MEMORANDUM

Date: July 3, 2019

To: The Honorable Chairman and Members
Pima County Board of Supervisors

From: C.H. Huckelberry
County Administrator

Re: **Attempted Constitutional One-percent Owner Occupied Property Tax Transfer to Local Taxpayers by the State of Arizona**

As the Board recalls, four years ago, the Arizona Legislature amended Arizona law to transfer the one-percent Constitutional property tax payment burden to Pima County. At the time, the action would have required the County, instead of the State, to pay Tucson Unified School District (TUSD) nearly $16 million in "additional State Aid for Education." The County sued and got this legislation declared unconstitutional, successfully voiding the Arizona Legislature's attempt to transfer this cost burden to local County taxpayers.

Last year, the Legislature passed new legislation requiring that school district pay for federal-court-ordered desegregation programs with a "secondary" property tax, in an apparent attempt to force homeowners in those districts to pay taxes in excess of the Constitutional 1% limit. The County, along with TUSD, objected to this method of shifting school funding from the State to TUSD homeowners, recognizing that simply calling a tax a "secondary" tax doesn't take it outside of Constitutional limitations. The County again refused to levy what it believed was an illegal tax, instead giving TUSD homeowners the tax credits to which they were statutorily and constitutionally entitled, and notifying the State that it owed TUSD over $8 million in additional state aid. When the State refused to pay, the County and TUSD sued the State.

The Arizona Tax Court ruled on July 2, 2019 in favor of Pima County and TUSD, and found that the new legislation did not in fact shift responsibility for additional state aid for education to residential taxpayers. I very much appreciate the County Attorney professional representation in this matter and in particular the efforts of Deputy County Attorney Regina Nassen.

CHH/anc

Attachment

c: The Honorable Barbara LaWall, Pima County Attorney
Amelia Cramer, Chief Deputy Pima County Attorney
Andrew Flagg, Chief Civil Deputy Pima County Attorney
Regina Nassen, Deputy Pima County Attorney

Clerk of the Superior Court
*** Electronically Filed ***
07/02/2019 8:00 AM

THE SUPERIOR COURT OF THE STATE OF ARIZONA
IN THE ARIZONA TAX COURT

TX 2018-000737 06/25/2019

HONORABLE CHRISTOPHER WHITTEN

CLERK OF THE COURT
D. Tapia
Deputy

PIMA COUNTY

REGINA L NASSAN

v.

STATE OF ARIZONA

LISA A NEUVILLE

P BRUCE CONVERSE
JUDGE WHITTEN

MINUTE ENTRY

Defendants' Motion to Dismiss Complaint for Failure to State a Claim, filed February 14, 2019, and fully briefed as of April 8, 2019 is pending. On April 23, 2019 the Court heard oral argument on the Motion to Dismiss, and indicated that it would take the matter under advisement until the completion the briefing on Pima County's Motion for Summary Judgment, which it filed with its response to the Motion to Dismiss on March 27, 2019, and the State's Cross-Motion for Summary Judgment, filed May 15, 2019.

Those summary judgment motions were fully briefed on June 12, 2019. The Court benefited from oral argument on Plaintiffs' Motion for Summary Judgment on June 18, 2019.

Article IX, Section 18 of the Arizona Constitution limits the total amount of *ad valorem* property taxes that may be levied by all applicable jurisdictions[1] to 1% of full cash value of residential property. There are only three permissible exemptions from this limitation:

(a) taxes levied to pay debt service on bonds or other types of indebtedness,

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1 These jurisdictions include municipalities, counties, community college districts and school districts.

(b) taxes levied by certain special taxing districts, and

(c) taxes specifically authorized by vote in an override election.

Ariz. Const., Art. IX, § 18 (1) and (2).

The Arizona Constitution goes on to charge the State with the responsibility to "provide by law a system of property taxation consistent with the provisions of this section." Ariz. Const., Art. IX, § 18 (8). The modification to the system for doing so which were implemented by the legislature in 2018 as part of Senate Bill 1529 abrogate this duty,

Prior to Senate Bill 1529 the legislature met the burden of providing a taxation system as required by Ariz. Const., Art. IX, § 18 (8), in part by adopting A.R.S. § 15-972(E). That statute explicitly solved at least one potential problem – what to do if the eligible jurisdictions levied taxes in excess of 1%. In such a situation, A.R.S. § 15-972(E) mandates that three things happen:

First, under A.R.S. § 15-972(E), the County must determine whether the "total primary property taxes" to be levied by all eligible jurisdictions would exceed 1% of the full cash value of residential property, which would violate Ariz. Const., Art. IX, § 18 (1) (referred to herein as the "addition step").

Second, A.R.S. § 15-972(E) explains that when "such a situation exists," the County "shall apply a credit against the primary taxes due from each such parcel in the amount in excess" of 1%. That credit shall reduce any taxes levied for "school purposes" (referred to herein as the "reduction step").

Finally, A.R.S. § 15-972(E) requires that the State provide "additional state aid for education" equal to that amount of the reduction (referred to herein as the "pay-back step").

Importantly, the term "primary property taxes" used in the implementation formula is specifically defined. It includes only *ad valorem* taxes that are not "secondary property taxes." A.R.S. § 15-101 (20). Secondary property taxes are those "used to pay the principal of and the interest and redemption charges on any bonded indebtedness or other lawful long-term obligation issued or incurred for a specific purpose by a school district or a community college district and amounts levied pursuant to an election to exceed a budget, expenditure or tax limitation." A.R.S. § 15-101 (25).

The A.R.S. § 15-101 (25) definition of "secondary property taxes," does not include those taxes used to pay expenses of complying with desegregation orders. A.R.S. § 15-101 (25). They are therefore "primary property taxes" pursuant to A.R.S. § 15-101 (20).

In 2018 the legislature amended A.R.S. § 15-910 to add subsection L, which provides:

> Beginning in fiscal year 2018-2019, subsections G through K of this section apply only if the governing board uses revenues from secondary property taxes rather than primary property taxes to fund expenses of complying with or continuing to implement activities that were required or allowed by a court order of desegregation or administrative agreement with the United States department of education office for civil rights directed toward remediating alleged or proven racial discrimination that are specifically exempt in whole or in part from the revenue control limit and district additional assistance. Secondary property taxes levied pursuant to this subsection do not require voter approval, but shall be separately delineated on a property owner's property tax statement.

The statutory label of "secondary taxes" in the new A.R.S. § 15-910(L) cannot trump the constitutional limitation on *ad valorem* taxes found in Ariz. Const. art. 9, § 18.

A.R.S. § 15-972(E) was not amended by the legislature and must be construed in a manner consistent with the Arizona Constitution. Since the "secondary property tax" levy for desegregation expenses is not a voter-approved *ad valorem* tax, it is still subject to the constitutional 1% Limit and must be included in the calculation under A.R.S. § 15-972(E).

The Defendant's argument that A.R.S. § § 15-910(L) must be read to prevent desegregation expenses from being included in the calculation under A.R.S. § 15-972(E) is unworkable. It attempts to isolate the amounts levied by one of the eligible jurisdiction (school districts) which are used for one particular purpose (complying with desegregation orders) into a different class, labeling them as "secondary" tax, even though they do not fit the definition of that term under A.R.S. § 15-101 (25). It then attempts to remove these "secondary" taxes from the formula created in A.R.S. § 15- 972(E), the payback step.

By following the Defendant's argument that amounts used to comply with desegregation orders must be included in the first part of the A.R.S. § 15- 972(E) formula (reduction step) but then be omitted from the second step (payback step), a fourth exemption to limitation to Article IX, Section 18 of the Arizona Constitution, would be statutorily created. At a minimum, such a system would violate the constitutionally imposed requirement that the legislature "provide by law

a system of property taxation consistent with the provisions of this section." Ariz. Const., Art. IX, § 18 (8).

The only way to read § 15-972 in a manner consistent with the constitution, is to read it to include any tax subject to the 1% Limit in the calculation, regardless of the label applied by the in A.R.S. § 15-910(L). Read in this manner, the tax levy for desegregation expenses must be included in the calculation of taxes subject to the 1% Limit under A.R.S. § 15-972(E) and "shall be additional state aid for education," which is paid by the State as provided in § 15-973(B).

ACCORDINGLY, the Defendants' Motion to Dismiss Complaint for Failure to State a Claim and the Defendants' Cross-Motion for Summary Judgement are denied and Pima County's Motion for Summary Judgment is granted.