Legislative leadership from the House and Senate provided the attendees of ATRA’s 71st Outlook Conference with a perspective of the issues that lawmakers plan to address in the upcoming session. The lawmakers that presented their insights at the conference included Speaker of the House Andy Tobin, Senator Kyrsten Sinema, and Senate President-elect Steve Pierce.

Included in the major policy issues that lawmakers will address during the 2012 legislative session is consideration of the state’s current fiscal climate, as well as economic development. Some even felt the need to continue to provide changes to encourage job growth.

Each lawmaker gave their perspective on the state’s fiscal situation. Leadership noted that although the Legislature was required to make budget cuts in recent years in order to deal with declining revenues, first quarter revenues in FY 2012 showed an increase above the levels projected in the budget.

Eileen Klein, the chief of staff to Governor Jan Brewer, provided the keynote address at ATRA’s 71st Annual Meeting Luncheon. Ms. Klein began her remarks by thanking ATRA for its consistent support of the Governor’s efforts to bring fiscal stability to the State of Arizona. She noted that Governor Brewer has reduced spending by almost 20% and employees by 15% — more than any other governor in state history.

She made a strong point that the Governor is now focusing on a structurally balanced budget at the end of her term and that the temporary sales tax will sunset in July 2013. To that end, she said that the fiscal year (FY) 2012 budget is the new budget baseline and that budget “restorations” will not be considered.

More specifically, Ms. Klein informed the group that the state’s accounting system, installed in 1992, desperately needs to be replaced, which will be a budget priority for FY 2013. In addition, Governor Brewer will pursue reform of the state’s personnel system next session by asking the Legislature to consolidate the state’s multiple personnel systems, improve the management of the workforce, restructure the grievance and appeal system, and modify human resource practices.

Eileen closed her remarks by thanking ATRA for its support of Governor Brewer’s competitiveness package and noted that the historic legislation significantly improves Arizona’s ability to attract quality jobs to Arizona.
Jim Eads Provides Overview of Arizona’s Sales Tax Structure, Highlights Federal Sales Tax Proposals

Jim Eads provided Outlook attendees with an overview of the current issues and trends in state and local sales taxes. Mr. Eads focused on the lack of authority that states have to collect sales and use taxes on Internet commerce and the current federal reforms that are being considered to address the issue.

Forty-six states plus D.C. impose sales and use taxes. If a retailer has a physical presence (nexus) in a state, the retailer must collect and remit the sales tax to that state for online purchases. The problem arises when a retailer does not have nexus, in which case the state is prohibited from requiring the remote seller from collecting sales or use tax. When a remote seller does not collect a sales tax, the consumer is required to pay a use tax. However, in many cases, consumers are unaware that they owe the use tax, and as Internet-based commerce increases, state and local governments continue to lose revenue as a result.

Mr. Eads referenced a 2009 study conducted by the University of Tennessee on the loss in sales tax revenue resulting from electronic commerce. According to this study, state and local governments failed to collect $6.9 billion in sales taxes in 2009 from electronic commerce. By 2012, the projected loss is expected to increase to $11.4 billion. According to the report, Arizona is projected to lose $369.8 million in 2012 as a result of the state’s lack of authority to require remote sellers to collect sales and use taxes.

Mr. Eads continued by providing an overview of the Streamlined Sales Tax Project (SSTP). The SSTP was created in response to the U.S. Supreme Court decision *National Bellas Hess v. Dept. of Revenue, Illinois*, which held that a state may not require a remote seller to collect tax on sales into the state. The Court ruled that the existing sales tax system was too complicated to impose such a burden on a business that didn’t have a physical presence and that only Congress has the authority to place that requirement on remote sellers. As a result, the Streamlined Sales and Use Tax Agreement (SSUTA) was established, with the purpose to simplify and modernize sales and use tax administration, thereby reducing the tax compliance burden on businesses.

Only four states, including Arizona, allow sales and use taxes to be administered at the local level, while the rest of the states have a uniform tax base that is administered at the state level. Arizona’s dual tax system makes it one of the most complex systems in the country. Mr. Eads noted that if Arizona is to have any chance of requiring remote sellers to collect sales and use tax on Internet sales, major steps need to be taken to develop a system that is uniform and administered by a single entity.

Jim discussed the three proposals currently going before Congress: Main Street Fairness Act; Marketplace Equity Act; and the Marketplace Fairness Act. Each proposal is an attempt to provide a solution to the issues surrounding Internet sales but take slightly different approaches. Under the *Main Street Fairness Act*, collection authority would be provided only to members of the Streamlined Sales Tax Agreement (SSTA). The proposal would provide 18 minimum simplifications including state level administration of sales and use tax collections, uniformity in the state and local tax bases, a central electronic registration system for all member states, and the simplification of state and local tax rates.

The *Marketplace Equity Act*, on the other hand, would not require membership in the SSTP but states would be required to meet certain minimum simplification standards. Those minimum standards would include a uniform sales and use tax base, a single sales tax return and remittance point at the state level, as well as a uniform rate structure.

Lastly, under the *Marketplace Fairness Act*, states would not be required to be a member of SSTP. However, this Act would apply strictly to interstate sales and a state would be required to adopt and implement minimum simplification requirements, including a uniform sales and use tax base that is administered by a State agency.

Mr. Eads closed his remarks by recommending that Arizona focus on simplifying its sales and use tax system and that doing so would make the system more efficient and make tax compliance easier, specifically noting that “taxpayers can justify non-compliance when it is complicated.”
Kicking off ATRA’s Annual Outlook Conference was the Director of the Office of Strategic Planning and Budgeting (OSPB), John Arnold. The Director provided guests with updates on the state’s economy and explained how Arizona’s current fiscal climate affects the budgeting process. In addition, he presented the budget challenges the state will face as a result of state and national issues.

Mr. Arnold began his presentation by comparing the general fund budget composition of fiscal year (FY) 2007 and FY 2012. While the largest component, K-12 education, has been relatively constant at around 40% of the general fund, Medicaid has grown from 17% in FY 2007 to 25% in FY 2012. He expects that percentage to continue to grow in future years as a result of federal health reforms.

He continued by highlighting state and national job losses since the beginning of the recession in 2007, with Arizona exceeding the national rate. However, the Director had positive news regarding job growth in Arizona, which is up in 2011. He noted that most of the job growth was in education and health care, and that temporary employment growth is minimal compared to previous years.

The Director reported that total state revenue grew in each quarter in FY 2011 over corresponding FY 2010 revenues, including 16.5% growth in fourth-quarter revenue aided by the temporary one-cent sales tax. He also revealed that first-quarter revenue in FY 2012 grew 7.6% over its FY 2011 counterpart, although growth is projected to drop throughout the year.

A major source of revenue, Arizona’s retail sales tax, like total revenues, recorded increasing growth in FY 2011. The Director’s revenue graph showed first-quarter retail sales tax in FY 2012 came in 9.2% higher than in FY 2011. On a positive note, individual income tax, another main revenue generator, experienced stair-stepping quarterly growth in FY 2011, with fourth-quarter growth of nearly 35%. Furthermore, first-quarter individual income tax revenue in FY 2012 is up 10% from FY 2011.

After the update of economic indicators, Mr. Arnold moved to the challenges that OSPB has encountered in constructing the state budget. He cited the dramatic population growth in Arizona over the last decade as one of the challenges, since the growth has led to increased usage of government services. Over the last decade, population has increased 50% in Corrections, 40% in Universities, 25% in K-12 education, and a whopping 133% in Medicaid, while state population increased 21%. In the same span, state revenue increased only 17%, not adjusting for inflation, which has made it difficult for lawmakers to adopt a balanced budget.

The Director also noted the loss of the temporary sales tax in the FY 2014 budget, which is expected to generate over $900 million in FY 2013. He then reiterated the Governor’s position that the temporary sales tax will not be reinstated after its expiration on June 1, 2013, and that lawmakers need to plan for the loss in revenue.

Lastly, he discussed the impact of federal health care mandates, which will take effect halfway through FY 2014. These mandates will expand Arizona Medicaid eligibility and, as a result, will increase the state’s AHCCCS population. He mentioned that the federal government will pay 85% of the state’s cost, but given the federal budget woes, he fears that obligation may not be met. Later, he noted the long-term impact of the federal health care legislation, adding that health expenditures in state and local governments are projected to exceed non-health expenditures within the next several decades.

In his conclusion, Mr. Arnold informed guests that surpluses are expected for the FY 2012 and FY 2013 budgets after several consecutive years of a structural deficit. He listed several potential uses for the excess cash, including debt reduction and the retirement of budget gimmicks, such as the K-12 rollover. He said another priority is replacing the state’s accounting system, which has been in place for 19 years and is nearing the end of its functionality. Mr. Arnold closed by strongly emphasizing that the surplus will not be used to restore programs that were discontinued to balance the budget, but rather will be used based on need.
McCarthy Outlines Top Fiscal Issues

ATRA President Kevin McCarthy presented Outlook Conference attendees with an overview of the following four major fiscal issues facing state policymakers and taxpayers:

**State Fiscal Stability**

McCarthy began his presentation by noting the historic state budget crisis that has gripped state government over the last four years. While the current fiscal year (FY) 2012 budget is balanced, it also relies on the temporary sales tax that is generating an estimated $950 million this year. Without that revenue, the FY 2012 budget has a deficit close to $770 million. Recognizing that most state policymakers have already committed to the sunset of the sales tax, McCarthy focused on how critical the FY 2013 state budget decisions will be for the stability of state finances. While the state adopts budgets annually, it is critical that the state develop a multi-year budget strategy that accounts for the loss of the temporary sales tax revenue for FY 2014.

**Sales Tax Reform**

Moving to tax issues, McCarthy noted that at least two groups are considering circulating an initiative to make the temporary sales tax permanent. He argued that any discussion about making the sales tax rate increase permanent should not occur in isolation of reforming Arizona’s complicated and burdensome sales tax code. Arizona is one of only three states in the country that allow for an independent municipal sales tax code, and McCarthy said it is crucial that the system be simplified in order for Arizona to sustain its most important revenue source.

Arizona has historically ranked in the top ten nationally in per capita sales tax collections and now ranks second in the country in total state and local sales tax rates. McCarthy argued that Arizona’s very high sales tax rates provide a strong incentive for Arizonans to evade those taxes through on-line purchases. The national effort to address on-line sales taxes has focused on simplifying state sales tax structures. Arizona’s system, arguably the most complicated in the country, needs considerable reform if Arizona wants to align itself with the national movement to tax e-commerce.

**Instability in the Property Tax System**

On the property tax front, McCarthy discussed the current instability in the property tax system stemming from the boom and bust of the real estate market in Arizona. After experiencing explosive growth in real estate values in Arizona between 2006 and 2009 (59%), assessed valuations have fallen almost 30% over the last two years. The state average tax rate, after falling 16.3% between 2006 and 2009, has climbed 19% over the last two years.

The recent volatility in the property tax caused ATRA to study proposals that would limit such dramatic fluctuations in the future. Currently, Arizona’s Constitution requires county assessors to value all property at its market value. Therefore, if the market dictates a large annual increase in those values, as was the case in 2006 and 2007, the assessor is required to do so.

ATRA’s recommendation for creating greater stability in the property tax system in the future is to impose a 5% annual cap on both secondary and primary valuations. This would require a constitutional amendment that the Legislature would refer to the 2012 general election ballot. *(For more information on the 5% proposal, refer to the ATRA website at http://www.arizonatax.org.)*

**Tax Reform and Economic Development**

The last fiscal policy issue discussed by McCarthy was tax reform and economic development. He reviewed the substantial
progress that has been made over the last twenty years in addressing areas of Arizona’s tax system that were considered impediments to business expansion and job growth.

In reviewing the major progress that has been achieved in the politically difficult area of high business property taxes, he noted that such successes would never have been achieved if policymakers would have opted for the politically easier path of targeted tax breaks.

McCarthy reviewed the impacts of Governor Brewer’s Arizona Competitiveness Package from the 2011 session that continued the policy of focusing on fundamental tax reforms in the area of business property and corporate income taxes. While many of those tax changes are phased in over several years, ATRA estimates that they will continue to improve Arizona’s competitive position for business expansion. Once ranked as high as 3rd nationally, Arizona’s business property tax ranking has fallen to 15th. ATRA estimates that ranking to improve to 20th when the recent reforms are fully implemented.

For almost two decades, Arizona policymakers have consistently focused on decreasing the punitive taxes placed on capital intensive companies through an accelerated depreciation formula on personal property. The Arizona Competitiveness Package provided another enhancement to that formula that will, beginning in tax year 2012, reduce the taxes on new equipment 75% in the first year of operation. When Arizona’s accelerated depreciation formula is considered, ATRA estimates Arizona’s ranking for capital intensive companies to possibly fall as low as 40th nationally (based on the tax burden in the first year of acquisition).

Lastly, McCarthy focused on Arizona’s improved position in the area of corporate income tax that was also reduced this passed session. Once as high as 9.3% and ranking Arizona 7th nationally, that rate is scheduled to fall to 4.9% in 2017, improving Arizona’s ranking to 43rd nationally.

McCarthy wrapped up his presentation by noting that “the credit for this sustained effort to improve Arizona’s business tax picture really goes to state policymakers that made the tough political decisions to address systemic problems and rejected a policy path that side-stepped those problems through targeted tax breaks.”

Lyn White Elected New ATRA Chairman

Lyn White, the Director of Governmental Relations for Freeport McMoRan Copper and Gold, was elected as the Chairman of Arizona Tax Research Association’s Board of Directors at the 71st Annual Meeting. Ms. White replaces Larry Lucero from Tucson Electric Power who served the last two years as ATRA’s Chairman.

The other officers elected with Ms. White were Jason Bagley, Intel Corporation, first vice-chair; Michael DiMaria, CenturyLink, second vice-chair; Barb Dickerson, Deloitte Tax LLP, third vice-chair; Dave Minard, Individual, Secretary/Treasurer.

The following members were elected to seats on the ATRA Board of Directors for terms expiring in 2016: Eric Bjornholt, Microchip Technology; Samantha Omey, Honeywell International; Heidi Schaefer, Salt River Project; Larry Lucero, Tucson Electric Power; Jaime Kimmelman, El Paso Electric; Tom Farley, Arizona Association of Realtors; Steve Twist, Service Group of America; Edward Munoz, Raytheon; Gretchen Kitchel, Lewis & Roca.

In accepting her nomination as the new ATRA Chairman, Lyn White said “For seventy-one years ATRA has provided sound tax policy advice to state and local elected officials. I am very honored to serve as the Chair of Arizona’s leading tax policy organization. I will work to ensure that ATRA continues to provide Arizona policymakers with sound fiscal solutions to meet our current challenges.”
Bill Molina Named 2011 Outstanding Member

On behalf of the ATRA Board of Directors, ATRA Chairman Larry Lucero presented Bill Molina with the 2011 Outstanding Member Award at the Outlook Conference Luncheon.

Since joining ATRA as a representative of Apollo Group, Bill has been a constant presence around ATRA. In fact, it is rare to attend any ATRA meeting without seeing Bill. Bill currently serves on the ATRA Board of Directors, the ATRA Executive Committee, the ATRA Tax Practitioner’s Committee, and the ATRA Legislative Policy Committee where he plays a vital role in helping ATRA develop a sound tax policy agenda for Arizona.

Lucero noted how Bill’s dedication and personal expertise in state and local taxation have helped to make ATRA a better organization. In presenting the award to Bill, Lucero said “ATRA truly appreciates Apollo Group’s generous support and your dedication to our organization and we hope to benefit from your participation for years to come.”


(Right) ATRA Legislative Policy Chairman Jason Bagley introduces state lawmakers at Outlook Conference.
Fritz Behring Receives the 2011 J. Elliott Hibbs ATRA Good Government Award

The Arizona Tax Research Association (ATRA) selected Fritz Behring as the recipient of the J. Elliott Hibbs ATRA Good Government Award for 2011. The award was presented during ATRA’s Annual Meeting Luncheon on Friday, November 18 at the Pointe Hilton Tapatio Cliffs Resort.

For the last 18 years, ATRA has recognized outstanding individuals whose work in the public sector is characterized by strong, continuing, and consistent efforts to spend taxpayer dollars wisely and to promote government that is efficient, open, and accountable. ATRA solicits nominations from local governments and state agencies, which are then reviewed by ATRA members and staff.

Fritz Behring was hired as the Manager of Pinal County in November 2010. Immediately after arriving in Pinal County, Fritz set his sights on a crucial examination of the county’s budget. In his explanation to the Board of Supervisors and other county elected officials in formulating the fiscal year (FY) 2011-12 budget, Fritz provided a clear and direct message: “The business model for local government in Arizona has to change. The old model no longer works given the financial situation we find ourselves in.” The outcome was that Pinal County ended up cutting its total budget nearly 17% in FY 2011-12 – by far, the largest decrease of all of Arizona’s counties. The dramatic decrease in Pinal County’s budget was largely the result of the county keeping its primary tax rate the same although the county lost over 15% in taxable property values. By keeping the tax rate the same, the county’s primary levy plummeted over $16 million.

One of the key criteria for the ATRA Good Government Award is openness and transparency in government. Openness and transparency provides taxpayers and citizens the opportunity to work cooperatively with public employees, which ultimately leads to more effective and efficient government. In the short amount of time that Fritz Behring has been the Pinal County Manager, he has created a culture of conservative financial management, as well as government transparency and accountability. During the FY 2011-12 budget process, Fritz regularly met with local taxpayers to discuss their major concerns and to educate those taxpayers on the fiscal issues facing the county.

Mr. Behring met the challenges of Pinal County’s budget through strategic personnel cuts, salary freezes and a thorough review of policies and procurement, coupled with better, more accurate forecasting. In presenting the award to Fritz, ATRA President Kevin McCarthy noted that, “In just one year as the Pinal County Manager, Fritz has displayed the attributes of a true public finance professional: accountability, transparency, expertise, and customer service. It is ATRA’s hope that this award will not only serve as a much deserved pat on the back to Fritz and Pinal County but also encouragement to Pinal County to continue this path of fiscal responsibility.”
2011 ATRA OUTLOOK CONFERENCE ATTENDEES

ATRA Board Members Barb Dickerson (left) and Michael Preston-Green (right).

(Below) ATRA Legislative Policy chairman, Jason Bagley, talks with Representative Justin Olson (left) and Senator John McComish (center).

(Above) ATRA Board Member Jim Brodnax talks to ATRA Vice President Jennifer Stielow.


(Below) Representative Karen Fann asks a question to one of the conference presenters.

(above) Munir Malik (left) talks with ATRA Treasurer Dave Minard.