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ARIZONA TAX RESEARCH ASSOCIATION

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Senator Flake Delivers Keynote Address at ATRA Outlook Conference



Capping off an informative and interesting ATRA Outlook Conference, Senator Jeff Flake delivered the Keynote Address at the ATRA Awards Luncheon.

ATRA was excited to welcome back

the recipient of the 2009 ATRA Watchdog Award, a recognition given just five times to Arizona elected officials who are excellent stewards of the taxpayer. Speaking to a crowd of over 300, Senator Flake reaffirmed the importance of the legislative process. In particular, he stressed that Congress needs to fulfill its role by crafting responsible legislation in response to ongoing crises.

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ATRA Outlook Highlights

Dickerson Wins Lifetime Achievement

Former ATRA Chairman Balich Passes

Legislative Leaders Discuss Priorities for the 2015 Session

Leadership from the Arizona Legislature took the opportunity at the ATRA Outlook conference to set the stage for the 2015 legislative session.

Senate President Andy Biggs boldly declared that Arizonans can be assured that the Legislature will have a good working relationship with the Governor's office when both he and House Speaker-elect Representative David Gowan are standing behind Governor Ducey as he delivers his first budget to the House floor. If that



happens, President Biggs predicts a quick legislative session with a balanced budget designed by leadership from the Legislature and the Governor. He stressed the

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Legislature needs to carefully consider all options as it manages the structural deficit in FY 2016. “Nothing is off of the table.”

Senate Assistant Minority Leader Steve Farley encouraged a bipartisan approach to addressing problems in Arizona. Senator Farley opened by reminding the crowd that as a small-business owner, he understands the trials of negotiating burdensome regulations. He also pointed out that he sponsored a bill in the previous session simplifying transaction privilege tax (TPT) filing requirements for small business owners and affirmed to the attendees that he is a friend of the taxpayer.

Senator Farley stressed the need to settle the K-12 inflation lawsuit and create a plan to increase state revenues by the amount owed. He lamented Arizona’s low ranking in education spending, which he argued creates a hindrance for businesses in need of an educated workforce. In order to find revenues to accomplish this as well as close the structural deficit, Senator Farley encouraged the Legislature to consider removing exemptions in TPT (sales tax). Though he did not recommend which exemption he would eliminate, he suggested that some are based on commercial needs which are no longer relevant or justifiable.

Senator Farley suggested the Legislature revisit tax credits by instituting sunset reviews and create a process to determine their efficacy. Finally, he argued for the suspension of the corporate income tax rate and sales factor reductions, which began phasing in this year and could increase tax revenues roughly \$50 million per year.

Arizona House of Representatives Speaker-elect David Gowan spoke about the importance of balancing the budget in 2015 in the face of a looming deficit, which would be his top priority. In particular, Speaker-elect Gowan said his goal would be to avoid financial gimmicks and balance the budget the old-fashioned way. He mentioned that he expected communication between both legislative houses to be improved, citing his strong relationship with President Biggs. In addition, he was confident the Legislature would develop a positive and consistent interaction with Governor-elect Ducey. Finally, Speaker-elect Gowan emphasized that he was not interested in raising taxes to fix the structural deficit.



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Rep. Olson Explains Budget Philosophy

Rep. Justin Olson, the newly appointed House of Representatives Appropriations Chairman, relayed his budget philosophy at the ATRA Outlook conference. Following Richard Stavneak's budget presentation, Rep. Olson reminded the crowd that the budget situation should not be overstated. Rep. Olson pointed out that during the recession years, state revenues were hemorrhaging badly; whereas in this fiscal year, they are actually growing— just not as fast as predicted. He explained that if spending remained at current levels, projected revenues would create a budget surplus in FY 2016. Formulaic increases in K-12 education and expected growth in AHCCCS costs constitute the majority of projected new spending.

Rep. Olson provided some insight as to how he plans to balance the budget next year. As others suggested throughout the day, Rep. Olson stressed a gimmick-free approach; avoiding pitfalls like debt financing or one-time funds for ongoing expenditures.

Borrowing a page from Governor-elect Ducey, Rep. Olson suggested lawmakers go line-by-line through the budget looking for efficiencies with the goal of providing the same services at lower costs. As an example, he cited the Phoenix Biomedical Campus spends more per student to train physicians than does the University of Arizona's Health Sciences Center.

Finally, Rep. Olson hinted at a few policy proposals for the 2015 legislative session. First, he argued for using more fee-for-service for certain government functions, particularly in the regulatory sector. He suggested making full-day Kindergarten a pay-for-service, citing that only some districts provide it for free right now. School districts have a strong incentive to attract kindergartners considering most K-12 revenues are per-pupil based. Forcing all districts to offer a half-day for free or charge for a full-day would even the playing field and free about \$155 million for other K-12 uses. He added that there would need to be a scholarship for low-income families. Lastly, Rep. Olson said that he wanted to look into creating flexibility for school districts to shift extracurricular tuition tax credit monies to their general fund budgets, as well as pool those tax credits and spread them evenly across all districts to create fairness for these added expenditures.



Bob Robb Breaks Down the 2014 Election

Bob Robb, Arizona's leading political commentator and editorialist at *The Arizona Republic*, shared his thoughts on the outcomes of the November 2014 election in Arizona. Following national trends, Robb pointed out that it was a big year for Republicans, citing the depressed Democratic turnout, which helped lead to the sweep of Republicans for statewide offices. Robb argued that while Governor-elect Ducey won by a significant margin over Duval, he does not have a mandate for any particular set of policies, since he ran on and was elected for his private-sector experience and ability to lead.

Of note, Robb pointed out that rural counties typically do not factor heavily in statewide elections in Arizona, comprising just 25% of the vote (outside of Maricopa and Pima counties), but this year played a rather significant role in the Superintendent of Public Instruction (SPI) race and in Proposition 122. Republican Diane Douglas and the ballot measure suffered in Maricopa and Pima counties but did well in most rural counties, carrying Douglas to victory and passing Prop 122. Robb surmised this phenomenon as unusual but argued it suggested a growing chasm between urban and rural political sentiments. Robb pointed out that while Democrats used to retain a voter registration advantage in rural Arizona counties, Republican registration now trumps in 7 of the 13 rural counties.

For more election analysis from Robb, see his November 10 and November 20 articles in *The Arizona Republic*.



McCarthy Outlines Taxpayer Threats

ATRA President Kevin McCarthy addressed the 2014 Outlook Conference attendees and provided an overview of the major public finance threats facing taxpayers in 2015.

STATE BUDGET DEFICIT

The first threat McCarthy addressed is the looming state budget deficits for both Fiscal Year (FY) 2015 and FY 2016. He noted the state's chronic budget deficit are in part related to Arizona's regrettable practice of ballot-box budgeting that has stripped state policymakers of their authority to manage budget demands through the inevitable changes in the economic cycle. McCarthy argued that Arizona's on-going budget challenges should provide the impetus for new leadership to pursue meaningful reforms in the state's budgeting process. As an example, McCarthy pointed to the sunset of Prop 301 in 2021 as a key opportunity for fundamental budget reform and

encouraged state policymakers to begin that process now.

PUBLIC PENSION REFORM

The second major taxpayer threat McCarthy addressed is the public pension crisis facing many Arizona local governments. He noted that, in particular, the costs of funding the Public Safety Personnel Retirement System (PSPRS) in many Arizona cities have reached unsustainable levels. McCarthy pointed out that the same legal handcuffs that restrain lawmakers on the state budget also apply to reforming public pensions – except they are tighter. Because retirement benefits are viewed as vested rights by the courts, as well as the Arizona Constitution, there are very few options that will provide meaningful relief to taxpayers in the near future. McCarthy argued that because the deck is so clearly stacked against taxpayers, policymakers should seriously consider the wisdom of supporting systems that are entirely outside their control and management.



CHAOS IN SCHOOL FINANCE

The last major threat to taxpayers McCarthy addressed is Arizona's school finance system, which has become the subject of perpetual litigation as well as a major burden to property taxpayers in many school districts. He informed attendees of the enormous disparities in taxpayer burdens to fund K-12 schools where some taxpayers have a zero tax rate for the operational support of schools while others pay rates as high as \$15.26 per \$100 of assessed value. McCarthy focused particular attention on the significant equity challenges created by the desegregation/OCR spending that state law allows for 18 school districts. The Deseg/OCR levies allow several school districts to spend more than 30% above what is allotted to other districts. These school districts, without voter approval, levy over \$211 million annually in property taxes. Taxpayers in several districts pay primary tax rates over \$2.00 just to fund the Deseg/OCR levy.

McCarthy explained that ATRA will pursue legislation in the 2015 session to phase out the Deseg/OCR levies in these 18 school districts. A copy of his presentation can be found at <http://www.arizonatax.org/publications/presentations>

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In response to President Obama's executive order on immigration, Senator Flake said "Rather than poke him in the eye, I'd rather put legislation on his desk." He said he did not support shutting down the government in response to the executive action.

Regarding Arizona, Senator Flake stressed the need for sensible forest management and water policy, drawing applause from the audience. He said he would continue to fight to resolve border issues by pushing legislation which addresses comprehensive immigration reform.

Barb Dickerson Receives ATRA Lifetime Achievement Award

Each year at the ATRA annual awards luncheon, one of its members is recognized with the Outstanding Member Award. There are a number of factors that explain the success of ATRA over the last 74 years and certainly one of the most important is the dedicated support and service of its members. One of the characteristics of ATRA is the impressive length of service that many members of the board of directors have dedicated to the organization. This year, ATRA recognized one of its members with the first Lifetime Achievement Award.

The first recipient of the Lifetime Achievement Award is the perfect person to receive such distinction. Over the last 24 years, Barb Dickerson's commitment of time and expertise is simply unparalleled. She has been a member of the ATRA Board of Director's for the last 24 years and served as the Chair of ATRA's Tax Practitioner's Committee for most of those years.

Through her career she was not only a fixture at ATRA but at the state Capitol where she was widely regarded as the state's foremost expert on state and local tax compliance and one of the most respected tax practitioners in Arizona. She dedicated countless hours to several tax reform efforts through her career including the most recent effort to reform the Transaction Privilege Tax and multiple efforts on the Prime Contracting Tax.

Barb's career in state and local tax compliance and policy development spans over 30 years in both the public and private sector. Her career includes service at the Internal Revenue Service, the Arizona Department of Revenue, Arthur Andersen LLP and the last of 12 years as a Director at Deloitte Tax LLP. ATRA thanks Barb for her service and wishes her the best of luck in the future.



Michael DiMaria Re-Elected ATRA Chairman



Michael DiMaria, Director of Legislative Affairs for CenturyLink, was re-elected as the Chairman of the Arizona Tax Research Association's Board of Directors at the 74th Annual Meeting.

The other officers elected with **Michael DiMaria** were **Steve Barela**, *Arizona Public Service*, first vice-chair; **Jason Bagley**, *Intel Corporation*, second vice-chair; **Ann Seiden**, *Southwest Gas Corp.*, 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 2019: **Bas Aja**, *Arizona Cattlemen's Association*; **Lori Daniels**, *State Farm Insurance*; **Tim Lawless**, *NAIOP*; **Bill Molina**, *Apollo Education Group*; **Kelley Wilson**, *Deloitte Tax LLP*; **Gina Polewka**, *Western Refining*; **Robert Schwimmer**, *Snell & Wilmer*; **Michael Stull**, *Cox Communications*; **Byron Williams**, *Southwest Gas Corp.*; **Lyn White**, *Clark Hill PLC*.

ATRA Chairman, Michael DiMaria remarked "I'm excited to start year two as the Chairman of ATRA; we've got a lot of work to accomplish this year."

Stavneak Delivers Grim Budget News

Kicking off the 2014 ATRA Outlook conference was Richard Stavneak, Director of the Joint Legislative Budget Committee (JLBC), who set the tone for the conference with sobering remarks on the state budget. Shortfalls of \$(189) million for FY 2015 and \$(667) million for FY 2016 are now projected, not including the \$336 million the state may owe for the K-12 inflation reset ruling, which could push the number to \$(1) billion for FY 2016.



To measure the shortfalls, JLBC modeled a net growth in state spending of \$122 million for FY 2016, which takes into account the planned use of one-time funds. Their FY 2016 expenditures estimate includes \$175 million in formulaic increases to K-12 and \$57 million in increased AHCCCS/Medicaid spending.

To contextualize the current crisis, Stavneak pointed out the inherent danger in projecting revenue growth, as just a 1% error across three years changes the budget balance by \$575 million. The Legislature does have significant work to do, as even strong 7% growth in 2016 would leave the state in the red by \$(267) million using JLBC modeled spending growth.

Stavneak cautioned the audience against thinking Arizona would return to the historically high growth numbers

of the 1990's and 2000's, as slower growth remains the predicted future. Stavneak cited some growth challenges such as low population growth (1% to 1.5%), reductions in federal defense contracts and flat wages. Tax revenues have maintained roughly 3% growth in the last 16 months and JLBC predicts just 4.1% for FY 2016.

With an eye towards resolving structural deficits; Stavneak encouraged lawmakers to pay homage to the three-year budget planning construct. Projected deficits of \$(928) million in FY 2017 and \$(787) million in FY 2018 are looming. The continued use of rollovers and one-time funds create systemic problems for future budgets. He encouraged lawmakers to use one-time funds for one-time purposes such as capital projects and to consider an effort to dedicate a small percentage of annual revenues to a rainy-day fund or to buy down state debt. Mr. Stavneak's presentation can be found at <http://www.arizonatax.org/publications/presentations>



In Memoriam

Nick Balich

Long time ATRA supporter, Nick Balich, passed away this fall. As a representative from Phelps Dodge Corporation, Nick served on the ATRA Board of Directors for almost 20 years and served as ATRA's Chairman of the Board in 1988 and 1989. Nick's dedicated support of ATRA continued after his retirement from Phelps Dodge as he maintained his seat on the ATRA Board for several years.

Nick was a vocal advocate for ATRA and never missed an opportunity to spread the organizations message, as well as encourage his many business colleagues to join ATRA.

The entire ATRA family extends its thoughts and prayers to Nick's wife Diana and the entire Balich family.

