

Fiscal Note

BILL # SB 1039

TITLE: income tax; subtraction; school tuition

SPONSOR: Rogers

STATUS: As Introduced

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Description

SB 1039 would establish an individual income tax subtraction for K-12 private school tuition expenses, up to \$10,000 per student. This subtraction would become effective in tax year (TY) 2023.

Estimated Impact

The fiscal impact of the bill would depend on the actual net out-of-pocket tuition expenses incurred by private school families in Arizona after accounting for scholarships and other forms of financial assistance that lower gross tuition charges. We lack complete data on net tuition expenses, so our estimates are subject to uncertainty. Based on our methodology and information available on tuition and financial assistance from public data sources, we estimate that private school enrollees may incur total out-of-pocket tuition expenses of \$426.3 million statewide. Under that assumption, we estimate that SB 1039 would result in a General Fund revenue loss of \$(10.1) million each year relative to the JLBC Baseline, beginning in FY 2024.

The revenue loss to the Student Support and Safety Fund, established by Proposition 208, would be \$(2.5) million each year, beginning in FY 2024.

The Department of Revenue has not yet provided an estimate of the impact of the bill.

Analysis

SB 1039 establishes an individual income tax subtraction for K-12 private school tuition expenses, up to \$10,000 per student. The subtraction would be available to both taxpayers that itemize their deduction and those that utilize the standard deduction. According to the National Center for Education Statistics, there were 59,171 students in Arizona private schools in the 2019-2020 school year.

The Education Data Initiative, a research group that collects data on the U.S. education system, estimates that average Arizona gross private school tuition is \$12,650. The \$12,650 in gross tuition charges implies that total private school tuition before scholarships and financial aid would be \$748.5 million [= \$12,650 x 59,171 private school students]. The report does not, however, estimate data on net out-of-pocket tuition expenses for Arizona private school enrollees after accounting for scholarships and other forms of financial assistance. Given that SB 1039 specifies that only tuition expenses paid by the taxpayer are eligible for the subtraction, the actual amount of tuition expenses that would be eligible for the subtraction created by the bill is subject to uncertainty.

To estimate net out-of-pocket tuition expenses, we first deduct from the \$748.5 million gross tuition estimate the amount of private school tuition scholarships awarded by School Tuition Organizations (STOs). In FY 2020, the Department of Revenue reports that Arizona private school students received \$193.3 million in STO scholarships. STO scholarships would lower aggregate net out-of-pocket tuition expenses to \$555.2 million. To the extent that non-STO forms of financial aid are also available, this figure and the estimated impact of the bill may be lower.

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Private school families may also be able to lower their out-of-pocket tuition expenses via participation in the Empowerment Scholarship Account (ESA) program. Tuition paid with ESA monies would also not be eligible for the income tax subtraction under SB 1039. According to the Arizona Department of Education's most recent quarterly report, the average annual ESA award is \$15,189. As a result, we assume that these students utilize their ESA awards to pay for their tuition expenses and therefore do not qualify for an income tax subtraction. There are 10,475 students in the ESA program, who either attend private schools or are homeschooled. We estimate that 6,379 of the 10,475 ESA students are in private schools. This estimate is based on homeschooled student population data from Arizona Families for Home Education, which estimates that Arizona has 38,000 homeschooled students. This implies that private school students represent approximately 60.9% of the non-public school child population [= 59,171 private school students / (38,000 homeschooled + 59,171 private school students)]. Our estimates therefore assume that the private school share of ESA enrollees is proportionate to their share of the non-public school child population. Under that assumption, ESA awards would further reduce tuition eligible for the SB 1039 subtraction by \$96.9 million [= 6,379 private school ESA enrollees x \$15,189 award].

SB 1039 also states that taxpayers may not take a subtraction for tuition expenses that are reimbursed by 529 plan withdrawals. Ascensus, a financial services company that manages 529 plans, reports that roughly 7.5% of withdrawals are for K-12 educational expenses and the average withdrawal amount is \$4,487. Assuming that a withdrawal is made from each of the 94,758 Arizona 529 accounts, approximately \$32.0 million may be withdrawn for K-12. This amount would also not qualify for an income tax subtraction.

After accounting for STO scholarships, ESA awards to private school enrollees, and 529 plan withdrawals for K-12 tuition expenses, the aggregate net out-of-pocket K-12 tuition expenses eligible for the SB 1039 income tax subtraction would be \$426.3 million.

JLBC Baseline

The outcome of a referendum and litigation could affect the availability of General Fund resources in the next several years. To avoid overstating the availability of resources, the JLBC Baseline is based on a "maximum commitment" scenario. The JLBC Baseline assumes that: (1) Proposition 208 is upheld in litigation, and (2) the enacted income tax reductions, including the triggers, go into effect. Under the JLBC Baseline, the individual income tax rates for General Fund collections in TY 2023 would be 2.53%, 2.75%, and 1.00%. The average effective tax rate for all tax brackets is 2.36%. As a result, the revenue loss to the General Fund would be \$(10.1) million each year, beginning in FY 2024.

The 1.00% rate would apply to individuals subject to the Proposition 208 3.50% surcharge. Monies collected from the 3.50% surcharge would be deposited into the Student Support and Safety Fund. As a result, the revenue loss to the Student Support and Safety Fund would be \$(2.5) million each year, beginning in FY 2024.

Local Government Impact

Beginning in FY 2024, incorporated cities and towns receive 18% of the individual income tax from two years prior. We estimate that SB 1039 would result in an annual revenue loss to local governments of \$(1.8) million, beginning in FY 2026.

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