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Goldwater Lawsuit Against Gilbert's Tax Increase Highlights Problems of Prop. 126

Back in 2018, the [Arizona Association of Realtors drafted](#) and put [8 million dollars](#) behind what they called "The Protect Arizona Taxpayers Act," which really should have been called "Protect Realtor Services from Being Taxed Act," as they were concerned that discussion to broaden the sales tax base (actually a transaction privilege tax or TPT) could be extended to realtors, even though it had no legislative momentum. They did not write it as a narrow self-interest exclusion, but as an exclusion of any new taxes on services that weren't taxed as of December 31, 2017 or any increase on taxes on services that were taxed. However, Prop. 126 had a significant drafting problem. Neither it, nor the existing Arizona tax code, defined "services."

This was peculiar as legislation normally defines terms.

While both [Gov. Doug Ducey and his challenger David Garcia](#) opposed Prop. 126, [little money came forward to oppose it](#), even though an interesting cross-section of groups opposed it from the libertarian Americans for Prosperity and Arizona Free Enterprise Club to the more progressive Children's Action Alliance. The Grand Canyon Institute (GCI) provided key research for the effort.

While one concern with Prop. 126 relates to constraining the ability of government to tax, since in practice almost all tax increases need voter approval or on the state-level a two-thirds vote of the legislature. In that sense, it was unnecessary. However, a potentially more worrisome concern related to creating a prohibition based on an undefined term "services."

Gilbert is no bastion of liberals; its conservative town council [determined in October](#) that it needed to increase its local TPT tax from 1.5% to 2%. They also increased the lodging bed tax from 2.8% to 5%. Gilbert has been growing and funds are needed to support infrastructure to support police, fire and park services. The higher taxes went into effect on January 1, 2025.

Now Gilbert is being sued for violating Prop. 126 by the Goldwater Institute. Yet even the [Goldwater legal complaint](#) is unclear statutorily when it comes to "services," stating, for instance, "The term 'service' **generally encompasses** activities of and businesses in the hospitality industry, including hotels, restaurants, bars, and the like" (emphasis added).

The Joint Legislative Budget Committee, when estimating the [fiscal impact of Prop. 126](#) in 2018 noted, "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" (emphasis added).

The Arizona Department of Revenue prepares an [annual tax expenditure report](#) which includes transactions that are exempt from the Transaction Privilege Tax—which in FY2024, they estimated was about \$27 billion in exempted TPT transactions, including realtors' services.

When GCI did [its analysis in 2018](#), it applied the definition of "services" used by economists as represented by the Bureau of Economic Analysis, which represents the most intrusive interpretation. While it has an economic basis, it has no basis in statute.

The Bureau of Economic Analysis identifies many areas that are currently subject to TPT as "services" as detailed in the table below.

Table 1: Bureau of Economic Analysis Demarcation of Goods and Services and Arizona TPT Coverage.

BEA Classification Goods	State Tax	County Tax	City Tax
Durable goods Motor vehicles and parts Recreational goods and vehicles Other durable goods	Retail Prime Contracting Mining Pipelines	Retail Prime Contracting Mining Pipelines	Retail Prime Contracting Mining Pipelines Manufactured Buildings
Nondurable goods Food and beverages purchased for off-premises consumption Clothing and footwear Gasoline and other energy goods Other nondurable goods	Retail (excludes food) Job Printing and Publication Gasoline excise tax	Retail (excludes food) Job Printing and Publication	Retail (some cities include food) Job Printing and Publication
BEA Classification Services	State Tax	County Tax	City Tax
Household consumption expenditures (for services)	Personal Property Rental	Personal Property Rental	Personal Property Rental
Housing and utilities	Utilities	Utilities Commercial Leases	Utilities Commercial Leases
Health care	None	None	None
Transportation services	Transporting Personal Property Rental	Transporting Personal Property Rental	Transporting Personal Property Rental

BEA Classification Services	State Tax	County Tax	City Tax
Food services and accommodations	Bars & Restaurants Transient Lodging Amusements	Bars & Restaurants Transient Lodging Amusements	Bars & Restaurants Transient Lodging Amusements
Financial services and insurance	Insurance Premium		
Professional services			Advertising

The drafters of Prop. 126 chose not to define what they were regulating, which is why Prop. 126 was a bad idea. How bad is now up to judicial proceedings.

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