Citizens Finance Review Commission

An Examination of Possessory Interest Exemptions

Prepared for the Citizens Finance Review Commission

by

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September 12, 2003

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This report was prepared for the Citizens Finance Review Commission with funding and/or assistance from the Arizona Department of Commerce and the Commerce and Economic Development Commission, and may be presented independently elsewhere at the authors' discretion. This report will be available on the Internet for an indefinite length of time at www.azcfrc.az.gov. Inquiries about this report or the Citizens Finance Review Commission should be directed to the Office of the Governor of Arizona, (602) 542-7601.

1. Description

More than 10% of the assessed property (after assessment ratios), nearly $5 billion, in Arizona is exempt. The majority of these properties are government owned, whether federal, state or local. In Maricopa County, government exemptions makeup almost 74% of all exemptions. Other exemptions include religious, non-profit and fraternal organizations and personal exemptions for widows, widowers or disabled. Many properties are unassessed and not even listed as exemptions, such as possessory interests and the Native American land and most of its improvements.

The review of this topic involves an examination of property tax exemptions and therefore has limited scope in reference to eliminating this tax relief.

2. Administration

The administration of exemptions resides predominantly with the County Assessors and involves the verification and review of exemption qualification and status. The addition of new exempt property is also the responsibility of the Assessor, as well as the valuation of existing exempt property.

3. Impact on Existing Revenue Systems

Not applicable

4. Cost

The cost of administering exemptions is primarily involved with the verification and review of organizational and individual applications. Costs are also incurred for the addition of exempt property, such as new government buildings. The valuation process for government properties is minimal as no tax impact removes any need for appeals or an extensive valuation analysis. For Maricopa County, from a personnel perspective, the cost is about 3% of the entire budget.

5. Policy Considerations

A. Equity

Exemptions are applied equitably based upon the current statutes. Arguments could be made that current statutes may not apply exemptions equitably across all taxpayers.

B. Economic Vitality

Government and religious exemptions, the majority of the exempt property, are standard practices in other states. Many states also provide relief for non-profits and special needs individuals including seniors and the disabled.

C. Volatility

Unless new exemptions are enacted, the current exemption structure does not produce volatility as these exempt properties do not produce any property tax revenue.

D. Simplicity

The government exemptions are very straightforward. The individual and organizational exemptions can be somewhat complicated. Verifiable qualifications, which may include tax returns or statements of organization, must be reviewed so that only those individuals or groups, who truly should qualify, are granted exemptions.

6. Economic Impact

If some exempt government property could be sold to the private sector, the property tax revenue currently exempted, could be added back to the tax rolls lowering the burden on the rest of the tax base. For possessory interest cases, state and municipal governments have begun using this exemption for possibly more than just economic development, but also perhaps as a way for businesses to avoid most property tax liability altogether. For example, the Buttes Resort in Tempe is exempt from taxation. This property sold for more than $200 million eight years ago. America West, Southwest and Lufthansa German airlines have property listed as possessory interest that is also exempt from taxation. Abuse of the possessory interest statute can lead to a distinct disadvantage to similar businesses currently subject to the full property tax liability. Abuse may extend to Native American and Federal properties as well. Under current tracking systems, most Assessor Office's do not have complete information associated with possessory interests. However, it is acknowledged that the use of Arizona's possessory interest classification is becoming a growing trend.

7. General Information

The table below shows the distribution of exemptions by county. The percent exempt is comparing the exemption amount to the "assessed" full cash value. The "assessed" full cash value is after assessment ratios have been applied. On average, about 10% of property is exempt. This amount varies by county and is influenced by the makeup of the county. In La Paz County, for example, the large amount of federal land relative to the rest of the tax base creates a very high exemption percentage.

In Maricopa County, the majority of the exempt property, about 74%, is government owned. Religious organizations and other non-profit organizations each make up about 9%. And the balance is scattered among different categories with residential exemptions being about 2% of the total exemptions.

2003 Abstract Information			
County	**Assessed Full Cash Value**	**Exemptions (Net of SRP)**	**% Exempt**
Apache	$455,683,643	$17,806,833	**3.9%**
Cochise	$637,496,728	$50,442,009	**7.9%**
Coconino	$1,264,555,620	$67,941,637	**5.4%**
Gila	$391,881,338	$22,229,085	**5.7%**
Graham	$111,059,952	$9,264,419	**8.3%**
Greenlee	$146,751,063	$4,290,666	**2.9%**
La Paz	$216,536,873	$86,741,584	**40.1%**

Maricopa	$31,338,510,032	$3,259,871,080	**10.4%**
Mohave	$1,343,073,820	$142,464,283	**10.6%**
Navajo	$856,911,870	$204,684,504	**23.9%**
Pima	$5,927,304,349	$693,913,606	**11.7%**
Pinal	$1,119,715,800	$73,836,467	**6.6%**
Santa Cruz	$270,991,452	$24,660,334	**9.1%**
Yavapai	$1,676,020,996	$72,295,807	**4.3%**
Yuma	$771,600,322	$121,110,093	**15.7%**
Totals	**$46,528,093,858**	**$4,851,552,407**	**10.4%**

Source: 2003 Department of Revenue Abstracts.

8. Other: Narrative on Possessory Interest

Within the discussion of Arizona's exemption policies, no debate is livelier than the one surrounding the current use of possessory interest classification to avoid commercial property taxes.

Possessory Interest for this discussion means the ownership of land by federal, state, local and tribal entities for the purpose of commercial development. It goes something like this – The City of Phoenix goes out and purchases a parcel of taxable land from the private sector. Once bought and vested into the city's name, the land becomes exempt from property taxes. The city then goes out and finds a suitable commercial developer to build on this sight. These improvements are also vested into the city's name, but are leased back to the developer for a nominal fee. This is called a Leasehold Interest Agreement. Through such an agreement, all property taxes for these often large commercial projects become 100% tax exempt. Some examples in Maricopa county include – Renaissance Towers in Downtown Phoenix, the Arizona Center, the Mercado, Chase Bank Card Center, Harkins Theatre in Tempe, Laird Dines Building, Buttes Resort, Papago Park, TPC Golf Course, Post Apartment Homes, Hayden Ferry South, and many more.

In other cases, the government buys land while allowing the improvements to be kept in the developer's name. Under this scenario, the land is still exempt while many of the improvements are taxable.

What concerns many who question the use of this exemption scheme is the unfair relationship which develops between competing businesses who do not receive this exemption, and those who do. In addition, the loss of taxable property from the rolls increases the tax rates for remaining property owners, thereby creating a tax shift.

It could be argued that local jurisdictions should on principle avoid meddling in commercial development not directly associated with their operational needs. By creating an unfair advantage through the use of Possessory Interest tax exemptions, local governments artificially create a convoluted tax base, subsequently protecting one tax payer while creating additional liabilities on the rest. In addition, it distorts our commercial markets by giving unfair tax advantage to one business over their competitors.

One solution to this problem would be to strip away local exemption authority on all parcels not directly associated with government duties. By allowing only sales tax enticements, it would limit the fiscal impact on taxing districts outside the effected jurisdictions and create a more uniform property tax base. Such a solution would also generate additional revenue while reducing overall tax rates.