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ARIZONA TAX RESEARCH ASSOCIATION

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Legislature Passes Historic Tax Package

The Legislature passed the state budget and adjourned Sine Die on June 30th, just in time to start the new fiscal year. The session was highlighted by the Legislature's passage of a tax package that will eventually provide for a flat income tax rate of 2.5% and protect small businesses from the negative impacts of Prop 208. The package also included ATRA's top legislative priority this session to reduce the property tax burden on Arizona businesses. All told, it may amount to the most significant tax law changes in Arizona history.

There were many obstacles to getting the tax package to the finish line. With the unexpected growth in tax revenues despite the pandemic, negotiations were bogged down with how much to cut and how much to spend. In the final days of session, the Legislature was successful in passing a massive tax package and a balanced budget that provides benefits to all.

Property Tax – Class 1 assessment ratio reductions

Arizona's property tax system shifts taxes among nine different classes of property through the use of assessment ratios. With an 18% assessment ratio, the tax burden on class 1 (business) property is 80% higher than the 10% assessed on class 3 (residential) property. With its high assessment ratio, the tax burden on Arizona businesses ranks in the top ten across the country and is at a competitive disadvantage particularly with our neighboring states.

Historic Tax Package Continues on Page 2

2021 Legislative Wrap-Up

Though the 2021 legislative session at times felt interminable, it proved to be very productive for taxpayers and a resounding success for ATRA. All pieces of the ATRA Legislative Program ultimately became law save one and ATRA's signature legislative goal on the tax front in reducing class one property tax assessment ratios was included in the tax package.

ATRA's Legislative Program included nine bills, eight of which ultimately became law. Updates on these bills were provided in the ATRA March Newsletter. One minor change is the ATRA bill SB1076 on audit transparency became HB2906 and had an unrelated amendment added to it, but the reforms in SB1076 were fully included in the final version.

The tax package and the reduction of Class One assessment ratios is covered in the adjoining article in this newsletter. The remainder of the

See 2021 Leg Wrap-Up, Page 3

Mark Your Calendars!

ATRA Golf Tournament
Nov 5, 12pm, Stonecreek
ATRA Outlook Conference:
Nov 18 @ 8:00am, Scottsdale Hilton

For decades, ATRA has argued that the best approach to addressing Arizona’s competitive disadvantage is to reduce the assessment ratio on all business property rather than provide rifle-shot tax breaks to a select few. That consistent message resonated once again in this year’s tax package.

The initial proposal (SB1108) would have reduced the assessment ratio on business property from 18% to 17% over two years. Key lawmakers involved in crafting the final package, however, believed more was needed to be impactful. Effective beginning tax year (TY) 2022, the assessment ratio on class 1 property is reduced from 18% to 16% in half-percent increments over four years. Although the class 1 reduction is spread over multiple years, lawmakers front-loaded the increase in the state general fund homeowner rebate subsidy from the current 47.19% to 50% in the first year.

Additionally, the Legislature provided rate relief for fire districts who currently levy the maximum \$3.25 tax rate cap. In TY 2022, the tax rate cap is increased to \$3.375, and again to \$3.50 in TY 2023.

Income Tax Cuts/Reforms

The tax package provides major relief for individual income taxpayers and for small businesses exposed to the top marginal tax rate of 8% due to Prop 208’s 3.5% surcharge.

Passed by the voters in November 2020, Prop 208 imposes a 3.5% surcharge on individual income tax filers with income exceeding \$250,000 if single, and \$500,000 for married filing joint returns. Small businesses, however, also file under the individual income tax system and were left exposed to a top marginal tax rate of 8%. With a 4.9% flat rate on corporate income taxpayers, small businesses were left at a comparative disadvantage.

Mitigating the damaging impacts of Prop 208 on small businesses and providing tax cuts to all individuals was Governor Ducey and legislative leadership’s top goal.

Beginning in TY 2022, the first round of income tax cuts become effective and the income tax brackets are reduced from four to two tiers. The high marginal tax rate (without the 3.5% Prop 208 surcharge) is dropped from 4.5% to 2.98% for taxable income \$27,273/\$54,545 and over. The bottom marginal rate is decreased from 2.59% to 2.55% for taxable income below these amounts.

Some lawmakers had concerns with adopting a flat tax without certainty in state revenue growth. Therefore, final negotiations resulted in the creation of specific revenue thresholds before further rate reductions could be

Current tax rates: Tax Year 2021	
Single filers	
Taxable Income	Tax is:
\$0 - \$26,500	2.59% of taxable income
\$26,501 - \$53,000	\$686, plus 3.34% over \$26,500
\$53,001 - \$159,000	\$1571, plus 4.17% over \$53,000
\$159,001 and over	\$5,991, plus 4.5% over \$159,000
Married filing joint	
Taxable Income	Tax is:
\$0 - \$53,000	2.59% of taxable income
\$53,001 - \$106,000	\$1,373, plus 3.34% over \$53,000
\$106,001 - \$318,000	\$3,143, plus 4.17% over \$106,000
\$318,001 and over	\$11,983, plus 4.5% over \$318,000

Tax Year 2022	
Single filers	
Taxable Income	Tax is:
\$0 - \$27,272	2.55% of taxable income
\$27,273 and over	\$695, plus 2.98% over \$27,272
Married filing joint	
Taxable Income	Tax is:
\$0 - \$54,544	2.55% of taxable income
\$54,545 and over	\$1,391, plus 2.98% over \$54,544
↓	
Revenue trigger: > \$12,782,800, but < \$12,976,300	
Single filers	
Taxable Income	Tax is:
\$0 - \$27,272	2.53% of taxable income
\$27,273 and over	\$690, plus 2.75% over \$27,272
Married filing joint	
Taxable Income	Tax is:
\$0 - \$54,544	2.53% of taxable income
\$54,545 and over	\$1,380, plus 2.75% over \$54,544
↓	
Revenue trigger: ? \$12,976,300 = 2.5% flat tax rate	

triggered.

If state general fund ongoing revenues exceed \$12.78b but are less than \$12.98b, the top tax rate drops to 2.75% and the bottom rate to 2.53%. If and when state general fund revenues exceed \$12.98b, a 2.5% flat tax rate is activated for all filers.

To allow small businesses to remain competitive, SB1827 limits the maximum income tax rate to 4.5% when combined with the 3.5% Prop 208 surcharge. Prop 208 is made whole since 3.5% of the total is paid to Prop 208 and the remaining 1% is deposited into the state general fund.

In a separate bill (SB1783), pass-through business entities have an alternate option to report their Arizona income taxes under the Arizona Small Business Income Tax (ASBIT) instead of the individual income tax. Opting into this new entity-level tax eliminates the Prop 208 surcharge exposure

Arizona Small Business Income Tax (ASBIT)	
Tax Year	Tax Rate
2021	3.5%
2022	3.0%
2023	2.8%
2024	2.8%
2025	2.5%

on these businesses. The initial tax rate is set at 3.5% in TY 2021, and is reduced incrementally over four years to 2.5% in tax year 2025.

2021 Leg Wrap-Up, Continued from Page 1

Status of ATRA Bills		
HB2906	governance; audits; training (Hoffman) <i>local gov't audit portion</i>	Ready for Governor
SB1108	tax omnibus (Mesnard)	Included in SB1828, Ch. 411
SB1164/HB2018	schools; audits; financial records; budgets (Boyer/Udall)	Chapter 7
SB1449	schools; state aid; adjustment (Kerr)	Chapter 156
SB1659	fire district annual budget; summary (Leach)	Chapter 158
HB2112	truth in taxation; press releases (Bolick)	Chapter 98
HB2114/SB1350	income tax; returns; filing extension (Bolick/Leach)	Chapter 178
HB2211	TPT; prime contracting; exemptions; certificates (Cobb)	Held House WM
HB2391	county property tax information; worksheet (Kaiser)	Chapter 109

ATRA bills were largely unchanged from the March update. The remainder of this update will be on the status of other legislation ATRA tracked. For other Good Bills which ATRA supported, eleven of thirteen ultimately were signed into law. Below are summaries on those that have updated since March.

Other Good Bills ATRA Supported		
SB1105	ballot measures; 200-word description (Mesnard)	Chapter 345
SB1297	S/E: income tax filing extension; 2020 (Bolick)	Chapter 177
SB1603	appropriation; refunds; Transwestern Pipeline litigation (Gowan)	Included in SB1823, Ch. 408
SB1643	attorney fees; costs; recovery (Leach)	Held Senate 3rd Rd
SB1734	agricultural property; reclassification; notice (Kerr)	Chapter 151
SB1752	conformity; internal revenue code (Leach)	Chapter 232
HB2268	schools; total compensation statements (Grantham)	Chapter 260
HB2316/SB1111	centrally assessed property; valuation; pipelines (Toma/Mesnard)	Chapter 26
HB2442	county treasurers; reports; posting; website (Nutt)	Chapter 113
HB2430	publicity pamphlet; submittal dates (Bolick)	Held Sen Gov
HB2879	S/E: DOR; administrative rulings; procedures (Toma)	Chapter 342
HB2898	K-12 BRB; <i>specifically the SFB reform provisions</i> (Fann)	Chapter 404

SB1105 ballot measures; 200-word description (Mesnard) The length of the description of a proposed ballot initiative and referendum on the official circulated petition is changed to allow a 200-word description from a 100-word description. Voter initiatives are becoming increasingly complex and a challenge to the description in Prop 208 failed in the courts because proponents could rely on the argument that they were limited to just a 100-word description, ergo the description could leave out key features of the proposed law. Signatories should have the benefit of a more complete explanation of the key provisions of a measure before they agree to sign in support. *Chapter 345.*

SB1603 appropriation; refunds; Transwestern Pipeline litigation (Gowan) After years of litigation over property valuations for a large Arizona pipeline, the State has finally conceded its methods for valuing the property were not in accordance with the law. The impacted jurisdictions owe approximately \$17 million back to the plaintiff. Given this was Centrally Valued Property administered by the Department of Revenue and the impact was felt across many rural jurisdictions, it made sense for the State to hold these districts harmless by paying them for the cost of the tax refund. The bill was ultimately included in the budget in SB1823, the feed bill, as an appropriation to the Department of Administration to give to the impacted subdivisions. It includes procedures to ensure correct amounts are dispersed and that taxpayers get recognition for the payments and are not double taxed. *SB1823 passed with the state budget.*

SB1752 conformity; internal revenue code (Leach) SB1752 enacted full conformity to the federal internal revenue code (IRC) in effect on January 1, 2021, including provisions that became effective during 2020 such as the Families First Coronavirus Response Act, the Coronavirus Aid, Relief, and Economic Security Act, the Paycheck Protection Program Flexibility Act of 2020, and the Consolidated Appropriations Act, 2021. ATRA supports conformity to IRC each year as Arizona conforms its personal income tax to the federal system with annual legislation. This year, conformity was not merely a formality given the significant federal changes in response to the pandemic. Specific conformity provisions include the temporary removal of the 80% limit on net operating losses and a five-year carryback for losses incurred in 2018 through 2020. Additionally, the \$250k and \$500k limit on losses by pass-through businesses was removed for tax years 2018 through 2020. While those two provisions caused the greatest reduction in state income taxes owed, there were several other smaller provisions. All told, the net reduction in state revenues as scored by JLBC is an estimated \$625 million. Senator Leach deserves special recognition for his leadership on this difficult issue. *The bill passed unanimously, Chapter 232.*

HB2268 schools; total compensation statements (Grantham) All school districts and charter schools will provide all employees a statement which explains the total value of all pay and benefits, to include the value of healthcare and retirement benefits. The value of a defined benefit contribution plan is not always appreciated by new and young employees and should be fully understood. *The bill passed unanimously, Chapter 260.*

HB2898 K-12 BRB; Specifically the SFB Reform Provisions (Fann) Originally HB2555, the K-12 budget reconciliation bill included the House engrossed version of the School Facilities Board (SFB) reform. The primary thrust of the reform is to place the agency within the Department of Administration as the Division of School Facilities. The oversight board will set policies and procedures and manage new school construction approvals while the division itself will manage the Building Renewal Grant (BRG) program. The oversight board is reduced from nine to seven members and calls for two members who have construction experience but whose business does not include education. SFB is allowed to use BRG funds to procure assessments before a grant is awarded. SFB will brief the Joint Committee on Capital Review (JCCR) once per year on the use of all funds and activity.

Placing SFB within ADOA should help professionalize the agency and improve its operations with access to the robust tools of a large department. Moving authority over BRG approvals to ADOA while leaving policy development with the oversight board should balance speed and efficiency with standardization and accountability. *Chapter 404.*

Bad Bills

Since the March ATRA Newsletter there have only been two updates on Bad Bills, HB2555 and HB2455. The remainder are unchanged from the last summary. Zero ATRA Bad Bills passed the Legislature this year, a solid accomplishment considering the length of the session and the amount of legislation passed.

Bills ATRA Opposed		
SB1101/HB2161	tourism marketing authorities (Pace/Kaiser)	Held in Senate
SB1294	S/E: community college; expenditure limitation (Shope)	Held in House
SB1309	property classification; gasoline manufacturing equipment (Shope)	Held Sen FIN
SB1721	TPT; prime contracting classifications (Fann)	Held Sen COW
HB2455	S/E: county recreation improvement district	Held Sen FIN
HB2555	SFB; department of administration (Udall)	Failed Senate 3rd Rd
HB2802	ambulance services; service areas (Burges)	Disc./Held House HHS
HB2834	economic development; project certification (Dunn)	Failed House COM

HB2455 S/E: county recreation improvement districts Under current statute, a county improvement district is a tax-levying district that is governed by the county board of supervisors (BOS). The strike everything to HB2455 would have changed the governance of a District to a three to five-member board of directors that would originally be appointed by the BOS and subsequently elected to serve four-year terms. The powers of the District were expanded to improve and maintain levees and other structures, maintain adequate water levels in the District, and to provide personnel for the safe use and enjoyment of District property for members and their authorized guests. According to Navajo County officials, the legislation was intended for the White Mountain Lake County Recreation Improvement District seeking local control. ATRA was mainly opposed to the expansion of the powers of the District and agreed to work with Navajo County over the interim.

HB2555 SFB; department of administration (Udall) Originally a Good Bill that ATRA had spent considerable time working on, HB2555 was amended in Senate Appropriations to completely eliminate the independent oversight board for the School Facilities Board (SFB) and simply make the agency a division in the Department of Administration. ATRA opposed this bill as amended because removing the oversight board would remove the need for public meetings, which removes the accountability that comes with public explanations of important policy and spending decisions. It also removes the ability of the public and school districts to address concerns and seek redress on agency decisions in a public manner. The balance of power would be shifted too far towards the executive branch. SFB was created with public meetings to shine a bright light on the important issue of school capital finance and burying it in a state agency would be a step too far in the wrong direction. See HB2898 for the version ATRA ultimately supported. *HB2555 failed Senate Third Read.*

Monitored Bills

SB1411 unemployment insurance (Fann) Changes to the state's unemployment insurance (UI) program ultimately became a part of budget negotiations and were included in the tax omnibus bill, SB1828. Beginning in CY 2023, the first \$8,000 in wages are subject to the UI tax, from \$7,000 and the maximum weekly benefit is increased from \$240 to \$320. The amount of weekly income a person collecting UI may earn before their benefit begins to decline by a corresponding amount, called earnings disregard, is increased from \$30 to \$160 per week in FY23. As part of an effort to shore up the UI trust fund, which was heavily depleted during the pandemic, the State is adding \$62m to the fund from the General Fund. In addition, the State is electing to use \$70m of Coronavirus Relief Funds and \$766.9m in American Rescue Plan (ARPA) funds to prevent tax increases on businesses who would otherwise pay higher rates when the fund balance is low. *Statutory changes passed in SB1828.*

SB1453 NOW: four-year degrees; community colleges (Boyer) SB1453 allows community college districts to offer four-year degree programs. In the first year of offering four-year degrees, Pima and Maricopa are limited to no more than 5% of their total offerings. After four years, that is increased to 10%. In those counties, tuition is limited to 150% of the resident per credit hour charge. Degree programs must be regionally accredited. A workforce need in the state and demand must be demonstrated. The college must show the program does not unnecessarily duplicate an offering by other higher education institutions in the state. A state university in the same county as a college with a new four-year program offering must be notified and may submit in writing their position on the new program to the governing board.

Though there has been some historical concern with community colleges putting the cost of undergraduate programs on the property tax, recent history has demonstrated colleges must balance their appetite for additional taxes. Furthermore, colleges have constitutional levy limitations which have proven to work as a suitable governor. ATRA successfully sought an amendment to ensure that out-of-county tuition charged to counties without a college district will not factor expenses from students in 300 and 400 level classes. *Chapter 315.*

HB2321 NOW: qualified facilities (Toma) Under the current Qualified Facility tax credit program, applicants that invest less than \$2 billion qualify for a refundable income tax credit that is the lesser of 10% of the qualifying capital investment or \$200,000 for each net new full-time employment position created. HB2321 expands the program for applicants that invest \$2 billion or more to a refundable income tax credit of 10% of the investment or \$300,000 for each net new full-time employment position. The law increases the total income tax credit cap that can be approved each calendar year from \$70 million to \$125 million. Existing law also requires the State Treasurer

pay state prime contracting revenues generated from a qualifying manufacturing project to a municipality or county to fund up to 80% of the public infrastructure costs associated with the project. HB2321 extends that policy from the current sunset date of September 30, 2023 through September 1, 2033. *Chapter 80.*

HB2373 expenditure limitation; community colleges (Dunn) With SB1294 failing to advance, HB2373 was amended to provide temporary relief to community college districts on expenditure limit (EL) penalties in FY 2022 alone. There are no statutory changes; the session law provides for a lesser fine of \$5,000 if the district exceeds its EL in FY22 by less than 5%, \$15,000 fine if between 5% and 10%, and \$20,000 if between 10% and 12% over their constitutional EL. If the district is above 12%, the fine is a reduction in state aid as directed by statute. *Awaits action by Governor.*

HB2835 theme park districts; extension (Cobb) The theme park district law is extended through 2031 from 2020 and modified in several ways. The bill was primarily advanced by the Arizona Diamondbacks in an effort to sell municipal bonds to be repaid by the users of the Maricopa County stadium. HB2835 expands districts to any city with more than one million persons or any county with more than 125,000 persons. Sports venues are allowed and it clarifies that while a district may include a hotel, only a district with more than 20 acres or 1 million square feet of improvements may do so. It allows a tax on items in the district to secure bond debt, which may be less than the prescribed 9% rate, but only if the size of the district is the same as above. A hotel must be deeded back to the prime lessee and become subject to *ad valorem* taxes when the bonds are fully paid.

The total amount of bonds which may be sold in all theme park districts statewide is increased from \$1 billion to \$2 billion. A district must be located entirely within one city and must be contiguous. Any user in the district may not relocate until the bonds are terminated. The makeup of the theme park board adds one member of the county Board of Supervisors and removes one city council member from the city establishing the district.

ATRA was neutral on the bill because while the baseline position of the organization is to reject sports franchises leveraging the public, the stadium is already a county-owned asset (and liability) and all the theme park district does is allow the franchise to bundle their own revenues to pay for stadium upgrades through cheaper financing in municipal bonds. *Chapter 298.*

HB2838 income tax; partnerships; S corporations (Chaplik) HB2838 allows non-corporate businesses to elect to be taxed at the entity level. This treats state income taxes on businesses similarly to other business taxes such as property taxes, which would then not be counted as state and local taxes paid by the owners for purposes of the federal \$10,000 State and Local Tax (SALT) deduction cap. Partnerships and S Corporations in Arizona with income above \$150k in the preceding year are eligible. The result is taxpayers could elect to deduct their entire amount of state income taxes resulting from the aforementioned business income from their federal income taxes and not be limited by the SALT cap, which was created by the 2017 Tax Cuts and Jobs Act.

The business entity would owe income taxes at a flat 4.5% rate. The entity receives a credit for taxes paid by the entity or owners in other states. The business owners then add back to their Arizona gross income their pro-rata share of the amounts deducted from their income on their federal income. The business owner(s) receive a pro-rata credit on their personal income tax filing for taxes paid by the entity. The law as amended removes the five year carryforward and retroactivity to tax year 2018. The law is effective beginning January 1, 2022. The measure has no impact on the state general fund because all income taxes are otherwise owed. *Awaits Action by Governor.*