

Department of Finance and Administration

Legislative Impact Statement

Bill: HB1222

As Engrossed: 1/27/2017

Bill Subtitle: THE ARKANSAS PARENTAL EMPOWERMENT FOR EDUCATION CHOICE ACT OF 2017; AND TO DECLARE AN EMERGENCY.

Basic Change :

Sponsor: Representative Dotson

HB1222 has been engrossed to incorporate the language in Amendment 3.

Amendment 3 to HB1222 eliminates the language "throughout the academic year" from the language requiring quarterly transfers of payments to education savings accounts by eligible nonprofit organizations, and adds language that receipts from education savings accounts by an eligible parent or student does not constitute taxable income. The Amendment raises no additional substantive issues.

HB1222 has been engrossed to incorporate the language in Amendment 2.

Amendment 2 to HB1222 replaces all references to "a quality education" with "an appropriate educational opportunity," and substitutes language claiming that "every child has a civil right to a quality education that fits his or her individual needs" with language that "allowing a parent the means and choice to provide an appropriate educational opportunity that fits his or her child's individual needs is important to the civic and economic health of the state."

HB1222, as amended by H-1 provides that eligible nonprofit organizations (NPO) may establish education savings accounts for use in paying the non-public school education expenses for a student. The NPO must satisfy various criteria outlined in the Act and must file an application with the Department of Finance and Administration (DFA) by May 1 before the academic year for which the NPO intends to fund education savings accounts. Within sixty (60) days after receipt of the application, DFA would certify the eligible NPO if it meets all necessary requirements.

Parents may apply to a NPO to establish an education savings account for an eligible student. The parent must use the funds from the account for educational expenses at a nonpublic school. Eligible education expenses are outlined in the bill. The NPO may contract with financial institutions to establish the savings accounts and would transfer into the account for the eligible student an equivalent amount of the foundation funding as provided in state law for each academic year. For the 2016-2017 school year, that amount was \$6,646.

Taxpayers who make eligible contributions will receive a state income tax credit equal to 100% of the contribution amount. The tax credit may be used to offset up to 50% of the income tax due for the tax year. Unused credits may be carried forward for five consecutive tax years following the tax year in which the credit was earned. Contributions are not eligible for a charitable contributions deduction for state income tax purposes. The act is effective for tax year 2017 and following. The bill limits the available tax credit in 2017 to \$10M to be allowed on a first-come, first-served basis. The bill does not account for the fact that some taxpayers file returns early, some file on the due date, and some file with an extension. Consequently, individual income tax returns are filed from January through October of the filing year and all of those returns are timely under state law. Those taxpayers making contributions under this Act who do not file until later will expect to receive the tax credit and may file too late to benefit from this Act because the \$10M limit has been reached. In addition, corporate income tax returns are due throughout the year based on whether the corporation is a calendar year or fiscal year filer. Corporations with a later due date may be denied the tax credit.

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Revenue Impact :

FY2018 \$10,000,000 Reduction in State General Revenues. For subsequent years the total impact is unknown. The bill provides a growth mechanism that is unclear.

Taxpayer Impact :

Individuals and corporations may offset up to 50% of their state income tax for contributions to an education savings account. In FY17 there were 19,490 students in private schools. The \$10M limit will allow approximately 1,504 of those current private school students to benefit from this Act ($\$10M \div \$6,646 = 1504$). In addition, students currently in public schools may seek to take advantage of this Act.

Resources Required :

Additional staff will be needed to review applications and to determine limitation amounts available for later years. Anticipated staff needed is as follows:

- 1 DFA Revenue Manager 2 or higher to monitor tax credits established and claimed for purposes of allocating the \$10 million dollar first year tax credit limit and limits established in future years, and to supervise other personnel needed to administer program and coordinate with Dept. of Education. \$90,000 per year.
- 1 Audit Supervisor to supervise audit staff. \$75,000 per year.
- 3 Auditors to review audits of eligible non-profit organizations. \$200,000 per year.
- 3 DFA Service Representatives to process returns claiming credits. \$120,000 per year.

Time Required :

At least 6 months following the Act's passage will be needed to develop procedures and promulgate rules for the proper administration of the program. It will be very difficult for DFA to promulgate rules quickly enough to effectively administer the program for 2017. The bill is currently effective for tax years beginning on or after January 1, 2017. An organization that seeks to become an eligible NPO shall apply to the DFA for initial certification by May 1 before the academic year for which the organization intends to fund education savings accounts. It is not realistic for DFA to be able to set up this new program by May 1, 2017.

Procedural Changes :

Computer programs, tax forms, training manuals and procedures manuals would need to be updated. DFA employees must be hired and trained.

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Other Comments :

1. The bill limits the tax credit to \$10M in the first year but does not specify how this limitation is to be applied. This may create a race to file income tax returns to ensure the \$10M credit amount is still available. Taxpayers who file more complex returns or who must wait for needed information required to complete their return often request an extension to file that return. Taxpayers requiring an extension may lose the benefits of this act.
2. The bill limits the corporate tax credit by the amount of difference in federal income tax with and without using this credit. DFA does not have federal tax information available to apply this limitation.
3. The 2017 limitation for overall credit is \$10 million, but the calculation to determine the subsequent years' limitations is confusing and unclear.
4. There is no date set for accumulating the estimated costs for all eligible students from all qualified non-profit organizations to determine the limit to the income tax credit for each year after the first year.
5. The bill will result in the issuance of many tax assessments and reduced income tax refunds for taxpayers. These occur because taxpayers will file their income tax return believing that they are entitled to the credit under this act and will later discover that the \$10M limit was reached before their tax return was filed.

Legal Analysis :

HB1222 creates "education savings accounts" ("ESA") that may be used to pay for private school or charter school costs and other related costs. The ESAs would be administered by "eligible nonprofit organizations." A NPO seeking to administer education savings accounts is required to apply to DFA for initial or renewal certification. The ESAs would be funded by "eligible taxpayer contributions" made to eligible NPO's in exchange for income tax credits. This bill creates \$10M in state income tax credits and carry forwards for later tax years. The bill provides that the available tax credits for years subsequent to 2017 will increase in an amount equal to the foundation funding level required for ten percent of the applicants for ESAs still on a waiting list.

This bill will have a significant impact on DFA as it will be required to certify a NPO's eligibility within 60 days of submission of an application. DFA will also be required to review the annual financial audit of every eligible NPO within 30 days of receipt of the audit. An analysis of the bill's tax issues especially in relation to carry forwards of individual and corporate income tax matters demonstrates the significant amount of additional duties the bill requires of the DFA. Not only will these duties require an expansion of additional DFA personnel and physical resources, such an expansion will require many resources that are outside the DFA's existing expertise. The implementation of this bill will have a significant impact on DFA.

This bill contains an emergency clause and shall become effective retroactively for tax years beginning on or after January 1, 2017.