

**Ballot Proposition 126**  
**Protect Arizona Taxpayers Act**  
**Fiscal Analysis**

**Estimated Impact**

A.R.S. § 19-123E requires the Joint Legislative Budget Committee Staff to prepare a summary of 300 words or less on the fiscal impact of voter-initiated ballot measures. Proposition 126 would amend the Arizona Constitution by prohibiting state and local governments from imposing any new or increasing any existing transaction-based fee or tax, including a transaction privilege (sales) tax, on any service performed in the state. Proposition 126 would not repeal or nullify any tax, fee, or other assessment in effect before January 1, 2018. The level of foregone revenue under Proposition 126 cannot be determined in advance as it would depend on the specific details of a particular proposal to tax services.

If Proposition 126 is approved by voters and later challenged in court, and if the Attorney General does not defend the measure, any resident of the state could pursue litigation to enforce its provisions. If the resident prevails in litigation, Proposition 126 would require the state or local government to pay the resident's attorney fees and other legal costs to the resident. The amount of such costs, if any, cannot be determined in advance.

**Background**

The Transaction Privilege Tax (TPT) is a gross receipts tax levied by the state on vendors for the privilege of conducting business in the state. Although TPT is commonly referred to as Arizona's sales tax, it differs from the "true" sales tax imposed by many other states as it is imposed upon the seller rather than the buyer.

Under statutes, businesses that perform certain activities are subject to TPT and must be licensed. The major business classifications are retail sales, contracting, utilities, and restaurants and bars. Businesses operating under any of the state's TPT classifications are also required to file their TPT returns with the Department of Revenue (DOR) along with their TPT payments on a monthly, quarterly or annual basis.

Businesses that perform activities that do not come under any of the state's TPT classifications are not subject to TPT and are therefore not required to be licensed or report their sales activities to the state. These are businesses that provide services, although there are some exceptions.

If enacted, Proposition 126 would prohibit the state from imposing any new sales tax on services. Moreover, the measure would also prohibit a sales tax increase on any currently taxed service. The measure would not repeal or nullify any tax, fee, or assessment in effect before January 1, 2018.

**Analysis**

Each year, DOR reports the estimated amount of sales tax revenue that the state foregoes by exempting services from TPT. For FY 2017, this amount was estimated to be \$5.2 billion. This estimate is based on the current state TPT rate of 5.0%. The estimate by major service category is displayed in *Table 1* below.

(Continued)

**Table 1**

**Foregone State TPT Revenue by Major Service Category**

**[\$ in Millions]**

| <u>Major Service Category</u>          | <u>Foregone TPT</u> |
|--|---------------------|
| Professional, Scientific and Technical | \$1,063             |
| Health Care                            | 2,079               |
| Administrative and Business Support    | 735                 |
| Personal Care                          | 82                  |
| Educational                            | 65                  |
| Finance                                | 933                 |
| <u>Other Services</u>                  | <u>266</u>          |
| <b>Total</b>                           | <b>\$5,223</b>      |

Source: *The Revenue Impact of Arizona's Tax Expenditures Fiscal Year 2016/2017*, Department of Revenue

Since Proposition 126 would prohibit the state from imposing any new sales tax on services, the amount of foregone state revenue is estimated to be as high as \$5.2 billion. The actual amount of foregone state revenue would depend on the details of a specific tax proposal, which cannot be determined in advance. The amount of foregone General Fund revenue would also depend on whether such a proposal would distribute a portion of these monies to cities and counties. (Under current law, a portion of state TPT is distributed to cities and counties based on a statutory formula.)

Proposition 126 would also prohibit the state from increasing any existing sales tax on services. Although the state is currently levying a sales tax on certain business activities that could be considered services (e.g., transient lodging, telecommunications, and utilities), these classifications are not specifically defined as services in statute. (There is no definition of "service" in state tax statutes.) As a result, we cannot determine the existing tax base for services.

**Local Government Impact**

Proposition 126 would also prohibit counties, cities, towns or other political subdivisions of the state from imposing any new or increasing any existing transaction-based fee or tax, including a sales tax, on any service performed in the state. As with the state, counties and cities generally do not currently impose a sales tax on services.

The amount of foregone revenue to counties and cities would depend on the details of a specific proposal as well as the tax rate levied by a specific county or city, which cannot be determined in advance.