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FISCAL IMPACT REPORT

LAST UPDATED _____

SPONSOR Johnson/Lundstrom **ORIGINAL DATE** 2/3/23

BILL

SHORT TITLE Equal Education Opportunity Scholarship **NUMBER** House Bill 266

ANALYST Faubion

REVENUE* (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
--	(\$5,900.0)	(\$5,900.0)	(\$5,900.0)	(\$5,900.0)	Nonrecurring	General Fund**

Parenthesis () indicate revenue decreases

*Amounts reflect most recent version of this legislation.

**See fiscal implications.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT* (dollars in thousands)

	FY23	FY24	FY25	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	--	\$53.9	--	\$53.9	Nonrecurring	TRD – ASD/ITD
	--	\$80.0	\$80.0	\$160.0	Recurring	TRD - Revenue Processing Division
	\$194.6	\$194.6	\$194.6	\$583.8	Recurring	PED
Total	\$194.6	\$328.5	\$274.6	\$797.7		

Parentheses () indicate expenditure decreases.

*Amounts reflect most recent version of this legislation.

Relates to Senate Bill 109.
Duplicates Senate Bill 113.

Sources of Information

LFC Files
LESC Files

Responses Received From

New Mexico Attorney General (NMAG)
Public Education Department (PED)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of House Bill 266

House Bill 266 establishes the Equal Education Opportunity Scholarship Act to provide scholarships of up to \$5,000 for low-income students to attend certain public and private elementary, middle, and high schools. The scholarship is intended to encourage individuals and businesses to contribute money to tuition scholarship organizations (TSO) that provide scholarships for eligible students to attend schools that are chosen by the students' parents.

HB266 creates income tax and corporate income tax credits for contributions to TSOs to fund scholarships for low-income students. Individual taxpayers can recoup up to 80 percent of donations made to TSOs in tax credits annually. Any credit amount in excess of 50 percent of the taxpayer's liability can be carried forward for three consecutive years.

HB266 limits the number of students in each school district who may utilize a scholarship associated with a donation to a TSO from an individual or business entity that claims the tax credit.

HB266 outlines the process for a private nonprofit organization to seek certification to become a TSO from the Public Education Department (PED). It also outlines the duties of the TSO, PED, and the Taxation and Revenue Department (TRD) in administering the Equal Educational Access Scholarship Act and related personal and corporate tax credits. TRD will also be required to compile an annual report to be presented to the Revenue Stabilization and Tax Policy Committee with an analysis of the credit.

The effective date of enacting the equal education opportunity scholarship act and providing for tuition scholarship organizations to grant educational scholarships to low-income students to attend certain public and nonpublic schools is July 1, 2023. The effective date of creating income tax and corporate income tax credits is January 1, 2024. Those credits apply to taxable years beginning on or after January 1, 2023, but before January 1, 2027. The delayed repeal date of this bill is July 1, 2027.

FISCAL IMPLICATIONS

Section 5 of HB266 limits student participation by district size, severely limiting the total number of students eligible to participate in this scholarship program. LESC district-level analysis of student enrollment shows a total of 1,470 students statewide would be able to claim this scholarship out of the nearly 192 thousand students receiving federal reduced-priced lunch programs in the state. The full \$5,000 scholarship multiplied by the number of eligible students is \$7.35 million, putting the potential total for the 80 percent tax credit, assuming donations meet eligibility, at \$5.9 million. The analysis assumes districts remain within the same size classification and enrollment remains relatively stable; therefore, the number of students participating and costs remain flat.

It is important to note this analysis assumes donations to TSOs and, therefore, the total value of the credit claimed will be proportionate to the program saturation of \$5,000 scholarships for about 1,500 students. However, contributions to TSOs and the tax credit for those contributions

are not capped. It is highly possible contributions to TSOs outpace the amounts needed to provide scholarships to eligible students, and the fiscal impact could be much higher than is presented in the fiscal impact table above. If contributions do not reach program saturation, the cost of the credit could be lower. The value of contributions to TSOs, and therefore the cost of the tax credit, could vary widely.

The Taxation and Revenue Department (TRD) notes the following:

TRD identified 10,816 organizations in New Mexico that have been granted an exemption from federal income tax as described in section 501(c)(3) of the Internal Revenue Code of 1986. However, at this point, some unknown aspects do not allow TRD to make a precise fiscal impact. First, it is unknown how many of these organizations will seek certification from the department as a tuition scholarship organization. Second, there is no financial information to verify how many organizations are financially viable to receive donations of \$50,000 or more. Third, TRD cannot anticipate how many taxpayers will contribute and how much they will contribute and therefore potentially claim a credit against either their income tax or corporate tax liability, since it depends on whether organizations can provide educational scholarships based on the first and second criteria identified above and if the process to claim a credit and the amount of the final credit will incentive contributions. Finally, the credit is dependent on 80 percent of the total contribution and then 50 percent is applied to current liability which again are dependent on the points above and knowing what the average income tax liability is for these potential taxpayers. Therefore, based on these limitations of information and ability to make assumptions, TRD determined the fiscal impact might be negative but unknown.

The provisions of this bill will likely not result in decreased annual general fund appropriations to the state equalization guarantee (SEG) distribution—operational funding provided to public schools. However, the average SEG per public school student was \$11.2 thousand in FY23, over twice the amount of the \$5,000 scholarship contemplated in this bill.

This bill creates or expands a tax expenditure with a cost that is difficult to determine but likely significant. LFC has serious concerns about the significant risk to state revenues from tax expenditures and the increase in revenue volatility from erosion of the revenue base. The committee recommends the bill adhere to the LFC tax expenditure policy principles for vetting, targeting, and reporting or action be postponed until the implications can be more fully studied.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

Administrative Costs

TRD would need to update forms, instructions, and publications and make information system changes. In addition, TRD would need to develop new forms related to the contribution receipts. These changes would be incorporated into annual tax year implementation starting with tax year 2023 and represent 200 hours, or about 1.5 months, and \$42 thousand of contractual costs for TRD's Information Technology Division (ITD) and 40 hours for two Administration Services

Division (ASD) staff focused on testing the changes and reports.

All certifications would be entered manually, so this credit certification process would increase the administrative workload for TRD. Without electronic automation of this process, and assumed manual reconciliations with PED for certification, TRD would require 1 additional full-time employee (FTE) to process these new credit receipts and claims. The recurring budget estimate for the Revenue Processing Division (RPD) is based on an account auditor-A. PED would also need 1 FTE to manage the workload related to HB266. (See Administrative Implications.)

TRD expects to be able to absorb the impact of these changes, as outlined in this standalone bill, with 1 additional FTE. However, if several bills with similar effective dates become law there will be a greater impact to TRD and additional FTE or contract resources may be needed to complete the changes specified by the effective date of each bill.

SIGNIFICANT ISSUES

The office of the Attorney General (NMAG) noted in analysis of a similar bill proposed in the 2020 legislative session the anti-donation clause of Article IX, Section 14, of New Mexico's Constitution states, "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." The anti-donation clause has been interpreted to prohibit the use of vouchers to fund private school tuition. (See *N.M. Attorney General Opinion No. 99-01 (1999)*). Whether the tax credit proposed in HB266 constitutes a voucher from the state is unclear.

The bill allows both personal and corporate taxpayers to redirect 50 percent of their tax liability to scholarship organizations. The Taxation and Revenue Department (TRD) is required to provide certificates to the scholarship organization so the contributors and value of contributions can be identified. This is an unusual requirement for credits within the department. It is presumed that such contributions take the place of tuition for the students. This effectively allows families to apply their state tax liabilities to allow increased access to private schools, effectively acting as a state subsidy to these schools. By redirecting general fund tax liability revenue to certain private institutions, the bill bypasses the state educational budgeting process.

Because the identification and amount of the contribution to be used for the tax credit passes through the scholarship organization, it could be argued the act violates the privacy of taxpayers, as provided in statute.

It should be noted the scholarship organizations are allowed to discriminate on admissions based on religion, as per Section 4-B(3) of the bill, but not on the grounds of race, color or national origin.

PED notes the following:

It may not be in the state's interest to fund a private school system that competes with the state-supported public school system. Additionally, the state has a responsibility to ensure children in foster care have a free and appropriate education in public schools, not in private schools.

This issue has been litigated before the U.S. Supreme Court (SCOTUS) on Establishment Clause grounds in the *Winn* series of cases. Plaintiffs sued alleging that programs that would permit tax credits for education be applied to parochial schools violated the Establishment Clause. However, SCOTUS found the plaintiffs lacked standing and therefore did not reach the merits of the case. See *Arizona Christian School Tuition Organization v. Winn*, (563 U.S. 125 (2011)). New Mexico courts are not bound by the same standing constraints and may therefore be called upon to address this issue.

TRD notes the following policy issues:

The bill aims at fostering education opportunities for low-income children and youth and investing in the formation of human capital will positively impact communities and improve people’s lives. Nonetheless, it is important to mention that this bill subsidizes the demand for education instead of the supply of these services. Since public schools typically do not charge a tuition fee, the bill will mainly subsidize private schools. An alternative to foster education opportunities would be to finance the supply by investing those resources in improving access and quality of public education services. The effect of this bill will be to reduce revenues from PIT and CIT, which fund public education, and instead divert those resources to private education. In addition, since the funds to cover the cost of tuition stem from private donations, low-income families that have chosen a private school might experience a sudden financial burden in the event the amounts of those donations decline significantly or once the program finishes.

The credit has a defined end date of tax year 2026 and thus a sunset date. TRD supports sunset dates for policymakers to review the impact of tax expenditures before extending them. This appears critical to this bill as at the current moment the fiscal impact is unknown.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill’s requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the credit and other information to determine whether the credit is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

The reporting, verification, and regulatory requirements required by the bill would create additional responsibilities for both PED and TRD. The Public Education Department (PED) would be required to certify organizations as “tuition scholarship organizations” (TSOs), defined as organizations that provide educational scholarships of up to \$5,000 to students attending qualified schools of their parents' choice and that meet the provisions of the bill.

PED would have to create and implement additional criteria for the TSOs to meet the minimal standards of an appropriate education and may create a conflict between private schools as they seek to bolster the private school enrollment. PED would need to notify TRD if the certification of an organization as a tuition scholarship organization is denied, suspended, or revoked within 10 days of the denial, suspension, or revocation.

TRD would be required to enter all tax credit certifications and perform a manual reconciliations

with PED for certification.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB266 relates to SB109, Education Freedom Accounts, which would create the "education freedom account program" in the PED to allow the department, in contract with parents of participating students, to pay for private school and other eligible expenses under the act through "education freedom accounts."

HB266 duplicates SB113.

TECHNICAL ISSUES

TRD notes the following technical issues:

In **Sections 1 through 5** of the bill, a new act is created for the "Equal Education Opportunity Scholarship Act." Under Section 2 of the new act there are various definitions that appear to also apply to the administration of the new credits being proposed in Sections 6 and 7 which fall under the Income Tax Act and Corporate Income and Franchise Tax Act. The definitions applicable to the credit need to have references to the new act under the Income Tax Act and the Corporate Income and Franchise Tax Act or be listed separately under those two acts respectively.

Sections 6 & 7: It is not clear why TRD needs to provide the numbered documents to the tuition scholarship organization, and seems as if this certification could occur without the department issuing out special pieces of paper. Thus, on page 17, lines 14 and 15 TRD recommends striking certification document with contribution receipt. A "certification document" is defined on page 2 line 1 of the new act as a document for the organization from the Public Education Department (PED). This certification document should be changed to a "contribution receipt" as defined on page 2, Line 7 and detail the amount is 80 percent of that total contribution for that taxable year.

The credits are limited to 50 percent of the tax liability for the taxable year the contribution is made. So, the contribution would be made before the income tax liability was known. Thereby, a taxpayer who may have a net operating loss or adjustments to taxable income, may not be able to have the benefit of the tax credit in the first year, but would be able to carry it forward for three consecutive taxable years.

Sections 6 & 7: On page 12, line 13 and page 16, line 9, the bills refer to a "contribution" by a taxpayer to a tuition scholarship organization to determine the amount of the credit. "Contribution" is not defined in the new income tax statutes nor is it defined in the "Equal Education Opportunity Scholarship Act." Contribution could extend beyond a dollar amount contribution to include donations of property, donations for fund-raising, etc. and should be clearly defined. In addition, in Section 3 of the bill, on page 6, line 10, an additional term of "donations" is used in reference to define a "tuition scholarship organization." "Donations" are also not defined and appears to be interchangeable with the word "contributions." Consistent defined language will ensure clarity in the tax code.

The contribution receipt is issued to contributing taxpayers by the tuition organization on

receipts as prescribed on page 13, line 6 presents a risk by allowing an external party to have a predetermined amount of sequentially numbered certificates from TRD in advance of a contribution being made. This language prescribes a paper process that cannot be reconciled until after the calendar year and is dependent upon reporting by the tuition organization. Essentially, this bill has TRD provide a blank receipt book to an organization to issue to contributors. The receipt details are not required to be reported to PED and TRD until the end of the calendar year. (See page 8, Line 8). Since the receipt is “filled out” manually by external party, the receipts are not controlled and may have calculation errors, missing fields, and required information. Prescribing an electronic format allows these fields to be required and calculated in accordance with statute. Contribution receipts will not be verified at the time of filing and will be reconciled after the claim period. TRD recommends language that:

1. Requires that a certified organization data is shared with TRD within 30 days in a manner agreed upon by both agencies (preferably electronic)
2. Requires the organization to report contributions to TRD within 10 days in a manner prescribed by Taxation and Revenue Department. (Preferably through the Taxpayer Access Point (TAP))
3. Requires Tax & Rev to issue a contribution receipt to the taxpayer within 10 days, in a format determined by TRD. This can be modeled after the current issuance of certification letters that TRD sends to taxpayers when a tax credit is awarded. This letter is generated by GenTax and can be emailed or mailed to the taxpayer. Prescribing this process allows, the receipts to be sequentially numbered, and contribution receipt or tax credit is documented in real time to allow for automated processing of returns with tax credits, so long as receipts match account.

OTHER SUBSTANTIVE ISSUES

According to a recent Education Commission of the States (ECS) analysis, there were 24 scholarship tax credit programs in 19 states in 2021. ECS notes private school choice programs, including scholarship tax credit programs, have seen a significant expansion in recent years. Typically, these programs target specific student groups, such as students from low-income households or students with disabilities. Some may find these programs a more palatable private choice option because they do not directly draw money out of state education coffers in the same way as education savings accounts or voucher programs. However, each tax credit granted to donors amounts to a dollar-for-dollar reduction in state revenue.

Private school choice programs have drawn national attention to instances where state dollars are used to fund education at religious institutions. The U.S. Supreme Court has recently issued rulings clarifying the circumstances where religious educational institutions may participate in publicly funded programs. Historically, the court has ruled there is some room for state action regarding religion as long as it permits religious exercise to exist “without sponsorship and without interference,” creating a “benevolent neutrality” toward religion—a balance, or “play in the joints,” between the Establishment Clause and Free Exercise Clause of the First Amendment.

The First Amendment’s explicit protection of religion is divided into two clauses that sometimes appear at odds: the Establishment Clause, which bars the government from making a law “respecting an establishment of religion”; and the Free Exercise Clause, which forbids the

government from “prohibiting the free exercise” of religion. Each consideration of constitutionality regarding religious liberty weighs up the two clauses in some way.

In 2017’s *Trinity Lutheran v. Comer* decision, the Supreme Court found that a Missouri policy disqualifying a religious school from receiving state funds for playground materials “expressly discriminates against otherwise eligible recipients by disqualifying them from a public benefit solely because of their religious character.” The ruling acknowledged the state’s policy preference for “skating as far as possible from religious establishment concerns” but ruled that this concern “goes too far” and violates the Free Exercise Clause.

In 2020’s *Espinoza v. Department of Revenue* case, the Supreme Court found Montana’s prohibition against the use of a tax-credit program at a religious school also violated the First Amendment’s Free Exercise Clause. The majority stated that “any Establishment Clause objection ... is particularly unavailing” and ultimately that “a State need not subsidize private education. But once a State decides to do so, it cannot disqualify some private schools solely because they are religious.”

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy:** Revenue should be adequate to fund needed government services.
2. **Efficiency:** Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity:** Different taxpayers should be treated fairly.
4. **Simplicity:** Collection should be simple and easily understood.
5. **Accountability:** Preferences should be easy to monitor and evaluate

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?

1. **Vetted:** The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
2. **Targeted:** The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent:** The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable:** The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective:** The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions “but for” the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

LFC Tax Expenditure Policy Principle	Met?	Comments
Vetted	✘	This bill has not been vetted through an interim committee.
Targeted Clearly stated purpose	✘	No stated purpose.

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Long-term goals	✘	No stated long-term goals.
Measurable targets	✘	No measurable targets.
Transparent	✓	This bill does require annual reporting to interim legislative committees.
Accountable		
Public analysis	?	As there are no stated annual targets or goals, there is nothing from which to determine progress, effectiveness, or efficiency.
Expiration date	✓	The tax exemptions expire at the end of tax year 2026.
Effective		
Fulfills stated purpose	?	As there are no stated annual targets or goals, there is nothing from which to determine effectiveness or passing of the “but for” test.
Passes “but for” test	?	
Efficient	✘	No desired results.
Key: ✓ Met ✘ Not Met ? Unclear		

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