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ARIZONA TAX RESEARCH ASSOCIATION

NEWSLETTER VOLUME 80 NUMBER 2 FEBRUARY 2020

Arizona Lands $11.6B in Income From Migrants

In the last five years of available data, Arizona has imported a net increase of 120,466 income tax filers from domestic migrants, meaning people who moved from one U.S. state to Arizona in the following year. The increase led to a gain of $11.6 billion in taxable income, which was 7% of all taxable Arizona personal income in 2018. With an average liability of 2.4%, this translates to $282 million in state income taxes. The Internal Revenue Service (IRS) tracks and publishes this two-year data, which shows migrants both to and from states. They report the Adjusted Gross Income (AGI) of filers who departed a state and also the AGI at the state where migrants arrived after they have moved. https://www.irs.gov/statistics/soi-tax-stats-migration-data

As a growth state, Arizona receives net income growth from all but four states in the union. The largest number of annual domestic migrants (by filer) to Arizona is California, which also is the largest source of net AGI growth. In the last five years, Arizona's AGI has grown by $3.5B due to California migrants. Illinois is second at $1.6B, Minnesota at $760M, Washington at

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The Coming High School Enrollment Decline

A combination of declining birth rates and open enrollment have created precipitous declines in many elementary schools, a phenomenon which will impact high schools in the next several years. While the reporting on open enrollment and the growth in charter schools is well documented, the student vacuum in Arizona's elementary schools resulting from dropping birth rates has received little attention.

The K-12 population overall declined for the first time in decades during the Great Recession from 2008-2010. Since then, there has been a reduction in child births in Arizona that has not abated despite the economic recovery—Arizonans are simply having fewer children. Arizona births are down from 78.9 per 1,000 women to 61.1 from 2007 to 2017 according to the Arizona Department of Health Services (DHS). Arizona's

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Expenditure Limits: Pension Liability Is Not Long-Term Debt

Maricopa County is at its expenditure limit and is searching for creative ways to get some relief. Although the constitution gives the county authority to ask its voters for an increase, it has declined to do so. Recently, the County attempted to convince the Office of the Auditor General (OAG) to treat its pension liability as "long-term debt." Not only did the OAG not agree with the County's interpretation, but the Attorney General (AG) backed the OAGs position in an opinion requested by the County. Unable to convince the state's head attorney and auditor, the County is

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$579M, and New York at $560M.

Migrants to Arizona tend to file higher AGIs than the migrants from Arizona to that state, by an average of $9,000 per filer. It is worth noting filers include both individuals and married filing jointly. It is both net positive migration to Arizona combined with higher AGIs for those that arrive in Arizona that leads to this net gain in AGI due to migration.

The highest average AGI for domestic migrants to Arizona comes from New Jersey and Minnesota at $108,000 per filer. Domestic migrants from Ohio, Connecticut, New York, Massachusetts, District of Columbia, and Illinois each earn an AGI of over $90,000 in Arizona, which represents far more than migrants from Arizona to those states. The largest gap in AGI delta between inbound and outbound migrants is from Ohio, where inbound migrants to Arizona reported an average AGI of $100,000 per filer while outbound migrants earn an average of $53,000 in Ohio.

It's possible Arizonans headed for other states are more likely to be single filers than inbounds to Arizona, and joint married filers usually have higher AGIs. With that said, Arizona receives roughly four times more public university students from other states than it sends to other states, per a study by the New York Times in 2016. The only significant state that benefits from an outflow of Arizona AGI is Florida because even though Arizona receives more migrants than it sends to Florida, the average filer who moves to Florida takes a considerable amount of AGI with them.

What migrant filer data shows is Arizona is not only a destination state for moving Americans from a variety of regions, those who migrate to Arizona tend to earn high incomes on average. Arizona's total AGI increased substantially over the last decade due to economic growth so it's difficult to say how much of the net AGI gain would have occurred anyway, but it's quite clear that Arizona benefits from population growth. Personal income taxes in the last five years have grown from $3.8 billion to $4.8 billion to the state general fund in FY 2019.

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Retirees

The IRS data also dispels a myth that domestic migrants tend to be retirees that won't generate much income when they arrive. Census Bureau data shows Arizona ranks second among states for moving retirees and it comprises a plurality of Arizona's in migration. Net migrants to Arizona over age 60 roughly doubled in five years, from 18,733 in 2014 to 31,203 in 2019. In fact, Mesa typically ranks top five in the nation each year for net migration for those over age 60 per *SmartAsset*. Though many retirees live on smaller incomes, the IRS data shows movers continue to earn income in Arizona, whether it's through work, realized investments, pensions or other income.

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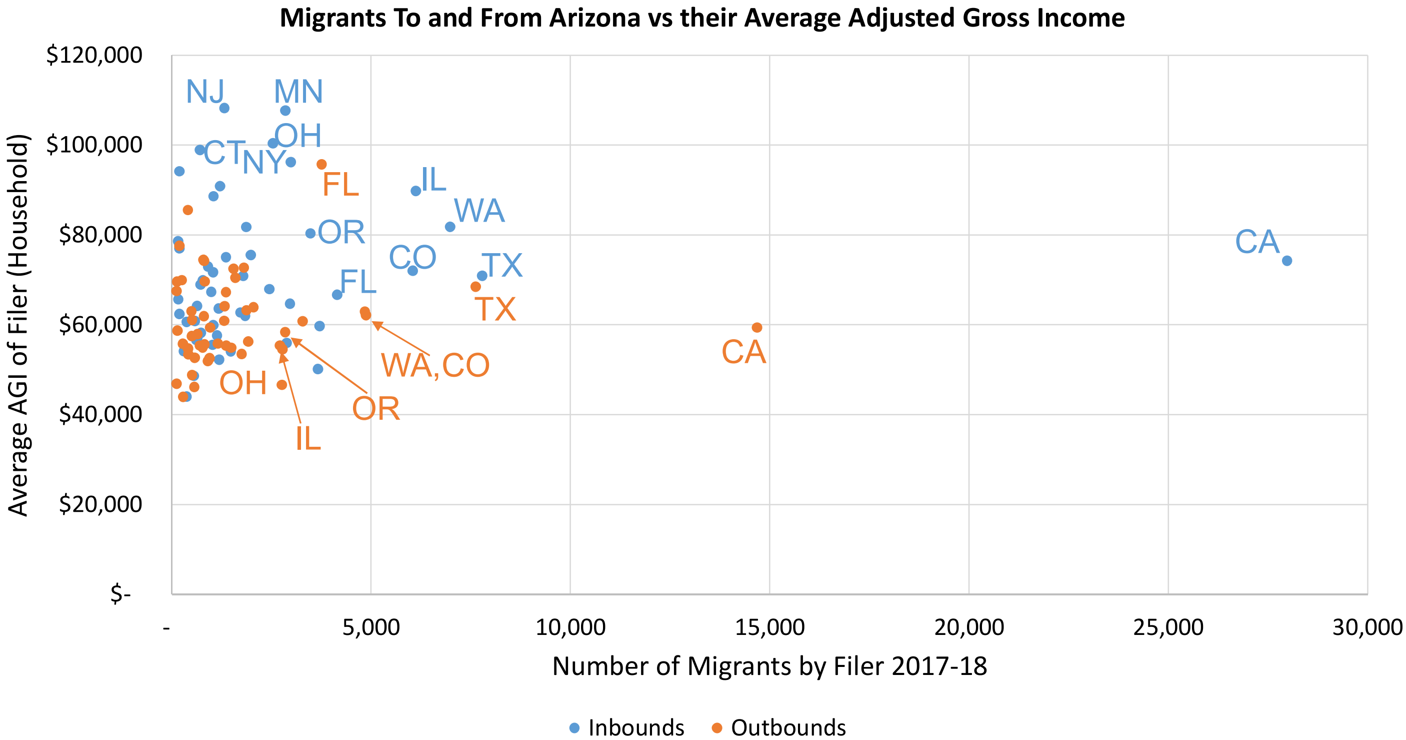


Wealthy Migrants

Arizona used to be a high personal income tax state regionally with a top bracket of 7% in 1992 and its share of high income filers, or those with $500,000 of AGI or more, was less than 0.3% of filers. The percentage of these filers in Arizona has grown 278% since 2000. Between 1991 and 2018, filers with more than $1 million in AGI grew from just 493 to 6,500. The percentage of all filers with over $1 million in AGI in Arizona grew 450% over that period. The total income tax revenues paid by $1 million filers grew from just $100.7 million in 1991 to more than $700 million by 2018 (in constant 2017 dollars). This data is taken from Arizona Department of Revenue Annual Reports. Nonresident filers with more than $500,000 in AGI, who are seasonal/part-time Arizonans and by definition are mobile taxpayers, have increased by 400% since 1991.

Migrant data shows the wealthy move at slightly higher rates than the middle class, and when they do move, they tend to favor low tax states. The only peer-reviewed study on the choices of wealthy migrants finds that a 10% increase in a state's top rate leads to a 1% decline in millionaires in that state, plus a 1% decline in future migrants. Intuitively, this impact would be higher in states high filers could avoid and domicile elsewhere, as opposed to international business centers found on the coasts that tend to have "persistent millionaires." (Young, Cristobal & Charles Varner. *Millionaire Migration and Taxation of the Elite*).

Using this data, a doubling of Arizona's top personal income tax bracket would cause a loss of at least 10% of high wealth filers and cause 10% of future high wealth filers to move elsewhere. Arizona is not California or New York. Those states have a disproportionate share of wealthy filers despite high income tax rates for a variety of inherent factors which Arizona does not share. With attractive rates, wealthy nonresident filers in particular have flocked to Arizona.

-Sean McCarthy

EXPENDITURE LIMITS, *Continued from Page 1*

advocating for a statutory fix to define "unfunded accrued liability" as a "long-term obligation," and therefore excludable from the constitutional expenditure limits.

Armed with a team of lawyers, Maricopa County is now asking state lawmakers to ignore the AG Opinion and pass a law in SB1280 to grant them expenditure limit relief by renaming unfunded pension liability as long term debt, which gives them increased spending authority.

The constitutional expenditure limits were approved by the voters in 1980 with the objective of limiting dramatic growth in government spending. The 1980 base year is adjusted annually by population and inflation and allows for certain exclusions from "local revenues." One such exclusion includes "[a]ny amounts or property received from the issuance or incurrence of bonds or other lawful long-term obligations issued or incurred for a specific purpose, or collected or segregated to make payments or deposits required by a contract concerning such bonds or obligations."

In 2016, Maricopa County proposed legislation that would have provided a statutory exclusion from the expenditure limits for pension contributions made "in excess" of the required annual payments. As introduced, the legislation was intended to incentivize local governments to pay-down the massive unfunded liability that had accumulated under the Public Safety Personnel Retirement System (PSPRS) over the last decade without consuming their expenditure limit capacity.

Although the constitutionality of the bill was questionable, ATRA was supportive because it was good policy to allow local governments to reduce their pension liabilities. And while the original goal of the bill was to exclude only the lump-sum payments from the expenditure limits, the measure was subsequently amended on the House floor to exclude *all* payments made against unfunded accrued liability, including the current year payments. That amendment forced ATRA to oppose the measure in the Senate, as it became clear the bill had nothing to do with addressing PSPRS unfunded liability and everything to do with providing expenditure limit relief for Maricopa County. As a result, the bill sponsor, Senator Debbie Lesko, refused to allow the bill to proceed.

Left without a legislative solution, Maricopa County began excluding its unfunded pension liability payments from its expenditure limit, arguing to the OAG that the pension payments qualify as "debt" under the expenditure limits. The OAG did not agree. According to the County's FY 2016 Annual Expenditure Limit Report, the OAG stated that the County "improperly excluded contributions it made toward unfunded pension liabilities" from its expenditure limit. Had the County not improperly excluded its unfunded pension payments, its total expenditures subject to the limitation would have been over $43 million higher. The County again excluded its unfunded pension liabilities in FY 2017 despite the OAGs adverse opinion. Following that second opinion, both the OAG and the Maricopa County Attorney sought a legal opinion from the AG.

The AG issued its Opinion on August 9, 2019 and reaffirmed the OAGs position. Specifically, the question posed to the AG by the OAG and County Attorney was this: *"Maricopa County pays monies each fiscal year to satisfy the County's duty to pay annual amounts necessary to amortize unfunded liabilities for certain public retirement plans ("Amortization Amounts"). Are the Amortization Amounts excluded from 'local revenues' under §20(3)(d)(i)?"*

As to why Amortization Amounts are not excludable, the AG explained that "the duty to compensate county employees for their services, whether through salaries or benefits, is not a 'bond or other lawful long-term obligation.'" Specifically, the payments for services are not "bond-like" and no "amounts or property" are received in return. Furthermore, Amortization Amounts are not incurred voluntarily and they are not "required by a contract." Although an employee's membership in the state's pension plan is contractual, the County's annual responsibility to make payments to its pension plans is statutory. Finally, the AG noted that excluding these amounts would "contravene" the history and purpose of Article 9, § 20, which was intended to stop "runaway growth of local spending and an 'ever-increasing local tax burden.'"

Unable to sway the OAG or AG, Maricopa County returned to the Capitol again this year seeking expenditure limit relief under SB1280. However this time the bill would allow all payments toward unfunded accrued liability, current year and excess payments for all four of the state's pension plans, to be excluded from the expenditure limits.

Testifying before the Senate Finance Committee, ATRA President Kevin McCarthy reiterated ATRA's position from a few years ago that while a statutory exclusion from the expenditure limit is likely unconstitutional, it's good policy to incentivize local governments that have accumulated substantial cash reserves to pay down their PSPRS unfunded liability. However, allowing an exclusion for the payment of the accrued unfunded liability that government is required to pay on an annual basis is only about expenditure limit relief, nothing more. The bill sponsor and chairman of the Finance Committee, Senator J.D. Mesnard, affirmed that his intent was to have only lump-sum payments made toward unfunded liability be excluded from the expenditure limit. Committing to amend the bill to accomplish that intent, the Finance Committee passed SB1280 with a 5-3-2 vote. If the County refuses to settle for SB1280 as amended, its last option is to finally ask voters for increased spending authority.

-Jennifer Stielow

BIRTH RATES IMPACT ENROLLMENT, *Continued from Page 1*

growing population (10% since 2010) has not improved this trend. Total births have dropped 21% in a decade from 102,687 to 81,664 in 2017.

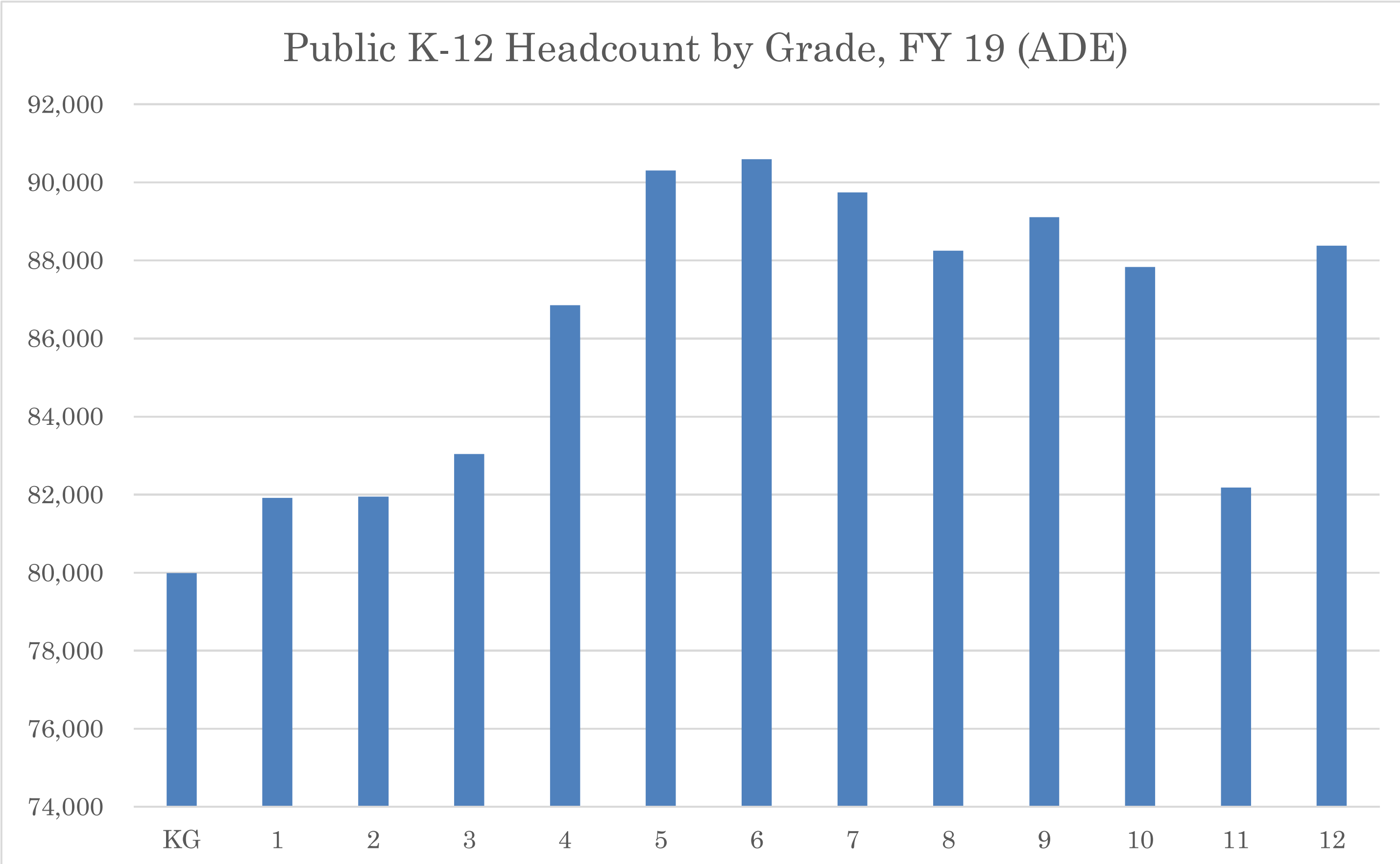
Union High School districts in particular should pay attention to the enrollment levels of feeder elementary districts. These Union districts, which only serve grades nine through twelve, have mostly not experienced enrollment declines because their students are still among the pre-recession boom cohort. Many high schools have seen growth largely because births jumped before the recession. That will likely change and it will be financially difficult for these schools as their student-driven funding recedes. Naturally, the trend will also

			Birth Rates by Birth Mom Age				
		General Fertility Rate	15-19 years	20-24 years	25-29 years	30-34 years	35-39 years
2007	AZ	78.9	59.5	132.2	124.7	98.6	46.8
	U.S.	69.5	42.5	106.3	117.5	99.9	47.5
2012	AZ	67.2	35.4	100.1	116.4	94.6	45.9
	U.S.	63.0	29.4	83.1	106.5	97.3	48.3
2017	AZ	61.1	21.9	78.9	105.6	94.9	57.8
	U.S.	60.3	18.8	71	97.9	100.3	52.2
2007-2017 AZ change		**-23%**	**-63%**	**-40%**	**-15%**	**-4%**	**24%**

Gen Fertility Rate: # of births per 1,000 women of childbearing age (15-44 years)

Birth Rate: # of births per 1,000 population

Source: Arizona Dept of Health Statistics



begin to impact colleges and universities.

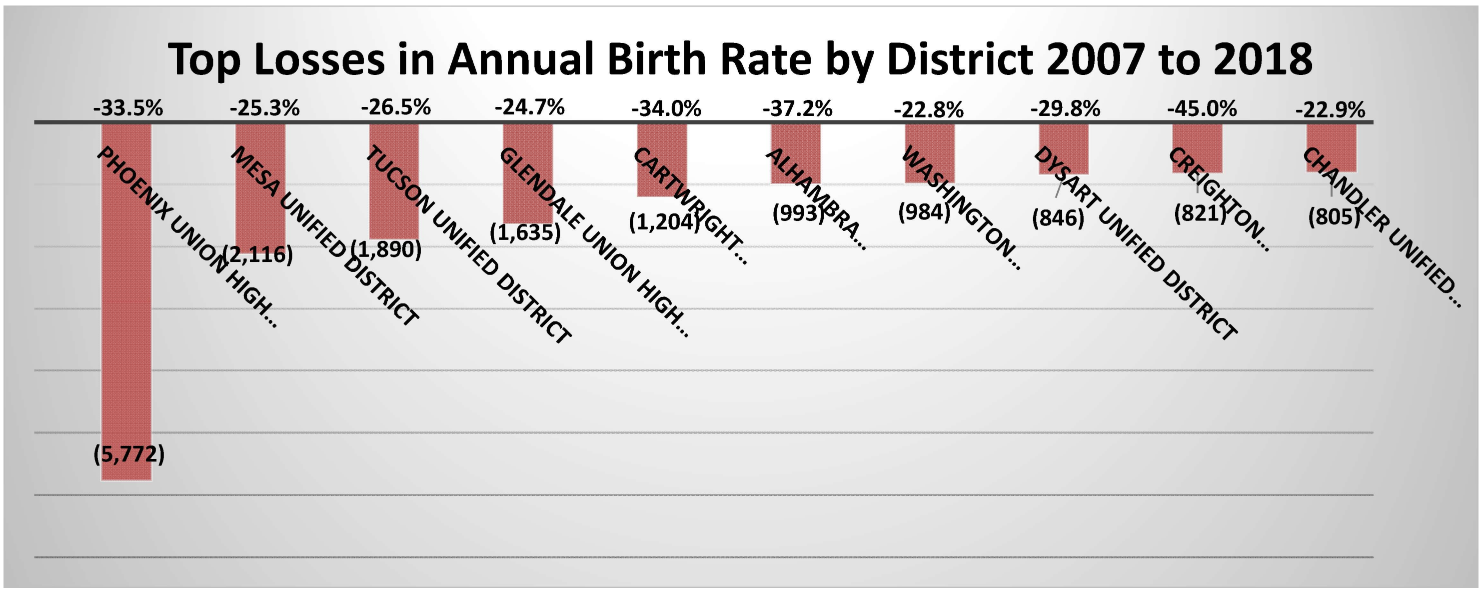
Arizona's declining birth rate is part of a global phenomenon. Per a report by the population forecasting firm Demographic Intelligence, "Fertility declines have been comparatively modest among non-Hispanic white, black, and Asian Americans but extremely large among Hispanics. Both native and foreign-born Hispanic women have seen declines….birth rates have fallen about 50% faster than non-Hispanic women over the last 15 years. As Hispanic marriage becomes more delayed, Hispanic fertility is plummeting." This has been the case in Arizona, where Hispanic births are down 27% while white, non-Hispanic births are down 15% since 2007.

Per DHS, Arizona's birth rates have fallen most dramatically in younger women. The birth rate for Arizona women ages 15-19 has fallen 63% and for ages 20-24 it is 40% since 2007. The rate of teen pregnancy in Arizona has fallen from 34.4 to 13.7 births per 1,000 women age 19 and younger with massive drops in each demographic group but especially among Hispanics, dropping from 55.3 to 17.8 births per 1,000.

In Maricopa County, enrollment gains in suburban areas like the far southeast and southwest valleys have been offset by substantial enrollment declines in urban areas. Roosevelt and Phoenix Elementary have lost an estimated 34% of enrollment since FY 2008. Creighton, Isaac, Alhambra, Cartwright, Pendergast, and Glendale Elementary have lost 17-25% over that period. Even Kyrene Elementary, which benefits greatly from open enrollment, is down 8% since 2008.

In Pima County, growth in suburban areas like Vail and Tanque Verde Unified do not make up for massive contractions elsewhere. Tucson Unified has lost 30% of its students since their peak in 2000; this year they have roughly 42,200 students. Amphitheater Unified is down 20% and Sunnyside Unified is down 9% since 2008. Pima County total district enrollment declined 7.3% in the last decade, per the School Facilities Board (SFB) FY 2019 Annual Report.

It's difficult to understate the impact of enrollment patterns for Arizona schools. For most districts, annual growth was normal and expected. In 2007, the University of Arizona Population Projections team predicted district enrollment would grow to roughly 1.4 million by FY 2020 (ADE pegged it at 1.3 million students) per a 2007 SFB Performance Audit. Instead of continuing past growth patterns, enrollment declined to an estimated 900,000 in FY 2020. Twenty-four of the largest 40 districts by enrollment (which comprise 76% of all district students) have declined since 2008.



Though 84 districts reported enrollment growth in FY 2019, only 14 experienced significant growth over the last decade. Most districts have either contracted small or large amounts. Ten percent or more declines over the last decade in some of Arizona's largest districts such as Mesa, Tucson, Scottsdale, and Flagstaff Unified have created extraordinary budget challenges. In addition to the recession-era fiscal cutbacks such as the partial suspension of District Additional Assistance, districts across the state began budgeting in an environment where they faced an overall budget decrease because of enrollment declines.

The SFB also tracks births by school district, which shows declines are more severe in urban areas. Freshman entering high school next year were born in 2005-2006, when birth rates peaked before falling precipitously in 2008. In the Phoenix Union High School District, there were 17,227 births in School Year (SY) 06-07 while there were just 11,455 in SY 17-18, a 34% decline. This 5,772 decline is the largest in the state but is hardly alone. Glendale Union is down 25%, Casa Grande Union is down 34%, and Tempe Union is down 18% over that period.

Unified districts see the challenges in their elementary enrollment. Chandler Unified had nearly 1,000 more 8th graders than Kindergartners in FY 2019. Gilbert, Peoria, Scottsdale, Dysart, and Deer Valley Unified each have roughly 500 more 8th graders than Kindergartners.

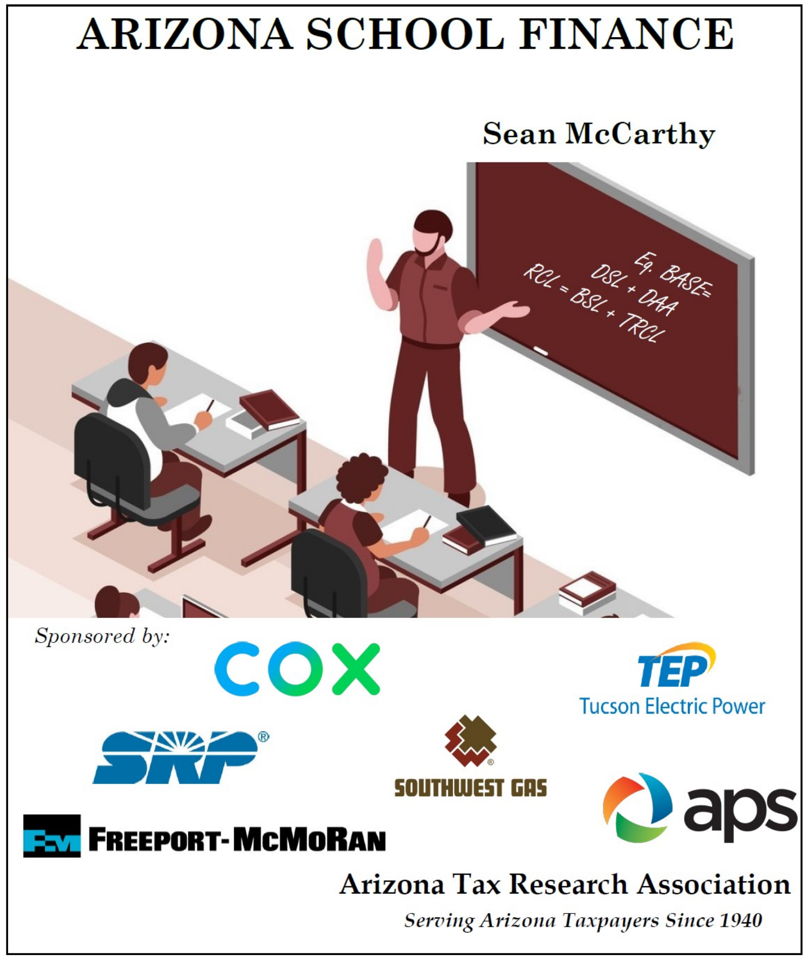
Only Queen Creek Unified and Somerton Elementary have had significant gains of 100 or more annual births in their district since 2007. Arizona had 32,900 fewer births statewide in SY 2018 than 2007.

Though high schools and colleges should be planning for these contractions, elementary programs are not out of the woods just yet. Birth rates for children too young for Kindergarten continue to decline, roughly 6% statewide between Kindergarten eligible students and those born in SY 17-18, the latest data set available. However, research suggests the decline in birth rates may be over. Per the report from *Demographic Intelligence*, nationwide birth rates began to slowly rise at the end of 2019, which is about two years after the rates of homeownerships for those under 35 years finally stopped falling and began to rise, suggesting financial stability and permanent income leads to higher birth rates. If this trend holds true for Arizona, it suggests total enrollment will stabilize in roughly ten years or sooner for elementary districts.

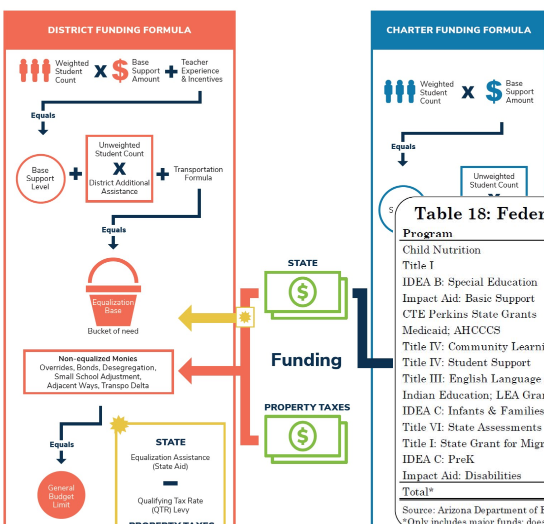
Impact on ASRS

A lack of cumulative growth in district schools has an impact on the state's retirement system, which is buoyed by growth in employees and suffers when new system entrants slows. K-12 employees have long comprised just over half of all ASRS membership. In percentage terms, very few charter operators participate in ASRS, which means their growth does not offset district losses. Indeed the number of total ASRS active members remains down from 2008 when it was 226,000 to just 208,000 as of June 2019. Between 1980 and 1999, there was a 74% increase in ASRS membership against just 18% growth in membership between 1999 and 2019. Contribution rates for both employees and employers continue to hover well above the "normal" cost of the pension fund despite years of strong markets as the fund recovers from multiple recessions in the 2000s which created significant unfunded liabilities. A lack of growth in ASRS membership contributes to sustained high contribution rates.

-Sean McCarthy



School Finance Flowchart



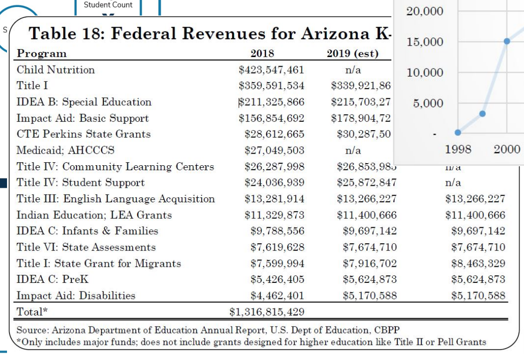


Table 18: Federal Revenues for Arizona K-

Program	2018	2019 (est)	
Child Nutrition	$423,547,461	n/a	
Title I	$359,591,534	$339,921,86	
IDEA B: Special Education	$211,325,866	$215,703,27	
Impact Aid: Basic Support	$156,854,692	$178,904,72	
CTE Perkins State Grants	$28,612,665	$30,287,50	
Medicaid; AHCCCS	$27,049,503	n/a	
Title IV: Community Learning Centers	$26,287,998	$26,853,98	n/a
Title IV: Student Support	$24,036,939	$25,872,847	n/a
Title III: English Language Acquisition	$13,281,914	$13,266,227	$13,266,227
Indian Education; LEA Grants	$11,329,873	$11,400,666	$11,400,666
IDEA C: Infants & Families	$9,788,556	$9,697,142	$9,697,142
Title VI: State Assessments	$7,619,628	$7,674,710	$7,674,710
Title I: State Grant for Migrants	$7,599,994	$7,916,702	$8,463,329
IDEA C: PreK	$5,426,405	$5,624,873	$5,624,873
Impact Aid: Disabilities	$4,462,401	$5,170,588	$5,170,588
Total*	$1,316,815,429		

Source: Arizona Department of Education Annual Report, U.S. Dept of Education, CBPP
*Only includes major funds; does not include grants designed for higher education like Title II or Pell Grants

Figure 14: STO Scholarships 1998-2017

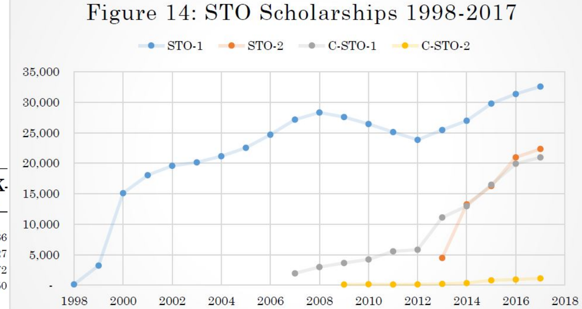


Figure 8: K-12 Capital Expenditures

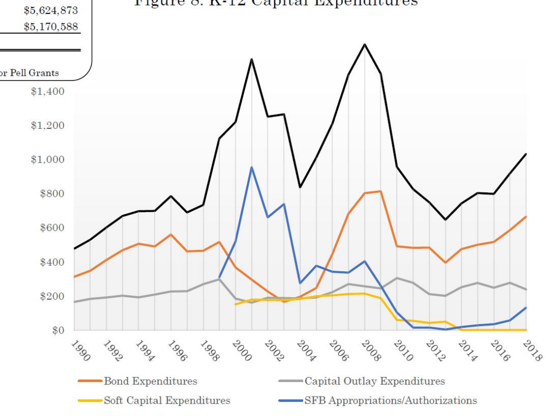


Table 5: State Aid Comparison (FY 2020)

	Tempe Elementary	Glendale Elementary	Glendale as a % of Tempe Value
ADM	12,693	12,905	101.7%
Equalization Base	$67,699,550	$66,484,784	98.2%
Value of Taxable Property	$1,725,055,671	$316,914,429	18.4%
Elementary QTR	$1.8954	$1.8954	100.0%
QTR Levy	$32,696,705	$6,006,796	18.4%
Equalization Assistance	$35,002,845	$60,477,988	172.8%
District's Primary Property Tax	$2.6993	$2.0258	75.0%

Source: Districts' adopted FY 2020 expenditure budgets and worksheets