Department of Finance and Administration

Legislative Impact Statement

Bill: HB1371
Bill Subtitle: TO CREATE THE ARKANSAS CHILD ACADEMIC OPPORTUNITY SCHOLARSHIP AND GRANT ACT.

Basic Change :

HB1371 creates the Arkansas Child Academic Opportunity Scholarship and Grant Act, which provides grants for eligible public schools and scholarships to enable eligible students to attend nonpublic schools.

HB1371 provides an income tax credit to individuals or businesses equal to 100% of contributions to eligible student support organizations that fund the grants and scholarships. The credit may not exceed an eligible taxpayer's income tax due. Unused income tax credits may be carried forward for five years. Spouses who file separate returns may each claim one-half of the credit. Contributions made before the 15th day of the fourth month of the tax year may apply as a credit to either the current year or the previous year.

The Act would become effective for tax years beginning on or after January 1, 2022.

Revenue Impact :

FY2023 – Up to $10 million reduction to State General Revenue.

[Initially, the total amount of state income tax credits under HB1371 shall not exceed a cap of $10 million. However, HB1371 provides that the $10 million amount can increase by 25% for the following year if 90% or more of the credits are utilized.]

Taxpayer Impact :

Funds received are not taxable income of a parent or an eligible student.

Resources Required :

The Division of Elementary and Secondary Education (DESE) may require additional staff to implement and administer the program including staff to perform initial certification and renewal of certification of eligible student support organizations.

The Tax Credits Section of the Department of Finance and Administration (DFA) would require additional staff to review applications and to determine limitation amounts available for later years. Anticipated staff needed are as follows (total additional personnel cost of $465,000 per year):

- One DFA Revenue Manager 2 or higher to monitor tax credits established and claimed for purposes of allocating the $10 million first year tax credit limit and limits established in future years, and to supervise other personnel needed to administer program and coordinate with the Department of Education. - $90,000 per year.
- One Audit Supervisor to supervise audit staff. - $75,000 per year
- Three Auditors to review audits of eligible non-profit organizations. - $200,000 per year.
- Two Fiscal Support Analysts to help with any extra duties and support audit staff members. - $100,000 per year.

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Time Required :

Adequate time is provided for implementation.

Procedural Changes :

DESE shall promulgate rules necessary to implement the program and produce the required annual report. DFA would update the forms and publications necessary for taxpayers to claim the new tax credit.

Other Comments :

Annual reports will be published by DESE of the participation in and performance of the Arkansas Child Academic Opportunity Scholarship and Grant Act program. Participating nonpublic schools will not be subject to the regulatory authority of the State Board of Education.

An eligible public school is defined as one with 55% of the enrollment receiving free and reduced-price lunches. The average school district in Arkansas has 73.3% of students on free or reduced-price lunches and currently approximately 75% or 198 school districts meet the threshold and are eligible to receive grants.

An eligible student must have a household or family income that is less than or equal to 200% of the federal poverty guidelines. Over 300,000 Arkansas students receive free and reduced-price lunches at or below the 185% threshold. Currently 200% of the federal poverty guidelines is less than $52,400 for a household of four and $34,480 for a household of two.

Each eligible student support organization will be audited annually by an independent certified public accountant licensed in this state and provide a copy of the report to the state. No more than 10% of eligible contributions may be used for administrative expenses and at least 75% must be expended or reserved for eligible school payments. No more than 25% may be carried forward to the following fiscal year.

Of the $10 million in state income tax credits, $6 million shall be allotted for public school payments and $4 million for allotted for eligible private school payments. An eligible contribution for which a state tax credit is claimed that is made on or before the fifteenth day of the fourth month following the close of the tax year may apply either to the current or proceeding tax year.

Legal Analysis :

HB1371 provides that an eligible student support organization (SSO) may establish grants for eligible public schools and scholarships to enable eligible students to attend nonpublic schools. The SSO must satisfy various criteria outlined in the bill and must file an application with the Division of Elementary and Secondary Education (DESE) by May 1 before the academic year for which the SSO intends to provide grants or fund scholarships. Within 60 days after receipt of the application, the DESE must certify the eligible SSO if it meets all necessary requirements. The SSO must prepare quarterly reports

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and must conduct annual audits of all public school grant accounts and nonpublic school student scholarship accounts.

The SSO must maintain separate accounts for eligible private school payment funds, eligible public school payment funds, student scholarship funds for each student, and operating funds of the organization. The SSO must develop a system for direct payment by electronic funds transfer, automatic clearing house transfer, or other payment method.

With respect to the public school grants, a public school that satisfies certain statutory criteria may apply for a grant administered by the SSO. The public school must use the grant funds for one or more expenditures included in the bill. Examples of allowed expenditures include public school technology enhancements, building upgrades, and remote learning intervention platform technology. The SSO must disburse grant funds directly to the eligible public school.

With respect to the nonpublic school scholarships, parents may apply to an SSO to establish a scholarship account for an eligible student at an approved nonpublic school. The bill identifies a set of eligible education expenses for which scholarship funds are available. The SSO must approve student applications by order of receipt. The SSO may fund for each eligible student an equivalent amount of the foundation funding amount as provided in state law for each academic year. For the 2020-2021 school year, that amount was $6,899. The SSO must disburse nonpublic school scholarship amounts to the nonpublic school that the student attends in quarterly installments. Scholarship funds will not be taxable income of a parent or eligible student.

Taxpayers who make eligible contributions to an SSO will receive a state income tax credit equal to 100% of the contribution amount. The taxpayer may use the credit to offset up to 100% of the income tax due for the tax year. The taxpayer may carry forward unused credits for five consecutive tax years following the tax year in which the taxpayer earned the credit. The bill is effective for tax years 2022 and following.

HB1371 initially limits the available tax credit beginning in 2021 to $10 million, including tax credits carried forward from previous years. Of that $10 million, the allotment for eligible contributions to public school grants is $6 million, and the allotment for eligible contributions to nonpublic school scholarships is $4 million. In any fiscal year in which the claimed tax credit amount is equal to or greater than 90% of the $6 million dollar cap for public school grants, the $6 million cap will increase by 25% for the following fiscal year. In any fiscal year in which the claimed tax credit amount is equal to or greater than the $4 million cap for private school scholarships, the $4 million cap will increase by 25% for the following fiscal year.

DFA and DESE must publish information on their respective websites that identifies the tax credit cap when it increases. DFA must adopt rules necessary to allocate the tax credits on a first-come, first-served basis. The DESE must adopt a rule that establishes the forms for a tax credit application.

The bill provides that DFA must adopt rules to allocate the tax credits on a first-come, first-served basis. It is possible that taxpayers will make a contribution but not be entitled to the credit because the $10 million limit has been reached. DFA would need to adopt rules as to whether the taxpayer would be able to reapply for the credit during the next tax year.

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Drafting concerns:

Beginning on page 26, line 28, § 26-51-515(c)(2)(A), the bill states that the $10 million credit cap will take effect "beginning with tax year 2021." However, section 7 of the bill provides that it is effective for tax years beginning on or after January 1, 2022. Proposed § 26-51-515(c)(2)(A) should likely be amended to read that the $10 million cap will take effect "beginning with tax year 2022."

Beginning on page 27, line 25, § 26-51-515(c)(2)(E), the phrase "identifying the tax credit cap when it is increased" likely should read "identifying the amount of the tax credit cap when it is increased."

Beginning on page 28, line 21, § 26-51-515(h), the bill requires that DESE must adopt a rule that establishes the forms for a tax credit application. DFA likely will need to coordinate with DESE on rules involving procedures for claiming the tax credit.

This bill does not contain an emergency clause. The bill states that the act will become effective for tax years beginning on or after January 1, 2022.