Fiscal Note

BILL # HCR 2023

TITLE: property tax; combat veterans; exemption

SPONSOR: Kolodin

STATUS: House Engrossed

PREPARED BY: Hans Olofsson

Description

If approved by voters at the 2026 General Election, the House Engrossed version of HCR 2023 would provide a full property tax exemption on the home of a combat veteran with a service-connected disability that is combat related and is rated as 100% by the U.S. Department of Veterans Affairs. There is no property assessment limit or income limit for these combat veterans to qualify for the exemption under HCR 2023.

In addition, the resolution provides that a county, municipality, community college district and school district cannot increase their primary property taxes to offset the loss of tax levies resulting from the exemption. If HCR 2023 is approved by voters at the 2026 General Election, the resolution will become effective in Tax Year (TY) 2027.

Estimated Impact

We estimate that the resolution would have a net General Fund cost of $2.2 million, beginning in FY 2028, prior to the application of the Truth-in-Taxation (TNT) provisions for equalization assistance to K-12 school districts. The resolution 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 resolution 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 $2.2 million net cost increase could be more than offset by savings under the automatic school tax rate adjustments provided under TNT pursuant to A.R.S. § 41-1276. If such TNT savings were incorporated, the General Fund would realize a net savings of $(1.2) million, beginning in FY 2028.

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 resolution. This rate increase effectively eliminates the BSA cost increase that would otherwise occur under the resolution.

Second, since the TNT calculation would automatically result in a higher QTR, the amount of QTR levied on property other than that owned by veterans receiving the full exemption under HCR 2023 (such as commercial and industrial property) would be higher under the resolution than under current law. This QTR levy shift has the effect of reducing the state cost for the HOR program. (Note that while HCR 2023 would disallow taxing jurisdictions from the type of tax shift described above for the primary taxes that they levy pursuant to A.R.S. § 42-17151, Legislative Council does not believe that this provision under the resolution would apply to the QTR calculated under A.R.S. § 41-1276.)

Analysis

<u>Background</u>

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) 2027, the maximum allowable exemption amount is projected to $5,075. To be eligible, the assessed value of the property cannot exceed a projected $33,504 in TY 2027, which corresponds to a limited property value (LPV) of $335,040. In addition, household income cannot exceed a projected $41,516 in TY 2027 (or $49,806 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 $5,075 in TY 2027, or $2,537. The main provisions of the exemption under current law, as projected for TY 2027, are summarized in *Table 1* below.

Table 1 **Projected TY 2027 Disabled Veterans Property Tax Exemption – Current Law**

Disability Type	Disability Rating	Exemption Limit [1/]	Assessment Limit [1/]	Income Limit [1/,2/]
Service-Connected	100%	$5,075	$33,504	$41,516 / $49,806
Service-Connected	10% to 90%	$5,075 x Rating	$33,504	$41,516 / $49,806
Nonservice-Connected	100%	$5,075	$33,504	$41,516 / $49,806
Nonservice-Connected	10% to 90%	$5,075 x Rating	$33,504	$41,516 / $49,806

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 Net Assessed Value (NAV) Loss

According to the Arizona Department of Veterans' Services (ADVS), there are 154,083 veterans in Arizona with disability ratings from 10% to 100%. This figure includes both veterans with service-connected and nonservice-connected disability. The distribution of veterans with each disability rating is displayed in *Table 2* below. Of the 154,083 disabled veterans in the state, 37,970 have a disability rating of 100%.

Table 2

Arizona Veterans with Disabilities

Disability Rating	Veterans
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%	37,970
Total	**154,083**

The full property tax exemption under the resolution would apply only to combat veterans with 100% service-connected disability that is combat related. Other disabled veterans would continue to receive the same exemption as under current law.

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 37,970 Arizona veterans with 100% disability rating, 11,201 veterans have service-connected disability while the remaining 26,769 veterans have nonservice-connected disability.

ADVS is not aware of any data that specifically shows a breakdown of veterans into categories of combat versus non-combat veterans. There is, however, data on veterans who served during periods of peace versus periods of war. This information indicates that 80% of all veterans (disabled or otherwise) in Arizona are what the U.S. Department of Veterans refers to as "wartime veterans" while the remaining 20% are "peacetime veterans." Due to a lack of more specific data on the veteran population, we have assumed in our analysis that 80% of the 11,201 veterans with 100% service-connected disability, or 8,961 veterans, have disability that is combat related.

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 6,972 of the 8,961 Arizona combat veterans with 100% disability rating reside in homes owned by them. Under the resolution, these 6,972 homes would be fully exempt from property tax irrespective of the assessed value of their homes or the annual income of these veterans. Since we are not able to determine from available data, which homes are owned by combat veterans with 100% disability rating, we have assumed (for the purpose of this analysis) that the total statewide NAV for all these homes combined is equal to the number of properties owned by 100% disabled combat veterans (6,972 parcels) multiplied by the projected TY 2027 statewide average per-parcel NAV of $26,654. Based on this assumption, we estimate the total statewide NAV for the 6,972 properties owned by these combat veterans to be $185.8 million. Since the resolution would provide a full property tax exemption, the total statewide NAV exemption under HCR 2023 is also an estimated $185.8 million.

Under current law, the homes owned by combat veterans with 100% disability are eligible for the projected TY 2027 maximum exemption of $5,075 (rather than the full exemption under HCR 2023). However, if the NAV of their home in TY 2027 exceeds $33,504 ($335,040 in terms of limited property value) or their annual income in TY 2027 is greater than $41,516 ($49,806 if minor children reside in the household), they do not qualify for the property exemption (see *Table 1*). We are not aware of any information that specifically provides the income levels of 100% disabled combat veterans or the assessed value of their homes. However, considering the severity and degree of their disability as rated the by U.S. Department of Veterans Affairs, we believe that it is reasonable to assume that most, if not all, these veterans earn an income that is less than or equal to the maximum allowable amount and their homes are assessed at or below the assessment limit. For this reason, we estimate that all combat veterans with a 100% disability rating in the state will receive the projected TY 2027 maximum exemption of $5,075 provided under current law. Statewide, this translates into a total NAV exemption of $35.4 million [= 6,972 properties x $5,075 maximum exemption]. This means that based on the assumptions outlined above, we estimate that HCR 2023 would result in a statewide NAV loss of $(150.4) million [= $35.4 million - $185.8 million] relative to current law.

Estimated General Fund Cost

Based on the analysis above, we estimate that the resolution would result in a statewide NAV reduction of $(150.4) million compared to current law. The estimated NAV reduction would result in a direct cost increase of the K-12 Basic State Aid (BSA) program by $4.4 million annually, beginning in FY 2028. The $(150.4) million Class 3 (primary residence) NAV reduction would also have the effect of reducing the cost of the Homeowner's Rebate (HOR) program by an estimated $(2.2) million. Therefore, the direct net impact on the 2 state programs is a cost increase of $2.2 million, beginning in FY 2028.

Truth-in-Taxation (TNT) Impacts

The NAV reduction under the resolution 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 $(150.4) million NAV loss, the TNT adjustment would result in the QTR being an estimated 0.45¢ higher in FY 2028 under the resolution than under current law. The QTR increase of 0.45¢ under TNT would generate a small net savings of $(81,600) for the K-12 Basic State Aid (BSA) program. This savings is attributable to the higher QTR generated on new construction under the resolution than under current law. After including the impact of TNT, the resolution would produce a net General Fund savings of $(1.2) million, of which $(81,600) is for the BSA program and $(1,151,300) is for the Homeowner's Rebate (HOR) program.

The $(1.2) million General Fund savings is primarily attributable to 2 factors: (1) the lower NAV for Class 3 property owned by 100% disabled combat veterans under the expanded exemption and (2) the higher QTR resulting from the TNT adjustment pursuant to A.R.S. § 41-1276. The combined effect of these 2 factors is summarized in *Table 3* below.

Table 3

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	$2,384,200	$0	$2,384,200
Class 3 – other than combat veterans with 100% disability rating	1,814,300	907,100	907,200
Class 3 – combat veterans with 100% disability rating	(4,116,800)	(2,058,400)	(2,058,400)
Total Net Change [1/]	**$81,600**	**$(1,151,300)**	**$1,233,000**

1/ Numbers may not add up due to rounding

The combination of lower Class 3 NAV and higher QTR would result in a QTR levy decrease (under the statutory K-12 funding formula) of $(4.12) million for combat veterans with 100% disability rating receiving the expanded exemption under the resolution. As shown in *Table 3*, the $(4.12) million savings incurred by combat veterans with 100% disability rating 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 $1.81 million and $2.38 million, respectively. (The total net QTR levy increase of $81,600 is due to the higher QTR levied on new construction under the resolution than under current law.) These are the statutory QTR levy 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 3*, of the $1.81 million QTR increase on other Class 3 property, $907,100 would be paid by the General Fund in the form of higher HOR cost, while the remaining $907,200 would be paid by homeowners not receiving the exemption. Therefore, the QTR levy shift to other Class 3 property, net of HOR, would be $907,200. Since commercial and other non-Class 3 properties do not receive HOR, the QTR levy shift for this category would remain at $2.38 million. The $(4.12) million QTR levy reduction on homes owned by combat veterans with 100% disability rating would not be fully realized by them. Instead, the state General Fund would receive 50% of this savings, or $(2.06) million. The remaining $(2.06) million represents the net savings realized by the combat veterans.

In summary, the state General Fund impact of the resolution 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 $2.2 million, beginning in FY 2028. If the QTR is adjusted to account for TNT, however, the resolution would generate net General Fund savings of $(1.2) million, beginning in FY 2028. This amount includes the combined savings from both the BSA and the HOR programs. The General Fund savings would primarily occur due to a QTR levy shift under A.R.S. § 41-1276 from combat veterans with 100% disability rating 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 2028.

Local Government Impact

HCR 2023 mandates that local taxing jurisdictions cannot increase their primary property taxes under A.R.S. § 42-17151 to offset the loss of tax levies resulting from the expanded property exemption under the resolution. For this reason, local taxing jurisdictions in the state with properties qualifying for the exemption under the resolution would see some reductions of their primary property tax levies.

3/13/25