SKIN IN THE GAME

Who really pays Arizona taxes?
CHILDREN’S ACTION ALLIANCE

Through research, publications, media campaigns, and advocacy, CAA seeks to influence policies and decisions affecting the lives of Arizona children and their families. CAA builds momentum for positive change in child care and early education, children’s health, juvenile justice, protection from abuse and neglect, and family income issues.

CAA STATE FISCAL ANALYSIS PROJECT

This project translates the complex world of state fiscal policy into credible and timely information that is used by policy makers, community activists and the media.

This research was funded by the Annie E. Casey Foundation and the Ford Foundation. We thank them for their support but acknowledge that the findings and conclusions presented in this report are those of the authors alone, and do not necessarily reflect the opinions of these foundations.

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According to the Oxford English Dictionary, a skin game can be a betting card game. Golfers also know a betting game for a foursome called a “skins” game. When a player wins a hole, they are said to have won a skin. Players often ask each other “How much skin do you have in the game?”
“As I roll this thing back and I think of American history, there was a time in American history when you had to be a male property owner in order to vote. The reason for that was, because they wanted the people who voted — that set the public policy, that decided on the taxes and the spending — to have some skin in the game.”
— Rep. Steve King (R-IA), Judiciary Committee hearing on a balanced budget amendment.

“We have a system today in the United States where 45% of Americans don’t pay any income tax... You have to have skin in the game.”
— Stephen Schwarzman, billionaire cofounder and chief executive of private equity firm, Blackstone Group.

SKIN IN THE GAME

In political talking points, the phrase “everyone should have skin in the game” is being used to push unfair revenue schemes around the country. The phrase is used under the false assumption that low-income Americans aren’t paying their fair share of taxes. In Arizona, some proponents of the so-called flat tax are using this slogan to justify tax cuts for the wealthy and tax increases for everyone else. The facts show that the Arizona legislature has created numerous methods that profitable corporations and taxpayers of all incomes use to shrink their taxes. And low-income Arizonans already have more skin in the game than anyone else for total tax payments. Arizonans want a state budget and tax system that work for families and succeed for the health, education, and security of our children. Taxpayers deserve to go beyond the slogans and false claims to see who really pays Arizona taxes.
Arizonans who do not pay state income taxes are still paying to support schools, roads and other public assets. They pay state sales taxes when they make purchases at the store. They pay property taxes, either directly because they own a home or indirectly if they rent. If they own a car they pay taxes when they renew their registration and fill the tank with gas. Each time they pay their water bill, they’re also likely paying for other public services like county jails. Together, these other taxes and fees make up a large majority — 90% — of Arizona’s total state and local government revenues.1

In fact, 80% of Arizonans pay a higher percentage of their income in general sales taxes than in income taxes.

224% more
THE LOWEST INCOME BRACKET PAYS 224% MORE in combined taxes as a share of their income than Arizonans in the top 1%.

151% more
MIDDLE INCOME TAXPAYERS PAY 151% MORE in combined taxes as a share of their income than Arizonans in the top 1%.

7th worst
ARIZONA’S RANK for the disparity between the share of income paid in taxes by the poorest compared to the wealthiest.
WHEN ALL TAXES ARE CONSIDERED, ARIZONA’S LOW-INCOME FAMILIES HAVE THE MOST “SKIN IN THE GAME.”

Low-income households pay a higher share of their income in overall state and local taxes (12.5%) than do higher-income households. In fact, tax liability actually decreases as income increases. Arizonans with incomes in the top 1% have the very least skin in the game, devoting only 5.6% of their income to state and local taxes.²

Among the 50 states, Arizona has the 7th worst disparity between the share of income paid in taxes by the poorest compared to the wealthiest. Arizonans in the lowest 20% income bracket pay 224% more in combined taxes as a share of their income than those in the top 1%. Middle-income taxpayers fare better but still pay 151% more than the wealthiest. Without lower income tax rates for lower income families, these disparities would be much greater.³

$12.50
Amount that Arizona’s LOW-INCOME FAMILIES pay in state and local taxes out of every $100 in income.

$5.60
Amount THE RICHEST 1% pays in Arizona state and local taxes out of every $100 in income.

Arizonans with incomes in the top 1% have the very least skin in the game, devoting only 5.6% of their income to state and local taxes.

TAXPAYERS WITH LOWEST INCOMES PAY HIGHEST PERCENTAGE IN STATE & LOCAL TAXES

- General sales
- Residential/Property
- Personal Income
- Other

THE GRADUATED INCOME TAX BALANCES OTHER TAXES

The balance and fairness of any tax system depends on the impact of all the taxes an individual or family pays. State and local sales taxes always take a bigger bite out of the income of taxpayers at the lowest income levels.

Arizona’s graduated income tax partially offsets the impact of the sales tax on low-income taxpayers. The state has six income brackets, with the tax rate increasing as income increases. The graphs below show that the impact of income taxes with graduated rates is a mirror image of the impact of the general sales tax. The different income tax brackets and rates help to shrink the gap between the tax bill of lower- and middle-income taxpayers and that of wealthier taxpayers.

A single, flat income tax rate like the one some have proposed for Arizona would erase the small equalizing effect that Arizona’s current graduated income tax provides and leave wealthier taxpayers with even less skin in the game.

During the 2011 legislative session, a proposal for a flat Arizona income tax was introduced (HB 2636). It passed out of the House and was on its way to being passed by the Senate when it was pulled by the sponsor. There has been discussion about similar legislation being introduced in the 2012 legislative session.

An Arizona Flat Tax would increase taxes for 88% of taxpayers to pay for tax cuts for the top 12%.

HB 2636 called for the adoption of a single tax rate, to be phased in over a three-year period. The proposal was designed to be “revenue neutral” — it would neither increase nor decrease total state income tax revenues.

However, the tax would be anything but flat in its consequences. In fact, it would turn the current graduated income tax system on its head, with the top 12% — those with the highest incomes — seeing significant tax cuts at the expense of low and middle-income taxpayers. The remaining 88% would see their income taxes rise.4

Source: Joint Legislative Budget Committee Fiscal Note on HB 2636, 3/23/11.

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**FLAT TAX IMPACT, BY INCOME LEVEL**

- **% Tax Increase**
  - Over $5,000,000: 100%
  - $1,000,000-5,000,000: 80%
  - $500,000-1,000,000: 60%
  - $200,000-500,000: 40%
  - $100,000-200,000: 20%
  - $40,000-50,000: 10%
  - $30,000-40,000: 5%
  - $20,000-30,000: 2%

- **% Tax Cut**
  - Over $5,000,000: -60%
  - $1,000,000-5,000,000: -40%
  - $500,000-1,000,000: -20%
  - $200,000-500,000: 0%
  - $100,000-200,000: 10%
  - $40,000-50,000: 20%
  - $30,000-40,000: 50%
  - $20,000-30,000: 80%

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Source: Joint Legislative Budget Committee Fiscal Note on HB 2636, 3/23/11.
WHO DOESN’T PAY INCOME TAX IN ARIZONA?

People who do not pay income taxes in a given year likely paid them in the past or will pay them in the future. These are seniors who paid income taxes during their working years, students whose careers have not yet started, and individuals whose current income is low but who may have paid taxes in the past or who will pay in the future when their incomes increase.

Many families with very low incomes still owe and pay state income taxes. In 2010, a family with two parents and two children owed income taxes in Arizona if their total income was $23,600 — just $1,300 out of poverty.5

HOW TAX CREDITS CAN ELIMINATE TAX LIABILITY

A tax credit is a dollar-for-dollar reduction in a filer’s income tax bill for money donated or spent in particular ways. Households who start out owing taxes can significantly reduce or completely eliminate their tax bill through the use of credits.

There are 24 tax credits available to individuals and families on Arizona state income taxes. Some of these are for specific situations or investments, such as defense contracting, recycling equipment, or solar energy devices. There are tax credits that nearly any taxpayer can claim to avoid paying all or a portion of her tax bill. The example at right shows how a family with adjusted gross income of more than $130,000 — in the second-highest tax bracket — can end up paying nothing in state taxes through the use of five common tax credits.

FAMILIES IN AZ CLAIM MILLIONS OF DOLLARS IN TAX CREDITS

<table>
<thead>
<tr>
<th>Tax Credit</th>
<th>Dollars in millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private School Tuition Donations</td>
<td>$40</td>
</tr>
<tr>
<td>Public School Donations*</td>
<td>$20</td>
</tr>
<tr>
<td>Increased Excise Taxes**</td>
<td>$30</td>
</tr>
<tr>
<td>Charities helping the working poor</td>
<td>$40</td>
</tr>
<tr>
<td>Family Tax Credit**</td>
<td>$4</td>
</tr>
<tr>
<td>Military Family Relief Fund</td>
<td>$4</td>
</tr>
<tr>
<td>Clean Elections</td>
<td>$100</td>
</tr>
</tbody>
</table>

*Donations for extra curricular activities.
**Available to taxpayers who meet income limits. Family Tax Credit also requires the taxpayer claims at least one dependent.
Source: Arizona Department of Revenue, 2010 data.

A family with income of more than $130,000 can end up paying nothing in state taxes through the use of five common tax credits:

HOW 5 TAX CREDITS CAN WIPE OUT A TAX BILL FOR A MARRIED COUPLE WITH 2 CHILDREN

Sample tax form

<table>
<thead>
<tr>
<th>Tax and Credits</th>
<th>Adjusted gross income...</th>
<th>$130,300</th>
</tr>
</thead>
<tbody>
<tr>
<td>01</td>
<td>Dependents</td>
<td>-$4,600</td>
</tr>
<tr>
<td>02</td>
<td></td>
<td></td>
</tr>
<tr>
<td>03</td>
<td>Personal exemption</td>
<td>-$6,300</td>
</tr>
<tr>
<td>04</td>
<td>Itemized deductions</td>
<td>-$10,000</td>
</tr>
<tr>
<td>05</td>
<td>AZ Taxable income</td>
<td>$109,400</td>
</tr>
<tr>
<td>06</td>
<td>Computed tax</td>
<td>$3,460</td>
</tr>
<tr>
<td>07</td>
<td>Credits</td>
<td></td>
</tr>
<tr>
<td>Donation to charities that provide assistance to the working poor</td>
<td>-$400</td>
<td></td>
</tr>
<tr>
<td>Contributions to public schools</td>
<td>-$400</td>
<td></td>
</tr>
<tr>
<td>Contributions to private school tuition organization</td>
<td>-$1,000</td>
<td></td>
</tr>
<tr>
<td>Donation to Military Family Relief Fund</td>
<td>-$400</td>
<td></td>
</tr>
<tr>
<td>Donation to Clean Elections Fund</td>
<td>-$1,260</td>
<td></td>
</tr>
</tbody>
</table>

| Arizona Taxes Due... | $0 |

Based on laws for tax year 2011.
THOSE WITH VERY LOW INCOMES ARE NOT THE ONLY ONES EXEMPT FROM PAYING STATE INCOME TAXES.

In Arizona, households with gross income below $15,000 do not owe state income taxes. Arizonans with higher incomes can get below the $15,000 threshold if part of their income comes from one or more of the following:

- Interest from US Government obligations
- Social Security Retirement Benefits
- Railroad Retirement Benefits
- Pay received for active service as a reservist or National Guard member
- Active duty military pay

Taxpayers can also take subtractions if they are blind, 65 or older, or supporting dependents.

For tax year 2009, 2.3 million individual tax returns were filed with the Arizona Department of Revenue. Thirty percent (676,000) of these returns owed no state income taxes. In more than eight out of ten of these no-tax returns, gross income was reduced below taxable levels through standard or itemized deductions or a variety of tax credits. This means, for example, that taxpayers with high medical expenses, large amounts of mortgage interest, or high tax credits may owe zero income taxes even if their gross incomes are higher than $15,000.

Why some Arizonans don’t pay state income taxes:

- 8% Low-income/Subtractions/Exemptions
- 17% Tax Credits
- 68% Standard/Itemized Deductions
- 7% All other

Source: Arizona Department of Revenue, 2009 data.
CORPORATE TAXES SHRINKING

Chambers of commerce, trade associations, and big businesses frequently lobby the Arizona legislature to reduce taxes levied on businesses in the state. That has resulted in significant changes in Arizona’s tax laws and a decline in corporate “skin in the game.” The corporate income tax rate has been reduced from 9.3% in 1990 to its current rate of 6.968%. The legislature and Governor Brewer approved legislation in 2011 which will phase the rate down even further — to 4.9% by 2017.

When fully phased in, these rate cuts will cost the state $270 million each year. That amount would be enough to restore full-day kindergarten statewide, cover qualified children with KidsCare health insurance, and provide qualified working parents with financial assistance to pay for child care.

The method of calculating taxable income for multi-state corporations has also been changed twice, cutting taxes for some large corporations by $175 million when fully phased in.7

In addition, Arizona lawmakers have reduced commercial property taxes. Laws passed in 2005 phased down the commercial property tax assessment ratio (which determines the value of property subject to taxation) from 25% to 20%. Additional changes made during the 2011 legislative session will reduce the ratio further, to 18% by 2016.

Because changes to property tax ratios affect school funding, these tax cuts will increase the requirements for state education dollars by $169 million annually.

### REDUCING TAXES THROUGH TAX CREDITS

<table>
<thead>
<tr>
<th>CREDIT</th>
<th>No. of Corporations Using Credit</th>
<th>2009 Taxes Reduced by</th>
<th>Carryforward to Reduce Future Taxes Owed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Research/Development</td>
<td>211</td>
<td>$32,827,767</td>
<td>$265,527,418</td>
</tr>
<tr>
<td>Enterprise Zones</td>
<td>94</td>
<td>$6,144,599</td>
<td>$6,430,349</td>
</tr>
<tr>
<td>Private School Tuition</td>
<td>54</td>
<td>$5,538,024</td>
<td>$1,182,614</td>
</tr>
<tr>
<td>Pollution Control Device</td>
<td>13</td>
<td>$1,715,381</td>
<td>$3,506,231</td>
</tr>
<tr>
<td>Coal Consumed in Generating Electrical Power</td>
<td>4</td>
<td>$658,252</td>
<td>$8,686,078</td>
</tr>
<tr>
<td>Solar Energy</td>
<td>6</td>
<td>$75,150</td>
<td>$61,430</td>
</tr>
<tr>
<td>Employing TANF Recipients</td>
<td>10</td>
<td>$43,178</td>
<td>$40,224</td>
</tr>
<tr>
<td>Employing National Guard Members</td>
<td>6</td>
<td>$7,000</td>
<td>$7,900</td>
</tr>
<tr>
<td>Clean Elections</td>
<td>228</td>
<td>$1,241</td>
<td></td>
</tr>
<tr>
<td>Unidentified</td>
<td>13</td>
<td>$3,487,120</td>
<td>$18,211,739</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>639</strong></td>
<td><strong>$50,497,712</strong></td>
<td><strong>$303,653,983</strong></td>
</tr>
</tbody>
</table>

Source: Arizona Department of Revenue, Arizona Income Tax Credits, 11-1-11.

### SHRINKING CORPORATE TAX RATE

Source: Joint Legislative Budget Committee.
CORPORATE TAX CREDITS SHRINK MORE TAXES

Corporations have 18 income tax credits available to them that reduce their tax bill dollar for dollar. Some of the corporate tax credits are for very specific expenditures, such as purchasing pollution control equipment or employing members of the National Guard. Another credit is for donating to private school tuition organizations.

For tax year 2008, nearly three out of four corporations that filed income taxes in Arizona had the minimum tax liability of $50 — more than 35,500 corporations. Fewer than one in ten corporations (3,500) paid $5,000 or more in income taxes. A total of 421 corporations claimed one or more tax credits, and 65% of these (272) were able to wipe out their entire tax bill by claiming credits.8

In 2009, corporations reduced their Arizona tax liability by $50.5 million through the use of tax credits. Another $303.7 million in tax savings was carried forward to apply in future years.9

Confidentiality laws prevent us from knowing how all corporations lower their tax bills. When tax credits are used by very few corporations, the Department of Revenue will not publicly release the number of corporations claiming the credit nor the total dollar amount taken. In 2009, 13 undisclosed claims were made totaling $3.5 million. On average, that means each undisclosed claim reduced a corporation’s “skin in the game” by more than a quarter million dollars.

Fewer than one in ten corporations paid $5,000 or more in income taxes.

ANNUAL REVENUE LOSS TO STATE GENERAL FUND
$778 million in business tax cuts 2005 to 2018:

- $169 million Corporate Tax Rate Cuts
- $175 million Lower Taxable Income for Multistate Corporations
- $270 million Industry Tax Credits
- $81 million Property Tax Cuts (Cost to General Fund)
- $10 million: Research/Development Tax Credit
- $74 million Private Tuition Credits

Source: Compiled from 2011 Tax Handbook, Joint Legislative Budget Committee.

Note: Does not include IRS conformity changes.

WHAT ARIZONA CORPORATIONS PAY IN STATE INCOME TAXES

$50 minimum

- $100,000 to $1 million
- $5,000 to $100,000
- $50 to $5,000
- More than $1 million

Source: Arizona Department of Revenue Data for 2008.
$50 minimum
STATE INCOME TAX
Paid by 3 out of 4 Arizona corporations

$50.5 million
TAXES CUT
By Arizona corporations in 2009 through tax credits

$778 million
ANNUAL LOSS
To state general fund from corporate tax cuts

Companies like Intel, which employs 10,000 in Arizona, will pay close to only the state’s minimum of $50 in annual corporate income taxes in years ahead.

“That’s where it trends,” said Jason Bagley, government-affairs manager for Intel, referring to his company’s eventual tax bill.

“Do you know any small (or large) businesses who pay Arizona taxes? If so, they can redirect those tax dollars to ASCT. Determine how much you would like to donate versus pay to the state this fiscal year. (Your company can donate the entire corporate tax liability amount).”
— Arizona School Choice Trust, Fall 2011 Newsletter

PRIVATE SCHOOL TUITION TAX CREDIT CAN WIPE OUT CORPORATE TAX BILLS

Private school tuition organizations raise money to provide partial or full scholarships to help students pay the tuition. Arizona’s individual taxpayers have a $500 cap on the tax credit they can receive for donating to these organizations. (The cap is $1,000 for married couples filing jointly.) For corporations, on the other hand, the limit is a statewide total, not a cap on what any single corporation can claim. Starting at $10 million in 2006, the total corporate tax credit limit is raised each year by 20%. For 2011, the limit is $20.7 million. Since the inception of the corporate credit, no corporations have been denied claiming the credit due to the limit. In 2010, 63 corporations donated a total of $11 million to private school tuition organizations; 19 of these donated less than $10,000 and 8 donated $500,000 or more.¹⁰

Historically, corporations have not claimed all donations as a tax credit. But they can and do use this credit to avoid paying a significant portion — or all — of their Arizona tax bill. In fact, private schools and private school tuition organizations market this chance for businesses to cut their taxes. In 2009, 54 corporations made contributions that cut their taxes that year by $5.5 million and gave them the chance to cut future taxes by $1.2 million.¹¹

<table>
<thead>
<tr>
<th>Tax and Credits</th>
<th>01 Taxable income</th>
<th>$1,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>02 Tax @ 6.968%</td>
<td>$69,680</td>
<td></td>
</tr>
<tr>
<td>03 Credits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>04 Arizona Taxes Due...</td>
<td>-$69,680</td>
<td></td>
</tr>
</tbody>
</table>

A MILLION-DOLLAR CORPORATION CAN USE PRIVATE SCHOOL TAX CREDIT TO ELIMINATE STATE TAX BILL:

Sample tax form

Source: Arizona Department of Revenue, Calendar Year 2010.
All Arizonans support education, health care, public safety and other state assets by paying a variety of taxes – from property taxes to sales taxes to car registration fees. Using the income tax as the only measure of “skin in the game” is an attempt to distort reality for political purposes. In fact, eight out of ten Arizonans pay more in state and local sales taxes than in state income taxes. And sales taxes make up the largest share of state tax revenues.

Arizona lawmakers have given corporations and families at all income levels a variety of methods to cut their income taxes. Upper income families and profitable corporations can legally wipe out the income taxes they owe by using tax credits. Numerous tax cuts in recent years continue to shrink the skin in the game for corporations in both income and property taxes. Corporate income tax cuts and credits passed between 2005 and 2011 will cost the state $609 million a year by the time they are completely phased in. Corporate property tax cuts over the same period of time add up to an additional state cost for education of $169 million a year. Together, the amount of these tax cuts is enough to fund all-day Kindergarten statewide, help families afford child care, provide health insurance to children in working families, build and repair schools, and buy new equipment for K-12 classrooms and campuses.

The facts show that low-income Arizonans already have more skin in the game than anyone else for total state and local taxes. They spend $12.50 out of every $100 in income on state and local taxes, while the wealthiest 1% spend only $5.60. Contrary to political claims, adopting a single, flat income tax would only widen this gap, giving the wealthiest families a tax cut at the expense of everyone else.

Arizona needs a budget and tax system that fuels our goals for a vibrant economy and strong families. We can’t afford policies that sell out our future and damage the health and education of the children who already have the least opportunity. Taxpayers deserve an honest analysis of who pays taxes and the reforms that will make our communities healthier and more secure.
SOURCES:
1. State and Local Revenue, Fiscal Year 2007-08, Center on Budget and Policy Priorities tabulations based on data from the Bureau of the Census and the Bureau of Economic Analysis.
3. Ibid.
6. email information from Karen Jacobs, Office of Economic Research and Analysis, Arizona Department of Revenue, 12/9/11, kjacobs@azdor.gov.
11. Arizona Income Tax Credits, Arizona Department of Revenue, 11/1/11.

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January 2012