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ARIZONA TAX RESEARCH ASSOCIATION NEWSLETTER VOLUME 82 NUMBER 4 JULY 2022

2022 Legislative Wrap-Up

This year's legislative session was highlighted by the enactment of one of ATRA's long-term property tax reform efforts to reduce the class 1 (business) assessment ratio to 15%. In addition to reaching this historic goal, the business community successfully rallied behind legislation to reduce the tax burden on locally assessed businesses by taxing newly acquired personal property at 2.5% of the acquisition price (*See ATRA May 2022 Newsletter*). A great session for property taxpayers was topped by the elimination of SETR (*See accompanying article*).

Below are the final outcomes of several bills that ATRA continued to support, oppose, and monitor throughout this year's 166-day session.

GOOD BILLS

HB2749 TPT; prime contracting; exemption; alterations (Cobb)

ATRA's latest effort to simplify MRRA (maintenance, repair, replacement, alteration) projects under Arizona's prime contracting system was met by opposition again this year from the League of Arizona Cities & Towns. This year's measure addressed only residential contracts and specified that the contract would be taxable under prime contracting only when adding square footage to the existing structure. All other contracts, such as those to simply remodel a home, would remain taxable under MRRA in which only the materials are subject to tax at retail (*See ATRA March 2022 Newsletter*).

See LEG WRAP-UP, Page 3

Legislature Adjourns Long Session

Budget Agreement Includes Elimination of State Property Tax Rate

The Arizona Legislature finally adjourned the 2022 session on June 25th, just days before the beginning of a new fiscal year. With record revenue available to state policymakers, the Fiscal Year (FY) 2023 state budget jumped to over \$18 billion. The final bipartisan budget agreement included an ATRA recommendation to direct tax relief to the property tax. House Bill (HB) 2866 eliminated the State Equalization Tax Rate (SETR) which was set at almost 43 cents for the 2021 tax year. That reduction is estimated to save property taxpayers \$330 million for the 2022 tax year.

Record available revenue led to historic increases in

See SETR, Page 2

Save The Dates!

ATRA Golf Tournament

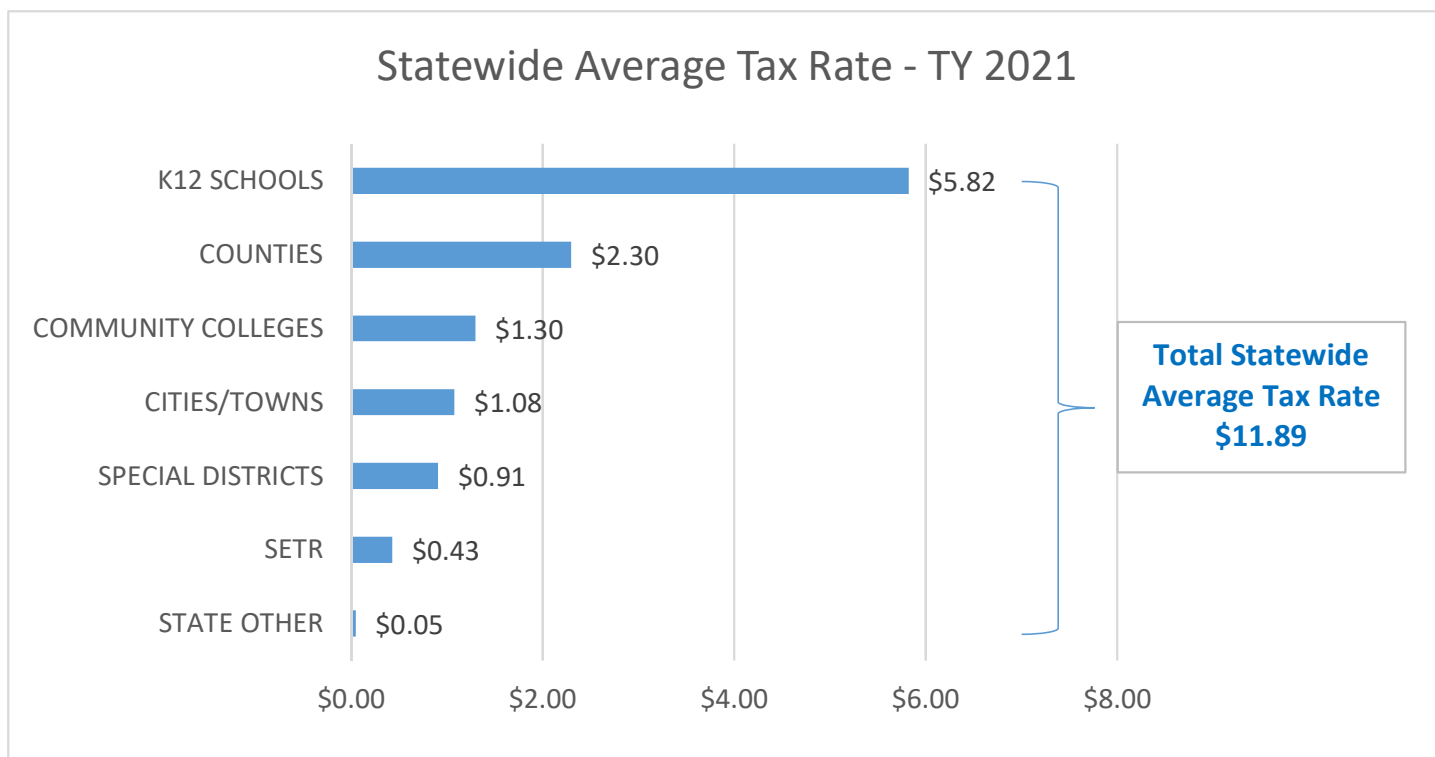
Friday, Nov 4th @ 12pm,
Stonecreek Golf Club, Phx

ATRA Outlook Conference:

Friday, Nov 18th @ 8:00am,
Scottsdale Hilton

SETR, *Continued from Page 1*

the FY 2023 budget. Scoring the actual growth in the FY2023 budget is much more complicated than a normal budget cycle. After controlling for one-time monies for debt retirement that were booked in the FY2022 budget, the FY2023 budget climbed roughly 47% over FY2022 levels. Fortunately, most of that \$5.8 billion in spending was dedicated to one-time appropriations for debt reduction and infrastructure. According to the Joint Legislative Budget Committee (JLBC), on-going spending was \$2.2 billion or 18.4% higher. However, that percentage increase drops to 15.6% after controlling for the cost of the SETR elimination – which had the effect of increasing state aid to schools \$330 million for FY2023.



JLBC estimates the state's ending balance at the end of the required three-year budget plan at a very modest \$26.7 million. Interestingly, the budget fails to account for some state expenditures in FY2023 and beyond. HB2853 provides for a universal Empowerment Savings Account (ESA) for every elementary or high school student for private or home schooling education as well as special needs instruction. JLBC estimated the cost of the ESA expansion at \$33.4 million for FY2023 and increasing to \$125.4 million in FY2025. The budget also ignores the cost for Arizona's new movie refundable tax credit in HB2156. Beginning in FY2023, that legislation requires the state to appropriate \$75 million to qualified movie production companies. That amount increases to \$100 million in FY2024 and \$125 million in FY2025 and thereafter and ultimately exposes the state to \$2.425 billion in spending over the next 20 years.

As is custom in the state budget, the major increases in on-going spending were directed at the K12 schools.

Policymakers increased the base support level 8.8%, group B weights for special ED, additional assistance, and a new opportunity weight for increased on-going funding of \$803 million. Lawmakers added another \$306 million in one-time spending for a total of \$1.1 billion. Notably, the K12 appropriation did include one school finance reform that was pulled from a broader ATRA-backed school finance reform (SB1269). The change eliminated the inequitable Additional Teacher Compensation formula in favor of an increase in the base support level for all districts and charters.

This K12 appropriation was championed by some Democrat lawmakers who supported the budget as historic and a game changer. Considering taxpayers got little credit for the \$3.3 billion in increased K12 formula funding over the last five years, it is doubtful the FY2023 appropriation will do anything to change the narrative that Arizona's K12 schools are profoundly underfunded. As was the case last year, the FY2023 budget doesn't address the fact that K12 districts are unable to spend all of the appropriation unless the Legislature passes an override of their constitutional expenditure limit.

Following Governor Ducey's recommendation, the three-year budget reflects a \$1 billion appropriation for water infrastructure that passed in the waning hours of the session. Behind the leadership of Speaker of the House Rusty Bowers and Senator Sine Kerr, SB1740 expands the authority of the Water Infrastructure Finance Authority (WIFA) for water infrastructure and conservation. Additionally, \$965 million is earmarked in FY2023 to a laundry list of transportation projects. Clearly, the historic level of available revenue was the major impetus for these legislative earmarks and unlikely to be repeated at this level anytime soon. However, from a state highway planning standpoint, lawmaker's involvement in securing earmarks for projects in their districts is not a positive development.

Finally \$544 million in one-time funding is directed to border security, the majority for building and maintaining a fence, as well as purchasing boarder security technologies. The money is appropriated to the Department of Emergency and Military Affairs (DEMA) and expenditures overseen by JLBC. The spending flexibility provided to DEMO is extensive and could create new demands for on-going appropriations.

LEG WRAP-UP, *Continued from Page 1*

Although HB2749 passed the House with bipartisan support, the bill faced opposition in the Senate and stalled by late March. In the last days of session, however, Rep. Cobb's request to put the bill to a vote in the Senate was granted but failed as a result of four Republican senators voting against it. Although ATRA and the contracting industry worked together in crafting the final language in which all agreed would simplify the system, a League lobbyist argued the measure would actually make the system more complicated. In fact, the League testified that they preferred last year's measure that was proposed by President Fann under SB1721, which not surprisingly, would have resulted in a major tax increase on businesses.

Senators Paul Boyer, Tyler Pace, T.J. Shope, and President Karen Fann joined the democrats in voting the measure down. Failing to fix this complicated system leaves taxpayers who simply install a kitchen island as part of a home remodel vulnerable to city tax auditors.

SB1095/SCR1011 constitutional property tax exemptions (Mesnard)

SCR1011 restores the tax benefit provided to Arizona's disabled veterans that was struck down by the courts due

to unconstitutional residency requirements. Furthermore, the measure specifically allows the Legislature to adjust the exemption amounts in state statute for certain property, including the property of disabled persons, widows, and widowers, and business personal property.

ATRA believes it is good tax policy to move these modest property tax exemptions into state statute in order to provide the State Legislature with the flexibility to react when circumstances change.

BAD BILLS

HB2156 tax credits; motion picture credits (Cobb)

Initially introduced under SB1708 by Senator Gowan, HB2156 was struck in the final days of session to establish \$125 million in annual “refundable” income tax credits over the next 20 years for motion picture production companies (*See ATRA March 2022 Newsletter*).

ATRA believes this refundable tax credit is unconstitutional under the Arizona Constitution. An analysis submitted to the Legislature by the Goldwater Institute described how Arizona’s Gift Clause prohibits the disproportionate gift of public resources to private enterprises. Goldwater reinforced that *“the (refundable) tax credit is not just an adjustment of the motion picture production company’s tax liability but a method of making a payment to the motion picture production company.”*

-Arizona Legislative Council

Under HB2156, the company is only required to satisfy the location requirements for production and filming, and any other benefits associated with production activities are “indirect” benefits, and therefore, would not be considered as offsets to the public benefit received by the private entity. Because HB2156 provides significant state appropriations to companies without receiving a direct benefit in return, the tax credit scheme under HB2156 would likely be in violation of the Arizona Constitution’s Gift Clause.

An Arizona Legislative Council memo requested by House Chairman Rep. Travis Grantham echoed Goldwater’s analysis. Specifically differentiating between tax credits that are carried forward versus credits that are refundable, the Legislative Council memo emphasized that “the (refundable) tax credit is not just an adjustment of the motion picture production company’s tax liability but a method of making a payment to the motion picture production company.”

Despite the opinions by Goldwater and Legislative Council, the measure passed with bipartisan support with the majority of votes cast by the Democrats. In his request for a veto of HB2156, ATRA President Kevin McCarthy argued that “the refundable tax credit actually has nothing to do with taxation. Rather it is an outright appropriation repackaged for political purposes.”

By not acting on the measure, the Governor allowed the bill to automatically become law without his signature.

Chapter 387

SB1710 sports; tourism; film authority; appropriation (Gowan)

SB1710 establishes the Southern Arizona Sports, Tourism and Film Authority (Authority) consisting of Greenlee, Graham, Cochise, Santa Cruz, Pima, and Pinal Counties.

The measure states that the Board and the Authority do not have the authority to “levy or otherwise impose any tax or assessment.” However, the qualified electors residing in the boundaries of the Authority *do* have the authority to levy a tax. Consequently, the measure was poorly drafted and leaves much left up to the imagination and nearly impossible to implement for several reasons. The bill fails to describe what type of tax would be levied—property, income, sales, or otherwise. Furthermore, the measure lacks direction as to what happens if approval of the new tax isn’t unanimous among all six counties.

The Authority may also issue bonds to fund the capital costs associated with acquiring, constructing, equipping, repairing, maintaining, and improving stadiums and multipurpose facilities, directly related improvements and infrastructure. However, the amount in bonds that may be issued appears to be unlimited and it’s likely that all six counties will be on the hook to repay the bonds upon a default. *Chapter 364*

SB1241 gift clause; violation; statute limitation (Pace)

SB1241 would have limited the timeframe for filing an action against a public entity or public employee that alleges a violation of the constitution’s Gift Clause from one year to 30 days after the cause of action accrues. ATRA opposed the measure as it would dramatically limit taxpayer’s ability to bring a Gift Clause challenge against a public entity, thereby thoroughly undermining the provision.

As a result of ATRA’s opposition, SB1241 failed as it never received a committee hearing.

SB1374 full-time equivalent student; expenditure limitation (Shope)

ATRA successfully defeated the latest attempt by Arizona’s community colleges to do an end run around voters for expenditure limit relief.

Approved by the voters in 1980, the constitutional expenditure limits for community colleges are calculated annually by adjusting the base-year expenditures by inflation and the change in full-time student equivalents (FTSE). Due to declining enrollment, however, some districts have lost expenditure limit capacity. Rather than ask voters for approval to increase their spending limits, the colleges repeatedly attempt to seek statutory relief at the capitol.

“SB1374 would reflect growth in student population and an arbitrary twenty-five percent growth in the expenditure limitation based on the use of the different definitions for full-time equivalent student.”

-Arizona Legislative Council

ATRA argued that a statutory amendment to increase the constitutional expenditure limits would clearly be unconstitutional. That position was strongly reinforced by a legal opinion from Leg Council that unequivocally agreed it was unconstitutional. The memo specifically stated that the calculation prescribed by SB1374 failed to include a constitutionally required adjustment to the Base-limit. Specifically, Leg Council stated that the new calculation prescribed by SB1374 “would reflect growth in student population and an arbitrary twenty-five percent growth in the expenditure limitation based on the use of the different definitions for full-time equivalent student.”

The proposal failed when House Appropriations adopted a strike-everything amendment with a different subject.

HB2609 ambulance services; service areas (Borges)

As introduced, HB2609 would have upended the current Certificate of Necessity (CON) process that certifies applicants for the delivery of emergency medical services (EMS).

Under the current CON process, the Administrative Law Judge (ALJ) conducts a detailed review of the facts and a public hearing is held in which all interested parties may participate. If the ALJ approves the CON, the recommendation goes to the Director of the Department of Health Services (DHS) for a final determination.

As introduced, HB2609 would have allowed the Director of DHS to issue a CON without a public hearing and ALJ review. Only after a CON is issued could an affected CON holder appeal, which would then trigger a public hearing and ALJ review. Furthermore, the bill wasn't clear as to whether a new CON holder could proceed with the delivery of EMS when an existing CON holder appeals. Although the intent of the proponents may have been to expedite the current process, doing so in this manner would have only served to undermine the integrity of the CON process.

The bill was amended in the Senate to remove ATRA's opposition. Specifically, language was added to clarify that if the DHS Director's decision to certify a new or amended CON is appealed, the new CON does not go into effect until a final determination is made.

HB2609 passed the Legislature near unanimously and was signed by the Governor. *Chapter 381*

SB1266 property tax; administration; county assessor (Livingston)

SB1266 was a proposal by the Maricopa County Assessor to dramatically change the statutory method for valuing shopping centers.

Under current law, the county assessor is required to initially value shopping center property based on the replacement cost new less depreciation (RCNLD) method, unless the owner elects to have the property valued based on the straight line building residual (SLBR) income approach. Upon such election, the shopping center owner must submit the necessary income and expense information to the county assessor before September 1 in the preceding year.

Inaccurately characterized as a "technical cleanup" bill by the proponents, SB1266 would have eliminated the SLBR option for shopping center owners. The measure also eliminated the option for shopping center owners to appeal based on the market comparison approach when there is a subject sale, leaving the cost approach as the only method to value such property. Most concerning was that the proposal was being advanced without any input from shopping center industry representatives.

ATRA opposed SB1266 as it would have dramatically limited the methods used to value shopping centers. At a stakeholder meeting convened by the bill sponsor, ATRA invited industry representatives for their first opportunity to explain to the Assessor the importance of maintaining the SLBR method as an option. After listening to the industry, the Maricopa County Assessor agreed to remove all amendments to the shopping center valuation statutes, leaving in place only the unrelated provisions in the bill. *Chapter 228*

MONITORED BILLS**HB2685 NOW: transportation tax; Maricopa County; election (Carroll)**

Governor Ducey's veto of HB2685 nixes Maricopa County's plans of asking voters for an extension to its transportation sales tax. The existing tax that was approved by voters in 2004 expires at the end of 20 years and HB2685 would have allowed voters to approve an extension to the tax another 25 years at the next spring special election.

The Governor described a variety of reasons for his veto, but the main purpose may have been due to urging by Senator Michelle Ugenti-Rita. In his veto letter, the Governor noted that the Senator "offered numerous commonsense amendments" that would have allowed for more transparency and accountability but that those amendments were never adopted.

The Governor's veto of HB2685 still leaves the proponents two more years to ask the voters for an extension of the sales tax before it expires.

SCR1049 NOW: fire districts; funding; TPT increment (Boyer)

The Legislature's approval of SCR1049 will allow the 2022 general election ballot to carry the question whether to impose a 0.10% statewide sales tax to fund Arizona's 144 fire districts.

Currently, fire districts receive the majority of their revenue from the property tax. All of Arizona's counties are required to levy a fire district assistance tax (FDAT), which is capped at 10-cents per \$100 of assessed value and generates approximately \$20 million per year. Fire districts also levy a local property tax rate that generates over \$340 million annually. That amount will grow as the current property tax rate cap of \$3.375 is scheduled to ratchet up over the next few years to \$3.75 as a result of the passage of SB1093 (*See ATRA May 2022 Newsletter*).

If voters approve the measure this fall, fire districts will receive a major infusion of money as the sales tax is expected to raise an additional \$160 million annually over the next 20 years.

As ATRA has reported in the past (*See ATRA October 2020 Newsletter*), Arizona fire districts continue to struggle with the extraordinary costs associated with the Public Safety Personnel Retirement System (PSPRS).