COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

# FISCAL NOTE

L.R. No.: 5276-01
Bill No.: HB 2458
Subject: Education, Elementary and Secondary; Economic Development Department; Revenue Department; Tax Credits; Taxation and Revenue - Income.
Type: Original
Date: April 8, 2008

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Bill Summary: This proposal establishes the Children's Educational Freedom Act.

## FISCAL SUMMARY

| ESTIMATED NET EFFECT ON GENERAL REVENUE FUND | | | |
|---|---|---|---|
| FUND AFFECTED | FY 2009 | FY 2010 | FY 2011 |
| General Revenue | ($80,163) to ($40,000,000) | ($75,463) to ($41,200,000) | ($77,728) to $2,400,000 |
| | | | |
| **Total Estimated Net Effect on General Revenue Fund** | **($80,163) to ($40,000,000)** | **($75,463) to ($41,200,000)** | **($77,728) to $2,400,000** |

| ESTIMATED NET EFFECT ON OTHER STATE FUNDS | | | |
|---|---|---|---|
| FUND AFFECTED | FY 2009 | FY 2010 | FY 2011 |
| | | | |
| | | | |
| **Total Estimated Net Effect on Other State Funds** | **$0** | **$0** | **$0** |

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 11 pages.

| ESTIMATED NET EFFECT ON FEDERAL FUNDS | | | |
|---|---|---|---|
| FUND AFFECTED | FY 2009 | FY 2010 | FY 2011 |
| | | | |
| | | | |
| **Total Estimated Net Effect on All Federal Funds** | **$0** | **$0** | **$0** |

| ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE) | | | |
|---|---|---|---|
| FUND AFFECTED | FY 2009 | FY 2010 | FY 2011 |
| General Revenue | 1 | 1 | 1 |
| | | | |
| **Total Estimated Net Effect on FTE** | **1** | **1** | **1** |

☐ Estimated Total Net Effect on All funds expected to exceed $100,000 savings or (cost).

☒ Estimated Net Effect on General Revenue Fund expected to exceed $100,000 (cost).

| ESTIMATED NET EFFECT ON LOCAL FUNDS | | | |
|---|---|---|---|
| FUND AFFECTED | FY 2009 | FY 2010 | FY 2011 |
| **Local Government** | **$0** | **$0 to Unknown** | **Unknown to ($44,800,000)** |

## FISCAL ANALYSIS

ASSUMPTION

Officials from the **Office of Administration - Budget and Planning (BAP)** state this bill creates a tax credit for contributions to educational assistance charities. The cumulative amount of tax credits to be issued is capped at $40 million in the first year of existence. This cap is adjusted upward by the Midwest CPI in subsequent years. BAP assumes that the first credits will be issued and likely claimed in FY'09. BAP has no estimate of the amount of donations that may be received. Therefore, assuming a 3% annual inflation rate, this proposal could lower general and total state revenues by an unknown amount up to $40 million in FY'09, $41.2 million in FY'10, and $42.4 million in FY'11.

Officials from the **Department of Economic Development (DED)** state the bill creates a tax credit program administered by DED that allows a tax credit based on donations to an "Educational Assistance Organization", which uses the donations for scholarships to eligible students. The credit may be carried forward for 4 years. The cumulative FY cap is $40 million that may be adjusted annually for inflation based on the consumer price index.

DED would be required to administer the program or work with a designated administrator to review documentation and approve charities. DED or the administrator would allocate $40 million in credits to authorized charities. DED or the administrator would also answer questions as well as promote and oversee the program. Tax credits claimed would need to be tracked by DED. The Department of Revenue would have to track when $40 million in credits had been claimed in any one year. $40 million in credits issued plus carry forward of unused credits may mean that more than $40 million is requested each year when tax returns are filed. This might mean that some taxpayers may be denied use of the credit in any given year.

It appears administrative and marketing costs of 10% may be kept by the scholarship granting organizations. DED assumes that donations of $47.059 million would equate to $40 million in credits. The educational assistance organizations would be allowed to keep about $4.7million + in marketing cost fee and the rest would be used as designated. The DED or designated administrator would have to insure compliance with the rest of the provisions of the bill, including designation of educational assistance organizations, reporting, coordination with DOR, etc. At this point, DED projects one FTE would be needed to administer and oversee the program. Costs for that person are projected. Other costs may be incurred as the bill is implemented. Costs projected are not definitive.

DED assumes responsibility for administration of the credit and that one person plus associated expenses would be required to administer the program, initially. DED assumes the credits will

ASSUMPTION (continued)

go into effect in August 2008 and will be claimed on CY 2008 tax returns filed in 2009. The cost of the credits will be $40 million in FY 2009. DED assumes that one person would be needed in FY 2009 to set up the program. DED assumes some computer programming will be needed to adjust existing systems to track the credits claimed and keep a list of scholarship organizations. ITSD indicates 40 hours of programing time for a Computer Information Technologist III to do programing. The cost for one Economic Development Incentive Specialist III, expense, and equipment will be needed in FY 2009. DED assumes the full $40 million in credits will be issued and claimed each year. DED assumes General Revenue funding will be appropriated and used for program costs. DED assumes some compliance/auditing functions will need to be added but the extent is unknown.

**Oversight** will assume DED will not incur additional lease space charges for the one FTE. Oversight will also assume DED will be able to absorb the potential programming charges within existing budgetary appropriations.

Officials from the **Department of Revenue (DOR)** state this proposal adds a new tax credit as well as a line to the MO-A Form. MINITS and Speed-up changes will be required. Missouri Tax Forms will require change as well. DOR assumes their Personal Tax section will need;

- 2 Temporary Tax Employees for keying the add-back on the MO-A;
- 1 Tax Processing Technician I for every 6,000 credits claimed;
- 1 Tax Processing Technician I for every 19,000 returns to be verified by Quality Review; and
- 1 Tax Processing Technician I for every 2,400 pieces of correspondence.

DOR states that due to the Statewide Information Technology Consolidation, their response will now also reflect the cost estimates prepared by OA-IT for impact to the various systems. As a result, the impact shown may not be the same as previous fiscal notes submitted. In addition, if the legislation is Truly Agreed To and Finally Passed the OA-IT costs shown will be requested through appropriations by OA-IT.

Office of Administration Information Technology (ITSD DOR) estimates the IT portion of this request can be accomplished within existing resources; however, if priorities shift, additional FTE/overtime would be needed to implement. Office of Administration Information Technology (ITSD DOR) estimates that this legislation could be implemented utilizing 2 existing CIT III for 2 months for modifications to MINITS and 3 existing CIT III for 1 month for modifications to the corporate tax systems. The estimated cost is $29,302.

ASSUMPTION (continued)

In response to a similar bill from 2007 (SB 698), DOR assumed they could absorb the additional duties from the program with existing resources. Therefore, **Oversight** will not show a fiscal impact to the Department of Revenue.

Officials from the **Office of the Secretary of State (SOS)** assume many bills considered by the General Assembly include provisions allowing or requiring agencies to submit rules and regulations to implement the act. The SOS is provided with core funding to handle a certain amount of normal activity resulting from each year's legislative session. The fiscal impact for this fiscal note to the SOS for Administrative Rules is less than $2,500. The SOS recognizes that this is a small amount and does not expect that additional funding would be required to meet these costs. However, we also recognize that many such bills may be passed by the General Assembly in a given year and that collectively the costs may be in excess of what our office can sustain with our core budget. Therefore, we reserve the right to request funding for the cost of supporting administrative rules requirements should the need arise based on a review of the finally approved bills signed by the governor.

Officials from the **Department of Elementary and Secondary Education (DESE)** state the Department of Revenue will likely experience an administrative burden. No impact to DESE. Tax credits will reduce income tax receipts flowing to the General Revenue fund. Tax subsidies reduce the state's tax revenues and decrease the amount of money available for public schools and all public school students.

The changes outlined in section 163.036 will not impact the state's burden in terms of school funding. A district's loss of state aid for a pupil who is no longer enrolled in the school district, does not equate to an equal savings in state funding. It merely makes such funding available to distribute to school districts statewide. In addition, costs to educate students differ from district to district. Therefore, there can be no assumption that the transfer of students between districts will have an equal impact on both districts' education costs.

The credit is for donations starting within calendar year 2008; therefore, **Oversight** assumes the first credits could be claimed on tax returns filed in January 2009, or FY 2009. Oversight will assume an adjustment for inflation of 3% regarding the annual cap of the tax credits. Therefore, Oversight will assume tax credits up to $40 million in FY 2009, $41.2 million in FY 2010 and $42.4 million in FY 2011.

The proposal states that taxpayers may claim a credit in the amount of 50 percent of the amount the taxpayer contributed during the tax year. Therefore, with the first annual limit of tax credits that can be issued of $40 million, this would equate to a potential of $80 million in

ASSUMPTION (continued)

contributions ($40 million / 50%). With the inflation factor discussed above, this would equate to $82.4 million of potential contributions in calendar year 2009 and $84.8 million in calendar year 2010.

The proposal also states that at least 80% of the qualifying contributions (donations) shall be used for educational scholarships. Therefore, Oversight will assume eighty percent of the donations, will be used for scholarships, or $64 million ($80 million of contributions x 80%). Oversight will assume the other twenty percent of the contributions will be spent on either administrative costs or other expenses for students such as tutoring or transportation.

**Oversight** will also assume the average amount of each scholarship will be $5,000. Dividing 80 percent of the potential contributions by the program's average amount per student of $5,000, yields 12,800 ($64,000,000 / $5,000) students that may receive the scholarship in the first year. Since the average scholarship amount per student is adjusted to inflation as is the total number of credits allowable per year, Oversight would assume a relatively stable number of scholarships would be available each year.

**Oversight** will assume the majority of students who receive this scholarship currently are enrolled in either the Kansas City or St. Louis school districts. The average amount of state aid per eligible pupil from the St. Louis and Kansas City school districts is roughly $3,500. Multiplying the average state aid to St. Louis or Kansas City and the number of students that may get a scholarship, results in a potential savings to the sate of $44,800,000 ($3,500 x 12,800).

**Oversight** will also assume that the state may not realize a savings in school funding until the 2010 - 2011 school year. Even though the proposal has an emergency clause and allows contributions in calendar year 2008, Oversight assumes the program will not be established and a Educational Assistance Organization determined timely enough to provide students with scholarships for the 2008 - 2009 school year. Therefore, Oversight will assume donations would be available for granting scholarships in school year 2009 - 2010. Therefore, Oversight assumes the state would not realize any savings from reduced payments to the school districts until the 2010 - 2011 school year because the funding for the 2009 - 2010 school year would still be based on pupil count from 2008 - 2009.

**Oversight** assumes the local school districts will lose the funding for these students in the year after they attend other schools. If students from the St. Louis or Kansas City school districts receive scholarships, the amount of state funding to these school districts would be reduced in the following year. State funding is partly based on eligible pupils from the previous school year, therefore, the school districts would still receive funding for the first year for those students that

ASSUMPTION (continued)

attend other schools with this scholarship.

Oversight will range the fiscal impact of the tax credits and the potential savings from reduced payments of state aid to the school districts from $0 to the maximum amounts. The potential savings of $44,800,000 assumes that the proposal would actually result in a reduced payment from the state to the local school districts and not just a change in the distribution of the same amount of funds.

The state, however, would not realize a possible savings or would realize a reduced savings in certain circumstances, such as children who are home-schooled, or children who are currently not attending any schools. The state had not paid $3,500 for these children in the previous fiscal year, therefore the savings would be reduced. There is not information available to determine how many of the scholarships would be utilized by the children who are receiving more or less than the average amount spent per pupil by the state.

**Oversigh**t has ranged the fiscal impact of the scholarship (both the tax credit and the savings to the state) from $0 to the maximum amount calculated per year.

**Oversight** notes that this fiscal note does not include shifting between school districts from Proposition C funds, Fair Share funds and Free Textbook funds which would result in a zero net effect to the local school districts.

**Oversight** assumes St. Louis or Kansas City school districts may realize some potential cost savings as a result of the reduction in students that are now attending their schools, but would attend other schools as a result of this proposal. According to DESE reports, the school districts spent nearly $10,888 per student. Oversight couldn't determine the fixed versus the variable costs associated with these amounts. Therefore, Oversight has reflected a $0 to Unknown potential savings resulting from reduced variable expenses to the two local school districts.

**Oversight** assumes there would be positive economic benefits from this proposal, but Oversight assumes those benefits to be indirect and have not reflected them in this fiscal note.

Subsection 135.735.4 states that the educational assistance organization (or DED) may receive up to 2 percent of contributions for administrative expenses - up to the actual costs incurred in administering the program (whichever is less). **Oversight** will range this from $0 to Oversight's estimated cost to be incurred by DED.

ASSUMPTION (continued)

**Oversight** compared the total tax credit issuances relative to the total tax credit redemptions for the previous four years in order to determine a relationship between the two. Oversight discovered that the annual redemptions ranged from 79 percent to 86 percent of the annual issuances. Depending on the program, the redeemed credits may have been issued several years prior and carried forward to the years studied; however, Oversight will utilize an estimated redemption total of 83 percent of tax credits issued. Therefore, under this proposal, if $40,000,000 of credits are issued, Oversight would assume $33,200,000 (83%) of credits to be redeemed, reducing Total State Revenues.

Officials from the **St. Louis Public Schools**, **Kansas City Public Schools** and **Parkway Public Schools** did not respond to our request for fiscal impact.

**This proposal could reduce Total State Revenues.**

| FISCAL IMPACT - State Government | FY 2009 | FY 2010 | FY 2011 |
|---|---|---|---|
| **GENERAL REVENUE FUND** | | | |
| Savings - Education costs the state would not pay to the local school districts for students receiving the scholarship set up through this proposal | $0 | $0 | $0 to $44,800,000 |
| Income - DED may receive up to two percent of the qualifying contributions for marketing and administrative expenses - or cost incurred in administering the program - whichever is less | $0 to $80,163 | $0 to $75,463 | $0 to $77,728 |
| Costs - DED | | | |
| Personal Service (1 FTE) | ($41,715) | ($42,966) | ($44,255) |
| Fringe Benefits | ($18,447) | ($19,000) | ($19,570) |
| Expense and Equipment | ($20,001) | ($13,497) | ($13,903) |
| Total Costs - DED | ($80,163) | ($75,463) | ($77,728) |
| FTE Change - DED | 1 FTE | 1 FTE | 1 FTE |

| FISCAL IMPACT - State Government (continued) | FY 2009 | FY 2010 | FY 2011 |
|---|---|---|---|
| Loss - DED | | | |
| Tax credit for contributions to educational assistance organizations | $0 to ($40,000,000) | $0 to ($41,200,000) | $0 to ($42,400,000) |
| **ESTIMATED NET EFFECT TO THE GENERAL REVENUE FUND** | **($80,163) to ($40,000,000)** | **($75,463) to ($41,200,000)** | **($77,728) to $2,400,000** |

| FISCAL IMPACT - Local Government | FY 2009 (10 Mo.) | FY 2010 | FY 2011 |
|---|---|---|---|
| **LOCAL SCHOOL DISTRICTS** | | | |
| Savings - of educational expenses of not educating students who receive scholarships to attend other schools | $0 | $0 to Unknown | $0 to Unknown |
| Loss - of state funding for students who receive scholarships from program to attend other schools | $0 | $0 | $0 to ($44,800,000) |
| **ESTIMATED NET EFFECT TO LOCAL SCHOOL DISTRICTS** | **$0** | **$0 TO UNKNOWN** | **UNKNOWN TO ($44,800,000)** |

FISCAL IMPACT - Small Business

No direct fiscal impact to small businesses would be expected as a result of this proposal.

FISCAL DESCRIPTION

This proposal establishes the Children's Education Freedom Act which authorizes a 50% tax credit beginning January 1, 2008, for taxpayers who donate to a scholarship-granting organization if the donations are not claimed on the taxpayer's federal income tax return. The credit is nonrefundable but may be carried forward for three years or transferred. The cumulative amount of tax credits cannot exceed $40 million annually, adjusted for inflation based on the federal Consumer Price Index. Scholarships must average $5,000, adjusted for inflation based on the index. The Director of the Department of Economic Development or a designated oversight organization must establish a procedure by which the cumulative amount of tax credits is apportioned among all nonprofit educational assistance organizations.

Eligibility standards for students receiving scholarships include residence in a provisionally accredited, unaccredited, or interim accredited school district; attendance at a public school for the semester before a scholarship is granted or starting school in the state for the first time; and a family income of 185% of the level which qualifies the student for the federal reduced-price school lunch program.

Scholarships may be given to a disabled child three years of age or older if the child's parents have nonreimbursed medical expenses in excess of 7.5% of their federal adjusted gross income or to a child identified by a principal and approved by his or her superintendent on the basis of disciplinary or academic criteria specified in the bill. Public schools are given the right of first acceptance of scholarship recipients, and scholarships may be used at public schools for certain purposes which include tutoring, general educational development, and transportation. Public school districts may opt into the scholarship program. Public schools whose students transfer under the program cannot continue to receive state aid money for those students beyond the immediately preceding year.

Scholarship-granting organizations must meet requirements for fiscal soundness, percentage of revenues devoted to educational scholarships, and public reporting. Private schools qualify to accept scholarship students by meeting certain requirements including employee background checks and student assessments. The bill specifies how scholarship checks will be distributed.

The provisions of the bill will expire six years from the effective date, but a child who is receiving a scholarship may continue in the program until completion of the twelfth grade.

The bill contains an emergency clause.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Department of Economic Development
Department of Elementary and Secondary Education
Department of Revenue
Office of Administration - Budget and Planning
Office of the Secretary of State

**NOT RESPONDING:**
**St. Louis Public Schools**
**Kansas City Public Schools**
**Parkway Public Schools**

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