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# ARIZONA TAX RESEARCH ASSOCIATION NEWSLETTER VOLUME 83 NUMBER 1 JANUARY 2023

## 2023 ATRA Legislative Program

### Introduction/State Budget

ATRA's legislative program is developed each year with recognition that the Legislature and Governor's highest priority for the session should be passing a Fiscal Year (FY) 2024 state budget that is balanced and sustainable.

The 2022 session saw an extraordinary increase in state spending due to skyrocketing state revenue growth. However the current three-year JLBC budget predicts much slower revenue growth for the FY 2024 budget year.

Current estimates suggest that the state's cash position continues to outpace budget estimates. The Governor's Office of Strategic Planning and Budgeting (OSPB) estimates the structural surplus this year at \$2.7 billion.

ATRA will provide updated state budget recommendations to the Legislature after the JLBC and the OSPB have submitted their recommendations for the FY 2024 budget.

### Taxation

**Property tax reform.** ATRA has led the effort to reform Arizona's property tax system and reduce the disparity in tax treatment between business and residential property. As a result of previous ATRA-backed legislation passed in 2005, 2007, 2011, 2021, and 2022, ATRA achieved its decade's long goal of reducing the class one assessment ratio to 15% beginning in 2027. In addition, the historic reductions in the business personal property tax, coupled with the passage of Proposition 130 this November, now provides a realistic opportunity for its complete elimination.

**Prevent greater access to the property tax.** For the 2023 session, ATRA will oppose efforts on the part of Arizona state and local governments and special districts to increase access to the property tax base.

In addition, ATRA will advocate for the continued compliance with the state's Truth-in-Taxation (TNT) law. Since its passage in 1998, the state has consistently complied with the TNT law and state controlled tax rates have declined in each of the last eight years. While those rates have both risen and fallen with the fluctuations in the real estate market, ATRA believes adherence to the TNT law is an important principle that has and will continue to benefit taxpayers over time.

**Targeted Property Tax Breaks.** For decades, ATRA has led the effort at the Capitol to oppose rifle-shot property tax breaks to specific industries. ATRA will continue to support policies that provide for equitable treatment among property taxpayers and oppose efforts that undermine that important policy principle.

*For the 2023 session, ATRA will pursue the following legislation:*

### Property Tax

**Property Tax Reform.** The 2021 and 2022 legislative sessions saw significant progress in the area of business property tax reform. In 2021, legislation was passed to reduce the class one assessment ratio from 18% to 16% over four years. In 2022, legislation passed to further reduce the class one assessment ratio to 15% through half-percent decreases beginning in 2026. The 2022 session was further highlighted by a significant prospective reduction in the locally assessed personal property tax by reducing the taxable value of new property to 2.5%. 2022 was wrapped up with the passage of ATRA supported Proposition 130 in November giving Arizona lawmakers the statutory authority over business personal property tax exemptions.

In 2023, ATRA will support an effort to accelerate the class one assessment ratio reduction to 15% from 2027 to 2025. This acceleration should be combined with further personal property tax relief under the new authority provided to the Legislature, which will consist of increasing the personal property exemption from \$207,366 to \$500,000 and enhancing the accelerated depreciation schedule for property enrolled prior to tax year 2022.

### Sales Tax

**Clarify Taxation of Digital Goods and Services.** Following a 2017 legislative study committee which found the state lacks statutory authority to tax digital goods and services, the Legislature attempted a legislative fix in 2018 and 2019 to provide the state the legal authority to tax digital goods and exempt digital services. The bill established definitions for software, digital goods, and digital services in a new classification of TPT. It made licensed prewritten software and all digital goods subject to TPT, regardless of transfer method. Licensed software is software where the user has the right to electronic transfer; in essence the user has a right to a full copy as opposed to remote access. For digital goods, such as ebooks, movies, television shows and audio files, they are taxable if transferred electronically or accessed remotely. Though this made streaming audio and video taxable, there were exemptions for scheduled programming, such as live linear broadcast, which have never been subject to TPT. ATRA will again pursue legislation to update Arizona's tax code related to the taxation of digital goods and services.

**Prime Contracting Simplification.** Arizona's prime contracting tax is generally regarded as the most complex and inefficient areas of Arizona's transaction privilege tax (TPT) system. Some improvement was achieved through TPT Simplification in 2013 that transitioned activities involving maintenance, repair, replacement, and alteration (within certain thresholds) from prime contracting to a tax on materials at the point of sale, now known as MRRA. MRRA simplified tax compliance for most contractors that only work on MRRA projects; however, contractors involved in residential home remodels, for instance, can unknowingly get pulled into prime contracting. For example, tax guidance published by the Arizona Department of Revenue considers moving interior walls or adding a kitchen island as "modification" activity, which will make the entire contract taxable under prime contracting if the cost of the modification activity exceeds 15%. ATRA will pursue legislation to simplify residential remodels by eliminating the current thresholds for alteration projects, and instead, only tax contracts under prime contracting that add or expand square footage regardless of the amount of modification activity performed within the existing roof and exterior walls of the home.

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## **Public Finance:**

**Fire District Debt Limits.** Current statute limits the amount of general obligation debt that a fire district can absorb to six percent of the net assessed value of the district. However, current statute does not limit the amount that a fire district is able to request from district voters. ATRA will pursue legislation to limit the amount that a district can request from voters to the amount of their current debt capacity under their debt limits.

**School Finance Reform:** For decades, ATRA has advocated for a school finance system that is equitable and reflective of Arizona's K12 system that encourages and promotes parental choice. ATRA has also argued that a more equitable school finance system reduces that state's exposure to the continuous litigation facing the state. ATRA will pursue the following school finance reforms in the 2023 session:

**Create a state student funding formula.** This proposal would allow any school district with no secondary property tax (no bonds or overrides) to switch to a new state funding formula similar to the current charter funding system. Upon the approval of district voters, eligible districts would opt into the new state funding system (an average of \$1,200 more per pupil) and agree to forgo bond and override funding. In order to offset some of the state general fund impacts of the new state funding formula, district voters would also be required to approve an additional property rate tax of \$0.35 for elementary and union districts or \$0.70 for unified districts.

**Reform the current district transportation formula.** Arizona's long standing formula to provide transportation funding to school districts is both flawed and antiquated. Among other problems, the current system actually provides more per-pupil transportation funding to districts that are losing students and actually experiencing decreased demand for transportation dollars. What would normally be a rather simple transportation funding system (approved daily route miles multiplied by the per-mile support level) is complicated by a formula to hold districts harmless at their highest historical transportation expenditure.

The formula funding on actual route miles is called the Transportation Support Level (TSL). The historical high water mark is the Transportation Revenue Control Limit (TRCL). The state is only liable for the actual route miles or the TSL. For districts with higher TRCL's, those expenditures are funded through a local district property tax.

ATRA will pursue legislation to phase out the TRCL and transition districts to a more equitable per pupil allotment.

**County Flex Language.** Beginning in FY 2009, counties were provided the broad authority to shift revenues from their special revenue funds, including countywide special taxing districts, to their general funds. The initial intent of this broad authority was to offset state cost shifts that began during the Great Recession. This "flexibility" language exists both in state statute and has been included in session law in the state budget every year. To date, the counties have shifted more than \$68 million from their special revenues that were intended for a specific purpose into their general funds to fund any county fiscal obligation. Although the state cost shifts have ceased, this broad authority remains. ATRA will pursue legislation to repeal the authority in state statute and discourage lawmakers from continuing this practice as they negotiate the FY 2024 state budget.