- **DRAFT** -

FINDINGS AND RECOMMENDATIONS

of the

Arizona Joint Select Committee on State Revenues and Expenditures

Final Report
Chapter 1

September 20, 1989

- **DRAFT** -

CHAIRMAN'S FORWARD TO CHAPTER ONE

Chapter One of this Report presents the findings and recommendations voted on by the Committee. The Chapter includes 29 recommendations that provide major structural improvements to Arizona's fiscal system. The recommended changes greatly simplify the fiscal system. The recommended shift away from sales taxes to personal income taxes will provide for a fairer fiscal system to meet the needs of our growing state. The Committee's intention with its recommendations was to develop an overall system in which the major components, functioning together, produce a balanced and rational system.

One of the 29 recommendations offers three integrated revenue packages that indicate how Arizona's revenue system can be restructured for the 1991 fiscal year. These packages close the projected 1991 deficit and address, in part, the long-term structural deficit. The packages focus on major changes to the fiscal system, some of which might well occur over a phase-in period rather than in a single step.

On the expenditure side, the Committee did not attempt a detailed program or efficiency review. The Committee studied major expenditure areas by comparing Arizona to other states, by evaluating trends in spending, and by projecting expenditures to the year 2000. As charged, the Committee examined the Cost Efficiency Commission report and recommended that the Legislature continue to evaluate and implement the Commission's recommendations. The Committee also recommended reforms of the budget process, the audit process, and the personnel system to improve the efficiency and productivity of state government.

In developing their recommendations the Committee members wrestled with difficult policy trade-offs and the benefits and costs of potential reforms. While the Committee did not unanimously support each individual component of the recommendations, Committee members recognize that restructuring Arizona's fiscal system will assist the State in more effectively meeting the needs of its citizens.

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INTRODUCTION

The State of Arizona is facing a structural deficit. Projected revenues do not support projected expenditures, and without structural changes, the gap will widen over time. The costs of the services that we have chosen to provide are higher and growing faster than our current revenue collections. Addressing the problem requires examining both the expenditure side of the ledger, as well as the revenue side. We cannot afford merely to increase the amount of revenues collected without justifying the type and levels of expenditures being made.

In recent years, the pressures resulting from the gap between revenues collected and planned expenditures have led to **ad hoc** short-term adjustments to both revenues and expenditures. Due to these piece-meal adjustments, our fiscal system is now extremely complex. We lack an overall fiscal policy framework, thereby making the system susceptible to band-aid changes and erosion of our tax bases.

In the 1980s, Arizona's economy has grown much faster than the U.S. economy, although we have experienced our share of downturns. During this period, Arizona has been an average-taxing and average-spending state overall. Thus, it is clear that tax burdens and spending patterns have not driven the growth or cycles of Arizona's economy.

While Arizona's total state and local government spending has been average, expenditures in specific categories have varied significantly from the average state. Arizona expenditures per capita are substantially above national averages for: highways -- due in part to catching up for past inadequacies; higher education -- due in part to higher per capita student enrollment; and public safety -- due in part to higher crime and incarceration rates. On the other hand, Arizona's expenditures per capita are below average for welfare and health care. These differences from the national average result from policy choices. Many of the major spending categories have been greatly affected by Arizona's rapid population growth.

Much of the complexity of our fiscal system is manifested in the relationship between the state and local governments. The distribution of state aid to counties and cities, the homeowner's rebate, and the current levy and expenditure limits on local governments are not well designed to accomplish policy goals. Many of these state policies are directed toward reducing reliance on local property taxes.

This chapter presents the findings and recommendations adopted by the Committee. The first part of the chapter consists of findings and implications that evolved as the Committee's work progressed. The second part of the chapter consists of Committee recommendations that are based on the findings and implications, Committee research reports, subcommittee analysis, additional topics and information covered in staff memos, and public input. These recommendations involve structural changes that improve Arizona's fiscal system.

CRITERIA FOR JUDGING A STATE AND LOCAL FISCAL SYSTEM

The purpose of defining a set of criteria for evaluating a fiscal system is to provide a common, general framework that policymakers can refer to when policy options are considered. Ideally, any potential change to the fiscal system should be judged against these criteria, and policy choices should be made based on how they fit into the overall fiscal framework rather than on an **ad hoc** basis to meet short term needs.

The Committee used the following criteria in evaluating Arizona's current fiscal system and considering potential changes. Each criterion listed represents a desirable characteristic of a good fiscal system. Because these characteristics are often in conflict, it is impossible to design a system that excels in every category. Using these criteria, the Committee identified weaknesses in our current system and adopted recommendations for structural changes to strengthen and improve the system.

PREDICTABILITY: Avoid frequent **ad hoc** changes to the fiscal system. A certain, predictable fiscal system benefits both taxpayers and policy makers.

SIMPLICITY: Minimize fiscal compliance and administration costs. The system should be easily understood by affected individuals and businesses, and easily implemented by government agencies.

HORIZONTAL EQUITY: Treat individuals of equal means equally under the fiscal system.

VERTICAL EQUITY: Impose higher taxes on individuals with greater ability to pay, or provide these individuals with fewer public services.

EFFICIENCY: Avoid causing changes in economic behavior by keeping tax bases broad and marginal tax rates low. Tax individuals and businesses in relation to public services received, where appropriate.

NEUTRALITY: Avoid differential treatment of like economic activities -- keep the playing field level.

STABILITY: Employ a system that does not produce wide swings in expenditures or revenues in response to economic cycles.

RESPONSIVENESS: Employ a system that adequately tracks the long-term growth in the state's economy and population.

COMPETITIVENESS: Design the fiscal system so that it does not deter economic growth and prosperity.

ACCOUNTABILITY: Provide links between revenue raising responsibility and spending authority, so that voters can hold elected officials responsible for both revenue and spending decisions.

FINDINGS AND IMPLICATIONS
A Summary of the Committee Research Reports

STRUCTURAL DEFICIT

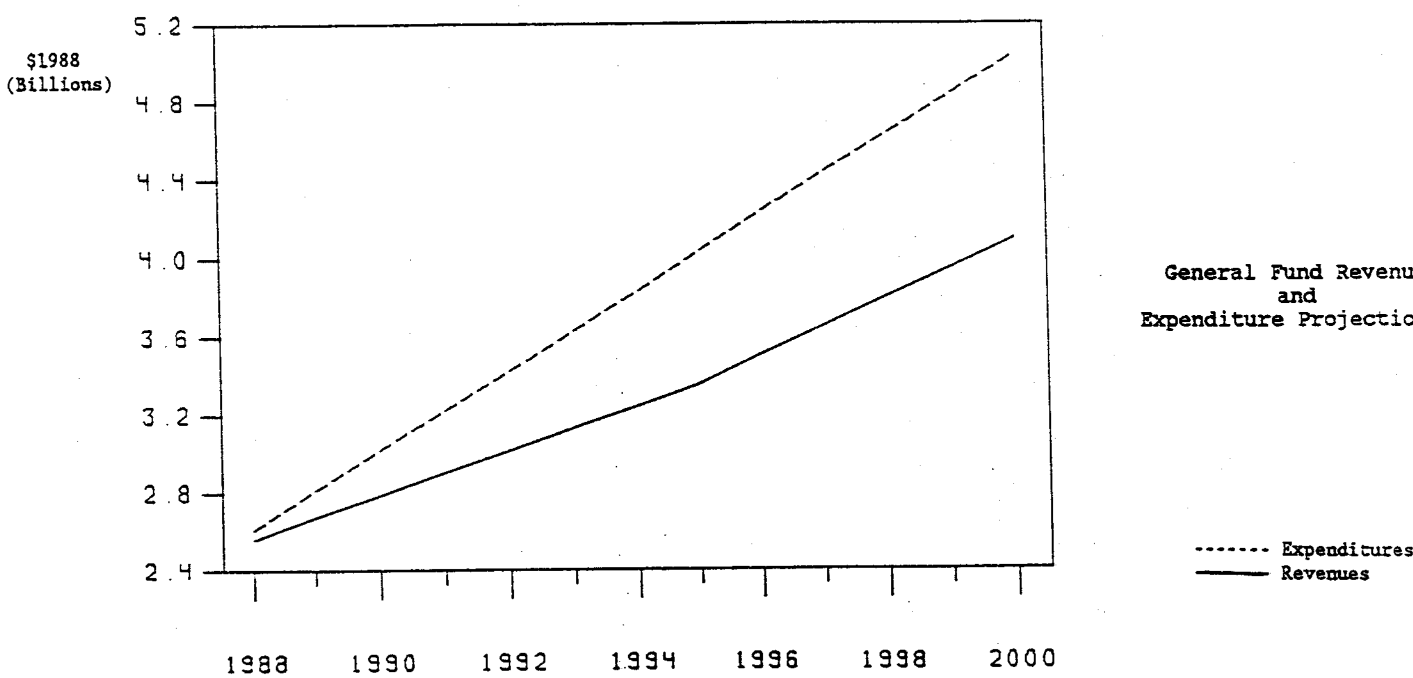
FINDING

1) Under the current revenue structure and the expenditure system resulting from current programs and policies, real general fund revenues are expected to increase by 60 percent from 1988 to 2000, while real general fund expenditures are expected to increase by 93 percent over the same twelve year period.

2) Real general fund revenues increased at an average annual rate of 2.6 percent over the last decade, while real general fund expenditures increased by an average of 3.8 percent per year over the same period.

IMPLICATION

1) The Arizona fiscal system has a structural deficit that is estimated to reach $932 million in 2000, which represents 23 percent of total revenues in that year.



General Fund Revenue
and
Expenditure Projections

FISCAL COMPARISONS AND THE ARIZONA ECONOMY*

FINDING	IMPLICATION
3) In 1987, Arizona state and local own-source revenues per capita were 98 percent of the average for all states.	3) The overall level of taxes in Arizona is competitive.**
4) Per capita income in Arizona is approximately 95 percent of the average for all states. Arizona tax base capacity -- a measure of ability to tax that incorporates actual tax bases, such as sales, property and income -- is 99 percent of the average for all states.	4) To have an average level of state and local expenditures per capita, Arizonans must spend a slightly higher share of their income on public programs than average. However, Arizona has the tax base capacity to spend and tax at an average level.
5) From 1980 to 1987, total state and local revenues per capita grew 75 percent in Arizona and 78 percent nationally.	5) Revenue raising by Arizona governments has been in line with state and local revenue raising throughout the country in the 1980s.
6) In 1987, total Arizona state and local spending per capita (including capital expenditures) was about the average for all states. State and local spending per capita was: about average for K-12 education; significantly above average for higher education, highways, and public safety; and significantly lower than average for welfare and health care.	

* See Appendix I for charts and graphs that illustrate many of the findings contained herein.

**For the purposes of these findings and implications, we have assumed that the competitiveness criterion is met by keeping revenues and expenditures from becoming far out of line with the national average or neighboring states.

7) Arizona's tax effort on the sales tax base is significantly above the average for all states, while its tax effort on personal income, corporate income, property, and user charge bases is below average.	7) The mix of revenues and taxes in Arizona may not be competitive.
8) The techniques used to develop revenue forecasts in Arizona are generally sound.	8) Recent budgetary problems are not attributable to forecasting deficiencies.
9) Reasonable margins of error inherent in forecasting suggest that general fund surpluses or deficits of 3 to 4 percent are not unusual.	9) To inject predictability into the budget process, a specific, enforceable, constitutional or statutory mechanism could be developed to manage unexpected deficits or surpluses of 3 to 4 percent.
10) The state aid link between state and local governments is strong in Arizona.	10) Because of fiscal interrelationships between the state and local governments, changes to the State's fiscal system cannot be thoroughly evaluated without examining potential impacts on local government operations.
11) Since 1970, Arizona's economic cycles have been roughly synchronized with national economic cycles.	11) National economic cycles affect the Arizona economy.
12) The magnitude of Arizona's economic cycles has been approximately one third greater than the magnitude of U.S. cycles.	12) The need for a stable fiscal system is greater in Arizona than in the average state -- in fact, Arizona's fiscal system is more stable than average.
13) Fiscal factors do not explain state economic growth or decline in the 1980s. A state's fiscal system must be far out of line from other states before it has a noticeable impact on economic growth.	

REVENUE SOURCES

FINDING	IMPLICATION
Personal Income Taxes	
14) In 1987 Arizona relied on the personal income tax for 18 percent of state own-source revenues compared to an average of 24 percent for all states.	14) Because personal income taxes track the cycles and long-term growth of the economy, Arizona's current state tax mix, which has a light reliance on personal income taxes, is less responsive and more stable than the average state tax system.
15) The total state and local personal income tax burden in Arizona was $225 per capita in 1987 compared to an average of $344 per capita for all states.	15) The personal income tax burden in Arizona is very competitive, and the burden can be reasonably increased without jeopardizing economic growth.
16) The current personal income tax structure is remarkably complex.	16) Unnecessary administrative and compliance costs result from a complex personal income tax structure.
17) The Arizona personal income tax distributes the burden across income classes in a progressive way.	17) The personal income tax is an instrument for progressivity in the state and local revenue system.
Business Income Taxes	
18) Arizona is one of only seven states to allow a deduction for federal taxes paid from the base of the corporation income tax. Because of this deduction, the top statutory rate is approximately two percentage points higher than it would need to be without the deduction, while still raising the same amount of revenue.	

19) In 1987, the state and local corporation income tax burden was low relative to other states, $59 per capita in Arizona compared to an average of $93 per capita for all states.

20) Corporation income taxes raise relatively little revenue for state governments in Arizona and across the country (less than 7 percent of state own-source revenues nationally and less than 5 percent in Arizona in 1987).

20) Reasonable changes in the level of the corporation income tax will not have a major impact on the overall state revenue picture.

21) It is impossible to determine with accuracy who bears the burden of the corporation income tax.

21) The corporation income tax cannot be used as a tool for fair or equitable taxation.

22) Currently reinsurers are substantially free from taxation in Arizona. They are not subject to the corporation income tax, and because they seldom receive premiums, they do not usually pay premium taxes.

22) To improve neutrality, reinsurers could be made subject to the corporation income tax. This is likely to have little impact on the reinsurer business in Arizona, because Arizona's primary attraction to them is generous capital requirements.

23) The premium tax imposed on insurance companies doing business in Arizona is in line with the practices in most states, both in terms of structure and rate.

23) No serious problems of anti-competitiveness or complexity exist with the premium tax.

24) Arizona is one of 17 states that tax financial firms under the general corporation income tax.

24) This treatment is non-neutral because financial corporations differ from other corporations in the way they earn their income. Replacing the corporation income tax with a franchise tax based on net income would result in more neutral treatment.

25) Thirty-four states tax their financial corporations with a franchise tax, and the base of the franchise tax is often net income, defined in the same manner as the corporation income tax.

25) Employing a franchise tax would not be anti-competitive.

Sales Taxes

26) In 1987, state and local general sales tax collections were $554 per capita in Arizona compared to an average of $398 per capita for all states.

26) The sales tax burden in Arizona may be placing the State at a competitive disadvantage.

27) Arizona collects a relatively large share of its revenues from the general sales tax -- 37 percent of own-source state revenues in 1987 compared to the average for all states of 25 percent.

27) The Arizona revenue system is both more stable and less responsive than the average state revenue system.

28) The Arizona transaction privilege tax is more complicated than a consumption tax on final sales. The sales tax code appears to have evolved in a piecemeal fashion, lacking an overall conceptual framework.

28) The resulting **ad hoc** revisions diminish the simplicity and predictability of the tax, and the frequency of revisions leads to fluctuations in revenue.

29) The broad base of the Arizona sales tax includes many business purchases.

29) The sales tax treatment of business purchases results in nonneutralities and inefficiencies.

30) Despite exemptions intended to reduce regressivity (such as the exemption for food for home consumption), the Arizona sales tax, like sales taxes everywhere, is regressive. That is, tax burdens as a share of income fall as income rises.

30) Heavy reliance on sales taxes makes for a more regressive tax system.

31) Food for home consumption and personal services are exempt from the sales tax, regardless of income level.

31) Exempting food narrows the sales tax base dramatically without targeting relief to low-income individuals. Including food in the sales tax base would make the tax more regressive, more stable, and less responsive. Including personal services in the sales tax base would make the tax more efficient, more responsive, simpler, and only very slightly more regressive.

32) Sales taxes are a major direct conduit for non-resident visitors to compensate state and local governments for public services they consume.

33) The tax rate on cigarettes in Arizona is approximately 25 percent below the average for all states. The tax rate on distilled spirits is slightly above average, the tax rate on wine is significantly above average, and the tax rate on beer is somewhat below average.

34) The burden of taxes on cigarettes and alcohol is highly regressive.

34) A heavier reliance on either of these taxes would make for a more regressive tax system.

35) Unlike the general sales tax, cigarette and alcohol taxes are collected on a per-unit basis in Arizona and other states.

35) Without frequent rate increases, revenue from these two taxes does not keep pace with inflation.

36) Total state and local bed tax rates in Arizona are in line with the total rates in neighboring states and other states with large tourism industries.

36) The taxes imposed on hotel and motel rooms are competitive.

Property Taxes

37) In 1987, Arizona's state and local property tax burden was $462 per capita, 93 percent of the per capita average for all states.

38) In 1987, property taxes accounted for less than 3 percent of state own-source revenues in Arizona and less than 2 percent of state own-source revenues nationally.

38) Reasonable changes in the level of state property taxes will not have a major impact on the overall state revenue picture.

Other Revenue Sources

39) Arizona's 2.5 percent severance tax on mining is higher than the average for all states, and Arizona's mineral tax base is also defined more broadly than that of most other states.

39) These higher taxes may place mineral production in Arizona at a competitive disadvantage compared to other states.

40) The State government in Arizona relies less on charges than the average for all states -- current charges accounted for 8 percent of state own-source revenues in Arizona in 1987, compared to 10 percent nationally.

40) The State may be losing opportunities to link benefits received to charges paid.

41) Thirty states have a realty transfer tax with rates ranging from 0.01 percent to 3 percent of property value.

41) Because 30 other states impose a realty transfer tax, imposing such a tax in Arizona would not put the State at a competitive disadvantage. The tax would make the system more responsive to growth, but would add to the instability of the tax system.

EXPENDITURE PROGRAMS

FINDING	IMPLICATION
Higher Education	
42) Per capita full time student equivalent enrollment in universities and community colleges is 20 percent higher in Arizona than the average for all states. Because of this above average enrollment and below average per capita income, Arizona is above the average for all states in per capita expenditures and expenditures per $1,000 of personal income. Arizona is below average in expenditures per full time student equivalent.	42) Quality does not depend on effort relative to population or personal income. To stay competitive Arizona needs to spend an above average amount relative to population. Arizona could reduce the number of students enrolled in public institutions of higher education, but because Arizona has few private institutions of higher education, enrollment cutbacks at the public institutions will make higher education less accessible.
43) In the 1980s, state support per community college student has not grown as fast as expenditures. At the same time, community colleges have increased their reliance on local sources of revenue and on tuition and fees, and community college expenditures per student have fallen in real terms.	43) The State could enhance community college education services by increasing state aid or by granting greater revenue raising authority to community college districts.
44) At Arizona universities, both in-state and out-of-state tuition are somewhat below the average for all states.	44) Slight increases in university tuition would bring Arizona in line with tuition rates elsewhere, but may preclude access to higher education. Policy considerations may warrant different changes to in-state and out-of-state tuition.

Health Care

45) Current evidence suggests that the Arizona Health Care Cost Containment System (AHCCCS) has contained costs when compared to a traditional Medicaid program, though not by a large amount.

45) Changing to Medicaid is not likely to alter indigent health care costs significantly.

46) A combination of factors outside of state control -- such as medical price inflation, technological changes, and demographic shifts -- has caused increased health care expenditures.

46) The State can reduce health care costs significantly only by eliminating programs, making eligibility requirements more restrictive, or reducing the level of service.

47) In 1987, Arizona state health care spending per capita, including mental health care, was far below the average for all states.

47) The State can spend more on health care without exceeding the average for all states.

K-12 Education

48) Local school districts have varying fiscal capacities and face varying educational costs.

48) Without state aid to these districts, the variation in school tax burdens and educational services would increase considerably.

49) Arizona state and local school expenditures per pupil (including capital and current spending) were above the average for all states in 1987. Arizona's greater-than-average growth in student population resulted in capital spending per pupil roughly three times higher than the average for all states.

50) Despite the equalizing effect of the basic state aid formula, significant variation remains in both school tax burdens and expenditures per pupil. This variation reflects different local fiscal choices involving expenditure limit overrides, expenditures allowed outside the equalization base limit, and other fiscal decisions.

50) The state aid formula could be revised to address these differences more directly.

51) Current state and local education expenditures per pupil in Arizona were 3 percent below the average for all states in 1987. When the Advisory Commission on Intergovernmental Relations' (ACIR) Representative Expenditure System (RES) is used to account for the higher costs of educating high school students and low income students, Arizona's current expenditures per pupil on K-12 education were 11 percent below the average for all states in 1987.

51) To achieve an average RES level of current spending per pupil that reflects the higher cost of educating high school students and low income students, Arizona would have had to spend $231 million more on K-12 education in 1987. There is no evidence, however, that this additional spending would necessarily improve educational performance.

Welfare

52) The characteristics of the Arizona population do not explain the low level of welfare expenditures relative to the average for all states.

52) Increased spending on welfare would require a realignment of policy priorities.

53) The federal Family Support Act mandates several changes to state welfare programs that expand benefits for welfare recipients and alleviate some of the harmful incentives built into the current system.

53) To meet these mandates, the State either must spend more money or reduce the scope of current programs provided.

Natural Resources

54) The groundwater withdrawal fee of $1.00 per acre foot is low relative to the cost of other sources of water.

54) Increases in this fee could encourage the conservation of groundwater and provide an offset to general fund revenues for the Department of Water Resources.

55) Compared to other state park systems, Arizona's system has relatively few sites and visitors, and operating expenditures per capita are much lower than other western states and the average for all states.

55) If the State decides that preservation of and access to sites of natural beauty are important state responsibilities, then more sites will have to be acquired and more resources committed.

56) The Game and Fish Department is financed solely by federal monies and licenses and fees. Federal monies comprise about 25 percent of total revenues.

56) If federal funding is insufficient, license and fee revenue cannot fund both game and non-game programs adequately.

Public Safety

57) Despite the fact that real expenditures per inmate have fallen during the 1980s, increases in the inmate population have caused dramatic increases in total corrections expenditures.

57) Corrections expenditures can be decreased significantly by reducing the number of people in prison -- through alternatives to incarceration or changes in policies defining crimes and criminal sentences.

58) In 1987, per capita state and local expenditures on public safety were significantly higher in Arizona than the average for all states, due in part to Arizona's higher than average crime and incarceration rates.

Highways

59) In 1987, Arizona's total state and local highway expenditures were nearly 70 percent higher than the average for all states and nearly 25 percent higher than the average of eleven other western states. Evidence suggests, however, that Arizona under-invested in highways relative to other states in the decade prior to 1987.

59) To accommodate population growth and to maintain parity with other western states, Arizona may need to continue to spend a higher than average amount on highways.

60) Arizona's current highway fees and taxes are not structured to keep pace with the costs of highway construction and maintenance.

60) Indexing highway fees and tax rates to a highway cost price index would allow revenues to keep pace with highway costs without frequent statutory changes in rates, although it will not prevent shortfalls due to unanticipated costs.

Privatization

61) Competitive forces in the private sector provide incentives for minimizing costs and enhancing productivity.

61) Privatizing the delivery of public services has the potential for cost savings.

62) Arizona has been a national leader in the privatization of public services. Most privatization arrangements, both in Arizona and other states, are contracts with private firms that require financing from public funds.

62) Privatization offers limited solutions to significant budget deficits because much privatization requires public funding.

LOCAL GOVERNMENT FINANCE

FINDINGS

63) Arizona's municipal sales taxes are unusual in that cities have complete authority to set their own tax rates and define their own tax bases.

64) Arizona local government sales tax collections per capita were nearly twice as high as the average for all states in 1987.

65) Approximately 85 percent of state assistance to cities and counties in Arizona is not appropriated, but rather is a pre-determined share of specified revenue collections.

66) The State of Arizona devotes a larger share of its revenues to local assistance than the average for all states -- 41 percent of state revenues in Arizona compared to 33 percent nationally in 1987. This greater-than-average distribution reflects the greater decentralization of expenditures in Arizona.

IMPLICATIONS

63) This arrangement is advantageous to city governments because it allows them to tailor their sales tax bases to their particular circumstances and preferences, and insulates them from state tax changes enacted by the Legislature. The multiplicity of tax bases and rates, however, greatly complicates tax compliance, collections, and enforcement.

64) The exceptionally high sales tax reliance of Arizona local governments magnifies the advantages and disadvantages of sales taxes relative to alternative sources of local revenues.

65) This pre-determined level of aid limits legislative flexibility on fiscal decisions from year to year. At the same time, the certainty of the pre-determined allocation facilitates fiscal planning on the part of recipient local governments.

66) This greater distribution of state aid weakens the accountability in the fiscal system by displacing the link between revenue-raising responsibility and spending authority.

67) Since 1986, the State has not met its statutory funding commitments to community college districts.

67) To meet the statutory formula, the State would have had to allocate an additional $9.9 million in aid to community colleges in 1988.

68) Much state aid in Arizona is allocated based on population.

68) State aid programs are not designed to equalize fiscal disparities across local jurisdictions.

69) Property taxes are slightly progressive and efficient sources of revenue that are not heavily utilized by states or the federal government.

70) Property classification systems are costly to administer and comply with. The tax differentials arising from classification distort investors' decisions regarding property ownership. Because Arizona's system defines an unusually high number of classes, these disadvantages are acute.

70) Economic criteria support the elimination of property classification systems. Because the tax is a tax on property value, there is no economic justification for different rates on different types of property.

71) Despite the general advantages of local property taxes, their use is limited by the Arizona Constitution. It is unclear whether these limits have constrained property tax levies in the 1980s, but they may become constraining in the future as the rate of new construction declines.

71) The property tax levy limits may prevent local governments from gaining the full advantages of property taxes.

72) The homeowner's rebate offsets 56 percent of most homeowner primary property taxes for school districts, up to a maximum of $500.

72) The large rate of the rebate and the fact that very few taxpayers currently reach the maximum suggest that an incentive exists for increasing school primary taxes and spending. Because voters do not pay the full cost of additional education services and school districts do not have to raise their full revenues from local taxpayers, the homeowner's rebate diminishes accountability and efficiency.

COMMITTEE RECOMMENDATIONS

The recommendations of the Committee are based on the Committee research reports, findings and implications, subcommittee analysis, additional topics and information covered in staff memos, and public input. (See Appendices II and III for a complete listing and abbreviated descriptions of all policy options considered by the Committee.) The recommendations address structural deficiencies in Arizona's fiscal system, and improve the simplicity, neutrality, predictability, competitiveness, accountability, responsiveness, efficiency and fairness of the system.

1. To reduce administration and compliance costs greatly and to base tax liability more accurately on ability to pay, the Committee recommends that the Arizona personal income tax system start with a federal definition of the tax base, and make a minimal number of adjustments to that base. The broader base results in lower statutory tax rates and less interference with private economic activity. (An illustrative sample tax form that achieves simplicity and fairness by employing Federal Adjusted Gross Income as the tax base is contained as Appendix IV.)

2. To improve the responsiveness and progressivity of the Arizona tax system, the Committee recommends a heavier reliance on the personal income tax.

3. To design a more effective sales tax, the Committee recommends that the base be broadened to include a wider array of consumer purchases of goods and services. The Committee also recommends that the structure for determining the base to be shared with cities and counties be simplified, and the number of separate taxable categories be reduced. These changes result in lower statutory rates and reduced administration and compliance costs.

4. To improve neutrality and enhance the competitive position of the state, the Committee recommends that used agricultural equipment, expendable materials used in processing and the commercial rental of real property be exempted from the sales tax.

5. To improve the neutrality and simplicity of the property tax, the Committee recommends that the nine classes of property be collapsed into three classes, one for residential property (currently classes 5, 6 and 8), one for vacant land and agricultural property (currently class 4), and the other for commercial and industrial property (currently classes 1, 2, 3, 7 and C). This change improves fairness by making the tax better reflect property value.

6. To improve neutrality and the fairness of the property tax system, the Committee recommends that the highest assessment ratio be no more than twice the lowest assessment ratio. The classification commercial/industrial should have the highest assessment ratio, the classification agricultural/vacant land should have a middle assessment ratio, and the classification residential (including home owners and rental property) should have the lowest assessment ratio.

7. To simplify the property tax system, the Committee recommends that the distinction between full cash value and limited property value be eliminated. Property tax rates, levy limits and voter-approved spending would all apply to one measure of property wealth -- the full cash value.

8. To simplify the corporation income tax, the Committee recommends that the deduction for federal taxes be eliminated. The change reduces compliance and enforcement costs because it eliminates the need to apportion federal taxes among states. This change also lowers the statutory tax rates, causing fewer distortions to economic decisions. To improve neutrality, the Committee recommends that the Legislature consider replacing the corporation income tax with a franchise tax based on net income.

9. To improve the responsiveness of the Arizona tax system and to tax corporations competitively with other states' tax systems, the Committee recommends that the reliance on corporation income taxes be increased.

10. To improve competitiveness and horizontal equity between corporations incorporated in Arizona and corporations incorporated elsewhere, the Committee recommends that the corporation income tax be changed to provide equitable treatment of dividends received from controlled corporations. The Committee further recommends that net operating losses be treated the same in Arizona as for federal tax purposes.

11. To improve the responsiveness of the revenue system and to minimize the need for periodic changes to fee structures and per-unit taxes, the Committee recommends that user charges, license fees, and luxury taxes be indexed to relevant measures of inflation. Without indexation or frequent changes, the real value of charges, fees, and luxury taxes falls over time.

12. To make product prices reflect the costs their use imposes on society, the Committee recommends the creation of a selective tax on hazardous products that can cause pollution. Revenues collected should be kept in a special fund for clean-up programs. After the fund has reached a level deemed appropriate to cover potential losses, the revenues may be used for other costs within the Department of Environmental Quality. This would improve efficiency by linking pollution-generating activities to pollution-abatement expenditures.

13. To enhance the equalization function of the K-12 state aid program, the Committee recommends that spending items currently allowed outside the expenditure limits (financed by primary property tax levies) be prohibited or included as cost factors in the equalization aid formula. Currently, districts have varying capacities to support expenditures on these items. By disallowing the irrelevant items and including the valid cost differences in the formula, districts' capacities will be equalized.

14. To ensure that state equalization assistance to school districts accurately accounts for differences in school costs, the Committee recommends that the state implement routine evaluation of formula factors. Current factors reflect differences across districts in student populations, teacher experience, and transportation costs. As priorities and circumstances change, new factors may need to be added and weights may need to be changed.

15. To improve horizontal equity in the funding of K-12 school districts in Arizona, the Committee recommends a minimum primary school property tax rate be required to be levied on all property over and above the 50-cent county equalization rate and the state education rate (currently 47 cents), and that this be phased in.

16. To improve the accountability and simplicity of the fiscal system and provide more targeted benefits to low-wealth, high-cost school districts, the Committee recommends that the homeowner's rebate be phased out and that a portion of the savings to the state be targeted to increasing state equalization aid. This change improves the fairness of the system by treating owner-occupied residential property like other property. The change also removes distortions by having taxpayers/voters face the true costs of increased education spending. Unlike the rebate, state equalization aid targets state assistance to low-wealth, high-cost districts.

17. To improve equity for taxpayers in school districts, the Committee recommends a funding system be developed to equalize access to voter-approved spending overrides. Currently, districts have varying capacities to fund spending above expenditure limits. Fairness could be increased by establishing a state program to supplement the override tax levies collected by districts with low property wealth. Districts would be able to finance overrides up to a limit with more similar tax rates.

18. To make tuition better reflect the cost of education at the universities, the Committee recommends that both in-state and out-of-state tuition be increased, but not necessarily in the same proportions. To preserve access to higher education for people at all income levels, financial need-based scholarship programs should be expanded.

19. To assist low income families and to establish a welfare system that provides not only support, but work incentives, the Committee recommends implementation of those programs in the federal Family Support Act that address these goals. The Committee encourages the Legislature to develop further incentives to help people out of poverty in order to hold down future welfare costs. The Committee also recommends that Aid to Families with Dependent Children (AFDC) benefits be increased. Arizona's benefits are low relative to the national average. In addition, the Committee recommends that the Department of Economic Security take steps to reduce the error rates in eligibility determination in the AFDC and Food Stamp programs.

20. To prevent the occurrence of mid-year budget crises and to improve the predictability of the fiscal system, the Committee recommends that the state establish a specific, enforceable, constitutional or statutory mechanism to accommodate budgeting and forecasting errors. Even with solid forecasting and budgeting techniques, margins of error of 3 to 4 percent are common. One possible mechanism would be a contingency fund from which monies would be transferred to the general fund whenever actual revenues fell short of projected revenues or actual expenditures exceeded projected expenditures.

21. To improve the budget process, the Committee recommends that long-term strategic planning to meet established objectives be incorporated into the budget process. This could be facilitated by requiring agencies to submit prioritized budget requests at several different expenditure levels. The budget process could also be improved by implementing budgets biennially for the smaller state agencies

22. To encourage higher productivity and more effective management, the Committee recommends that the personnel system be modified to allow for greater monetary incentives through merit pay and bonuses. Currently, the framework exists for merit pay, but there has not been a great financial commitment by the state to the program. In conjunction with the greater opportunities for reward for state employees, the Committee believes that there should be greater accountability for job performance.

23. To improve the effectiveness and efficiency of state programs, the Committee recommends increasing the frequency of performance audits of major agencies and implementing follow-up actions to audit findings. Currently, sunset performance audits are scheduled only once every ten years and there are no formal follow-up procedures to ensure that problems identified by the audits are addressed. The Committee also recommends that the private sector loan executives to the Auditor General to increase audit resources. To increase the usefulness of both financial and performance audits, the Committee recommends greater interaction between the audit and budget processes. The Committee also recommends the initiation of audits of statewide functions, such as the use of motor vehicles or consultants, and recommends the creation of an audit function within the Executive branch.

24. The Arizona Cost Efficiency Commission (Mini-Grace) identified several areas in state government for potential cost savings and cost avoidance. The Committee recommends that the Legislature specify procedures for obtaining closure on each of the Mini-Grace recommendations.

25. To provide greater fiscal equalization across cities and counties, the Committee recommends that per capita income be one of the factors used to allocate state aid. Jurisdictions with higher per capita income have lower need and higher capacity, and, therefore, need less state aid.

26. To provide local autonomy and voter approval of local fiscal decisions, the Committee recommends that voter-approved permanent changes be allowed to the bases of both levy and expenditure limits for cities, counties and community college districts. This change, while maintaining constraints on local fiscal behavior, allows for flexibility to address changing circumstances.

27. To provide counties with more revenue flexibility to meet their expenditure needs, the Committee recommends that counties be granted authority to impose sales taxes by a vote of the people. The current state sales tax distribution to the counties could then be reduced or eliminated. County sales taxes are common nationally and regionally. Because many counties are at their property tax levy limits, this authority would provide greater own-source revenue capacity. To facilitate administration and uniform enforcement, the authority granted should be restricted to a uniform code imposed by the state on the counties.

28. Our research report of August 23 illustrated that general fund current-program expenditures are projected to grow much faster than general fund current-program revenues between now and the year 2000: 5.6 percent a year for expenditures compared to 4.0 percent a year for revenues. The Committee has provided a set of recommendations on revenues and expenditures to serve as a foundation for a good fiscal system. This foundation provides a more responsive revenue system than the current revenue system and, therefore, addresses the structural deficit, in part. Because the growth rate of expenditures will remain above the growth rate of revenues, there will be a need for future revenue increases or expenditure decreases. To address the structural deficit further, the Committee recommends that the Legislature re-evaluate the fastest growing components of total expenditures to identify ways to decrease the growth rates of those components.

29. To improve the responsiveness, fairness, simplicity, neutrality and predictability of the revenue system, the Committee recommends that Packages A, B and C be given consideration by the Legislature and the Governor. Each of these packages addresses the structural deficit recognized by the Committee. However, Package B best represents the preferences of the Committee. (These packages and the rationale underlying this recommendation of the Committee are described in the next section.)

REVENUE PACKAGES THAT ADDRESS THE STRUCTURAL DEFICIT

Frequent, **ad hoc** changes to Arizona's revenue system enacted to address short-term needs have resulted in a revenue system that is unnecessarily complex, imposes non-neutral treatment on taxpayers, and is unpredictable. The system lacks accountability and fails to track growth in the state's economy at a pace sufficient to cover expenditures. Sales and income tax bases have been eroded over the years, resulting in high statutory tax rates and inefficiencies.

The Arizona revenue system can be simpler, fairer, more predictable, more responsive, and more accountable. An improved revenue system includes a broader, simpler base for income taxes; a broader base of consumer purchases for sales taxes; and a more rational intergovernmental system. Appendix V presents three revenue packages, each of which raises the same revenue as projected for the current system in 1991. Each would result in an improved fiscal system for Arizona.

Our research has found that the Arizona fiscal system does indeed have a structural deficit: under the current system, revenues are projected to grow more slowly than expenditures. As time goes on, the gap between expenditures for current programs and revenues raised under the current structure will widen. Adjusted projections indicate that the deficit is estimated to be $340 million in 1991. This estimate for the 1991 deficit is based on staff long-term projections adjusted for short-term changes in the economy and fiscal policies. The exact amount of the 1991 deficit will vary from this amount due to outside forces, such as changes in federal law, and to policy choices not reflected in these projections. Changes to the levels of expenditures and revenues to close the projected 1991 deficit will not solve the long-term structural deficit. To eliminate the structural deficit, not only must the levels of revenues and expenditures be equal, but the future growth rates of expenditures and revenues must be brought closer in line.

Because the magnitude of the deficit is large, minor adjustments to revenues or expenditures will not eliminate it. Significant expenditure cuts or revenue increases or a combination of the two are required.

Expenditures

For example, if the Legislature chooses to address the problem solely through expenditure cuts, it could do so by freezing real expenditures for corrections, health care and welfare at their 1988 levels. No increases for population growth would be affordable. Alternatively, the future growth rates of major expenditures could be cut in half. This would result in major reductions in public services. For example, there would be 60,000 fewer AFDC recipients and 5,000 fewer prison inmates by the year 2000 (i.e., a 28 percent and 22 percent reduction, respectively, from the projected caseloads in the year 2000.)

Our research has shown that Arizona is an average spender overall. While there exist areas for cost efficiencies, we have found no evidence of areas where the state is clearly over-spending relative to identified needs. Policy choices have resulted in higher than average spending in some areas and lower than average spending in others.

Revenues

If the Legislature chooses to address the structural deficit problem solely through revenues, it could do so along the lines of one of the following three revenue packages for 1991. These revenue packages are not meant to be a reflection of the other Committee recommendations, but rather are illustrations of possible integrated revenue packages that improve upon the current system. These packages focus on major components that together result in a well-balanced system. Although the Committee did not vote on individual components of these packages, the Committee forwards these packages to the Governor and Legislature as illustrations of revenue systems that close the 1991 projected gap and address, in part, the long-term structural deficit. Of the three, Package B best represents the preferences of the Committee.

These packages address the structural deficit with changes to the two major sources of revenue for the state, the personal income tax and the sales tax, and with certain other taxes or structural changes that have major general fund revenue implications. The personal income tax and sales tax provide complementary components to the system. The sales tax brings stability and contributes to the regressivity of the system. The personal income tax is responsive to economic growth and contributes to the progressivity of the system.

Changes to other taxes have much smaller impacts on the overall revenue system. Adjustments to the system using minor revenue sources may be desirable if they contribute to a rational revenue system, but they should not be used simply to raise revenue. The danger of relying on minor adjustments to meet revenue needs is that they often consist of **ad hoc** band-aid solutions that make the system more complex, less neutral and less predictable.

All three packages use federal adjusted gross income (FAGI) as a base for the personal income tax, with no itemized deductions or deductions for federal taxes paid. This broad base for the personal income tax results in a greatly simplified structure, allows for lower statutory tax rates, and provides an income base that better reflects ability to pay. By adopting FAGI as the base with a minimal number of adjustments, Arizona will be affected very little by tax changes at the federal level.

The percentage share of total sales tax collections retained by the state is assumed to be constant and equal to the current share of 78 percent. The share of income taxes retained by the state is assumed to be 87 percent, equal to the current share.

In all three revenue packages and the amounts shown for the current system, the miscellaneous category includes severance taxes, property taxes, luxury taxes, licenses, charges and fees, lottery revenues, insurance premium taxes, and other miscellaneous revenues. Also included under miscellaneous is the revenue currently collected from minimum property tax payments required from school districts not receiving state aid (based on one-quarter of the qualifying tax rate). Changes to the system that raise the required minimum tax are labeled as "additional minimum school tax rate." Finally, the amount shown under the homeowner's rebate represents a reduction in state spending and thus a savings to the general fund.

As recognized in Committee Recommendation #28, these potential changes to the level and structure of state revenues do not provide a complete solution to the structural deficit. Even these three more responsive revenue systems are not projected to grow as fast as expenditures to the year 2000. Arizona will continue to face deficits, although less severe deficits if the Legislature acts upon these recommended packages, throughout the next decade unless the growth rate of expenditures is decreased through: a) a strong economy, b) the maturation of state policies, c) a change in state policies in fast-growth areas such as corrections, health and welfare, or d) a combination of all three.

Package A

This package simplifies the personal income tax, broadens the sales tax base to include personal services and repair, casual auto sales, and interstate telephone calls; narrows the sales tax base to exclude commercial rent; and lowers the sales tax rate to 4.5 percent. The package includes a real estate transfer tax at a 0.5 percent rate, requires school districts not receiving state aid to levy a primary school tax rate equal to the qualifying tax rate, and eliminates the homeowner's rebate. This package decreases the reliance on the sales tax and increases the reliance on the personal income tax and on other sources, primarily property taxes.

	Current System		Package A	
Sales Tax	$1,465		$1,289	
Personal Income Tax	1,003		1,175	
Corporation Income Tax	172		172	
Other:				
Real Estate Transfer				75
Additional Minimum School Tax Rate				92
Homeowner's Rebate				177
Miscellaneous		648		648
Total Other	648		992	
TOTAL	$3,288		$3,628	

By changing the sales tax base, this system is more neutral than the current system, and the lower tax rate results in less interference with private economic decisions. The regressivity of the sales tax is not altered significantly by this package. Including a real estate transfer tax increases responsiveness of the system, and brings our tax structure in line with 30 other states. Raising the minimum school tax rate improves the fairness of the system. Eliminating the homeowner's rebate improves fairness and removes distortions: the current homeowner's rebate does not target needy school districts or needy taxpayers/voters; this change makes the local price to taxpayers/voters better reflect the costs of K-12 education.

This package improves the overall responsiveness of the system and reduces the regressivity. The package increases the property tax burden on homeowners and on property taxpayers in wealthy school districts.

Package B

This package simplifies the personal income tax, changes the sales tax base to include personal services and repair and to exclude commercial rent, and lowers the sales tax rate to 4.8 percent. The package includes a real estate transfer tax at a 0.3 percent rate, requires school districts not receiving state aid to levy a primary school tax rate equal to 75 percent of the qualifying tax rate, and reduces the homeowner's rebate subsidy from 56 percent to 25 percent. This package decreases the reliance on the sales tax, increases the reliance on the personal income tax and increases reliance on other taxes, primarily property taxes.

	Current System		Package B	
Sales Tax	$1,465		$1,338	
Personal Income Tax	1,003		1,275	
Corporation Income Tax	172		172	
Other:				
Real Estate Transfer				45
Additional Minimum School Tax Rate				62
Homeowner's Rebate				88
Miscellaneous		648		648
Total Other	648		843	
TOTAL	$3,288		$3,628	

By changing the sales tax base, this system is more neutral than the current system, and the lower tax rate results in less interference with private economic decisions. The regressivity of the sales tax is not altered significantly by this package. Including a real estate transfer tax increases responsiveness of the system, and brings our tax structure in line with 30 other states; imposing the tax at a low rate causes little interference in the private market. Raising the minimum school tax rate improves the fairness of the system. Reducing the homeowner's rebate subsidy improves fairness and reduces distortions: the current homeowner's rebate does not target needy school districts or needy taxpayers/voters; this change makes the local price to taxpayers/voters better reflect the costs of K-12 education.

This package increases the overall responsiveness of the system, and increases the overall progressivity of the system. The package increases the property tax burden on homeowners and property taxpayers in wealthy school districts.

Package C

This package simplifies the personal income tax, broadens the sales tax base to include food for home consumption and consumer purchases of gasoline, and lowers the sales tax rate to 4.6 percent. To direct the revenues from a sales tax on gasoline to the general fund, as shown below, would require a constitutional change. This package replaces the homeowner's rebate with a homeowner's exemption at an equal cost to the state. This package increases sales tax revenues and increases personal income tax revenues, while all other sources remain the same as in the current system.

	Current System	Package C
Sales Tax	$1,465	$1,515
Personal Income Tax	1,003	1,293
Corporation Income Tax	172	172
Total Other	648	648
TOTAL	$3,288	$3,628

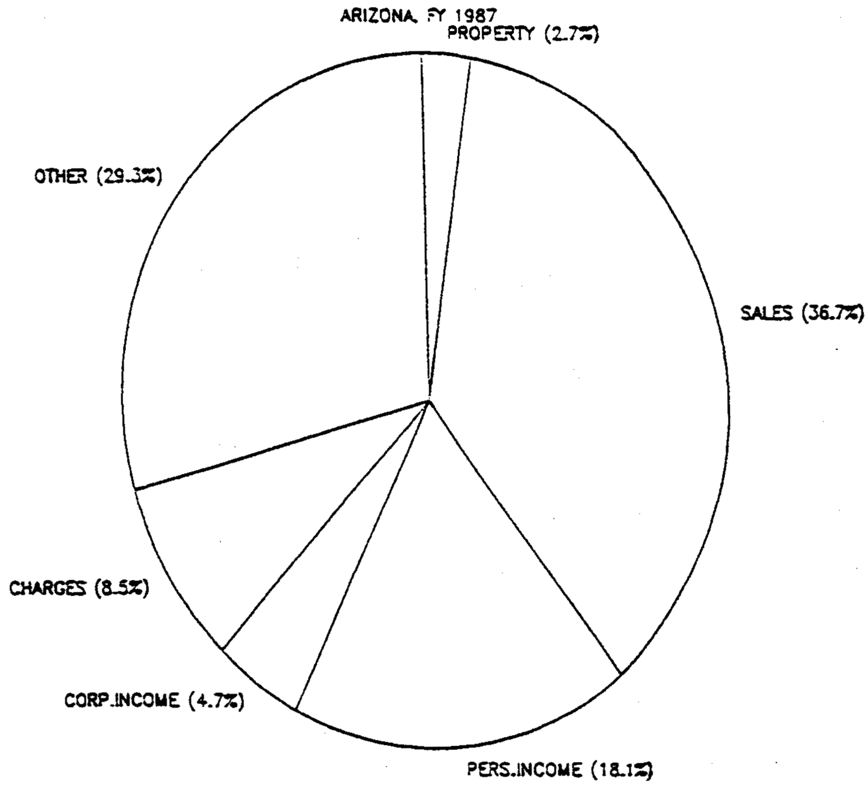
By expanding the sales tax base, this system is more neutral than the current system and the lower tax rate results in less interference with private economic decisions. The regressivity of the sales tax is increased by this change. The change to a homeowner's exemption provides more targeted and less distortionary property tax relief.

Relative to the current system, Package C relies slightly less on the sales tax and more on the personal income tax as a share of total revenue. The changed reliance on sales, personal income and other taxes is not likely to affect overall regressivity or responsiveness relative to the current system.

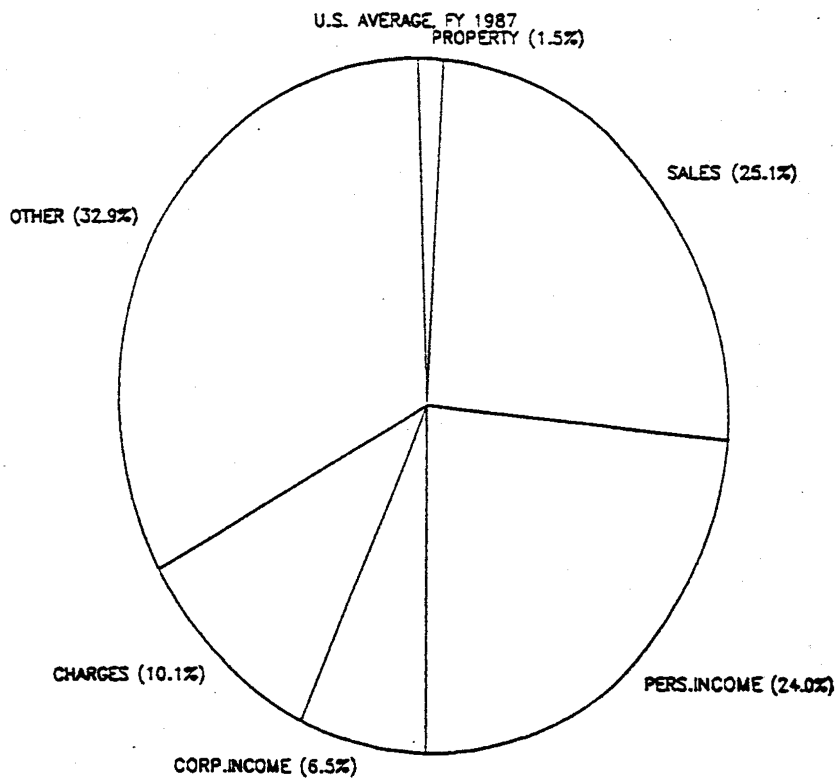
APPENDIX I

CHARTS AND GRAPHS

MIX OF STATE OWN-SOURCE REVENUE



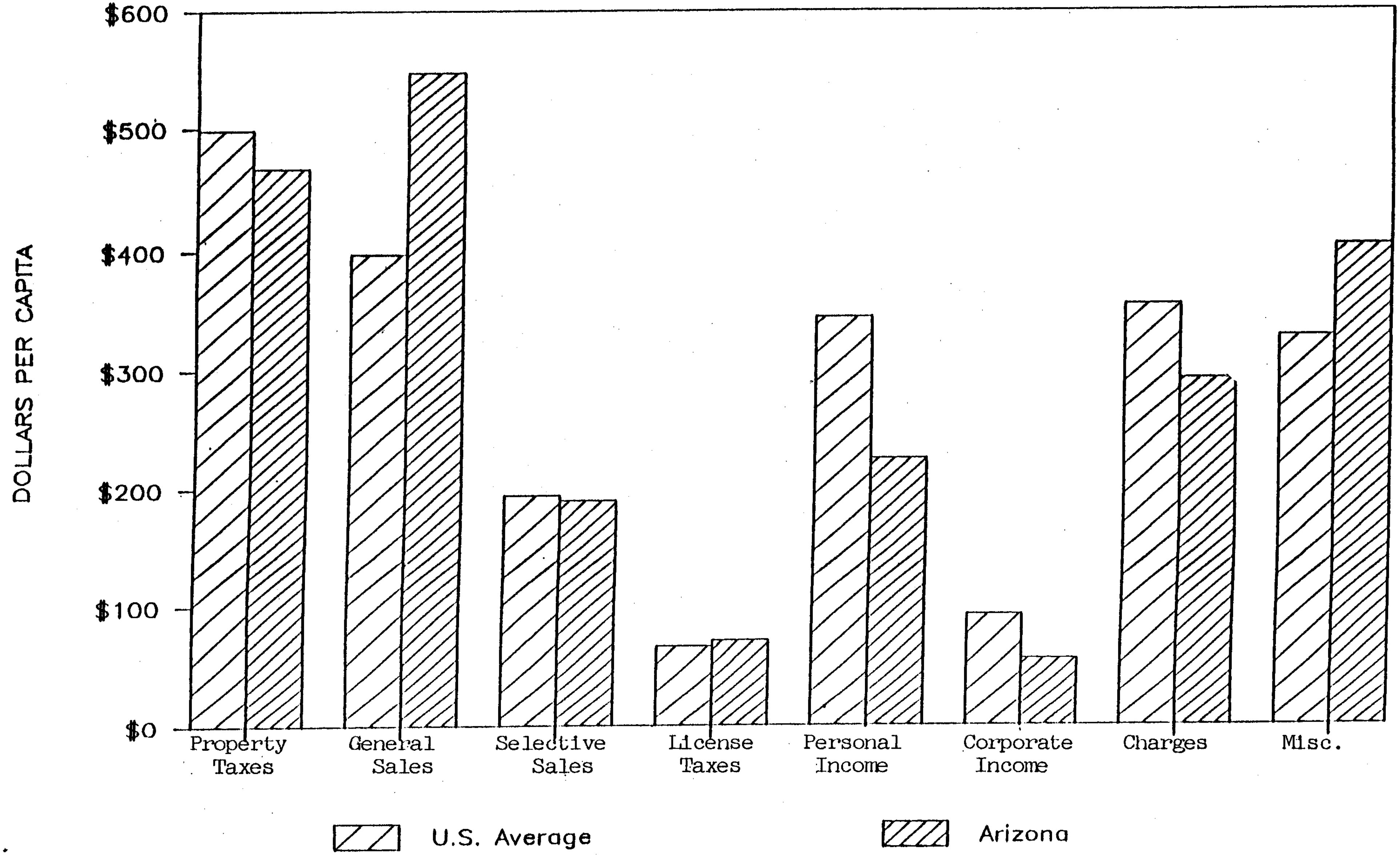
MIX OF STATE OWN-SOURCE REVENUE



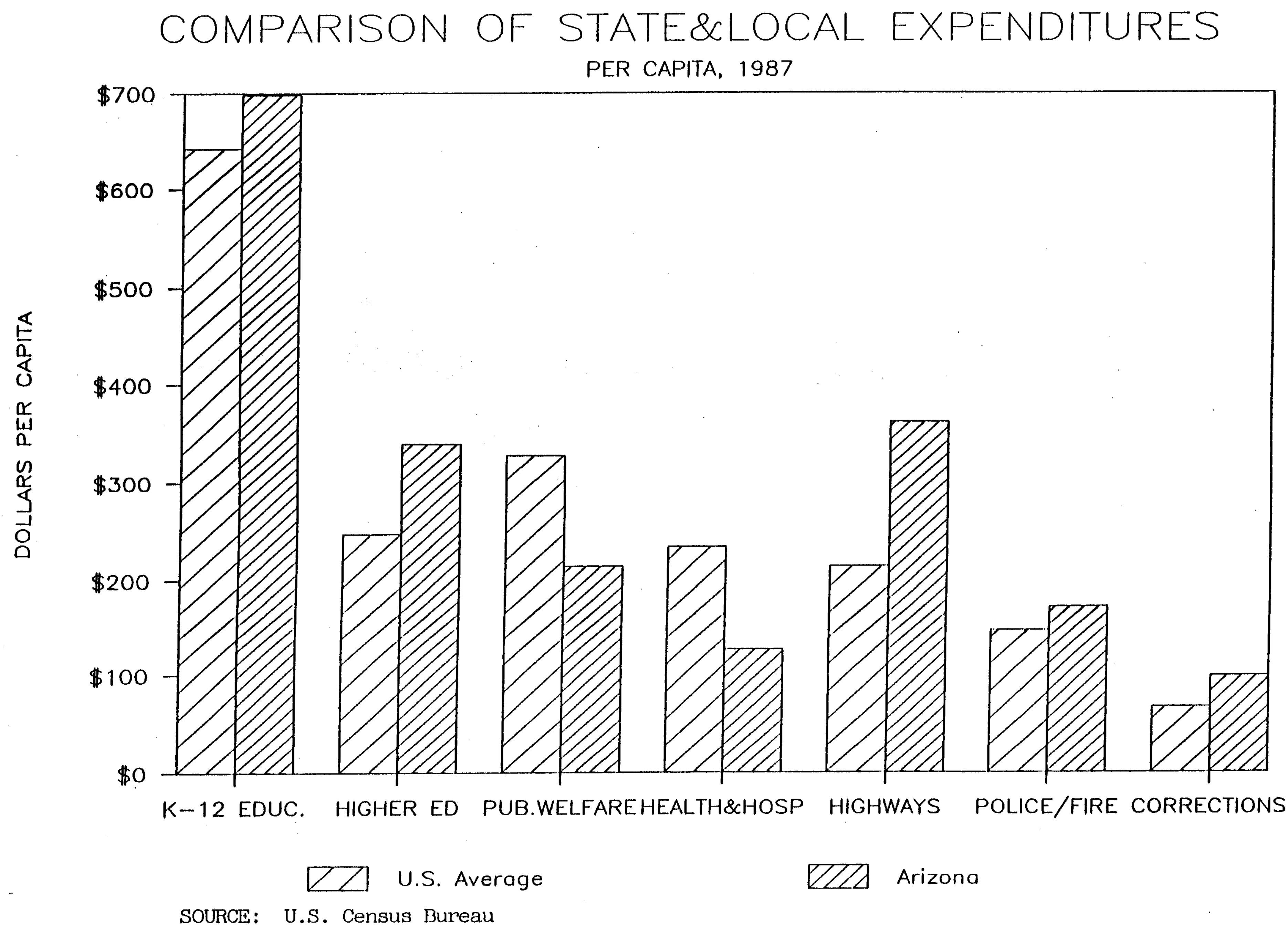
SOURCE: U.S. Census Bureau

COMPARISON OF STATE AND LOCAL REVENUES

PER CAPITA, 1987



SOURCE: U.S. Census Bureau


COMPARISON OF STATE&LOCAL EXPENDITURES
PER CAPITA, 1987
DOLLARS PER CAPITA
$700
$600
$500
$400
$300
$200
$100
$0
K-12 EDUC.
HIGHER ED
PUB.WELFARE
HEALTH&HOSP
HIGHWAYS
POLICE/FIRE
CORRECTIONS
U.S. Average
Arizona
SOURCE: U.S. Census Bureau

APPENDIX II

POLICY OPTIONS INVENTORY

The Committee has considered over one hundred miscellaneous policy options dealing with revenues and expenditures. Most of these options derive from Committee research reports. Several, however, were generated from public input or by individual Committee members. The policy options are listed here as an inventory.

The options are not numbered or arranged on the basis of any priority. Nor should the fact that some options are followed by pro or con remarks or comments and others are not be construed to mean that either the Committee or staff intend that such options are entitled to greater or less weight than others. In some cases, options may overlap. In others, there may be conflicts. The intent of this appendix is only to present the broad array of options that have been considered. The exact wording of this appendix has not been voted upon by the Committee.

POLICY OPTIONS INVENTORY

OPTION	PRO'S	CON'S	COMMENTS
1. Simplify the personal income tax.	Greatly reduces administration and compliance costs.	Reduces opportunity for state-specific adjustments.	Policy goals that differ from federal tax policy goals are not effectively pursued through the income tax due to low marginal rates at the state level relative to federal income tax rates.
a. Adopt federal adjusted gross income (FAGI) as the base.	a. Provides for the most broadly defined base, enhancing efficiency.		
b. Adopt federal taxable income as the base.		b. The narrower base (relative to FAGI) requires higher rates, diminishing efficiency.	b. This option incorporates federal itemized deductions.
c. Apply Arizona percentage to federal tax liability.		c. Would require change in Arizona rate in response to any change in federal tax to maintain revenue.	
2. Increase reliance on the personal income tax.	Provides for more responsive and equitable tax system. State income taxes are deductible at the federal level.	Adds instability. Income taxes are not exportable.	The personal income tax burden and reliance in Arizona are low. Personal income tax revenues could be increased substantially and Arizona would still be below the US average burden.
3. Eliminate deduction for federal taxes paid on the corporation income tax.	Simplifies the system and improves efficiency by reducing the marginal rate.		
4. Impose a franchise tax based on net income on:	Improves neutrality, because income earned on federal obligations may be included in the base. Such income may be more significant for financial institutions than for other corporations.		Federal law prohibits states from taxing federal obligations under a corporation income tax, but not under a franchise tax.

OPTION	PRO'S	CON'S	COMMENTS
a. financial corporations, only.		a. May be difficult to administer as the line between financial and other corporations blurs.	a. 34 states impose a franchise tax on financial corporations.
b. all corporations, by replacing the corporation income tax with the franchise tax.			
5. Broaden the base of the sales tax to include:	Improves efficiency and stability, and provides for more neutral treatment across taxpayers.	May make the tax more regressive.	
a. food.	a. Improves efficiency, simplicity, and stability.	a. Would make the tax more regressive.	a. A refundable state income tax credit for low-income households would address vertical equity issues and target tax relief to those most in need. Food purchased with food stamps would remain exempt.
b. personal & repair services.	b. Improves neutrality, efficiency, and responsiveness.	b. Taxing a wide array of services could harm the state's competitive position.	b. Would require registration and administration of many additional vendors.
c. motor fuel.	c. Improves efficiency.	c. Would make tax slightly more regressive.	c. Would require constitutional change to direct revenues to the general fund.
d. casual auto sales.	d. Improves neutrality and efficiency.	d. Might complicate administration by making ADOT a collecting agent for sales taxes.	d. No good evidence available on distribution of the burden of the tax across income classes.
e. interstate phone calls.	e. Improves responsiveness, neutrality, and efficiency.	e. May hurt Arizona's competitiveness, initially.	e. Revenue estimates include tax on business calls, which should be exempt according to theory that tax should apply only to final sales to consumers.
6. Remove selected business purchases from the sales tax base:	Simplifies the tax, improves neutrality, and potentially enhances the competitive position of the state.	Would result in large revenue losses.	Generally, should not exempt business purchases of items or services which are commonly purchased by individual consumers due to administrative problems and potential for tax evasion.

OPTION	PRO'S	CON'S	COMMENTS
a. equipment.			a. Much equipment is already exempt. Revenue estimates are not available.
b. expendable materials.			b. Revenue estimates are not available.
c. commercial rent.	c. Improves state's competitiveness, and provides for neutral treatment of businesses whether they own or rent property.		c. Arizona is one of five states that tax rentals of real property.
7. Require conformity of state and local sales tax bases.	Greatly reduces complexity and administration and compliance costs.	Diminishes local control and flexibility, local governments are not insulated from state policy choices.	Policy decision must be made on which base to use as a standard.
8. Change alcohol and tobacco taxes from per unit to ad valorem structure.	Improves responsiveness and predictability by minimizing the need for statutory changes in rates.	Could increase regressivity of the fiscal system.	This would be easy to achieve by adding a rate at the retail level and eliminating the tax at the wholesale level.
9. Impose a real estate transfer tax.	Increases responsiveness.	Increases instability.	30 states impose the tax at rates from 0.01% to 3%.
10. Determine whether state higher education resources should be concentrated on one or two major research universities.	Supporting two research oriented universities could help economic development.	Dividing support between two major universities could lead to lower quality overall.	Very few states have more than one outstanding research university. There are no major private universities in Arizona as there are in many other states.
11. Limit enrollment at universities and accommodate more students at community colleges.	Allows the state to concentrate university resources on upper division courses and on research-related activities.	Limits opportunity for university education.	Might involve more state aid to community colleges or higher community college property taxes or tuition.
12. Increase university tuition.	Reduces subsidy to out-of-state students and makes tuition better reflect cost of education.	Limits access to university education.	Could be accompanied by more need-based scholarship funding.
13. Alter eligibility or service coverage under AHCCCS.	Increasing eligibility or service coverage provides greater benefits for low-income individuals.	Increasing eligibility or service coverage requires a larger commitment of resources.	Arizona spends far below the average on health care per capita.

OPTION	PRO'S	CON'S	COMMENTS
14. Reform K-12 financing by:			
a. requiring a minimum primary school property tax.	a. Improves horizontal equity for taxpayers.	a. Increases property tax burden in wealthy districts.	a. Could be implemented in revenue/expenditure neutral way for the state by lowering QTR, or could provide additional revenues for state general fund. The closer the minimum rate is to the QTR, the greater the improvement in horizontal equity.
b. equalizing access to overrides.	b. Improves horizontal equity for taxpayers.	b. Increases complexity.	b. Could be expenditure neutral for state by increasing QTR, and thus substituting override aid for some portion of equalization aid.
c. prohibiting spending outside the equalization base limits.	c. Improves horizontal equity for taxpayers and students.	c. Spending items currently allowed outside the limits could be prohibited or incorporated into the equalization base as cost factors.	
d. implementing routine evaluation of formula factors.	d. Ensures that formula cost factors accurately reflect actual service costs.	d. Evaluation requires resources.	
e. taxing certain industrial /utility property at state level only.	e. Improves horizontal equity for taxpayers.	e. Local governments would bear the costs of providing services to these properties without receiving property tax revenues from them.	e. This option is irrelevant for school districts, if Option No. 14a is adopted.
f. increasing state share of school financing.	f. Improves horizontal equity for taxpayers.	f. Diminishes accountability.	f. Increasing the state share increases the portion of K-12 expenditures funded by sales and income taxes, decreases the portion funded by local property taxes.
g. requiring minimum level of school district expenditures.	g. Could improve horizontal equity in services received by students.	g. Conflicts with local choice.	g. The rationale for minimum expenditures rests on a link between education spending and service levels that is difficult to document.

OPTION	PRO'S	CON'S	COMMENTS
h. merging low enrollment districts with neighboring districts.	h. Could improve horizontal equity for taxpayers and students, could reduce costs per student through economies of scale.	h. Conflicts with local choice.	
i. applying spending limits to small districts.	i. Promotes equal treatment of school districts regardless of size.	i. Conflicts with local choice.	i. Could reduce expenditures in small districts.
j. appropriating funds to districts for strategic planning to meet educational goals.	j. Could promote better local decision-making and improved services.	j. Would require additional state expenditures.	
15. Increase AFDC benefit payments.	Benefits low-income mothers and children and may provide welfare recipients with the means to become financially independent.	Requires large commitment of resources.	Arizona spends far below the average on welfare per capita.
16. Earmark additional gas tax revenues for pollution programs (to DEQ).	Provides a link between pollution generating activities and spending on pollution abatement.	Higher gas taxes may hurt competitiveness.	Would require a constitutional change.
17. Assume full state funding of the judicial system.	Improves horizontal equity in tax burdens and services received across local jurisdictions, may achieve economies of scale.	May create unwieldy state bureaucracy.	Could be revenue neutral by decreasing state shared revenues.
18. Alter sentencing policies, both length and nature of sentence.	Alternatives to incarceration could be cost effective, shorter sentences put less demand on prisons.	Using alternatives to prison or shorter sentences could result in increased crime and less security for the public.	Arizona has a high crime rate and high incarceration rate.
19. Impose a selective sales tax on polluting household products.	Improves efficiency by making the tax reflect the costs imposed on society.	May be costly to administer, would be regressive.	Revenues could be earmarked to pollution clean-up programs.
20. Index all user charges and license fees.	Improves responsiveness, minimizes the need for periodic rate changes.		Set-up costs may be high and a decision must be made as to the appropriate index.
21. Index highway fees and taxes to the cost of highway construction and maintenance index.	Improves responsiveness, provides link between highway revenues and highway expenditure needs.	Would increase reliance on a regressive tax.	

OPTION	PRO'S	CON'S	COMMENTS
22. Permit local option fuel taxes and vehicle fees.	Provides transportation revenues for local governments to finance transportation expenditure responsibilities.	Differences between local taxes could distort consumer decisions.	
23. Grant authority for county sales taxes.	With limits on property taxes, this provides more flexibility to counties.	Sales taxes are already high in Arizona, base capacities would vary greatly across counties.	
24. Remove property tax limits.	Would allow lower city use of sales taxes and lower county use of fees, would remove distortions to local fiscal decisions.	If local voters do not have effective representation, then property taxes may be higher than desired.	This requires a constitutional change. State aid could be reduced if local governments have greater own-source revenue capacity.
25. Add per capita income to state aid distribution formulas.	Improves fiscal equalization across jurisdictions.		Would require collection of timely data on personal income by jurisdiction.
26. Reduce state aid to local governments.	Improves accountability in the fiscal system.	Diminishes the potential for fiscal equalization across jurisdictions.	May require easing of property tax limits or authority for additional local option taxes.
27. Appropriate state aid rather than setting a pre-determined share.	Improves fiscal flexibility and accountability at the state level.	Makes fiscal planning for local jurisdictions more difficult.	About 85 percent of aid to cities and counties is not appropriated.
28. Move toward uniformity of property classes:	Greatly improves simplicity and neutrality.		Property tax burden is redistributed dramatically.
a. one class (complete uniformity).			
b. two classes: residential and commercial/industrial.			
c. three classes: residential, agricultural, commercial/industrial.			
29. Allow permanent voter-approved changes to the base of levy and expenditure limits.	Allows voter-approved flexibility to respond to changing circumstances.		Currently cities and counties can change the base of their expenditure limits.

OPTION	PRO'S	CON'S	COMMENTS
30. Eliminate homeowner's rebate.	Improves accountability and simplicity.	Increases homeowner property tax burden, could result in unintended (by the state) decreases in school spending.	As a school aid program, the homeowner's rebate is not well targeted. As a property tax relief mechanism, it provides perverse incentives to homeowners.
31. Implement structural changes to the homeowner's rebate.			
a. Reduce the rate.	a. The perceived cost of education is closer to the actual cost.		
b. Replace with homeowner exemption or credit.	b. At the margin, increased spending is financed totally by local taxpayers, results in lower effective tax rates for lower valued homes.		
c. Target rebate to low income or low wealth individuals.	c. Provides relief where it is needed.	c. May be more complex.	
32. Improve budget process by adding strategic planning and increasing focus on meeting objectives.	Encourages more effective government.	May require investment of resources.	May be hard to accomplish in a political environment, as the players and priorities change frequently.
33. Increase focus and follow-up on performance audits.	Encourages more effective government.	May require investment of resources.	
34. Implement personnel policies that provide for more accountability for job performance and greater monetary incentives.	Encourages better employee performance.	May be difficult to administer and may require resources.	May require negotiations with AFSCME.
35. Establish a state contingency fund:	Prevents need for short term crisis solutions, improving predictability.		Requires constitutional change.
a. to accommodate forecasting errors.			a. Uncertainty is inherent in forecasting and, therefore, planning for unforeseen errors is justified and prudent.

OPTION	PRO'S	CON'S	COMMENTS
b. to improve the stability of the fiscal system.			b. Collects revenues during economic upswings and draws upon the fund during economic downturns.
36. Encourage Legislative follow-through on study of Cost Efficiency Commission (Mini-Grace).	Significant cost savings may be possible.	May require investment of resources.	Governor's report on Mini-Grace identifies areas for further evaluation.
37. Redefine sales tax base for nuclear fuel production to be gross receipts.	Improves neutrality and efficiency.	Could lead to increases in fuel prices.	The current tax base is narrower for the nuclear power industry than for other types of firms.
38. Impose sales tax on transfers of securities.			Taxing transfers of securities is administratively feasible only in states with stock market exchanges. A proper method of taxing income generated by such transfers is through capital gains taxation.
39. Tax amount of power generated rather than receipts of in-state power sales.	Simplifies the tax and exports some burden to out-of-state residents.	Could lead to retaliatory tax increases on Arizona fuel purchased out of state.	Arizona exports more energy than it imports.
40. Repeal the vendor allowance.	Improves simplicity.	Could increase costs of goods.	Arizona's current vendor allowance is low compared to other states.
41. Repeal the sales tax exemption for advertising.	Could improve responsiveness.	Diminishes neutrality and simplicity.	
42. Extend sales tax to employee meals.	Improves neutrality and efficiency.	Might increase labor costs.	
43. Extend sales tax to carbonated drinks.		Distorts consumer decisions between carbonated and non-carbonated beverages.	Carbonated drinks are now included in exemption for food for home consumption.
44. Exempt purchases of used agricultural equipment from the sales tax.	Improves neutrality.		
45. Increase severance tax rate on mining and timbering.	Burden likely exported to other states and introduces few behavioral distortions.	May diminish competitiveness of Arizona's mining industry.	Severance tax base for mining differs from transaction privilege tax base so equivalent rates do not ensure neutrality.
46. Extend sales tax to cable T.V.	Improves efficiency.		

	OPTION	PRO'S	CON'S	COMMENTS
47.	Increase sales tax rate on wholesale feed.			Lower rate at wholesale is equivalent to higher rate at retail.
48.	Extend sales tax to mining and drilling equipment.		May harm competitiveness and neutrality and may diminish simplicity.	
49.	Require remittance of sales tax collections over $1 million twice monthly.	Increases tax revenue at any given rate.	Increases compliance costs.	
50.	Treat corporations incorporated in Arizona like corporations incorporated elsewhere with respect to dividends received from controlled corporations.	Improves neutrality.	Would result in revenue loss to the state or tax increase for some Arizona corporations.	Current law exempts dividends from subsidiaries of Arizona domiciled corporations and discriminates against firms domiciled elsewhere.
51.	Conform with federal law on the length of carry-back and carry-forward periods for net operating losses for corporation income tax.	Simplifies the corporation income tax.		Attention should be paid to transition rules.

52. Eliminate gradations in the rate structure of the corporation income tax.

53. Change the weights in the corporation income tax apportionment formula to favor the sales factor.

54. Impose the corporation income tax on reinsurers with a credit for premium taxes paid.

55. Broaden the premium tax to cover untaxed insurance forms such as self insurance and fraternal insurance.

56. Include premiums paid by government agencies in the tax base for Health Care Service Corporations.

57. Eliminate the tax credits allowed for insurance examination fees and assessments.

58. Adjust the apportionment formula for multistate financial institutions to:

    a) add intangibles to the property factor,
    b) eliminate the property factor,
    c) use a receipts factor only.

59. Base nexus rules on solicitation rather than physical presence for financial institutions.

60. In determining the appropriate severance tax rate, compare Arizona's severance tax to other states' severance taxes rather than to sales tax rates.

61. Develop indigent behavioral health care as part of the AHCCCS program, part of the Department of Health Services, or an independent entity.

62. Develop a centralized, coordinated data base for state and local health care spending.

63. Implement provisions of the federal Family Support Act prior to the required deadline.

64. Establish poverty prevention programs.

65. Strengthen child support enforcement policies.

66. Raise the groundwater withdrawal fee.

67. Release State Park entrance fees and concessions revenues for use on current operations.

68. Fund non-game and wildlife habitat programs in the Game and Fish Department with General Fund monies.

69. Implement new law enforcement technologies.

70. Enhance court charge and fee revenues.

71. Determine funding, allocation, and appropriate use of Criminal Justice Enhancement Fund monies.

72. Conduct a statewide inventory of potential fees and charges.

73. Establish greater fee flexibility.

74. Evaluate earmarking more fees into special funds.

75. Establish congestion tolls for highway travel.

76. Conduct a cost allocation study of Arizona's highway structure.

77. Evaluate the potential for privately operated prisons.

78. Evaluate current privatization in behavioral health service delivery.

79. Evaluate privatization of government support services.

80. Utilize alternative, private mechanisms to resolve disputes.

81. Privatize inspection and regulation activities.

82. Increase privatization in areas where feasible.

83. Insert matching requirements to categorical state aid programs.

84. Adjust fiscal limits for changes in intergovernmental aid.

85. Allow cities to pass temporary overrides of levy limits.

86. Change state budget process to operate biennially.

87. Alter the level of centralization in state government operations.

88. Establish central data base on Arizona local governments.

89. Establish state body to collect and analyze local government data and act as liaison between local governments and the State.

90. Equalize the effective tax rates on the different types of alcohol.

91. Conduct a study to estimate the revenue losses associated with exempting business purchases from the sales tax base.

92. Reserve mid-year budget adjustment procedures for truly unforeseen emergency situations; a formal mechanism should be established to address such situations.

93. Combine small state agencies.

94. Invest resources in establishing a thorough, well-documented data base on state revenues.

95. Reduce jet fuel taxes in Arizona.

96. Charge a graduated co-payment fee for AHCCCS benefits.

97. Extend sales tax base to include business services and non-health professional services.

98. Prohibit state or local discriminatory rates on products and/or services within the same industry.

99. Eliminate duplication of programs within the university system.

100. Revise residency requirements to reserve in-state tuition rates for bona-fide Arizona residents.

101. Create cooperative venture teams with public/private partnerships utilizing loaned executives to supplement the budget process.

102. Shorten time between sunset reviews.

103. Encourage private sector loaned executives to the Auditor General to increase audit resources.

104. Allow reverted monies to be used for employee rewards.

105. Amend Constitution to allow general obligation bonding for capital outlay for prison construction.

106. Require privatization bidding before general obligation bonding can be undertaken.

107. Limit state bonded indebtedness to a percentage of state personal income.

108. Require that bonds be voter-approved.

109. Increase support for community colleges and raise the admission standards at all four-year universities.

110. Increase out-of-state tuition to cover the actual costs of providing services to those students and increase in-state tuition to the national average.

111. Define a "basic" K-12 education in terms of specific dollar funding and commit state resources to fund that level in each district.

112. Allow local residents the opportunity to increase education funding beyond the basic level through the local property tax.

113. Authorize open enrollment in K-12 school districts to foster competition and accountability.

APPENDIX III

FISCAL OPTIONS GROUPED BY CRITERIA

There is no perfect revenue source to finance state government expenditures. Different sources of revenue serve different policy goals. These goals are often in conflict so that designing a fiscal system involves policy tradeoffs. While a single revenue source may have undesirable characteristics, it may fit effectively into an overall revenue system. It is important then, to evaluate a revenue system on its merits as a whole: do the component parts, functioning together, meet the state's goals for equity, simplicity, responsiveness, stability, competitiveness, predictability, efficiency, accountability, and neutrality? In reality, it is desirable to design a system that meets all of these goals to some degree, a system that is well-balanced. For discussion purposes, it is useful to examine the extremes.

Displayed below are three packages composed by staff, each of which emphasizes a different fiscal criterion. The purpose of these packages is to illustrate which elements of a revenue system best address equity, efficiency and responsiveness. Each package includes only those components that meet these specific goals. All three packages strive for simplicity, where simplicity can be gained without diminishing some other goal.

Package X. Efficiency\Neutrality\Accountability

To improve efficiency, Package X broadens the sales and income tax bases so that statutory rates can be reduced. Broadening the sales tax base to include all consumer purchases, while narrowing it to exclude all business purchases, simplifies the tax. It also provides for more neutral treatment of different types of business. Accountability is improved by having taxpayers and consumers face the true cost of the benefits they receive, and by forcing the jurisdiction that spends tax dollars to be responsible for collecting them.

- o Base the personal income tax on federal adjusted gross income (FAGI)
- o Impose a franchise tax rather than an income tax on all corporations
- o Do not allow a deduction for federal taxes paid on the corporation income tax
- o Remove all business purchases from the sales tax base
- o Expand the sales tax base to include all consumer purchases

- Require conformity between local and state sales tax bases
- Increase university tuition
- Impose a selective sales tax on polluting products
- Permit local option fuel and vehicle taxes
- Reduce state aid to local governments
- Appropriate state aid annually, rather than setting a predetermined share
- Establish uniform classification of property with uniform assessment ratios
- Eliminate the homeowner's rebate
- Remove local property tax and expenditure limits or expand allowance of overrides
- Increase user charges and license fees to reflect actual benefits, and earmark more fees into special funds

Package Y. Equity

Package Y emphasizes both horizontal and vertical equity. It increases reliance on the progressive personal income tax, and decreases reliance on the regressive sales and tobacco and alcohol taxes. The package targets state aid and other subsidies to areas of greatest need, rather than providing broad tax relief programs. It equalizes spending and tax burdens across all types of local jurisdictions.

- Increase the reliance on personal income taxes
- Base the personal income tax on FAGI
- Make the personal income tax more progressive by increasing marginal rates at higher income levels
- Reduce the reliance on sales taxes
- Reduce the reliance on tobacco and alcohol taxes
- Increase university tuition and provide more need-based scholarships
- Impose a minimum school tax rate
- Equalize access to school spending overrides

- Prohibit school district spending outside equalization base limits

- Tax some industrial/commercial/utility properties at state level only -- remove them from local tax bases

- Add per capita income to state aid distribution formulas and provide more aid to jurisdictions with lower per capita income

- Alter the structure of the homeowner's rebate to target aid to low income and low wealth homeowners or to low wealth and high cost school districts

Package Z. Responsiveness

Package Z is designed to grow more quickly relative to growth in the underlying economy. Reliance on the personal income tax, a very responsive revenue source, is increased, and other revenue sources are redesigned to be more responsive. Note that responsiveness and stability are opposing goals so that a package emphasizing stability would have the reverse of the components in Package Z.

- Increase reliance on personal income taxes

- Decrease reliance on sales taxes

- Add personal services to the sales tax base

- Base tobacco and alcohol taxes on the dollar value of sales rather than on the quantity purchased

- Impose a real estate transfer tax

- Index all charges and fees to keep pace with some measure of inflation

- Make the personal income tax more responsive by including brackets with higher marginal rates at higher income levels

APPENDIX IV

SAMPLE SIMPLIFIED PERSONAL INCOME TAX FORM

Arizona Form 140 — Resident Personal Income Tax — Tax Year 1989

Name
Home Address
City State Zip
Your Social Security Number
Spouse's Social Security Number

Filing Status 1. ☐ Married filing joint return or Head of household 2. ☐ Married filing separately or Single

Exemptions	Personal	Dependents	Age 65 or over	Blind
Write number of exemptions claimed	1. ______	2. ______	3. ______	4. ______
	Total (add lines 1 through 4) 5. ______			

6. Federal Adjusted Gross Income (U.S. form 1040, line 31 or U.S. form 1040A line 13 or U.S. form 1040 EZ line 3) 6. ☐

7. Interest or dividends earned on bonds of another state or its governmental units 7. ☐

8. Add lines 6 and 7 and enter total here 8. ☐

9. Interest received from U.S. bonds, Treasury notes, other U.S. certificates of indebtedness 9. ☐

10. Multiply the number on line 5 by $X thousand 10. ☐

11. Add lines 9 and 10 and enter total here 11. ☐

12. Subtract line 11 from line 8. This is your Arizona taxable income. 12. ☐

13. Tax from the table on page X of instructions 13. ☐

14. Voluntary contributions for wildlife, child abuse prevention, and political parties. 14. ☐

15. Add lines 13 and 14 and enter total here. 15. ☐

16. Arizona income tax withheld (from 1989 W-2 forms) 16. ☐

17. Estimated tax paid in 1989, and extension payments. 17. ☐

18. Add lines 16 and 17, and enter total here 18. ☐

19. If line 18 exceeds line 15 enter your REFUND. 19. ☐

20. If line 15 exceeds line 18 enter your TAX DUE. 20. ☐

Your signature ______________ Spouse's Signature __________ Date ______

Paid Preparers Signature ________________ Firm's Name ________________

Address ______________________ Social Security # ____________

APPENDIX V

REVENUE PACKAGES THAT ACCOMPLISH STRUCTURAL REFORM

Frequent, **ad hoc** changes to Arizona's revenue system enacted to address short-term needs have resulted in a revenue system that is unnecessarily complex, imposes non-neutral treatment on taxpayers, and is unpredictable. The system lacks accountability and fails to track growth in the state's economy at a pace sufficient to cover expenditures. Sales and income tax bases have been eroded over the years and inappropriately exclude categories, resulting in high statutory tax rates and inefficiencies.

The Arizona revenue system can be simpler, fairer, more predictable, more responsive, and more accountable. An improved revenue system includes a broader, simpler base for income taxes; a broader base of consumer purchases for sales taxes; and a more rational intergovernmental system. Each of the following three revenue systems would result in an improved fiscal system for Arizona.

Based on our research report of August 23, 1989 that presented long-term revenue projections, and based on adjustments for short-term variations (including both structural changes and economic changes), staff projects that 1991 general fund revenues will be $3,288 million (in 1991 dollars) under the current system. The three potential revenue systems presented below each raise $3,288 million. These packages combine major options that represent improvements upon the current system. The packages include only those options that affect general fund balances.

All three packages use federal adjusted gross income (FAGI) as a base for the personal income tax, with no itemized deductions or deductions for federal taxes paid. This broad base for the personal income tax results in a greatly simplified structure, allows for lower statutory tax rates, and provides an income base that better reflects ability to pay. By adopting FAGI as the base with a minimal number of adjustments, Arizona will be affected very little by tax changes at the federal level.

The percentage share of total sales tax collections retained by the state is assumed to be constant and equal to the current share of 78 percent. The share of income taxes retained by the state is assumed to be 87 percent, equal to the current share.

In all three revenue packages and the amount shown for the current system, the miscellaneous category includes severance taxes, property taxes, luxury taxes, licenses, charges and fees, lottery revenues, insurance premium taxes, and other miscellaneous revenues. Also included under miscellaneous is the revenue currently collected from minimum property tax payments required from school districts not receiving state aid (based on one-quarter of the qualifying tax rate). Changes to the system that raise the required minimum tax are labeled as "additional minimum school tax rate." Finally, the amount shown under the homeowner's rebate represents a reduction in state spending and thus a savings to the general fund.

Package A'

This package simplifies the personal income tax, broadens the sales tax base to include personal services and repair, casual auto sales, and interstate telephone calls; narrows the sales tax base to exclude commercial rent; and lowers the sales tax rate to 4.1 percent. The package includes a real estate transfer tax at a 0.5 percent rate, requires school districts not receiving state aid to levy a primary school tax rate equal to the qualifying tax rate, and eliminates the homeowner's rebate. This package decreases the reliance on both the sales and personal income taxes, and increases reliance on other sources, primarily property taxes.

	Current System		Package A'	
Sales Tax	$1,465		$1,175	
Personal Income Tax	1,003		949	
Corporation Income Tax	172		172	
Other:				
Real Estate Transfer				75
Additional Minimum School Tax Rate				92
Homeowner's Rebate				177
Miscellaneous		648		648
Total Other	648		992	
TOTAL	$3,288		$3,288	

By changing the sales tax base, this system is more neutral than the current system, and the lower tax rate results in less interference with private economic decisions. The regressivity of the sales tax is not altered significantly by this package. Including a real estate transfer tax increases responsiveness of the system, and brings our tax structure in line with 30 other states. Raising the minimum school tax rate improves the fairness of the system. Eliminating the homeowner's rebate improves fairness and removes distortions: the current homeowner's rebate does not target needy school districts or needy taxpayers/voters; this change makes the local price to taxpayers/voters better reflect the costs of K-12 education.

This package does not markedly change the overall responsiveness of the system, nor does it change the overall burden on low-income people relative to high-income people. The package increases the property tax burden on homeowners and on property taxpayers in wealthy school districts.

Package B'

This package simplifies the personal income tax, changes the sales tax base to include personal services and repair and to exclude commercial rent, and lowers the sales tax rate to 4.2 percent. The package includes a real estate transfer tax at a 0.3 percent rate, requires school districts not receiving state aid to levy a primary school tax rate equal to 75 percent of the qualifying tax rate, and reduces the homeowner's rebate subsidy from 56 percent to 25 percent. This package decreases the reliance on the sales tax, slightly increases the reliance on the personal income tax, and increases reliance on other taxes, primarily property taxes.

	Current System		Package B'	
Sales Tax	$1,465		$1,175	
Personal Income Tax	1,003		1,098	
Corporation Income Tax	172		172	
Other:				
Real Estate Transfer				45
Additional Minimum School Tax Rate				62
Homeowner's Rebate				88
Miscellaneous		648		648
Total Other	648		843	
TOTAL	$3,288		$3,288	

By changing the sales tax base, this system is more neutral than the current system, and the lower tax rate results in less interference with private economic decisions. The regressivity of the sales tax is not altered significantly by this package. Including a real estate transfer tax increases responsiveness of the system, and brings our tax structure in line with 30 other states. Imposing the tax at a low rate causes little interference in the private market. Raising the minimum school tax rate improves the fairness of the system. Reducing the homeowner's rebate subsidy improves fairness and reduces distortions: the current homeowner's rebate does not target needy school districts or needy taxpayers/voters; this change makes the local price to taxpayers/voter better reflect the costs of K-12 education.

This package increases the overall responsiveness of the system, and increases the overall progressivity of the system. The package increases the property tax burden on homeowners and property taxpayers in wealthy school districts.

Package C'

This package simplifies the personal income tax, greatly broadens the sales tax base to include food for home consumption and consumer purchases of gasoline, and lowers the sales tax rate to 3.6 percent. To direct the revenues from a sales tax on gasoline to the general fund, as shown below, would require a constitutional change. This package replaces the homeowner's rebate with a homeowner's exemption at an equal cost to the state. This package decreases sales tax revenues by $290 million and, correspondingly, increases personal income tax revenues by $290 million, while all other sources remain the same as in the current system.

	Current System	Package C'
Sales Tax	$1,465	$1,175
Personal Income Tax	1,003	1,293
Corporation Income Tax	172	172
Total Other	648	648
TOTAL	$3,288	$3,288

By expanding the sales tax base, this system is more neutral than the current system and the lower tax rate results in less interference with private economic decisions. The regressivity of the sales tax is increased by this change. The change to a homeowner's exemption provides more targeted and less distortionary relief.

This package markedly increases the overall responsiveness of the system. The increased reliance on the personal income tax and the decreased reliance on the sales tax likely offset the increased regressivity of the expanded sales tax base.