Fiscal Note

BILL # SB 1034

TITLE: veterans; disabilities; property tax exemption

SPONSOR: Rogers

STATUS: As Introduced

PREPARED BY: Lydia Chew

Description

SB 1034 and its companion bill, SCR 1009, would provide a property tax exemption for veterans with disabilities. Since SCR 1009 would amend the Arizona Constitution, it would require voter approval at the next general election. The enactment of SB 1034 is conditional upon the passage of SCR 1009. If SCR 1009 is approved, the proposal would become effective beginning in tax year (TY) 2023.

The proposal would provide a full property exemption to veterans with service-connected disabilities of 100% or who are legally blind, or the unmarried surviving spouse of such a veteran. The proposed legislation would also provide a property exemption of up to $5,000 to veterans with service-connected disabilities of 10% or more. These exemptions would not be subject to income limits.

Estimated Impact

We estimate that the legislation would have a net General Fund cost of $11.3 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 50% of a homeowner's primary school district tax.

This $11.3 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 $(5.4) 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 net assessed value (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 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.

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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, which are adjusted for inflation each year. For TY 2022, the assessed value of the property cannot exceed $28,459, which corresponds to a limited property value (LPV) of $284,590. In TY 2022, the maximum allowable exemption amount for widows, widowers, and persons with total and permanent disabilities is $4,188.

The proposal would provide a full property exemption to veterans with service-connected disabilities of 100% or who are legally blind, or the unmarried surviving spouse of such a veteran. It would also provide a property exemption of up to $5,000 to veterans with service-connected disabilities of 10% or more. These exemptions would 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 a veteran with a disability) would be eligible to claim only one such exemption.

Cost Estimate – According to the Arizona Department of Veterans' Services, 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 disability.

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.

In addition, to qualify for the exemption, the home's LPV cannot exceed $284,590. The average statewide LPV of a primary residence is $200,756. Our analysis assumes that 80% of the 84,524 homes owned by veterans with disability ratings of between 10% and 90%, or 67,619 properties, and 80% of the 17,823 homes owned by veterans with disability ratings of 100%, or 14,259 properties, have a LPV of $284,590 or less.

We assume that the exemption for eligible veterans with 100% disability ratings would be $20,076 (the average statewide NAV for Class 3 property) and the exemption for eligible veterans with between 10% and 90% disability ratings will be $5,000. This means that, under this proposal, approximately $(564.6) million in statewide NAV will be exempt [= (14,259 properties x ($20,076 - $4,188) for 100% disability ratings) + (67,619 properties x $5,000 for between 10% and 90% disability ratings)].

By reducing NAV by $(564.6) million in TY 2023, the proposal would result in a direct cost increase of the BSA program by $20.4 million, beginning in FY 2024. The $(564.6) 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 $(9.0) million. The direct net impact on the 2 state programs is a cost increase of $11.3 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 QTR and 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 $(564.6) million NAV loss, the TNT adjustment would result in the QTR and SETR being an estimated 2.34¢ and 0.28¢ higher, respectively, in FY 2024 under the proposal than under current law. The higher QTR of 2.34¢ and SETR of 0.28¢ under TNT would generate a small net savings of $(526,000) for the BSA program. This savings is attributable to the higher QTR and SETR generated on new construction under the proposal than under current law. After including the impact of TNT, the proposal would produce a net General Fund savings of $(5.4) million, of which $(526,000) is for the BSA program and the remaining $(4.9) million is for the HOR program.

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The $(5.4) 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.

The combination of lower NAV and higher QTR would result in a QTR levy decrease of $(17.5) million for veterans with disabilities receiving the exemption. As shown in *Table 1*, the $(17.5) 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 $7.7 million and $10.2 million, respectively. (The total net QTR levy increase of $478,600 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.

Table 1

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	$10,228,100	$0	$10,228,100
Class 3 – other than veterans with disabilities	7,743,100	3,871,550	3,871,550
Class 3 – veterans with disabilities	(17,492,600)	(8,746,300)	(8,746,300)
Total Net Change	**$478,600**	**$(4,874,850)**	**$5,353,400**

As shown in *Table 1*, of the $7.7 million QTR increase on other Class 3 property, $3.9 million would be paid by the General Fund in the form of higher HOR cost, while the remaining $3.9 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 $3.9 million. Since commercial and other non-Class 3 properties do not receive HOR, the tax shift for this category would remain at $10.2 million. The $(17.5) 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 $(8.7) million. The remaining $(8.7) million represents the net savings realized by veterans with disabilities.

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 $11.3 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 $(5.4) million, beginning in FY 2024. This amount includes the combined savings from both the BSA and the HOR programs. 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 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.

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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 $(56.7) million. The higher QTR and SETR under the bill would generate total General Fund savings of $(5.4) million, of which $(4.9) million would be attributable to HOR savings and $(526,000) 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 veterans with disabilities of $(56.7) million and by the General Fund of $(5.4) million would essentially be "paid for" in the form of a tax shift of $37.7 million to non-Class 3 property and $24.4 million to Class 3 property (other than that owned by veterans with disabilities), for a total of $62.1 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	$24.5	$13.2	$37.7
Class 3 – other than veterans with disabilities	14.7	9.7	24.4
Class 3 – veterans with disabilities	(33.8)	(22.9)	(56.7)
General Fund	(5.4)	0.0	(5.4)
Total Net Change	**$0.0**	**$0.0**	**$0.0**

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