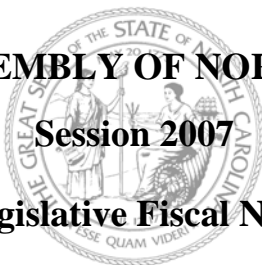


GENERAL ASSEMBLY OF NORTH CAROLINA



Session 2007

Legislative Fiscal Note

BILL NUMBER: House Bill 388 (First Edition)

SHORT TITLE: Tax Credits for Children with Special Needs.

SPONSOR(S): Representatives Lucas, Stam, Glazier, and Wiley

FISCAL IMPACT					
	Yes (X)	No ( )	No Estimate Available ( )		
	<u>FY 2007-08</u>	<u>FY 2008-09</u>	<u>FY 2009-10</u>	<u>FY 2010-11</u>	<u>FY 2011-12</u>
<b>REVENUES:</b>					
<b>EXPENDITURES:</b>	<b>**See Assumptions and Methodology Section for explanation of the estimated range of possible effects on Revenue and Expenditures at both the State and County levels**</b>				
<b>POSITIONS (cumulative):</b>					
<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>	Section 1 is effective for taxable years beginning on or after January 1, 2007 and applies to semesters beginning on or after July 1, 2007. The remainder becomes effective July 1, 2007.				

**BILL SUMMARY:** The legislation creates a new tax credit for parents of children with special needs who choose to educate those children in private school or through a home school. The credit amount is set at \$3,000 per semester, up to two semesters a year. The credit also applies if the child attends a public school where tuition is charged, but the credit is capped at the associated tuition cost. To qualify a student must be 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. In addition, the child must have attended a public school for at least two semesters in one year. The taxpayer must be able to claim a personal exemption for the child in order to claim the credit. The credit is refundable. The legislation also allows local county commissioners to offer up to \$500 to a parent of a qualifying child with special needs if that child is educated in a nonpublic school.

## **ASSUMPTIONS AND METHODOLOGY:**

### **Overview**

The impact of the bill is dependent entirely on choices made by parents of children who may have special educational needs that meet 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 data that is available, potential public behavior in the presence of the new law.

Three types of taxpayers could benefit from the bill: (1) those taxpayers with eligible children in private schools, (2) those who home school their eligible children, and (3) those whose children are currently enrolled in public school but who might transfer their children to private schools or home school after passage of the bill. The bill's potential fiscal impact depends primarily on how many children from each of these groups might meet the eligibility requirements described in the bill. The following subsections describe how each pool of eligible children is estimated, and how net costs or savings associated with each pool contributes to the total net fiscal impact of the bill.

### **Eligible Students Currently in Private Schools and Home Schools**

There is no data available regarding the exact number of students who: (a) have spent two semesters in public schools, (b) were identified as requiring special instructional and/or therapeutic services outside the regular classroom at least daily, and (c) are no longer attending public schools. It seems reasonable however to assume that some number of children would fit this description, therefore entitling their parents to file for the credit created by the bill. The analysis attempts to estimate this population using exit data and an estimated percentage of children with IEPs who fit the specific daily service requirements of the bill.

The NC Department of Public Instruction (DPI) reports that in FY 2004-05, 2,890 students with individualized education programs (IEPs) dropped out of the public schools. Based on data provided by DPI, this analysis assumes that approximately 20-40% of students in public schools who have been identified as having special needs require special instructional and/or therapeutic services outside the regular classroom at least daily. Applying this percentage to the drop out population produces a range of 578-1,156 students whose families would be eligible for the tax credit if they sent their children to private school or registered their homes as home schools. These totals produce a range of potential cost to the State of \$3,468,000 - \$6,936,000. Since these students are not currently in the public schools, the effect of their families' participation in the credit program would not produce any reduced public expenditures. The cost figures above would therefore represent the net fiscal impact of the bill associated with this group.

It is possible 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.

### **Eligible Students Transferring from the Public Schools**

Given the amount of the tax credit created by the bill and the private educational or therapeutic services that could be purchased with that sum of money, some parents of children with special needs may choose to transfer students out of the public school system into other educational settings. Unfortunately, no data exists on price elasticity of demand for private school and home school education specifically for children with special needs. The only data from which some inferences might be drawn comes from Florida's McKay Scholarship Program for Students with Disabilities. This program gives parents a voucher 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 2005-06 school year voucher amounts ranged from \$4,805 to \$20,703, with an average payment of \$6,897, depending on the child's disability. Program data suggests that approximately 4.0% of eligible students participate in the program. While this experience may provide some insight into usage of the NC credit, however, the substantial differences between the Florida and NC initiatives (particularly, the amount of State support provided to families) suggest that using the 4% figures as a proxy would be inappropriate. Thus a simulation is used to show the potential fiscal impact of transfers on education funding. The analysis contemplates the effects of 1%, 5%, and 10% of eligible students transferring.

DPI indicates that in 2005-06 approximately 12.6% of public school students, or 197,564 children, are identified as having special educational needs that warrant an IEP. As mentioned above, DPI also estimates that approximately 20-40% of students in public schools who have been identified as having special needs require special instructional and/or therapeutic services outside the regular classroom at least daily. Applying these percentages to the 197,564 students with IEPs produces an estimated pool of students who would be eligible for the \$3,000 per semester credit should their parents transfer them to private or home school settings.<sup>1</sup> While each transfer would cost the State revenue, 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 FY 2005-06 State average transfer of appropriation to charter schools of \$4,043.36 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 \$2,935.60 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 \$6,978.96 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. Based on data regarding State average contribution per child to local school systems for capital expenditures, the analysis assumes further State savings of \$131.39 per transferring student for capital expenditures. State average local expenditure per child for operational expenses is \$1,464.09 and average local per child expenditure for capital is \$730.73.

Applying all of the above figures related to potential transfers from public schools produces the following range of potential annualized maximum savings to State and local governments in FY

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<sup>1</sup> For the sake of simplicity, the analysis assumes that any child in the count of children with IEPs in 2005-06 will have spent two semesters attending public schools in time to be considered eligible for tax year 2007.

2008-09 (only 2007-08 calculations are shown; note that credit amount assumed is \$6,000 in order to represent annualized cost; cost in 2007-08 would actually be roughly half of what appears):

<b>Estimated Annualized Fiscal Impact: Potential Transfers from the Public Schools</b>			
	<b>Potential Transfers: 2007-08</b>		
	<b>1%</b>	<b>5%</b>	<b>10%</b>
Total Students with Special Needs in Public Schools (2005-06 actual)	197,564	197,564	197,564
Potential Transfer Students	1,976	9,878	19,756
Adj. for daily services requirement (low end of range: 20%)	395	1,976	3,951
Adj. for daily services requirement (high end of range: 40%)	790	3,951	7,903
<b>Cost of Credit (low max)</b>	<b>\$ (2,370,768)</b>	<b>\$ (11,853,840)</b>	<b>\$ (23,707,680)</b>
<b>Cost of Credit (high max)</b>	<b>\$ (4,741,536)</b>	<b>\$ (23,707,680)</b>	<b>\$ (47,415,360)</b>
State Operational Savings (low max)	\$ 2,757,583	\$ 13,787,913	\$ 27,575,825
State Capital Savings (low max)	\$ 51,916	\$ 259,579	\$ 519,159
<b>Total State Savings (low)</b>	<b>\$2,809,498</b>	<b>\$14,047,492</b>	<b>\$28,094,984</b>
State Operational Savings (high )	\$ 5,515,165	\$ 27,575,825	\$ 55,151,650
State Capital Savings (high)	\$ 103,832	\$ 519,159	\$ 1,038,317
<b>Total State Savings (high)</b>	<b>\$5,618,997</b>	<b>\$28,094,984</b>	<b>\$56,189,967</b>
<b>NET TO STATE (low)</b>	<b>\$438,730</b>	<b>\$2,193,652</b>	<b>\$4,387,304</b>
<b>NET TO STATE (high)</b>	<b>\$877,461</b>	<b>\$4,387,304</b>	<b>\$8,774,607</b>
Local Operational Savings (low)	\$ 578,503	\$ 2,892,515	\$ 5,785,030
Local Capital Savings (low)	\$ 288,732	\$ 1,443,659	\$ 2,887,319
<b>NET LOCAL SAVINGS (low)</b>	<b>\$ 867,235</b>	<b>\$ 4,336,174</b>	<b>\$ 8,672,348</b>
Local Operational Savings (high)	\$ 1,157,006	\$ 5,785,030	\$ 11,570,059
Local Capital Savings (high)	\$ 577,464	\$ 2,887,319	\$ 5,774,638
<b>NET LOCAL SAVINGS (high)</b>	<b>\$ 1,734,470</b>	<b>\$ 8,672,348</b>	<b>\$ 17,344,697</b>

## 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. The analysis does not account for this potential cost. To the extent that evaluations do increase substantially as a result of the bill, the analysis therefore understates costs and overstates savings created by the bill.

**Other Local Funds**

The legislation also allows a local board of county commissioners to appropriate funds for the educational expenses of children with special needs who are in non-public schools. The amount appropriated may not exceed \$500 per year per child. Because the language is discretionary, no estimate of fiscal impact is possible. It should be noted, however, that any appropriations of this type would reduce the savings to local governments produced by students transferring out of the public schools.

**Summary of Estimated Fiscal Impact (State Only)**

The chart below aggregates the various sub-analyses discussed above. Specifically, the chart summarizes the potential net fiscal impact of the bill if one assumes that approximately 20-40% of public school and home and private school students identified with special needs will meet the daily service requirement needed to be eligible for the tax credit:

<b>Summary of Estimated Annualized Fiscal Impact (State): Low and High Maximums (20-40% of Students with IEPs Qualify)</b>		
	<b>20%</b>	<b>40%</b>
NET Cost/Savings Generated by:		
Private & Home School Students	\$ (3,468,000)	\$ (6,936,000)
Public School Students		
Assumed transfers: 1%	438,730	877,461
5%	2,193,652	4,387,304
10%	4,387,304	8,774,607
Additional Evaluations	Not Known	Not Known
<b>Estimated Total NET Fiscal Impact</b>		
<b>Assumed transfers: 1%</b>	<b>\$ (3,029,270)</b>	<b>\$ (6,058,539)</b>
<b>5%</b>	<b>\$ (1,274,348)</b>	<b>\$ (2,548,696)</b>
<b>10%</b>	<b>\$ 919,304</b>	<b>\$ 1,838,607</b>

**TECHNICAL CONSIDERATIONS:**

A number of technical considerations must be noted when considering the degree to which transfers out of public schools would affect public school expenditures. In particular, the distribution of transfer students across school systems and across schools within a given system would affect what savings would be realized, and the timing of any savings realized, by the schools or the State as a result of the transfers. Both operational and capital expenditures are less sensitive to marginal changes in numbers of students served than the “dollars per student” simplifications used in the analysis imply.

**SOURCES OF DATA:** North Carolina Department of Public Instruction (DPI), North Carolina Association of Independent Schools, the National Association of Independent Schools, individual private schools, North Carolina Division of Non-Public Education (DNPE), U.S. Department of Education's National Center for Education Statistics, National Challenged Home School Association (NATHAN), Florida's McKay Scholarship Program, the Manhattan Institute.

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