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FISCAL IMPACT REPORT

ORIGINAL DATE 1/20/06

SPONSOR Smith LAST UPDATED _____ HB _____

SHORT TITLE Private School Scholarship Tax Credits SB 238

ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY06	FY07	FY08		
(5,000.0)	(10,000.0)	(10,000.0)	Recurring	General Fund
	See narrative for detail			

(Parenthesis () Indicate Expenditure Decreases)

SOURCES OF INFORMATION

LFC Files
 Taxation and Revenue Department (TRD)
 Public Education Department (PED)
 Educate NM (ENM)

Responses Received From

Taxation and Revenue Department (TRD)
 Public Education Department (PED)

SUMMARY

Synopsis of Bill

Senate Bill 238 adds a section to the Income Tax Act to create a “school tuition tax credit.” This credit allows a taxpayer to claim a credit up to \$500 to an organization designated by the Internal Revenue Service (IRS) as a charitable organization that allocates 90 percent of its annual revenue for educational scholarships or grants for students to attend private elementary and secondary schools in NM. The credit can be applied to either personal income tax or corporate income tax.

FISCAL IMPLICATIONS

TRD:

This estimate is an approximation because statistics that would allow an accurate estimate do not appear to be available. Statistics on the National Center for Education Statistics web site suggest 20.3 percent of American households made contributions to educational institutions

in 1995 averaging \$318 per contribution. This amount has probably grown substantially over the past decade, but probably includes contributions to higher education institutions. Assuming 20 percent of New Mexico's approximately 730,000 households (i.e., 140,000) make contributions averaging \$200 per household and claim the proposed credits suggest a total of approximately \$30 million in credits would be provided by the proposed program. The New Mexico Public Education Department web site lists a total of 215 non-public elementary and secondary schools in New Mexico with a total enrollment of approximately 30,000 students. If it is assumed that 15,000 households, or parents of half the total number of enrolled students, claim credits averaging \$500 the proposed program, the resulting credit total would be \$7.5 million. This figure is probably closer to the amount of credits that would be claimed than the \$30 million estimate. As a point of comparison, I.R.S. data on charitable contributions indicate that contributions to educational institutions comprise approximately 4% of total itemized deductions each year. Approximately \$3 billion in total itemized deductions are reported each year in New Mexico. 4% of this amount is \$120 million. Thus, the estimate assumes that a small proportion of total itemized deductions will be converted to credits under the proposal.

According to testimony before the Revenue Stabilization and Tax Policy Interim Committee, Educate New Mexico estimated that 7,000 children have applied to their organization for just 430 scholarships. Educate NM is currently the only non-profit organization that provides scholarships for private school assistance to low income families. Using their data on donations, the FY06 impact is estimated to be \$125 thousand and \$250 thousand for FY07 and subsequent years.

SIGNIFICANT ISSUES

There is considerable debate going on about whether governments (state, local, federal) should use taxpayer money to support private educational institutions which compete with taxpayer financed public education institutions. A credit against income tax is considered a tax expenditure in that, while it is not a direct payment from the state to the taxpayer, the taxpayer reduces the amount of tax paid to the state.

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

Public Education Department:

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 this credit. This implicates the Establishment Clause (1st Amendment) of the federal Constitution. There is a three-prong 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:

- *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 in 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, #02-1809 (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.)

ADMINISTRATIVE IMPLICATIONS

If, as a condition of claiming the tax credit, verification of private school accreditation status is required, the Public Education Department would experience administrative impact.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Taxpayers who seek an income tax credit for contributing to a charitable organization that contributes to scholarships to attend a private elementary or secondary school in New Mexico will not be entitled to such income tax credit.

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