BILL # SB 1497 **TITLE:** educational expenses; income tax subtraction

SPONSOR: Gorman **STATUS:** As Introduced

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FISCAL ANALYSIS

Description

The bill would allow individual income tax filers to take a subtraction from income of up to $2,000 for individual filers and $4,000 for joint filers for their child's K-12 educational expenses. The filer must be a parent of a student who is in public, private, or a home school. Educational expenses that may be subtracted under the bill include "educational materials and supplies, computer hardware to be used in the student's home, textbooks, educational computer software, and fees for regular and extracurricular activities or instruction."

Estimated Impact

The bill would result in an estimated General Fund revenue loss of $(15.7) million in FY 2009 if all filers took their qualifying subtraction. The impact is difficult to estimate with certainty and will ultimately depend on both the level of qualifying expenses and the usage of the income subtraction. The estimated $(15.7) million revenue loss includes reductions of $(8.9) million, $(6.4) million, and $(0.4) million from parents of public, private, and home schooled pupils, respectively.

The Arizona Department of Revenue does not have a fiscal impact estimate for this bill.

Analysis

The fiscal impact of the bill would depend primarily on the following factors: 1) total qualifying expenses for all school age pupils statewide, 2) the percentage of qualifying subtractions actually "claimed" by filers, and 3) the average tax rate for participating filers. This analysis assumes that eligible parents typically would have a state marginal income tax rate of 3.5% under Arizona law, as Arizona individual income tax rates currently range from 2.59% to 4.54%. It assumes, however, that levels of qualifying expenses per pupil and participation rates among filers could vary depending on whether filers had children in public school, private school, or home school, as described below.

<u>Public School Pupils</u>
Public schools currently serve approximately 1,060,000 children according to Arizona Department of Education (ADE) data. The National Retail Federation reports that an average of about $200 is spent per child nationally on "back to school" items such as electronics or computer related equipment and school supplies. This implies that parents of public school students potentially could subtract up to $212 million from their Arizona taxable income under the bill (1,060,000 public school pupils X $200 per pupil = $212 million).

If a subtraction from income was claimed for all of these expenses, state income tax collections would decrease by approximately $7.4 million under the bill ($212 million X 3.5% assumed average tax rate = $7.4 million). Even at this maximum assumed level, however, parents typically would save only $7 per child, which might not induce most parents to do the recordkeeping needed to take the new subtractions ($7.4 million / 1,060,000 public school children = $7 tax saving per pupil). Therefore, the actual reduction would depend on the percentage of parents actually taking the subtraction, which is unknown.

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Parents of public school students potentially spend more than $200 per year on qualifying expenses, such as extracurricular fees. In FY 2007, for example, a total of approximately $43 million was claimed for the existing public school extra-curricular activity fee tax credit, which is unaffected by the bill. The bill does not preclude a filer from taking both the credit in addition to the subtraction. This would decrease General Fund collections by approximately $1.5 million ($43 million X 3.5% assumed average tax rate = $1.5 million), for a total General Fund collection loss of $8.9 million for expenses related to public school pupils.

Private School Pupils

The National Center for Education Statistics reports that approximately 46,400 students attended a private school in Arizona in the 2003-2004 school year (latest data available). The average tuition cost for these students was approximately $4,400 in FY 2005 according a survey conducted by the Goldwater Institute (also latest data available). This suggests that combined tuition costs for all private school pupils statewide currently equal roughly $210 million (46,400 pupils X $4,600 assumed average tuition cost for FY 2009 = $213 million). Approximately $50 million of that total, however, is assumed to be funded with scholarships from school tuition organizations (STO's) and other entities under this analysis, for a net statewide out-of-pocket tuition cost of roughly $160 million. (For FY 2007, the Arizona Department of Revenue reports that $51.0 million was contributed to STO's statewide, which must use at least 90% of their revenue for scholarships.) Based on anecdotal evidence, this analysis assumes that parents of private school pupils also spend roughly $23 million statewide ($500 per pupil) for other items that would qualify for income subtractions under the bill, such as school uniforms, textbooks, fees, computers and software. These items, plus tuition costs, therefore, would provide $183 million in estimated subtractions under the bill ($160 million for tuition + $23 million for other qualifying expenses = $183 million).

If the entire $183 million amount was subtracted from income by parents of private school pupils, Arizona individual income tax collections would decrease by approximately $6.4 million ($183 million X 3.5% average assumed tax rate = $6.4 million). The actual reduction would depend on the percentage of parents actually taking the subtraction, which is unknown. The average potential savings is estimated at $138 per pupil ($6.4 million total potential subtraction / 46,400 pupils = $138 per pupil), however, which is substantially higher than the estimated average $7 savings per pupil for public school pupils described above. Parents of private school pupils, therefore, would be expected to take the new subtraction from income under the bill at higher rates than parents of public school pupils.

Home School Pupils

Available data suggest that there are approximately 20,000 home schooled students in Arizona. A study from the National Home Education Research Institute indicates that the average cost to home school a student is around $550. This suggests that parents of home schooled students statewide could subtract up to $11 million in education related costs from their collective taxable income under the bill (20,000 home schooled pupils X $550 = $11 million). If the entire $11 million amount was subtracted from filers' income, Arizona individual income tax revenues would decrease by approximately $385,000 ($11 million X 3.5% assumed average tax rate = $385,000). This would give parents of home schooled pupils a savings of approximately $19 per pupil ($385,000 statewide tax savings / 20,000 pupils = $19), which is similar to the $14 average savings per pupil estimated above for public school pupils. Again, the actual reduction would depend on the percentage of parents actually taking the subtraction.

Local Government Impact

Each year, incorporated cities and towns receive 15% of income tax collections from 2 years prior. The bill would reduce individual income tax collections in FY 2009 by an estimated $(15.7) million; therefore, the corresponding distributions to local government will be reduced by 15%, or approximately $(2.4) million, beginning in FY 2011.

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