

FISCAL ANALYSIS MEMORANDUM

[This confidential fiscal memorandum is a fiscal analysis of a draft bill, amendment, committee substitute, or conference committee report that has not been formally introduced or adopted on the chamber floor or in committee. This is not an official fiscal note. If upon introduction of the bill you determine that a formal fiscal note is needed, please make a fiscal note request to the Fiscal Research Division, and one will be provided under the rules of the House and the Senate.]

DATE: February 23, 2009

TO: Representative Stam

FROM: Kristopher Nordstrom
Fiscal Research Division

RE: Tax Credits for CWD_V2n1

FISCAL IMPACT (\$ in millions)

	Yes (X)	No ()	No Estimate Available ()		
	<u>FY 2009-10</u>	<u>FY 2010-11</u>	<u>FY 2011-12</u>	<u>FY 2012-13</u>	<u>FY 2013-14</u>
<u>STATE IMPACT</u>					
Revenue (tax credits):	(\$1.7) to (\$8.3)	(\$3.4) to (\$16.8)	(\$3.4) to (\$17.1)	(\$3.5) to (\$17.3)	(\$3.5) to (\$17.5)
Operational Savings:	\$0	\$4.6 to \$22.9	\$4.7 to \$23.3	\$4.7 to \$23.6	\$4.8 to \$23.9
Net State Impact:	(\$1.7) to (\$8.3)	\$1.2 to \$6.1	\$1.2 to \$6.2	\$1.3 to \$6.3	\$1.3 to \$6.4
Trnsf. Out Gen Fund:	N/A	(\$1.1) to (\$5.6)	(\$1.1) to (\$5.7)	(\$1.2) to (\$5.8)	(\$1.2) to (\$5.8)
Trnsf. In Spec. Ed. Fund:	N/A	\$1.1 to \$5.6	\$1.1 to \$5.7	\$1.2 to \$5.8	\$1.2 to \$5.8
Net State Impact	N/A	\$0	\$0	\$0	\$0
<u>LEA IMPACT</u>					
Revenue:	N/A	N/A	N/A	N/A	N/A
Operational Savings:	N/A	\$1.1 to \$5.3	\$1.1 to \$5.4	\$1.1 to \$5.5	\$1.1 to \$5.6
Net LEA Impact:	N/A	\$1.1 to \$5.3	\$1.1 to \$5.4	\$1.1 to \$5.5	\$1.1 to \$5.6
<u>POSITIONS</u>					
(cumulative):	N/A	N/A	N/A	N/A	N/A
PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: North Carolina Department of Revenue, North Carolina Department of Public Instruction, Local Public Schools					
EFFECTIVE DATE: This bill is effective for taxable years beginning January 1, 2009, and applies to semesters beginning on or after July 1, 2009. This act expires December 31, 2013.					

BILL SUMMARY: The legislation creates a new tax credit for parents of children with special needs who choose to educate those children in a nonpublic school or in a public school at which tuition is charged per G.S. 155C-366.1. The credit amount is set at \$3,000 per semester, up to two semesters a year (a maximum of \$6,000 for a full academic or taxable year). The credit is refundable, and is capped at the associated tuition cost.

To qualify for the tax credit, the taxpayer must be able to deduct a personal exemption for an “eligible dependent child.” An “eligible dependent child” is one who:

1. has been determined, based on an evaluation conducted by the appropriate public school system, to be a child with special needs who requires special instructional or therapeutic services outside of the regular classroom on at least at daily basis; and

2. was enrolled in and attended at least two semesters in a public school in the immediately preceding taxable year prior to first receiving the tax credit.

The legislation also amends G.S. 115-C to create the Fund for Special Education and Related Services (“the Fund”). The Fund will be a special revenue fund under the control of the State Board of Education. Revenue of the Fund will be used only for special educational and related services for children with disabilities. Revenue for the Fund will come from a transfer at the end of each fiscal year, beginning in fiscal year 2010-11, from income tax revenue, equal to the number of credits taken under this act multiplied by \$2,000.

ASSUMPTIONS AND METHODOLOGY:

Overview

The impact of the bill is dependent entirely on choices made by parents of children who have special educational needs meeting the criteria specified in the bill. As there is no data available regarding elasticity of demand for the specific educational circumstances for which the tax credit is granted, this analysis must make an effort to estimate, using available data, potential public behavior in the presence of the new law.

Eligible Students Transferring out of Public Schools

This analysis assumes that 1% to 5% of eligible children will take advantage of the tax credit proposed by this bill. The only data from which some inferences might be drawn comes from Florida’s McKay Scholarship Program for Students with Disabilities. This program, begun in 2000, gives parents a scholarship for any special needs student in the Florida public schools to shift out of the public system to a private school, or to transfer to a different public school. During the 2007-08 school year scholarship amounts averaged \$7,295.¹ Program data suggests that approximately 5% of eligible students participate in the program in 2007-08. While there are differences between the Florida program and the program proposed by this bill (level of support, application process, marketing, etc.), the Florida experience provides the best available insight into potential usage of the proposed North Carolina tax credit. Therefore, presents a range for participation of eligible students of 1% to 5%.

In April 2008, DPI identified 179,321 school-aged children as having special educational needs that warrant an individualized education program (IEP). DPI estimates that approximately 30% of students in public schools with IEPs require special instructional and/or therapeutic services outside the regular classroom at least daily. Applying this percentage to the 179,321 students with IEPs produces an estimated pool of 53,796 students that would potentially be eligible for the \$3,000 per semester tax credit.

While each transfer would decrease State revenue (in the form of the tax credit), it would also reduce State and local expenditures, as State and local school systems would no longer be financially responsible for educating the child for which the credit was granted.

¹ Actual scholarship amounts ranged, depending on the child’s disability, from \$5,160 to \$21,769.

The estimated reduction in State expenditure per child using the tax credit is \$8,296, and the estimated reduction in local expenditures per child using the tax credit is \$1,934. The FY 2008-09 State average transfer of appropriation to charter schools of \$4,909 per child serves as a reasonable proxy for the total avoided annual State operational expenditure for a student who transfers out of a typical public school. The per child supplemental appropriation of \$3,387 for each child with special needs (for up to 12.5% of a school system's population) serves as a reasonable proxy for the additional State average expenditure for a child with special needs. A total of \$8,296 is therefore used as a proxy for the average operational "savings" to the State that results from a student with an IEP transferring (i.e., withdrawing) from the public schools. State average local expenditure per child for operational expenses is \$1,934.

Applying all of the above figures related to potential transfers from public schools produces the following estimate of potential annualized savings to State and local governments. Note that timing issues affect the first-year fiscal impact in two ways:

1. The maximum tax credit granted in April 2010 is \$3,000, reflecting those students moving out of public schools during the Fall 2009 semester.² In future years, the full tax credit of \$6,000 per year is used.
2. State and local governments do not realize savings from reduced expenditures until the 2010-11 school year. This delay is because allotted average daily membership (ADM) is based off of the higher of projected ADM or prior year actual ADM. Therefore, the reduced enrollment experienced in the 2009-10 school year will impact allotted ADM – and therefore State and local budgeting decisions – in the 2010-11 school year.

² For simplicity's sake, this analysis assumes that all taxes are filed, and credits granted, in April.

Estimated Fiscal Impact on State and LEAs

	2009-10***		2010-11		2011-12		2012-13		2013-14****	
Identified Children with IEPs*	184,377		186,958		189,575		192,229		194,920	
% of Children Meeting Elig. Reqs.	30%		30%		30%		30%		30%	
Eligible Student Pool	55,313		56,087		56,873		57,669		58,476	
Usage Percent	1%	5%	1%	5%	1%	5%	1%	5%	1%	5%
Tax Credits Granted	553	2,766	561	2,804	569	2,844	577	2,883	585	2,924
Cost of Tax Credits (lost State Rev.)	(\$1,659,000)	(\$8,298,000)	(\$3,366,000)	(\$16,824,000)	(\$3,414,000)	(\$17,064,000)	(\$3,462,000)	(\$17,298,000)	(\$3,510,000)	(\$17,544,000)
State Exp. Per Eligible Student	\$8,296	\$8,296	\$8,296	\$8,296	\$8,296	\$8,296	\$8,296	\$8,296	\$8,296	\$8,296
Reduced Public School Expenditures**	N/A	N/A	\$4,587,688	\$22,946,736	\$4,654,056	\$23,261,984	\$4,720,424	\$23,593,824	\$4,786,792	\$23,917,368
Net Fiscal Impact on State	(\$1,659,000)	(\$8,298,000)	\$1,221,688	\$6,122,736	\$1,240,056	\$6,197,984	\$1,258,424	\$6,295,824	\$1,276,792	\$6,373,368
LEA Exp. Per Eligible Student	\$1,934	\$1,934	\$1,934	\$1,934	\$1,934	\$1,934	\$1,934	\$1,934	\$1,934	\$1,934
Reduced LEA Expenditures**	N/A	N/A	\$1,069,502	\$5,349,444	\$1,084,974	\$5,422,936	\$1,100,446	\$5,500,296	\$1,115,918	\$5,575,722
Net Fiscal Impact on LEAs	\$0	\$0	\$1,069,502	\$5,349,444	\$1,084,974	\$5,422,936	\$1,100,446	\$5,500,296	\$1,115,918	\$5,575,722

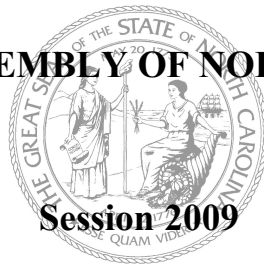
*Grows by 1.4% per year to reflect average growth in ADM

**Because allotted ADM is based off of the higher of projected ADM or prior year actual ADM, savings from reduced expenditures are not realized until the 2010-11 school year.

***Maximum tax credit in FY09-10 is \$3,000. Maximum tax credit in all future years is \$6,000.

****This act expires December 31, 2013. It is assumed that children generating a tax credit in the Fall 2013 semester will remain out of assigned public school through the Spring 2014 semester.

GENERAL ASSEMBLY OF NORTH CAROLINA



Fund for Special Education and Related Services

There is no *net* fiscal impact associated with the creation of the Fund. This bill simply transfers monies into the Fund that would have otherwise ended up in the General Fund. Because both the Fund and the General Fund are State resources, there is no net fiscal impact.

TECHNICAL CONSIDERATIONS:

There are many technical considerations that should be considered as this fiscal note is based on a number of assumptions. The fiscal impact presented here is an estimate, and any number of factors could move the fiscal impact up or down in a significant way.

Evaluations

The bill requires that, in order to be eligible for the credit, a child be determined through evaluation by the public schools to need an IEP that requires special instructional and/or therapeutic services for the child outside the regular classroom on at least a daily basis. If one assumes that the tax credit created by the bill is a sufficient incentive for some number of parents of current public school students to seek evaluation in order to obtain eligibility for the tax credit, one must assume that the number of evaluations conducted by the public schools will increase. No data exists, however, on which to base an estimate of such additional evaluations. Given an average cost to the public schools of \$1,500 per evaluation, the cost of additional evaluations could be significant. This analysis does not account for this potential cost. To the extent that evaluations do increase substantially as a result of the bill, this analysis therefore understates costs and overstates net savings created by the bill.

Tuition Costs

Not all private school tuitions are greater than \$6,000 per year. It is possible that there would be a number of tax credit recipients for whom the tuition and other educational and therapeutic expenses would be less than \$6,000 per year. If a substantial number of children will not receive the full tax credit, then this analysis understates the net savings created by this bill.

Gaming the System

It is possible, but unlikely, that some parents of potentially eligible children who have never attended public schools would enroll their children in public schools for the required two semesters in order to then be able to avail themselves of the credit in a subsequent year. It seems unlikely, however, that a significant number of parents who have already made a decision not to send their children to public schools would make this choice, even in the face of potential financial gain. The analysis therefore assumes that any costs associated with this group of children will be negligible. To the extent that this assumption is incorrect, the analysis will understate total cost and overstate total savings created by the bill.

SOURCES OF DATA: North Carolina Department of Public Instruction (DPI), Florida's McKay Scholarship Program.