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ARIZONA TAX RESEARCH ASSOCIATION

NEWSLETTER

VOLUME 70  
NUMBER 1

JANUARY 2010

## 2010 LEGISLATIVE PROGRAM

ATRA's Board of Directors officially adopted its 2010 legislative agenda and ATRA staff is already pursuing those objectives in the recently commenced second regular session of the 49<sup>th</sup> Legislature.

### STATE BUDGET

As was the case last year, this year's agenda was developed with recognition that the legislature's highest priority for the session should be closing the state's on-going budget deficit. In percentage terms, Arizona faces the largest budget deficit in the country and policymaker's inability to close that deficit now threatens Arizona's financial future.

For the fifth-straight year, ATRA will forward to the Governor and Legislature a laundry list of specific recommendations on budget reductions as well as improvements to the state's fiscal management. In 2010, those recommendations will be further expanded to take into account the severity of the state's historic budget crisis. One of the most significant actions taken to date to close the ongoing structural deficit was a \$250 million statewide property tax increase. Clearly, significant reductions to baseline spending need to be achieved before taxpayers are again asked to pay higher taxes to close the deficit.

To that end, in 2009, ATRA supported Governor Brewer's call for a temporary increase in the state sales tax. In September, following the governor's veto of both the repeal of the state equalization property tax and budget reductions, the ATRA Board of Director's pulled its support for any further tax increases until meaningful progress was made to reduce the deficit through budget reductions.

In addition to specific budget reductions, the 2010 budget recommendations will strongly

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## Letter to Cities and Towns Describes ATRA's Opposition to RDS Contract

While Arizona businesses shed jobs and struggle to survive in the worst economic environment they have faced in decades, the leadership of Arizona cities and towns has developed plans to make survival even more difficult.

Arizona is one of only three states in the country that allows for an independent municipal sales tax structure. Unlike other states, our system requires many businesses to maintain two sets of books for the payment of sales tax — one for the state and another for municipal tax obligations. In addition to multiple points of contact for the payment of sales tax, Arizona businesses are also faced with the potential administrative burden of audits from the state as well as municipal auditors.

Regrettably, and over ATRA's strong opposition, the Arizona League of Cities and Towns is aggressively pursuing a change to municipal sales tax collections and auditing that will make an already bad situation much worse. The League of Cities has forged a partnership with the out-of-state firm Revenue Discovery Systems (RDS) to take over the tax collection and auditing process for cities currently in the state collection program. RDS would receive a percentage of the monthly sales tax collections of any city that contracted for their services. In addition, as

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## SCHULTZ APPOINTED TO THE DEBT OVERSIGHT COMMISSION



On December 8, Senate President Bob Burns and House Speaker Kirk Adams announced the appointment of ATRA Vice President Jennifer Schultz to the Debt Oversight Commission.

The Commission is responsible for annually reviewing information provided by the Department of Revenue regarding the bonded indebtedness of all taxing jurisdictions and the relationship to the appropriate debt limits.

Schultz will be taking the seat on the five-person board statutorily intended for a "private citizen who is knowledgeable in the area of finance or bond financing." Schultz's extensive experience in government finance will prove to be invaluable to the Commission.

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explained to ATRA, a small percentage of the amount received by RDS would also flow back to the League of Cities.

Arizona's state and local sales tax structure is one of the most complicated and burdensome systems in the country for taxpayer compliance. In addition to being a dramatic move in the wrong direction from a tax policy perspective, ATRA believes the cities lack the legal authority to contract with a third party vendor for sales tax collections.

The following letter was sent on October 21, 2009 by ATRA to every Arizona city and town to inform them of the policy and legal objections ATRA has with the RDS contract.

To Whom It May Concern:

The recent development of the partnership between the League of Arizona Cities and Towns (League) and Revenue Discovery Systems (RDS) has created several legal and policy concerns for Arizona Tax Research Association (ATRA) and the taxpayers of this state.

Upon learning of the partnership, ATRA met with the League and RDS representatives to understand the details of the partnership and to discuss ATRA's concerns with that partnership. Without addressing any of ATRA's concerns, the League moved forward and formed the partnership with RDS. Among the concerns ATRA attempted to communicate to the League were the legality of disclosing confidential information to a third-party vendor, the increased difficulty in taxpayer compliance as a result of partnering with RDS, and the rationale behind a city paying a third-party vendor for the same services that are offered at no cost by the Arizona Department of Revenue (DOR).

At the meeting with the League and RDS, ATRA questioned the legal authority of cities to disclose confidential information to a third-party vendor. That question was never clearly answered during the meeting, and ATRA is not confident that this issue has been thoroughly researched and considered by League officials. ATRA does not believe that the cities have the legal authority to disclose confidential information to a third-party vendor under either the Model City Tax Code (MCTC) or state statutes.

Under MCTC § -510, it is unlawful for any official or employee of a city to make known information obtained pursuant to the MCTC concerning the business financial affairs of operations of any person. The exceptions to this prohibition do not include contracting with third parties to administer the return filing compliance for a city. Under this provision, confidential taxpayer information can only be disclosed to:

- ◆ The federal government, State of Arizona or a political subdivision
- ◆ An Arizona county, city or town
- ◆ Successors, receivers, trustees, personal representatives, executors, guardians, administrators and assignees of taxpayers, if they have a direct interest
- ◆ Upon written direction from the City Attorney or other legal advisor to a city designated by the City Council, a city may disclose confidential information to a private collection agency pursuant to a written agreement with the city in order to collect delinquent taxes
- ◆ Another Arizona city or town to resolve tax jurisdiction disputes, conduct joint audits or before the municipal tax hearing officer
- ◆ Another Arizona governmental agency to resolve allocation of taxes on the publication and distribution of periodicals
- ◆ Another governmental agency with which a city has a tax enforcement and collection agreement

Since the contract with RDS meets none of these criteria, a city is precluded from entering into a contract for the administration of tax return filing compliance. Further, a city may not amend this provision of the MCTC without approval of the Municipal Tax Code Commission pursuant to A.R.S. §42-6053(B). Any proposal to broaden the parties to which confidential tax information can be disclosed obviously would cause a tremendous amount of taxpayer concern. Taxpayers have enough concern with the proliferation of confidential tax information being provided to governmental agencies, let alone a private party for which there are

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Published 10 times annually 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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no statutory consequences for disclosure. In essence, the employees of government agencies are held to a higher standard of protection of tax information than those of RDS under MCTC § -510, and that is a very problematical situation.

Additionally, state statute specifically limits the disclosure and use of confidential information by cities and towns relating to transaction privilege and use tax:

A.R.S. § 42-2003 (H) “confidential information relating to transaction privilege tax, use tax, severance tax, jet fuel excise and use tax and rental occupancy tax may be disclosed to any county, city or town tax official if the information relates to a taxpayer who is or may be taxable by the county, city or town. Any taxpayer information released by the department to the county, city or town:

1. May only be used for internal purposes.
2. May not be disclosed to the public in any manner that does not comply with confidentiality standards established by the department. The county, city or town shall agree in writing with the department that any release of confidential information that violates the confidentiality standards adopted by the department will result in the immediate suspension of any rights of the county, city or town to receive taxpayer information under this subsection.”

Again, a contract with RDS does not meet these criteria and would be in violation of state statute.

In previous years, ATRA made clear that having a separate tax code at the state and city level, and even among different cities, complicates taxpayer compliance. Multijurisdictional taxpayers are further burdened with the requirement to file numerous tax returns to various entities, based on the different tax bases. Cities that contract with RDS will further exacerbate the problem, making taxpayer compliance even more difficult. A multijurisdictional taxpayer could now add another layer of compliance to one of the most complex compliance structures in the country. In any month, that taxpayer could have to file with numerous non-program cities, DOR for the state and program cities in the state collection program and now RDS cities. It would be hard to come up with a state in this country other than Louisiana with such a difficult compliance burden for taxpayers.

In August 2002, the state entered into a contract with Accenture to fund DOR’s Business Reengineering/Integrated Tax System (BRITS) program in order to streamline the state’s tax collection and reporting services that are provided to cities at no cost. Although there have been problems associated with the implementation of the BRITS program, DOR has continued to work closely with Accenture to improve the system. To date, the state has invested more than \$160 million into BRITS.

It is difficult to understand the reasons a city would pay RDS for the same services that it can get at no cost from DOR. ATRA questions whether the “increased revenues” promised by RDS is enough to offset the costs associated with providing those services. For instance, as of April 1, 2009, Bullhead City became the first city to contract with RDS. Based on the first five months of tax collections, the city was required to remit \$43,802 to RDS for services rendered (\$105,125 annualized), which is tax revenue that would have remained with the city if the city remained in the DOR program.

The Town of Queen Creek recently considered a contract with RDS; however, the town cancelled negotiations upon meeting with DOR representatives and observing the improvements that have been made to the BRITS program. ATRA encourages cities that are considering leaving the DOR system to first meet with DOR representatives regarding the improvements that have been made to the BRITS program.

ATRA recommends that the remaining cities refrain from contracting with RDS based on the concerns outlined in this letter.

Sincerely,

Kevin J. McCarthy, President

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encourage state leaders to maximize their authority to manage the state's budget crisis. Simply put, this crisis cannot be resolved while simultaneously adhering to stipulations from the federal government to spend money Arizona does not have or strict interpretations of the limitations on the state's budget authority through voter initiatives. To that end, ATRA recommends that Governor Brewer give serious consideration to declaring a fiscal emergency and make recommendations to resolve the crisis. (*A detailed list of ATRA's budget recommendations can be viewed online at [www.arizonatax.org](http://www.arizonatax.org)*)

### TAXATION

The state's on-going budget deficit will continue to put pressure on increasing taxes. As noted above, last session property taxpayers were saddled with a \$250 million property tax increase that ATRA opposed. In addition, House Democrats proposed an extraordinary \$980 million property tax increase.

ATRA has consistently cautioned policymakers to first **Do No Harm** when making changes to the state's tax system. Any increase in taxes should avoid aggravating existing problems in Arizona's state and local tax structure. State policymakers should avoid, and ATRA will strongly oppose, further increases in property taxes to close the deficit.

#### Property Taxation

**Prevent further increases in property taxes.** As noted above, property taxpayers were hit with a record tax increase this year as a result of Governor Brewer's veto of the repeal of the state equalization rate last year. In addition, the legislature and governor dramatically expanded the K-12 schools access to the property tax base through a 50% increase in the override authority. In an effort to avoid undermining some of the recent progress that has been achieved to decrease business property taxes, the expansion to the school override authority was accompanied with a decrease in the class one assessment ratio to 16% on voter-approved secondary property taxes. While the increased K-12 override authority became law last session, the assessment ratio reforms were a casualty of the Governor's veto stamp.

- ◆ **ATRA will oppose efforts to increase both state and local property taxes.** In addition, ATRA will advocate for the continued compliance with the state's Truth-in-Taxation (TNT) law. Since its passage in 1998, the state has consistently complied with TNT. Undoubtedly, the budget deficit creates more of a threat for non-compliance than in previous years. The JLBC staff's "shortfall options list" contains a recommendation to increase the qualifying tax rate (QTR) for K-12 schools to \$4.25, an estimated \$625 million property tax increase.
- ◆ **K-12 Primary Tax Rate Reform.** ATRA will pursue legislation that requires county school superintendents to certify to the Property Tax Oversight Commission that the K-12 primary tax rates that they calculate comply with A.R.S. 15-991.
- ◆ **Clarify County Accommodation School Taxation Authority** – ATRA will pursue legislation to make clear that County Accommodation Schools do not have the authority to levy primary or secondary property taxes.

**Property Tax Reform.** For several years, ATRA has advocated reforms to Arizona's property tax system that address the disparity in tax treatment between business and residential property. As the result of previous ATRA-backed legislation passed in 2005 and 2007, the effective tax rate on business properties has improved from 3<sup>rd</sup> highest in the country to 10<sup>th</sup> according to the most recent statistics from the National Taxpayers Conference. However, Arizona's policy that shifts taxes from residential property to business continues to be the number one impediment in attracting new industry to the state.

- ◆ **Class One Assessment Ratio Reductions** – ATRA will pursue reductions in the class one assessment ratio consistent with the reductions achieved in the 2009 session that were vetoed by Governor Brewer. The Legislature passed those assessment ratio reductions to offset the impacts of increased K-12 secondary taxes also passed in 2009.
- ◆ **County-wide Secondary Levy Limits** – pursue legislation to place levy limitations on the following countywide special districts: Library Districts, Public Health Services Districts, and Jail Districts. These countywide special district levies should be limited to the same percentage growth as the annual increase in the county's primary levy limit.

#### Corporate Income

- ◆ **Net Operating Loss Carryforward** – ATRA will support legislation that extends the current five-year limit on net operating loss carryforwards to 20 years for losses arising in tax years beginning from and after 12/31/2009.

#### Sales Tax

- ◆ **Oppose the wholesale expansion of the sales tax base.** Arizona's on-going budget deficit has led to numerous recommendations to dramatically raise sales taxes through the wholesale elimination of most exemptions and deductions that currently define Arizona's transaction privilege tax (sales tax) base. The advocates for sweeping expansion of the sales tax base ignore that Arizona already has a very broad sales tax base and eliminating many of the exemptions and deductions would result in double taxation of many business inputs. Arizona already taxes many services and Governor Brewer has recommended further expansion of the base for some repair services.

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- ◆ **Prohibit cities from contracting with a non-government third party for the collection of taxes and contingent-based audits.** Arizona businesses are burdened with one of the most complicated sales tax systems in the country. Much of that burden is grounded in Arizona's independent municipal sales tax structure that allows cities to levy taxes on a different tax base than the state as well as collect and audit those taxes independently of the state. Historically, most Arizona cities and towns have relied on the Arizona Department of Revenue for the collection of their local sales taxes. Over the years, many of Arizona's larger cities created their own tax departments for the collection and audit of city sales taxes. Recently, the League of Cities and Towns has engaged an out-of-state firm to begin contracting with cities that are currently in the state's collection program for both the collection and auditing of their local sales tax.
- ◆ In a letter to every Arizona city and town, ATRA communicated its strongest objection that a city would turn over the collection and audit of sales taxes to a private entity. Among other things, that letter pointed out that neither state law nor the Model City Tax Code gives cities the authority to enter into such contracts. ATRA will pursue legislation to make clear that cities and towns do not have the authority to turn over confidential taxpayer information to a private entity for the collection of taxes or contingency-based audits.

**Public Finance**

- ◆ Public Health Services Districts – ATRA will pursue legislation that would require a county board of supervisors to receive voter approval prior to creating a Public Health Services District.
- ◆ US Census Bureau Reporting – pursue legislation to transfer Arizona's reporting of public finance/tax information to the US Census Bureau from ASU to JLBC.