based on a 180-day school calendar, $5.5 million was appropriated from the General Fund to fund FY2007 transportation costs.