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BILL ANALYSIS

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House Bill 5404 (Substitute H-1 as discharged)
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Sponsor: Representative Bryan Posthumus (H.B. 5404)
Representative Phil Green (H.B. 5405)
House Committee: Education
Senate Committee: Education and Career Readiness (discharged)

CONTENT

House Bill 5404 (H-1) would enact the "Student Opportunity Scholarship Act", which would do the following:

-- Require the Department of Treasury to establish a Student Opportunity Scholarship (SOS) program.
-- Require each scholarship-granting organization (SGO) to create a uniform process to determine the amount of funds to be allocated to each eligible student's SOS account.
-- Specify the qualifying education expenses for which SOS funds could be used.
-- Prohibit a school from charging an SOS student tuition or for services in an amount specific to SOS students or that was different than what would be charged to non-SOS students.
-- Specify that funds allocated to an SOS account and used for qualifying education expenses would not be considered taxable income to the parent or SOS student.
-- Allow unused funds to roll over until an SOS account was closed because of misuse of funds, withdrawal from the SOS program, specific increase in household income, or until the student completed high school or reached 19 years of age, or 26 years of age if the student had a disability.
-- Require unused funds within a closed SOS account to revert to the granting SOS or, if the granting SGO were not operating, to an operating SGO in good standing.
-- Prescribe the manner in which an SGO would have to prioritize funding SOS accounts.
-- Prohibit an SGO from accepting a contribution from any person that specified that the contribution would have to be awarded to a particular student, or from funding an SOS for dependents of its board of directors, its staff, or its donors.
-- Require a parent to submit an application to establish an SOS account for an eligible student and require the SGO to approve the application if certain requirements were met.
-- Prescribe the requirements an organization would have to meet to be certified or receive renewal certification as an SGO.
-- Require the Department to publish a list of SGOs on its website on or before January 1 of each year.
-- Require each SGO to implement a cost-effective and parent-friendly system for payment of qualifying education expenses from SOS accounts to education service providers.
-- Require each SGO to establish a process to approve education service providers.
-- Specify that if the Act were challenged in State court as violating the Michigan or United State Constitution, parents of students who would be eligible for the program could intervene in a lawsuit to defend the Act's constitutionality.

House Bill 5405 (H-1) would amend the Income Tax Act to do the following:

- -- Amend the definition of "taxable income" to include a deduction of funds allocated to an SOS account under the Student Opportunity Scholarship Program proposed under House Bill 5404 (H-1).
- -- Allow a taxpayer, for tax years beginning on or after January 1, 2022, to claim a tax credit against the taxes imposed under Parts 1 and 2 of the Income Tax Act in an amount up to 100% of the total amount of contributions made by the taxpayer during the tax years to one or more SGOs.
- -- Require a taxpayer to submit an application and contribution plan to the Department of Treasury for preapproval of the tax credit and prescribe the information that would have to be included in those documents.
- -- Require the Department to approve or deny a completed application within 10 business days after receiving it and to issue a preapproval letter to the applicant if the application were accepted.
- -- Specify that the total of all credits reserved under preapproval letters could not exceed $500.0 million for any State fiscal year.
- -- Require the tax credits available for the current State fiscal year to be increased by 20% if the total aggregate amount of tax credits approved for the previous fiscal year were equal to or greater than 90% of the total aggregate amount of all tax credits available for the previous year.
- -- Allow a credit that exceeded the taxpayer's tax liability for the tax year to be carried forward to offset tax liability in subsequent tax years or until used up, whichever occurred first.
- -- Prohibit a taxpayer from claiming a credit in excess of the amount of proposed contributions reflected on the preapproval letter.
- -- Require an SGO, within 10 days after receiving contribution, to notify the Department and issue a certificate of contribution to the taxpayer and require the taxpayer to attach a copy of the certificate to his or her annual return.
- -- Require the Department to include on its website the current amount of the total credit applications pending verification, the amount of the total credits allocated to date, and the remaining credit that was available to taxpayers that made contributions to SGOs.
- -- Require the Department, by November 1, 2023, and by each November 1 thereafter, to submit a report concerning the administration, operation, and fiscal impact of the SOS program and the corresponding credits to Legislature.

MCL 206.30 et al (H.B. 5405) Legislative Analyst: Dana Adams

FISCAL IMPACT

House Bill 5404 (H-1) would increase costs in the Department of Treasury to establish the Student Opportunity Scholarship Program. The costs likely would exceed current appropriation and would result from establishing the program, certifying SGOs, monitoring contributions made to an SGO, and providing annual reports on the program. The final costs to the Department would depend on the number of SGOs that sought certification and the level of contributions made to organizations.

To the extent the bill would provide new financial opportunities for low-income, disabled, or foster care students to attend nonpublic schools or home schools (rather than attending public schools), local units of government (schools) would see a decrease in State foundation allowance and categorical funding commensurate with the number of students who, because of the scholarships, unenrolled in public schools and enrolled in nonpublic or home schools. Similarly, the State would see lower costs for fewer pupils enrolled in public schools if the scholarships resulted in public school students' unenrolling and enrolling instead in nonpublic or home schools. However, the extent to which these financial opportunities would be available and used is unknown; therefore, a more precise fiscal impact estimate is indeterminable.

House Bill 5405 (H-1) would reduce State revenue by as much as $500.0 million in the first year it was effective, with the potential for the revenue loss to increase 20% per year in later years. Even excluding the provisions that would allow the maximum amount of credits to increase 20% in future years, carry-forward provisions would make it possible for the revenue reduction in any given year to exceed $500.0 million (or the respective cap for that tax year).

The revenue reduction would lower General Fund and School Aid Fund revenue. However, the impact on each fund would depend on both 1) the dollar value of credits claimed under the Corporate Income Tax (CIT) versus the Individual Income Tax (IIT), and 2) the degree to which claiming the credit under the IIT would lower annual and quarterly payments versus increasing refund claims. All credits claimed against the CIT would reduce General Fund revenue. Similarly, all refunds claimed under the IIT would reduce General Fund revenue. However, to the extent that a credit lowers gross collections (such as estimated or annual payments), 23.8% of the reduction will lower School Aid Fund revenue, while the remaining impact will reduce General Fund revenue. There is no information upon which to estimate either of these factors.

As an example of the potential splits between funds, assume that, because corporations generally exhibit larger tax liabilities and may have a greater ability to manage the cash flows necessary to take advantage of the credit, 60% of the dollar value of the credits would be claimed under the CIT. Furthermore, assume 80% of reduction in IIT revenue would be borne by the General Fund. Under these assumptions, if $500.0 million of credits were claimed, General Fund revenue would be reduced by $460.0 million and School Aid Fund revenue by $40.0 million. If instead 50% of the impact lowered CIT revenue and 60% of the IIT impact lowered General Fund revenue, the bill would reduce General Fund revenue by $350.0 million and School Aid Fund revenue by $150.0 million. As indicated earlier, there is no information upon which to make an estimate of how the bill's impact would be spread across tax types or between payment reductions and larger refunds.

Because the credit would be a 100% credit, the credit would be essentially costless to taxpayers beyond cash-flow constraints and the administrative requirements of the bill. As a result, there would be a high risk that a significant portion of each year's annual limit on credits would be approached, although the nonrefundable nature of the credit could reduce the likelihood of reaching the limit by an unknown magnitude.

If the cap on the maximum value of credits grew 20% per year, the cap would be $500.0 million in the first year, $600.0 million in the second year, $720.0 million in the third year, $864.0 million in the fourth year, and more than $1.0 billion by the fifth year.

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