The taxpayer's watchdog for 85 years

ARIZONA TAX RESEARCH ASSOCIATION

NEWSLETTER VOLUME 85 NUMBER 3 APRIL 2025

City Revenues Remain Strong But Cities Continue to Cry Foul

Arizona cities have tucked away billions in state and local tax revenues. As reported in the *ATRA October 2024 Newsletter*, the $9.1 billion in FY 2025 city general fund (GF) budgets included $4.2 billion in cash reserves, nearly 47% of total budgeted expenditures. The robust cash position of cities resulted from the continuous strong tax revenue growth in sales and income taxes. Despite their healthy financial positions, some cities are using recent state legislative actions as an excuse to raise taxes. In particular, the cities point to the personal income tax cut passed in 2021 and the elimination of the tax on residential rents.

State shared revenues

Annually, the state shares over $2 billion that it collects in TPT (sales) and income taxes with cities and towns. In FY 2025, the total amount in sales and income tax revenues distributed to cities and towns was estimated at $915.5 million and $1.27 billion, respectively.

TPT Revenue Sharing

In FY 2025, over $915M in state shared sales taxes will be shared with Arizona's cities and towns based on population. In FY 2026, that amount is expected to grow again to $918 million.

Sales taxes continue to be a strong revenue generator supporting state and local government budgets. The last five years exhibited extraordinary growth, mainly as a

See **Cities**, Page 2

Bill Requiring Developers to Pay School Taxes Vetoed

Governor Hobbs vetoed ATRA's latest attempt to reform the Government Property Lease Excise Tax (GPLET). The Governor vetoed last year's measure that would have reduced the abatement period from 8 to 4 years. This year's measure under SB1050 was revised to maintain the current abatement period but limit the abatement of taxes to all entities except for school districts. Requiring developers to pay their school taxes would have plugged a hole in the "state aid" calculation, saving the state general fund millions in revenue each year. ATRA's pursuit to reform GPLET is in response to two recent major court cases that struck down incentive deals that the court's ruled were in violation of Arizona's Constitutional Gift Clause. Lack of any reform to GPLET to reduce the probability that the "give" doesn't exceed the "get" exposes future deals to potential violations.

GPLET allows a government lessor to shield developers from paying property taxes for 8 years on

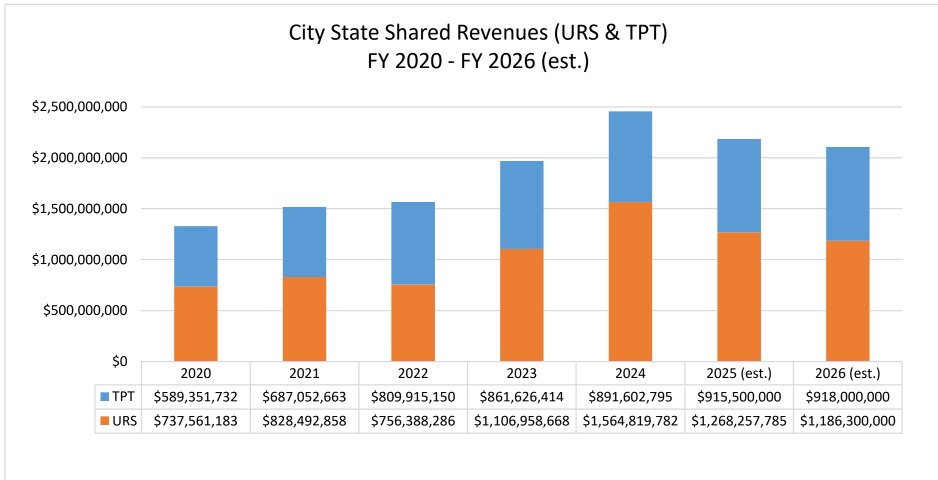
See **GPLET**, Page 8

Cities, *Continued from page 1*

result of the *Wayfair* legislation enacted in 2019 that authorized our state and local jurisdictions to tax the sales transactions of remote sellers in this state. This new authority resulted in a boon for state and local government budgets, as sales tax revenues grew dramatically. Between FY 2020 and FY 2022, sales taxes shared with the cities increased over $220 million, a 37% increase. Over the last five years, sales taxes shared with the cities grew over 55% (11% per year on average), from $589 million in FY 2020 to $915.5 million in FY 2025.

Urban Revenue Sharing (URS)

The largest chunk of state-shared revenues to the cities and towns is generated from the state income tax. The state distributes a portion of its individual and corporate income taxes with cities and towns based on the amounts collected from two years prior. In FY 2025, cities and towns received over $1.26 billion in state shared income taxes based on population.



Corporate income tax collections over the last five years have tripled in growth. However, that extraordinary growth has been offset, at least temporarily, in the reduction in individual income tax collections. Beginning in FY 2023, the individual income tax brackets were reduced from four brackets, with a high marginal rate of 4.54%, to the two brackets of 2.55% & 2.98%. The 2.5% flat income tax rate went into effect beginning in FY 2024. To hold the cities harmless, the Legislature increased the percentage shared with the municipalities from 15% to 18%, effective beginning in the same year.

INCOME TAX RATE CUTS & URS DISTRIBUTION

	FY 2022	FY 2023	FY 2024	FY 2025
TAX RATES	4.54% TOP RATE	2.55%/2.98%	2.5% FLAT RATE	2.5% FLAT RATE
URS %	15%	15%	18%	18%
DISTRIBUTION YEAR	FY 2020	FY 2021	FY 2022	FY 2023

URS distributions to the cities declined initially in FY 2025 by 19%, from $1.56 billion to $1.27 billion (the first year the income brackets were dropped from four to two). In FY 2026, URS is estimated to drop again, but this time by 6.5% to $1.19 billion. Despite this dip in URS, which is likely temporal, cities shouldn't ignore how they benefitted from the 46.3% and 41.4% increases they received in URS in FY 2023 and FY 2024 that downloaded over $800 million more in URS to city coffers. Over the last five years, URS distributions to the cities grew 72%, or 14.4% per year on average.

1980 - Retail	**2024 - Retail**
State Rate = 4%	State Rate = 5.6%
Avg. City Rate = 1.2%	Avg. City Rate = 2.80%
Total Avg. Rate = 5.2%	Avg. County Rate = 0.82%
	Total Avg. Rate = 9.22%

ARIZONA TAX RESEARCH ASSOCIATION
Bill Molina……………………………Chairman
Kevin J. McCarthy……………………President
Jennifer Stielow……………………Vice President
Jack Moody……………………Senior Research Analyst
Kathleen Farnsworth……………………Office Manager

Published by the Arizona Tax Research Association, a nonprofit organization whose purpose is to promote efficient and effective use of tax dollars through sound fiscal policies. Permission to reprint is granted to all publications giving appropriate credit to the Arizona Tax Research Association.

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

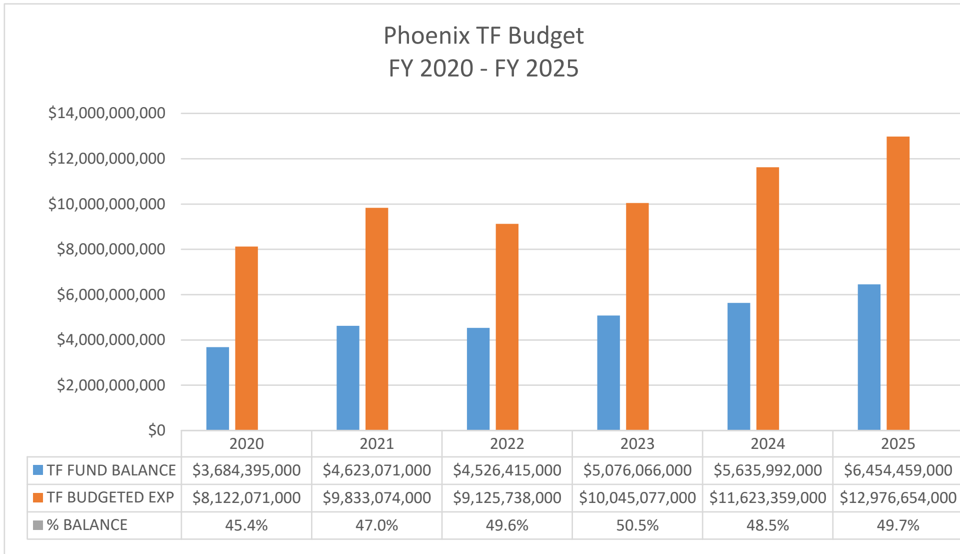
www.arizonatax.org

See **Cities**, Page 3

Cities, *Continued from page 2*

City Sales Tax Increases

In addition to state shared revenues, Arizona's cities rely heavily on local sales taxes, and their reliance has grown significantly over the past few decades. The average city retail sales tax rate has more than doubled since 1980, from 1.2% to the current 2.8%. Including the 5.6% rate levied by the state and the 0.82% average rate levied by counties, the total rate has climbed from 5.2% in 1980 to 9.22% in 2024. The Legislature has not capped city sales tax rates, and unless a city has a charter provision that requires voter approval for tax increases, cities and towns can increase taxes with just a simple majority vote of the council.



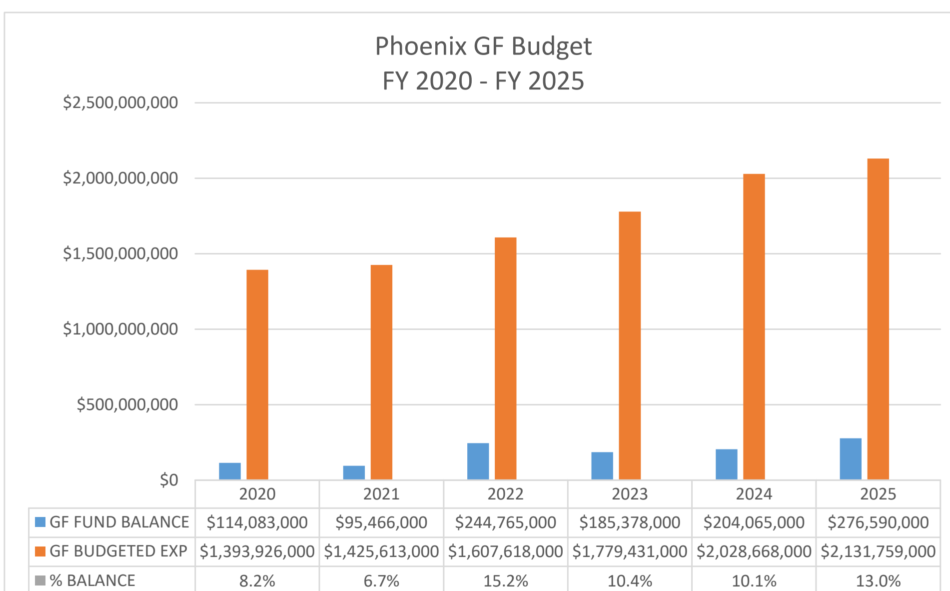
	2020	2021	2022	2023	2024	2025
TF FUND BALANCE	$3,684,395,000	$4,623,071,000	$4,526,415,000	$5,076,066,000	$5,635,992,000	$6,454,459,000
TF BUDGETED EXP	$8,122,071,000	$9,833,074,000	$9,125,738,000	$10,045,077,000	$11,623,359,000	$12,976,654,000
% BALANCE	45.4%	47.0%	49.6%	50.5%	48.5%	49.7%

Over the past year, several cities have proposed to increase sales taxes. While the reasons for the tax increases vary, in nearly every instance, the list of reasons opens with the elimination of the residential rental tax and the reduction in state shared revenue as justification. While these factors may result in a dip in revenues, at least temporarily, the argument ignores the massive amounts of cash the cities have amassed over recent years that should cover any short term impacts.

City of Phoenix

The Phoenix city council recently approved a half-cent increase to its sales tax rate, from 2.3% to 2.8%. In justifying the tax increase, the city referenced revenue losses from residential rents and state shared revenue.

According to the Arizona Department of Revenue's (DOR) FY 2024 annual report, the 2.3% tax rate levied by the City of Phoenix generated $1.4 billion. Based on this data, a half-cent increase in the sales tax rate will



	2020	2021	2022	2023	2024	2025
GF FUND BALANCE	$114,083,000	$95,466,000	$244,765,000	$185,378,000	$204,065,000	$276,590,000
GF BUDGETED EXP	$1,393,926,000	$1,425,613,000	$1,607,618,000	$1,779,431,000	$2,028,668,000	$2,131,759,000
% BALANCE	8.2%	6.7%	15.2%	10.4%	10.1%	13.0%

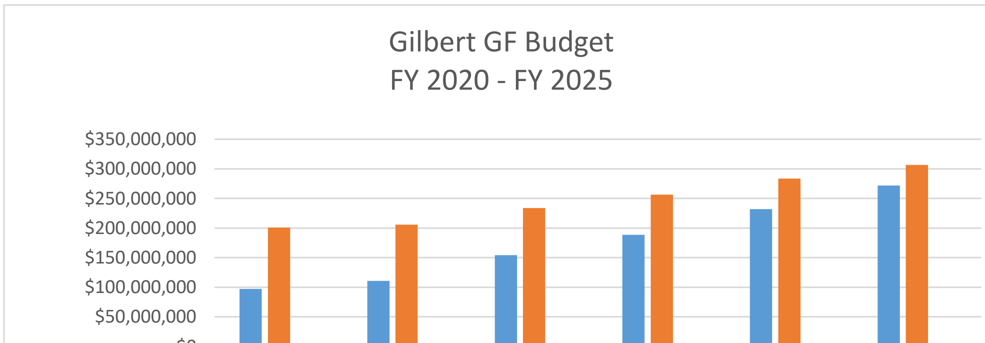
See **Cities**, Page 4

Cities, *Continued from page 3*

generate over $300 million more annually in sales tax revenue to the city.

The tax increase comes despite the fact that Phoenix has significant cash reserves. In its FY 2025 budget, Phoenix showed a general fund (GF) beginning fund balance of $276 million. The GF fund balance represents 13% of the $2.1 billion in budgeted expenditures; however, the city's $12.98 billion total funds (TF) budget carries a fund balance of $6.5 billion, which represents nearly 50% of total budgeted expenditures. The $6.5 billion TF fund balance designates $3.1 billion as the "Reappropriation Funds" fund balance, which the city describes as budgeted amounts rolled over from the prior fiscal year that remain unexpended.

Over the past five years, the Phoenix GF budget has increased 53%, representing a 10.5% average annual increase. At the same time, the City's GF balance has grown 140%, a 28% average annual increase. TF budgeted expenditures have grown 60% over the last five years and the TF fund balance increased 75%, averaging a 15% increase each year.

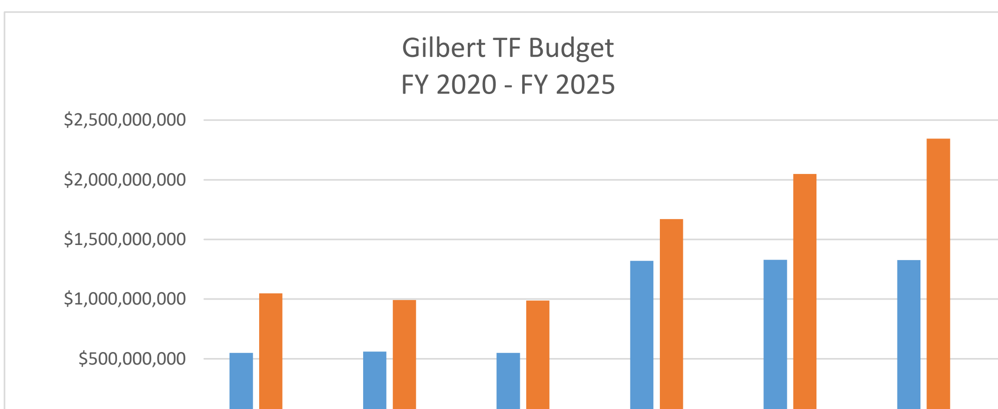


	2020	2021	2022	2023	2024	2025
GF FUND BALANCE	$97,156,431	$110,937,877	$154,154,285	$188,864,821	$231,946,766	$272,059,928
GF BUDGETED EXP	$200,894,365	$205,888,720	$234,085,690	$256,369,370	$283,886,960	$306,679,270
% BALANCE	48.4%	53.9%	65.9%	73.7%	81.7%	88.7%

According to Phoenix, loss of the residential rental tax will have an $85.5 million annual impact. DOR estimates that the FY 2026 URS to Phoenix is dropping $22.7 million (6.5%) to $328.3 million. However, over the past five years, URS to the City has increased $113.6 million, or 47%.

Town of Gilbert

Last fall, the Gilbert Town Council approved a half-cent sales tax rate increase, from 1.5% to 2%. At the same time, the Council enacted a 2% use tax and increased its bed tax rate from 2.8% to 5%. Based on the DOR FY 2024 annual report, over $157 million was collected in sales taxes. With the increased sales tax rate, the Town is anticipating to collect approximately $55 million more each year, pushing the annual



	2020	2021	2022	2023	2024	2025
TF FUND BALANCE	$548,690,920	$560,205,529	$550,159,464	$1,321,552,404	$1,329,612,972	$1,327,896,353
TF BUDGETED EXP	$1,048,945,125	$992,839,910	$988,252,510	$1,670,841,740	$2,049,501,300	$2,344,218,800
% BALANCE	52.3%	56.4%	55.7%	79.1%	64.9%	56.6%

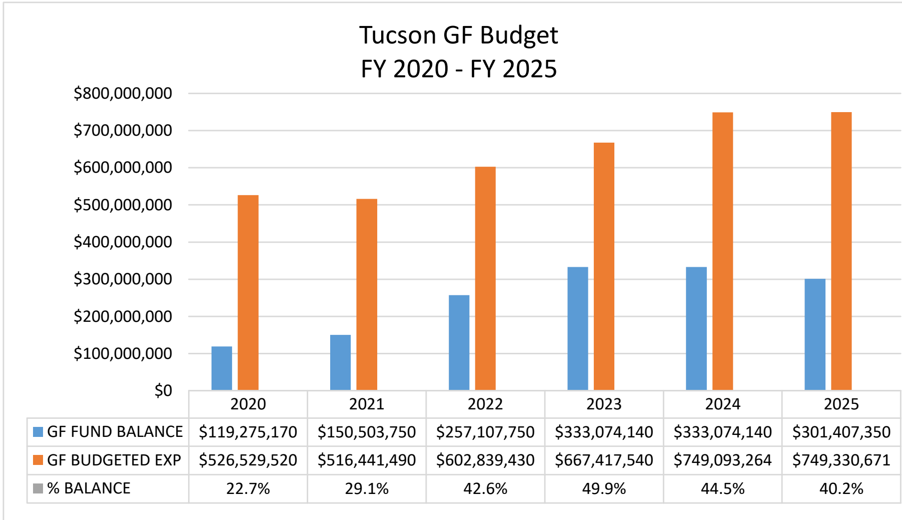
See **Cities**, Page 5

Cities, *Continued from page 4*

collections to over $210 million.

The Town of Gilbert's GF Budget of $307 million carries a significant fund balance of $272 million, nearly 90% of budgeted expenditures. Gilbert's TF budgeted expenditures of $2.3 billion includes a fund balance of $1.3 billion, 56.6% of budgeted expenditures. The TF balance designates $122 million for financial stability, $64.7 million of which is in the GF.

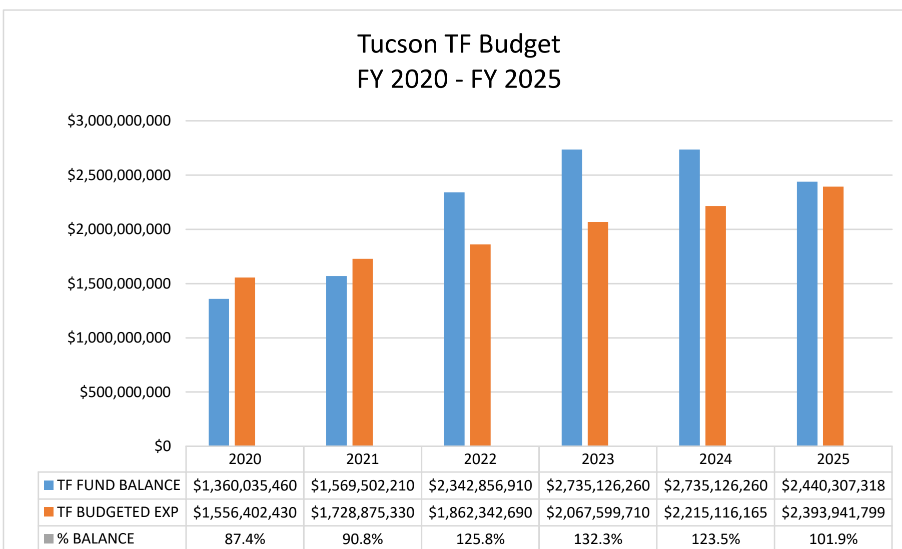
Like Phoenix, Gilbert also blamed the tax increase on the state Legislature, pointing to the $8.5 million annual loss in residential rental taxes. The FY 2026 URS share to Gilbert is estimated to decrease $3.8 million (6.5%) to $54.8 million; however, the Town receives approximately $23 million more than it did five years ago, a 71% increase.



	2020	2021	2022	2023	2024	2025
GF FUND BALANCE	$119,275,170	$150,503,750	$257,107,750	$333,074,140	$333,074,140	$301,407,350
GF BUDGETED EXP	$526,529,520	$516,441,490	$602,839,430	$667,417,540	$749,093,264	$749,330,671
% BALANCE	22.7%	29.1%	42.6%	49.9%	44.5%	40.2%

City of Tucson

The City of Tucson's charter requires voter approval to increase sales taxes. Under Prop 414, a half-cent sales tax rate increase over ten years would have generated $800 million in additional revenues ($80 million per year) by increasing the tax rate to 3.1%. In advocating for the tax increase, the City began by noting that the additional revenue would "help offset declining state-shared revenues" from the flat income tax, followed by the other reasons which included funding for public safety and community programs. The proposition drew opposition from the business community and voters overwhelmingly shot it down.



	2020	2021	2022	2023	2024	2025
TF FUND BALANCE	$1,360,035,460	$1,569,502,210	$2,342,856,910	$2,735,126,260	$2,735,126,260	$2,440,307,318
TF BUDGETED EXP	$1,556,402,430	$1,728,875,330	$1,862,342,690	$2,067,599,710	$2,215,116,165	$2,393,941,799
% BALANCE	87.4%	90.8%	125.8%	132.3%	123.5%	101.9%

Despite Prop 414's failure at the ballot, the City budget appears flush with revenue. According to its FY 2025 GF budget, Tucson's $301 million fund balance represented 40% of the $749 million in GF budgeted expenditures. Of its $301 million fund balance, the City designated nearly $132 million for "financial stability." Tucson's TF budget carries a fund balance of $2.4 billion, which exceeds the $2.39 billion in total budgeted expenditures. Included in the TF fund balance is $113 million designated for future capital projects.

See **Cities**, Page 6

Cities, *Continued from page 5*

Tucson's share of URS in FY 2026 will be $109 million, a $7.5 million reduction from last year. Over the last five years, URS for Tucson has actually increased over $38 million, or 54%. The elimination of the residential rental tax did not impact Tucson since they don't tax that activity.

- Jennifer Stielow

Arizona National Tax Rankings Improve

The United States Census Bureau annually publishes data on a variety of public finance and tax categories that allow for comparisons across the fifty states and the District of Columbia. ATRA has compiled the most recent data available from FY22 showing Arizona's relative comparison to other states on the major state and local tax categories.

Arizona's tax collection ranking per capita and per $1,000 of income are as follows (higher rank = higher relative tax burden):

	Arizona Rankings State and Local Tax Collections FY12				Arizona Rankings State and Local Tax Collections FY21				Arizona Rankings State and Local Tax Collections FY22			
	Per Capita		Per $1,000 of Income		Per Capita		Per $1,000 of Income		Per Capita		Per $1,000 of Income	
Tax Type	Amount	Rank	Amount	Rank	Amount	Rank	Amount	Rank	Amount	Rank	Amount	Rank
Total Taxes	$3,417	44	$ 96.07	37	$ 4,640	41	$ 87.64	41	$ 5,195	42	$ 91.91	42
US Average	$4,600		$ 105.68		$ 6,334		$ 102.88		$ 7,089		$ 108.74	
Sales Taxes	$1,361	9	$ 37.29	6	$ 1,835	10	$ 34.66	8	$ 2,214	7	$ 39.17	7
US Average	$1,034		$ 23.97		$ 1,437		$ 23.34		$ 1,668		$ 25.59	
Property Taxes	$1,009	33	$ 29.65	30	$ 1,253	36	$ 23.67	37	$ 1,257	38	$ 22.24	39
US Average	$1,439		$ 33.96		$ 1,898		$ 30.83		$ 1,943		$ 29.81	
Income Taxes	$512	41	$ 13.39	41	$ 899	38	$ 16.98	39	$ 1,021	39	$ 18.06	40
US Average	$1,070		$ 23.40		$ 1,642		$ 26.67		$ 1,798		$ 27.59	

Between FY21 and FY22, Arizona's total state and local (S&L) tax collections fell from 41st to 42nd nationally on both a per-capita basis and per $1,000 of personal income. This represented a $555 (12%) increase per capita. Rankings for property and income taxes remained mostly unchanged. However, Arizona's already high sales tax ranking climbed from 10th to 7th, with collections increasing by $379 per capita (21%). This highlights an even greater reliance on state and local sales taxes at levels well above the national average. In FY22, Arizona collected about $546 more per capita in sales taxes than the U.S. average.

Arizona's tax *rankings* have remained stable over the past decade. However, Arizona's total per-capita S&L tax *collections* have risen by $1,778 (52%) since FY12. Except in the case of income taxes, Arizona's collections in these categories grew at roughly the rate of the US average. On a per capita basis, this still means substantial growth across the board. From FY12 to FY22, sales taxes increased by 63% ($853), property taxes grew 25% ($248), and income taxes nearly doubled with a 99% ($509) gain on a per capita basis. However, when measured relative to personal income, the growth is less dramatic. Over the same period, total collections actually declined by 4% (-$4.16) per $1,000 of personal income, property taxes fell by 25% (-$7.41), sales taxes rose just 5% ($1.88), and income taxes increased by 35% ($4.67).

- Jack Moody

2022 Net Migration Resulted in $3.7 Billion AGI Gain

According to the most recent Internal Revenue Service (IRS) migration data, Arizona processed 22,102 new tax returns from interstate migrants in 2022, resulting in a net Adjusted Gross Income (AGI) gain of approximately $3.69 billion. This puts Arizona at 12th place in population growth and 6th in net AGI growth related to interstate migration. In 2021, Arizona placed 5th and 6th in those categories, respectively. In the February 2020 ATRA newsletter, ATRA's analysis of IRS state migration data highlighted the significant impact of interstate migration on Arizona's AGI. Between 2013 and 2018, ATRA observed a remarkable $11.6 billion increase in taxable income, attributed to approximately 120,000 domestic migrants relocating to Arizona.

According to IRS data, individuals moving to Arizona from other states are more likely to have an AGI exceeding $200,000 compared to migrants to most other states. Specifically, Arizona was ranked 5th in net gains of filers falling into the $200k+ AGI bracket, trailing behind South Carolina (4th), North Carolina (3rd), Texas (2nd), and Florida (1st). Migrant data also shows that California, New York, Illinois, Massachusetts, and New Jersey experienced the most significant outflow of high-income filers. Notably, these states share a commonality; very high personal income taxes.

Of course, people relocate for various reasons, but financial considerations can wield influence over such decisions. The good news for states grappling with high population outflows is that the tax landscape is one of the few elements within the decision-making spectrum that policymakers directly influence. It is imperative for state and local governments to recognize the profound impact that sound tax policies can have on their respective economies. According to IRS data, California and New York witnessed a combined net loss of $38 billion in AGI due to outmigration in 2022, resulting in a substantial decline in tax revenue. As notably high-tax jurisdictions, both states would likely have retained more residents, businesses, and consequently, higher tax revenue had their tax environments been more attractive. Meanwhile, states like Arizona, Florida, and Texas continue to enjoy the dividends of their more competitive tax environments.

Though Arizona currently boasts a competitive 2.5% flat income tax rate, that wasn't always the case. In 1992, for incomes above $17,705, the top marginal rate was 7%, which made Arizona a comparatively high income tax state at the time. At the same time, high income filers, or those with $500,000 of AGI or more, made up less than 0.3% of filers. In 2006, there were 16,294 with $500,000 of AGI or more, making up more than 0.7% of filers. In 2019, there were 25,171 filers, a 54% increase. What this shows is that Arizona not only continues to be a destination for moving Americans, but that those who move to Arizona tend to earn higher incomes on average, which is a boon for state and local revenue growth.

When considering migration data, many point to the significant portion of retirees as a missed tax revenue opportunity. In 2022, Arizona had the sixth highest net gain of migrants over 55 at 16,369. Though many retirees live on smaller incomes, the IRS data shows movers over 55 continue to earn income in Arizona, whether it's through work, realized investments, pensions, or other income. Unlike Florida where there is no state income tax, the tax environment in Arizona is both competitive and enticing for retirees, while ensuring that they still make substantial contributions to state and local revenues in Arizona.

- Jack Moody

GPLET, *Continued from page 1*

property located in a Central Business District (CBD). These agreements are predominantly used by the cities for the development of major projects. To exempt the property from the tax rolls, the developer transfers title to the city once the project is completed and the city "leases" the property back to the developer through the GPLET agreement. Although the property is used for a private purpose, the property is shielded from the property tax because it is "owned" by a governmental entity.

In testimony on SB1050, the cities both feigned ignorance of the school finance impacts of GPLET while deceptively contending they hold the schools harmless. When in fact, for every dollar that is abated by GPLET, the state general fund backfills the taxes the developer does not pay for the operating costs of the schools.

The attractiveness of the city's use of GPLET as an "economic development tool" is that they can abate the taxes for all other jurisdictions while making themselves whole through these agreements. Cities' reliance on property taxes is low compared to counties, community colleges and school districts, which makes entering into these agreements attractive. These agreements typically require the developer to make payments to the cities in the form of "rents" or other assessments, all the while abating the tax for all other jurisdictions that have no say in the matter. Exempting these expensive projects from the tax base results in all other taxpayers paying higher taxes than they would otherwise.

In 2021, the Arizona Supreme Court handed a Gift Clause challenge victory to taxpayers under *Schires v. Carlat* that consideration to a private entity was grossly disproportionate and therefore violated the Gift Clause. In the year prior to *Shires*, a Maricopa Superior Court decision found under *Englehorn v. Stanton* that the GPLET subsidy between the City of Phoenix and the developer violated the Gift Clause. In that case, the court ruled that the benefits to the developer over the term of the lease was "grossly disproportionate" to the amount received by the public. With a second veto in the books, taxpayers are left to legally challenge every deal.

- Jennifer Stielow