

**LEGISLATIVE EDUCATION STUDY COMMITTEE
BILL ANALYSIS**

Bill Number: SB 88

50th Legislature, 2nd Session, 2012

Tracking Number: .188024.2

Short Title: Equal Opportunity Scholarship Act

Sponsor(s): Senator Pete Campos

Analyst: Kevin Force

Date: February 7, 2012

Bill Summary:

SB 88 creates new sections of law and amends the *Public School Finance Act* to:

- create the *Equal Opportunity Scholarship Act*;
- provide for tuition scholarship organizations to grant educational scholarships to low-income students to attend certain public and nonpublic schools;
- create income tax and corporate income tax credits for contributions to tuition scholarship organizations; and
- require that the membership and, as a result, the program units be deducted or reduced in the State Equalization Guarantee (SEG, or the Public School Funding Formula) for a public school student that participates in the scholarship program.

A section-by-section summary of SB 88 follows:

Section 1 cites Section 1 through Section 5 as the “*Equal Opportunity Scholarship Act*” (effective July 1, 2011).

Section 2 defines certain terms used in the Act, including:

- “eligible student” as:
 - qualifying for the federal reduced-price lunch program;
 - attending a New Mexico public school for the semester prior to first receiving a scholarship under the act; and
 - residing in New Mexico while receiving a scholarship under the act.
- “qualified school” as a public or nonpublic elementary, middle, or secondary school located in New Mexico that a parent has chosen; and
- “tuition scholarship organization” as an organization that provides educational scholarships to students attending qualified schools of their parents’ choice that meet the criteria established in the act.

Section 3 prescribes the requirements for certification as a tuition scholarship organization, including documentation to the Public Education Department (PED) to verify that:

- the organization is exempt from federal income tax under Section 501(c)(3) of the *Internal Revenue Code of 1986*;
- the scholarships are funded from contributions received by the organization in or prior to the current calendar year;
- at least 90 percent of contributions are awarded as educational scholarships; and a scholarship award does not exceed 80 percent of the three-year rolling average of the SEG for an eligible student;
- the organization distributes scholarship payments as checks issued to the parent of an eligible student but mailed to the qualified school in which a qualified student is enrolled;
- a scholarship award can be used at any qualified school during the school year and prorated between schools based on the number of days attended at each school;
- criminal background checks of the organization's employees and board members have been conducted;
- the organization has systems in place that provide financial accountability; and
- the organization is likely to have received donations of \$50,000 or more during a school year.

Section 4 outlines the duties of a tuition scholarship organization (TSO), among them:

- providing PED with the name and previous school district or charter school attended of students awarded a scholarship and;
- assuring that a school participating in the program complies with certain requirements, including:
 - health and safety laws or rules;
 - a valid occupancy permit;
 - nondiscrimination in admissions on the basis of race, color, or national origin; and
 - school employee background checks;
- certain reporting requirements, including student academic developmental information and information for tax purposes.

Section 5 includes the administrative duties of PED, including:

- calculating the reductions of amounts in the SEG associated for a student receiving an educational scholarship pursuant to this act.

Section 6 adds a new section to the *Income Tax Act* that, pursuant to Section 9, applies to taxable years beginning on or after January 1, 2013 but before January 1, 2017 (effective January 1, 2013) to:

- allow taxpayers to take an income tax credit for contributions to a tuition scholarship organization for up to 90 percent of total contributions, but not exceeding 50 percent of a taxpayer's total income tax liability for a taxable year;
- require that the Taxation and Revenue Department (TRD) develop contribution receipts and determine what may be included in reported tax credits;
- allow contributions of 50 percent or more of a taxpayer's total income tax liability to be carried over for three consecutive years;
- limit a husband and wife who file separate returns for a taxable year (in which they could have filed jointly) to claim only one-half of the scholarship income tax credit;

- prohibit a taxpayer from claiming the same credit both as an individual contribution credit and a corporate contribution credit;
- limit the maximum annual aggregate amount of special needs student scholarship income tax credits and special needs student scholarship corporate income tax credits to \$5.0 million, and requires that any amount over that limit shall be placed in a queue, by date of receipt, to be paid first in the subsequent tax year before any new tax credits are applied; and
- authorize the TRD to disclose the amount of claimed credit to the Revenue Stabilization and Tax Policy Committee of the Legislature.

Section 7 creates a new section of the *Corporate Income and Franchise Tax Act*, pursuant to Section 9, that applies to taxable years beginning on or after January 1, 2013 but before January 1, 2017 (effective January 1, 2013) to:

- allow a corporate taxpayer to take an income tax credit for contributions to a tuition scholarship organization for up to 90 percent of their total contributions but not exceeding 50 percent of a taxpayer's total tax liability for a taxable year;
- require the TRD to develop contribution receipts and determine what may be included in reported tax credits;
- allow contributions totaling more than 50 percent of a corporate taxpayer's total income tax liability to be carried over for three consecutive years;
- direct the TRD to determine, every three years, whether the corporate tax credit is fulfilling its purpose;
- prohibit a corporate taxpayer from claiming the same credit both as a corporation contribution and as an individual contribution credit;
- limit the maximum annual aggregate amount of special needs student scholarship income tax credits and special needs student scholarship corporate income tax credits to \$5.0 million, and requires that any amount over that limit shall be placed in a queue, by date of receipt, to be paid first in the subsequent tax year before any new tax credits are applied; and
- authorize the TRD to disclose the amount of claimed credit to the Revenue Stabilization and Tax Policy Committee of the Legislature.

Section 8 amends the *Public School Finance Act* in the *Public School Code* to require that the membership and, as a result, the program units be deducted or reduced in the SEG for a public school student that participates in the scholarship programs of the *Equal Opportunity Scholarship Act*, effective July 1, 2012, pursuant to Section 10.

Fiscal Impact:

SB 88 does not contain an appropriation.

Fiscal Issues:

The Legislative Finance Committee's (LFC) Fiscal Impact Report (FIR) of HB 166, which is identical to SB 88, notes a recurring loss of \$5.0 million to the General Fund.

The LFC's FIR of HB 427 (2011), a bill virtually identical to SB 88¹, predicted a revenue loss to the General Fund of:

- \$575,000 in FY 12; and
- \$4.418 million in FY 13.

Further, the FIR of HB 427 (2011) notes that, while purporting to subsidize the cost of low-income students to attend schools that would have been too expensive in the absence of the scholarships, thus expanding parents' choices and, in theory, improving all schools, tax credits like those proposed in these bills shrink the tax base and introduce more complexity into the New Mexico tax system. These characteristics run contrary to the tax policy principles of efficiency and simplicity.

According to the Taxation and Revenue Department (TRD), based on the experiences of Ohio and Arizona relating to similar programs, and factoring in the differences between those two states' populations and the population of New Mexico, the fiscal impact of the bill would include recurring losses to the General Fund, estimated to be:

- \$500,000, in FY 13;
- \$3.20 million, in FY 14;
- \$3.30 million, in FY 15; and
- \$3.4 million, in FY 16.

TRD further reports that the administration of the program will cost the department between \$40,000 and \$44,000 per year.

According to the PED analysis of HB 166:

- the tax credits provided in the bill may provide greater options for students to attend nongovernmental schools;
- this bill would immediately reduce taxes for New Mexicans who choose to donate to a TSO;
- under this bill parents are offered opportunities and incentives to enroll their children in private schools that they may not have had otherwise;
- PED must deduct participating students' program costs from the students' previous school district or charter schools prior to distributing SEG funds;
- PED must adjust school district and charter school SEG allocations and not distribute funds generated by students participating in the scholarship program;
- the SEG funds generated by participating students would revert to the General Fund at the end of the year resulting in additional SEG appropriations being reverted to the General Fund; and
- depending on the number of students involved per district, the amounts deducted from a school district's SEG may impact the amount of supplemental emergency funding requested by the district.

¹ The only substantive difference to between HB 427 (2011) and the current bill is the addition of a \$5.0 million aggregate annual cap on scholarship tax credits.

PED offers the following illustration:

- If one assumes that:
 - there are 78,000 low-income students who qualify for the scholarship statewide;
 - each student generates about 2 funding units, multiplied by the current unit value of \$3,598.87, thus determining the total amount of SEG generated by each student; and
 - 1.0 percent of the low income students enrolled in school throughout the state participate in the program;
- Then one can conclude that:
 - approximately \$5.6 million statewide could be required to meet the needs of the scholarship program, resulting in a similar amount withheld from SEG distributions to school districts and reverted to the General Fund; and
 - approximately \$5 million in tax credits would be granted at a rate of 90 percent of the amount contributed to TSOs, resulting in a net gain of about \$600,000 to the General Fund.

Additionally, PED expects that this bill would impact its budget negatively by requiring new staff and program oversight for implementation and reporting.

Technical Issues:

According to PED:

- while the bill defines “department” as the PED, it later uses the term “department” possibly to mean the Taxation and Revenue Department, although it does not so differentiate;
- 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;
- the reference to “generally accepted accounting procedures” should be changed to “generally accepted accounting principles,” which is the standard applicable to any audits by which PED must determine whether a TSO should be certified;
- the requirement that PED verify that “criminal background checks” have been performed on employees and board members of TSOs is ambiguous, as is language “with the understanding,” which is not a standard and raises the question of whose understanding this section is referring to;
- it is not clear who is financially responsible for such background checks;
- the background checks required by the *Public School Code* referred to in the bill are only required for persons seeking initial licensure from PED or initial employment from a school district;
- the requirement that PED deny, suspend, or revoke a TSOs certification does not consider any due process due the TSO if it alleges any abuse of discretion on the part of the department; and
- it is not clear if undistributed funds resulting from a student’s withdrawal from public school prior to the start of the school year revert to the General Fund.

According to TRD:

- Under this scholarship program, the TRD may impose a fee for each numbered “contribution receipt” it issues to a tuition scholarship organization, yet the bill makes no provision for the distribution of this fee. Thus, it is unclear how the fee should be used or deposited, and the department recommends that a reference to the provision of the fee be included in the title of the bill.
- Section 6 of the bill suggests that TRD may be required to disclose the amount of the tax credit claimed by a taxpayer. The *Tax Administration Act* should be amended to permit the department to release such information without violating its confidentiality.
- It is unclear what constitutes the “acceptance of” the equal opportunity scholarship credit which would provide authorization to TRD to disclose the amount of the claimed credit:
 - As currently written, mere application for the credit would not permit such disclosure.
 - The bill only permits disclosure of the amount of the tax credit *claimed* by the taxpayer, not necessarily the amount of the tax credit *allowed* for that taxpayer.
 - Section 6 of the bill allows only aggregate approved amounts to be disclosed to the Revenue Stabilization and Tax Policy Committee, without identifying the taxpayer.
- Section 6 requires the TRD to consider applications for equal opportunity scholarship credits in the order they were received. However, SB 88 makes no provision for an application for the credit that is separate from the credit claim. Therefore, the sponsor may wish to consider amending that section to require that credit *claims* be considered in the order they are received. In the alternative, provisions for a separate application process could be required by the proposed legislation.
- Section 7(F) of the bill applies to personal income tax, not corporate income tax.
- It is unclear to what extent students would qualify for scholarships to public schools for which tuition is not required.
- The definition of “educational scholarship” may require additional clarification, because the current definition:
 - suggests that public school students may be eligible for scholarships for transportation costs not covered by a qualified public school; and
 - does not specify whether an “educational scholarship” is for costs *paid* by the student for attendance at a qualified school, but includes “costs *of* the student” at a qualified school. (Emphasis added.)
- Section 6(K) requires the Department to determine every three years, beginning in 2015, whether the equal opportunity scholarship income tax credit is performing the purpose for which it was created. If the Department makes such a determination on January 1, 2015, it is required to make its next determination on January 1, 2018. However, the tax credits created by SB 88 are applicable to tax years that begin *before* January 1, 2017, so that by the time the Department is required to make its last determination, the tax credits no longer apply.

Substantive Issues:

- According to PED:
 - the definition of “eligible student” includes a student who “is starting school in New Mexico for the first time”;
 - this language might have the unintended consequence of encouraging out of state parents to move to New Mexico in order to enroll their child in a private school for which they would receive a tax credit;
 - the language suggests that they would not have to enroll their child in public school for any length of time in order to be eligible for the tax credit; and
 - it is unclear how PED can verify that an eligible student is enrolled in a qualified school, as indicated by the endorsement of the parent on the scholarship check, because of the definition of “parent” includes caretakers and custodians.

- In 2009 and 2010, according to the PED analyses of SB 355 (2009), *Nonpublic School Scholarship Tax Credit*, and SB 198 (2010), *Scholarship Donation Tax Credit*, (both bills substantially similar to SB 88):
 - there was a potential conflict between the bill’s provisions and the Establishment Clause of the US Constitution, and the anti-donation clauses of the Constitution of New Mexico;
 - because the bill allows a taxpayer to take a tax credit even if the taxpayer’s contribution is to a 501(c) (3) charitable organization that primarily supports private religious schools, “the state may find itself indirectly supporting private religious schools,” thus coming into conflict with the Establishment Clause of the First Amendment to the US Constitution, which states, “Congress shall make no law respecting an establishment of religion”;
 - for many years, the standard in deciding so-called “establishment” cases was *Lemon v. Kurtz*, 403 US 602 (1971), where the Supreme Court’s nearly unanimous decision established a three-part test for laws dealing with religious establishment. To be constitutional, a statute must:
 - have a “secular legislative purpose”;
 - have principal effects that neither advance nor inhibit religion; and
 - must not foster “an excessive entanglement with religion”;
 - the language in these bills does not reflect all three prongs of the “*Lemon test*”; and
 - since the *Lemon* decision, the Supreme Court has announced a string of opinions on the constitutionality of state assistance to nonpublic schools, leaving the law in this area less settled.

- Although the PED analyses of similar bills in sessions prior to 2011 raised those issues, the PED analysis of HB 427 (2011) merely noted that:
 - HB 166 may allow more school choices for students, especially to attend nonpublic schools; and
 - the bill does not prohibit schools from discriminating on the basis of religion.

In its analysis, TRD notes that:

- it is unclear to what extent students would qualify for scholarships to public schools for which tuition is not required;
- the definition of “educational scholarship may require additional clarification, because it”:
 - suggests that public school students may be eligible for scholarships for transportation costs not covered by a qualified public school; and
 - does not specify whether an “educational scholarship” is for costs paid by the student for attendance at a qualified school, but includes “costs of the student” at a qualified school.

US Supreme Court Decisions

- In *Hibbs v. Winn*, 542 U.S. 88 (2004), despite a provision in the federal *Tax Injunction Act* prohibiting federal courts from restraining the implementation of state tax laws, the Supreme Court asserted the jurisdiction of the federal courts in such cases. At issue was a claim 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 award scholarships to students in private elementary and secondary schools, including those attending religious-based schools. The case did not resolve the main question regarding the constitutionality of the tax credit.
 - In April 2009, in *Winn v. Arizona Christian School Tuition Organization*, the 9th Circuit Court of Appeals ruled that a group of taxpayers had stated a valid legal claim that an Arizona tuition tax credit law similar to that proposed in SB 113 violates the US Constitution’s Establishment Clause. In that case, the statute allowed for contributions to “state tuition organizations (STOs)” that “allow them to attend *any* [emphasis added] qualified school of their parents’ choice”—language identical to that in SB 88.
 - In April 2011, in a five-to-four decision, the US Supreme Court reversed the 9th Circuit Court of Appeals’ decision in *Winn*, for want of jurisdiction. According to the majority opinion:
 - Plaintiffs lacked standing to bring suit under the doctrine of taxpayer standing, which holds that the mere fact that a plaintiff is a taxpayer is insufficient to seek relief in federal court.
 - Unless the plaintiff falls within a narrow exception to this doctrine, articulated in *Flast v. Cohen* (392 U.S. 83, 1968), they must show an injury in fact in order to bring suit alleging that a government action violates the Establishment Clause.
 - According to *Flast*:
 - ✓ There must be a “logical link” between the plaintiff’s taxpayer status and the “type of legislative action attacked.”
 - ✓ A “nexus” must exist between the plaintiff’s taxpayer status and “the precise nature of the constitutional infringement alleged.”

- ✓ Thus, individuals suffer a particular injury for standing purposes when, in violation of the Establishment Clause, and by means of “the taxing and spending power,” their property is transferred through the Government’s Treasury to a sectarian entity.
 - The Court stated that the plaintiffs in *Winn* failed to meet the conditions imposed by *Flast*, and thus did not fall within this narrow exception.
 - Further, according to the majority opinion, tax *credits* do not enter the public fisc, and as the money involved is never within government control, the actions alleged to be in violation of the Establishment Clause were not accomplished by means of the taxing and spending power, thus making *Flast* inapplicable in this case.
- However, according to Justice Kagan, who wrote the dissenting opinion:
- The majority’s distinction between appropriations and tax credits has little basis, both in fact and Court precedent.
 - Cash grants and target tax breaks are means of accomplishing the same government objective: that of providing financial support to select individuals or groups.
 - The Court’s distinction between tax credits and appropriations threatens to eliminate *all* occasions for a taxpayer to contest the government’s monetary support of religion [emphasis in original].
 - Because appropriations and tax breaks can achieve identical objectives, the government can easily substitute one for the other.
 - The Court’s decision enables the government to avoid the access to the judiciary guaranteed in *Flast* by subsidizing religious activity through the tax system, and thus precluding taxpayer standing to challenge state funding of religion.
 - Plaintiffs have shown that they have standing under the *Flast* exception because:
 - ✓ by challenging legislative action taken under the taxing and spending power, they showed the required “logical link between their taxpayer status and the enactment attacked”; and
 - ✓ by invoking the Establishment Clause, a specific limit on the legislature’s taxing and spending power, they demonstrated the necessary “nexus between their taxpayer status and the precise nature of the constitutional infringement alleged.”
 - With this decision, the Court has contradicted decades of its own jurisprudence. Since the *Flast* decision, the Court has on many occasions accepted that ordinary taxpayers have standing to challenge tax advantages that benefit religious organizations. While plaintiffs did not always succeed on the *merits*, in no instance had the court dismissed the claims for want of jurisdiction. For example, see:

- ✓ *Walz v. Tax Commission of City of New York*, 397 U.S. 664 (1970), where the Court upheld the constitutionality of a property tax exemption for religious organizations;
 - ✓ *Committee for Public Education & Religious Liberty v. Nyquist*, 413 U.S. 756 (1973), where the Court struck down a tax deduction for parents who paid tuition at religious and other private schools; and
 - ✓ the Court’s decision on a preliminary issue *in the instant case*, where the Court ruled that the *Tax Injunction Act* posed no barrier to plaintiff’s litigation, but did *not* dispute the litigants’ standing. (See, above, *Hibbs v. Winn*, 542 U.S. 88 (2004)).
- It is important to note that by overturning the 9th Circuit’s decision on jurisdictional grounds, the Court has still not addressed the main issue of the constitutionality of the tax credit scholarship legislation.
- In *Zelman v. Simmons-Harris*, 536 U.S. 639 (2002), the Supreme Court held that an Ohio pilot scholarship program did *not* violate the Establishment Clause in giving aid primarily to families below the poverty line with children at a failing school district so they could choose to attend either another public school or private school, receive tutorial assistance, enroll in a magnet school, or receive a scholarship.
 - In *Mueller*, on a five-to-four vote, the Supreme Court *upheld* a Minnesota law, challenged on the basis that it violated the Establishment Clause, that allowed state taxpayers, in computing their state income tax, to deduct expenses incurred in providing “tuition, textbooks and transportation” for their children attending a private elementary or secondary school.
 - Earlier, in *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.
 - In *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.
 - In *Nyquist*, the court stated, “The system of providing income tax benefits to parents of children attending New York’s nonpublic schools also *violates* [emphasis added] 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.”

New Mexico Constitution

- Article 12, Section 3 of the Constitution of New Mexico states in part, “...no part of the proceeds arising from the sale or disposal of any land granted to the state by congress, or any other funds appropriated, levied, or collected for educational purposes, shall be used for the support of any sectarian, denominational or private school, college, or university.” According to the Legislative Finance Committee, proceeds from state income taxes are the second largest source (after gross receipts taxes) of General Fund revenues, and

General Fund dollars are the source of an average of 90 percent of funding for public schools in New Mexico.

- The New Mexico constitution’s so-called “Anti-Donation Clause” (Article 9, Section 14):
 - states in part, “Neither the state nor any county, school district or municipality...shall directly or indirectly lend or pledge its credit or make any donation to or in aid of any person, association or public or private corporation...”); and
 - is often interpreted as a prohibition against public support of private interests.
- Article 4, Section 31 of the Constitution of New Mexico:
 - states in part, “No appropriation shall be made for charitable, educational, or other benevolent purposes to any person, corporation, association, institution, or community, not under the absolute control of the state.”; and
 - has been interpreted possibly to prohibit tuition assistance in the form of vouchers. It is arguable, therefore, that subsidies to parents in the form of tax credits might also violate this section.
- The New Mexico Attorney General (AG) has considered the question of the constitutionality of state assistance to private school students on several occasions:
 - In Opinion Number 99-01, dated January 29, 1999, the AG:
 - cited the federal decisions in *Nyquist* and *Mueller*, above, and stated that the prohibition in Article 12, Section 3 is not limited to direct payments from the state to private schools, but prohibited payments provided to private school students or their parents;
 - stated that the anti-donation clause in Article 9, Section 14 appears to prohibit the state from providing tuition assistance in the form of vouchers to private school students, stating, “Whether the beneficiary of the assistance is the parents or the schools, the use of public money to subsidize the education of private school students, without more, is a donation to private persons or entities in violation of the state Constitution.”;
 - suggested that a voucher program might run afoul of Article 12, Section 1, which states that a “uniform system of free public schools sufficient for the education of, and open to, all the children of school age in the state shall be established and maintained.” If it diverted funds from the public schools to the extent that it compromised the state’s ability to meet its obligation to establish and maintain a public school system sufficient to educate all school-age children in the state, such a program might be found to be unconstitutional; and
 - noted that a school voucher program would violate Article 4, Section 31 if the legislature appropriated money directly to parents or private schools. While admitting that the issue of vouchers had not been specifically addressed, the AG stated that it was arguable that such a program might result in a more than incidental benefit to private organizations, and thus might be prohibited.²

² (See *State ex. Rel. Interstate Stream Commission v. Reynolds*, 71 N.M 389, 1963)

- More recently, the AG affirmed those 1999 findings in Opinion No. 10-06 (*State funds for private school text books*), dated December 28, 2010. When considering the constitutionality of PED paying a publisher or depository to “reimburse it for the lending of textbooks to sectarian, denominational, or private schools for the use of their students,” the AG reaffirmed that:
 - Article 12, Section 3 prohibits “direct state aid or *subsidies to private schools or to aid provided to students or parents that effectively subsidize private schools.* [emphasis added]; and
 - the anti-donation clause in Article 9, Section 14 probably prohibited a proposed school voucher program under which state money would be used to provide tuition assistance to parents of private school students.

Related Bills:

SB 31 *Special Needs Student Scholarship Act* (Identical to HB 65)

HB 65 *Special Needs Student Scholarship Act* (Identical to SB 31)

HB 166 *Equal Opportunity Scholarship Act* (Identical to SB 88)