

2006 PROPERTY TAX LEGISLATION AND CASE LAW

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CONSTITUTIONAL AMENDMENTS

Proposition 101, House Concurrent Res. 2056. *The Arizona Constitution Was Amended to Reset the Property Tax Levy Limits for Cities, Towns, Counties and Community College Districts.* The Arizona Constitution restricts the amount of primary property tax that may be levied by Arizona counties, cities, towns and community college districts. The levy limit for each jurisdiction was established in 1980, but under the Constitution is permitted to increase two percent per year plus any new construction. Any levy in excess of this limit must be approved by voters. However, many Arizona jurisdictions did not levy to the applicable limit in 2005, leaving an excess taxing capacity that could be imposed without voter approval. Proposition 101 amended Article IX, Section 19 of the Constitution by resetting the base year and requiring the levy limit for 2007 to be calculated from actual 2005 tax levies. It thus eliminated the excess taxing capacity of Arizona jurisdictions for which voter approval was not required.

LEGISLATION

House Bill 2175 (Ariz. Sess. Laws 2006, Chapter 327). *Exemption for Non-profit Health Care Providers Broadened.* Before this enactment, Arizona exempted three types of health care properties from property taxation: (1) non-profit hospitals that serve the indigent or afflicted; (2) non-profit facilities that provide health-related services to the disabled or elderly; and (3) non-profit primary care facilities that give care in underserved areas or populations. These exemptions were driven and limited by the function of the property. Consequently, non-profit medical clinics, such as those affiliated with Arizona's universities, that provide health care to non-indigent, non-afflicted, or non-disabled patients for training, research or other educational purposes, did not qualify for the exemption. Neither did non-profit hospital administrative buildings. This bill amends A.R.S. § 42-11105 and broadens the scope of the property tax exemption to include all property owned by a health care provider that is incorporated and

recognized as a 501(c)(3) organization under the Internal Revenue Code. The bill applies retroactively to January 1, 2000.

House Bill 2350 (Ariz. Sess. Laws 2006, Chapter 134). *County Treasurer Procedures Amended to Clarify Interest Rate for Refunds, to Allow Treasurers to Require Electronic Submission of Payments and Documentation and to Extend Abatement Processes to Personal Property.* This bill makes a number clarifying and procedural changes including:

Interest Rate for Refunds. Arizona taxpayers who overpay taxes as a result of incorrect tax rolls are entitled to refunds with interest once the error is corrected. Before this enactment, the statutes required county treasurers to use the interest rate established by the Department of Revenue when calculating interest on refunds. It did not, however, specify whether the treasurer should use the Department's rate as of the date the error occurred, the date the error was corrected or the date on which the refund is issued. This bill amends A.R.S. § 42-16254 and requires county treasurers to use the Department's interest rate as of the date it issues the refund check.

Additional Electronic Submissions. Before enactment, Arizona statute permitted county treasurers to require electronic submission of payments and documentation only with regard to taxpayers who made lump sum payments of more than \$50,000. This bill amends A.R.S. § 42-18051 and allows treasurers to additionally require electronic submission from taxpayers who own 100 or more parcels and, thus, submit 100 or more tax payments.

Personal Property Abatement Allowed. Arizona statutes have allowed county treasurers to abate real property taxes when the costs of a statutory lien sale would be greater than the taxes due. This bill amends A.R.S. §§ 42-18351 and 42-18352 by extending this same treatment to personal property. It also allows county treasurers to abate property taxes without first obtaining approval from the Department of Revenue.

House Bill 2377 (Ariz. Sess. Laws 2006, Chapter 332). *Composition of State Board of Equalization Changed.* In addition to changing the number of members from 17 to 33 and reducing the years of experience in property valuation required for board members, this bill amends A.R.S. §§ 42-16153 and 42-16156 and sets new requirements that are designed to ensure the independence of the Board. It prohibits a person, other than the chairperson, from Board membership if that person has worked for the Department of Revenue, a county assessor or attorney, or the Department of Law within two years of his or her appointment. It also restricts three- and five-member panel composition based on prior work experience.

House Bill 2429 (Ariz. Sess. Laws 2006, Chapter 333). *Solar Energy Devices that Enable On-Site Energy Consumption Prohibited from Increasing Property Value.* In addition to providing both income tax credits and transaction privilege tax exemptions to promote the sale, installation and use of solar energy producing devices, this bill amends A.R.S. § 42-11054, which outlines standard property appraisal techniques. Under this amendment, solar energy

devices and solar energy production systems that produce energy for on-site consumption are deemed to add no value to property.

House Bill 2474 (Ariz. Sess. Laws 2006, Chapter 322). *Counties and the Department to Work Jointly to Verify Class Three Property Classifications.* Arizona has nine property classifications with varying assessment ratios. Owner-occupied residential property and residential rental property are separate classes (three and four respectively). While the assessment ratio is the same for both classes, Arizona statutes provide for a homeowner rebate under class three property. Thus, counties want to ensure that property listed as class three property is actually class three property. This bill amends A.R.S. §§ 42-12052 and 42-13002. It allows Arizona counties to enter into intergovernmental agreements with the Department of Revenue to verify class three property and grants oversight of the process to the Department.

House Bill 2717 (Ariz. Sess. Laws 2006, Chapter 323). *Permanent Improvements on Land Owned by and Leased from an Agricultural Improvement District Exempt from Property Taxes to Avoid Double Taxation.* While all property in Arizona is subject to property taxation, the constitution exempts federal, state, county and municipal property from property taxes. Before enactment, Arizona levied a *property* tax on permanent improvements that a private party lessee constructed on land owned by and leased from an agricultural improvement district. It also levied an *excise* tax on private parties that lease government-owned property and use that property for commercial or industrial purposes. Because a single taxpayer may be subject to both of these taxes, this bill amends A.R.S. § 42-11102 and exempts a private party's permanent improvements constructed on property owned by and leased from an agricultural improvement district from property taxation.

House Bill 2821 (Ariz. Sess. Laws 2006, Chapter 143). *Statutory Definitions Clarified for Property Valuation and Appeals; Elderly Assistance Fund Established.* As a result of legislative efforts to identify and correct areas of ambiguity in Arizona property tax assessment and appeal statutes, this bill makes the following changes:

Definitions. This bill adds or clarifies the definitions of several commonly-used property tax terms by amending A.R.S. § 42-11001. First, it adds a definition of "due date" to clarify that if a return, filing or claim falls due on a Saturday, Sunday or legal holiday, it is not due until the following business day. Second, it adds a definition of "net assessed value" to mean assessed value minus any exempt property. Third, it clarifies that "full cash value," which forms the basis of determining and assessing secondary property tax, can never be more than the fair market value of the property regardless of the appraisal method used. The bill also amends A.R.S. § 42-17052 to prohibit county assessors from changing the values it reported on the February 10th tax rolls for levy limit purposes without obtaining prior approval of the Property Tax Oversight Commission.

Appeal Deadlines. Before enactment, taxpayers had to file appeals from the county boards of equalization to a court within sixty days of the county board's decision, but no later than December 15th. Taxpayers had to appeal state board of equalization decisions to court within sixty days of the date of

state board's decision. Similarly, taxpayers had to file appeal from either state or county boards regarding new construction within sixty days of the decision. This bill amends A.R.S. §§ 42-16202, 42-16203, 42-16205 to clarify that appeals are due sixty days from the date of mailing the decision rather than the date of the decision itself. It also changes the appeal deadlines from county decisions to the *later* of sixty days from the date of mailing or December 15th.

Elderly Assistance Fund. This bill also adds new A.R.S. § 42-17401 and establishes an elderly assistance fund in Maricopa County. The monies in the fund will be used to reduce the primary property taxes for taxpayers who are both approved for a property valuation protection option under the Arizona constitution and live in an organized school district.

House Bill 2876 (Ariz. Sess. Laws 2006, Chapter 354). *The Primary Property Tax Levy Limits and County Education Equalization Rates Are Restricted.* Arizona's Truth in Taxation ("TNT") statutes hold political subdivisions accountable for increases in local property tax revenues that result from higher property values. The TNT statutes require hearings when a community college district, city, town or county proposes a primary property tax levy that exceeds the amount levied the previous year, exclusive of amounts attributable to new construction. This bill requires that these jurisdictions set their 2006 primary property tax levies at the lesser of (1) the constitutional levy limit or (2) the actual 2005 primary property tax levy plus a two percent increase for inflation plus amounts attributable to new construction. In short it sets forth a similar directive as Proposition 101 for the 2006 tax year. The bill also amends A.R.S. § 41-1276 by changing both the name of the "county equalization assistance for education tax rate" to the "state equalization assistance property tax rate" and the rate for 2006 through 2008. Under normal TNT procedures, the 2006 rate would be \$0.4358 per \$100 of assessed value and the 2007 rate would be \$0.4190 per \$100 of assessed value. This bill sets the rate at zero for the 2006 through 2008 tax years. The 2009 rate will be calculated under the normal TNT procedures. Finally, the bill amends A.R.S. §§ 42-17201 through 42-17203 with respect to voter elections for county and community college district override elections. Before enactment, overrides could be authorized by the voters at either general or special elections. This bill requires that all future override proposals be submitted to voters only at general (November) elections.

Senate Bill 1074 (Ariz. Sess. Laws 2006, Chapter 387). *Small Commercial Printers Added to Enterprise Zone Property Under Class Six.* Arizona's enterprise zone tax credit program encourages small business start-ups in high unemployment and poverty areas. Before enactment, small manufacturing businesses that both met certain eligibility requirements and were located in an enterprise zone were classified as class six property with a five percent assessment ratio for primary property taxes and a twenty five percent assessment ratio for secondary property taxes. In addition to extending the enterprise zone tax credit program for another five years until 2011, this bill amends A.R.S. §§ 42-12006 and 42-15006. It now classifies property owned and used by small commercial printers, as well as small manufacturers, as class six property under the enterprise zone credit program. It also reduces the twenty-five percent assessment ratio for secondary property taxes by one half of a percent each year until 2014. This bill also changes several eligibility requirements, but generally expands the number and type of businesses that can qualify for the enterprise zone credit program.

Senate Bill 1346 (Ariz. Sess. Laws 2006, Chapter 388). *100% Biodiesel Production Facilities Are Added as Class 6 Property.* As noted above, Arizona has nine classes of property for property tax purposes. The classes are based on the use of the property. Each class has an assessment ratio that is used to calculate the assessed value of that type of property. Class six property, under A.R.S. § 42-12006 includes non-commercial historic property, foreign trade zone and qualifying military reuse zone property, enterprise zone property, and environmental technology and environmental remediation properties. For most uses under class six the assessment ratio for both primary and secondary taxes is five percent. This bill adds a new provision at A.R.S. § 42-12006(8) that classifies real and personal property used solely to produce 100% biodiesel fuel (an entirely renewable fuel containing no petroleum) and its by products as class six property. The class six classification applies only to the portion of the property actually used to manufacture and process 100% biodiesel fuel. Any other commercial or industrial use of the property disqualifies the entire property from the class six categorization and assessment ratio.

Senate Bill 1390 (Ariz. Sess. Laws 2006, Chapter 38). *Department Must Consider Obsolescence when Valuing Telecommunications Properties.* To determine value, personal property is depreciated over its useful life. Physical deterioration and functional and economic obsolescence are all species of depreciation. Arizona statute allows the Department to consider obsolescence for properties such as electric generation facilities, railroads and airlines. Before this enactment, however, Arizona statutes did not provide explicit authority to consider obsolescence in valuing telecommunications properties. This bill amends A.R.S. § 42-14403 to provide such an explicit authorization. The bill defines “obsolescence” as a reduction in value due to functional or economic obsolescence and dictates that the taxpayer may submit, and the department must consider, any documentation showing the need for an adjustment in value due to obsolescence.

Senate Bill 1461 (Ariz. Sess. Laws 2006, Chapter 391). *Joint Legislative Oversight Committee on Property Tax Assessment and Appeals to Review Modifications to Department’s Substantive Valuation Guidelines, Tables and Manuals.* In addition to clarifying taxpayer protections against retroactive applications of new Departmental interpretations of tax statutes, this bill adds a new section to A.R.S. § 42-11054. This section requires the Department to submit any substantive property valuation guideline, table or manual that is developed or modified after December 31st, 2006 to the Joint Legislative Committee Oversight Committee on Property Tax Assessment and Appeals (“Committee”). The Department may not finally adopt such a document until thirty days after submission to the Committee. The committee may hold hearings and amend the Department’s guidelines, tables and manuals. However, if it takes no action within thirty days, the Department’s submission becomes final.

Senate Bill 1481 (Ariz. Sess. Laws 2006, Chapter 392). *New Property Tax Exemptions for (1) Property Leased to Educational Non-profits by Charitable and Religious Organizations and (2) Low-Income Housing Projects.* This bill adds to new property tax exemptions to Arizona exemptions statutes under A.R.S. § 42-11101 *et seq.*

Educational Exemption. New provision A.R.S. § 42-11131 exempts property owned by a charitable or religious organization that is leased to a non-profit educational organization that uses the property to provide educational instruction in any grade or program up to twelfth grade. The property will qualify for the exemption if the owner files evidence of its own 501(c)(3) tax-exempt status and an affidavit executed by the not for profit educational organization that it uses the property for educational instruction as required.

Low-Income Housing Exemption. New provision A.R.S. § 42-11132 provides an exemption for low-income housing projects that meet certain requirements. Property used exclusively to provide low-income housing and related services is exempt if: (1) the property is not used or held for profit; (2) it is owned and operated by a non-profit organization, a wholly owned subsidiary of a non-profit organization, or a limited partnership if the managing general partner is a non-profit corporation; and (3) the project:

- is rent restricted by deed or agreement;
- is financed through tax exempt bonds, or local, state or federal loans and grants;
- is eligible for and receives low-income housing tax credits under Section 42 of the Internal Revenue Code;
- is used as an assisted living facility for low-income elderly residents; and
- does not exceed 200 residents.

Senate Bill 1502 (Ariz. Sess. Laws 2006, Chapter 170). *County Assessors Must Use A Judicially Determined Reduction in Value or Classification Change in the Following Tax Year.* Before enactment, Arizona statutes required county assessors or treasurers to use any reduction in value or change in property classification determined by an appeal to the county assessors, the county boards of equalization or the state board of equalization for one tax year in the following tax year. This result is mandatory unless new construction or changes in use occur or the property is valued under a specific statutory formula. This bill amends A.R.S. § 42-16002 to require the same treatment by county assessors and treasurers when the reduction in value or change of classification was determined in a judicial, as opposed to an administrative, appeal.

CASES

Arizona Dep't of Revenue v. Salt River Agric. Improvement & Power Dist. and Arizona Public Service Company, 212 Ariz. 35, 126 P.3d 1063 (App. 2006). *In Conformity with Legislation Passed in 2005, Contributions in Aid of Construction ("CIAC") Paid by Developers to Electric Utilities Are Not Included in Valuing Electric Utilities' Property.* Arizona statutes provide a specific method for valuing and taxing the property of utilities. This method is not based on fair market value, but rather on construction costs. The starting point for this statutory method is determining the utilities' costs of constructing its "original plant in service." Utilities often bear the costs of constructing their electrical generation and distribution facilities directly. However, when, for example, real estate developers request utility service in a non-standard manner, such as specific types of cable, separate transformer vaults or the movement of existing power lines,

the developer must pay a non-refundable contribution to the utility to cover the difference between standard delivery systems and the special systems the developer has requested. These differences paid by the customer are called “contributions in aid of construction” or CIAC. In 2005, the Arizona legislature passed a bill that specifically excluded CIAC from utilities’ original plant in service, but the statute did not apply to tax years prior to 2005.

This case involved the resolution of this issue for both the Salt River Agricultural Improvement and Power District and for Arizona Public Service for the 2003 tax year. The Department argued that (1) CIAC should be included in the plant costs because it reflects an actual construction cost and that (2) including CIAC better approximates the properties’ fair market value. The court rejected both of these arguments and held for the taxpayers. First, it observed that the utility valuation statute directed that all of its terms, including “original plant in service” be interpreted in accordance with the federal energy regulatory commission (FERC) uniform system of accounts. FERC regulations exclude CIAC from the original costs of the electric plant. Second, it noted that little or no market exists for utility property and that the Arizona legislature expressly moved away from fair market value concepts to value utility property when it created the statutory valuation methodology.