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

SPONSOR HWMC **ORIGINAL DATE** 03/12/15 **LAST UPDATED** **HB** 333/HWMC

SHORT TITLE Equal Opportunity Scholarship & Tax Credit **SB**

ANALYST Gudgel

REVENUE (dollars in thousands)

Estimated Revenue				Recurring or Nonrecurring	Fund Affected
FY16	**FY17**	**FY18**	**FY19**		
($5,000.0)	($5,000.0)	($5,000.0)	($5,000.0)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		Up To $5,980.3	Up To $5,980.3	Up To $11,960.6	Nonrecurring	School District Budgets/State Equalization Guarantee Distribution - General Fund
Total		$73.0	$73.0	$146.0	Recurring	Taxation and Revenue Department Operating Budget
Total		$240.0	$240.0	$480.0	Recurring	Public Education Department Operating Budget

(Parenthesis ( ) Indicate Expenditure Decreases)

Relates to Appropriation in the General Appropriation Act

SOURCES OF INFORMATION
LFC Files

SUMMARY

Synopsis of Bill

House Ways and Means Committee Substitute (198150.3) for House Bill 333 establishes the

Equal Opportunity Scholarship Act that will provide a tuition grant or other grant of funds to qualified economically disadvantaged students to attend a nonpublic elementary, middle, or secondary school by creating a tax credit for personal and corporate contributions to tuition scholarship organizations that provide qualifying scholarships. The bill requires tuition scholarship organizations to prioritize scholarships for eligible students that attend or live within the boundaries of low-performing schools as identified by the statewide school grading system.

The bill creates individual and corporate income tax credits that can be taken against the liability of a taxpayer for contributions made to a tuition scholarship organization that provides educational scholarships to economically disadvantaged students. The bill provides for a maximum annual aggregate of both individual and corporate income tax credits up to $5 million for taxable years 2016, 2017, and 2018. 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 o 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 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 bill outlines the process for private nonprofit organization 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 Opportunity Scholarship Act and related personal and corporate tax credits.

The bill limits the amount of a scholarship award to an eligible student to no more than 80 percent of the three-year rolling average statewide per-MEM program cost. Additionally, the bill requires PED to deduct an amount equal to 100 percent of the prior year’s average per-MEM program cost from each school district or charter school for each student that is awarded a tuition scholarship and leaves the school district or charter school to attend a nonpublic school, whether the student leaves the public school before the beginning of a school year or during the second semester.

Effective Dates: July 1, 2015 for donations and scholarships; January 1, 2016 for tax credits through tax returns filed prior to January 1, 2020; however, tax credits are only effective until the taxable year 2019. As noted below, effective dates for claiming the tax credit should be clarified to state which calendar year an individual or corporation is able to claim the tax credit.

FISCAL IMPLICATIONS

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.

Tax credits provided for in this bill appear to be available for income tax returns filed for the 2015, 2016, 2017, and 2018 calendar years, though provisions related to effective dates make it fairly unclear if the intent is to include taxable year 2015. The Legislature may want to clarify language throughout the bill and the effective dates to specify which taxable year the credit is available to be claimed. It is assumed that the bill’s $5 million maximum total in tax credits would be reached during calendar year 2015, thus reducing revenue to the general fund by that amount in FY16.

Potential general fund savings are uncertain as they are dependent on whether the activity would have occurred without current legislation – whether private donors would continue making educational scholarship donations for low-income students and whether low-income would transfer from public schools to public or private schools with tuition and other costs. The number of students who will take advantage of the educational scholarship annually is also uncertain. The provisions of this bill will likely not result in decreased annual general fund appropriations to the state equalization guarantee. The potential savings are dependent on certain reductions to school district's and charter school's state equalization guarantee (SEG) distributions and, in the case of students who withdraw in the middle of a school year, reversion of SEG funds to offset the tax credits given to individuals and corporations for donations.

For students using a scholarship at the beginning of a new school year for the entire school year, the bill requires PED to reduce a school district's or charter school's SEG distribution by an amount equal to the prior year statewide average per-MEM program cost. For FY15, the average statewide per-MEM program cost totals $7,667. However, it is important to note that average per-MEM program cost varies greatly statewide, from a low of $5,821 per-MEM to a high of $31,671 per-MEM. **For 57 school districts and charter schools, this provision (Paragraph 2 of Subsection B on pages 10 and 11) will result in the reduction of more per-MEM funding than the school district or charter school received. For the remaining school districts, the provisions of Paragraph 2 of Subsection B will result in the withholding of less per-MEM funding than was received.**

Program cost under the public education funding formula includes both the state and certain "local revenues" and "federal revenues", including federal Impact Aid, forest reserve funds, and local property taxes. The bill appears to require PED to capture these local and federal funds.

Additionally there is no provision for PED to revert funds withheld from school districts or charter schools for students that withdraw prior to the beginning of a school year. PED calculates the preliminary unit value for the next fiscal year around March or April of the calendar year and sets each school district's and charter schools SEG allocation prior to the beginning of the fiscal year. The department generally holds back some of the SEG appropriation for final calculation of total program units and the final unit value the following January. Provisions of Paragraph 3 of Subsection B included on page 3 requires a deduction of the prior year per-MEM program cost but is does not explicitly state the funds are to revert. Because of the final unit value calculation in January, it is possible any withheld funds would be included in this calculation and distributed to school districts and charter schools. **Therefore, it does not appear there are any SEG savings for students who are receiving a full year of a tuition scholarship – only savings for students that leave a public school between semesters.**

As noted above, any savings that are reverted to the general fund are dependent on the prior year average per-MEM program cost deducted for students receiving and using a tuition scholarship. The bill reduces payments to school districts and charter schools, but the savings to the general fund are less clear. The bill could reduce payments to school districts and charter schools by an estimated $6.3 million using the following assumptions provided by PED in 2012:

- PED estimated there were approximately 78 thousand economically disadvantaged students statewide in FY12;
- In 2012, PED estimated 1 percent of economically disadvantaged students would take advantage of this scholarship;
- In FY16, each school district and charter school would lose $7,667 per student that accepts an equal opportunity scholarship for a full school year or single semester.

If one percent of economically disadvantaged students statewide do take advantage of the scholarship, the SEG of school districts and charter schools would be reduced by $6 million, though as noted above it is unclear if these dollars would be redistributed through the SEG or result in general fund savings by being withheld and reverted to the general fund. If dollars are redistributed, there are not any savings to the general fund. If the intent is to revert these funds to the general fund the bill should explicitly state this so funds are not used when the final unit value is calculated.

As noted below, it is unclear if low-income families will be able to take advantage of a tuition scholarship, as in many instances the scholarship will not come close to covering tuition costs. For example, the Albuquerque Academy reports an annual tuition of $21 thousand. Because the tax credit is not dependent on a scholarship being made, $5 million in donations to tuition scholarship organizations could be made, resulting in $5 million in tax credits, while no scholarships are awarded.

If a student leaves a district or charter school during the middle of the year, the bill provides that PED would reduce the SEG distribution by year average per-MEM program cost and revert the savings to the general fund. This provision allows PED to withhold a full school year's funding from a school district or charter school despite the school district or charter school serving that student for a half of a school year.

As a result, under either scenario any savings that could revert to the general fund would not begin until after the close of FY16, and would instead impact FY17. Since PED would only remove funding from the SEG calculation once, the savings would be nonrecurring.

In 2012 PED noted, depending on the number of students receiving equal opportunity scholarships per school district, the amounts deducted from a school district's SEG may impact the amount of supplemental emergency funding requested by the district. For FY15, $5 million was appropriated for emergency supplemental funding for school districts experiencing budgetary shortfalls. House Bill 2 currently includes $4 million in emergency supplemental funding for FY16. Given PED's concern in 2012, this bill could increase the amounts of emergency supplemental funding needed by school districts or result in serious budget shortfalls for those school districts.

School districts and charter schools are funded on average student enrollment reported on the second Wednesday in October and December 1 of the prior school year, adjusted for current year enrollment growth over 1 percent. Excluding the enrollment growth calculation, school district and charter school SEG distributions are not made based on current year enrollment. The provision to decrease a school district's or charter school's SEG distribution in the current year for a student who has left the district or charter because they have received an educational scholarship attempts to eliminate the general fund impact of "double funding" of the student who is receiving the tuition scholarship; however, generally when that student moves from one school to the next it would not be captured during the year the student moves, but the succeeding year. This provision allowing the withholding of SEG will have a negative impact on the ability of school districts and charter schools to properly budget for the current year. The bill will result in the reduction of a school district or charter school's state equalization guarantee distribution for a year in which they are not claiming that particular public school student for funding purposes.

This could potentially be compounded if the amount of individual scholarships awarded are minimal (less than 80 percent of the average SEG). A situation could be created whereby a large number of students are given modest scholarships to pay for transportation costs to attend, for example, a nonpublic school. The school district could lose a large number of students resulting in the loss of a large amount of funding.

In addition to fiscal impacts of the scholarship tax credits and SEG deductions, in FY12 both TRD and PED indicate the bill will have recurring fiscal impacts on the departments. TRD estimated that the department will need an additional FTE to manage the requirements of the credit at a cost of $40,000. In 2012, PED indicated the department would be required to provide additional fiscal and programmatic oversight and estimated needing an additional $240 thousand annually.

SIGNIFICANT ISSUES

Of note, unlike a charitable donation made pursuant to the Internal Revenue Code, where the donor cannot receive any benefit from the donation for it to be deductible, this tax credit can be claimed by a parent whose child is attending a parochial or private school.

It is unclear how many low-income families would be able to take advantage of a tuition scholarship. The bill limits the tuition scholarship to a student who is a member of a household for which the total annual income does not exceed an amount used to qualify for free and reduced-price lunch. Current guidelines published by the federal government indicates a family of four would qualify if total annual income is less than $23,850. Scholarships for the FY16 school year would be limited to $5,870 per qualifying low-income student. Information regarding average private school costs in New Mexico is difficult to locate. Privateschoolreveiw.com indicates there are 220 private schools in New Mexico and elementary schools cost on average $5,066 per year and secondary schools cost $10,238 per year. It is likely, given the 80 percent limit on tuition scholarship grants, the amount of funding will not cover tuition at many nonpublic schools statewide.

PED also indicates federal reduced-price lunch eligibility is directly certified through SNAP/TANF eligibility and no longer require school verification of income.

"Educational scholarship" means a tuition grant or other grant of fund to an eligible student to cover all or part of the costs of that student at a nonpublic elementary, middle or secondary school. It is unclear what costs could be funded by this provision. For example, could costs to participate in extracurricular sports or programs be funded?

PED's 2012 analysis noted provisions allowing a student who is starting school in New Mexico for the first time (see page 3, line 6 through 9) may have the unintended consequences of incentivizing out of state parents to move to New Mexico to enroll their child in a private school.

The bill requires distribution of 90 percent of the donations received during a calendar year as educational scholarships. This provision may create a situation whereby a tuition scholarship organization collects more donations than they are able to award because of the student demand for scholarships.

PED's analysis on the original bill noted the bill allows for tuition scholarships to be portable during the school year and prorated between schools based on the number of days in attendance at each school. PED stated this provision may lead to increased student mobility during the school year, which can be detrimental to student performance.

PED also noted Section 8 requires local school boards and charters to submit by October 15 an annual estimate to PED of deductions to the number of qualified students to be enrolled due to student participation in the scholarship program. PED states it is unclear how school districts and charters can project with any accuracy 10 months ahead of time how many student may transfer from their schools due to this program.

ADMINISTRATIVE IMPLICATIONS

Both TRD and PED previously indicated administration and oversight of the new scholarship tax credit program would have an impact on their operating budgets. Additionally, TRD will be required to compile an annual report for the Revenue Stabilization and Tax Policy Committee on approved credits.

<u>TRD</u>
High Impact (Information Technology Division GenTax Impact 600 hours). In order to implement this, the following require changes: GenTax and Taxpayer Access Point documents and configuration changes to the Business Credit Module. A method of depositing the money for the certificates issued to the tuition scholarship organization will need to be developed. A certificate will need to be developed. The certificate distribution process will need to be developed and maintained, which may require FTE and a web application developed. An application and application process will need to be developed.

The division of duties between PED, TRD and the scholarship organization are not clear. A lot of coordination between the three organizations will be needed to develop the forms, instructions, and processes to administer the credit.

Audit procedures will need to be developed. The timing and coordination of the issuance of the certificates, the applications and the receipt of information from PED and the scholarship organization to verify the credit claimed could delay some of the verifications until after the credit is claimed. Procedures could be developed to avoid a taxpayer from being able to claim the credit before verification.

Additionally, TRD notes there is no defined method of recapturing credits claimed. Tracking the carry forward of credits will be difficult in the business credit manager of GenTax because the balance of a credit carry forward may extend out into another three-year carry forward depending upon the taxpayer's liability in any of the carry forward years. Manual intervention will be required.

Moderate impact. Develop contribution receipts that are sequentially numbered and a system of tracking those contribution receipts at an estimated initial cost of $4,000 and continued manual cost. The cost to develop the application and claim form was estimated to be another $4,000, and will require FTE to approve and manage. An additional line will be needed on the Schedule PIT-CR allowing the deduction and another on the PIT-ADJ that adjusts for any amount that has been included in itemized deductions. Coordination between PED and TRD will be required. The Department will need to develop a system of collecting and processing the charges for the certificates. The bill does not discuss where those charges should go. The tracking of the certificates and the carry forward of the credits will be manual, and will require additional FTE. The annual aggregate is going to be cumbersome for the Department and for the contributor. The contributor will need to apply for the credit, then once approved may claim the credit. Reports will need to be generated manually as well. TRD estimated the department would need one FTE to manage the requirements of the credit at a cost of $40,000.

<u>PED</u>
PED expects this bill would impact its budget negatively in that it would require new staff for fiscal and programmatic oversight. The bill imposes numerous statutory requirements on multiple bureaus within PED, and requires these requirements to be in place by July 1, 2015 for PED. PED states this will result in significant expenditures and potential FTEs related to administrative services for developing the method of qualifying for, reporting on, and accounting for and/or auditing tuition scholarship organizations and their scholarships.

Additionally, the bill will require PED to calculate the amount of SEG generated for each student and make the associated adjustments to the SEG allocation for each impacted district.

TECHNICAL ISSUES

Page 10, Paragraphs 3 and 4 refer to a student withdrawing; however, the bill does not specify where the student is withdrawing from. It would be clearer if the term “from a public school” were included after “withdraws.”

<u>TRD analysis raised the following issues in 2012:</u>

The requirement in Subparagraph 6 of Subsection B on page 6 that “all pertinent findings” from the required criminal background checks on employees and board members be provided to TRD and requirement in Subsection A on page 7 that “names of eligible students who received scholarships” and other personal information regarding students be provided to TRD will make the information subject to inspection under the Inspection of Public Records Act.

Subsection F on page 14 permits TRD to imposing a fee for each numbered “contribution receipt” issued by TRD to a tuition scholarship organization. The bill makes no provision for the distribution of this fee, making it unclear how the fee should be used or deposited. Since the bill imposes a fee, TRD recommended a reference to the provision of the fee be included in the title of the bill.

Paragraph 1 of Subsection B on page 8 states that a tuition scholarship organization shall ensure that a school participating in the tuition scholarship program is in compliance with all health and safety laws or rules that apply to schools. The school itself may be better suited to state whether or not it is compliant with such laws and rules. TRD recommended Paragraph 1 of Subsection B on page 8 be amended to require the school to certify compliance. Similar certification requirements could also be added to the requirements contained in Paragraphs 4, 6, and 7 on pages 7 and 8.

Subsection L on page 15 suggests TRD may be required to disclose the amount of the tax credit claimed by a taxpayer. To the extent that such information is information contained in a taxpayer return, Section 7-1-8.8 NMSA 1978 should be amended to permit TRD to release such information without violating confidentiality provisions in Section 7-1-8 NMSA 1978.

The definition of “educational scholarship” does not specify whether an “educational scholarship” is for costs paid by the student for attendance at a qualified school. As currently drafted, “educational scholarship” includes “costs of the student” at a qualified school. If it is the intention to provide scholarships for costs to be paid by a student, the definition of “educational scholarship” may require additional clarification.

There is no guidance on how to deal with taxpayers whose contribution receipts become revoked, denied or canceled.

<u>PED Analysis raised the following issues in 2012:</u>

It is not clear whether a school operated by an Indian Tribe, nation or pueblo could be considered an eligible school under the bill.

It is not clear as to what tax year the tax credit would become available (page 23, Section 9 and Section 10 indicate differing effective dates).

On page 7, line 1, the reference to “generally accepted accounting procedures”. This should be changed to “generally accepted accounting principles”, as this is the standard applicable to audits for which the PED must determine if a tuition scholarship organization should be certified.

The requirements on page 6 (lines 14 through 21) that the PED verify certain “criminal background checks” have been performed on certain employees and board members of scholarship organizations is ambiguous as is language regarding “with the understanding” because it is not a standard and raises the question: “Whose understanding?” If what is meant here is a fingerprint-based background check conducted by the FBI, which is not clear in the bill. Also it is not clear is who pays for such background checks.

PED analysis indicates it is not clear that undistributed funding pursuant to Paragraphs 3 and 4 of Subsection B on page 11 will revert to the general fund.

The ability of the PED to deny, suspend or revoke a qualified organization’s certification is not only based upon ambiguous standards and would impose unique administrative burdens on PED, but does not provide for any due process which would subject the PED to liability for “abuse of discretion”.

OTHER SUBSTANTIVE ISSUES

The Attorney General’s Office provided an analysis on the scholarships awarded under the Special Needs Students Scholarship Act proposed in House Bill 65 of the 2012 legislative session (this bill was similar to HB333). The scholarship tax credit does not appear to implicate

Article IX, section 14, the anti-donation clause, or Article XII, Section 3 of the New Mexico Constitution, which proscribes the use of public money for the support of private schools, because the Act contemplates that the scholarships would be funded entirely by private donations. And, because the tax credits are available to all individuals and corporate entities, including those whose special needs children attend public schools and those whose children attend nonsectarian private schools or sectarian private schools, these may be permissible under the establishment clauses of the federal and state constitutions. See Mueller v. Allen, 463 U.S. 388 (1983) (state statute providing tax deduction for public and private school expenses held not violative of the establishment clause of the First Amendment.).

RSG/je/bb