F I S C A L   I M P A C T   R E P O R T

ORIGINAL DATE 2/28/17
SPONSOR Baldonado **LAST UPDATED** **HB** 414

SHORT TITLE Equal Educational Access Scholarship Act **SB**

ANALYST Iglesias

REVENUE (dollars in thousands)

Estimated Revenue					R or NR **	Fund Affected
FY17	FY18	FY19	FY20	FY21		
$0.0	($5,000.0)	($5,000.0)	($5,000.0)	($5,000.0)	Recurring	General Fund

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	R or NR **	Fund Affected
Total	$0.0	$140.0	$140.0	$280.0	Recurring	TRD (general fund)

Parenthesis ( ) indicate expenditure decreases. ** R = recurring; NR = non-recurring

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 414 establishes the Equal Educational Access Scholarship Act, which provides for tuition scholarship organizations to grant educational scholarships to low-income students to attend private schools.

Additionally, it creates Income Tax and Corporate Income Tax credits for contributions to tuition scholarship organizations that provide educational scholarships for low-income students to attend private schools. The bill provides for a maximum annual aggregate of both individual and corporate income tax credits up to $5 million for taxable years beginning January 1, 2017. The credit may not exceed the lesser of $10 thousand or 50 percent of the taxpayer's liability in any single year and any credit amount in excess of 50 percent of the taxpayer's liability can be carried forward for three consecutive taxable years. Because the tax credit is capped at $5 million, a taxpayer is not guaranteed to be able to claim the tax credit in the year the donation is made. In the case of more than $5 million in donations are made to qualifying nonprofit tuition scholarship organizations, applications for tax credits will be considered in the order TRD receives them and taxpayers that are unable to claim their donations because of the $5 million cap will be placed at the front of the queue the next year.

The purpose of the Equal Educational Access Scholarship Income Tax and Corporate Income Tax credit is to encourage individuals and businesses to contribute money to tuition scholarship organizations that provide scholarships for eligible students to attend non-public schools that are chosen by the students' parents.

The bill outlines the process for private nonprofit organizations to seek certification to become a tuition scholarship organization from the Public Education Department. It also outlines the duties of the tuition scholarship organization, PED and TRD in administering the Equal Educational Access Scholarship Act and related personal and corporate tax credits.

The Taxation and Revenue Department (TRD) will be required to compile an annual report to evaluate the effectiveness of the credit. TRD will be required to compile and present the annual reports to the Revenue Stabilization and Tax Policy Committee with the analysis of the effectiveness and cost of the tax credit and whether the credit is performing the purpose for which it was created.

The effective date of this bill is July 1, 2017.

FISCAL IMPLICATIONS

This bill creates incentives for taxpayers to invest in private elementary/secondary school education. TRD's approach to estimating the fiscal impact entails contributions to a pre-approved tuition scholarship organization that either awards, or intends to award, scholarships to qualifying, underprivileged students currently enrolled in a New Mexico public school.

Personal income tax taxpayers can maximize their benefit by contributing $12,500 to a qualified tuition scholarship organization. In return, the taxpayer receives a tax credit worth $10 thousand; the taxpayer can carry-forward the unused portion of the credit for three years. Corporate income tax taxpayers maximize their benefit by contributing $25 thousand; the taxpayer receives credits worth $20 thousand with a three-year carry-forward period. In either case, the taxpayer cannot reduce their tax obligation by more than 50 percent. However, the taxpayer is buying a tax credit at a significant discount. The taxpayer recoups 80 percent of their contribution, and thus, they are incentivized to convert tax liabilities to charitable donations. For this reason, TRD assumes that the credit will be fully utilized in every year of eligibility.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency, and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

SIGNIFICANT ISSUES

TRD indicates tax credits to corporations and individuals to encourage private school attendance may conflict with the State's obligation to establish and finance a public education system.[1]

This legislation gives tax credits to individuals and corporations that donate funds to benefit low-income families so students can attend private schools. Students must first attend a public school for a full school year or start school in New Mexico for the first time and be on free or reduced lunch to be eligible to receive scholarships. A qualified school eligible to accept scholarship money must be a nonpublic elementary, middle or secondary school. See page 3 (line 25) through page 4 (lines 1-3).

ADMINISTRATIVE IMPLICATIONS

TRD indicates the bill will have a significant impact on its operating budget, requiring two new FTE.

TECHNICAL ISSUES

TRD points out that rules, regulations, policies, and procedures will be needed. TRD and the Public Education Department (PED) will need to coordinate to comply with the bill. The bill creates significant coordination issues to ensure a limited number of certificates are issued each year, that pre-qualified tuition scholarship organizations exist, and that only qualified tuition scholarship organizations receive contributions to award tax credits.

TRD also notes the following technical issues:

> Page 4, line 14 et seq.: it is not clear whether a tuition scholarship organization is required to apply for certification only once, or annually, or whether it is required to keep all of its information current (e.g. criminal background checks on employees hired subsequent to certification).
>
> Page 6, line 19 et seq.: a tuition scholarship organization is required to provide independent annual audits, but no deadline is provided, nor is it specified how, and how quickly, the department will review these documents, or what the consequences will be if there are problems in the audits.
>
> Page 10, line 23 et seq.: certification of a tuition scholarship organization may be denied, suspended or revoked by this provision. No procedure is provided, and no differentiation between denial, suspension or revocation. The public education department does not grant itself the power to audit a tuition scholarship organization.

[1] *ACLU Michigan v. Highland Park School System*, November, 2014.

Page 11, Sections 6 and 7 do not address what TRD should do if the tuition scholarship organization loses its certification. Taxpayers who made a contribution while the tuition scholarship organization had its certification will be harmed if their tax credit claim was denied. However, allowing the tax credit is equally problematic.

Additionally, TRD identified several terms that are not defined:

Page 5, line 21 et seq.: the terms "final unit value", "final membership units" and "total membership used to determine the prior year final unit value" are not defined.

Page 10, line 4-5: the term "associated program units" is undefined, and the method of calculating it is described by using undefined terms (see comment to Page 5, line 21 et seq. above).

Page 10, line 13-14: the term "state equalization guarantee distribution allocation" is not defined in this act.

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?

1. **Vetted**: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee (RSTP), to review fiscal, legal, and general policy parameters.
2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable**: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective**: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

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