

# **Current Issues in Public Finance**

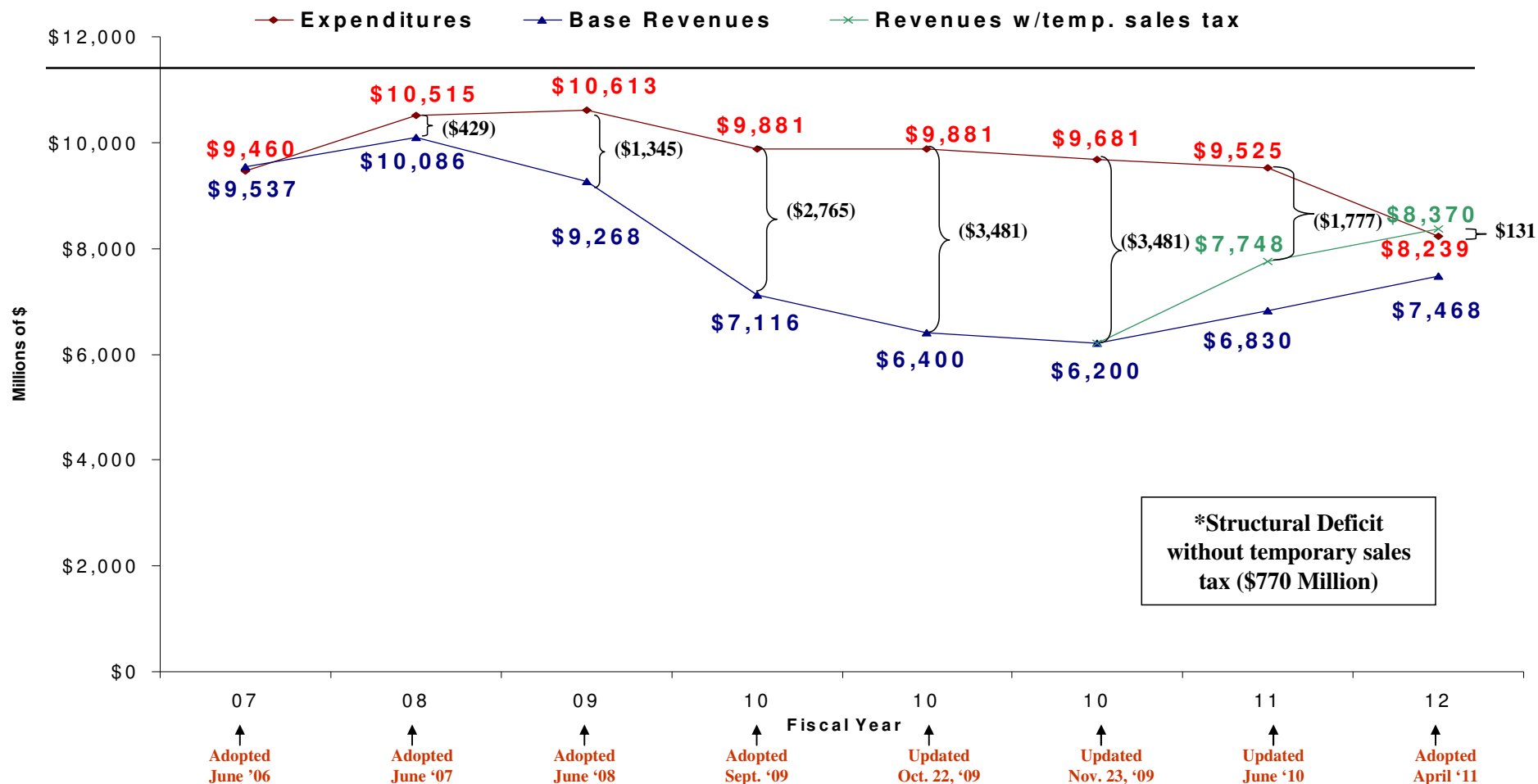
*Kevin McCarthy, ATRA*

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- ***State Fiscal Stability***
- ***Sales Tax Reform***
- ***Instability in the Property Tax System***
- ***Tax Reform & Economic Development***

# FY '12 State Adopted Budget

*Excludes beginning balance, one-time revenues & expenditures*



**\*Structural Deficit  
without temporary sales  
tax (\$770 Million)**

Beg. Balance (in millions): 1.047      529      1      1      1      1      1      (332.3)

\*FY 2008 on-going spending of \$10,515 includes \$370 million in SFB cash financing, as well as \$250 million in K-12 school aid not included in the FY 2010 and FY 2011 budgets.



# State Fiscal Stability

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- ❑ Fiscal stability or a return to budget deficits rests on FY13 state budget decisions.
- ❑ Governor has reiterated that the sales tax was temporary and that it will sunset on June 1, 2013.
- ❑ There appears to be little interest in the Legislature to make the temporary sales tax permanent.
- ❑ To that end, it is imperative that the Legislature and Governor develop a FY13 budget that can be sustained in FY14 without the temporary sales tax.



# What Happens to the Temporary Tax?

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- There is obviously considerable interest in the tax not going away. By all accounts, there are two groups that are considering an initiative for the November 2012 ballot to make the tax permanent.
- Regrettably, unlike the soft earmark of Prop 100, it is anticipated that these initiatives would include hard earmarks of the sales tax - this despite the widespread recognition that such earmarking has done considerable damage to the state's budgeting process.



# Sales Tax Reform

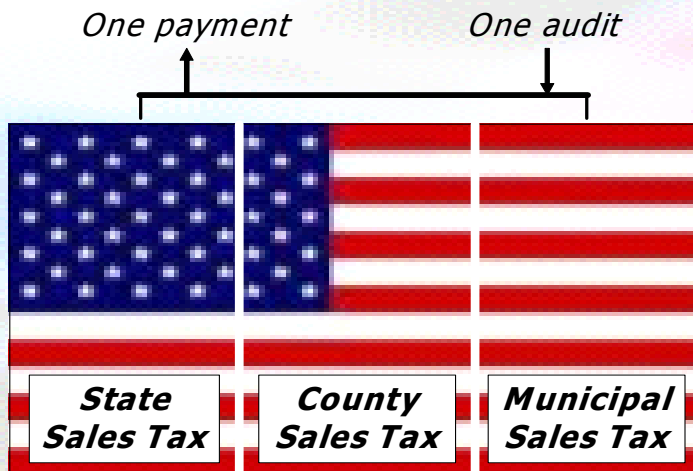
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- Taxpayers shouldn't be asked to agree to a permanent 1-cent increase without reforms.
- The case for reforming Arizona's sales tax system is significant:
  - It is our most important revenue source
  - Arizona's sales tax system is the most complex in the country

# Arizona's Sales Tax Structure vs. Other States

## Most States

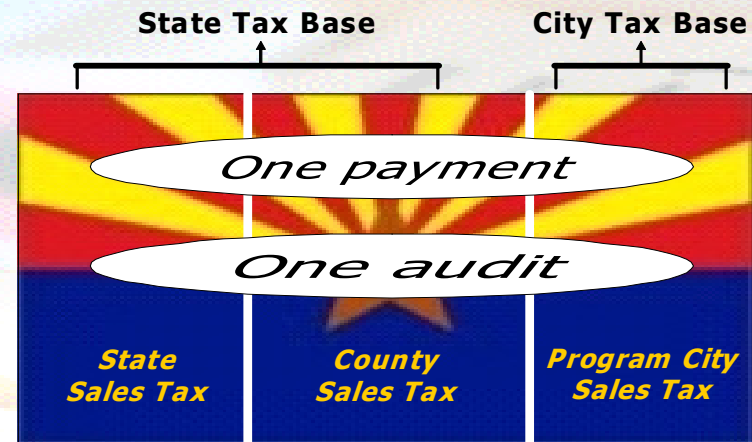
One payment, one audit



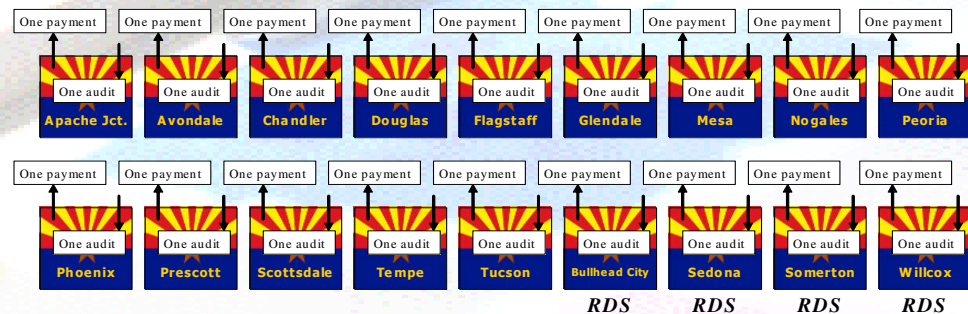
**One uniform sales tax base**

## Arizona

Multiple payments, multiple audits



## Non-Program Cities





# Historical Snapshot of AZ's Tax System

## Average Overall Reliance

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- **Total taxes** – 39<sup>th</sup>/capita & 34<sup>th</sup>/\$1,000 income
- **High sales taxes** – 10<sup>th</sup>/capita & 7<sup>th</sup>/\$1,000 income
- **Avg. property taxes** – 33<sup>rd</sup>/capita & 23<sup>rd</sup>/\$1,000 income
  - High business property taxes – 15<sup>th</sup>
  - Low homeowner property taxes – 42<sup>nd</sup>
- **Low personal income taxes** – 42<sup>nd</sup>/capita & \$1,000 income (44-state comparison)



# Arizona's Three-legged Stool

## 1980-2000-2010

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	1980	2000	2010
<b>Sales</b>	<b>38%</b>	<b>38%</b>	<b>37%</b>
<b>Property</b>	<b>32%</b>	<b>28%</b>	<b>37%</b>
<b>Income</b>	<b>17%</b>	<b>21%</b>	<b>14%</b>





# National Rankings

## *Total State & Local Taxes*

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Total Tax Collections - State and Local FY 2009				
	Per Capita		Per \$1,000 of Income	
	Amount	Rank	Amount	Rank
Arizona	\$3,130.09	46	\$93.17	39
<i>Arizona adj.</i>	<i>\$3,284.78</i>	<i>39</i>	<i>\$97.78</i>	<i>34</i>
U.S. Average	\$4,141.14		\$103.66	



# National Rankings

## *Total State & Local General Sales Taxes*

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General Sales Tax Collections - State and Local FY 2009				
	Per Capita		Per \$1,000 of Income	
	Amount	Rank	Amount	Rank
Arizona	\$1,122.68	12	\$33.42	9
<i>Arizona adj.</i>	<i>\$1,229.27</i>	<i>10</i>	<i>\$36.59</i>	<i>7</i>
46-state avg. + D.C.	\$970.16		\$24.26	



# Average Sales Tax Rates

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## 1980 - Retail

- State Rate = 4%
- Avg. City Rate = 1.2%
- **Total Avg. Rate = 5.2%**

## 1990 - Retail

- State Rate = 5%
- Avg. City Rate = 1.6%
- Avg. County Rate = 0.5%
- **Total Avg. Rate = 7.1%**

## 2011 - Retail

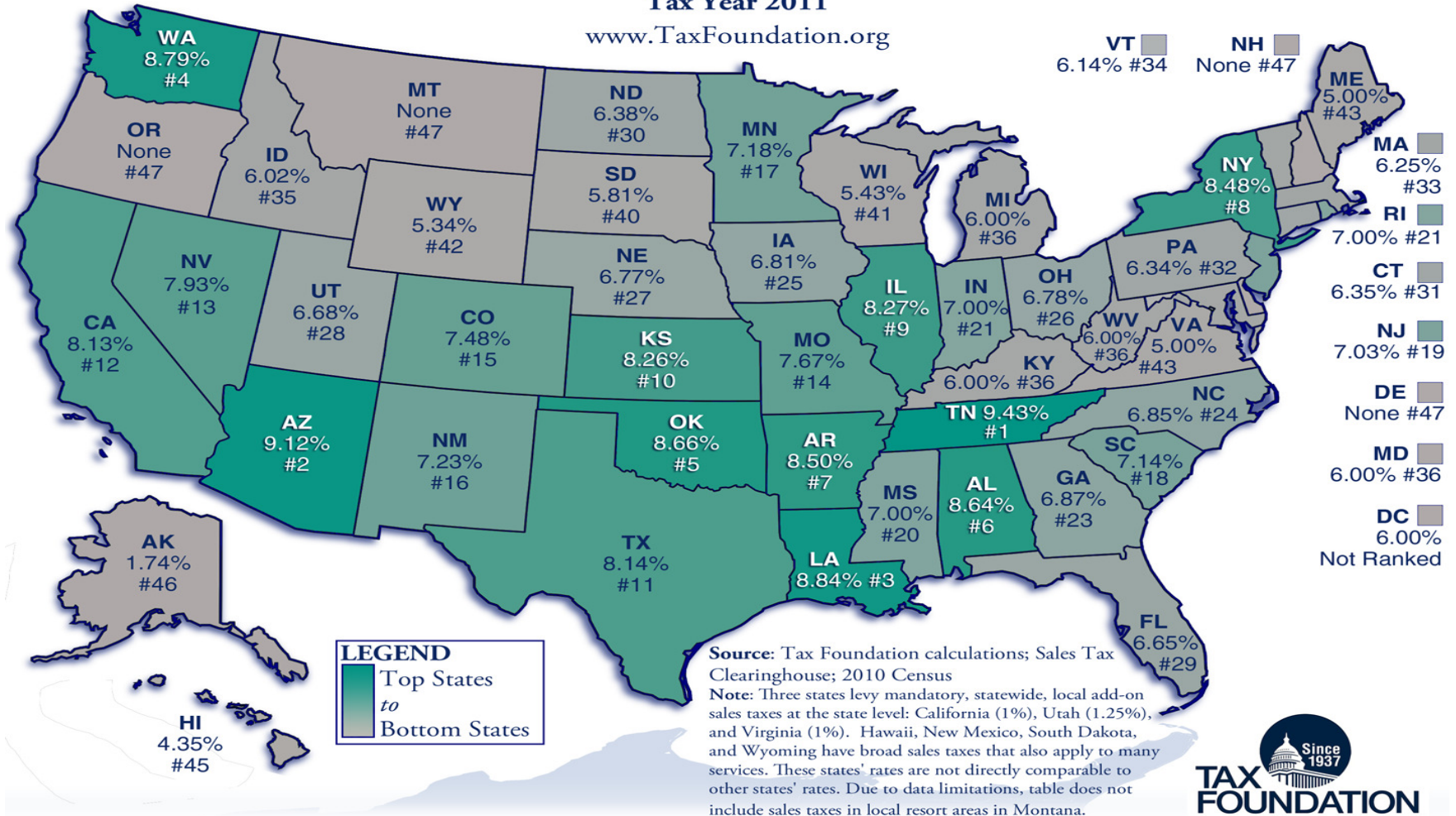
- State Rate = 6.6%
- Avg. City Rate = 2.5%
- Avg. County Rate = 0.7%
- **Total Avg. Rate = 9.8%**

# Tax Foundation Sales Tax Rate Study - AZ Ranks 2<sup>nd</sup>

## Sales Tax: Combined State and Average Local Rates

Tax Year 2011

www.TaxFoundation.org



Arizona Tax Research Association

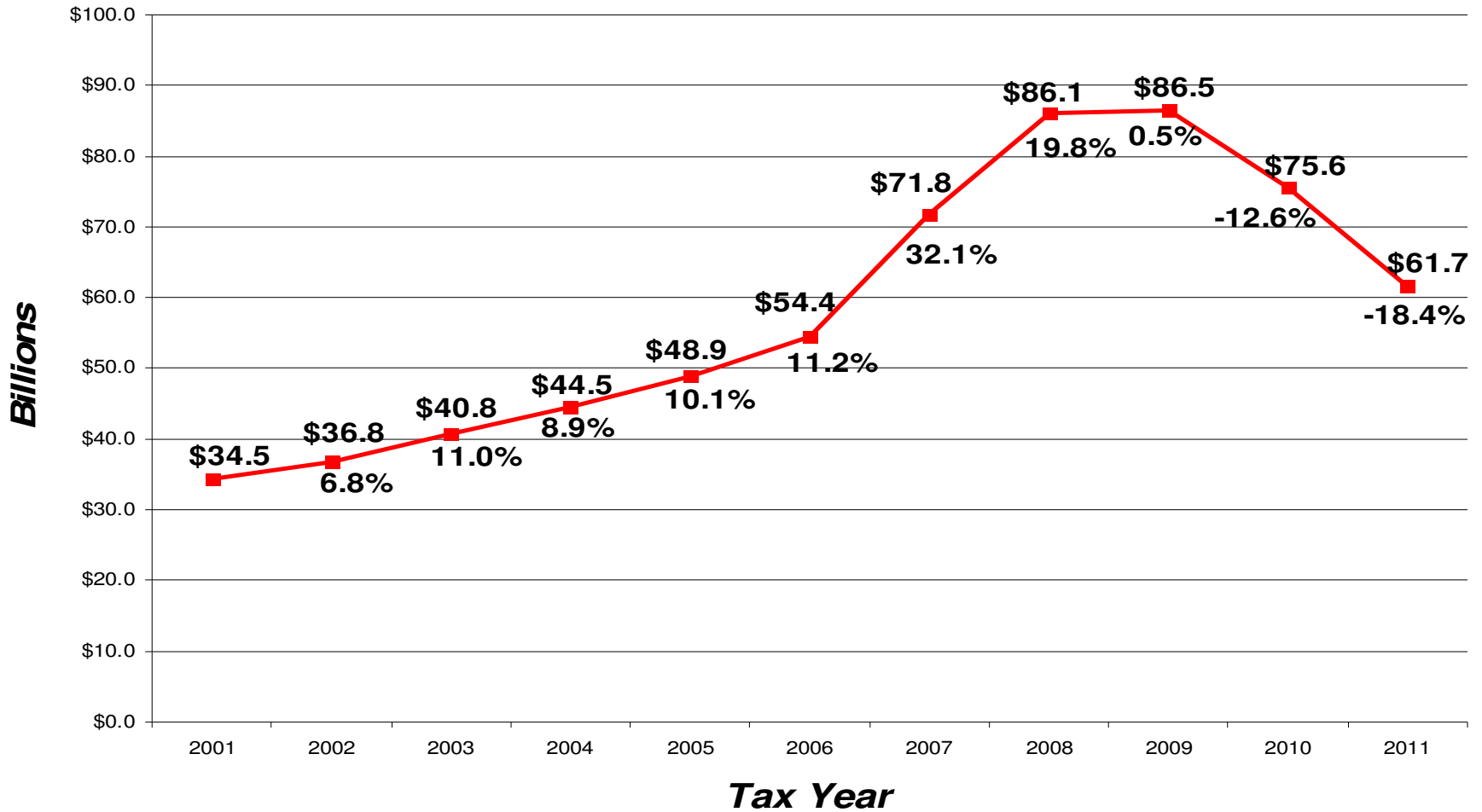


# Instability in the Property Tax System

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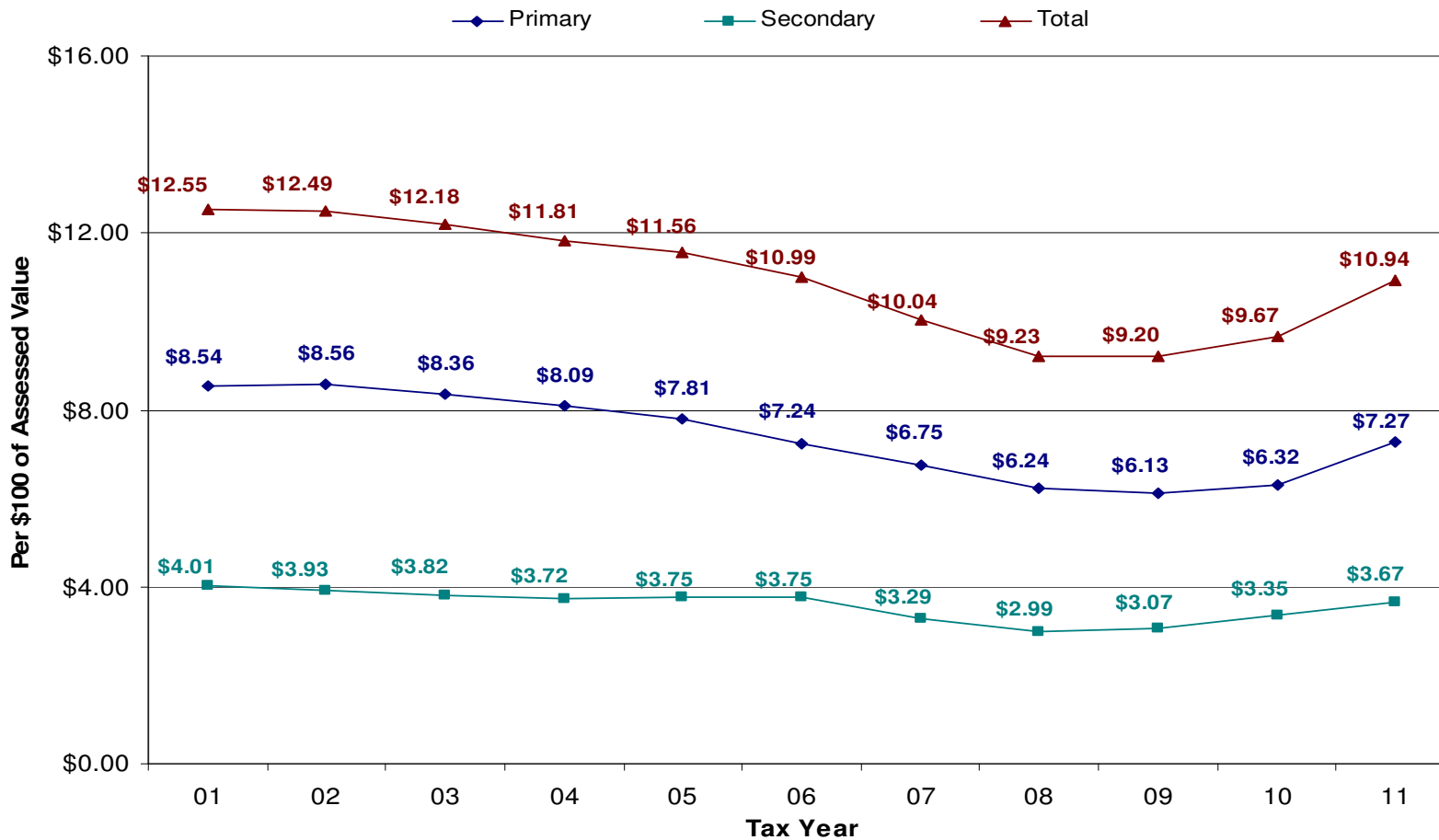
- Boom & Bust of the real estate market in Arizona has caused considerable volatility in Arizona's property tax system.
- 2006 – 2009 SNAV increase was 59.1%.
- 2009 – 2011 SNAV decrease was 28.7%.
- 2006 – 2009 avg. tax rate decrease was 16.3%.
- 2009 – 2011 avg. tax rate increase was 18.9%.

# Secondary NAV, 2001-2011



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# Statewide Average Tax Rate



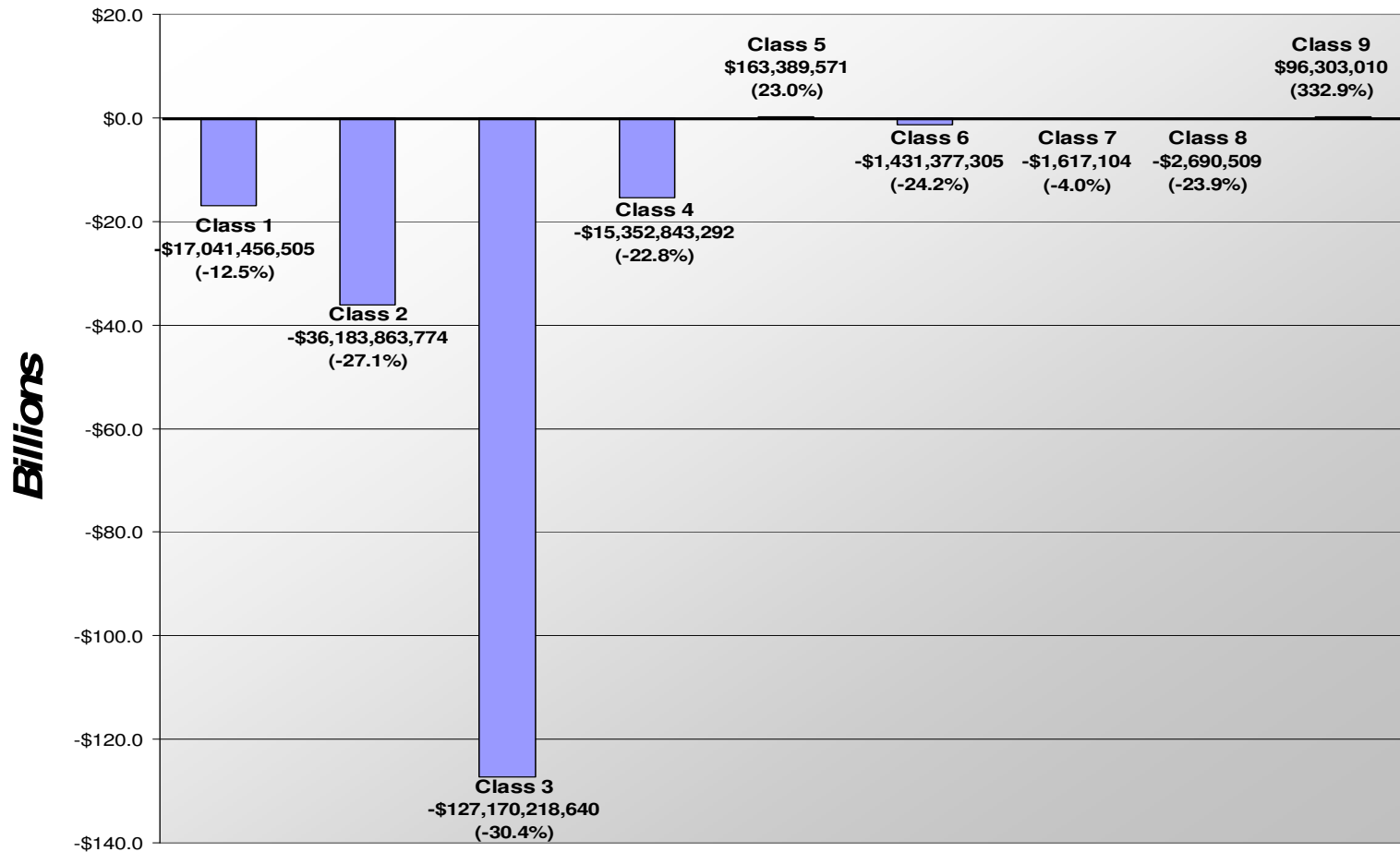
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# FCV Change By Class, 2009-2011

Class	Description	TY 2009	TY 2011	2-year Change	2-year % Change
1	Commercial, Industrial, Utilities, & Mines	\$136,318,330,574	\$119,276,874,069	-\$17,041,456,505	-12.5%
2	Agricultural & Vacant Land	\$133,431,932,497	\$97,248,068,723	-\$36,183,863,774	-27.1%
3	Owner-occupied Residential	\$418,028,320,989	\$290,858,102,349	-\$127,170,218,640	-30.4%
4	Rental Residential	\$67,405,912,775	\$52,053,069,483	-\$15,352,843,292	-22.8%
5	Railroad, Private car, airline flight	\$710,907,428	\$874,296,999	\$163,389,571	23.0%
6	Residential historic, Enterprise zones	\$5,903,340,961	\$4,471,963,656	-\$1,431,377,305	-24.2%
7	Commercial Historic	\$40,844,754	\$39,227,650	-\$1,617,104	-4.0%
8	Rental Residential Historic	\$12,400,708	\$9,440,199	-\$2,960,509	-23.9%
9	Possessory Interests	\$28,928,925	\$125,231,935	\$96,303,010	332.9%
<b>Total</b>		<b>\$761,880,919,611</b>	<b>\$564,956,275,063</b>	<b>-\$196,924,644,548</b>	<b>-25.8%</b>



# FCV Change By Class, 2009-2011





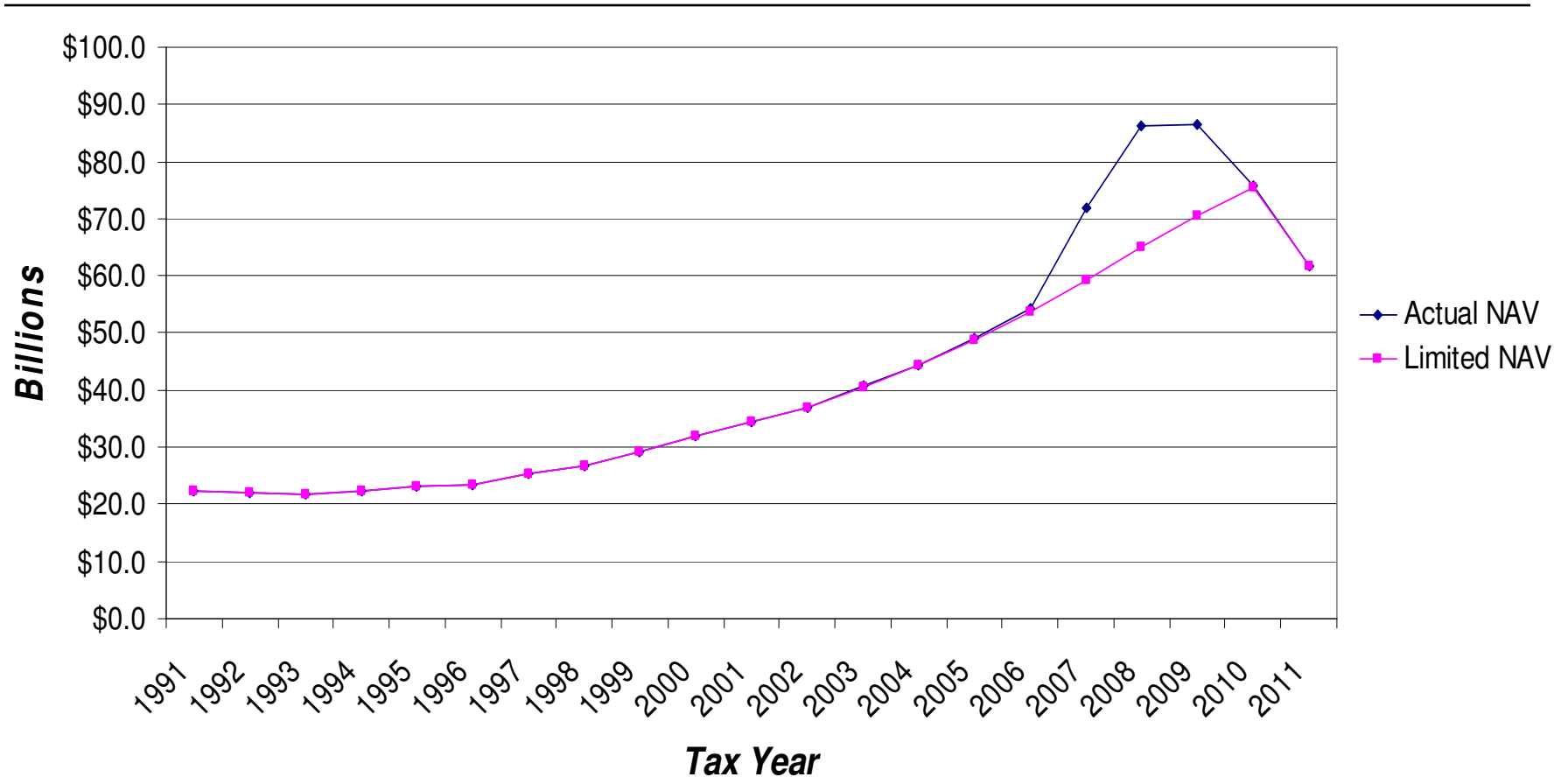
# ATRA 5% Valuation Limitation Proposal

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- Limit the annual growth in both the primary and secondary net assessed valuations to no more than 5%.
- In order to maintain equity between new and existing property, new construction will be enrolled using the current “Rule B” calculation. This means new construction will receive the same value as that of similarly situated properties.
- While primary and secondary values would be the same, the distinction would be maintained for taxing purposes. Note the 1% cap.
- (ATRA position paper on 5% cap in the handout)

# Actual Value Growth vs. 5% Limit Proposal

Actual SNAV Vs. Limited SNAV, 1991-2011





# Tax Reform & Economic Development

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- 2011 session was highlighted by the passage of the Governor's Arizona Competitiveness Package.
- Tax reforms focused on improving areas of Arizona's tax system that were viewed as impediments to economic development and job growth.
- ATRA has advocated for fundamental tax reform and opposed targeted tax incentives designed to side-step problems in the tax system:
  - Reductions in the assessment ratio for business property as well as reductions in the corporate income tax rate.



# Major Tax Reforms in Arizona Competitive Package

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- Class one assessment ratio reductions:
  - 2013 – 19.5%
  - 2014 – 19%
  - 2015 – 18.5%
  - 2016 – 18%
- Corporate income tax rate reductions:
  - 2014 – 6.5%
  - 2015 - 6.0%
  - 2015 – 5.5%
  - 2016 – 4.9%
- Elective sales factor for corporate income tax increased from 80% to 100% by 2017



# Major Tax Reforms in Arizona

## Competitive Package (cont.)

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Accelerated depreciation for locally assessed personal property enhanced another 5% (75% reduction in value the first year):

Assessment Year	Percentage of scheduled depreciated value	
	Current Percentages	Effective Tax Year 2012
1	30%	25%
2	46%	41%
3	62%	57%
4	78%	73%
5	94%	89%
6	DOR Schedule	DOR Schedule



# Update on Arizona Business Property Tax Ranking

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- 2000 – Ranked 3<sup>rd</sup> (class one ratio @ 25%)
- 2007 – Ranked 5<sup>th</sup> (class one ratio @ 24%)
- 2008 – Ranked 10<sup>th</sup> (class one ratio @ 23%)
- 2010 – Ranked 15<sup>th</sup> (class one ratio @ 21%)
- \*Rank 20<sup>th</sup> if we fast forward the class one assessment ratio to 18%



# Estimated Ranking After Applying Accelerated Depreciation to New Personal Property

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- Assessment ratio at 21% - 39<sup>th</sup>
- Assessment ratio at 20% - 40<sup>th</sup>
- Assessment ratio at 19% - 42<sup>nd</sup>
- Assessment ratio at 18% - 44<sup>th</sup>





# Arizona's Corporate Income Tax Rate

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Once one of the highest in the country, Arizona's rate will be competitive among the states that impose a corporate income tax (Ranking improved from 7<sup>th</sup> to 43<sup>rd</sup>):

1990	9.3%
1997	9.0%
1998	8.0%
2000	7.968%
2001	6.968%
2014	6.5%
2015	6.0%
2016	5.5%
2017	4.9%

*Arizona Tax Research Association*



# What are the Implications of Targeted Tax Relief for Economic Development Purposes?

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- ❑ Does it undermine good tax policy?
- ❑ Does each tax break granted stand alone on its merits or does it set a precedent for more?
- ❑ What are the implications of dividing the business community between those receiving preferential treatment and those paying the going rate?