Fiscal Note

BILL # SB 1467

TITLE: STOs; corporations; caps; scholarship eligibility

SPONSOR: Yarbrough

STATUS: As Introduced

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Description

The bill reduces the current 20% cap on annual growth for corporate low-income School Tuition Organization (STO) tax credits under A.R.S. § 43-1183 to 2.5% or the rate of inflation, whichever is greater, over a 4-year period starting in FY 2019. The bill also modifies the current $5.0 million hard cap on corporate displaced or disabled pupil STO tax credits authorized by A.R.S. § 43-1184 by increasing the cap by 2.5% annually or the rate of inflation, whichever is greater, starting in FY 2019.

The bill also makes additional statutory changes. Among these, the bill strikes language requiring prior public school attendance for pupils switching from a corporate displaced or disabled STO scholarship to an Empowerment Scholarship Account (ESA) and makes recipients of corporate low-income STO scholarships also eligible to switch to an ESA if they meet additional criteria required under existing law, such as that they are disabled or previously attended a failing school.

Estimated Impact

The primary fiscal impact of the bill would be to slow growth in the overall level of corporate STO tax credits. Under the bill, the combined low income and displaced/disabled credits are projected to grow from $79.3 million in FY 2018 to $90.6 million in FY 2019. The projected level of credits is $94.2 million in FY 2019. As a result, the bill is projected to increase state revenues by $3.6 million in FY 2019 through slower credit growth.

The FY 2019 Baseline assumes that the combined STO credits would remain at the current law FY 2019 maximum level of $94.2 million in FY 2020 and beyond. This assumption was based on recent slower growth in utilization and is unrelated to the bill. Given that the revised caps would still be above $94.2 million, the bill does not result in additional estimated revenue in FY 2020 and beyond relative to the JLBC Baseline.

Under the current law growth formula, however, the combined credits could reach as high as $159.1 million by FY 2022 if fully used. Compared to this scenario, the bill would result in higher revenue in each year. Once the bill is fully phased in by FY 2022, for example, the combined credit cap would be $106.7 million, resulting in $52.4 million in additional revenue in FY 2022 if the cap was fully utilized.

The bill would also include partially offsetting increases in General Fund costs by increasing the number of STO recipients who could switch to an ESA. We estimate that these provisions would increase General Fund costs by $498,000 in FY 2019, $1.0 million in FY 2020, and $2.0 million in FY 2021. These estimates are highly speculative, however, and actual costs could vary substantially depending on the actual proportion of newly eligible students who would switch to an ESA under the bill.

The Department of Revenue (DOR) estimates that the bill would increase state General Fund revenues by $3.6 million in FY 2019, but decrease them each year thereafter. The JLBC Staff has requested a clarification of the DOR analysis of the post-FY 2019 estimates.

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Analysis

Background

A.R.S. § 43-1183 and A.R.S. § 20-224.06 permit corporations and insurers to claim an income tax credit for contributions to STOs that provide scholarships to low-income students in private schools. The aggregate amount of tax credits that may be claimed under these laws each year is capped by statute at 20% above the prior year cap, which for FY 2018 is $74.3 million. The cap for FY 2019 under current law therefore would be $89.2 million ($74.3 million X 1.2 = $89.2 million).

In addition, A.R.S. § 43-1184 and A.R.S. § 20-224.07 permit corporations and insurers collectively to claim up to $5 million of income tax credits annually for contributions to STOs that provide scholarships to displaced or disabled students in private schools. That $5 million cap does not change under current law.

The FY 2019 Baseline assumes that the current law caps of $89.2 million for corporate low-income STO tax credits and $5.0 million for corporate displaced or disabled STO tax credits will be reached for FY 2019 for total combined corporate STO tax credits of $94.2 million. We assume, however, that corporate low-income credits will not increase after FY 2019 for 2 reasons: the recent slowing of STO tax credit claims and declining corporate tax liability.

Specifically, while corporate donations reached the allowed cap within the first few weeks of each fiscal year from FY 2013 through FY 2017, it took 6 months to reach the FY 2018 credit cap, suggesting less pent up demand for the credits. Likewise, by FY 2020 the full tax impact of previously enacted multi-year reductions in corporate income tax rates will likely have been realized. For this reason, businesses may not have sufficient tax liability to fully utilize the increased credit-eligible donation limits provided under current law after FY 2019.

We will reassess the FY 2020 estimates after analyzing FY 2019 credit claims.

Estimated Revenue Impact of Revised Corporate STO Caps

Table 1 compares growth in credit caps for the 2 corporate tax credit programs under current law versus SB 1467 through FY 2022, when the bill would be fully implemented. In FY 2022, for example, the cap on low-income credits would be $154.1 million under current law versus $101.2 million under the bill. The cap on displaced or disabled credits would remain at $5.0 million in FY 2022 under current law, but increase to $5.5 million under the bill.

Table 1 also compares the estimated caps under both scenarios to the assumed $94.2 million of combined corporate low-income + displaced or disabled STO tax credits that are assumed for all years beginning in FY 2019 in the FY 2019 Baseline ($89.2 million "low-income" + $5.0 million "displaced or disabled" = $94.2 million). The proposed caps are $(3.6) million lower than $94.2 million for FY 2019, but exceed $94.2 million for all other years. The bill therefore is projected to reduce corporate low-income STO credits by $(3.6) million in FY 2019, but not affect corporate credits thereafter. This would increase state General Fund revenues by $3.6 million above the FY 2019 JLBC Baseline, but not affect General Fund revenues in subsequent fiscal years *(see Table 1).*

Under the current law growth formula, however, it is possible that corporate STO tax credits could continue to rise with the annual 20% increase in the credit cap, reaching $159.1 million by FY 2022. Compared to this scenario, the revised caps under the bill would result in higher revenue in each year. Once the bill is fully phased in by FY 2022, for example, the combined credit cap would be $106.7 million under the bill, resulting in $52.4 million in additional revenue in FY 2022 ($159.1 million claimed under current law FY 2022 maximum - $106.7 million revised cap = $52.4 million).

Estimated Revenue Impact of Additional ESA Eligibility

The bill strikes language requiring prior public school attendance for pupils switching from a corporate displaced or disabled STO scholarship to an ESA. The bill also makes recipients of corporate low-income STO scholarships eligible to switch to an ESA if they meet additional criteria required under existing law, such as being disabled or having previously attended a failing school.

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Table 1

Corporate STO Tax Credits under Current and Proposed Caps

	(In $ M)				
	FY 2018	**FY 2019**	**FY 2020**	**FY 2021**	**FY 2022**
Low-Income STO Tax Credits					
Current Law Cap Revenue (Loss) (20% Annual Increase)	(74.3)	(89.2)	(107.0)	(128.4)	(154.1)
Estimated Revenue (Loss) under Current Law 1/	(74.3)	(89.2)	(89.2)	(89.2)	(89.2)
Proposed Cap Revenue (Loss) 2/	(74.3)	(85.4)	(94.0)	(98.7)	(101.2)
Relative to JLBC Baseline: Change in Revenue	**0.0**	**3.7**	**0.0**	**0.0**	**0.0**
Relative to Current Law Maximum: Change in Revenue	**0.0**	**3.7**	**13.0**	**29.7**	**52.9**
Displaced/Disabled STO Tax Credits					
Current Law Cap Revenue (Loss)	(5.0)	(5.0)	(5.0)	(5.0)	(5.0)
Estimated Revenue (Loss) under Current Law 3/	(5.0)	(5.0)	(5.0)	(5.0)	(5.0)
Proposed Cap Revenue (Loss) 4/	(5.0)	(5.1)	(5.3)	(5.4)	(5.5)
Relative to JLBC Baseline: Change in Revenue 5/	**0.0**	**(0.1)**	**0.0**	**0.0**	**0.0**
Relative to Current Law Maximum: Change in Revenue 5/	**0.0**	**(0.1)**	**(0.3)**	**(0.4)**	**(0.5)**
Low Income STO + Displaced/Disabled STO Credits					
Combined Current Law Cap Revenue (Loss)	(79.3)	(94.2)	(112.0)	(133.4)	(159.1)
Estimated Revenue (Loss) under Current Law	(79.3)	(94.2)	(94.2)	(94.2)	(94.2)
Proposed Combined Cap Revenue (Loss)	(79.3)	(90.6)	(99.2)	(104.1)	(106.7)
Relative to JLBC Baseline: Total Change in State Revenues	**0.0**	**3.6**	**0.0**	**0.0**	**0.0**
Relative to Current Law Cap: Total Change in State Revenues	**0.0**	**3.6**	**12.7**	**29.3**	**52.4**

1/ The FY 2019 Baseline assumes that corporate STO donations will remain at FY 2019 levels after that year.
2/ Under the bill, the maximum allowed credits for corporate low-income STO scholarships will grow by 15% in FY 2019, 10% in FY 2020, 5% in FY 2021, and by 2.5% or the rate of inflation, whichever is greater, each year beginning in FY 2022.
3/ Baseline keeps at $5 M due to current law cap.
4/ Under the bill, the maximum credits for corporate disabled and displaced STO scholarships will grow by 2.5% or the rate of inflation, whichever is greater, beginning in FY 2019.
5/ Assumes that if there is enough demand to fill the current law tax credit caps, a reduction in the low-income STO tax credit cap would induce an increase in the displaced/disabled tax credits up to their new cap.

This would be expected to increase ESA costs, as students with disabilities generally would have a financial incentive to switch from the STO scholarship program to the ESA program under the bill. Specifically, disabled students (excluding those with mild learning disabilities) receive an average ESA award amount of $24,900. In comparison, based on our analysis of data from DOR, displaced or disabled STO scholarship awards to disabled students averaged approximately $9,000 as of FY 2016 (the last year of available data).

Since students may receive multiple STO scholarships and DOR reports only the number of STO scholarships awarded—rather than the number of individual recipients—we do not know how much total STO assistance each recipient typically receives on average. Students who receive multiple STOs totaling more than the $9,000 average scholarship amount would have a comparatively smaller incentive to switch to an ESA.

DOR reports that STOs statewide awarded 936 displaced or disabled pupil scholarships in FY 2016. Of these, approximately 350 go to schools that primarily serve disabled students, and the remaining 586 appeared to generally fund "displaced" pupils (mainly pupils in the foster care system).

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A portion of the 350 disabled scholarships, however, were likely awarded to students with mild disabilities who would not qualify for material additional funding if they switched to the ESA program. Using 1) the share of special education ESA participants who have only mild disabilities as a proxy for the proportion of disabled STO recipients who likewise have only a mild disability and 2) a review of the school websites connected to the 350 disabled STO awards, we estimate that between one-third and one-fourth of the 350 scholarships were awarded to students with mild disabilities. As a result, we estimate that roughly 250 STO scholarships were awarded to students with more severe disabilities who might have a significant economic incentive to switch to the ESA program under the bill.

As noted above, students can receive multiple STO scholarships, and DOR reports only the number of scholarships awarded, rather than individual recipients. We speculatively estimate, therefore, that the 250 scholarships represent approximately 200 individual students who received the awards.

The rate at which these students would switch to ESAs under the bill is unknown, as this would depend on how quickly their parents learned about their new ESA eligibility under the bill and how long it took them to successfully apply for ESAs for their children. As a very rough estimate, however, we assume that 10% of these students would switch to an ESA for FY 2019, and that the number of cumulative "switchers" would be 20% by FY 2020 and 40% by FY 2021. These percentages are the same assumptions used in the JLBC Staff fiscal note on HB 2465 that was introduced in 2017 (53rd Legislature, First Regular Session).

We therefore assume a new state cost under the bill of $498,000 for FY 2019 (200 individual disabled students currently receiving a disabled/displaced STO scholarship X 10% switching to ESAs for FY 2019 X $24,900 [the average ESA amount for disabled pupils based on ADE data] = $498,000).

For FY 2020 we assume a cumulative new state cost of $996,000 (200 individual disabled students currently receiving a disabled/displaced STO scholarship X 20% switching to ESAs cumulatively by FY 2019 X $24,700 = $996,000).

For FY 2021 we assume a cumulative new state cost of $1,992,000 (200 individual disabled students currently receiving a disabled/displaced STO scholarship X 40% switching to ESAs cumulatively by FY 2021 X $24,700 = $1,992,000).

A portion of these estimated costs potentially could be offset by a decreased use of STO tax credits under the bill due to students switching to ESAs. However, we assume that STOs would be able to increase per pupil amounts for remaining displaced or disabled students in a manner that fully used up all available tax credit monies.

The number of students who would be incentivized to switch to an ESA under the bill could be smaller than 200 if some of these students also receive other (non-displaced/disabled) STO scholarships to supplement their displaced/disabled STO award.

Additionally, if Laws 2017, Chapter 139 is approved at the November 2018 general election, these costs would decrease by roughly (5)% due to the smaller ESA award sizes under that legislation compared to current enacted law.

The estimated costs could also be lower if a large share of the disabled students receiving disabled/displaced STO scholarships had attended public school prior to receiving their STOs, since these students would already be eligible to switch to an ESA under current law.

The costs of the bill's expanded ESA eligibility provisions could also be higher if students who currently receive the corporate low-income STO (who also meet other ESA eligibility criteria) switched to ESAs. However, their incentive to switch to an ESA would likely be significantly less due to the much smaller size of non-disabled ESA awards. As discussed above, DOR reports only the number of scholarships awarded—not the number of individual recipients—so it is not possible to know whether non-disabled recipients receive more or less than they would in the ESA program, on average.

Local Government Impact

Incorporated cities and towns and cities receive 15% of state income tax collections from 2 years prior from the Urban Revenue Sharing Fund (URSF) established by A.R.S. § 43-206. The bill therefore would increase URSF distributions to cities and towns by an estimated $540,000 in FY 2021 ($3,600,000 state increase for FY 2019 X 15%).