Fiscal Note

BILL # HB 2454

TITLE: statutory conformity; property tax exemptions

SPONSOR: Carter

STATUS: House Engrossed

PREPARED BY: Lydia Chew

Description

HB 2454 and its companion bill, HCR 2017, would provide a property tax exemption for veterans with service- or nonservice-connected disabilities. The amount of the exemption would be in direct proportion to the percentage rating of the veteran's disability. The maximum exemption and eligibility limits would also be adjusted upward. Since HCR 2017 would amend the Arizona Constitution, it would require voter approval at the next general election. The enactment of HB 2454 is conditional upon the passage of HCR 2017. If HCR 2017 is approved, the proposal would become effective beginning in tax year (TY) 2023.

Estimated Impact

We estimate that the legislation would have a net General Fund cost of $2.1 million, beginning in FY 2024, prior to the application of Truth-in-Taxation (TNT) provisions. 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 50% of a homeowner's primary school district tax.

This $2.1 million net cost increase could be more than offset by savings under the automatic school tax rate adjustments provided under TNT. If such TNT savings were incorporated, the General Fund would realize a net savings of $(1.0) 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. 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 would be a shift of the property tax collections from 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

Background – 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,

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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. In TY 2022, the maximum allowable exemption amount for widows, widowers, and persons with total and permanent disabilities is $4,188. To be eligible, the assessed value of the property cannot exceed $28,459, which corresponds to a limited property value (LPV) of $284,590. In addition, household income cannot exceed $34,901 (or $41,870, if minor children or children with total and permanent disabilities reside in the household).

The proposal would provide a property exemption to veterans with service- or nonservice-connected disabilities. The amount of the exemption would be in direct proportion to the percentage rating of the veteran's disability. As an example, a veteran with a disability rating of 50% would receive a property tax exemption equal to 50% of the maximum allowable exemption. Under this proposal, the maximum allowable exemption would be increased from the current amount of $4,188 to $4,200. The assessment limit would be increased from $28,459 to $30,000, and the income limit would be increased from $34,901 to $35,000 (or from $41,870 to $42,000, if minor children or children with total and permanent disabilities reside in the household).

Due to data constraints, we are unable to estimate the impact of increasing the current amounts of assessment and income limits for widows, widowers, and persons with total and permanent disabilities to the amounts provided under the bill, as outlined above. However, since the increases of the assessment and income limits are relatively small, we expect that the impact of these provisions would be minimal.

In addition to creating a property tax exemption for veterans with service- or nonservice-connected disabilities, the proposal would increase the constitutional limit for the commercial agricultural and business personal property exemption. Currently, the Arizona Constitution exempts the first $50,000 of full cash value for business and agricultural personal property from taxation. Pursuant to A.R.S. § 42-11127(B), the maximum amount of the exemption is increased each year to account for inflation. For TY 2022, the maximum amount of the exemption was $207,366. The proposal would institute an exemption amount of $220,000, which would be adjusted for inflation each year. Commercial agricultural personal property and business personal property are classified as Class 2 and Class 1, respectively. Due to data constraints, we are unable to quantify the impact of raising the agricultural and business personal property exemption from $207,366 to $220,000. However, considering the relatively small increase of the personal property exemption limit under the bill, we do not expect the impact to be significant.

Cost Estimate – According to the Arizona Department of Veterans' Services (ADVS), there are 110,345 veterans with disability ratings of at least 10%, but less than 100%, in Arizona. There are also 23,268 veterans with disability ratings of 100% in Arizona. Our analysis assumes that veterans with disability ratings of 100% are already using the existing $4,188 property tax exemption for persons with total and permanent disabilities. The distribution of veterans with each disability rating is displayed in *Table 1* below.

According to estimates by the Housing Assistance Council, the homeownership rate among Arizona veterans is 76.6%. Based on this estimate, our analysis assumes that 84,524 of the 110,345 Arizona veterans with disability ratings of between 10% and 90% and 17,823 of the 23,268 Arizona veterans with disability ratings of 100% reside in homes owned by them.

To qualify for the exemption, the veteran's household income cannot exceed $35,000 (or $42,000, if minor children or children with total and permanent disabilities reside in the household). For the purpose of determining eligibility, this amount does not include cash public assistance, social security payments, and veterans' disability pensions.

According to the American Community Survey (ACS), 75% of Arizona veterans have wages or salary income of less than $35,000 (in 2020 inflation-adjusted dollars). Wages or salary income excludes cash public assistance, social security payments, and retirement income. As a result, we assume that 75% of the homeowners that are veterans

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with disabilities have income below the proposal's income limit. This means that the number of veterans potentially exempted under the proposal is approximately 62,980 veterans with disability ratings of between 10% and 90% and 13,274 veterans with disability ratings of 100%.

Table 1

Arizona Veterans with Disabilities

Disability Rating [1/]	Veterans
10%	23,256
20%	10,808
30%	9,926
40%	9,796
50%	8,035
60%	11,471
70%	12,780
80%	12,811
90%	11,462
100%	23,268
Total	**133,613**

1/ Disability rating is available only for veterans with service-connected disabilities. Analysis assumes the same disability rating for veterans with nonservice-connected disability.

In addition, to qualify for the exemption, the home's limited property value (LPV) cannot exceed $300,000. The average statewide LPV of a primary residence is $200,756. Our analysis assumes that 80% of the 62,980 homes owned by veterans with disability ratings of between 10% and 90%, or 50,385 properties, and 80% of the 13,274 homes owned by veterans with disability ratings of 100%, or 10,624 properties, have a LPV of $300,000 or less.

The exemption amount for the 50,385 homes owned by veterans with disability ratings of between 10% and 90% that are assumed to be eligible for the exemption is calculated based on the veteran's disability rating up to the maximum allowable amount under this proposal of $4,200.

For example, a qualified veteran with a disability rating of 20% and whose home is valued at $180,000 (and therefore with a corresponding net assessed value of $18,000), would receive an exemption of $840 [= $4,200 x 20%]. This means that the net assessed value (NAV) of the veteran's home would be reduced from $18,000 to $17,160. We estimate the aggregate NAV loss for the 50,385 homes owned by veterans with disability ratings of between 10% and 90% to be $(99.3) million.

For the 10,624 homes owned by veterans with disability ratings of 100% that are assumed to already be using the existing $4,188 property tax exemption under current law, this proposal would exempt an additional $12 per property. We estimate that this provision would result in a NAV reduction of $(140,100).

In addition, the proposal would increase the exemption for widows, widowers, and persons with total and permanent disabilities from $4,188 to $4,200. Based on ACS estimates, there are roughly 500,000 eligible widows, widowers, and persons with total and permanent disabilities in Arizona. For these individuals, the proposal would also exempt an additional $12 per home. Therefore, we estimate that this provision would result in a NAV reduction of about $(6.1) million.

In total, based on the data provided by ADVS and ACS, we estimate that the proposal would reduce statewide NAV by approximately $(105.5) million.

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The net NAV reduction is an estimated $(105.5) million in TY 2023. This would result in a direct cost increase of the BSA program by $3.8 million, beginning in FY 2024. The $(105.5) 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 $(1.7) million. Therefore, the direct net impact on the 2 state programs is a cost increase of $2.1 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 $(105.5) million NAV loss, the TNT adjustment would result in the QTR and SETR being an estimated 0.44¢ and 0.05¢ higher, respectively, in FY 2024 under the proposal than under current law. The higher QTR of 0.44¢ and SETR of 0.05¢ under TNT would generate a small net savings of $(77,700) for the BSA program. This amount is due to savings of $(68,800) from to the higher QTR plus savings of $(8,900) due to the higher SETR generated on new construction under the proposal than under current law.

Table 2

QTR Tax Shift and Change in HOR Cost

Property Class	**Change in QTR Levy**	**Change in HOR Cost**	**Change in Net QTR Levy**
Non-Class 3 – commercial and other	$1,898,100	$0	$1,898,100
Class 3 – other than veterans with disabilities	1,437,000	718,500	718,500
Class 3 – veterans with disabilities	(3,266,300)	(1,633,150)	(1,633,150)
Total Net Change	**$68,800** [1/]	**$(914,650)**	**$983,450**

1/ Due to the higher QTR levied on new construction under the proposal relative to current law.

The combination of lower NAV and higher QTR would result in a QTR levy decrease of $(3.3) million for veterans with disabilities receiving the exemption. As shown in *Table 2*, the $(3.3) 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 $1.4 million and $1.9 million, respectively. (The total net QTR levy increase of $68,800 is due to the higher QTR levied on new construction under the proposal than under current law.) These are the tax shifts before the HOR is applied. Under the HOR program, the state pays 50% of the QTR levied on Class 3 property. The remaining 50% is paid by the homeowner. Other classes of property do not receive the 50% QTR reduction.

As shown in *Table 2*, of the $1.4 million QTR increase on other Class 3 property, $718,500 would be paid by the General Fund in the form of higher HOR cost, while the remaining $718,500 would be paid by homeowners not receiving the exemption. Therefore, the QTR tax shift to other Class 3 property, net of HOR, would be $718,500. Since commercial and other non-Class 3 properties do not receive HOR, the tax shift for this category would remain at $1.9 million. The $(3.3) 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 50% of this savings, or $(1.6) million. The remaining $(1.6) million represents the net savings realized by veterans with disabilities.

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.

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Table 3 below shows the maximum potential shift of total (primary plus secondary) property taxes under the proposal.

The estimates included in *Table 3* 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 $(10.6) million.

The reduced HOR cost combined with the higher QTR and SETR levied on new construction under the bill would generate total General Fund savings of $(1.0) million. (This amount is the sum of HOR savings of $(914,650), plus BSA savings of $(68,800) from the higher QTR levied on new construction, plus BSA savings of $(8,900) on the higher SETR levied on new construction.)

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 veterans with disabilities of $(10.6) million and by the General Fund of $(1.0) million would essentially be "paid for" in the form of a tax shift of $7.0 million to non-Class 3 property and $4.6 million to Class 3 property (other than that owned by veterans with disabilities), for a total of $11.6 million.

Table 3

Maximum Potential Property Tax Shift
($ in Millions)

Property Class	**Primary Tax Shift**	**Secondary Tax Shift**	**Total Tax Shift**
Non-Class 3 – commercial and other	$4.6	$2.5	$7.0
Class 3 – other than veterans with disabilities	2.7	1.8	4.6
Class 3 – veterans with disabilities	(6.3)	(4.3)	(10.6)
General Fund	(1.0)	0.0	(1.0)
Total Net Change	**$0.0**	**$0.0**	**$0.0**

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