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FISCAL IMPACT REPORT

ORIGINAL DATE 2/8/09

SPONSOR Campos LAST UPDATED _____ HB _____

SHORT TITLE Nonpublic School Scholarship Tax Credit SB 355

ANALYST Lucero

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	FY10	FY11		
	(\$860.0)	(\$6,610.0)	Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY09	FY10	FY11	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total		Moderate	Moderate	Moderate	Recurring	General Fund

(Parenthesis () Indicate Expenditure Decreases)

Relates to Appropriation in the General Appropriation Act

SOURCES OF INFORMATION

LFC Files

Responses Received From

Public Education Department (PED)

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

Senate Bill 355 provides an “equal opportunity scholarship tax credit” for contributions made to scholarship granting organizations against corporate or personal income tax obligations. The credit could only be claimed in the same taxable year in which the contribution was made. Credits would not be allowed for contributions included in a taxpayer’s itemized deductions.

A scholarship granting organization must be a 501(c) (3) organization that devotes at least 90 percent of contributions it receives and all earnings from investment of these contributions on educational scholarships for students with family income (at the time of the initial scholarship

grant) no higher than the qualifying income for a reduced-price lunch under the federal school lunch program. Educational scholarships could only be used by students who reside in New Mexico, and only to pay tuition and fees to qualified schools as defined in the Act.

The credit would be for 100 percent of contributions, but not to exceed \$50,000 for contributions made by a corporation, \$500 for contributions made by a single taxpayer or \$1,000 for contributions made by married taxpayers filing a joint return.

The bill defines a “qualified school” as an accredited nonpublic elementary or secondary school in New Mexico that:

- does not discriminate in admissions or treatment of students on the basis of a student's race, national origin or ethnicity;
- has been granted exemption from the federal income tax as an organization qualified pursuant to Section 501(c)(3) of the Internal Revenue Code;
- requires students to take an annual academic test with individual scores provided to the parents of students;
- operates in New Mexico;
- complies with all state laws that apply to nonpublic schools regarding criminal background checks for employees and exclude from employment any person not permitted by state law to work in a nonpublic school; and
- fills available spaces by a random selection process, except that a qualifying school may give preference to siblings of enrolled students and previously enrolled scholarship students, if a qualifying school has more eligible students applying than spaces available.

The bill requires the Department of Taxation and Revenue (TRD) to adopt rules to implement the credit and to provide a standardized format for receipts. It also gives TRD the authority to conduct a financial review or audit of a scholarship-granting organization if there is evidence of fraud.

The provisions of the Act are applicable to tax years beginning on or after January 1, 2010, but before January 1, 2014.

FISCAL IMPLICATIONS

As estimated by TRD, the revenue impact related to the personal income tax was based on the experiences of two states that analyzed similar tax credits, Ohio and Arizona. The 2002 revenue loss estimated in Ohio was \$14.0 million and in Arizona \$14.2. Adjusting by population, the revenue loss for New Mexico would be \$2.6 million if we use the Ohio experience, and \$4.4 if based on the Arizona experience. For the purposes of this estimate, a simple average of \$3.5 million in 2002 was used.

The fiscal impact related to the corporate income tax was calculated using the amount of corporate giving in 2000 (\$10.9 billion) in the entire United States, out of which 4.5% (\$490.5 million) was donated to schools. Adjusting this number to New Mexico using the population ratio (0.65), the estimate is \$31.8 million, of which only 5% flows to scholarships for low-income students. Hence the estimate for New Mexico in 2000 is \$1.6 million. Both the individual and corporate income tax credit amounts (for 2002 and 2000, respectively) were assumed to grow at a 3% annual growth rate for purposes of the estimates shown above.

SIGNIFICANT ISSUES

The Public Education Department (PED) provides:

Although categorized as an “Equal Opportunity Scholarship Credit” (Credit), the Credit does not prohibit discrimination on the basis of religion. (See, e.g., pg 4 lines 12-14; pg 7 lines 11-15; pg 14 lines 9-13.)

Because the bill does not restrict the availability of the Credit if the 501(c) (3) charitable organization primarily supports private religious schools, the state may find itself indirectly supporting private religious schools by permitting corporate and individual taxpayers to take the Credit. This is more so of consequence since the bill does not prohibit discrimination on the basis of religion. This implicates the Establishment Clause (1st Amendment) of the federal Constitution. It bears observation that this bill defines a qualified school as one that does not discriminate on the basis of a student’s race, national origin or ethnicity, noticeably omitting religion or gender, and that qualified schools may not have admissions standards, as many secular private schools do. The language in the bill does not reflect all three prongs of the test for determining Establishment Clause violations, which were laid down by the Supreme Court in *Lemon v. Kurtz*, 403 U.S. 602 (1971). But see:

- On January 29, 1999, the New Mexico Attorney General Opinion 99-01 opined that “A school voucher program involving the use of public money to provide parents of private school children with tuition assistance raises serious and substantial state constitutional questions, most significantly under Article XII, Section 3, which proscribes the use of public money for the support of private schools, and the anti-donation clause of Article IX, Section 14.”

- In November 27, 2006, the U.S. Supreme Court refused to hear a challenge (by a writ of certiorari) to an April 2006 decision of the Maine Supreme Judicial Court that upheld a Maine law that prohibited the use of public funds to send students to private religious schools.

- *Zelman v. Simmons-Harris*, 536 U.S. 639 (2002) (The Supreme Court upheld an Establishment Clause challenge against an Ohio pilot scholarship program that sought to give aid primarily to families below the poverty line with children at a failing school district so they could choose to either attend another public or private school, receive tutorial assistance, enroll in a magnet school or receive a scholarship.)

- *Walz v. Tax Commission of the City of New York*, 397 U.S. 664 (1970) (The Supreme Court upheld the city’s granting of property tax exemptions to religious organizations for properties used solely for religious worship, which was authorized by the state constitution and the implementing statute providing for tax exemptions for property used exclusively for religious, educational or charitable purposes.)

- *Mueller v. Allen*, 463 U.S. 388 (1983) (The Supreme Court upheld a Minnesota law that allowed state taxpayers, in computing their state income tax, to deduct expenses incurred in providing "tuition, textbooks and transportation" for their children attending an elementary or secondary school and was challenged on the basis that it violated the Establishment Clause.)

- *Committee for Public Education & Religious Liberty v. Nyquist*, 413 U.S. 756 (1973) (“The system of providing income tax benefits to parents of children attending New York’s *nonpublic schools* also violates the Establishment Clause because, like the tuition reimbursement program, it is not sufficiently restricted to assure that it will not have the impermissible effect of advancing the sectarian activities of religious schools.”) (emphasis added)

- *Byrne v. Public Funds for Public Schools of New Jersey*, 442 U.S. 907 (1979) (The Supreme Court summarily affirmed a lower federal court holding that a state tax deduction for taxpayers with children attending nonpublic school violated the Establishment Clause.)

- *Franchise Tax Board of California v. United Americans for Public Schools*, 419 U.S. 890 (1974) (The Court summarily affirmed a lower federal court judgment that struck down a state statute providing income-tax reduction for taxpayers sending children to nonpublic schools.)

- *Hibbs v. Winn*, 542 U.S. 88 (2004) (Despite the federal Tax Injunction Act that prohibits federal courts from restraining the implementation of state tax laws, the Supreme Court here allowed Arizona taxpayers to proceed, on the basis of violation of the Establishment Clause, in a suit seeking to enjoin the operation of an Arizona tax law that authorizes an income tax credit for payments to nonprofit “state tuition organizations” that awards scholarships to students in private elementary/secondary schools including those attending religious-based schools.)

Another possible consequence of this bill might be that while it would provide a reduction of taxes for taxpayers who donate to scholarship organizations, it might provide an incentive for parents to enroll their child or children in a private school thus reducing public school enrollment. It should be noted that the school choice provision of the Assessment and Accountability Act [§22-2C-7(E)] favors a student’s choice to attend a higher ranked *public* school if the student’s public school fails to make adequate yearly progress for two or more consecutive school years.

ADMINISTRATIVE IMPLICATIONS

This bill could have an administrative impact to TRD. An additional 2 to 3 FTEs would be required to administer this program. Regulations, forms, instructions and procedures for processing applications from scholarship granting organizations would need to be created. Qualifying schools and students would need to be identified. Records would have to be maintained for scholarship recipients in the event the scholarship granting organization is not included in the program.

TECHNICAL ISSUES

Page 6, line 10 requires a school to be qualified to “operate in New Mexico”. This language leaves vague whether a *virtual school* with no physical school in New Mexico can be considered to be operating in New Mexico if parents in the state can enroll their children to attend online.

OTHER SUBSTANTIVE ISSUES

TRD reports that arguments challenging the constitutionality of a similar credit in Arizona have arisen on the grounds that credits essentially provide public funding for private schools. Similar arguments could be made with respect to the proposed the equal opportunity scholarship tax credit in New Mexico. The credit may also violate the Anti-Donation Clause of the New Mexico Constitution.

There are a number of requirements for scholarship-granting organizations, including a requirement that such organizations cooperate with the PED to conduct criminal background checks on all of its employees and board members and exclude from employment or governance any individual who might reasonably pose a risk to the appropriate use of contributed funds. The PED has no authority to mandate background checks of employees of private schools. Instead, only persons applying for initial educator licensure by the PED must submit to criminal history background checks per 22-10A-5, NMSA 1978. It is possible for teachers in private schools to be employed without any licensure or with licensure not issued by the PED.

It should be noted that contributions to charitable organizations are already tax deductible under federal and state income tax law.

DL/mt