# Fiscal Note

**BILL #** SCR 1027

**TITLE:** property tax exemption; veterans; disabilities

**SPONSOR:** Rogers

**STATUS:** As Introduced

**PREPARED BY:** Lydia Chew

**Description**

SCR 1027 would provide a property tax exemption for veterans with disabilities. Since SCR 1027 would amend the Arizona Constitution, it would require voter approval at the next general election. If approved, it would become effective beginning in TY 2023.

Under current law, widows, widowers, and persons with total and permanent disabilities are eligible to receive a property tax exemption. The exemption is subject to both income and property assessment limits, which are adjusted for inflation each year. The exemption amount is limited as well. As with the income and assessment limits, the exemption limit is also indexed to inflation. For TY 2021, household income cannot exceed $34,301, or $41,151 if minor children or children with total and permanent disabilities reside in the household. The assessed value of the property cannot exceed $27,970, which corresponds to a limited property value (LPV) of $279,700. The maximum allowable exemption amount for TY 2021 is $4,117.

The bill would provide a full property exemption to veterans with a service-connected disability of 100% or are legally blind, or the unmarried surviving spouse of such a veteran. This exemption would not be subject to income or assessment limits. SCR 1027 would also provide a property exemption of up to $5,000 to veterans with a service-connected disability of 10% or more, and this exemption would also not be subject to income limits. A person who qualifies for more than one exemption (e.g., if a person is both a widower and veteran with a disability) would be eligible to claim only one such exemption.

**Estimated Impact**

Due to data constraints, the impact of this proposal cannot be determined with certainty, as discussed in the *Analysis* section below. As a result, some of the forecast assumptions require considerable speculation. Under one sample scenario, the proposal could have a net General Fund cost of $10.8 million, beginning in FY 2024. The proposal would reduce net assessed valuation (NAV), which would increase the state's Basic State Aid cost for K-12 schools. At the same time, the bill would also reduce the cost of the Homeowner's Rebate (HOR) program (under which the state pays 47.19% of a homeowner's primary school district tax).

This $10.8 million net cost increase could be more than offset by savings under the automatic school tax rate adjustments provided by under the state's Truth-in-Taxation (TNT) provisions. If such TNT savings were incorporated, the General Fund would realize a net savings of $(4.6) million, beginning in FY 2024.

The General Fund net savings under TNT would occur for the following reasons. First, the TNT calculation automatically increases the statutory K-12 school tax rates, the Qualifying Tax Rate (QTR) and State Equalization Tax Rate (SETR), to offset the decrease in levies that would otherwise result from the NAV loss attributable to the proposal. Second, this rate increase has the effect of eliminating the Basic State Aid cost increase that would otherwise occur under the proposal.

Second, since the TNT calculation would result in a higher QTR under the proposal than under current law, there

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will be a shift of the property tax burden of veterans with disabilities to other property taxpayers, especially owners of non-residential property. As described in more detail in the *Analysis* section below, this tax shift has the effect of reducing the state cost for the HOR program.

The tax shift under the bill assumes that local governments respond to the NAV reduction by increasing their tax rates rather than lowering their spending.

**Analysis**

According to the Arizona Department of Veterans' Services, in 2019 there were 86,077 veterans with a disability rating of at least 10%, but less than 100%, in Arizona. There were also 14,501 veterans with a disability rating of 100% in Arizona.

According to estimates by the Housing Assistance Council, the homeownership rate among Arizona veterans is 75.4%. Based on this estimate, our analysis assumes that 64,902 of the 86,077 Arizona veterans with a disability rating of between 10% and 90% and 10,934 of the 14,501 Arizona veterans with a disability rating of 100% reside in homes owned by them, for a total of 75,836 homeowners.

The average statewide LPV of a primary residence is $192,749. Our analysis assumes that the total limited value of the 75,836 homes that would qualify for the exemption is $14.6 billion under current law [= 75,836 homes x $192,749 average LPV]. This amount corresponds to $1.5 billion in terms of NAV [= $14.6 billion x 10% assessment ratio for Class 3 property]. SCR 1027 would provide a full property exemption to veterans with a service-connected disability of 100% or are legally blind, and a property exemption of up to $5,000 to veterans with a service-connected disability of between 10% and 90%, or an exemption of the full amount if less than $5,000. We assume that the exemption for eligible veterans with a 100% disability will be $19,275 (the average statewide NAV for Class 3 property) and the exemption for eligible veterans with a 10% to 90% disability will be $5,000. This means that, under this proposal, approximately $(535.3) million in statewide NAV will be exempt [= (10,934 properties x $19,275 for 100% disability) + (64,902 properties x $5,000 for 10% to 90% disability)].

However, under current law, persons with total and permanent disabilities are already eligible to receive a property tax exemption of $4,117, subject to the household income limit of $34,301 ($41,151 if minor children or children with total and permanent disabilities reside in the household) and property LPV limit of $279,700. According to the county assessors, veterans with a disability rating of 100% are likely to already qualify for the existing exemption for persons with total and permanent disabilities. We assume that this also applies to veterans who are legally blind.

Our analysis makes several assumptions to estimate the number of veterans with a 100% disability that are currently receiving the existing exemption. For the purpose of determining eligibility, income from cash public assistance, social security payments, and veterans' disability pensions are not included. According to the 2019 American Community Survey, 56% of Arizona veterans are 65 years of age or older. We assume that income for individuals from this age bracket is largely comprised of social security payments and veterans' disability pensions, which are excluded from calculations for income eligibility. For this reason, we estimate that 56% of the 10,934 home-owning veterans with a disability rating of 100%, or 6,072 individuals, are income-eligible for the current property exemption. In addition, we assume that 80% of these 6,072 properties owned by income-eligible veterans with a 100% disability, or 4,858 primary residences, have a LPV of less than $279,700 and qualify for the existing exemption. As a result, we estimate that approximately $20.0 million in NAV is already exempt under current law for persons with total and permanent disabilities [= 4,858 properties x $4,117].

Therefore, SCR 1027 would reduce NAV by approximately $(515.3) million [= $(535.3) million + $20.0 million under existing exemption] in TY 2023.

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By reducing NAV by $(515.3) million in TY 2023, the proposal would result in a direct cost increase of the BSA program by $18.5 million, beginning in FY 2024. The $(515.3) million Class 3 (primary residence) NAV reduction would also have the effect of reducing the cost of the Homeowner's Rebate (HOR) by an estimated $(7.7) million. The direct net impact on the 2 state programs is a cost increase of $10.8 million, beginning in FY 2024.

TNT Impacts

The NAV reduction under the proposal would also have an impact on the state's TNT program. Under TNT, both the Qualifying Tax Rate (QTR) and State Equalization Tax Rate (SETR) are adjusted each year to offset the statewide annual valuation change of existing property. This rate change occurs automatically unless the Legislature decides to forgo the TNT adjustment. Due to the $(515.3) million NAV loss, the TNT adjustment would result in the QTR and SETR being an estimated 2.25¢ and $0.27¢ higher, respectively, in FY 2024 under the proposal than under current law. The higher QTR of 2.25¢ and SETR of 0.27¢ under TNT would generate an offsetting cost savings of $(18.9) million for the BSA program. The BSA net savings of $(0.4) million under TNT is due to the higher QTR and SETR levy on new property under the bill than under current law. Under TNT, the Class 3 NAV loss of $(515.3) million combined with the 2.25¢ higher QTR would have the effect of reducing the savings for the HOR program from $(7.7) million to $(4.2) million. Thus, after including the impact of TNT, the proposal would produce a net General Fund savings of $(4.6) million [= $(0.4) million BSA savings + $(4.2) million ASA savings].

The $(4.6) million General Fund savings is primarily attributable to 2 factors: (1) the lower NAV for Class 3 property owned by veterans with disabilities receiving the exemption and (2) the higher QTR resulting from the TNT adjustment. The combined effect of these 2 factors is summarized in *Table 1* below.

**Table 1**

**QTR Tax Shift and Change in HOR Cost**
**($ in Millions)**

| **Property Class** | **Change in QTR Levy** | **Change in HOR Cost** | **Change in Net QTR Levy** |
|---|---|---|---|
| Non-Class 3 – commercial and other | $9.3 | $0.0 | $9.3 |
| Class 3 – other than veterans with disabilities | 7.0 | 3.3 | 3.7 |
| Class 3 – veterans with disabilities | (15.9) | (7.5) | (8.4) |
| **Total Net Change** | **$0.4** | **$(4.2)** | **$(4.6)** |

The combination of lower NAV and higher QTR will result in a QTR levy decrease of $(15.9) million for veterans with disabilities receiving the exemption. As shown in *Table 1*, the $(15.9) million savings incurred by veterans with disabilities would be shifted to other Class 3 (owner-occupied residential) as well as non-Class 3 (commercial, rental residential, etc.) property owners in the amount of $9.3 million and $7.0 million, respectively. These are the tax shifts before the HOR is applied. Under the HOR program, the state pays 47.19% of the QTR levied on Class 3 property. The remaining 52.81% is paid by the homeowner. Other classes of property do not receive the 47.19% QTR reduction.

As shown in *Table 1*, of the $7.0 million QTR increase on other Class 3 property, $3.3 million would be paid by the General Fund in the form of higher HOR cost) while the remaining $3.7 million would be paid by homeowners not receiving the exemption. Therefore, the QTR tax shift to other Class 3 property, net of HOR, would be $3.7 million. Since commercial and other non-Class 3 properties do not receive HOR, the tax shift for this category would remain at $9.3 million. The $(15.9) million QTR levy reduction on homes owned by veterans with disabilities would not be fully realized by them. Instead, the state General Fund would receive 47.19% of this savings, or $(7.5) million. The remaining $(8.4) million represents the net savings realized by veterans with disabilities.

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As shown in *Table 1* above, the total net increase of the QTR levy under the bill is $0.4 million. This is due to the QTR levy from new construction being $0.4 million higher under the proposal than under current law. This amount represents the BSA cost savings of $(0.4) million mentioned above.

In summary, the state General Fund impact of the proposal depends on whether the TNT impact is included or not. In the absence of a TNT adjustment, the projected General Fund cost under the sample scenario is $10.8 million, beginning in FY 2024. If the QTR and SETR are adjusted to account for TNT, however, the proposal would generate net General Fund savings of $(4.6) million, beginning in FY 2024. The General Fund savings would primarily occur due to a tax shift from veterans with disabilities to other property owners. To a smaller extent, such savings would also be generated from higher QTR and SETR levies on property added to the tax roll ("new construction") for the first time in FY 2024.

**Local Government Impact**

Apart from the QTR shift described above, the proposal could also result in a tax shift of other primary as well as secondary taxes levied by local taxing jurisdictions, such as counties, community college districts, cities, school districts and special taxing districts. The amount of such tax shifts would depend on the extent to which local taxing jurisdictions would raise their tax rates to make up for the loss of levies under the proposal. *Table 2* below shows the maximum potential shift of total (primary plus secondary) property taxes under the proposal.

The estimates included in *Table 2* assume that taxing jurisdictions would levy the same amount under the proposal as under current law. Under this assumption, veterans with disabilities would have a total (primary plus secondary) tax reduction of $(53.6) million. The higher QTR and SETR under the bill would generate total General Fund savings of $(4.6) million, of which $(4.2) million would be attributable to HOR savings and $(0.4) million to BSA savings. This means that under the assumption that local taxing jurisdictions would set their rates in a manner that would "hold them harmless," the savings realized by disabled veterans of $(53.6) million and by the General Fund of $(4.6) million would essentially be "paid for" in the form of a tax shift of $35.1 million to non-Class 3 property and $23.1 million to Class 3 property (other than that owned by veterans with disabilities), for a total of $58.2 million.

**Table 2**

**Maximum Potential Property Tax Shift**
**($ in Millions)**

| **Property Class** | **Primary Tax Shift** | **Secondary Tax Shift** | **Total Tax Shift** |
|---|---|---|---|
| Non-Class 3 – commercial and other | $22.5 | $12.6 | $35.1 |
| Class 3 – other than veterans with disabilities | 13.6 | 9.5 | 23.1 |
| Class 3 – veterans with disabilities | (31.5) | (22.1) | (53.6) |
| General Fund | (4.2) | 0.0 | (4.2) |
| **Total Net Change** | **$0.4** | **$0.0** | **$0.4** |

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