

Fiscal Note

BILL # HB 2672

TITLE: property tax; exemption; veterans; disabilities

SPONSOR: Carbone

STATUS: House Engrossed

PREPARED BY: Hans Olofsson

Description

Current law provides a property tax exemption for veterans with service - or nonservice-connected disabilities in direct proportion to the percentage rating of the veteran's disability. The amount of the exemption is limited and is subject to certain income and property assessment limits.

The House Engrossed version of HB 2672 would provide several changes to the existing property tax exemption for disabled veterans. First, the exemption amount would be calculated differently based on whether the veteran's disability is service-connected or nonservice-connected. A veteran who has a service-connected disability with a 100% disability rating would receive a full property tax exemption, as would their surviving spouse. Second, while the income limits to qualify for the exemption would be the same as under current law, there would be no property assessment limit to qualify for the exemption. (Additional details are provided in the *Analysis* section below.)

Estimated Impact

We estimate that the bill would have a net General Fund cost of \$3.0 million, beginning in FY 2027, prior to the application of Truth-in-Taxation (TNT) provisions. The bill would reduce net assessed valuation (NAV), which would increase the state's Basic State Aid (BSA) 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 \$3.0 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 \$(1.7) million, beginning in FY 2027.

The General Fund net savings under TNT would occur for the following reasons. First, the TNT calculation automatically increases the statutory K-12 tax rate, known as the Qualifying Tax Rate (QTR), to offset the decrease in QTR levies that would otherwise result from the NAV loss attributable to the bill. This rate increase effectively eliminates the BSA cost increase that would otherwise occur under the bill.

Second, since the TNT calculation would result in a higher QTR, the property tax burden would shift from veterans with disabilities receiving the expanded exemption under the bill, to other property taxpayers, especially owners of non-residential property (including commercial property). This tax shift has the effect of reducing the state cost for the HOR program.

As discussed in the *Analysis* section below, 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.

As a part of our analysis, we contacted the Maricopa County Assessor's Office to get an estimate of the current use of the disabled veterans' property tax exemption. However, as of the publication of this analysis, we have not received any information. For this reason, we developed our own methodology to estimate current use of the exemption, as described below.



Analysis

Background

Under current law, an honorably discharged veteran of the uniformed services who has a service - or nonservice connected disability is 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. In Tax Year (TY) 2025, the maximum allowable exemption amount is \$4,748. To be eligible, the assessed value of the property cannot exceed \$31,347, which corresponds to a limited property value (LPV) of \$313,470. In addition, household income cannot exceed \$38,843 (or \$46,600 if minor children or children with total and permanent disabilities reside in the household).

The amount of the exemption under current law is 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 of \$4,748. The main provisions of the exemption under current law are summarized in *Table 1* below.

Table 1 Disabled Veterans Property Tax Exemption – Current Law				
<u>Disability Type</u>	<u>Disability Rating</u>	<u>Exemption Limit</u> ^{1/}	<u>Assessment Limit</u> ^{1/}	<u>Income Limit</u> ^{1/2/}
Service-Connected	100%	\$4,748	\$31,347	\$38,843 / \$46,600
Service-Connected	10% to 90%	\$4,748 x Rating	\$31,347	\$38,843 / \$46,600
Nonservice-Connected	100%	\$4,748	\$31,347	\$38,843 / \$46,600
Nonservice-Connected	10% to 90%	\$4,748 x Rating	\$31,347	\$38,843 / \$46,600

^{1/} The amounts listed in the table have been adjusted for inflation. The exemption limit provided in statutes prior to the annual inflation adjustment is \$4,188 while the assessment and income limits in statutes are \$28,459 and \$34,901/\$41,870, respectively.

^{2/} The lower income limit applies if no children under age 18 reside in the household. The upper income limit applies if minor children or children with total and permanent disabilities reside in the household.

Estimated Use of Property Exemption under Current Law

According to the Arizona Department of Veterans' Services (ADVS), there are 154,083 veterans in Arizona with disability ratings from 10% to 100%. The distribution of veterans with each disability rating is displayed in *Table 2* below. (Note that while we requested information on the number of Arizona veterans by county, such data is not currently available, according to ADVS.)

Table 2	
Arizona Veterans with Disabilities	
<u>Disability Rating</u>	<u>Veterans</u>
10%	23,079
20%	9,721
30%	9,065
40%	9,523
50%	7,565
60%	11,807
70%	14,279
80%	15,452
90%	15,622
100%	<u>37,970</u>
Total	154,083

According to estimates by the Housing Assistance Council, the homeownership rate among Arizona veterans is 77.8%. Based on this estimate, our analysis assumes that 119,877 of the 154,083 Arizona veterans with disability ratings of between 10% and 100% reside in homes owned by them.

To qualify for the exemption under current law, the home's limited property value (LPV) cannot exceed \$313,470. The average statewide LPV of a primary residence is currently \$231,000. Since we lack specific parcel data, our analysis assumes that 80% of the 119,877 homes (= 95,902 properties) owned by disabled veterans have a LPV of \$313,470 or less.

In addition to the assessment limit, the disabled veteran's household income cannot exceed \$38,843 (or \$46,600 if minor children or children with total and permanent disabilities reside in the household). The definition of income for the purpose of determining eligibility for the exemption does not include cash public assistance, social security payments, and veterans' disability pensions.

According to a report issued by the Congressional Budget Office (CBO) in December 2023, the amount of earnings (excluding veterans' disability compensation) of disabled veterans varies by disability rating. For male veterans (between the age of 22 and 54) with a disability rating of 10% to 20%, the average annual earning is \$65,600 (\$45,200 for female veterans); for a disability rating of 30% to 60%, the average earning is \$58,600 for male veterans and \$45,000 for female veterans; and for a disability rating of 70% or higher, the average earning is \$38,800 for male veterans and \$26,800 for female veterans.

Since we lack detailed income data for the disabled veteran population in Arizona, we have assumed for the purpose of this analysis that 10% of veterans with a disability rating of 10% to 20% meet the income requirement under current law. We have further assumed that 30% of veterans with a disability rating of 30% to 60% as well as 95% of veterans with a 70% to 100% disability rating earn no more than the allowable income limit to qualify for the exemption. Based on these income assumptions, we estimate that the number of properties that ultimately qualify for the exemption under current law is further reduced from 95,902 to 58,397 parcels.

The total statewide exemption amount for the 58,397 homes owned by veterans with disability ratings of between 10% and 100% that are assumed to qualify for and use the exemption under current law is calculated based on the veteran's disability rating up to the maximum allowable amount of \$4,748. As an example, a qualified veteran with a disability rating of 20% whose home is valued at \$250,000 (and therefore with a corresponding net assessed value of \$25,000), receives an exemption of \$950 [= \$4,748 x 20%]. This means that the net assessed value (NAV) of the veteran's home for property tax purposes is reduced from \$25,000 to \$24,050. We estimate that the aggregate NAV loss for the 58,397 homes owned by veterans with disability ratings of between 10% and 100% is \$(225.5) million [= 58,397 parcels x average per parcel exemption of \$3,862] under current law.

Estimated Use of Property Exemption under HB 2672

As noted above, the bill would make several changes to the existing property tax exemption for disabled veterans. First, the exemption amount would be determined differently based on whether the veteran's disability is service-connected or nonservice-connected. Specifically, a veteran who has a service-connected disability with a 100% disability rating would receive a full property tax exemption (i.e., the exemption would no longer be limited to a specific amount). Second, there would be no property assessment limits to qualify for the exemption irrespective of disability rating or whether the veteran has service- or nonservice-connected disability. The income limits would remain the same as under current law. The main provisions under the bill are summarized in *Table 3* below.

Table 3 Disabled Veterans Property Tax Exemption – HB 2672				
<u>Disability Type</u>	<u>Disability Rating</u>	<u>Exemption Limit</u> ^{1/}	<u>Assessment Limit</u>	<u>Income Limit</u> ^{1/2/}
Service-Connected	100%	None	None	\$38,843 / \$46,600
Service-Connected	10% to 90%	\$4,748 x Rating	None	\$38,843 / \$46,600
Nonservice-Connected	100%	\$4,748	None	\$38,843 / \$46,600
Nonservice-Connected	10% to 90%	\$4,748 x Rating	None	\$38,843 / \$46,600

^{1/} See footnote ^{1/} in *Table 1*.
^{2/} See footnote ^{2/} in *Table 1*.

The information provided by ADVS does not delineate between veterans who have service-connected versus nonservice-connected disability. However, according to the American Community Survey (ACS) published by the U.S. Census Bureau, in the period from 2008 to 2022, 29.5% of disabled veterans had service-connected disability. Based on the ACS data, we estimate that of the 154,083 disabled veterans in Arizona (see *Table 1* above), 45,453 veterans have service-connected

disability while the remaining 108,630 veterans have nonservice-connected disability. We further assume that the distribution of the disability rating is the same for veterans with service-connected disability as those with nonservice-connected disability.

Service-Connected Disability Exemption

Based on the data provided by ADVS and ACS, we estimate that there are 45,453 veterans with service-connected disability in the state, of which 11,201 have a disability rating of 100%. Based on the assumed homeownership rate and income by disability rating discussed above, we estimate that 8,279 [= 11,201 parcels x 77.8% homeownership rate x 95% below income limit] homes owned by disabled veterans with 100% service-connect disability would receive a full property tax exemption under the bill. Using the average NAV of \$23,100 (or \$231,000 in LPV) for a primary residence, we estimate that the total NAV exemption for this subset of veterans would be \$191.2 million [= 8,279 parcels x \$23,100 NAV] under the bill. For the remaining 34,252 disabled veterans with a service-connected disability rating of 10% to 90%, we estimate that 13,255 properties would qualify for the exemption after adjusting for the homeownership rate and the income requirement. The total NAV exemption for these 13,255 properties is an estimated \$43.9 million [= 13,255 properties x average per parcel exemption of \$3,308]. This means that the total exemption for all veterans with service-connected disability is estimated to be \$235.1 million [= \$191.2 million + \$43.9 million] under the bill.

Nonservice-Connected Disability Exemption

As noted above, we estimate that that are 108,630 veterans in Arizona with nonservice-connected disability from 10% to 100%. Based on a homeownership rate of 77.8%, we estimate that 85,514 of these disabled veterans are homeowners. We estimate that this number is further reduced from 85,514 to 51,463 parcels after adjusting for the exemption's income requirement. The total exemption for these 51,463 properties is an estimated \$198.7 million [= 51,463 parcels x average per parcel exemption of \$3,862].

Estimated General Fund Cost of HB 2672

Based on the analysis above, we estimate that the bill would result in a statewide NAV reduction of \$(208.3) million compared to current law [= \$235.1 million service-connected exemption total + \$198.7 million nonservice-connected exemption total - \$225.5 million current law exemption total]. The estimated NAV reduction would result in a direct cost increase of the K-12 Basic State Aid (BSA) program by \$6.0 million annually, beginning in FY 2027. The \$(208.3) 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 \$(3.0) million. Therefore, the direct net impact on the 2 state programs is a cost increase of \$3.0 million, beginning in FY 2027.

Truth-in-Taxation (TNT) Impacts

The NAV reduction under the bill would also have an impact on the state's TNT program. Under TNT, the Qualifying Tax Rate (QTR) is 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 \$(208.3) million NAV loss, the TNT adjustment would result in the QTR being an estimated 0.66¢ higher in FY 2027 under the bill than under current law. The QTR increase of 0.66¢ under TNT would generate a small net savings of \$(120,300) for the K-12 Basic State Aid (BSA) program. This savings is attributable to the higher QTR generated on new construction under the bill than under current law. After including the impact of TNT, the bill would produce a net General Fund savings of \$(1.7) million, of which \$(120,300) is for the BSA program and \$(1,619,500) is for the Homeowner's Rebate (HOR) program.

The \$(1.7) million General Fund savings is primarily attributable to 2 factors: (1) the lower NAV for Class 3 property owned by veterans with disabilities under the expanded exemption and (2) the higher QTR resulting from the TNT adjustment. The combined effect of these 2 factors is summarized in *Table 4* below.

Table 4			
QTR Tax Shift and Change in HOR Cost			
Property Class	Change in QTR Levy	Change in HOR Cost	Change in Net QTR
Non-Class 3 – commercial and other	\$3,359,300	\$0	\$3,359,300
Class 3 – other than veterans with disabilities	2,552,400	1,276,200	1,276,200
Class 3 – veterans with disabilities	<u>(5,791,400)</u>	<u>(2,895,700)</u>	<u>(2,895,700)</u>
Total Net Change	\$120,300	\$(1,619,500)	\$1,739,800

The combination of lower Class 3 NAV and higher QTR would result in a QTR levy decrease of \$(5.8) million for veterans with disabilities receiving the expanded exemption under bill. As shown in *Table 4*, the \$(5.8) 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 \$2.6 million and \$3.4 million, respectively. (The total net QTR levy increase of \$120,300 is due to the higher QTR levied on new construction under the bill 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 4*, of the \$2.6 million QTR increase on other Class 3 property, \$1.3 million would be paid by the General Fund in the form of higher HOR cost, while the remaining \$1.3 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 \$1.3 million. Since commercial and other non-Class 3 properties do not receive HOR, the tax shift for this category would remain at \$3.4 million. The \$(5.8) 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 \$(2.9) million. The remaining \$(2.9) million represents the net savings realized by veterans with disabilities.

In summary, the state General Fund impact of the bill depends on whether the TNT impact is included or not. In the absence of a TNT adjustment, the projected General Fund cost is estimated to be \$3.0 million, beginning in FY 2027. If the QTR is adjusted to account for TNT, however, the bill would generate net General Fund savings of \$(1.7) million, beginning in FY 2027. 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 levies on property added to the tax roll for the first time in FY 2027.

Local Government Impact

Apart from the QTR shift described above, the bill 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 bill.

Table 5 below shows the maximum potential shift of total (primary plus secondary) property taxes under the bill.

Table 5			
Maximum Potential Property Tax Shift (\$ in Millions)			
Property Class	<u>Primary Tax Shift</u>	<u>Secondary Tax Shift</u>	<u>Total Tax Shift</u>
Non-Class 3 – commercial and other	\$7.6	\$4.7	\$12.3
Class 3 – other than veterans with disabilities	4.5	3.6	8.1
Class 3 – veterans with disabilities	(10.4)	(8.3)	(18.7)
General Fund	<u>(1.7)</u>	<u>0.0</u>	<u>(1.7)</u>
Total Net Change	\$0.0	\$0.0	\$0.0

The estimates included in *Table 5* assume that taxing jurisdictions would levy the same amount under the bill as under current law. Under this assumption, veterans with disabilities would have a total tax reduction of \$(18.7) million. The higher QTR under the bill would generate total General Fund savings of \$(1.7) million. This means that under the assumption that local taxing jurisdictions would set their rates in a manner that would "hold harmless" their own revenues, the savings realized by veterans with disabilities of \$(18.7) million and by the General Fund of \$(1.7) million would essentially be "paid for" in the form of a tax shift of \$12.3 million to non-Class 3 property and \$8.1 million to Class 3 property (other than that owned by veterans with disabilities), for a total of \$20.4 million.

3/4/25