

Citizens Finance Review Commission

Commissioners

Tony Astorga
(Co-Chair)

William J. Post
(Co-Chair)

Frank Alvarez

Fritz Aspey

David Bartlett

Johnny Basha

Drew Brown

James Bush

Ray Clarke

Peter Fine

Tom Franz

Kristine Garrett

Yolanda Kizer

Ivan Makil

Anne Mariucci

Monsignor Edward Ryle

Rano Singh Sidhu

David Smith

Randie Stein

Mary Upchurch

Joel Valdez

Executive Director

Leezie Kim

Applying a Single Assessment Ratio for Voter-Approved Bonds and Overrides

Prepared for the Citizens Finance Review Commission

by

Property Tax Research Committee

Tom Franz, Chair

Randie Stein, Chair

and

Authors:

James Bush, Partner at Fennemore Craig PC

**Timothy Hogan, Executive Director, Arizona Center for Law in the
Public Interest**

Gretchen Kitchel, Senior Public Affairs Representative of APS

Penny Kotterman, President of Arizona Education Association

Kevin McCarthy, President of Arizona Tax Research Association

James Meulemans, Deputy Assessor for Maricopa County

Steven Partridge, Of Counsel at Fennemore Craig PC

Kevin Ross, Assessor for Maricopa County

Randie Stein, Principal of Glennon Stein Associates

Joseph Usher, Senior Tax Specialist of Intel Corp.

Neil Wolfe, President of Neil R. Wolfe, LLC

This paper is the result of the collaborative efforts of many people. This paper is not, however, representative of the views of all or even a consensus of the committee members and the critical reviewers. To attribute any author with the various positions taken in this paper would be misleading. Rather, the authors attempted to disclose as fully and succinctly as possible the various different opinions and literature on any given topic to aid the CFRC in its deliberations.

September 12, 2003

Critical Reviewers:

Lisa Atkins
Executive Director
County Supervisors
Association

Mark Barnes
Economist
Barnes & Associates of behalf of
League of Arizona Cities and
Towns

Kent Ennis
Economic Consultant
CH2M Hill

Dr. Roy Flores
Chancellor
Pima County
Community College

Elaine Smith
Senior Economist
Arizona Department of Revenue

Jill Welch
Economist
Elliott D. Pollack & Co.

© 2003 by the Citizens Finance Review Commission. This document may be reproduced without restriction provided it is reproduced accurately, is not used in a misleading context, and the author(s), the Citizens Finance Review Commission and the Arizona Department of Commerce are given appropriate recognition.

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.azcfr.com. Inquiries about this report or the Citizens Finance Review Commission should be directed to the Office of the Governor of Arizona, (602) 542-7601.

The authors and sponsors have made every reasonable effort to assure the accuracy of the information contained herein, including peer and/or technical review. However, the contents and sources upon which it is based are subject to changes, omissions and errors and the authors and sponsors accept no responsibility or liability for inaccuracies that may be present. THIS DOCUMENT IS PROVIDED FOR INFORMATIONAL PURPOSES ONLY. THE AUTHORS AND SPONSORS PRESENT THE MATERIAL IN THIS REPORT WITHOUT MAKING ANY WARRANTY, EXPRESS OR IMPLIED, INCLUDING THE WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE, OR ASSUMING ANY LEGAL LIABILITY OR RESPONSIBILITY FOR THE ACCURACY, COMPLETENESS, OR USEFULNESS OF ANY INFORMATION, APPARATUS, PRODUCT, OR PROCESS DISCLOSED, OR REPRESENTING THAT ITS USE WOULD NOT INFRINGE PRIVATELY OWNED RIGHTS. THE USER ASSUMES THE ENTIRE RISK AS TO THE ACCURACY AND THE USE OF THIS DOCUMENT AND ANY RELATED OR LINKED DOCUMENT.

PROPOSAL

On a prospective basis, any voter-approved (secondary) property tax levies to fund debt service on bonds or for budget overrides for counties, cities and towns, community college districts and school districts would be financed using a single assessment ratio for all classes of property. The proposal would not change any existing or future property tax levies that have already been approved by the voters. Rather, it would require levies approved by voters, as of a certain specified date, to be based on a single assessment ratio.

Please note: Actual tax burdens would not vary based upon the set ratio, as long as it is the same for each class. In other words, a ratio of 100%, 25%, 18%, 10%, or any other percentage is immaterial.

The following examples assume a school district whose boundaries contain \$200 million of full cash value (FCV) split evenly between residential and business property, and that the school district requires a levy of \$1,000,000.

	FCV	Assessment Ratio	Assessed value	Property Tax Rate	Tax
home	\$100,000,000	25%	\$25,000,000	\$2.00	\$500,000
business	\$100,000,000	25%	\$25,000,000	\$2.00	\$500,000

	FCV	Assessment Ratio	Assessed value	Property Tax Rate	Tax
home	\$100,000,000	18%	\$18,000,000	\$2.7778	\$500,000
business	\$100,000,000	18%	\$18,000,000	\$2.7778	\$500,000

Changing the assessment ratio results in a higher rate, however each taxpayer's actual tax would not change. In this example (again levying \$1 million), an assessment ratio of 10% would result in a \$5.00 rate, but the tax paid would remain the same.

ADMINISTRATION OF PROPOSAL

County assessors and the department of revenue would be required to maintain two sets of secondary assessed values: one that continues the current assessment ratios for the duration of those bonds and overrides already authorized by voters; a second set from and after the enactment of a single assessment ratio for any future voter authorized taxes.

IMPACT OF EXISTING REVENUE SYSTEMS

The impact of the change on voter behavior is difficult to predict. Clearly, the tax considerations for the homeowner/voter may influence their willingness to approve new bonds and overrides.

The changes this proposal would have on tax rate calculations for future debt service or overrides would vary between jurisdictions depending upon the proportions of different classes of property that make up the jurisdiction's total taxable value.

Under the current system, for example, a \$1 million levy on Maricopa County's value (which would apply for the community college district and other countywide entities) under the current system would result in a rate of 0.0041 per \$100 of assessed value. Assuming a 10% assessment ratio on all classes, the rate required to levy \$1 million would increase 38.9% to 0.0057 per \$100.

The Gilbert Unified School District, by comparison, would need a rate of 0.1290 to levy a million dollars using a 10% assessment ratio on a property. That is 23.5% higher than the 0.1044 that would be required under the current system. A million-dollar levy for Prescott Unified would need a rate of 0.2033 currently. If a uniform 10% assessment ratio were applied, that rate would go to 0.2584, a 27.1% change.

Taking a municipal example, the City of Tucson currently needs a rate of 0.0439 for every million-dollar levy. The rate requirement would increase 41.3% to 0.621 on a single 10% ratio.

Finally, to demonstrate the impact on a jurisdiction with disproportionately high levels of business property, Joseph City Unified's rate requirement for \$1 million would increase 140.4% (from 1.0068 to 2.4207 per \$100) if the business classes were brought to a 10% ratio.

The following are the actual tax changes for a hypothetical residential and business property taxpayer with \$100,000 of full cash value for the jurisdictions listed above:

Maricopa County

<u>Taxpayer</u>	<u>Current Tax Rate</u>	<u>New Tax Rate</u>	<u>Current Tax</u>	<u>New Tax</u>
Business	\$0.0041	\$0.0057	\$1.025	\$0.57
Home			\$0.41	\$0.57

Gilbert Unified School District

<u>Taxpayer</u>	<u>Current Tax Rate</u>	<u>New Tax Rate</u>	<u>Current Tax</u>	<u>New Tax</u>
Business	\$0.1044	\$0.1290	\$26.10	\$12.90
Home			\$10.44	\$12.90

Prescott Unified School District

<u>Taxpayer</u>	<u>Current Tax Rate</u>	<u>New Tax Rate</u>	<u>Current Tax</u>	<u>New Tax</u>
Business	\$0.2033	\$0.2584	\$50.83	\$25.84
Home			\$20.33	\$25.84

City of Tucson

<u>Taxpayer</u>	<u>Current Tax Rate</u>	<u>New Tax Rate</u>	<u>Current Tax</u>	<u>New Tax</u>
Business	\$0.0439	\$0.0621	\$10.98	\$6.21
Home			\$4.39	\$6.21

Joseph City Unified School District

<u>Taxpayer</u>	<u>Current Tax Rate</u>	<u>New Tax Rate</u>	<u>Current Tax</u>	<u>New Tax</u>
Business	\$1.0068	\$2.4207	\$251.10	\$242.07
Home			\$100.68	\$242.07

See Attachments 1 through 5 for more detail.

COST TO ADMINISTER THE PROPOSAL

The proposal would not change current assessment procedures. However, a separate category of assessed value (AV) would need to be calculated by applying the new single assessment ratio. Those values would then be tracked separately. This is similar to changes made when the Students FIRST legislation was enacted, requiring a distinction between school district debt limits for “class A” versus “class B” bonds.

POLICY CONSIDERATIONS

A. Equity

Arizona’s current property tax system that applies varying assessment ratios to nine classifications of property in order to shift the distribution of the tax burden from one class to another fails most equity tests. As has been repeatedly documented, the system results in large inequities in taxes between residential and business property. Arizona’s commercial and industrial property taxes have been documented to be some of the highest in the country.

The following example using two hypothetical properties demonstrates the impact of the current assessment ratio for residential and business (assuming a rate of \$1.00 per \$100 of assessed value and that each property has a full cash value [FCV] of \$500,000).

	FCV	Assessment Ratio	Assessed value	Property Tax Rate	Tax
business	\$500,000	25%	\$125,000	\$1.00	\$1,250
home	\$500,000	10%	\$50,000	\$1.00	\$500

In 2002, as the following table shows, commercial and industrial property comprised 23% of the total taxable full cash value of the state and paid 44% of the property taxes. Meanwhile, owner-occupied residential property made up nearly 59% of the state’s taxable value but paid 40% of

the taxes levies statewide. The effective tax rate for commercial and industrial property is nearly three times that for residential property.

2002 Statewide Average Effective Property Tax Rates

Class	Description	Assessment Ratio	Total Taxable Full Cash Value	Percent of Total FCV	Total Taxes Paid	Percent of Total Paid	Effective Rate
1	Commercial, Industrial, Utilities, & Mines	25%	\$63,327,870,879	23.47%	\$1,844,726,209	44.24%	2.91%
2	Agricultural & Vacant Land	16%	19,731,879,936	7.31%	317,242,001	7.61%	1.61%
3	Owner-occupied Residential	10%	158,164,295,799	58.62%	1,658,758,696	39.78%	1.05%
4	Rental Residential	10%	24,353,520,202	9.03%	306,948,518	7.36%	1.26%
5	Railroad, Private car, airline flight	21%	1,096,016,250	0.41%	26,554,841	0.64%	2.42%
6	Residential historic, Enterprise zones	5%	2,571,451,913	0.95%	15,025,509	0.36%	0.58%
7	Commercial Historic	1%	20,497,803	0.01%	445,152	0.01%	2.17%
8	Rental Residential Historic	1%	563,360,325	0.21%	109,584	0.00%	0.02%
9	Possessory Interests	1%	1,451,157	0.00%	1,823	0.00%	0.13%
Total			\$269,830,344,264	100.00%	\$4,169,812,332	100.00%	1.55%

The use of multiple assessment ratios contributes significantly to Arizona's high ranking in comparative studies on property tax burdens. For example, while homeowner property ranked in the bottom half (31st), industrial property in Arizona ranks as high as 3rd nationally in a comparison of property tax burdens published by the *Minnesota Taxpayers Association* (see *Attachment 6*).

Arizona's use of multiple assessment ratios also exacerbates inequities in the distribution of property wealth within school districts. Districts with large amounts of commercial or industrial property often have much higher assessed value per pupil than districts comprised primarily of residential property.

B. Economic Vitality

Some in the tax policy field believe that the practical effect of the high property tax burden is that few capital-intensive manufacturers are willing to locate in Arizona without some form of tax break. Many of the recent manufacturing plants have been placed in foreign trade or enterprise zones (class 6) which are taxed at only 5% of value. While the equalizing effects of this proposal will take several years, it will eventually provide some reductions to the effective tax rates on business property, thereby improving Arizona's position for business location.

C. Volatility

See the discussion above on the impact on existing revenue systems.

D. Simplicity

Arizona has one of the most complicated property tax systems in the country. One of the features most responsible for that complexity is the classification system and its differential determinations of taxable values. The proposal will add a degree of complexity in the near term. However, as debt and overrides are paid off or expire under the current system, those bonds and

overrides authorized under the proposed system would contribute significantly in the move toward a more simple and accountable system.

The current subsidy afforded residential property taxpayers undermines accountability for local government spending and allows proponents to downplay the true cost of bonds and overrides in the debate that surrounds the public vote. This proposal would add an element of transparency and accountability to the public debate upon which voter-approval requirements are prefaced.

ECONOMIC IMPACT

This proposal would, in time, result in a meaningful impact on equalizing property tax burdens between business and residential classes of property.

Attachment 6

**Residential vs. Industrial Property Taxes Rankings
(Payable 2000 – Largest Urban Areas)**

Residential Property Taxes \$150,000 Land and Building \$50,000 Fixtures				Industrial Property Taxes \$25,000,000 Land and Building \$12,500,000 Machinery and Equipment \$10,000,000 Inventories \$2,500,000 Fixtures			
Rank	State	Total Net Tax	Total ETR	Rank	State	Total Net Tax	Total ETR
50	Alabama	\$ 887	0.444%	42	Alabama	\$ 528,200	1.056%
19	Alaska	2,533	1.266%	34	Alaska	674,813	1.350%
31	ARIZONA	1,741	0.871%	3	ARIZONA	1,542,236	3.084%
30	Arkansas	1,742	0.871%	38	Arkansas	602,753	1.206%
29	California	1,788	0.894%	45	California	500,000	1.000%
49	Colorado	977	0.489%	27	Colorado	762,762	1.526%
15	Connecticut	2,989	1.495%	4	Connecticut	1,513,400	3.027%
32	Delaware	1,694	0.847%	49	Delaware	434,732	0.869%
48	District of Columbia	1,005	0.503%	19	District of Columbia	997,900	1.996%
10	Florida	3,278	1.639%	13	Florida	1,059,001	2.118%
42	Georgia	1,339	0.670%	37	Georgia	619,995	1.240%
51	Hawaii	378	0.189%	51	Hawaii	224,468	0.449%
27	Idaho	1,866	0.933%	32	Idaho	721,177	1.442%
1	Illinois	4,810	2.405%	1	Illinois	1,967,725	3.935%
20	Indiana	2,515	1.258%	5	Indiana	1,430,149	2.860%
14	Iowa	3,041	1.520%	11	Iowa	1,128,649	2.257%
37	Kansas	1,531	0.765%	8	Kansas	1,182,137	2.364%
22	Kentucky	2,197	1.099%	30	Kentucky	728,510	1.457%
43	Louisiana	1,246	0.623%	9	Louisiana	1,165,072	2.330%
9	Maine	3,432	1.716%	20	Maine	960,000	1.920%
12	Maryland	3,143	1.571%	31	Maryland	721,680	1.443%
38	Massachusetts	1,473	0.737%	25	Massachusetts	855,250	1.711%
2	Michigan	4,453	2.226%	2	Michigan	1,547,358	3.095%
23	Minnesota	2,110	1.055%	10	Minnesota	1,142,434	2.285%
28	Mississippi	1,862	0.931%	23	Mississippi	892,042	1.784%
24	Missouri	2,055	1.028%	12	Missouri	1,062,787	2.126%
41	Montana	1,386	0.693%	43	Montana	506,873	1.014%
17	Nebraska	2,688	1.344%	28	Nebraska	733,906	1.468%
35	Nevada	1,597	0.798%	48	Nevada	435,606	0.871%
3	New Hampshire	4,116	2.058%	33	New Hampshire	686,025	1.372%
5	New Jersey	4,047	2.024%	18	New Jersey	1,016,155	2.032%
40	New Mexico	1,399	0.700%	44	New Mexico	500,407	1.001%
44	New York	1,244	0.622%	15	New York	1,025,703	2.051%
33	North Carolina	1,693	0.846%	46	North Carolina	461,653	0.923%
16	North Dakota	2,926	1.463%	41	North Dakota	549,371	1.099%
25	Ohio	2,054	1.027%	24	Ohio	887,638	1.775%
36	Oklahoma	1,581	0.790%	36	Oklahoma	650,123	1.300%
13	Oregon	3,051	1.526%	26	Oregon	813,600	1.627%
6	Pennsylvania	3,927	1.964%	16	Pennsylvania	1,020,413	2.041%
8	Rhode Island	3,584	1.792%	7	Rhode Island	1,213,301	2.427%
45	South Carolina	1,139	0.570%	14	South Carolina	1,042,192	2.084%
18	South Dakota	2,680	1.340%	35	South Dakota	651,015	1.302%
21	Tennessee	2,399	1.199%	21	Tennessee	950,609	1.901%
4	Texas	4,076	2.038%	6	Texas	1,417,550	2.835%
39	Utah	1,442	0.721%	39	Utah	569,959	1.140%
11	Vermont	3,199	1.600%	17	Vermont	1,018,642	2.037%
26	Virginia	1,977	0.989%	40	Virginia	554,704	1.109%
34	Washington	1,641	0.820%	47	Washington	454,558	0.909%
47	West Virginia	1,020	0.510%	22	West Virginia	901,388	1.803%
7	Wisconsin	3,812	1.906%	29	Wisconsin	733,030	1.466%
46	Wyoming	1,062	0.531%	50	Wyoming	342,700	0.685%
	AVERAGE	\$ 2,271	1.136%		AVERAGE	\$ 864,752	1.730%

Source: Minnesota Taxpayers Association