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FISCAL IMPACT REPORT

ORIGINAL DATE 2/19/07

SPONSOR Taylor LAST UPDATED _____ HB _____

SHORT TITLE School Tuition Donation Tax Credit SB 1080

ANALYST Francis

REVENUE (dollars in thousands)

| Estimated Revenue | | | Recurring or Non-Rec | Fund Affected |
|-------------------|-----------|-----------|-------------------------|------------------|
| FY07 | FY08 | FY09 | | |
| | (5,000.0) | (5,000.0) | Recurring | General Fund |
| | | | | |

(Parenthesis () Indicate Revenue Decreases)

Relates to SB284

SOURCES OF INFORMATION

LFC Files

Responses Received From

Taxation and Revenue Department (TRD)

Public Education Department (PED)

SUMMARY

Synopsis of Bill

Senate Bill 1080 creates a tax credit against personal income tax liability for donations to qualified school tuition organizations of up to 75 percent of the amount of the donation. The total credit available is \$5 million per year on a first come, first served basis.

The school tuition organization must be a registered non profit with a board of seven members, allocates at least 90 percent of "tax credit revenue" in tuition grants, only awards tuition grants to children who reside in NM; provides the tuition grants to more than one school; only to students from households with income less than 300 percent of federal poverty; and who prepares an annual financial report and a report to the Public Education Department (PED).

The credit can be carried forward for five years and is effective immediately upon signing due to an emergency clause.

FISCAL IMPLICATIONS

While it is difficult to ascertain the total qualified donations that may be eligible for this credit, it is reasonable to assume that the \$5 million cap will be easily reached each year.

SIGNIFICANT ISSUES

People for the American Way (PFAW), a Washington DC advocacy organization, has reported that Arizona's tuition credit that is similar to the one proposed by SB1080 is operating in this manner. Although Arizona's credit also stipulates that the parent contributing is precluded from designating their own children as beneficiaries, they are able to designate a specific beneficiary. PFAW reports that parents designate friends' children as the beneficiaries and those friends reciprocate.

The tuition credit would be for contributions to an organization that provides scholarships for attendance at private schools, including religious schools. Whether state support of religious and private schools would pass a constitutional challenge is a significant issue. The Arizona credit faced such a challenge in 1998 and withstood it. PFAW also reports that 25 of the 35 organizations in Arizona set up to receive contributions provide tuition to religious schools.

According to an Arizona Department of Revenue report on the tuition credit, the largest single scholarship from one of the organization's set up to receive contributions went to a school for emotionally disabled children. The report which includes data on all schools that received scholarships from organizations shows that there were 345 private schools who received scholarships from organizations. The list includes mostly religious schools of all faiths. The report can be found at http://www.azdor.gov/ResearchStats/private_schl_credit_report_2006.pdf.

PED:

Another possible consequence of this bill might be that while it would provide a reduction of income taxes for taxpayers with a child or children in a private school, 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.

According to the latest federal poverty guidelines, the level for a family of three is \$17,170 which means that a student in a family with annual income of \$51,510 would qualify for tuition grants from this program.

ADMINISTRATIVE IMPLICATIONS

TRD:

The proposed measure would impose moderate administrative impacts on the Taxation and Revenue Department. To implement provisions of the measure, the Department would need to create certificates to issue to taxpayer wishing to claim the credits. The Department would also need to track the credit amounts that granted to ensure that the \$5 million is not exceeded. The department would also be require to need to create forms the tuition organizations would report information in support of the credits. The

Department would need to track these from year to year since the report refers to the previous tax year. The school that receives the contributions may need to complete a form as well to verify the amount that was donated and how it was used. The Department would also need to track amounts carried forward until they are fully expended.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Relates to SB284 which has provides a \$500 credit without any income limitations.

TECHNICAL ISSUES

TRD:

Meaning of the term "filed separately on a combined return" on page 3, lines 16 through 24 is unclear. It would apparently require the Department to wait until both spouses file returns before the processing the returns. It is also unclear what would occur in cases where one spouse does not file a return or files a return two years later. These provisions will be very difficult to administer properly, and require substantial amounts of human intervention.

The bill is not clear on whether the total approved tax credit of five million dollars is per year or total credit allowed and once exhausted, no longer exists.

When a husband and wife file separate returns, the Department normally allows them to claim half the credit on each return. This bill, however, stipulates allocation of the credit based on net income. This is inconsistent with how the Department administers all other credits claimed on married filing separate returns.

Non-resident and part-time resident allocation procedures in paragraph F may violate U.S. Constitutional provisions which prohibit states from providing their residents greater tax preference than non-residents.

The term "annual income" needs clarification as to whether it refers to the defined term "modified gross income" or if it is adjusted gross income. If it is adjusted gross income, a new form may be needed to calculate household adjusted gross income since it might be different from the taxpayer's adjusted gross income.

OTHER SUBSTANTIVE ISSUES

PED has prepared a digest of court cases that may support litigation pursuant to the *Establishment Clause* which deals with violations of separation of church and state:

Even though the bill does not promote that the state become involved or entangled with religions instruction or other operations of a private religious school, this does not insulate the proposed tax credit from legal challenge on those very grounds. 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 antidonation 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.)

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