



*The taxpayer's watchdog for 70 years*

# ARIZONA TAX RESEARCH ASSOCIATION

## NEWSLETTER VOLUME 70 NUMBER 8 DECEMBER 2010

### Legislative Leadership Focuses On Deficit, Economy

Leaders from the Arizona Legislature addressed ATRA's 70<sup>th</sup> Annual Outlook Conference with similar messages. It was no surprise that the state budget's ongoing structural deficit was frequently cited in the leaders' remarks, but the leaders also focused on their desire to jump-start the economy.



*Rep. Chad Campbell,  
House Minority Leader-Elect*

Representative Chad Campbell, the incoming House Minority Leader for 2011, began the leadership speeches by explaining that the

number one priority this legislative session will be to fix the state's budget. He added that reductions to the deficit must be long-term; referring to the expiration of the temporary sales tax in 2013 and one-time budget gimmicks used in recent years to balance the budget. He also stressed the importance of making the state competitive for business location and concluded that there needs to be comprehensive reform of the business tax structure while holding other entities harmless, specifically individuals. Representative Campbell also noted that there is a lot of common ground between Democrats and Republicans in the area of tax reform, which is why he remains optimistic about turning the state around. He summed up his speech by saying that bringing capital investment to Arizona will be the first step of recovery.

The next speech was given by incoming House Majority Leader Andy Tobin, who assured the audience that both newly-elected and veteran legislators are eager to get to work and solve the budget crisis. He



*Rep. Andy Tobin, House Majority Leader-Elect*

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### Senator Bob Burns Receives ATRA's Watchdog Award



*Russell Smoldon (left) and Senator Bob Burns*

The highlight of ATRA's Annual Meeting luncheon on November 19<sup>th</sup> was the presentation of the 2010 ATRA Watchdog Award to Senate President Bob Burns. Senator Burns is the seventh recipient of the award that ATRA instituted in 1990 as a way of recognizing an Arizona elected official for the often thankless job of opposing frivolous and wasteful spending of taxpayers' dollars.

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said he believes that veteran House Republicans will benefit from a very talented group of freshman lawmakers. Rep. Tobin noted that closing the state budget deficit is complicated by a host of restrictions on the appropriation powers of the State Legislature. He also expressed frustration that such restraints fundamentally undermine the primary responsibility of the State Legislature to annually pass a balanced budget. Rep. Tobin closed his remarks by saying that economic growth and job creation will again be a top priority for House Leadership next session and said that improving Arizona's business tax climate will be a key feature of the effort.

Senate Majority Whip Steve Pierce wrapped up the legislative outlook session with a renewed call for statesmanship at the Capitol. Senator Pierce noted that the state's fiscal problems are great and there are no politically easy answers to close the deficit. Senator Pierce also presented a comprehensive plan to improve on Arizona's relatively unfriendly business environment. He suggested that lawmakers should continue on the path of reducing Arizona's high business property tax burdens by reducing the assessment ratio on class one property (commercial and industrial properties) from 20% to 19% in 2012, down to 18% in 2013. He also recommended a reduction to the ratio for class two (vacant and agricultural land) from 16% to 15% in 2012. In addition, he said reductions in personal property taxes should be accomplished through an increase in the current \$66,440 exemption threshold. Closing out his property tax recommendations, he called for a constitutional amendment to limit annual valuation growth to 5%. Senator Pierce wrapped up his speech with a call for reform of Arizona's complicated sales tax system that allows for an independent municipal tax structure on top of the state's sales tax system.

Overall, the legislators agreed that the property tax burden on businesses needs to be significantly reduced to make Arizona more attractive to corporations, thus bringing employment back to the state. It was a consensus belief that once Arizona's economy is back on track, there will be an increase in revenue which will help to eliminate the deficit; however, the increase in revenue will need to be accompanied by fiscally sound budget reductions.



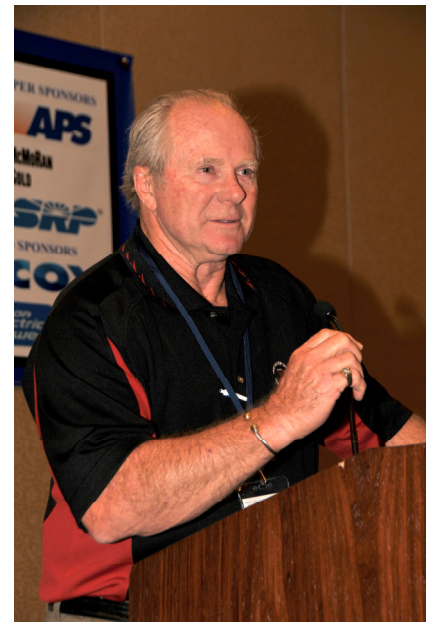
*Senator Steve Pierce, Senate Majority Whip-Elect*

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First elected to the Arizona House of Representatives in 1988, Senator Burns served 12 years there before being elected to the Arizona Senate in 2002. Through most of his service in the Legislature, he was a fixture in the Appropriations Committees, serving as the committee's chairman in both Houses. He currently serves as the Senate President in the 49<sup>th</sup> Legislature.

The award was presented by ATRA board member Russell Smoldon, who noted that Senator Burns' long career was almost singularly focused on advocacy for taxpayers' rights and principled stands against wasteful spending.

Smoldon said, "Bob leaves behind a great legacy of statesmanship that every member of the Legislature should aspire to. He was always working on issues of statewide importance. Not because they were fun or easy but because good statesmen embrace the major challenges of the day. His entire career has truly exemplified all of the qualities that this award is intended to honor and support."



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# Tax Experts Provide Arizona Tax 101 Overview

The debate at the State Capitol regarding tax reform and economic development prompted ATRA to dedicate a considerable portion of this year's Outlook Conference to an overview of Arizona's tax system.



*Kevin McCarthy, ATRA President*

ATRA President Kevin McCarthy led off the Arizona Tax 101 discussion with an overview of how Arizona's tax system has performed over the last 30 years, as well as how Arizona's state and local taxes compare to other states. McCarthy began his presentation by providing an updated ATRA analysis on total state and local tax collections from 1980 to 2010. McCarthy pointed out that despite its flaws, Arizona's state and local tax system has generated revenue that has outpaced both population and inflation since 1980. Per capita inflation-adjusted taxes grew 36% between 1980 and 2010. In noting that Arizona is not unique in that it doesn't have perfect balance among the three major tax types (property, sales, and income), the ATRA analysis also shows that there has been little change to Arizona's three-legged stool over the last 30 years.

Regarding national comparisons, McCarthy related that the most recent data available shows that Arizona ranks average in overall tax collections compared to other states. Arizona's total state and local tax ranking is 33<sup>rd</sup> on a per capita basis and 22<sup>nd</sup> per \$1,000 of personal income. Arizona's average ranking is achieved through very high sales taxes (5<sup>th</sup> per capita and 6<sup>th</sup> per \$1,000 personal income), average overall property taxes (36<sup>th</sup> per capita and 29<sup>th</sup> per \$1,000 personal income) and low personal income taxes (40<sup>th</sup> based both on a per capita and per \$1,000 personal income basis).

While providing an overview of Arizona's complicated property tax system, McCarthy also cautioned against drawing quick conclusions with many of the national rankings in circulation. For example, Arizona's average ranking in overall property tax

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## Joint Legislative Budget Committee Director Provides Update on State's Fiscal Woes

Richard Stavneak, Director of the Joint Legislative Budget Committee, provided attendees of the 2010 ATRA Outlook Conference with an update of the state's current fiscal woes. Stavneak began with an overview of the current state budget, stating that Arizona's fiscal year (FY) 2011 budget is in better shape than in FY 2010, as general fund revenues are beginning to grow after an unprecedented three-year decline. But despite growth in general fund revenue, the shortfall for FY 2011 is estimated at \$825 million and is projected to be \$1.4 billion in FY 2012 due to one-time budget solutions expiring at the end of this year. Stavneak attributed the FY 2011 cash shortfall to the failure of Propositions 301 and 302, lower federal matching funds, and a possible revenue shortfall. With the elimination of federal assistance, expenditures are expected to increase in FY 2012, which only fuels the projected shortfall of \$1.4 billion.



At the close of FY 2010, general fund base revenues dropped 10% from FY 2009 but are expected to grow 2.4% in FY 2011 per the Consensus Forecast, which actually shows base revenues increasing slowly through FY 2014. So far in FY 2011, first quarter revenue growth was up 4% with a steady rise in individual income tax receipts while corporate income tax receipts increased by one-half, a much-needed sign of recovery. However, even with the growth in revenue, the recovery will be slow, as indicated by the decrease in sales tax receipts.

The Director continued with an update of the structural deficit, comparing on-going expenditures to on-going revenues, which

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collections masks the fact that Arizona doesn't distribute those taxes equally across the property tax base. Arizona's property tax classification system shifts the property tax burden across property tax types through the use of assessment ratios. The assessment ratio on the largest class of property (owner-occupied homes) is 10% while the assessment ratio on the second largest class (commercial and industrial property) is 21%. As a result and by design, Arizona ends up with business property tax burdens considerably higher than other states and residential taxes well below most other states.

Steve Barela, State and Local Tax Manager for Arizona Public Service, provided an overview of Arizona's state and local sales tax structure. Barela noted that the sales tax is easily the most popular tax in Arizona, generating almost \$7.4 billion in revenue in FY 2010. In Arizona, the official legal term for our sales tax is Transaction Privilege Tax (TPT) and the liability for tax is on the gross receipts of any business engaging in an activity in one of 16 classifications. Business activities that do not fall into one of those classifications are not subject to the TPT.



*Steve Barela, APS State & Local Tax Manager*

Barela pointed out that the administrative burdens on Arizona businesses to comply with Arizona's state and local sales tax is arguably the highest in the country. Arizona is one of the few states in the country that allows for an independent, municipal sales tax system. Unlike other states that have one sales tax base, Arizona businesses are burdened with complying with a state sales tax obligation that is different than the sales tax base for cities. Worse, multijurisdictional taxpayers are forced to track differences in city codes from one jurisdiction to another.

Barela further noted that the lack of uniformity in Arizona's sales tax system also increases the administrative costs to both the taxpayer and government when audits are conducted. Different tax bases not only increase the length of audits, interpretations of the tax code can vary across jurisdictions. He noted the increasing trend of cities opting out of the state's collection system is a major move in the wrong direction and will frustrate efforts to simplify the system. He pointed out that ATRA has been very outspoken in its opposition to the recent development of cities to turn their tax collection and auditing power to a private, for-profit entity.



*Barb Dickerson, Deloitte  
Director, Multistate Tax  
Services*

Barb Dickerson wrapped up the Tax 101 program with a discussion of Arizona's personal and corporate income tax. She noted that while income taxes make up the smallest portion of the tax collections among the "big three," they still generate considerable interest with policymakers at the state capitol. She noted that despite Arizona's relatively low reliance on the personal income tax, it does generate 30% of the state general fund revenue. Frequent calls to eliminate the personal income tax would have to take into account significant shifts to either property or sales taxes. Dickerson also noted that discussions regarding eliminating state personal income taxes that result in shifts to other taxes need to recognize that state personal income taxes are a deduction from federal income taxes.

Dickerson wrapped up her presentation with an overview of several important issues in the area of corporate income tax. First, the higher tax rate that is imposed on corporate income compared to

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appeared to have bottomed out at \$3.5 billion in FY 2010. In FY 2011, the structural deficit is pegged at \$1.9 billion while the FY 2012 structural deficit is estimated at \$1.5 billion. Regrettably, the structural deficit is slated to again increase in FY 2014 to over \$2 billion when the temporary sales tax expires.

Stavneak concluded his presentation by focusing on the use of one-time solutions to balance recent budgets. He pointed out that the structural deficit continues largely because 80% of budget solutions since FY 2008 have been temporary. In other words, of the \$12.5 billion accumulated in budget solutions since 2008, only \$2.6 billion have been permanent. The permanent solutions came primarily in the form of budget reductions at \$2.2 billion (17% of total solutions), while permanent revenue added \$400 million (4%). Unfortunately, the largest budget solution was federal government assistance at \$2.4 billion (19%), followed closely by \$2.1 billion (17%) of debt. The sales tax increase has provided roughly \$900 million (7%) to reduce the deficit. These figures clearly reinforced Stavneak's message that permanent solutions will be necessary for the state to achieve a balanced budget.



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personal income penalizes those entities. Second, apportioning corporate income for state tax purposes continues to be a major policy issue across the United States. Arizona has joined the national trend to increase the apportionment ratio for sales by providing an election for companies to opt for an 80% sales factor. The new apportionment issue facing state policymakers is the apportionment of intangible property, where the trend is to source that income to the location of the customer. This move to “market-based sourcing” and away from “cost-of-performance,” which apportions income based on the location of the income producing activity, creates major issues for multi-state corporations. The state-to-state conflict between market-based sourcing and cost-of-performance can create situations where a corporation’s tax liability may exceed 100% as a result of sourcing its sales to multiple states.

The Arizona Tax 101 presentations, along with Richard Stavneak’s state budget presentation, are available on the ATRA website at [www.arizonatax.org](http://www.arizonatax.org).

## Larry Lucero Re-Elected ATRA Chairman

Larry Lucero, the Manager of Government Relations for Tucson Electric Power, was re-elected as the Chairman of Arizona Tax Research Association’s Board of Directors at the 70<sup>th</sup> Annual Meeting. Mr. Lucero will serve a second term as ATRA’s Chairman.

The other officers elected with Mr. Lucero were Jason Bagley, *Intel Corporation*, first vice-chair; Samantha Omev, *Honeywell*, second vice-chair; Barb Dickerson, *Deloitte Tax, LLP*, third vice-chair; and Dave Minard, *Individual*, Secretary/Treasurer.

The following members were elected to seats on the ATRA Board of Directors for terms expiring in 2015: Steve Barela, *Arizona Public Service*; Jim Brodnax, *B&G Property Tax Associates*; Loren Locher, *El Paso Corporation*; Jason Bagley, *Intel Corporation*; Michael DiMaria, *Qwest Communications*; Keely Hitt, *Circle K Corporation*; and Richard Smith, *Jennings Strouss*.

In accepting his re-election as ATRA Chairman, Larry Lucero said “I’m honored to serve another term as ATRA’s Chairman of the Board. Clearly, ATRA’s leadership on fiscal policy issues in our state is more important than ever and we are ready to work with policymakers to stabilize Arizona’s fiscal situation.”



*Russell Smoldon (above), Manager of State & Local Government Relations at the Salt River Project (SRP), presents the ATRA Watchdog Award to Senator Bob Burns.*

*Jason Bagley (below), ATRA Legislative Policy Committee Chairman, introduces legislative leadership at the 2010 ATRA Outlook Conference.*



## Susan Anable Named ATRA Outstanding Member

ATRA awarded Susan Anable, Director of Public Affairs for Cox Communications, with the 2010 Outstanding Member Award at the Annual Membership Meeting luncheon.

The award, presented this year by ATRA's Chairman of the Board Larry Lucero, is given to a member that has served the organization with distinction.

Susan joined the ATRA Board of Directors in 2005 representing Cox Communications. In addition to her service on the board, Susan is also an active member of the ATRA Legislative Policy Committee. In presenting the award, Chairman Lucero noted that one of ATRA's greatest strengths is a board of directors that is made up of members who possess considerable expertise in the public policy arena. That expertise serves to maintain a strong foundation for the organization in its effort to promote sound fiscal policy in Arizona.



Mr. Lucero said, "ATRA benefits greatly from Susan's wealth of experience and the wisdom of her advice in helping develop ATRA's policy agenda. ATRA hopes to benefit from her leadership for many years."

## Joe Crosby Provides Keynote Address at ATRA Luncheon



Joe Crosby, the COO and Senior Policy Director for the Council on State Taxation, provided the keynote address at ATRA's Annual Meeting luncheon. Mr. Crosby gave the audience an excellent overview of recent tax and budget developments in state capitols across the country. Joe noted that while Arizona is not alone in battling state general fund deficits, the size of Arizona's deficit is certainly one of the largest in the country.

Mr. Crosby also explained the budget deficits facing most states has created considerable activity as well as uncertainty on the tax front. Like Arizona, many states are combining budget cuts with tax and fee increases, with many of them targeted at the business community. He also suggested that while there is considerable talk about major tax reform in some states, no one should hold their breath for it to occur. He said tax changes almost always occur at the margins of tax systems and while major tax reform makes for interesting debate, it rarely occurs.

While in Arizona, Crosby took the opportunity to encourage lawmakers to focus on improving Arizona's state and local sales tax structure. He said Arizona has the unenviable distinction of having one of the most complicated and cumbersome sales tax structures in the country. He said Arizona's independent municipal sales tax system creates an unnecessary burden on businesses to comply with their sales tax obligations, which is enormously inefficient. Lastly, he encouraged lawmakers to end the practice of cities using for-profit companies for tax collection and audits, which has spread to Arizona in recent years. Crosby likened the practice of for-profit tax collectors to that of 18<sup>th</sup> century France where tax collectors bought their positions from the King and then reimbursed themselves by overcharging taxpayers.

***Crosby likened the practice of for-profit tax collectors to that of 18<sup>th</sup> century France where tax collectors bought their positions from the King and then reimbursed themselves by overcharging taxpayers.***