



GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Fiscal Note 2015 Biennium

Bill #	SB0081	Title:	Provide tax credits for contributions to scholarship organizations
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Primary Sponsor:	Lewis, Dave	Status:	As Amended on the Senate Floor
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| <input checked="" type="checkbox"/> Significant Local Gov Impact | <input checked="" type="checkbox"/> Needs to be included in HB 2 | <input checked="" type="checkbox"/> Technical Concerns |
| <input type="checkbox"/> Included in the Executive Budget | <input checked="" type="checkbox"/> Significant Long-Term Impacts | <input type="checkbox"/> Dedicated Revenue Form Attached |

FISCAL SUMMARY

	<u>FY 2014 Difference</u>	<u>FY 2015 Difference</u>	<u>FY 2016 Difference</u>	<u>FY 2017 Difference</u>
Expenditures:				
General Fund	\$586,514	(\$102,344)	(\$154,803)	(\$215,709)
Revenue:				
General Fund	(\$2,643,411)	(\$3,380,474)	(\$4,338,655)	(\$5,584,291)
Net Impact-General Fund Balance:	<u>(\$3,229,925)</u>	<u>(\$3,278,130)</u>	<u>(\$4,183,852)</u>	<u>(\$5,368,582)</u>

Description of fiscal impact: This bill, as amended, would allow individual and corporate taxpayers to claim partial credits for donations to organizations that provide scholarships to private school students or provide grants for new programs at public schools. The total amount of credits is limited each year, but the limit increases by 30% each year. The net reduction in general fund revenue would be \$2.6 million in FY 2014. It would grow to \$5.6 million in FY 2017. This reduction is partially offset by reductions in transfers to schools with declines in school ANB which is estimated to be approximately \$250,000 beginning in FY 2015 and grow by an additional \$50,000 each year thereafter through FY 2020. The bill as amended on the Senate floor, sunsets after TY 2019.

FISCAL ANALYSIS

Assumptions:

Department of Revenue

1. This bill provides credits against individual income tax or corporate license tax for donations to Student Scholarship Organizations (SSOs), which would give scholarships to students in private schools, and for donations to Education Improvement Organizations (EIOs), which would make grants to public schools for programs not included in their current curricula. For individuals, the credit would be for 40% of the donation. For corporations, the credit would be for 20% of the donation. Each credit would be limited to 50% of the taxpayer's tax liability. The total amount of each credit would be limited to \$2.5 million in 2013 with the limit increasing by 30% each year (See Technical Note 1). This bill would take effect in TY 2013 and would terminate at the end of TY 2019.

2. Several states have had credits for donations to SSOs long enough to have compiled and published data on credit use. Credit percentages for corporations in these states are much higher than in this bill, as amended, so that corporate donations are likely to be smaller relative to the size of the state in Montana than in other states. For corporations, the credit percentages in this bill are the same as the credit percentage for the charitable endowment credit. Corporate donations to SSOs are assumed to each be the average of corporate donations receiving the charitable endowment credit for the last five years, or \$594,475. Corporate credits would be \$118,895 per year.
3. Individual donations to SSOs are assumed to be limited by the cap on total credits rather than the limit that individual credits cannot be more than 50% of the taxpayer’s tax liability. In Arizona, individual donors to SSOs have averaged 1.35 times the number of private school students. For 2011, average state income tax liability for taxpayers with at least one dependent and positive tax liability was \$2,288. Fifty percent of this amount is \$1,144. Multiplying \$1,144 by 1.35 times the number of private school students in Montana gives a limit on individual credits that is higher than the limit on total credits each year. Therefore, individual credits are assumed to equal the difference between the cap on total credits and the amount of corporate credits.
4. The following table shows corporate and individual donations to SSOs and the resulting credits.

Credits for Donations to SSOs

Tax Year	Corporations		Individuals		Total	
	Donations	Credits	Donations	Credits	Donations	Credits
2013	\$594,475	\$118,895	\$5,952,763	\$2,381,105	\$6,547,238	\$2,500,000
2014	\$594,475	\$118,895	\$7,827,763	\$3,131,105	\$8,422,238	\$3,250,000
2015	\$594,475	\$118,895	\$10,265,263	\$4,106,105	\$10,859,738	\$4,225,000
2016	\$594,475	\$118,895	\$13,434,013	\$5,373,605	\$14,028,488	\$5,492,500
2017	\$594,475	\$118,895	\$17,553,388	\$7,021,355	\$18,147,863	\$7,140,250

5. Pennsylvania appears to be the only state with a credit for donations to EIOs and it is available only for corporations. Thus, there is no information on existing programs to serve as the basis for an estimate of individual EIO donations in Montana. However, it is likely that individual donations to EIOs will be less than corporate donations. Individuals who would donate out of an interest in a particular school or particular student are more likely to donate to SSOs than to EIOs. Individuals who donate to EIOs are likely to have relatively high incomes, to make regular donations to charities for which they take an itemized deduction, and to decide to allocate part of their donations to an EIO rather than to another charity. For purposes of this fiscal note, individual donations are assumed to be one-third of corporate donations. The following table shows estimated donations and credits, the tax effect of the corresponding reduction in deductions for charitable contributions, assuming all donors are in the 6.9% rate bracket, and the net change in tax revenue.

Credits for Donations to EIOs

Tax Year	Corporations		Individuals		Tax Impact of Reduced Deductions	Total Net Revenue Reduction
	Donations	Credits	Donations	Credits		
2013	\$594,475	\$118,895	\$198,158	\$79,263	\$13,673	\$184,485
2014	\$594,475	\$118,895	\$198,158	\$79,263	\$13,673	\$184,485
2015	\$594,475	\$118,895	\$198,158	\$79,263	\$13,673	\$184,485
2016	\$594,475	\$118,895	\$198,158	\$79,263	\$13,673	\$184,485
2017	\$594,475	\$118,895	\$198,158	\$79,263	\$13,673	\$184,485

6. The availability of scholarships from SSOs would induce some students to switch from a public school to a private school. Existing and new private schools will be able to accommodate increased enrollment only if tuition paid by new students plus new funding from donations to SSOs is more than the cost of serving the additional students.
7. Most private schools charge tuition that is less than the school’s expenses per student. The difference is made up from donations, subsidies from a church or other sponsoring organization, and other sources, such as earnings on an endowment. The following tables show estimated expenses, tuition revenue, and non-tuition revenue for private schools in Montana. The first table shows enrollment from OPI and two online directories of private schools (www.privateschoolreview.com/state_private_schools/stateid/MT and montana.educationbug.org/private-schools.) Schools were classified as they reported themselves in their directory listings or on their school websites. The second table shows expenses and tuition per student. Expenses per student is based on average cost per student in public schools from OPI and ratios of private school costs to public school costs estimated in Bruce D. Baker: *Private Schooling in the U.S.: Expenditures, Supply, and Policy Implications*, Boulder and Tempe: Education and the Public Interest Center, University of Colorado & Education Policy Research Unit, Arizona State University, 2009. Tuition is the average of full tuition plus fees, weighted by enrollment, reported on websites of schools in each category. The third table shows total tuition revenue, calculated by multiplying average tuition by number of students, and total non-tuition revenue, calculated by subtracting total tuition revenue from total expenses, which is average spending per student times the number of students.

Type of School	Students			
	Elementary	Middle School	High School	Total
religious, affiliated	2,174	1,250	1,055	4,479
religious, unaffiliated	635	401	356	1,392
non-religious	264	107	0	371
religious, reservation boarding	301	222	181	704
therapeutic boarding	20	80	301	401
Total	3,394	2,060	1,893	7,347
Total: Montana tuition paying	3,073	1,758	1,411	6,242

Type of School	Average Spending per Student			Average Full Tuition		
	Elementary	Middle School	High School	Elementary	Middle School	High School
religious, affiliated	\$9,073	\$9,073	\$10,739	\$4,337	\$4,499	\$7,855
religious, unaffiliated	\$6,372	\$6,372	\$7,542	\$5,251	\$5,223	\$5,672
non-religious	\$13,374	\$13,374	\$15,830	\$7,944	\$9,073	n/a

Type of School	Tuition Revenue \$ million				Non-Tuition Revenue \$ million			
	Elementary	Middle School	High School	Total	Elementary	Middle School	High School	Total
religious, affiliated	\$9.429	\$5.624	\$8.287	\$23.339	\$10.296	\$5.718	\$3.043	\$19.056
religious, unaffiliated	\$3.334	\$2.094	\$2.019	\$7.448	\$0.712	\$0.461	\$0.666	\$1.838
non-religious	\$2.097	\$0.971	n/a	\$3.068	\$1.434	\$0.460	n/a	\$1.894
Total	\$14.860	\$8.689	\$10.306	\$33.855	\$12.441	\$6.638	\$3.708	\$22.788

The first table includes two categories of schools, church-operated boarding schools serving Native American populations on reservations and therapeutic boarding schools, where enrollment is unlikely to be affected by SSOs. They are shown in the table because they account for a significant proportion of private school enrollment, particularly at the high school level. Most private school students attend schools that offer tuition discounts based on number of children enrolled, income, or other factors. Thus, the estimates of tuition revenue in the tables are almost certainly high.

8. Individual donations to SSOs in other states appear to come primarily from private school students' relatives. This group is targeted by current fund-raising efforts by private schools. A portion of the funds donated to SSOs by individuals would represent new funds to pay for private school operations but the rest would have gone to finance private school operations anyway, either as donations to a school or as tuition payments. Some corporate donations to SSOs would be funds that would have been donated directly to a private school, but the rest would represent new donations. This fiscal note assumes that the amount of new funding for private schools equals the amount of scholarships funded by corporate donations plus 25% of the amount of scholarships funded by individual donations.
9. Students who would attend a private school with a scholarship from an SSO but not without it have families that are not willing and able to pay the current net price of a private school (full tuition less discounts less existing scholarships) but would be willing to pay the net price with an SSO scholarship. Recent research indicates that a 10% reduction in the net price of private school results in about a 2% increase in children whose families are willing and able to pay the net price to send them to a private school. (see, for example, Susan Dynarski, Jonathan Gruber and Danielle Li: *Cheaper by the Dozen: Using Sibling Discounts at Catholic Schools to Estimate the Price Elasticity of Private School Attendance*, Center for Economic Studies, U.S. Census Bureau paper CES 11-34, 2011, and Richard Blundell, Lorraine Dearden and Luke Sibieta: *The Demand for Private Schooling in England: the Impact of Price and Quality*, Institute for Fiscal Studies working paper 10/21, 2010.)
10. This bill would allow SSOs and EIOs to spend up to 10% of donations for administrative costs. States with existing credits have limits ranging from 3% to 10%. This fiscal note assumes that the average in Montana will be 5%.
11. The change in private school enrollment due to scholarships from SSOs was calculated using the following formulas describing the actions of affected private schools, families of current and potential private school students, donors, and scholarship organizations:

$$\begin{aligned}
 &1. \\
 &\text{tuition} = \frac{\text{total expenditures} - \text{nontuition revenue}}{\text{students}} \\
 &\text{nontuition revenue} = 2012 \text{ nontuition revenue} - 75\% \text{ individual donations} \\
 &\frac{\text{additional students}}{2012 \text{ students}} = -0.2 \frac{\text{change in net price}}{2012 \text{ tuition}} \\
 &\text{additional scholarship support per student} = \frac{95\% (\text{corporate donations} + \text{individual donations})}{\text{students}}
 \end{aligned}$$

12. The following table shows the calculated changes in enrollment and private school finance using 2012-2013 enrollment and estimated spending and tuition as the baseline:

school Year	donations to SSOs		SSO scholarship support per student	average tuition	students		total spending \$ million	total revenue \$ million	
	corporate	individual			total	increase		tuition	other
2012-13	\$0	\$0	\$0	\$5,440	6,242	0	\$56.744	\$33.955	\$22.788
2013-14	\$594,475	\$5,952,763	\$988	\$6,182	6,299	57	\$57.262	\$38.938	\$18.324
2014-15	\$594,475	\$7,827,763	\$1,268	\$6,410	6,311	69	\$57.371	\$40.454	\$16.917
2015-16	\$594,475	\$10,265,263	\$1,631	\$6,705	6,326	84	\$57.507	\$42.418	\$15.089
2016-17	\$594,475	\$13,434,013	\$2,100	\$7,088	6,347	105	\$57.698	\$44.986	\$12.713

- This bill would limit individual scholarships from SSOs to 50% of the average cost per student in public schools and would limit the average scholarship to 30% of the average cost per student in public schools. For 2012, 30% of the average public school cost is \$2,875. To stay within these limits, SSOs would eventually need to be giving scholarships to a majority of private school students in Montana.
- Donations will be made in the summer and fall each year to fund scholarships for the school year beginning that fall. Individual taxpayers who make donations and claim credits will either reduce withholding or estimated payments or receive larger refunds (or pay less) when they file returns the following spring. Corporate taxpayers will reduce estimated payments by the amount of their credits. Thus, credits will reduce state revenue in the same fiscal year that donations are made. The following table shows the reductions in state general fund revenue. It assumes that one-quarter of individual donations to SSOs replace donations for which an itemized deduction would have been claimed and that taxpayers who would have claimed these deductions are in the 6.9% rate bracket.

fiscal year	Corporate Tax Credits		Individual Tax Credits		Offset from Reduced Itemized Deductions		Net Revenue Reduction						
	donations to SSOs	donations to EIOs	donations to SSOs	donations to EIOs	donations to SSOs	donations to EIOs							
2014	\$118,895	+	\$118,895	+	\$2,381,105	+	\$79,263	-	\$41,074	-	\$13,673	=	\$2,643,411
2015	\$118,895	+	\$118,895	+	\$3,131,105	+	\$79,263	-	\$54,012	-	\$13,673	=	\$3,380,474
2016	\$118,895	+	\$118,895	+	\$4,106,105	+	\$79,263	-	\$70,830	-	\$13,673	=	\$4,338,655
2017	\$118,895	+	\$118,895	+	\$5,373,605	+	\$79,263	-	\$92,695	-	\$13,673	=	\$5,584,291
2018	\$118,895	+	\$118,895	+	\$7,021,355	+	\$79,263	-	\$121,118	-	\$13,673	=	\$7,203,617

- This bill would require the Department of Revenue to process applications from new SSOs and EIOs and to review annual reports from existing SSOs and EIOs. The department also would need to process credit pre-approval applications, approve applications received before the credit limit is reached, and deny any received after the limit is reached. The department would need to verify that taxpayers who claim the credits on their returns were pre-approved. The department would also need to make changes to the individual and corporate income tax returns and to its data processing systems to add the new credits. Processing applications and verifying credit claims would require 2.50 FTE. Personal services costs would be \$134,344 per year in FY 2014 and FY 2015, \$136,899 in FY 2016, and \$139,503 in FY 2017. Annual operating expenses associated with the additional employees would be \$13,294 in FY 2014, \$13,944 in FY 2015, \$14,154 in FY 2016, and \$14,364 in FY 2017. One-time operating costs to set up the new employees would be \$6,758 in FY 2014. Implementing the process for applications and preapproval would be roughly equivalent to implementing a new tax in the department’s data processing system. The department would implement a system for taxpayers to apply for and claim credits through the Taxpayer Access Point, and change the department’s data capturing and processing systems to add the new credit form to individual, corporate, and pass-through tax returns. These changes would be done by the system vendors or department

employees working overtime at a total cost of \$432,118. Required reports to the legislature would be done instead of other interim work with no additional costs.

Office of Public Instruction

16. For the 2011-12 school year, the per-pupil average of total public school expenditures was \$9,100 for elementary programs and \$10,700 for high school programs. The funds that must be included in the calculation of the per-pupil average include general fund; transportation; bus depreciation; food services; tuition; retirement; miscellaneous programs; traffic education; non-operating; lease rental agreement; compensated absence fund; metal mines tax reserve; state mining impact; impact aid; litigation reserve; technology acquisition; flexibility fund; debt service; building reserve; and inter-local agreement.
17. Assumption 12 outlines the likely number of students who would transfer from public schools to a private school. This will result in a decrease in ANB in state public schools (students X 187 / 180) each year. State support per ANB for K-12 BASE Aid is approximately \$4,248. The impact of the decrease in ANB beginning in FY 2014 would represent decreased state expenditures for K-12 BASE Aid as presented in the following table:

FY	Reduction in Students	Change in ANB	Reduction in K-12 BASE Aid
FY 2014	0	0	\$0
FY 2015	57	59	\$250,632
FY 2016	69	72	\$305,856
FY 2017	84	87	\$369,576
FY 2018	105	109	\$463,032

18. The transfer of this number of students from public schools is not expected to affect any of the other formula-driven sources of state funding for schools such as school facility reimbursements, transportation aid, or county retirement GTB.

Fiscal Impact:	FY 2014	FY 2015	FY 2016	FY 2017
Department of Revenue (DOR)	<u>Difference</u>	<u>Difference</u>	<u>Difference</u>	<u>Difference</u>
FTE	2.50	2.50	2.50	2.50
<u>Expenditures:</u>				
Personal Services	\$134,344	\$134,344	\$136,899	\$139,503
Operating Expenses	\$452,170	\$13,944	\$14,154	\$14,364
TOTAL Expenditures	\$586,514	\$148,288	\$151,053	\$153,867
<u>Funding of Expenditures(DOR):</u>				
General Fund (01)	\$586,514	\$148,288	\$151,053	\$153,867
TOTAL Funding of Exp.	\$586,514	\$148,288	\$151,053	\$153,867
Office of Public Instruction (OPI)				
<u>Expenditures:</u>				
K-12BASE Aid	\$0	(\$250,632)	(\$305,856)	(\$369,576)
TOTAL Expenditures	\$0	(\$250,632)	(\$305,856)	(\$369,576)
<u>Funding of Expenditures(OPI):</u>				
General Fund (01)	\$0	(\$250,632)	(\$305,856)	(\$369,576)
TOTAL Funding of Exp.	\$0	(\$250,632)	(\$305,856)	(\$369,576)
<u>Revenues:</u>				
General Fund (01)	(\$2,643,411)	(\$3,380,474)	(\$4,338,655)	(\$5,584,291)
TOTAL Revenues	(\$2,643,411)	(\$3,380,474)	(\$4,338,655)	(\$5,584,291)
<u>Net Impact to Fund Balance (Revenue minus Funding of Expenditures):</u>				
General Fund (01)	(\$3,229,925)	(\$3,278,130)	(\$4,183,852)	(\$5,368,582)

Effect on County or Other Local Revenues or Expenditures:

Department of Revenue

1. Grants from EIOs to school districts are expected to be between 90% and 95% of donations. These grants must be for new programs that are not part of the district’s normal curriculum. Districts will not be able to use grant funds to offset revenue from property taxes or other sources for existing school operations.

Office of Public Instruction

2. School districts that have lower enrollments because students switch to private schools will have lower costs, lower spending caps and reduced state funding. This bill is expected to reduce public school enrollments by less than 1%, or less than one student per four classrooms. This generally will not allow affected school districts to reduce staff or facility costs. Therefore, actual cost savings are likely to be less than the average cost per student. Schools districts that are at the cap on per-student spending will have to reduce spending and property tax levies. Schools districts that are below the cap will be able to choose whether to reduce spending and property taxes.

Long-Term Impacts:

1. The extension of the sunset through TY 2019 means credits will be claimed through FY 2020. The claiming of credits is assumed to continue growing as in assumption 14 (approximately 28% per year) with some

reduction in this rate of growth as capacity constraints and criteria limits (as noted in technical note #1) may be reached. Costs would be expected to be around \$11.9 million in FY 2020, otherwise.

Technical Notes:

Department of Revenue

1. Sections 9(5)(a)(ii) and 10(5)(a)(ii) increase the annual cap on credits by 30% if grants or scholarships are more than 80% of the amount of credits. Credits would be 40% of the amount donated for an individual and 20% for a corporation. Section 3 requires EIOs to use at least 90% of each year’s contributions to make grants within the next three years. Section 5 imposes a similar requirement on SSOs. Given these requirements, the ratio of grants or scholarships generally will be at least 200%. The ratio could be lower than 80% if there are not enough applicants to use all donated funds or if there is a significant lag between the time donations are received and the time grants or scholarships are awarded, as might happen in the first years of operation. This fiscal note assumes that the ratio will always be greater than 80%, so that the credit limits will increase each year.
2. The language setting the credit percentages in Sections 9(1) and 10(1) has some ambiguities. In the case of a donation made by an S-corporation, it is not clear whether the credit is to be 20% of the donation since it is made by a corporation or 40% since the credit is passed through to the owners. Also, it is not clear whether a credit could be claimed for a donation by an estate or trust.
3. The appeals process in Sections 12(2) and (3) is different from the department’s current taxpayer appeals process. It is not clear whether these differences are intentional.

Sponsor’s Initials

Date

Budget Director’s Initials

Date