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ARIZONA TAX RESEARCH ASSOCIATION NEWSLETTER VOLUME 81 NUMBER 6 AUGUST 2021

ATRA Investigation Leads to 27 Felony Indictments

In 2015, ATRA published an investigative article on the misuse of public funds at Higley Unified. [<https://tinyurl.com/yzap6y28>] ATRA first began studying the district when it noticed they had levied \$15 million in property tax increases over a few years for Adjacent Ways, which is a specific tax assessment that may only be used on projects in the public right of way and for emergency traffic lanes.

District voters approved the acquisition of two middle schools in 2012 through a rarely used “lease purchase” mechanism but the accompanying capital override tax to pay for them failed at the ballot. ATRA made several requests for public information about the procurement and expenditures of Adjacent Ways funds and after months of delay, obtained records showing illegal

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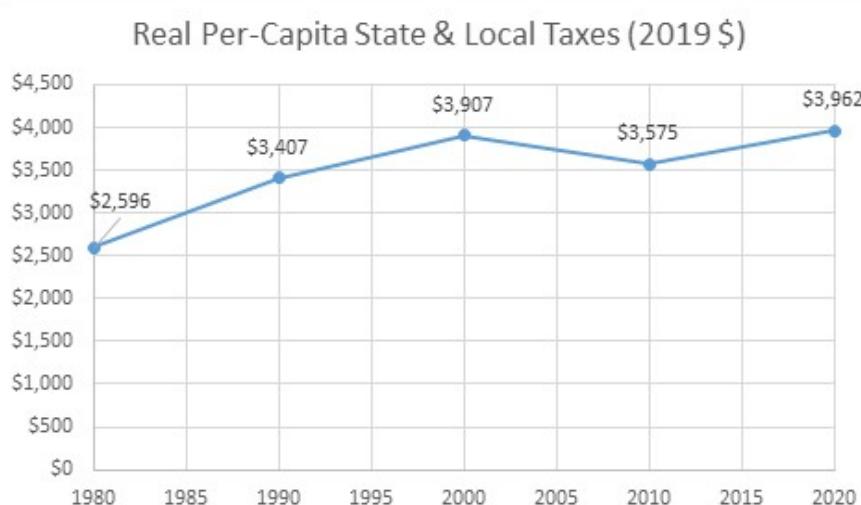
CITY BUDGETS FLUSH WITH CASH IN FY 2022

Arizona’s city and town budgets are healthy, thanks in part to the massive influx of federal stimulus dollars and higher than expected tax revenues. Among the toughest decisions for cities this year will be how to spend it all.

During last year’s budget year, most local governments cautiously crafted their spending plans in anticipation of lower revenues as a result of the pandemic. Contrary to those concerns, revenues came in stronger than expected and resulted in higher ending fund balances to begin this fiscal year. The \$2 billion in federal stimulus dollars distributed through CARES and ARPA funding is one-time revenue. However, the question remains as to whether the new base revenues are sustainable.

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Real Per-Capita Taxes up 53% Since 1980



In a blow to the narrative that Arizona has spent the last several decades eroding its tax base, Arizona closed out 2020 with increased per-capita tax collections, adjusted for inflation. In 2019 dollars, Arizona collected \$2,596 in total taxes per person in 1980 and last year collected \$3,962. It has increased in real terms in every decade except during the Great Recession in 2010.

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	Tax	FY 1980	FY 1990	FY 2000	FY 2010	FY2020
said without justification that Arizona has cut taxes “in almost every year” or that Arizona	Property	\$821,596,042	\$2,506,010,794	\$3,874,688,668	\$7,043,999,906	\$8,211,077,312
	TPT	\$983,075,114	\$2,341,449,197	\$5,264,576,318	\$7,364,083,841	\$12,299,796,093
	Individual Income	\$319,339,473	\$996,405,685	\$2,291,882,439	\$2,423,214,707	\$4,531,545,529
	Corporate Income	\$114,551,166	\$178,067,102	\$523,181,687	\$413,193,307	\$511,881,981
	Gas/Use Fuel	\$122,898,401	\$339,116,220	\$575,413,791	\$635,665,175	\$734,127,463
	VLT	\$73,800,000	\$297,280,096	\$583,199,118	\$735,972,889	\$1,053,745,450
	All Other	\$148,404,016	\$405,130,355	\$583,229,943	\$972,135,832	\$1,497,882,149
	TOTALS	\$2,583,664,212	\$7,063,459,449	\$13,696,171,964	\$19,588,265,657	\$28,840,055,977

leverages population growth to cut taxes. The conclusion is that public services are starved of necessary revenue because of these tax cuts. None of these claims withstand basic scrutiny.

The truth is Arizona has both increased and decreased taxes in the last forty years. State, county, and municipal governments have increased sales taxes (TPT). The total average TPT rate was 5.2% in 1980 and today is 9.1%—a 75% increase. Property taxes have grown steadily, collecting 37% more today in real per-capita collections, from \$825 to \$1,100 per person.

With a top rate of 9.3%, Arizona used to have one of the highest corporate income tax rates in the nation. Since it has dropped to a flat 4.9%, Arizona is far more competitive regionally and while it does produce less today, it remains a tiny fraction of all taxes collected at roughly 1.8%. While personal income tax rates have been lowered by roughly 1/3 through various efforts from their peak in the 1990s, Arizona collects almost 100% more in real per-capita personal income taxes than it did in 1980.

Notwithstanding significant increases in sales taxes, most of the changes in the area of income and property taxes were designed to improve Arizona’s competitive position from an economic growth standpoint. From that perspective, the reforms have produced the intended results.

Overall, the performance of Arizona’s tax system is a win for both taxpayers and those looking to spend taxpayer dollars. For taxpayers, the goal is to produce enough revenue for essential government services without growing the size of government beyond natural factors. For the spending lobby, it should be viewed as a success that despite several cuts to personal income taxes, the overall taxation system produces more revenue led by growth in personal income tax collections. As Arizona grows in population, it has also become a wealthier state. This has led to property value and income growth which has produced significant gains in those areas of tax.

Tax	2020	% of Total	Per Capita	1980 (Real \$)	% Change
Property	\$8,211,077,312	28.47%	\$1,128.09	\$825.50	37%
TPT	\$12,299,796,093	42.65%	\$1,689.83	\$987.75	71%
Individual Income	\$4,531,545,529	15.71%	\$622.57	\$320.86	94%
Corporate Income	\$511,881,981	1.77%	\$70.33	\$115.10	-39%
Gas/Use Fuel	\$734,127,463	2.55%	\$100.86	\$123.48	-18%
VLT	\$1,053,745,450	3.65%	\$144.77	\$74.15	95%
Other	\$1,497,882,149	5.19%	\$205.79	\$149.11	38%
TOTALS	\$28,840,055,977	100.00%	\$3,962.24	\$2,595.94	53%

ARIZONA TAX RESEARCH ASSOCIATION
Richard Bark.....Chairman
Kevin J. McCarthy.....President
Jennifer Stielow.....Vice President
Sean McCarthy.....Senior Research Analyst
Kathleen Farnsworth.....Office Manager

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1814 W. Washington Street
Phoenix, Arizona 85007
(602) 253-9121
www.arizonatax.org

CITY BUDGETS FLUSH *Continued from Page 1*

City Budgets In FY 2022, Arizona cities and towns increased their General Fund (GF) budgets 28.7% to \$7.4 billion. This year's growth is unprecedented, as the annual growth in city and towns budgets typically hovers around 5%. The GF beginning fund balances grew nearly \$1 billion to \$2.8 billion and account for 37.8% of total GF budgets. Much of the growth in fund balances is the result of the nearly \$2 billion in federal stimulus dollars that have funneled to local government budgets.

GF budgets fund the operations of municipal government, much of it dedicated to police and fire. The growth in some city budgets reflect at or near triple-digit growth, such as Casa Grande, Cottonwood, Douglas, Glendale, Kingman, Tempe, and Yuma. The cause for the dramatic growth in these city budgets was mainly due to the issuance of bonds to pay towards the Unfunded Actuarial Accrued Liability (UAAL) of the Public Safety Personnel Retirement System (PSPRS). Local governments have been scrambling for many years trying to get out from under the massive PSPRS UAAL burdening their operations budgets. The issuance of debt by the abovementioned cities will reduce their PSPRS UAAL by more than \$890 million. Doing so shifts the burden from an unfunded liability to a debt of the cities, which they believe will result in millions of savings due to lower interest rates.

Other notable GF budget increases occurred in Kingman (98.6%), Springerville (91.4%), Avondale (74.7%), and Cave Creek (62.3%). Common in this year's GF budgets is the stockpiling of stimulus dollars in contingency and reserve funds while determinations must be made over the new fiscal year exactly where to allocate the spending. Only 36 of the 91 cities project single digit growth in their FY 2022 GF budgets.

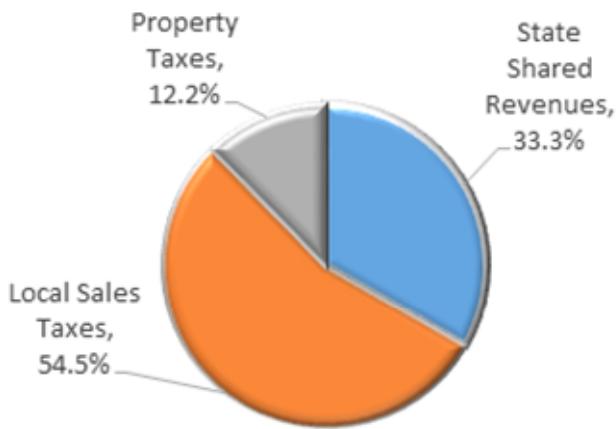
The city and town Total Funds (TF) budgets increased 8.4% to \$27.1 billion in FY 2022, with TF reserves breaking \$14 billion. In addition to the GF, TF budgets include expenditures for water, wastewater, and solid waste services, and in some cities, golf courses and airports.

Major Revenues The major revenues that support city and town budgets include revenues generated from local transaction privilege tax (sales), state shared revenues, and property taxes.

According to the Joint Legislative Budget Committee (JLBC), the FY 2021 statewide sales tax revenues grew by a significant 15.8%. JLBC notes that most of the growth was due to federal stimulus programs, which included enhanced unemployment insurance benefits and other stimulus payments. The retail and remote seller sales tax category reflected the most growth at 21%, which was boosted by the 2019 Wayfair legislation that requires remote sellers and marketplace facilitators remit sales taxes for online purchases.

Local sales tax revenues are the largest funding source for Arizona's cities and towns. In FY 2022, cities and towns are anticipating to receive approximately \$3.5 billion in local sales tax revenues. Additionally, the state is projected

Major City & Town Revenue Sources - FY 2022
(Not including Federal Stimulus \$)



to share another \$2.2 billion of its revenues with the cities and towns. Included is \$680 million in state shared sales taxes and \$726 million in Highway User Revenue Funds (HURF) and Vehicle License Taxes (VLT). Additionally, the state shares its income tax revenues, referred to as Urban Revenue Sharing (URS), only with cities and towns based on 15% of the income tax collections from the prior two years. In FY 2022, the state will distribute \$756 million under the URS formula.

Primary Property Taxes Fifty-one cities and towns levy a primary property tax to fund their maintenance and operations budgets. In FY 2022, cities and towns are levying \$403.3 million, 5.4% (\$20.7 million) more than last year. Excluding amounts attributable to new construction, nearly half of the cities and towns increased taxes \$9.3 million by exceeding their Truth in Taxation (TNT) limits. TNT requires that if a jurisdiction proposes to increase primary property taxes exclusive of new construction, the jurisdiction is required to hold a public hearing and publish notice of the tax increase in a newspaper of general circulation. Of this year's aggregate \$9.3 million increase, the City of Phoenix is responsible for 80% of it after increasing taxes \$7.5 million.

For any jurisdiction that proposes to increase taxes 15% or greater, TNT requires a unanimous vote, rather than a simple majority vote. The Town of Hayden was held to a unanimous vote requirement by implementing a 19.7% increase. The Town's primary tax rate increased \$2.1392 to \$13.00. The Town of Kearny stayed below the unanimous vote threshold this year by increasing primary taxes 14%. The penalty for lack of adherence to the TNT hearing and publication requirements prohibits a jurisdiction from increasing taxes over TNT for that tax year.

Secondary Property Taxes Nineteen cities and towns levy nearly the same amount in secondary property taxes to pay debt service on voter-approved General Obligation (G.O.) bonds as the 51 that levy primary taxes. In FY 2022, secondary levies increased 5.8% to just over \$404 million. Although taxpayers might expect the secondary tax rate to drop each year as debt is repaid, several cities manage their tax rate by issuing new debt as debt is paid off. Apart from three cities that increased their secondary tax rates within a few cents, Casa Grande increased its tax rate nearly 30 cents this year, which more than doubled the amount levied in secondary taxes to \$2.4 million. The cities that kept their tax rates the same included Chandler, Flagstaff, Gilbert, Peoria, and Surprise. The rest of the cities and towns reduced their secondary tax rates, with the most notable decreases occurring in Tolleson (-\$0.7750), El Mirage (-\$0.2170), and Coolidge (-\$0.1971).

-Jennifer Stielow

FELONY INDICTMENTS *Continued from Page 1*

payments from the special fund to the developer to cover lease payments for new middle schools. Furthermore, the procurement appeared to be rushed and uncompetitive, using a selection process clearly designed for one developer and construction firm to build the two new middle schools.

ATRA suggested to then Senate President Andy Biggs (Higley was in his Legislative district) that he request the Attorney General investigate, which he obliged. ATRA turned over all its materials to the Arizona Auditor General, who led the investigation. Some five

From the Arizona Auditor General Investigation

Source of check payments	Higley	Retirement	Scottsdale	Total
Hunt & Caraway	\$28,000	\$57,000	\$15,000	\$100,000
Hunt & Caraway's former president's personal bank accounts	1,000	2,000		\$3,000
CORE Construction	2,500			\$2,500
Total	\$31,500	\$59,000	\$15,000	\$105,500

years after the information was uncovered, the Arizona Attorney General has secured 27 felony indictments for the former school Superintendent Denise Birdwell, Gary Aller and Steve Nielsen of the development company, and Hartwell Hunnicutt, a confidant of Ms. Birdwell who allegedly was part of the scheme. Credit the Arizona Auditor General and Attorney General's office for their steadfast effort to bring justice in this case.

Not only did ATRA uncover the General Journal Entry which showed more than \$6 million being paid from Adjacent Ways to the development company for "Lease Payments," ATRA discovered that the developer plainly told the district in their proposal that the middle schools could be leased "with the incorporation of Adjacent Ways," hinting that this illegal use of funds could help fund lease payments. The Auditor General uncovered much more wrongdoing, including conspiracy, tax fraud, kickbacks, and more.

The Auditor General report is worth a read. [<https://tinyurl.com/46ymwzea>] It shows the construction team and architecture firm provided direct financial "kickbacks" to Superintendent Birdwell. Not only are these illegal procurements and expenditures concerning, but the ease of which an expensive capital project could be procured without competition is astonishing. School districts proudly claim their procurements of construction services are competitive but the RFP process shows that if a district wishes to select a certain vendor over others, it can do so without serious justification.

One of the most concerning findings in the investigation is Superintendent Birdwell was completely unconcerned with the consequences of breaking the law. The report had her quoted as saying "What are they going to do? Slap my hand?" There are few expectations of real accountability in the area of civil law because it is so rarely prosecuted and usually requires expensive litigation. In fact, this is the only Arizona case in recent memory where a government official was charged with procurement fraud and it's possible that charges may not have been filed at all if had not been for the criminal charges related to kickbacks

and tax fraud.

Civil law often goes entirely unenforced.

Dr. Birdwell initially denied knowing that Adjacent Ways Fund monies were used for these unauthorized Project purposes at the time, but when investigators presented her with a copy of her December 2012 wire transfer authorization letter, she claimed that it was an appropriate use. Additionally, a Higley consultant reported to investigators that Dr. Birdwell told her "What are they going to do, slap my hand?" after she told Dr. Birdwell that this use of Adjacent Ways Fund monies was illegal, that Dr. Birdwell needed to produce documentation to support the amount, which she did not provide, and that Higley's auditors would find it, issue a finding, and Higley would have to repay the Fund.

Over the years,

there has been some media attention paid to the issue of uncompetitive procurement of school district construction. Regrettably, none of those reports amounted to much. ATRA has noticed a slight increase in the use of more competitive procurement processes, especially "Select Bidders List," where construction firms compete for a low-bid contract after being vetted by the procurer. Procurement law is a challenging concept and while there are no simple solutions, lawmakers should be wary of proposals which may lead to more insider deals, the boxing out of competition, and higher costs for taxpayers.

While ATRA secured a small victory in 2016 at the Legislature by requiring the School Facilities Board to review all expenditures over \$50,000 made from the Adjacent Ways fund to ensure compliance with the law, districts can and do levy massive amounts of local tax dollars for this fund, often to supplement bond-funded schools. It's clear from the design of new schools that as much of the project that can be penciled into Adjacent Ways is done so to maximize the bond fund. If taxpayers are paying for schools with voter-approved bonds, they should be approving all sources of funds to include Adjacent Ways. ATRA will continue to work with lawmakers to bring rationality and controls to this unlimited property tax.

-Sean McCarthy