

# GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2011

## Legislative Fiscal Note

**BILL NUMBER:** House Bill 344 (First Edition)

**SHORT TITLE:** Tax Credits for Children with Disabilities.

**SPONSOR(S):** Representatives Stam, Randleman, Jordan, and Jones

<b>FISCAL IMPACT (\$ in millions)</b>					
	<b>Yes (X)</b>	<b>No ( )</b>	<b>No Estimate Available ( )</b>		
	<b><u>FY 2011-12</u></b>	<b><u>FY 2012-13</u></b>	<b><u>FY 2013-14</u></b>	<b><u>FY 2014-15</u></b>	<b><u>FY 2015-16</u></b>
<b><u>STATE IMPACT</u></b>					
Revenue (tax credits):	(\$14.4)	(\$29.3)	(\$29.7)	(\$30.1)	(\$30.5)
<u>Operational Savings:</u>	<u>\$0</u>	<u>\$39.3</u>	<u>\$39.8</u>	<u>\$40.4</u>	<u>\$40.9</u>
<b>Net State Impact:</b>	<b>(\$14.4)</b>	<b>\$10.0</b>	<b>\$10.1</b>	<b>\$10.3</b>	<b>\$10.4</b>
Trnsf. Out Gen Fund:	N/A	(\$9.8)	(\$9.9)	(\$10.0)	(\$10.2)
<u>Trnsf. In Spec. Ed. Fund:</u>	<u>N/A</u>	<u>\$9.8</u>	<u>\$9.9</u>	<u>\$10.0</u>	<u>\$10.2</u>
<b>Net State Impact</b>	<b>N/A</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>
<b><u>LEA IMPACT</u></b>					
Revenue:	N/A	N/A	N/A	N/A	N/A
<u>Operational Savings:</u>	<u>N/A</u>	<u>\$9.3</u>	<u>\$9.4</u>	<u>\$9.6</u>	<u>\$9.7</u>
<b>Net LEA Impact:</b>	<b>N/A</b>	<b>\$9.3</b>	<b>\$9.4</b>	<b>\$9.6</b>	<b>\$9.7</b>
<b><u>POSITIONS</u></b>					
<b>(cumulative):</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>
<b>NOTE:</b> This fiscal note relies on numerous assumptions that could result in the actual fiscal impact differing significantly from the numbers in the table above. Please see Assumptions & Methodology for likely ranges of fiscal impact.					
<b>PRINCIPAL DEPARTMENT(S) &amp; PROGRAM(S) AFFECTED:</b> North Carolina Department of Revenue, North Carolina Department of Public Instruction, Local Public Schools					
<b>EFFECTIVE DATE:</b> This bill is effective for taxable years beginning January 1, 2011, and applies to semesters beginning on or after July 1, 2011. Certain changes to tax credit eligibility become effective January 1, 2016, and apply to semesters beginning on or after July 1, 2016.					

**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 an Individualized Education Plan (IEP); and
2. was enrolled in and attended a public school for at least the two preceding academic semesters prior to first receiving the tax credit.

It is important to note that the second eligibility requirement is changed from two academic semesters to one academic semester beginning with semesters beginning on or after July 1, 2016.

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 2012-13, 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. The McKay Program is marketed to students and provides awards ranging from \$4,746 to \$19,133. During the 2009-10 school year scholarship amounts averaged \$7,144. Program data suggests that approximately 5% of eligible students participate in the program in 2009-10. Of course, there are differences between

the Florida program and the program proposed by this bill (level of support, application process, marketing, etc.) that would lead one to anticipate a higher participation in the Florida program than in the program proposed by this bill. Therefore, this analysis presents a range for participation of eligible students of 1% to 5%.

In April 2010, DPI identified 172,105 school-aged children as having special educational needs that warrant an individualized education program (IEP). It is important to remember that students must have enrolled in and attended at least two semesters in a public school prior to becoming eligible for the tax credit. This eligibility requirement eliminates kindergarteners from being eligible for the tax credit. Therefore, this analysis removes kindergarten students from the pool of eligible students. This leaves an estimated pool of 158,371 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.

The estimated reduction in State expenditure per child using the tax credit is \$8,160, and the estimated reduction in local expenditures per child using the tax credit is \$1,931. The FY 2010-11 State average transfer of appropriation to charter schools of \$4,562 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 \$3,599 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 \$8,160 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 to a nonpublic school. The average local expenditure per child for operational expenses is \$1,931.

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 2012 is \$3,000, reflecting those students moving out of public schools during the Fall 2011 semester.<sup>1</sup> 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 2012-13 fiscal 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 2011-12 school year will impact allotted ADM – and therefore State and local budgeting decisions – in the 2012-13 school year.

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<sup>1</sup> For simplicity's sake, this analysis assumes that all taxes are filed, and credits granted, in April.

## Estimated Fiscal Impact on State and LEAs

	2011-12***		2012-13		2013-14		2014-15		2015-16	
Eligible Student Pool*	160,541		162,740		164,970		167,230		169,521	
<b>Usage Percent</b>	<b>1%</b>	<b>5%</b>	<b>1%</b>	<b>5%</b>	<b>1%</b>	<b>5%</b>	<b>1%</b>	<b>5%</b>	<b>1%</b>	<b>5%</b>
Tax Credits Granted	1,605	8,027	1,627	8,137	1,650	8,249	1,672	8,362	1,695	8,476
Cost of Tax Credits (lost State Rev.)	(\$4,815,000)	(\$24,081,000)	(\$9,762,000)	(\$48,822,000)	(\$9,900,000)	(\$49,494,000)	(\$10,032,000)	(\$50,172,000)	(\$10,170,000)	(\$50,856,000)
State Exp. Per Eligible Student	\$8,160	\$8,160	\$8,160	\$8,160	\$8,160	\$8,160	\$8,160	\$8,160	\$8,160	\$8,160
Reduced Public School Expenditures**	N/A	N/A	\$13,096,800	\$65,500,320	\$13,276,320	\$66,397,920	\$13,464,000	\$67,311,840	\$13,643,520	\$68,233,920
<b>Net Fiscal Impact on State</b>	<b>(\$4,815,000)</b>	<b>(\$24,081,000)</b>	<b>\$3,334,800</b>	<b>\$16,678,320</b>	<b>\$3,376,320</b>	<b>\$16,903,920</b>	<b>\$3,432,000</b>	<b>\$17,139,840</b>	<b>\$3,473,520</b>	<b>\$17,377,920</b>
LEA Exp. Per Eligible Student	\$1,931	\$1,931	\$1,931	\$1,931	\$1,931	\$1,931	\$1,931	\$1,931	\$1,931	\$1,931
Reduced LEA Expenditures**	N/A	N/A	\$3,099,255	\$15,500,137	\$3,141,737	\$15,712,547	\$3,186,150	\$15,928,819	\$3,228,632	\$16,147,022
<b>Net Fiscal Impact on LEAs</b>	<b>\$0</b>	<b>\$0</b>	<b>\$3,099,255</b>	<b>\$15,500,137</b>	<b>\$3,141,737</b>	<b>\$15,712,547</b>	<b>\$3,186,150</b>	<b>\$15,928,819</b>	<b>\$3,228,632</b>	<b>\$16,147,022</b>

\*Grows by 1.37% per year to reflect the 10-year average growth in allotted 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 2012-13 school year.

\*\*\*Maximum tax credit in FY11-12 is \$3,000. Maximum tax credit in all future years is \$6,000.

## Estimated Fiscal Impact on State and LEAs -- MIDPOINT ESTIMATE

	2011-12***		2012-13		2013-14		2014-15		2015-16	
Eligible Student Pool*	160,541		162,740		164,970		167,230		169,521	
<b>Usage Percent</b>	<b>3.0%</b>	<b>3.0%</b>	<b>3.0%</b>	<b>3.0%</b>	<b>3.0%</b>	<b>3.0%</b>	<b>3.0%</b>	<b>3.0%</b>	<b>3.0%</b>	<b>3.0%</b>
Tax Credits Granted	4,816	4,882	4,882	4,882	4,950	4,950	5,017	5,017	5,086	5,086
Cost of Tax Credits (lost State Rev.)	(\$14,448,000)	(\$29,292,000)	(\$29,292,000)	(\$29,292,000)	(\$29,697,000)	(\$29,697,000)	(\$30,102,000)	(\$30,102,000)	(\$30,513,000)	(\$30,513,000)
State Exp. Per Eligible Student	\$8,160	\$8,160	\$8,160	\$8,160	\$8,160	\$8,160	\$8,160	\$8,160	\$8,160	\$8,160
Reduced Public School Expenditures**	N/A	N/A	\$39,298,560	\$39,298,560	\$39,837,120	\$39,837,120	\$40,387,920	\$40,387,920	\$40,938,720	\$40,938,720
<b>Net Fiscal Impact on State</b>	<b>(\$14,448,000)</b>	<b>(\$14,448,000)</b>	<b>\$10,006,560</b>	<b>\$10,006,560</b>	<b>\$10,140,120</b>	<b>\$10,140,120</b>	<b>\$10,285,920</b>	<b>\$10,285,920</b>	<b>\$10,425,720</b>	<b>\$10,425,720</b>
LEA Exp. Per Eligible Student	\$1,931	\$1,931	\$1,931	\$1,931	\$1,931	\$1,931	\$1,931	\$1,931	\$1,931	\$1,931
Reduced LEA Expenditures**	N/A	N/A	\$9,299,696	\$9,299,696	\$9,427,142	\$9,427,142	\$9,557,485	\$9,557,485	\$9,687,827	\$9,687,827
<b>Net Fiscal Impact on LEAs</b>	<b>\$0</b>	<b>\$0</b>	<b>\$9,299,696</b>	<b>\$9,299,696</b>	<b>\$9,427,142</b>	<b>\$9,427,142</b>	<b>\$9,557,485</b>	<b>\$9,557,485</b>	<b>\$9,687,827</b>	<b>\$9,687,827</b>

\*Grows by 1.37% per year to reflect the 10-year average growth in allotted 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 2012-13 school year.

\*\*\*Maximum tax credit in FY11-12 is \$3,000. Maximum tax credit in all future years is \$6,000.

### **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.

### **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.

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**Signed Copy Located in the NCGA Principal Clerk's Offices**