Fiscal Note

BILL # SCR 1043 **TITLE:** constitutional property tax exemptions

SPONSOR: Mesnard **STATUS:** As Introduced

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Description

SCR 1043 and its companion bill, SB 1575, would provide a property tax exemption for veterans with disabilities. Since SCR 1043 would amend the Arizona Constitution, it would require voter approval at the next general election. The enactment of SB 1575 is conditional upon the passage of SCR 1043.

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 assessment limits, the exemption limit is also indexed to inflation. For tax year (TY) 2020, the income cannot exceed $33,722 per household, or $40,456 with minor children or children with total and permanent disabilities. The assessed value of the property cannot exceed $27,498, which corresponds to a limited property value (LPV) of $274,980. The maximum allowable exemption amount for TY 2020 is $4,047.

The proposed legislation would provide a property exemption to veterans with service-connected or nonservice-connected disability. The income and assessment limits would be same as for the existing exemption for widows, widowers, and persons with total and permanent disabilities. The amount of the exemption would be in direct proportion to the percentage rating of a veteran's service- or nonservice-connected 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 for widows, widowers, and persons with total and permanent disabilities. Moreover, even if a person qualifies for more than one exemption (e.g., if a person is both a widower and veteran with a disability), they can only claim one such exemption.

In addition to creating a property tax exemption for veterans with service- or nonservice-connected disabilities, the proposed legislation would also remove the constitutional limit for commercial agricultural and business personal property. Currently, the Arizona Constitution allows a business to exempt the first $50,000 in full cash value (in terms of personal property) from property taxes. This amount is adjusted for inflation each year. For TY 2020, the business personal property tax exemption is $185,811. If approved by voters, the proposal would allow the Legislature to determine the exemption amount for business personal property.

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 $2.5 million, beginning in FY 2022. 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 program (under which the state pays 47.19% of a homeowner's primary school district tax).

This $2.5 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 $(1.0) million, beginning in FY 2022.

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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 will be a shift of the disabled veterans' property tax burden 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 Homeowner's Rebate 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

According to the U.S. Department of Veterans Affairs, in FY 2018 there were 115,840 veterans with disabilities residing in Arizona. Using the distribution of disability ratings provided by the Arizona Department of Veterans' Services (ADVS) for veterans in FY 2013, we estimate the number of veterans with each disability rating in *Table 1* below.

Table 1

Arizona Veterans with Disabilities

Degree of Disability 1/	**Veterans with Disabilities**
10%	21,869
20%	12,386
30%	10,896
40%	9,569
50%	8,110
60%	10,131
70%	12,114
80%	9,831
90%	6,183
100%	14,751
Total	**115,840**

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

As shown in *Table 1*, an estimated 14,751 Arizona veterans have 100% disability rating. According to the county assessors, these individuals are likely to already qualify for the existing exemption for persons with total and permanent disabilities and would therefore not be affected by the proposal. Therefore, the numbers of disabled veterans that could potentially qualify for the exemption under the proposed legislation would be reduced to 101,089.

According to estimates by the Housing Assistance Council, the homeownership rate among Arizona veterans is 75.4%. Based on this estimate, our analysis assumes that 76,221 of the 101,089 Arizona veterans with a disability rating of between 10% and 90% reside in homes owned by them.

To qualify for the exemption, the veteran's household income cannot exceed $33,722 (or $40,456, if minor children or children with 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 (as well as several other income sources outlined in the proposed legislation).

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According the American Community Survey (ACS), the median income for all Arizona veterans is $38,373 (in 2017 inflation-adjusted dollars). The median income for veterans with disability was not included in the ACS report. In addition, ACS did not report on the sources of income earned by veterans. However, the survey result indicated that 52% of Arizona veterans are 65 years of age or older.

Our analysis assumes that income from this age bracket is largely comprised of social security payments and veterans' disability pensions, which are excluded from the proposal's income limits. For this reason, we have assumed that 52% of the 76,221 disabled veterans that are homeowners have an income (excluding social security payments and disability pension) that is below the proposal's income limit. This means that the number of veterans potentially exempted under the proposal is reduced from 76,221 to 39,559.

To qualify for the exemption, the home's limited value cannot exceed $274,980. The average statewide limited value of a primary residence is $184,006. Our analysis assumes that 80% of the 39,559 homes owned by disabled veterans below the maximum allowable income level, or 31,647 primary residences, have a limited value that is $274,980 or less. The exemption amount for the 31,647 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 of $4,047.

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 $3,600 [= $18,000 x 20%]. This means that the net assessed value (NAV) of the veteran's home would be reduced from $18,000 to $14,400.

Our analysis assumes that the total limited value of the 31,647 homes that would qualify for the exemption is $5.82 billion under current law [= 31,647 homes x $184,006 average limited property value]. This amount corresponds to $582 million in terms of NAV [= $5.82 billion x 10% assessment ratio for Class 3 property]. Based on the data provided by ADVS regarding the distribution of Arizona veterans' disability ratings, we estimate that the average exemption amount would be $3,525 for the 31,647 qualified veterans. This means that the proposal would reduce statewide NAV by approximately $(111.5) million [= 31,647 properties x $3,525].

By reducing NAV by $(111.5) million in tax year 2021, the proposal would result in a direct cost increase of the BSA program by $4.2 million, beginning in FY 2022. The $(111.5) million Class 3 (primary residence) NAV reduction would also have the effect of reducing the cost of HOR by an estimated $(1.7) million. The direct net impact on the 2 state programs is a cost increase of $2.5 million, beginning in FY 2022.

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 forego the TNT adjustment. Due to the $(111.5) million NAV loss, the TNT adjustment would result in the FY 2022 QTR being an estimated 0.55¢ higher under the proposal than under current law. The 0.55¢ higher QTR under TNT would generate an offsetting cost savings of $(4.2) million for the BSA program while simultaneously reducing the savings for the HOR program from $(1.7) million to $(1.0) million. Thus, after including the impact of TNT, the proposal would produce a net General Fund savings of $(1.0) million.

The $(1.0) million General Fund savings is attributable to 2 factors: (1) the lower NAV for Class 3 property owned by disabled veterans 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.

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Table 2

QTR Tax Shift and Change in Homeowner's Rebate (HOR) Cost

	$ Millions		
Property Class	**Change in QTR Levy**	**Change in HOR Cost**	**Change in Net QTR Levy**
Non-Class 3 – commercial and other	$2.1	$0	$2.1
Class 3 - other than disabled veterans	1.5	0.7	0.8
Class 3 - disabled veterans	(3.6)	(1.7)	(1.9)
Total Net Change	**$0.0**	**$(1.0)**	**$(1.0)**

The combination of lower NAV and higher QTR will result in a QTR levy decrease of $(3.6) million for disabled veterans receiving the exemption. As shown in *Table 2*, the $(3.6) million savings incurred by disabled veterans 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 $1.5 million and $2.1 million, respectively. These are the tax shifts before the Homeowner's Rebate (HOR) is applied. Under the HOR program, the state pays 47.19% of the QTR levied on Class 3 property. The remaining 52.81% is paid by the homeowner. Other classes of property do not receive the 47.19% QTR reduction.

As shown in *Table 2*, of the $1.5 million QTR increase on other Class 3 property, $0.7 million would be paid by the General Fund (in the form of higher HOR cost) while the remaining $0.8 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 $0.8 million. Since commercial and other non-Class 3 properties do not receive HOR, the tax shift for this category would remain at $2.1 million.

The $(3.6) million QTR levy reduction on homes owned by disabled veterans would not be fully realized by them. Instead, the state General Fund would receive 47.19% of this savings or $(1.7) million. The remaining $(1.9) million represents the net savings realized by disabled veterans.

The General Fund has an overall savings of $(1.0) million through lower HOR costs. Of this amount, $(1.7) million is associated with recouping a portion of the disabled veterans' tax savings offset by $0.7 million in higher HOR costs for non-disabled veterans.

The implication of the discussion above is that the net savings realized by the General Fund and disabled veterans of $(1.0) million and $(1.9) million, respectively, would be offset by a commensurate tax increase of $2.9 million on property owned by non-disabled veterans ($2.1 million by non-Class 3 and $0.8 million by other Class 3).

Local Government Impact and Property Tax Shift

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 the table assume that taxing jurisdictions would levy the same amount under the proposal as under current law. Under this assumption, disabled veterans would have a total (primary plus secondary) tax reduction of $(11.8) million. This amount includes the net QTR reduction of $(1.9) million shown in *Table 2*. As discussed above, under TNT, the General Fund would incur a savings of $(1.0) million due to the reduced HOR cost. 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 disabled veterans and the General Fund would essentially be "paid for" in the form of a tax shift of $7.8 million to non-Class 3 property and $5.0 million to other (than disabled veterans') Class 3 property, for a total of $12.8 million.

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Table 3

Maximum Potential Property Tax Shift

	$ Millions		
Property Class	**Primary Tax Shift**	**Secondary Tax Shift**	**Total Tax Shift**
Non-Class 3 – commercial and other	$5.0	$2.8	$7.8
Class 3 - other than disabled veterans	3.0	2.0	5.0
Class 3 - disabled veterans	(7.0)	(4.8)	(11.8)
General Fund	(1.0)	0.0	(1.0)
Total Net Change	**$0.0**	**$0.0**	**$0.0**

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 $2.5 million, beginning in FY 2022. If the QTR is adjusted to account for TNT, however, the proposal would generate net General Fund savings of $(1.0) million, beginning in FY 2022. The General Fund savings would occur due to a tax shift from disabled veterans to other property owners.

2/17/20