Joint Legislative Budget Committee
Staff Memorandum

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DATE: December 18, 2020

TO: Senator J.D. Mesnard, Senate Finance Committee Chairman
Representative Ben Toma, House Ways and Means Committee Chairman

FROM: Hans Olofsson, Chief Economist

SUBJECT: 2020 INCOME TAX CREDIT REVIEW

Each year, the JLBC Staff prepares background materials for the Joint Legislative Income Tax Credit Review Committee as prescribed by A.R.S. § 43-222. It is our understanding, however, that the Committee will not meet this year. Given that our background information may still be of interest, we are now transmitting our material (including a PowerPoint slideshow) for the credits on the 2020 review schedule.

A separate memo provides confidential data on these credits where applicable.

Background

Laws 2002, Chapter 238 established the Joint Legislative Income Tax Credit Review Committee and specified a schedule for review of corporate and individual income tax credits. Pursuant to A.R.S. § 43-222, there are 5 credits scheduled for review in 2020, which are listed below.

Credit Page #

The Joint Legislative Income Tax Credit Review Committee is charged with determining the original purpose of each of the existing income tax credits and establishing a standard for evaluating the success or failure of the credit. Pursuant to A.R.S. § 43-221, the standard for evaluation of the credits may include: (1) the history, rationale and revenue impact, (2) the benefit to the state in various economic terms, and (3) the complexity in the use and administration of the credit.

(Continued)

Pursuant to Laws 2015, Chapter 199, the Department of Revenue (DOR) is authorized to disclose statistical information gathered from confidential tax credit information to this Committee, JLBC Staff and legislative staff. DOR considers tax credit information to be confidential if: (1) 3 or fewer taxpayers claimed the credit, or (2) 90% or more of the total credit used to offset tax liability was taken by 1 taxpayer. Both employment tax credits (credits for employing national guard members and TANF recipients) on the 2020 review list include confidential statistical information.

We have provided a separate memo to the Committee that contains the confidential credit data furnished by DOR. According to DOR, each recipient of this confidential information pursuant to Laws 2015, Chapter 199 is bound by confidentiality laws and therefore should not release the information to others. Any discussions regarding this memo must be held in Executive Session.

Limitations

There are certain limitations affecting the evaluation of income tax credits. The lack of performance measures for tax credits is one such example. None of the credits reviewed this year has stated performance measures. Laws 2002, Chapter 238, requires any new credit to include a clause that explains the rationale and objective of the credit (A.R.S. § 43-223).

Moreover, the evaluation of tax credits in terms of their economic benefits to the state is often difficult to conduct since the data required to do so is rarely available.

2020 Review

The following information is provided (where applicable) for each of the credit categories:

Description - The definition of the tax credit, including how the credit is calculated.

Refundable - Whether the credit is refundable or nonrefundable. A nonrefundable credit can never exceed the taxpayer's tax liability. Instead, any amounts not used to offset the taxpayer's liability in a taxable year either can be carried forward to future tax years or must be forfeited in the same tax year.

By contrast, a refundable credit is allowed to exceed the taxpayer's tax liability and any excess amounts are refunded to the taxpayer.

Carry Forward - Whether any unused nonrefundable credit may be carried forward into subsequent tax years, and if so, for how many years.

History and Rationale - The year the tax credit was implemented, revisions to the credit since its enactment, and relevant information regarding the intended purpose of the credit.

Revenue Impact - Based on data reported by DOR, information for each tax year on the number of claimants, the amount of total available credit, credit used, and credit carried forward to a subsequent tax year.

Economic Benefits - A summary of information available related to any economic benefits associated with each tax credit, including economic development, new investments, job creation or retention of existing jobs, and any other economic benefits that may be specific to each credit.

Complexity - Information related to the complexity of administration and application of each tax credit, including the perspective of the state agencies administering the credit, as well as the trade associations and representatives of the corporations and/or individuals claiming the credit.

(Continued)

Potential Performance Measures - A listing of potential measures that might be used to evaluate each of the income tax credits.

The reported information was obtained from a variety of sources. The JLBC Staff reviewed the statutes establishing each of the credits, as well as the tax forms and instructions used by businesses and individuals to claim the credits.

The JLBC Staff also reviewed summaries and minutes of committee and subcommittee hearings that were held prior to adoption of the credits. Various agencies were contacted, including the Department of Revenue.

HO:kp
Attachment
xc: Fletcher Montzingo, Director of Fiscal Policy, Senate
Sean Laux, Policy Advisor, Senate
Molly Graver, Analyst, Senate Finance Committee
Ryan Sullivan, Senior Policy Advisor, House
Paulino Valerio, Policy Advisor, House
Vince Perez, Analyst, House Ways and Means Committee

Credit for Employing National Guard Members

Employment of National Guard Members Credit

Summary

- The credit has been available since January 1, 2006.
- The credit is equal to $1,000 per tax year (TY) for each employee who is placed on active duty by the Arizona National Guard.
- The cost of the individual income credit was $0 in FY 2020.
- The cost and number of corporate claims have not been released by the Department of Revenue due to confidentiality rules.
- Very few corporate and individual taxpayers have used the credit. The corporate credit was claimed by 2 entities in TY 2016, 1 in TY 2017, and 1 in TY 2018. The individual credit was last claimed by 1 taxpayer in TY 2016 but was not claimed in TY 2017, TY 2018, or TY 2019.

Statutes

A.R.S. § 43-1167.01 (Corporate) and A.R.S. § 43-1079.01 (Individual)

Description

The statutes provide an income tax credit for corporations and individuals that employ Arizona National Guard members who are placed on active duty. The credit is equal to $1,000 per taxable year, per applicable employee. To qualify for the credit, several more conditions must be met:

- The employees claimed under the credit must be full-time.
- The employee must have served during the taxable year on active duty for training that exceeds the required annual training period, including any activation for federal or state emergencies.

Refundable

The credit is not refundable.

Carry Forward

The unused portion of the credit may be carried forward for a maximum of 5 consecutive years.

History and Rationale

This credit was created by Laws 2005, Chapter 264 and became effective January 1, 2006. According to a purpose statement included in the legislation, the credit was enacted in order to provide employers with some financial incentive to employ members of the National Guard. Arizona does not offer any other tax incentives for employers of National Guard members.

In the 2005 Legislative Session, Laws 2005, Chapter 115 created the National Guard Relief Fund consisting of donations from private citizens through their state individual income tax return. The monies are used to provide financial assistance to families of National Guard members when they are placed on active duty and are serving in a combat zone. Laws 2015, Chapter 208, however, repealed the National Guard Relief Fund and transferred the remaining balance to the Arizona Department of Veterans' Services for grants to nonprofit organizations that provide financial assistance to Arizona National Guard members and their families.

Revenue Impact

The Department of Revenue (DOR) began reporting individual and corporate income tax credits on a fiscal year basis in FY 2015 and FY 2016, respectively. As reported by DOR, the cost of the individual credit was $0 in FY 2015, not reported in FY 2016 and FY 2017 due to confidentiality rules, and $0 in FY 2018, FY 2019, and FY 2020. The cost of the corporate credit was $8,000 in FY 2016, not reported in FY 2017, FY 2018, FY 2019, and FY 2020 due to confidentiality rules.

DOR also reports credit use on a tax year basis. This data is available from 2006, when the credit was first established. It should be noted that this data differs from credit use by fiscal year for several reasons, including filing extensions and varied corporate tax years. *Table 1* shows the cost of the corporate tax credit by tax year since the credit's inception in 2006. *Table 2* displays the same information for the individual tax credit.

The most recent public data reported by DOR shows an aggregate cost to the state of $6,000 in 2014. The Arizona Department of Emergency and Military Affairs 2019 Annual Report states that 7,752 soldiers and airmen were authorized with the Arizona Army National Guard and Arizona Air National Guard, of which 1,091 are on active duty and 5,216 are on drill status. If the credit were allowed to be claimed by all National Guard members, including those that are not on active duty, the maximum cost of the credit program would be approximately $7.8 million annually.

Table 1

National Guard Members Credit - Corporate Credit Claims by Tax Year

Tax Year	# of Claimants	# of Employees Claimed	Total Credit Available	Credit Used	Carry Forward
2006	3	5	$5,000	$5,000	$0
2007	2	x	x	x	x
2008	5	9	$9,000	$3,100	$5,900
2009	6	9	$14,900	$7,000	$7,900
2010	8	10	$17,900	$17,900	$0
2011	6	8	$8,000	$7,000	$1,000
2012	6	7	$8,000	$6,000	$2,000
2013	5	11	$13,000	$10,050	$2,950
2014	5	4	$6,950	$6,000	$950
2015	3	x	x	x	x
2016	2	x	x	x	x
2017	1	x	x	x	x
2018	1	x	x	x	x

# of Claimants – The number of taxpayers who claimed the credit in each year.
Total Credit Available – The total tax credits identified in each tax year, including any new credits and any credits carried over from a previous year and identified in that year.
Credit Used – The total value of credits claimed in each year.
Carry Forward – The total credit identified but not used in each year. The full carry forward may not be reflected in the following year's estimate. For example, a taxpayer could have $400 in a particular credit identified in tax year 2010, use $300 of this amount in 2010 and leave $100 as a carry forward. If this taxpayer did not identify or claim the credit in 2011 the $100 carry forward would not be included in the credit carry forward total for 2011.
x – No data publicly released by the Department of Revenue.

Table 2

National Guard Members Credit - Individual Credit Claims by Tax Year

Tax Year	# of Claimants	# of Employees Claimed	Total Credit Available	Credit Used	Carry Forward
2006	1	x	x	x	x
2007	1	x	x	x	x
2008	1	x	x	x	x
2009	2	x	x	x	x
2010	2	x	x	x	x
2011	2	x	x	x	x
2012	3	x	x	x	x
2013	0	x	$0	$0	$0
2014	2	x	x	x	x
2015	2	x	x	x	x
2016	1	x	x	x	x
2017	0	0	$0	$0	$0
2018	0	0	$0	$0	$0
2019	0	0	$0	$0	$0

# of Claimants – The number of taxpayers who claimed the credit in each year.
Total Credit Available – The total tax credits identified in each tax year, including any new credits and any credits carried over from a previous year and identified in that year.
Credit Used – The total value of credits claimed in each year.
Carry Forward – The total credit identified but not used in each year. The full carry forward may not be reflected in the following year's estimate. For example, a taxpayer could have $400 in a particular credit identified in tax year 2010, use $300 of this amount in 2010 and leave $100 as a carry forward. If this taxpayer did not identify or claim the credit in 2011 the $100 carry forward would not be included in the credit carry forward total for 2011.
x – No data publicly released by the Department of Revenue.

Economic Benefits

Creation of New Jobs or Retention of Existing Jobs

While this credit may encourage employers to retain existing employees or to take on more employees than they otherwise would have due to the lowered cost of labor, it is unlikely that the credit has had any measurable economic impact to date due to its limited use.

Complexity

The credit does not appear to be unusually complex in its description, calculation or application.

Potential Performance Measures

The number of employers claiming the credit and the number of National Guardsmen claimed under this credit can both be determined from available data. As a result, no additional performance measures are suggested.

Prior Review

At its December 2015 meeting, the Joint Legislative Income Tax Credit Review Committee reviewed the credit and recommended its continuation.

Credit for Employment of TANF Recipients

Employment of Temporary Assistance for Needy Families (TANF) Recipients Credit

Summary

- The cost of the individual income credit was $0 in FY 2020.
- The cost and number of corporate claims for FY 2020 have not been released by the Department of Revenue due to confidentiality rules.
- The individual credit was claimed by a total of 31 taxpayers and the corporate credit was claimed by a total of 50 taxpayers from tax year (TY) 1998 through TY 2018.
- Over the same period, 2,232 positions were claimed under this credit for an average benefit of $1,106 per job.
- The number of former TANF recipients claimed as new hires decreased significantly – from 408 in TY 2003 to 30 in TY 2017. During the same time, the number of TANF recipients has declined significantly.
- The credit supplements similar federal income tax credits. While the state provides up to $500, $1,000 and $1,500 in credits for the first 3 years after hiring a TANF recipient, an employer may also qualify for federal tax credits of up to $4,000 in the first year and $5,000 in the second year.
- It is difficult to determine whether the credit directly results in savings from lower TANF participation. Former TANF recipients may find employment regardless of the income tax credits especially as the economy begins to improve.

Statutes

A.R.S. § 43-1175 (Corporate) and A.R.S. § 43-1087 (Individual)

Description

The statutes provide corporations and individuals an income tax credit for employing Arizona residents who are recipients of the low-income TANF assistance program. To qualify for the credit, several more conditions must be met:

- The employees claimed under the credit must be full-time.
- The employer must provide health insurance if coverage is provided to other employees not on TANF.
- The wages must meet or exceed the legal minimum wage and be comparable to wages received by non-TANF employees.
- The TANF employees must be employed for at least 90 days during the first year the credit is claimed.
- Periods for which the employee's wages were subsidized through the Jobs Program as provided by A.R.S. § 46-299 are not allowed to be included as periods of employment. (The Jobs Program is Arizona's mandatory employment and training program for work-eligible individuals in households receiving TANF cash assistance.)
- The TANF employees were not employed by the employer within 12 months before the current hire date.
- The TANF employees were not claimed under any other Arizona employment credit based on wages paid.

The credit is equal to:

- One-fourth of the taxable wages paid to a qualified employee up to a maximum of $500 in the first year of employment.

- One-third of taxable wages up to a maximum of $1,000 in the second year of continuous employment.
- One-half of taxable wages up to a maximum of $1,500 in the third year of continuous employment.

Refundable

The credit is not refundable.

Carry Forward

The unused portion of the credit may be carried forward for a maximum of 5 consecutive years.

History and Rationale

TANF is a federal block grant administered by the Department of Economic Security to provide a variety of assistance to low-income recipients, who are defined by A.R.S. § 46-101 as those who are granted assistance under Section 403 of Title IV of the 1996 Personal Responsibility and Work Opportunity Reconciliation (PRWORA) Act.

The state's TANF employer tax credit was created by Laws 1997, Chapter 300 and became effective January 1, 1998. The statutes creating the tax credits do not include a specific statement of purpose or a rationale. The likely intent was to encourage employers to hire TANF recipients into permanent jobs and reduce their reliance on public assistance.

The state's TANF tax credits were enacted during a time when the federal government was also creating tax incentives to promote the hiring of public assistance recipients. The U.S. Department of Labor, Employment and Training Administration (DOLETA), administers programs related to the Work Opportunity Tax Credit (WOTC), which is authorized by the Small Business Job Protection Act of 1996.

The WOTC is a federal income tax credit that encourages employers to hire 10 targeted groups of job seekers by reducing employers' tax liability by as much as $4,000 per qualified worker in their first year of employment. Two of the targeted groups are Short-Term and Long-Term TANF recipients. Short-Term TANF recipients are those that have received TANF benefits for any 9-month period during the 18-month period ending on the hiring date. Long-Term TANF recipients are individuals that have received TANF benefits for at least 18 consecutive months ending on the hiring date.

The available federal credit is 40% of qualified wages for the first year of employment, up to $4,000 and 50% for the second year, up to $5,000. The WOTC credit, which was extended through the end of 2020, has been continuously renewed since its inception. Notwithstanding the title of the enacting legislation, the WOTC is not restricted to small businesses.

Revenue Impact

The Department of Revenue (DOR) began reporting individual and corporate income tax credits on a fiscal year basis in FY 2015 and FY 2016, respectively. As reported by DOR, the cost of the <u>individual</u> credit was $0 in FY 2015, FY 2017, FY 2018, FY 2019, and FY 2020. DOR did not report the credit cost in FY 2016 due to confidentiality rules. The cost of the <u>corporate</u> credit was $129,500 in FY 2016, $123,200 in FY 2017, and $112,000 in FY 2019. The cost of the corporate credit was not reported for FY 2018 or FY 2020 due to confidentiality rules.

DOR also reports credit use on a tax year basis. This data is available from 1998, when the credit was first established. It should be noted that this data differs from credit use by fiscal year for several reasons, including filing extensions and varied corporate tax years. *Table 1* below shows the cost of the individual tax credit by tax year since the credit's inception in 1998.

Table 1

Employment of Temporary Assistance for Needy Families (TANF) Recipient Credit - Individual Credit Claims by Tax Year

Tax Year	# of Claimants	Total Credit Available	Credit Used	Carry Forward
1998	1	x	x	x
1999	1	x	x	x
2000	0	$0	$0	$0
2001	0	$0	$0	$0
2002	4	x	x	x
2003	5	x	x	x
2004	0	$0	$0	$0
2005	5	x	x	x
2006	0	$0	$0	$0
2007	5	$24,606	$12,666	$11,940
2008	1	x	x	x
2009	0	$0	$0	$0
2010	3	$21,929	$20,822	$1,107
2011	1	x	x	x
2012	1	x	x	x
2013	1	x	x	x
2014	2	x	x	x
2015	1	x	x	x
2016	0	$0	$0	$0
2017	0	$0	$0	$0
2018	0	$0	$0	$0
2019	0	$0	$0	$0

# of Claimants – the number of taxpayers who claimed the credit in each year.
Total Credit Available – the total tax credits identified in each tax year, including any new credits and any credits carried over from a previous year and identified in that year.
Credit Used – the total value of credits claimed in each year.
Carry Forward – the total credit identified but not used in each year. The full carry forward may not be reflected in the following year's estimate. For example, a taxpayer could have $1 million in a particular credit identified in tax year 2007, use $400,000 of this amount in 2007 and leave $600,000 as a carry forward. If this taxpayer did not identify or claim the credit in 2008, the $600,000 carry forward would not be included in the credit carry forward total for 2008.
x – No data publicly released by the Department of Revenue.

In TY 2018, the last year for which reasonably complete data is available, 4 employers claimed the credit and used $79,991 in related corporate tax credits. The number of companies claiming the credit has decreased over the past 5 years, ranging between 11 and 4 per year. The number of new employees for which the credit was claimed over the same period decreased from 48 to 0.

According to DOR, use of the individual tax credit has been negligible. There were no claimants of the individual credit in TY 2016 through TY 2019, and only 1 claimant in TY 2015, and 2 claimants in TY 2014. Due to the low numbers of claimants, credit information is unavailable due to confidentiality laws.

The caseloads for TANF Cash Benefits recipients have decreased markedly from 120,327 in FY 2003 to 25,878 in FY 2015 and 14,020 in FY 2020. This is due in part to policy changes during that time period that reduced the lifetime limit for receiving TANF Cash Benefits from 60 months to 24 months. Laws 2015, Chapter 18 further reduced that limit to 12 months starting in FY 2017.

Table 2, which summarizes the corporate income tax impact of this credit by tax year, was provided by the Arizona Department of Revenue (DOR).

Table 2

Employment of Temporary Assistance for Needy Families (TANF) Recipient Credit - Corporate Credit Claims by Tax Year

Tax Year	# of Claimants	Total Credit Available	Credit Used	Carry Forward
1998	3	$35,325	$35,325	$0
1999	5	$49,653	$47,189	$2,464
2000	6	$41,996	$27,598	$14,398
2001	6	$84,354	$57,851	$26,503
2002	8	$184,997	$173,600	$11,397
2003	9	$472,478	$466,392	$6,086
2004	14	$491,175	$485,190	$3,771
2005	13	$122,183	$99,575	$22,608
2006	11	$51,548	$40,754	$10,794
2007	12	$51,014	$45,014	$6,000
2008	10	$57,956	$28,956	$29,000
2009	12	$129,448	$43,128	$86,320
2010	7	$117,119	$61,239	$56,480
2011	8	$131,480	$64,500	$66,980
2012	9	$161,978	$87,498	$74,480
2013	8	$221,260	$121,998	$90,762
2014	11	$240,649	$131,046	$81,243
2015	6	$155,862	$64,619	$72,173
2016	5	$124,401	$27,100	$86,801
2017	4	$154,988	$88,915	$58,073
2018	4	$109,073	$79,991	$4,350

# of Claimants – the number of taxpayers who claimed the credit in each year.
Total Credit Available – the total tax credits identified in each tax year, including any new credits and any credits carried over from a previous year and identified in that year.
Credit Used – the total value of credits claimed in each year.
Carry Forward – the total credit identified but not used in each year. The full carry forward may not be reflected in the following year's estimate. For example, a taxpayer could have $1 million in a particular credit identified in tax year 2007, use $400,000 of this amount in 2007 and leave $600,000 as a carry forward. If this taxpayer did not identify or claim the credit in 2008, the $600,000 carry forward would not be included in the credit carry forward total for 2008.
x – No data publicly released by the Department of Revenue.

Economic Benefits

Measurable Economic Development
New Investments
Creation of New Jobs or Retention of Existing Jobs

The economic development or new investment related to this credit cannot be measured with the data available. While 30 jobs qualified for the credit in 2017, it is difficult to establish a direct link between the credit and subsequent economic development.

The administrators of the state's welfare-to-work programs believe that the federal and state tax credits are important tools in placing TANF recipients into jobs. The state tax credit does not provide a large incentive for prospective employers. However, it may influence a favorable hiring decision on the margin and help to overcome employers' reluctance to provide employment to program participants. By using both the federal WOTC tax credit and the state tax credit, a company could claim up to $4,500 in credit for a new hire in their first year of employment, $6,000 in the second year, and $1,500 in the third year.

DOR has provided some job retention estimates related to the tax credit:

- 50 corporate taxpayers have claimed the credit since it was created.
- From 1998 through 2018, corporate taxpayers reported that 2,232 positions were eligible for a total of $2.47 million in credits, or $1,106 per job.

The data indicates that the number of new hires claimed for the tax credit increased significantly in 2002 through 2004 as the economy emerged from the 2001 recession. Since 2004, the number of TANF employees claimed under the credit has steadily decreased. This coincides with a similar trend in overall TANF caseloads over the same time period.

To fully assess the net costs and benefits to the state associated with the tax credit, the value of TANF benefits paid to former recipients must be taken into account. In FY 2020, TANF recipients received an average of $82 per month. If an individual were to receive TANF benefits for a full 12 months, the total amount over this period would be slightly less than $1,000.

There would appear to be some savings to the state due to the reduction in TANF expenditures. However, it cannot be determined how many former TANF recipients would have found employment without the existence of the state tax credit. Moreover, as economic conditions change and affect the labor market, some former TANF recipients may return to apply for benefits.

Complexity

The TANF recipient employer credit does not appear to be unusually complex in its description, calculation or application. However, employers are required to keep additional records on qualifying employees and to complete another form to submit with their Arizona tax returns.

Potential Performance Measures

Performance measures could include:

1. 2- and 3-year retention rates for employees claimed under the credit. It appears that DOR has the data needed to make these calculations.

2. The value of wages and benefits paid to TANF recipients that are employed by companies claiming the credit. While the companies would have this information readily available, this measure would require them to compile and report additional data that is not currently required.

3. The growth in compensation for eligible employees that are retained for 2 or more years. This measure also could be obtained from the employers' payroll records but would be an additional reporting burden.

4. The length of unemployment of TANF recipients that are hired by companies claiming the credit. This measure could indicate whether the new hire may or may not have found employment without the benefit of the tax credit.

The statute does not impose any requirements related to these measures.

Prior Review

The credit was last reviewed by the Joint Legislative Income Tax Credit Review Committee in 2015. The Committee recommended that both the individual and corporate tax credits should be repealed.

Credit for Contributions to Qualifying Charitable Organizations

Contributions to Qualifying Charitable Organizations Tax Credit

Summary

- This credit has been available since January 1, 1998.
- The cost of the credit was $65.1 million in FY 2020.
- The credit was claimed by 154,648 taxpayers in FY 2020.
- Beginning in the 2013 tax year, taxpayers no longer needed to itemize their deduction to claim this credit.
- Beginning in 2016, individuals are allowed separate credits for voluntary cash contributions to Qualified Charitable Organizations and Qualified Foster Charitable Organizations.
- In 2016, the maximum credit was increased from $200 to $400 for individuals filing as single or head of household and from $400 to $800 for married couples filing jointly.
- There are currently more than 1,000 charitable organizations that qualify for credit eligible donations.

Statute

A.R.S. § 43-1088 (Individual Income Tax)

Description

This credit is provided to taxpayers that make voluntary cash contributions to qualifying charitable organizations (QCO). The credit is available to individuals but not to corporations. Partnerships cannot pass the credit through to their partners, and S corporations cannot pass through the credit to their shareholders. Taxpayers do not need to itemize their deductions to claim this credit. However, an individual cannot claim both a tax credit and an itemized deduction for the amount of contributions made to a QCO.

To qualify for credit eligible contributions, the charity must be either a tax-exempt 501(c)(3) charitable organization or a designated community action agency that receives community services block grant monies. Additionally, the organization is required to spend at least 50% of its budget on services to Arizona residents who are either: (1) Temporary Assistance for Needy Families (TANF) benefit recipients, (2) low-income persons, or (3) chronically ill or physically disabled (Statute defines “services” as cash assistance, medical care, child care, food, clothing, shelter, job placement, job training, or any other assistance that meets immediate basic needs.) The maximum general QCO tax credit is $400 for a single individual or head of household and $800 for a married couple filing a joint return.

To qualify for credit eligible donations, the charity is required to provide the Department of Revenue (DOR) with a written certification that it meets all the statutory requirements of a QCO. The written certification, which is signed under penalty of perjury, must include a copy of the organization’s financial statements showing that 50% of its budget is spent on qualifying recipients and a federal (501)(c)(3) tax-exempt letter (or status as a community action agency receiving block grant monies). The charity must also provide a statement indicating that it does not provide, pay for or provide coverage of abortions and does not financially support any other entity that provides, pays for or provides coverage of abortions.

In 2013, the QCO credit was expanded to include cash contributions to qualifying foster care charitable organizations (QFCO). A QFCO must meet all the requirements of a general QCO and spend at least 50% of its budget providing services to at least 200 foster children in Arizona. In 2016, a separate credit was created for cash contributions to a QFCO. (The JLBC Staff has prepared a separate review of the QFCO credit.)

Refundable

The credit is not refundable.

Carry Forward

The tax credit may be carried forward for 5 taxable years.

History and Rationale

This credit was created by Laws 1997, Chapter 300 and became effective on January 1, 1998. According to historical records, the credit was added as an amendment in Conference Committee to the omnibus welfare bill (SB 1357) that redesigned Arizona's welfare system to comply with federal welfare reform laws enacted in 1996.

Laws 2005, Chapter 334 increased the maximum credit for married taxpayers filing joint returns from $200 to $400. The maximum credit for single and head of household filers was left unchanged at $200.

Laws 2009, Chapter 80 expanded the credit to include donations to charitable organizations that provide services to chronically ill or disabled children. Additionally, the act restricted the credit to taxpayers itemizing their deductions and eliminated the requirement that a baseline year be established before the credit can be claimed. To qualify for the credit prior to 2009, taxpayers had to itemize their deductions (and specifically include deductions for charitable contributions) on a prior year's state tax return at least once in order to establish a "baseline" year and amount. The credit was calculated based on charitable contributions over and above the baseline amount.

Chapter 80 established a new certification process for QCO as outlined in the *Description* section above. Prior to 2009, charities were not required to submit any supporting documents to DOR, such as financial statements or verification of tax-exempt status. Instead, charities "self-certified" themselves by merely sending a letter to DOR stating that they met all the criteria of a QCO. Beginning in 2018, DOR assigns each QCO a 5- digit identification number that tax filers must list on a form when claiming the tax credit. According to information made available on DOR's website, there are currently more than 1,000 QCOs in the state.

Laws 2009, Chapter 167 provided that individual income taxpayers can authorize their employers to reduce their withholding tax amounts by the amount of the credit claimed. The act became effective in 2010.

Laws 2011, Chapter 55 required a statement that the QCO does not provide, pay for, promote, provide coverage of or provide referrals for abortions and does not financially support any other entity that provides, pays for, promotes, provides coverage of or provides referrals for abortions.

Laws 2012, Chapter 271 amended Laws 2011, Chapter 55 by removing the requirement that charitable organizations include a statement, which declare that they do not promote or provide referrals for abortion for purposes of the tax credit.

Laws 2013, Chapter 236 removed the requirement that an individual income tax filer itemize deductions in order to claim the tax credit.

Laws 2013, 1st Special Session, Chapter 9 expanded (retroactive to January 1, 2013) the tax credit to include qualifying foster care charitable organizations. The maximum credit for cash contributions to qualifying foster care organizations is currently $500 for individuals filing as single or head of household and $1,000 for married couples filing joint returns. A qualifying foster care organization must spend at least 50% of its budget providing services to at least 200 foster children in Arizona.

Laws 2015, Chapter 250 expanded the tax credit to include donations made to QFCOs that provide services to under-21-year-old former foster youth in the Transitional Independent Living program.

Laws 2016, Chapter 109 increased the maximum amount that an individual income taxpayer is allowed to claim for cash contributions to qualifying charitable organizations (QCO) and qualifying foster care charitable organizations (QCFO), beginning in TY 2016. Chapter 109 increased the maximum QCO credit from $400 to $800 for married couples filing joint returns and from $200 to $400 for all other filers. The maximum amount for the QCFO credit was increased from $800 to $1,000 for married couples filing joint returns and from $400 to $500 for all other filers. Additionally, Chapter 109 allows a taxpayer to receive separate credits for cash contributions to a QCO and a QFCO.

Laws 2016, Chapter 309 provides that cash contributions to charitable organizations made on or before April 15th for purposes of claiming the charitable tax credit can be applied to either the current or preceding taxable year.

Laws 2019, Chapter 297 expanded the eligibility criteria for the state charitable tax credit to include organizations that serve both children and adults with chronic illness or disability rather than solely children. Chapter 297 is effective retroactively from January 1, 2019.

Revenue Impact

The Department of Revenue (DOR) began reporting individual income tax credits on a fiscal year basis in FY 2015. As reported by DOR, the cost of the QCO credit was $29.6 million in FY 2015, $36.5 million in FY 2016, $57.7 million in FY 2017, $68.3 million in FY 2018, $70.8 million in FY 2019, and $65.1 in FY 2020.

DOR also reports credit use on a tax year basis. This data is available from 1998, when the credit was first established. It should be noted that this data differs from credit use by fiscal year for several reasons, including filing extensions and varied corporate tax years.

As noted above, this credit is only available to individual income tax filers. The total credit use was $66.1 million in TY 2019, the last year for which data is available. The table below, which was provided by DOR, summarizes the tax revenue impact of the credit by tax year.

Tax Year	# of Claimants	Total Credit Available	Credit Used	Carry Forward
1998	2,894	$481,037	$476,691	$4,346
1999	6,725	$1,168,515	$1,154,768	$13,747
2000	10,654	$1,829,205	$1,729,123	$35,581
2001	12,538	$2,257,673	$2,196,043	$41,852
2002	14,226	$2,687,900	$2,676,946	Not Available
2003	17,467	$3,286,100	$3,259,400	Not Available
2004	20,736	$3,884,600	$3,851,700	Not Available
2005	25,587	$6,637,500	$6,589,000	Not Available
2006	29,202	$7,988,039	$7,939,507	Not Available
2007 1/	18,280	$5,877,831	$5,860,953	Not Available
2008	36,568	$11,077,991	$11,059,408	Not Available
2009	49,915	$13,556,228	$12,889,895	$666,333
2010	61,602	$16,899,920	$16,727,074	Not Available
2011	66,396	$18,191,993	$18,012,263	Not Available
2012	78,736	$22,128,648	$21,835,458	Not Available
2013 3/	100,398	$27,457,025	$24,503,609	Not Available
2014 2/	116,225	$35,790,362	$31,617,855	$4,172,507
2015	130,419	$41,882,428	$36,796,635	$5,085,793
2016	148,703	$66,349,084	$58,459,196	$7,594,793
2017	165,525	$77,783,334	$68,594,148	$8,830,903
2018	164,897	$80,014,935	$68,644,862	$10,968,030
2019 4/	157,020	$77,794,334	$66,072,217	$11,722,117

1/ According to DOR, Tax year 2007 data is understated based on limited reporting information available when individual income tax was converted to a new processing program.

2/ According to DOR, based on a sample review of 2014 credit returns, 89% of the total credit was for contributions made to Qualifying Charitable Organization and 11% went to Qualifying Foster Care Charitable Organizations.

3/ The data for tax years 2013 through 2015 includes both Qualifying Charitable Organization and Qualifying Foster Care Charitable Organization information.

4/ Figures are preliminary.

As shown in the table above, the use of the credit has increased significantly over time; from $0.5 million in TY 1998 to $66.1 million in TY 2019, the last year for which credit data by tax year is available. The increase of the maximum credit for married couples from $200 to $300 in TY 2005 and from $300 to $400 in TY 2006 is evident from the close to 100% increase in credit use over the same 2-year period. Similarly, the elimination of the baseline requirement (for purposes of calculating the credit) in TY 2009 appears to have resulted in another large increase in credit usage. The elimination of the itemization requirement beginning in TY 2013 appears to have resulted in additional credit growth. The $22 million increase in credit use from TY 2015 to TY 2016 is likely the result of the increase of the maximum credit from $200 to $400 for individuals and from $400 to $800 for married couples.

Economic Benefits

New Investments
Creation of New Jobs or Retention of Existing Jobs
Commercial Infrastructure Development

This credit is not directly designed to promote economic development or spur new investments that would result in new jobs. Instead, according to DOR's August 2010 report "Income Tax Credits in Arizona," this credit is one of several tax credits in statutes primarily intended to encourage cash contributions to certain target groups in society, such as the working poor or students in private or public schools.

Although this credit was not directly intended to promote economic growth, it may still provide some economic benefits to society insofar as it generates funding to help move individuals from underemployment to economic self-sufficiency. There is no data currently available, however, to quantify such benefits.

Complexity

The credit does not seem to be unnecessarily complex in terms of its application, administration, and approval process. The elimination of the baseline year requirement in 2009 and the removal of the itemization requirement in 2013 appear to have simplified the use of the credit considerably.

Potential Performance Measures

Performance measures could include:

1. A requirement to report on the number of Arizona residents (TANF recipients, low-income persons, chronically ill or physically disabled individuals) that benefit from the services provided as a result of the credit donations.
2. A requirement to report on the specific type of services provided (e.g., cash assistance as opposed to job training) and the amounts allocated to such services from the credit donations.

Prior Review

The credit was last reviewed by the JLITCRC in 2015. The Committee recommended at that time that the credit be continued.

Credit for Contributions to Qualifying Foster Care Charitable Organizations

Contributions to Qualifying Foster Care Charitable Organizations Tax Credit

Summary

- The cost of the credit was $20.8 million in FY 2020.
- There were 33,236 claims for this credit in FY 2020.
- In 2016, the maximum amount taxpayers could claim was raised from $400 to $500 for individuals and from $800 to $1,000 for families.
- There are currently 49 qualifying foster care charitable organizations in Arizona.

Statute

A.R.S. § 43-1088 (Individual Income Tax)

Description

This credit is provided to taxpayers that make voluntary cash contributions to qualifying foster care charitable organizations (QFCO). The credit is available to individuals but not to corporations. Partnerships cannot pass the credit through to their partners, and S corporations cannot pass through the credit to their shareholders. Taxpayers do not need to itemize their deductions to claim this credit. However, an individual cannot claim both a tax credit and an itemized deduction for the amount of contributions made to a QFCO.

A QFCO is a qualifying charitable organization (QCO) that each year provides services to at least 200 children placed in a foster home or child welfare agency or to persons under 21 years of age participating in a transitional independent living program. The QFCO is required to spend at least 50% of its budget on services to such children or youth. Statute defines services as "cash assistance, medical care, child care, food, clothing, shelter, job placement and job training services or any other assistance that is reasonably necessary to meet immediate basic needs and that is provided and used in this state." Besides these requirements, a QFCO must meet all the same requirements as for a QCO, which are outlined below.

A QFCO must also be a charity that is exempt from federal income taxation under section 501(c)(3) of the Internal Revenue Code or is a designated community action agency that receives Community Services Block Grant program monies. The QFCO must spend at least 50% of its budget on services to Arizona residents who receive temporary assistance for needy families (TANF) benefits, to low-income residents of this state and their households, or to individuals who have a chronic illness or physical disability and who are residents of this state. Any entity that provides, pays for, or provides coverage of abortions or that financially supports any other entity that provides, pays for, or provides coverage of abortions is not considered a QFCO for purposes of this credit.

To become a QFCO, a charitable organization must complete an application form and submit it along with required documentation to DOR. If an organization meets all the requirements listed above, DOR will certify it as a QFCO. There are currently 49 QFCOs certified by DOR. Since statute does not define what constitutes "immediate basic needs," it is left to DOR's discretion to determine whether the spending on services by the charity meets the 50% threshold required for certification. The Arizona Republic reported in a recent article that according to their review of the credit program, "immediate basic needs" for some charities included rent and utilities and for others legal services to help foster children.

The maximum credit for cash contributions to QFCO's is $500 for individuals filing as single or head of household and $1,000 for married couples filing jointly. The QFCO credit is a separate credit from the QCO credit. Therefore, individuals and married couples may choose to claim one or both credits in the same taxable year.

Refundable

The credit is not refundable.

Carry Forward

The tax credit may be carried forward for 5 taxable years.

History and Rationale

The credit was created by Laws 2013, 1st Special Session, Chapter 9 as an expansion to the Contributions to Qualifying Charitable Organizations (QCO) tax credit. Since the credit was still part of the QCO credit, filers could not separately file claims for contributions to QFCO's. The maximum amount for both credits combined was $800 for married couples filing joint returns and $400 for all other filers. This took effect on January 1, 2013.

Laws 2016, Chapter 109 increased the maximum credit to be claimed by an individual to $500 and to $1,000 for married couples. Chapter 109 also fully separated the credit from the Contributions to Qualified Charitable Organizations (QCO) credit so that individuals and married couples can claim a credit for both contributions to QCO's and QFCO's in the same year.

Laws 2016, Chapter 309 provides that individuals who make cash contributions to charitable organizations prior to April 15th for the purposes of claiming the credit can be applied to either the current or previous tax year.

Revenue Impact

The Department of Revenue (DOR) began reporting individual income tax credits on a fiscal year basis in FY 2015. As shown in *Table 1* below, the cost of the QFCO credit was $13.4 million in FY 2017, $20.7 million in FY 2018, $22.4 million in FY 2019, and $20.8 million in FY 2020. DOR did not separately report the cost of QFCO credit in FY 2015 and FY 2016.

Table 1

QCFO Credit by Fiscal Year

Fiscal Year	# of Claimants	Credit Used
2017	21,908	$13,415,652
2018	32,607	$20,654,368
2019	35,845	$22,423,333
2020	33,236	$20,815,929

# of Claimants - The number of taxpayers who claimed the credit in each year.
Credit Used - The total value of credits claimed each year.

DOR also reports credit use on a tax year basis. *See Table 2*. This data is available from tax year (TY) 2016. This data differs from credit use by fiscal year for several reasons, including filing extensions, amended returns and varied tax years.

As noted above, this credit is only available to individual income tax filers. The cost of the credit was $20,550,476 in TY 2019, the last year for which data is available. (This figure is still preliminary and thus likely to be revised). The data included in *Table 2* below, which was provided by DOR, summarizes the tax revenue impact of the credit by tax year.

Table 2

QCFO Credit by Tax Year

Tax Year	# of Claimants	Total Contributions	Total Credit	Credit Used	Carry Forward
2016	26,235	$19,876,877	$18,146,367	$16,334,609	$1,811,758
2017	33,839	$25,893,820	$24,012,278	$21,502,241	$2,510,037
2018	36,440	$26,366,332	$25,398,873	$22,864,438	$2,532,732
2019	33,044	$23,411,430	$23,035,063	$20,550,476	$2,484,587

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# of Claimants – The number of taxpayers who claimed the credit in each year.
Total Credit – The total tax credits identified in each tax year, including any new credits and any credits carried over from a previous year and identified in that year.
Credit Used – The total value of credits claimed in each year.
Carry Forward – The total credit identified but not used in each year. The full carry forward may not be reflected in the following year's estimate. For example, a taxpayer could have $400 in a particular credit identified in tax year 2016, use $300 of this amount in 2016 and leave $100 as a carry forward. If this taxpayer did not identify or claim the credit in 2017, the $100 carry forward would not be included in the credit carry forward total for 2017.

Economic Benefits

The credit is not directly designed to promote economic development or spur new investments that would result in new jobs. It is meant to incentivize the funding of certain target groups in need of financial assistance and allow taxpayers the discretion to choose which organizations to sponsor.

Complexity

The credit is not unduly complex.

Potential Performance Measures

Performance measures could include:

1. A requirement to report on the number of Arizona children in foster care and individuals under 21 transitioning from foster care that benefit from the services provided as a result of the credit donations.
2. A requirement to report on the specific type of services provided and the amounts allocated to such services from the credit donations.

Prior Review

The credit has not been previously reviewed.

Pro Rata Credit for Contributions by S Corporations to School Tuition Organizations (STO)

Credits for Contributions by S Corporations to School Tuition Organizations

Arizona has two different types of Corporate Income Tax (CIT)/Insurance Premium Tax (IPT) Student Tuition Organization (STO) Tax Credits. One is for low-income students. The Joint Legislative Income Tax Credit Review Committee reviewed the Low-Income Credit in 2016 and is scheduled to do so again in 2021.

The second type of CIT/IPT STO Credit is available to displaced/disabled students. Scholarships from this program may be awarded only to students who lived in foster care at any time prior to graduating from high school or obtaining a GED, or who have been identified at any time as having a disability under federal or state law. This credit was reviewed in 2019 and is on the review schedule again in 2024.

Prior to 2015, only C Corporations could take either of the Corporate STO Credits. Laws 2015, Chapter 301 expanded the Corporate STO Credits to include S Corporations. The main difference between C and S Corporations is how they are taxed. C Corporations pay corporate income taxes directly on their profits (net income) while the profits from S Corporations flow untaxed to the owners, who pay individual income taxes on their pro rata share of these profits.

When enacting Laws 2015, Chapter 301, the statute gave both S Corporate STO Tax Credits their own unique review dates separate from the C Corporate STO Credits. Both the S Corporate Low-Income Credit and the Displaced/Disabled Credit are scheduled for review in 2020.

In FY 2020, the total dollar value of donations for the Low-Income STO Credit was $29 million for S Corporations compared to $32 million for C Corporations. Donations for the Displaced/Disabled STO Credit were $1 million for S Corporations and $395,000 for C Corporations.

To make the review process more efficient, we recommend that the statutory review schedule be amended to align the S and C Credit review dates; As a result,

- The S Corporate Low-Income Credit review date would be moved from 2020 to 2021 when the C Corporate Low-Income Credit is scheduled for review and,
- The S Corporate Displaced/Disabled Credit review date would be moved from 2020 to 2024 when the C Corporate Displaced/Disabled Credit is scheduled for review.

Please see *Attachment A* for the 2016 C Corporate Low-Income STO Credit review and *Attachment B* for the 2019 C Corporate Displaced/Disabled STO Credit review.

Attachment A

Credit for Corporate Contributions to School Tuition Organizations

Summary

- Current law authorizes tax credits for 4 different types of corporate or insurer contributions to school tuition organizations (STOs). This review specifically addresses corporate contributions to STOs awarding "low-income scholarships" (A.R.S § 43-1183), as statute does not require a separate review of the insurer credit program.
- In FY 2016, corporations and insurers claimed $50.9 million in related tax credits. For FY 2017 they contributed $61.9 million for "low income scholarships" under preliminary data. The FY 2017 contributions may not immediately result in a tax credit, however, as unused credits can be carried forward for 5 years.
- Approximately 100 corporations or insurers contributed to the program each year from 2007 through 2015, but that total increased to 202 in 2016 and to 371 in 2017 because Laws 2015, Chapter 301 now allows "S Corporations" to contribute.
- To the extent that scholarships result in students not attending public school, the credit results in foregone General Fund costs. To offset the reported $61.9 million in corporate donations for FY 2017, for example, approximately 10,900 students would have to be diverted from public schools if all potential tax credits from those donations are claimed.
- The four corporate and insurer STO credits and 2 individual STO credits combined have an estimated tax impact of $159.4 million *(see Attachment A).*

Statute

A.R.S. § 43-1183

Description

Current law authorizes tax credits for 4 different types of corporate or insurer contributions to school tuition organizations (STOs):

1. Corporate contributions to STOs awarding "low-income scholarships" (A.R.S § 43-1183),
2. Insurer contributions to STOs awarding "low-income scholarships" (A.R.S. § 20-224.06),
3. Corporate contributions to STOs awarding scholarships to "displaced or disabled" pupils (A.R.S § 43-1184), and
4. Insurer contributions to STOs awarding scholarships to "displaced or disabled" pupils (A.R.S § 20-224.07).

This review specifically addresses "corporate/low-income" contributions made pursuant to A.R.S § 43-1183, but also indirectly addresses "insurer/low income" contributions made pursuant to A.R.S. § 20-224.06 because the Arizona Department of Revenue (DOR) typically reports combined data for those two programs, as noted above. The income tax credit review schedule in A.R.S. § 43-222 does not require a separate review for the "insurer/low income" program.

This credit is provided to corporations for voluntary contributions to STOs. A STO is a nonprofit organization that is exempt from federal taxation and that is required to allocate at least 90% of its revenue for educational scholarships or tuition grants to children to attend non-governmental elementary or secondary schools (A.R.S. §43-1502). A STO may use up to 10% of corporate contributions for administration expenses.

Total corporate plus insurer contributions to STOs for "low-income scholarships" were capped at approximately $61.9 million for FY 2017 pursuant to A.R.S. § 43-1183C1, which increases the cap by 20% annually. Because of the cap, STO contributions from corporations and insurers must be pre-approved by DOR in order to be eligible for a tax credit. For FY 2017, DOR pre-approved $61.9 million in combined corporate and insurer contributions to STOs for "low-income scholarships" and corporations and insurers made $61.9 million in related donations under preliminary data (*see Table 1 below*). Contributions, however, do not always result in the taxpayer using the credit. For example, the taxpayer may lack sufficient liability to take the credit *(see Table 2).*

Contributions from this credit must only be made available for scholarships or tuition grants to students whose family income does not exceed 185% of the income limit required for a student to qualify for reduced-price lunch under the National School Lunch and Nutrition Acts. In FY 2017, the maximum annual income for a family of four for purposes of STO scholarship eligibility is $83,167 ($44,955 X 185%). Students also must have attended public school in the prior school year, be entering kindergarten, or have received tuition assistance from a STO during the prior school year. The maximum scholarship amounts for FY 2017 are $5,200 for grades K-8 and $6,500 for grades 9-12. Those amounts increase $100 annually pursuant to A.R.S. § 43-1504C. Lastly, a corporation may not use a tax credit for any contribution if a corporation designates the scholarship for a particular student.

Refundable

The credit is not refundable.

Carry Forward

The unused portion of the credit may be carried forward for a maximum of 5 consecutive years.

Transferable

The credit is not transferable.

History and Rationale

The corporate STO "low-income scholarship" tax credit was created by Laws 2006, Chapter 14 and became effective starting in FY 2007. The purpose of the program is to encourage corporate contributions to STOs that award "low-income scholarships" that enable students to attend non-governmental elementary and secondary schools.

As originally enacted, total corporate tax credits to STOs for "low-income scholarships" was capped at $5 million pursuant to A.R.S § 43-1183C1. Laws 2006, Chapter 325 raised the cap to $10 million and by an additional 20% annually starting in FY 2008.

In September 2006, the Arizona School Boards Association and the Arizona Chapter of the American Civil Liberties Union filed suit against the state regarding this tax credit. In *Green v. Garriott*, plaintiffs alleged that corporate contribution "set asides" in the associated laws violated the "general and uniform" provision of the state's public education system. The Maricopa County Superior Court ruled in favor of the state in a ruling that was later upheld by the Arizona Court of Appeals. The plaintiffs appealed to the Arizona Supreme Court, but in 2009 it declined to review the case, making the Maricopa County Superior Court ruling stand.

The program was originally scheduled to sunset on June 30, 2011, but that date was repealed by Laws 2009, Chapter 168. The program's enabling statute (A.R.S § 43-1183) also has been amended to include references to the related insurer premium tax credit and to new STO administrative requirements enacted by Laws 2009, Chapter 292.

Revenue Impact

Table 1 summarizes corporate and insurer contributions to STOs for "low-income scholarships" since FY 2007. In FY 2017 (the most recent data year for contributions), 327 corporations (including 248 S Corporations) and 44 insurance companies donated a total of $61.9 million to STOs under preliminary data.

Table 1

Corporate Contributions to School Tuition Organizations for "Low-Income Scholarships"

Fiscal Year [1/]	Statutory Limitation [2/]	# of Corporations [3/]	$ Approved by DOR [4/]	$ Received by STOs
2007	$10,000,000	108	$9,740,800	$9,535,800
2008	$12,000,000	73	$12,116,000	$11,996,000
2009	$14,400,000	98	$10,816,006	$10,495,506
2010	$17,280,000	63	$8,121,508	$8,100,008
2011	$20,736,000	69	$11,365,351	$11,324,351
2012	$24,883,200	84	$19,587,037	$19,035,987
2013	$29,859,800	118	$30,041,114	$29,858,865
2014	$35,831,800	100	$36,571,808	$35,831,808
2015	$42,998,200	95	$42,998,200	$42,998,200
2016	$51,597,800	202	$51,597,800	$51,597,800
2017 [5/]	$61,917,400	371	$61,917,400	$61,917,400

1/ DOR reports contributions on a fiscal year rather than tax year basis, since the statutory limitation on such contributions in A.R.S. § 43-1183C is per fiscal year. DOR, however, reports corresponding tax credit data on a tax year basis.
2/ Increases 20% annually pursuant to A.R.S. § 43-1183C1.
3/ Includes insurers starting in FY 2011 and S Corporations starting in FY 2016.
4/ May be higher than the statutory limitation due to corporations donating less than their approved amounts, which allows additional donations to be approved pursuant to A.R.S. §43-1183D.
5/ Preliminary data.

The table above notes that the statutory limit on contributions increases by 20% each fiscal year, growing from $10 million in FY 2007 (the program's first year) to approximately $61.9 million for FY 2017. Corporate and insurer contributions under the program have kept pace with these increases since FY 2013, fully funding the cap in each of the past 5 fiscal years. The number of corporations and insurers contributing to the program, however, remained at approximately 100 annually between 2007 and 2015 before increasing to 202 in FY 2016 and to 371 in FY 2017 because "S Corporations" now also could contribute pursuant to Laws 2015, Chapter 301. "S Corporations" are businesses that allocate all of their income to shareholders, so do not pay income taxes directly, whereas other corporations ("C Corporations") pay income tax directly on their net income.

DOR reports that 98 S Corporations contributed to the program in 2016 (the first year that S Corporations could contribute) and that 248 are expected to contribute in 2017. Under the data in *Table 1*, the average contribution increased from $88,300 in 2007 ($9,535,800 ÷ 108 contributions) to $166,900 in 2017 ($61,917,400 ÷ 371 contributions).

DOR also reports tax credits claimed for STO contributions, although on a tax year basis (January 1 - December 31) rather than a fiscal year basis (July 1 - June 30). *Table 2* summarizes tax credit data for the program since its inception through FY 2014 (last reported data for credit usage):

Not all corporate contributions result in tax credits. In Tax Year 2014, for example, corporations had $23.7 million of credits available, but used only $17.8 million *(see Table 2).* A.R.S. § 43-1183E allows corporations to carry forward unused credits for up to 5 years.

Table 2

Corporate Income Tax Credit Claims

Tax Year	# of Claims	Credits Available	Credits Used	Carry-Forward
2005	5	$530,000	$526,260	$3,740
2006	57	$10,625,940	$10,369,546	$256,394
2007	62	$11,625,278	$10,823,475	$801,803
2008	74	$9,180,214	$6,147,240	$3,032,974
2009	70	$10,805,124	$8,872,212	$1,932,912
2010	67	$11,714,656	$8,475,518	$3,199,138
2011	83	$15,368,862	$12,900,592	$2,460,215
2012	92	$28,804,101	$24,363,770	$4,279,634
2013	98	$31,340,112	$26,097,925	$4,571,570
2014 1/ 2/ 3/	65	$23,667,860	$17,822,902	$5,777,810

1/ Latest reported data by Tax Year.
2/ Fiscal Year data (now also reported) show $50,851,700 of credits used for FY 2016 (see narrative).
3/ Due to the timing of filing, there can be an overlap between tax and fiscal year data. As a result, fiscal year data should not be added to tax year data to produce a cumulative fiscal impact to the state.

DOR and the Arizona Department of Insurance recently began reporting data on credits used by fiscal year, which for FY 2016 equaled $50,851,700 ($28,065,300 from corporations and $22,786,400 from insurers). This equaled 98.6% of the $51,597,800 that corporations and insurers contributed to STOs for low-income scholarships for FY 2016 *(see Table 1).* A portion of the $50,851,700 of credits used in FY 2016, however, may have been carried forward from prior years *(see Table 2).* As a result, the $50,851,700 of credits and $51,597,800 of contributions for FY 2016 may not be directly comparable.

The tax credit may impact state K-12 education costs. Since students receiving the scholarships must have attended a government-funded school, be entering kindergarten, or have used the same scholarship in the previous year, at least some students who receive "low-income scholarships" from STOs probably otherwise would be in public schools. Currently each pupil added to the statewide K-12 Average Daily Membership (ADM) count costs the state General Fund on average about $5,700. The state General Fund, therefore, saves an average of about $5,700 for each STO "low-income scholarship" recipient who otherwise would attend public school. This implies that the program is currently "breaking even" from a state General Fund perspective if at least 10,900 students no longer attended public schools because of STO "low-income scholarships" ($61.9 million in corporate STO donations in FY 2017 ÷ $5,700 average state cost per public school student ≈ 10,900 students if corporations claim credits for all eligible donations). The number of students receiving a STO "low-income scholarship" who otherwise would be attending state-funded public schools, however, is unknown. The "break even" number of public school "leavers" under the program varies from year to year depending on the total value of tax credits used.

Beyond its impact on state-funded K-12 operating costs, the credit could result in lower School Facilities Board (SFB) costs for new school construction. New school construction costs would be reduced if the SFB approved fewer new schools because of lower public school enrollment growth from the credit. The amount of SFB "foregone costs" due to the credit, however, is unknown. For FY 2017, the state General Fund appropriation for SFB new construction statewide is approximately $24.3 million.

A student leaving a school district under the program also would reduce its local override funding, if any, since override funding is based indirectly on the number of students in a school district. School district override funding statewide currently averages roughly $500 per pupil.

Economic Benefits

This credit is not directly designed to promote economic development or spur new investments that would result in new jobs. Instead, according to DOR's August 2000 report "Income Tax Credits in Arizona," this credit is one of several tax credits in statutes primarily intended to encourage cash contributions to certain target groups in society, such as the working poor or students in private or public schools.

In FY 2014, STOs distributed $24.5 million in scholarships (13,118 scholarships to 187 schools) from corporate and insurance premium tax "low income scholarship" contributions for an average "low income" scholarship of $1,869 (*see Table 3*). The $24.5 million scholarship total for FY 2014 is less than the $35.8 million in reported "low income" contributions for that year primarily because STOs also reserved $22.9 million (including prior year carry forward) in FY 2014 for future year scholarships for current "low income scholarship" recipients.

Table 3

Scholarships for FY 2014 by School Tuition Organization

	# of Recipients	Total Scholarships	Average Scholarship
AAA Scholarship Foundation	278	$1,211,797	$4,359
Arizona Community Foundation STO	1	3,417	3,417
Arizona Episcopal Schools Foundation	59	218,101	3,697
Arizona Independent Schools Scholarship Foundation	62	345,300	5,569
Arizona Leadership Foundation	2,241	6,616,002	2,952
Arizona Private Education Scholarship Fund	341	717,265	2,103
Arizona Scholarship Fund	53	187,186	3,532
Arizona School Choice Trust	1,462	4,104,250	2,807
Arizona Youth Education Scholarships	16	20,051	1,253
Arizona's Catholic Tuition Support Organization	1,239	2,239,012	1,807
Brophy Community Foundation	1,099	2,087,373	1,899
Catholic Education Arizona	3,730	2,755,290	739
Chabad Tuition Organization	1	450	450
Christian Scholarship Foundation	65	22,013	339
Corporate Tax Foundation	67	273,770	4,086
Independent Schools Corporate Tax Foundation	94	459,500	4,888
Institute for Better Education	868	612,015	705
Jewish Tuition Organization	204	10,404	51
Northern Arizona Christian School Scholarship Fund	73	75,678	1,037
Pappas Kids Schoolhouse Foundation	2	4,676	2,338
School Choice Arizona	577	1,834,858	3,180
School Tuition Association of Yuma	223	146,203	656
Tuition Organization for Private Schools	309	543,252	1,758
Valley Lutheran Scholarship Organization	32	21,712	679
Yuma's Education Scholarship Fund for Kids	22	9,952	452
TOTAL	**13,118**	**$24,519,525**	**$1,869**

The average per pupil scholarship for FY 2014 (last reported data on scholarships) was $1,869, which was more than the $1,524 average reported for FY 2013, but less than the $2,100 - $2,500 averages reported for all years prior to FY 2012 *(see Table 4).* Between FY 2007 and FY 2014, the number of scholarships grew from 1,947 to 13,118. At the same time, the total amount of dollars distributed grew from $4.6 million to $24.5 million. DOR notes in its report for STO-related individual income tax credits that individual students may receive scholarships from more than one STO.

Table 4

School Tuition Organization Scholarships

Year [1/]	# Scholarships	# Schools	$ Distributed	Avg. Scholarship
2007	1,947	156	$4,621,290	$2,374
2008	2,967	176	$7,516,750	$2,533
2009	3,652	169	$7,881,787	$2,158
2010	4,215	187	$9,322,243	$2,212
2012	5,836	206	$11,375,721	$1,949
2013	11,653	216	$17,761,391	$1,524
2014	13,118	228	$24,519,525	$1,869

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1/ Data were reported on a calendar year basis through 2010, but on a fiscal year basis thereafter. FY 2011 data are omitted from the table, since it was a transition year.

Complexity

DOR indicates that feedback that it gave in 2011 regarding the administrative complexity of the program still applies: DOR indicates that it is administratively simple for corporations to donate to STOs and claim the credit, and for STOs to receive pre-approval from DOR to receive corporate donations. DOR notes, however, that STOs can only award scholarships from this credit to “low income” students, which complicates the scholarship awarding process for STOs. DOR also notes that the annual reporting process for donations is time-consuming for both STOs and DOR because of the sheer number of STOs and the fact that most STOs are staffed by volunteers, which leads to reporting inconsistencies and makes it difficult for DOR to educate STO staff on reporting requirements. Finally, DOR describes its oversight responsibilities over STOs as a “daunting task” that has not yet been fully accomplished and which has been affected by changing statutory requirements.

Potential Performance Measures

Performance measures could include:

1. Percentage of STO revenues retained for administrative costs.

   The STOs would have this information readily available.

2. Percentage of private school tuition paid for with award funding.

   This information appears to be collected by STOs, but would require additional reporting.

Prior Review

At its December 2011 meeting, the Joint Legislative Income Tax Credit Review Committee reviewed the credit and recommended its continuation. They did not recommend placing any performance measures into statute.

Corporate Contributions to School Tuition Organizations for Displaced or Disabled Pupils

Summary

- The cost of the credit was $6,007,300 in FY 2019 ($2,295,100 for corporations, $3,448,100 for insurers, and $264,100 for individuals (S-corporations).
- In FY 2019, the credit was claimed by 8 corporations at an average of $286,900 per claim, by 26 individuals (S-corporations) at an average of $10,200 per claim, and by an unknown number of insurers (the total value of credits taken by insurers was reported, but not the number of insurers taking a credit).
- The credit had a carry forward of $407,100 for corporations for TY 2016 (latest data available) and $28,100 for individuals (S-corporations) for TY 2018 (latest data available). Data on credits carried forward by insurers are not reported.
- The credit is capped at $5 million annually.
- The credit results in foregone General Fund costs to the extent that STO-funded scholarships result in students not attending public school. To offset the current $5 million level of original tax credits an estimated 230 students would have to be diverted from public schools due to displaced or disabled STO scholarships.
- In total, there are 4 private school tax credits with a total dollar value of $177.2 million for FY 2019.

Statute

A.R.S. § 43-1184 and § 20-224.07

Description

The credit was last reviewed in 2014. The description of the credit as well as other sections of the credit review have been updated from our 2014 report when relevant.

Current law authorizes tax credits for 4 different types of corporate or insurer contributions to school tuition organizations (STOs):

1. Corporate and individual (S-corporation) contributions to STOs awarding “low-income scholarships” (A.R.S § 43-1183),
2. Insurer contributions to STOs awarding “low-income scholarships” (A.R.S. § 20-224.06),
3. Corporate and individual (S-corporation) contributions to STOs awarding “displaced or disabled pupil scholarships" (A.R.S § 43-1184), and
4. Insurer contributions to STOs awarding "displaced or disabled pupil scholarships" (A.R.S § 20-224.07).

This review pertains to corporate and individual (S-corporation) income tax credits for displaced or disabled pupil scholarship contributions pursuant to A.R.S § 43-1184. It also addresses insurance premium tax credits for displaced or disabled pupil scholarship contributions pursuant to A.R.S § 20-224.07 because insurers share the program's $5 million annual tax credit cap. The tax credit review statute (A.R.S. § 43-222), however, does not literally require review of insurance premium tax credits for “displaced or disabled” STO contributions.

This credit is provided to corporations and insurers for voluntary contributions to STOs. A STO is a charitable organization that is exempt from federal taxation and that allocates at least 90% of its revenue for educational scholarships or tuition grants to children to attend non-governmental elementary or secondary schools. A STO may use up to 10% of corporate contributions for administration expenses.

STO scholarships from this program may be awarded only to students who lived in foster care at any time prior to graduating from high school or obtaining a GED, or who have been identified at any time as having a disability under federal or state law. Prior to FY 2015, recipients typically also had to be prior public school pupils, but that restriction and other related qualifiers (such as being a military dependent) were eliminated by Laws 2014, Chapter 278.

A student's scholarship or grant under the program is capped at the actual cost of their tuition or at 90% of the amount of state aid that the student would receive if in public school, whichever is less (A.R.S. § 43-1505B).

A corporation, S-corporation, or insurer may not use a tax credit for any contribution for displaced or disabled pupil scholarships if it designates the contribution for a particular student.

The Arizona Department of Revenue (ADOR) typically reports tax credit data for this program separately from related data on STO contributions and scholarships, and typically reports more current data for the former. In addition, some of ADOR's tax credit data excludes insurers and the Arizona Department of Insurance (ADOI) reports less detailed data on insurer tax credits for the program than ADOR reports for corporations and S-corporations. This analysis uses whatever available data are most recent and complete for each metric. It therefore is not always able to compare data for different program metrics, such as STO contributions and tax credits claimed, for the same fiscal year.

Refundable

The credit is not refundable.

Carry Forward

The unused portion of the credit may be carried forward for a maximum of 5 consecutive years.

History and Rationale

The corporate and insurer displaced or disabled pupil scholarship tax credits were both created by Laws 2009, 2nd Special Session, Chapter 1 and became effective starting in FY 2010. They were established after the Arizona Supreme Court ruled in March 2009 that prior scholarship programs established for displaced or disabled pupils by Laws 2006, Chapters 340 and 358 violated a prohibition in the state Constitution on appropriating public monies to private schools. The displaced or disabled pupil scholarship tax credit program addressed that ruling by funding scholarships for displaced or disabled pupils indirectly through tax credit-eligible STO contributions from corporations and insurers, rather than directly from the state General Fund.

In September 2006 (3 years before the displaced or disabled pupil scholarship tax credits took effect), the Arizona School Boards Association and the Arizona Chapter of the American Civil Liberties Union filed suit against the state regarding the related corporate "low income student scholarship" STO tax credit (A.R.S § 43-1183). In *Green v. Garriott*, plaintiffs alleged that corporate contribution "set asides" in the associated laws violated the "general and uniform" provision of the state's public education system. The Maricopa County Superior Court ruled in favor of the state in a ruling that was later upheld by the Arizona Court of Appeals. The plaintiffs appealed to the Arizona Supreme Court, but in 2009 it declined to review the case, making the Superior Court ruling stand.

Corporations, individuals (S-corporations), and insurers also may receive tax credits for contributions to STOs under a separately-authorized program for "low income" students. The "low income pupil scholarship" STO tax credit is not subject to Committee review this year. *Attachment 1* provides an overview of all current STO tax credit programs.

The statute creating the displaced or disabled pupil scholarship income tax credit program does not include a specific statement of purpose or a rationale. As noted above, however, the program was created after a related state-funded program for providing scholarships to displaced or disabled students was ruled unconstitutional.

Revenue Impact

There is no separate cap on the amount of tax credits that an individual corporation, individual (S-corporation), or insurer can claim under the program. In the aggregate, however, corporate, individual (S-corporation), and insurer tax credits for contributions for displaced or disabled pupil scholarships are permanently capped at $5.0 million per year pursuant to A.R.S. § 43-1184C1. Because of this cap, STO contributions from corporations, individuals (S-corporations), and insurers must be pre-approved by the ADOR to be eligible for a tax credit. Since FY 2015, contributions from corporations, individuals (S-corporations) and insurers combined have met the $5 million cap annually (*see Table 1 below*).

Table 1

Contributions to School Tuition Organizations for Displaced or Disabled Pupil Scholarships by Fiscal Year 1/

Fiscal Year	Statutory Limitation	# of Donors	$ Approved by DOR	$ Received by STOs
2010	$5,000,000	6	$1,478,880	$1,478,880
2011	$5,000,000	8	$1,079,000	$1,029,000
2012	$5,000,000	6	$283,000	$283,000
2013	$5,000,000	14	$3,580,350	$3,505,350
2014	$5,000,000	27	$3,112,745	$2,957,765
2015	$5,000,000	28	$5,000,000	$5,000,000
2016	$5,000,000	38	$5,325,000	$5,000,000
2017	$5,000,000	34	$5,147,000	$5,000,000

1/ Data are for corporations, individuals (S-corporations) and insurers combined.

Source: "School Tuition Organization Income Tax Credits in Arizona Summary of Activity: FY 2016/2017" (page 37) from the Arizona Department of Revenue (April 2019)

Table 2

Tax Credit Claims by Tax Year (Corporations and S-corporations only) 1/ 2/

Tax Year	# of Claimants 3/	Total Credit Available 4/	Credits Used 5/	Carry-Forward
2009	x 6/	x	x	x
2010	x	x	x	x
2011	3	$170,000	$170,000	$0
2012	x	x	x	x
2013	14	$506,600	$368,600	$138,000
2014	17	$2,624,300	$2,334,000	$290,300
2015	24	$2,575,900	$1,974,200	$601,600
2016	21	$1,190,400	$769,100	$421,200
2017 6/	35	$380,700	$318,500	$62,200
2018 7/	16	$210,100	$181,900	$28,100

1/ As reported by the Arizona Department of Revenue (ADOR). Excludes credits claimed by insurers, which are not reported by ADOR. The Arizona Department of Insurance (ADOI) reports tax credit usage data for insurers for this program, but in a less detailed manner and on a fiscal year rather than tax year basis *(see Table 3).*
2/ The table combines data reported for corporations and individuals (S-corporations).
3/ The number of taxpayers who claimed the credit in each year.
4/ The total tax credits identified in each tax year, including any new credits and any credits carried over from a previous year and identified in that year.
5/ The total value of credits claimed in each year. Since the credit is refundable, the amount of used credits equals the amount of available credits.
6/ No data publicly released by ADOR for Corporate Credits in Tax Years 2009, 2010, 2012, and 2017.
7/ Preliminary data for individuals (S-corporations) only.

Source: "Arizona's Individual and Corporate Income Tax Credit Report" (pages 1 and 5) from the Arizona Department of Revenue (October 2019).

Table 1 summarizes contributions to STOs for displaced or disabled pupil scholarships since the beginning of the program in FY 2010. In FY 2017 (latest published data on donations received), 9 corporations, 10 individuals (S-corporations), and 15 insurers (34 donors total) donated a total of $5.0 million to STOs under the program.

The average contribution made by donors in the first year of the program (FY 2010) was $246,500 ($1,478,880 ÷ 6 corporations). The average contribution in the most recent data year (FY 2017) was $147,100 ($5,000,000 ÷ 34 donors).

ADOR also reports tax credits claimed for STO contributions, but on a tax year basis (January 1 - December 31 for most taxpayers) rather than a fiscal year basis (July 1 - June 30) and for corporations and individuals (S-corporations), but not insurers. A tax year may start in any month of the calendar year. Given the overlap of tax years and fiscal years, the liability for any one tax year could affect one of 4 fiscal years.

Table 2 summarizes tax credit claims for corporations and individuals (S-corporations) for the program by tax year since its inception, as reported by ADOR. TY 2018 data for individuals (S-corporations) are preliminary due to extension returns pending at the time of the report.

Contributions do not necessarily result in the taxpayer using the credit immediately. A corporation, individual (S-corporation), or insurer may lack enough liability to take the full credit in the year in which the donation is made. To address that issue, A.R.S. § 43-1184E and A.R.S. § 20-224.07D allow them to carry forward any claimed but unused credit for up to 5 years. *Table 2* shows the amount of credits claimed and carried forward by corporations and individuals (S-corporations) by tax year since the program's inception. Similar but less detailed data for insurers are summarized in *Table 3*.

Table 3
Tax Credit Claims by Fiscal Year (Insurers only) 1/

Fiscal Year	Credits Used
2014	$2,762,900
2015	$2,988,400
2016	$2,950,900
2017	$3,477,300
2018	$2,762,900
2019	$3,448,100

1/ As reported by the Arizona Department of Insurance (ADOI) in unpublished memos for the fiscal years shown. ADOI was not required to report this information prior to FY 2014.

Table 3 summarizes tax credit data for insurance companies by fiscal year, as reported by the ADOI. *Table 3* has less detail than *Table 2* because ADOI reports less information on tax credit usage by insurers than ADOR reports for corporations and individuals (S-corporations). In addition, ADOR reports the detailed tax credit data shown in *Table 2* on a tax year basis only, while ADOI reports its data only by fiscal year.

Given the multi-year period over which corporations and insurers can claim credits under this program, the *Table 1* data on contributions are probably more reflective of the credit's current use than the *Table 2 & 3* data on credit usage.

The tax credit may impact state K-12 education costs, since some students receiving displaced or disabled pupil scholarships under the program otherwise might have attended public schools. Currently each pupil added to the statewide K-12 Average Daily Membership (ADM) count costs the state General Fund on average about $6,800, or roughly $23,500 if they are disabled (depending on their disability). Data on the mix of "displaced" versus "disabled" pupils receiving STO scholarships under this program are not available.

For the Empowerment Scholarship Account (ESA) program authorized by A.R.S. § 15-2402, however, (which also serves displaced or disabled pupils) ADE currently reports that there are approximately 9 "disabled" students for every 1 "displaced" student in the program. Assuming this same ratio for the corporate and insurer displaced or disabled pupil scholarship tax credit program would result in an assumed average savings for that program of roughly \$21,800 per student for students who otherwise would attend public schools (\$23,500 X 9 disabled students + \$6,800 X 1 displaced student = \$218,300 savings for every 10 displaced or disabled STO scholarship recipients; \$218,300 ÷ 10 students ≈ 21,800 average savings per student).

This implies that roughly 230 students would have to no longer attend Arizona public schools because of the program in order for it to have no net state cost (\$5.0 million in assumed annual credits ÷ \$21,800 estimated average state savings per student ≈ 230 students). The number of students receiving a STO displaced or disabled pupil scholarship who otherwise would be attending state-funded public schools is unknown. In addition, the break-even number of public school "leavers" under the program would vary from year to year depending on the total value of tax credits used and the mix of displaced versus disabled pupils in the program.

The program funded 1,103 scholarships in FY 2017, as shown in *Table 4*. The 1,103 number, however, is not directly comparable to the 230 "break even" number cited above because students can receive a displaced or disabled pupil scholarship from more than one STO, so it reflects a duplicated count of participating students.

Beyond its impact on K-12 operating costs, the credit theoretically could result in lower School Facilities Board (SFB) costs for new school construction. New school construction costs would be reduced if the SFB approved fewer new schools because of lower public school enrollment growth from the credit.

Economic Benefits

This credit is not directly designed to promote economic development or spur investments that would result in new jobs. Instead, according to DOR's August 2000 report "Income Tax Credits in Arizona," this credit is one of several tax credits in statutes primarily intended to encourage cash contributions to certain target groups in society, such as the working poor or students in private or public schools.

More Background

In FY 2017 (latest published data), STOs distributed \$5,750,839 in displaced or disabled pupil scholarships (1,103 scholarships to 164 schools) from corporate, individual (S-corporation), and insurer contributions (*see Table 4*). The \$5,750,800 scholarship total for FY 2017 is more than the \$5,000,000 contribution total shown for the year in *Table 1* because of the availability of carry-forward funding. In addition, STOs sometimes dedicate a portion of current year donations for multi-year scholarships for specific students, rather than earmarking all prior year contributions for current year scholarships. The data cited in *Table 4* are from STO annual reports, rather than corporate or insurer income tax filings, so are not confidential.

Historically, the average displaced or disabled pupil scholarship has varied from a low of \$3,360 in FY 2013 to a high of \$5,485 in CY 2009 (the program's first year) *(see Table 5).* Between CY 2010 and FY 2017, there was an increase of 989 scholarships distributed, or 867%. At the same time, the total amount of dollars distributed increased by \$5,125,500, or 820%.

ADOR's April 2019 STO report notes that the number of scholarships paid does not equate to the number of students receiving scholarships because families often apply for scholarships from more than one STO. Thus, the number of scholarships reported in *Tables 4 and 5* do not equal the number of students receiving STO scholarships from this program. Schools do not report the number of individual students receiving STO scholarships.

There are 4 different private school STO tax credit programs *(see Attachment 1)*. Students received 76,987 scholarships from the 4 STO scholarship programs combined in FY 2017 *(see Table 6)*. This equals 1.6 STO scholarships, on average, for each of Arizona's roughly 48,000 private school pupils (76,987 scholarships ÷ 48,000 pupils = 1.6 average scholarships per pupil). Some pupils, such as public school switchers and military dependents, can receive scholarships from more than one STO program (such as Switcher and Corporate Low Income) in addition to receiving scholarships from more than one STO within the same STO program (such as Switcher).

Table 4

Displaced or Disabled Pupil Scholarships for Fiscal Year 2017 by School Tuition Organization

School Tuition Organization	# of Scholarships	# of Schools	Scholarship Amount	Average
AAA Scholarship Foundation	80	44	$800,723	$10,009
Academic Opportunity of Arizona	24	7	$152,841	$6,368
America's Scholarship Konnection Inc.	12	2	$38,863	$3,239
Arizona Community Foundation STO	105	53	$381,201	$3,630
Arizona Leadership Foundation	361	67	$3,097,435	$8,580
Arizona Private Education Scholarship Fund	134	38	$410,241	$3,061
Arizona Scholarship Fund	2	1	$2,002	$1,001
Arizona School Choice Trust	20	5	$77,263	$3,863
Arizona Tuition Connection	25	15	$54,000	$2,160
Arizona's Catholic Tuition Support Organization (CTSO)	54	25	$182,993	$3,389
Dynamite Montessori Foundation	1	1	$1,500	$1,500
Financial Assistance for Independent Schools	25	2	$93,283	$3,731
Institute for Better Education	154	65	$224,120	$1,455
Lexington Education Foundation	4	1	$25,585	$6,396
Life Development Institute Education Fund	2	1	$4,406	$2,203
School Choice Arizona	24	8	$46,059	$1,919
Tuition Organization for Private Schools	62	22	$138,431	$2,233
Yuma's Education Scholarship Fund for Kids	14	2	$19,893	$1,421
TOTAL	**1,103**	**164** 1/	**$5,750,839**	**$5,214**

1/ Unduplicated total, as some schools received scholarships from more than one STO.

Source: "School Tuition Organization Income Tax Credits in Arizona Summary of Activity: FY 2016/2017" (page 43) from the Arizona Department of Revenue (April 2019)

Table 5

Displaced or Disabled Scholarships by Fiscal Year

Fiscal Year	# STOs	# Scholarships	$ Distributed	Avg. Scholarship
2009 1/	5	114	$625,335	$5,485
2010 1/	6	166	$715,424	$4,310
2011	5	114	$559,333	$4,906
2012	5	119	$583,865	$4,906
2013	6	217	$731,231	$3,360
2014	8	346	$1,611,469	$4,657
2015	12	806	$3,581,873	$4,444
2016	14	934	$4,370,439	$4,679
2017	18	1,103	$5,750,839	$5,214

1/ Reported data are for calendar year rather than fiscal year (reporting period changed after FY 2010).

Source: "School Tuition Organization Income Tax Credits in Arizona Summary of Activity: FY 2016/2017" (page 38) from the Arizona Department of Revenue (April 2019)

Table 6

Scholarship Summary for All STO Program Combined for FY 2017

STO Program	Number of Scholarships	Scholarships ($)	Tax Donations ($)
Original Individual	32,585	$58,005,669	$68,649,049
Switcher Individual	22,348	$32,990,297	$39,384,320
Low-Income Corporate	20,951	$51,751,384	$61,907,365
Displaced/Disabled Corporate	1,103	$5,750,839	$5,000,000
Total	**76,987**	**$148,498,189**	**$174,940,734**

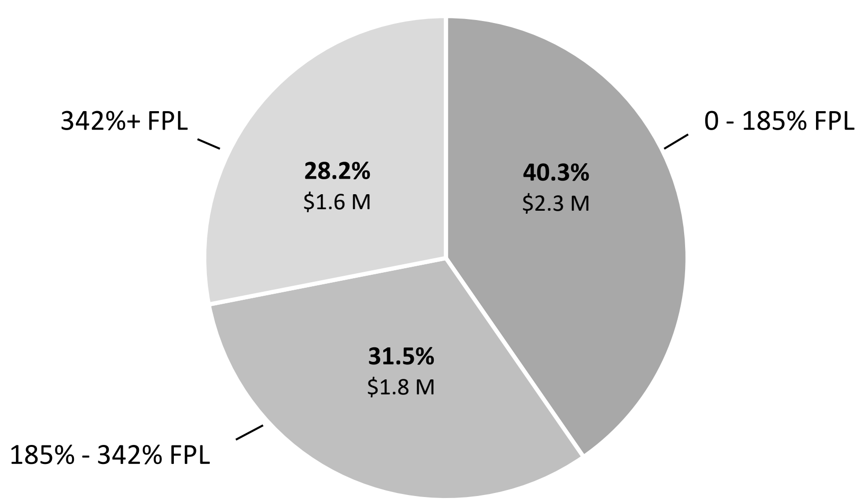
Source: "School Tuition Organization Income Tax Credits in Arizona Summary of Activity: FY 2016/2017" (pages 12, 21, 31, and 39) from the Arizona Department of Revenue (April 2019)

A.R.S. § 43-1603B5 requires STOs to report the percentage and total dollar amount of scholarships awarded during the previous year to the following: 1) students whose family income qualifies them for free or reduced price lunches (FRPL) under the federal school lunch program (up to 185% of the poverty level, or $44,863 for a family of four for FY 2016), and 2) students whose family income exceeds the FRPL eligibility threshold by less than 185% (up to 342.25% of the poverty level, or $83,167 for a family of 4 for FY 2017).

DOR reports that for FY 2017, students with family income of up to 185% of the federal poverty level (FPL) received 40.3% ($2.3 million) of program scholarships that year and that students with family income of 185% to 342% of the FPL received 31.5% ($1.8 million) of scholarships. The remaining 28.2% of scholarships ($1.6 million) went to students whose family income was greater than 342% of the FPL ($83,167 for a family of 4 for FY 2017) (see *Chart 1*).

Chart 1

Overall Share of FY 2017 Displaced/Disabled Scholarships by Family Income



Private schools enrolled an estimated 48,039 students in FY 2018 under most recent estimates from the National Center on Education Statistics (NCES), which is the federal clearinghouse for education data. This represented approximately 4.2% of Arizona's total K-12 population in FY 2018.

Historical data on private and public school enrollment is summarized in *Table 7.*

Table 7

Private and Public School Enrollment

	FY 1998	FY 2002	FY 2008	FY 2010	FY 2018	FY 98 – 18 Growth
Private School Enrollment [1/]	44,991	44,360	51,590	44,559	48,039	6.8%
Public School Enrollment [2/]	777,722	877,928	1,041,062	1,049,732	1,112,393	43.1%

1/ Data from the National Center for Education Statistics: Private School Universe Survey
2/ Data from the Arizona Department of Education: Annual Report

As indicated in *Table 7,* Arizona's private school enrollment grew from 44,991 students in FY 1998 (the first year of STO tax credits) to an estimated 48,039 students in FY 2018, which was an increase of 3,048 students, or 6.8%. *Table 7* shows relatively strong private school growth through FY 2008 (up by 6,599 students, or 15%) followed by a steep decline (-7,031 students, or - 13.6%) between FY 2008 and FY 2010. The latter decline then was followed by relatively strong private school growth between FY 2010 and FY 2018 (up by 3,480 students, or 7.8%). The steep decline after FY 2008 may have been influenced by the Great Recession and continuing growth in charter school options for school-age children.

Complexity

ADOR indicates that it is administratively simple for corporations, insurers, and individuals (S-corporations) to donate to STOs and claim the credit. However, due to the significant increase in volume of corporate donation pre-approval requests and the statutory requirement to process them on a first-come/first-served basis, ADOR indicates that the process by which STOs receive pre-approval from ADOR has become very complex for both the STOs and ADOR.

ADOR indicates that the annual reporting process for the program has been streamlined so that it is less time consuming for both STOs and ADOR. It reports, however, that many STOs still utilize volunteer staff, which leads to reporting inconsistencies and makes it difficult for ADOR to educate STO staff on reporting requirements.

ADOR indicates that its oversight responsibilities of STOs currently rely on the review of annual reports and audits/reviews submitted by the STOs. It notes that any additional oversight by ADOR is not fully achievable at this time due to the number of ADOR staff, the increase in the number of STOs as well as the growth in the donation/scholarship programs.

Potential Performance Measures

Performance measures could include:

1. Percentage of STO revenues retained for administrative costs.

   The STOs would have this information readily available.

2. Percentage of private school tuition paid for with award funding.

   This information appears to be collected by STOs but would require additional reporting.

Prior Review

The Credit for Contributions to School Tuition Organizations for Displaced or Disabled Students was previously reviewed during the 2014 review cycle. The Committee recommended that the credit be retained and placed on the income tax credit review schedule for 2019.