Fiscal Note

BILL # SB 1095 **TITLE:** property tax exemptions; statutory conformity

SPONSOR: Mesnard **STATUS:** As Introduced

PREPARED BY: Lydia Chew

Description

SB 1095 and its companion bill, SCR 1011, would provide a property tax exemption for veterans with disabilities. Since SCR 1011 would amend the Arizona Constitution, it would require voter approval at the next general election. The enactment of SB 1095 is conditional upon the passage of SCR 1011. If SCR 1011 is approved, the proposal would become effective beginning in tax year (TY) 2023.

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 $2.1 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 $2.1 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 $1.1 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 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

<u>Background</u> – 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

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assessment limits, the exemption limit is also indexed to inflation.

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 $4,177, which was the maximum exemption in TY 2021. Moreover, 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.

In addition to creating a property tax exemption for veterans with service- or nonservice-connected disabilities, the proposal would remove the constitutional limit for commercial agricultural and business personal property. 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 2021, the maximum amount of the exemption was $195,878. If the proposal becomes effective, the Legislature would be allowed to determine the exemption amount for business personal property in statute. SB 1095 would institute an exemption amount of $195,878, which is the same amount as in TY 2021.

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. Our analysis assumes that veterans with disability ratings of 100% are already currently eligible for the property tax exemption. The distribution of veterans with each disability rating is displayed in *Table 1* below.

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
Total	**110,345**

1/ Disability rating is available only for veterans with service-connected disabilities. Analysis assumes the same disability rating for veterans with nonservice-connected 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% reside in homes owned by them.

To qualify for the exemption, the veteran's household income cannot exceed $34,301 (or $41,151, if minor children or children with total and permanent disabilities reside in the household). These amounts are the same as the TY 2021 income limits. For the purpose of determining eligibility, this amount does not include cash public assistance, social security payments, and veterans' disability pensions.

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According to the American Community Survey (ACS), 78% of Arizona veterans have wages or salary income of less than $34,301 (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 78% of the 84,524 homeowners that are veterans with disabilities have income below the proposal's income limit. This means that the number of veterans potentially exempted under the proposal is reduced from 84,524 to 65,929.

In addition, to qualify for the exemption, the home's limited property value (LPV) cannot exceed $279,700. This amount is the same as the TY 2021 assessment limit. The average statewide LPV of a primary residence is $200,756. Our analysis assumes that 80% of the 65,929 homes owned by veterans with disability ratings of between 10% and 90%, or 52,743 primary residences, have a LPV of $279,700 or less. The exemption amount for the 52,743 homes 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 $4,117.

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 $823 [= $4,117 x 20%]. This means that the net assessed value (NAV) of the veteran's home would be reduced from $18,000 to $17,177.

Based on the data provided by ADVS regarding the distribution of Arizona veterans' disability ratings, we estimate that the proposal would reduce statewide NAV by approximately $(103.4) million.

By reducing NAV by $(103.4) million in TY 2023, the proposal would result in a direct cost increase of the BSA program by $3.7 million, beginning in FY 2024. The $(103.4) 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. The direct net impact on the 2 state programs is a cost increase of $2.1 million, beginning in FY 2024.

<u>*TNT Impacts*</u> – 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 $(103.4) 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 $(203,400) 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 $(1.1) million, of which $(203,400) is for the BSA program and the remaining $(864,200) is for the HOR program.

The $(1.0) 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 2* below.

The combination of lower NAV and higher QTR would result in a QTR levy decrease of $(3.2) million for veterans with disabilities receiving the exemption. As shown in *Table 2*, the $(3.2) 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 $1.9 million and $1.5 million, respectively. (The total net QTR levy increase of $45,400 is due to the higher QTR levied on new construction under the proposal than under current law.) These are the tax shifts <u>before</u> 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 $1.5 million QTR increase on other Class 3 property, $728,000 would be paid by the

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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	$1,923,200	$0.0	$1,923,200
Class 3 – other than veterans with disabilities	1,456,000	728,000	728,000
Class 3 – veterans with disabilities	(3,184,400)	(1,592,200)	(1,592,200)
Total Net Change	$194,800	$(864,200	$1,059,000

General Fund in the form of higher HOR cost, while the remaining $728,000 would be paid by homeowners not receiving the exemption. Therefore, the QTR tax shift to other Class 3 property, net of HOR, would be $728,000. 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 $(3.2) 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.

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 $2.1 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 $(1.1) 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 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 $(10.4) million. The higher QTR and SETR under the bill would generate total General Fund savings of $(1.1) million. 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 $(10.4) million and by the General Fund of $(1.1) million would essentially be "paid for" in the form of a tax shift of $6.9 million to non-Class 3 property and $4.5 million to Class 3 property (other than that owned by veterans with disabilities), for a total of $11.4 million.

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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	$4.5	$2.4	$6.9
Class 3 – other than veterans with disabilities	2.7	1.8	4.5
Class 3 – veterans with disabilities	(6.2)	(4.2)	(10.4)
General Fund	(1.1)	0.0	(1.1)
Total Net Change	**$0.0**	**$0.0**	**$0.0**

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