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ARIZONA TAX RESEARCH ASSOCIATION

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2024 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 state budget that is balanced and sustainable.

This year's budget exercise is complicated by the Joint Legislative Budget Committee's (JLBC) estimate that the current year (FY 2024) budget has a shortfall of $400 million. Assuming the FY 2024 deficit is resolved, JLBC estimates another $450 million deficit awaits them in balancing the FY 2025 budget.

ATRA will provide updated state budget recommendations to the Legislature after the JLBC and the Office of Strategic Planning and Budgeting (OSPB) have submitted their budget recommendations in January.

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 (business) assessment ratio to 15% beginning in tax year 2027. In addition, the historic reductions in the business personal property tax, coupled with the passage of Proposition 130

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Arizona Continues to Benefit From Interstate Migration

In the February 2020 ATRA Newsletter, ATRA's analysis of Internal Revenue Service (IRS) state migration data highlighted the significant impact of interstate migration on Adjusted Gross Income (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 the most recent IRS migration data, Arizona processed 32,636 new tax returns from interstate migrants in 2021 alone, resulting in a net AGI gain of approximately $4.4 billion from 2020. This puts Arizona at 6th place in population growth and 5th in net AGI growth related to interstate migration.

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 4th in net gains of filers falling into the $200k+ AGI bracket, trailing behind North Carolina (3rd), Texas (2nd), and Florida (1st). Migrant data highlights 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.

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in 2022, now provides opportunities for further reductions.

Prevent greater access to the property tax. For the 2024 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 ten 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 taxpayers. Too often, these bad precedents create a path dependency leading to more inequity in the system. 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 2024 session, ATRA will pursue the following legislation:

Property Tax

Personal Property Tax Relief. In November 2022, Arizona voters approved Proposition 130 that gave state lawmakers the statutory authority over business personal property tax exemptions. Under the new authority provided to the Legislature, ATRA will pursue increasing the personal property exemption from the current $225,572 to $500,000.

Sales Tax

Sales Tax Audit Reform:

Clarify ADOR's Audit Authority. The Director of ADOR is statutorily required to establish a Unified Audit Committee (UAC) with cities and towns to coordinate uniform audit functions. However in the most recent intergovernmental agreement between the Department and the cities and towns, the authority of UAC has been deferred to a non-statutory committee that diminishes the Department's authority over audit functions. ATRA will pursue legislation to expand the statutory authority of UAC that will maintain ADOR's oversight over state and local audits.

Limit City Multijurisdictional Audits. Arizona's historic 2013 transaction privilege tax (TPT) reforms targeted

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the longstanding administrative and compliance complications associated with the lack of a central auditing process in Arizona. Arizona is one of a few states nationally that allows for an independent municipal sales tax structure where cities tax bases can vary from the state, and cities are allowed to deploy their own auditors. The 2013 reforms were intended to limit city auditing to single location taxpayers in an effort to eliminate the considerable confusion associated with cities auditing multi-jurisdictional taxpayers. This meaningful reform has deteriorated over time as multijurisdictional taxpayers face more city audits. To the extent these audits are necessary, they should be conducted by the Arizona Department of Revenue (ADOR). In recent years, lawmakers have increased funding to ADOR for additional TPT auditors and ATRA would support more if necessary. ATRA will pursue legislation to limit the cities authority to conduct multijurisdictional audits.

Prime Contracting Simplification. Arizona's prime contracting tax is generally regarded as the most complex and inefficient area of Arizona's 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 ADOR 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.

__Public Finance__:

Government Property Lease Excise Tax (GPLET) Reform: GPLET continues to be a highly controversial feature of Arizona's public finance system. ATRA participated in several major successful GPLET reform efforts in 2010, 2017, and 2018 to limit cities use of their tax exempt status to harvest property taxes for private projects. However, a historic Arizona Supreme Court Gift Clause decision in 2021 (*Schires v. Carlat)* has made those reforms potentially moot. Arizona's Gift Clause states that a municipality may not "give or loan its credit in the aid of, or make any donation or grant, by subsidy or otherwise, to any individual, association, or corporation." To determine a violation of the Gift Clause, the courts rely on the *Wisturber* two-pronged test to determine whether the expenditure has a public purpose and if the consideration received by the government is grossly disproportionate to the amount paid to the private entity. In considering the direct payments that were bargained for in the case, the court determined that the agreement failed *Wisturber's* second prong and therefore violated the Gift Clause. To reduce Gift Clause challenges to future GPLET agreements, ATRA will pursue legislation to limit the current 8-year abatement period to 4 years so that the "give" doesn't exceed the "get."

In addition, in order to reduce the potential for Gift Clause violations for GPLET deals outside the Central Business District, the legislation will reduce the maximum GPLET lease term from the current 25 years to 10 years.

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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 the state's exposure to the continuous litigation facing the state. ATRA will pursue the following school finance reform in the 2024 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 tax rate of $0.35 for elementary and union districts or $0.70 for unified districts.

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Of course, people relocate for various reasons, but financial considerations wield significant 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 $54 billion in AGI due to outmigration in 2021, resulting in a substantial decline in tax revenue. Notably high-tax jurisdictions, both states could have retained more residents and businesses—and consequently, higher tax revenue—had their tax rates been more attractive. Meanwhile, states like Arizona, Florida, and Texas will continue to enjoy the dividends of their more appealing 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 AZ 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 2021, Arizona had the second highest net gain of migrants over 60. In 2014, Arizona imported 18,733 migrants over 60. In 2021, that number was 25,090. In fact, the City of Mesa had the highest net gain of migrants over 60 for the third year in a row. Though many retirees live on smaller incomes, the IRS data shows movers over 60 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, Arizona occupies a favorable position. Here, the tax environment is both competitive and enticing for retirees, while ensuring that they still make substantial contributions to state and local revenues in Arizona.

- Jack Moody