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2016 LEGISLATIVE SESSION UPDATE

Introduction

As the Legislature approaches mid-March, there are roughly two weeks remaining to hear bills in committee. Meanwhile lawmakers are preparing to debate the FY2017 state budget.

GOOD BILLS

ATRA BILLS

SB1117 school districts; adjacent ways; verification (Dial) As amended in the Senate, SB1117 creates a process to ensure a legal Adjacent Ways project exist before a school district makes an expenditure from this fund. It further adds the Adjacent Ways fund to the annual audit requirement. School districts would submit projects costing over \$50,000 to the School Facilities Board (SFB) for validation. This bill brings much needed sunlight to an area of school finance long recognized as a problem. The Adjacent Ways property tax levy represents unfettered access to the property tax and because it lacks any serious outside review, it has historically been rife with abuse. The most recent involved Higley Unified misspending at least \$6.4 million from their Adjacent Ways fund towards lease payments on middle schools, an obvious violation. Oversight from SFB will curtail future abuses of the Adjacent Ways levy and bring transparency to taxpayers. Despite working with K-12 stakeholders to amend the bill, the Arizona School Business Officials retained their opposition in the Senate. *SB1117 passed the Senate 18-12 and awaits House COW.*

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2015 Property Taxes Top \$7 Billion

Property taxes in Arizona topped \$7 billion in tax year 2015 which pays for FY2016 budgets, a \$145 million increase from the prior year. Total statewide property tax levies are back to pre-recession levels.

The Department of Revenue (DOR) annually publishes property tax collections by jurisdiction. Per DOR, the statewide combination of primary and secondary property tax levies for tax year (TY) 2015 was \$7.002 billion. ATRA has annually combined DOR data, valuations from

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SB1125/HB2401 schools; desegregation funding; phase-down (Lesko/Leach) SB1125 and its companion bill HB2401 phase out over five years the Office of Civil Rights (OCR) levies imposed by 16 Arizona school districts and a 10-year phase out for two Desegregation (Deseg) districts. In order to disentangle themselves from the federal court, the bill allows districts that remain under a federal court order to desegregate (Tucson Unified) to begin the phase-out the year following being declared unitary. Interestingly, the K-12 community is not publicly opposing the bill in as substantial a manner as they have in the past. In fact the public opposition testifying in committee was rather limited. Nearly all serious K-12 policymakers admit this 30-year old program has run its course and should be phased out. The ongoing policy debate surrounds the timing and manner of the phase-out. *SB1125 and HB2401 each await their respective Committee of the Whole.*

HB2476 school property; sales; leases; use (Norgaard) After discussion with school business officials, ATRA was able to craft language beneficial to both schools and taxpayers relating to the use of proceeds from the sale and lease of school property. The bill creates a new materiality test whereby all sales of items less than \$100,000 can be expended without restriction. It frees up all existing school plant funds for use on capital projects by creating prospective rules for the use of sale proceeds beginning July 1, 2016. The bill ensures that “high-debt” school districts use some of the large sale proceeds to pay off bonded indebtedness. Low debt school districts may expend all sale amounts for capital. The bill creates new financial incentives for school districts to sell and lease school property to other schools by placing those monies in less restrictive funds. *HB2476 passed the House 57-0 and awaits Senate Finance.*

HB2481 schools; primary property tax rates (Olson) As amended in the House, HB2481 changes the mechanism for setting K-12 primary school property tax rates from a floating rate that adjusts based on cash balances to a statutory rate. It explicitly states that school districts will annually levy the Qualifying Tax Rate plus any legal non-formulaic amounts which provides rate stability for taxpayers. The bill provides equitable cash management policies for school districts by removing the four percent budget balance carryforward limitation. Despite constructing two amendments which addressed transition concerns from the K-12 lobby and removed their opposition, House Democrats curiously opposed the bill. *HB2481 passed the House 34-23 and awaits Senate Education and Finance.*

HB2054 debt limitations; net assessed value (Mitchell) In 2012, the voters passed Prop 117 which changed the annual calculation of the Limited Property Value (LPV) to the lesser of the full cash value (FCV) or 5% over the previous year’s LPV. In addition, the LPV is now the only taxable value. In the following year, the Legislature passed a bill that conformed Arizona state statutes to the constitutional provision as amended by Prop 117 that also eliminated all references to the FCV as a taxable value, specifically, the “secondary net assessed value.” Consequently, the elimination of the term “secondary net assessed value” caused confusion since it was the basis for calculating the constitutional debt limits. As a result, the county assessors asked the Attorney General for

guidance on the subject, and in the opinion, the Attorney General concluded that the historical application of using the net assessed value of the FCV remains in effect and HB2054 codifies that opinion. *HB2054 passed both the House and Senate Finance without a no vote and awaits the Senate COW.*

OTHER GOOD BILLS

SB1523 truth in taxation; levy increases (Smith) Truth in taxation (TNT) requires the governing body of a county, community college district, city, town, and school district to hold a public hearing and publish notice in a newspaper of general circulation of the governing body's intent to increase primary property taxes, exclusive of any growth associated with new construction. Regardless of the extent of the tax increase, only a majority vote of the governing body is required to meet TNT requirements. There have been a few recent tax increases that breached 20%, which raised the question as to why such a dramatic tax increase doesn't require a higher threshold. SB1523 would require that a jurisdiction that intends to increase taxes 15% or more than TNT receive a unanimous vote of the board. Such dramatic tax increases should require the higher threshold of a unanimous vote of the governing body. *SB1523 passed the Senate on a partisan vote of 17-11 and awaits a hearing in House Ways & Means.*

HB2197 fire districts; merger; consolidation (Coleman) In addition to local property tax levies, fire districts also receive Fire District Assistance Tax (FDAT). The tax is a countywide secondary property tax and the rate is limited to 10 cents per \$100 of assessed value per county. The FDAT revenues are distributed based on 20% of each fire district's levy, not to exceed \$400,000. Prior to 2011, the \$400,000 cap did not apply to fire districts that merge or consolidate; however, a blatant abuse of the tax in 2008 in which three districts dramatically increased their local taxes to maximize their FDAT distribution in the year prior to the merger necessitated a remedy to protect taxpayers. As a result, ATRA and fire district representatives agreed to cap all districts in order to protect the integrity of the tax. In recent years, however, the cap has been an impediment for some districts to merge. As originally introduced, HB2197 would have simply reversed the 2011 reform by removing the \$400,000 cap altogether for consolidated or merged fire districts. In recognition of the obstacle that the FDAT cap presents for merger districts, ATRA worked with fire district officials on an amendment that removes the cap for merger districts but requires the distribution to be based on a five-year average. Additionally, the amendment included a retroactive clause for mergers that occurred on or after July 1, 2014. As amended, HB2197 removes the financial obstacle for districts to merge and protects taxpayers from a repeat abuse of the FDAT. *HB2197 is scheduled for Senate Finance on March 9. Similar provisions are being advanced under SB1244 fire districts; wildland fires; budgets (Allen).*

BAD BILLS

SB1322 community colleges; expenditure limitation (Allen) Following an interim study committee on community college expenditure limits, ATRA developed a bill addressing several reforms both colleges and taxpayers could live with. Community College lobbyists took ATRA's offer and spiked the bill with several other ideas which developed into SB1322. While it appears to be a compromise bringing accountability to the historic problem of student count over-estimations, it instead creates a far worse setup than the status quo. As amended in the Senate, the bill allows for a 10 year student-count averaging for the next three years, which exculpates the most egregious student-count exaggerators. Regrettably, the sponsor agreed to run this amendment at the request of Pima College, the school presently claiming to have 23,000 FTSE when it has fewer than 16,500. Worse, the bill mocks the constitutional intent of the expenditure limitations by arbitrarily assigning a 30% weight to all CTE

students without adjusting the student count similarly in the 1980 base year. The net effect is a 25% nonvoter approved expenditure limit override. Consistent with Arizona public finance laws, any significant increase to a jurisdiction's expenditure limitation outside the formula should come from its voters, the creators of this constitutional provision. *SB1322 passed the Senate 25-3 and awaits action in House Rules.*

SB1402 (Yarbrough) class six property; higher education SB1402 provides a generous property tax break for all regionally and nationally accredited institutions of higher education by changing their property class from 1 to class 6, which is assessed at 5%. For-profit business property is normally classified under class 1 and is assessed at 18.5%. Grand Canyon University has long advocated for this property tax break to avoid Arizona's high business property taxes. ATRA continues to support policies that provide for equitable treatment among property taxpayers and will oppose efforts that undermine that important policy principle. *SB1402 passed the Senate 16-14 and is scheduled for a hearing in House Government and Higher Education on March 10.*

HB2439 property tax valuation (Petersen) Arizona's property tax system is based on a dual-valuation system: full cash value (FCV) and limited property value (LPV). The FCV should reflect market value of the property and is the only value that can be appealed by taxpayers. The constitution limits the annual growth in the LPV to the lesser of 5% over the prior year's LPV or the property's FCV, and unlike the FCV, the LPV cannot be appealed. HB2439 would allow a property tax appeal to be filed against the LPV based on the "equity approach." ATRA believes the calculation of the LPV is a function of the formula that is mandated by Article IX, Section 18 of the Constitution, and as such, is not an appealable value. *HB2439 passed House Ways & Means 6-3 and was subsequently held in House Rules.*

HB2525 counties; annual audits (Thorpe) Current law requires the Auditor General (AG) to conduct, or cause to be conducted, an annual financial audit for all counties. HB2525 would have taken the decision-making process away from the AG by authorizing the counties the option to hire their own auditor to conduct the audit. ATRA is opposed to removing the AG's authority to oversee the audit process of counties. *The bill was assigned to House Counties & Municipal Affairs but never received a hearing.*

HB2531 fire districts; district assistance tax (Bowers) ATRA has a long history of working with the fire districts on tax legislation. In 2005, ATRA worked on legislation with the fire district representatives to increase the current tax rate cap to \$3.25. In 2009, ATRA and the fire districts worked together on legislation that imposed the levy limits of 8% plus annexations on fire districts, and to help districts weather through the recession, the legislation also authorized districts to seek voter-approved overrides. Furthermore, legislation passed in 2012 increased the FDAT to the current \$400,000, up from \$300,000. This year, Rep. Bowers introduced HB2531 on behalf of the fire districts to lift the current \$3.25 tax rate cap on fire district tax levies. ATRA is opposed to any proposal that expands fire district's access to the property tax that does not offer solutions to make districts more efficient and sustainable. ATRA continues to meet with fire district officials to come to some compromise that is beneficial to both fire districts and taxpayers. *HB2531 was assigned to House Ways & Means but never received a hearing.*

HB2538 municipal bonds; tax levy (Mesnard) Under current law, the annual secondary property tax levy for voter-approved bonds is limited to the amount necessary to make the annual debt service payment, plus a reasonable delinquency factor and any amount needed to correct prior year errors. HB2538 would allow a political subdivision to also levy for any projected payments on new debt planned for the ensuing year and for the early defeasance of existing debt. ATRA offered an amendment that requires the current year's levy to be net of any

cash that remains in the debt service fund from the previous year. In addition, the amendment would require that the amount levied for the various amounts be separately stated in the public entity's budget. ATRA remains opposed to the measure without the amendment. *HB2538 passed the House and awaits a hearing in the Senate.*

ATRA MONITORING

HB2482/SB1279 empowerment scholarships; expansion; phase-in (Olson/Lesko) As amended in the Senate, SB1279 expands Empowerment Scholarship Account access to all public school children statewide who have attended a public school at least 100 days as a full-time student. Known as the "Universal ESA" bill, the expansion is phased in over three years beginning in FY2017 with children in grades K-5, K-8 in FY2018 and K-12 in FY2019. The cap on ESA enrollees is set to expire in FY2019. *SB1279 awaits Senate Ed and HB2482 awaits House COW.*

AG Audit Harshly Critical of GPLET

A recent audit by the Arizona Auditor General (AG) revealed many critical flaws surrounding the calculation, collection, distribution, and reporting of the Government Property Lease Excise Tax (GPLET).

According to the AG's review of 268 leases, nearly half are currently under eight-year abatement; and therefore, no revenue is being collected. Forty-five percent of the leases examined are paying GPLET under the rate structure that existed prior to 2010 that imposes a dramatically lower tax burden than the current GPLET rates. Of all the leases audited, only 16 (6%) are subject to the new GPLET rates. As a result, the AG found that the 2010 GPLET revisions have not resulted in increased revenue as expected because so few leases pay tax under the new rate structure.

Overall, auditors' interviews with city, town, and county officials indicated a general lack of understanding of GPLET requirements and recommended the Legislature modify statutes to address GPLET deficiencies.

Additionally, the AG found many examples where the incorrect GPLET was calculated because either the wrong rates were used and/or not all of the property subject to GPLET was included. In fact, in certain instances lessees failed to remit GPLET payments altogether.

The audit also found that the distribution of GPLET revenues by county treasurers was done incorrectly by using the distribution percentages for property tax rather than GPLET, which are different. Furthermore, although county treasurers are required to assess penalties and interest on delinquent payments, none did so.

There are several reporting requirements under GPLET, one of which requires county assessors to annually report the value of all GPLET property, which includes properties under abatement, to the Arizona Department of Education (ADE). The AG found that only three of the seven counties that have GPLET deals reported the valuation of GPLET properties to ADE. This is a major cause for concern since underreporting GPLET values to ADE requires the state general fund to pay more in state aid payments to school districts than otherwise required. Overall, auditors' interviews with city, town, and county officials indicated a general lack of understanding of GPLET requirements and recommended the Legislature

modify statutes to address GPLET deficiencies.

This special audit was a requirement of the 2010 legislation that enacted several revisions to GPLET. The purpose of the audit was to determine if the revisions resulted in a viable revenue source in lieu of an ad valorem property tax on possessory interests for counties, cities and towns, community colleges, and school districts.

Originally enacted in 1996 as a successor to the possessory interest tax, GPLET allows government to enter into lease agreements with private entities to use government-owned property for private use and be subject to an excise tax in lieu of a property tax. By 2010, cities had dramatically expanded their use of the eight-year abatement. Additionally, the tax liability under the existing GPLET rate structure was not only considerably lower compared to the property tax, but the entire tax obligation disappeared at fifty years.

In an effort to address some of the inequities with GPLET, the 2010 legislation limited the size of Central Business District (CBD) boundaries for leases who qualify for the eight-year abatement. A new rate structure was implemented that nearly doubled the existing rates, and while rates under the old structure dropped 20% every ten years until reaching zero by the fiftieth year, the new rates are adjusted annually by the producer price index for new construction indefinitely. Finally, the legislation prospectively limited GPLET deals to a maximum of 25 years, including any abatement period, at which time the government lessor is required to convey the property to the prime lessee and the property is then placed on the property tax rolls.

-Jennifer Stielow

STATEWIDE PROPERTY TAXES, *Continued from Page 1*

the County Assessors and other information such as payment in-lieu of taxes from the Salt River Project into a property tax model to determine effective tax rates for all classes of property. Needless to say, it's a complex effort requiring dozens of hours. The result however, allows ATRA to analyze year-over-year trends as well as estimate the impacts of various policy changes.

The total yield in the attached charts do not reflect every dollar levied because the model cannot capture certain smaller special districts which do not significantly impact the effective tax rates (ETR's).

The most significant trend in TY2015 is the reduction in the ETR for all classes of property, reversing a multi-year trend since the housing market collapse. During the recession, total valuations in primary residences (Class 3) decreased from a peak in 2009 of \$417 billion to \$231 billion last year. A small part of the decrease was a result of assessor's properly reclassifying rental residential as Class 4 which led to a migration of value from Class 3 to Class 4 (rental residential). During this period, business property values decreased on a much smaller margin leading to a massive property tax shift to businesses and a 30% increase in effective tax rates from 1.78% to 2.30%. This despite new laws which were simultaneously reducing business property tax assessment ratios annually by a half percent. If not for those reductions, the shift would have been more significant in magnitude.

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2015 Effective Tax Rates

Class	Total Taxable Full Cash Value	Percent of Total	Total Yield	Percent of Total	Effective Rate
1	112,658,496,856	21.08%	2,441,157,109	36.62%	2.17%
2	23,148,827,697	4.33%	394,020,275	5.91%	1.70%
3	269,066,831,676	50.36%	2,477,152,821	37.16%	0.92%
4	121,015,087,115	22.65%	1,279,866,250	19.20%	1.06%
5	1,808,910,076	0.34%	33,787,177	0.51%	1.87%
6	6,369,484,730	1.19%	38,979,411	0.58%	0.61%
7	28,157,431	0.01%	590,256	0.01%	2.10%
8	14,647,784	0.00%	106,914	0.00%	0.73%
9	212,063,078	0.04%	265,169	0.00%	0.13%
Total	534,322,506,443	100.00%	6,665,925,383	100.00%	1.25%

2014 Effective Tax Rates

Class	Total Taxable Full Cash Value	Percent of Total	Total Yield	Percent of Total	Effective Rate
1	106,498,601,302	23.16%	2,446,515,275	37.68%	2.30%
2	21,293,405,173	4.63%	399,872,665	6.16%	1.88%
3	231,741,220,729	50.39%	2,449,118,294	37.72%	1.06%
4	92,492,787,741	20.11%	1,124,085,982	17.31%	1.22%
5	1,663,901,370	0.36%	31,999,907	0.49%	1.92%
6	5,997,956,162	1.30%	40,255,195	0.62%	0.67%
7	30,428,994	0.01%	664,387	0.01%	2.18%
8	13,739,760	0.00%	114,227	0.00%	0.83%
9	194,499,366	0.04%	265,794	0.00%	0.14%
Total	459,926,540,598	100.00%	6,492,891,726	100.00%	1.41%

Despite a 5.6% increase in business property tax Full Cash Value (FCV), total levies decreased by 0.03%, leading to a 6% decrease in the effective tax rate (ETR) from 2.3% to 2.17%. This was a combination of the reduction in the assessment ratio of Class 1 property from 19% to 18.5% as well as Prop 117, which limited taxation to the Limited Property Value (LPV) for locally assessed business property. [See the ATRA October 2015 newsletter for more information on Prop 117's impact on property taxpayers and changes in property tax rates for FY2016.]

Arizona homeowners also saw their ETR's drop in TY2015 with significant increases in FCV against marginal increases in taxes. The ETR for Class 3 dropped 13%, from 1.06% to 0.92%.

-Sean McCarthy