Ohio Legislative Service Commission

Russ Keller

Fiscal Note & Local Impact Statement

Bill: H.B. 419 of the 128th G.A. **Date**: March 23, 2010

Status: As Introduced **Sponsor**: Reps. Derickson and Mallory

Local Impact Statement Procedure Required: Yes

Contents: To authorize an income tax deduction for the taxable portion of a federal Pell Grant or Ohio College Opportunity Grant used to pay room and board for a postsecondary student

State Fiscal Highlights

STATE FUND	FY 2010	FY 2011	FUTURE YEARS
General Revenue Fund			
Revenues	Minimal loss, if any	Potential revenue loss up to $2.65 million	Potential annual revenue loss up to $2.64 million assuming current OCOG and Pell Grant distribution formulas remain constant
Expenditures	- 0 -	- 0 -	- 0 -

Note: The state fiscal year is July 1 through June 30. For example, FY 2010 is July 1, 2009 – June 30, 2010.

- Authorizing the taxable portion of a federal Pell Grant or Ohio College Opportunity Grant (OCOG) to be excluded from taxable income would reduce GRF personal income tax revenues by up to $2.65 million in FY 2011.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2010	FY 2011	FUTURE YEARS
Local Government Fund and Public Library Fund			
Revenues	Minimal loss, if any	Potential revenue loss up to $158,600	Potential annual revenue loss up to $165,600 assuming current OCOG and Pell Grant distribution formulas remain constant
Expenditures	- 0 -	- 0 -	- 0 -
School Districts			
Revenues	- 0 -	Possible loss	Possible loss
Expenditures	- 0 -	- 0 -	- 0 -

Note: For most local governments, the fiscal year is the calendar year. The school district fiscal year is July 1 through June 30.

- Authorizing the taxable portion of a federal Pell Grant or Ohio College Opportunity Grant (OCOG) to be excluded from taxable income would reduce Local Government Fund (LGF) and Public Library Fund (PLF) revenues up to $158,600 in FY 2011.
- The reduction in Ohio taxable income under the bill would reduce school district income tax revenues to those districts that use Ohio taxable income as the basis for calculation of taxes owed.

Detailed Fiscal Analysis

H.B. 419 authorizes an individual to deduct, for purposes of determining Ohio adjusted gross income, amounts used to pay for room, board, and any meal plan administered by the educational organization, if the amounts were received in the form of a federal Pell Grant or an Ohio College Opportunity Grant (OCOG). The Federal Pell Grant Program provides need-based grants to low-income undergraduate and certain postgraduate students. The Ohio College Opportunity Grant Program provides need-based assistance to Ohio residents in nursing degree and undergraduate programs.

Federal law excludes from an individual's adjusted gross income amounts received as a scholarship or fellowship grant to the extent the individual uses the funds for tuition, fees, books, supplies, and equipment required for courses of instruction at a post-secondary educational organization. Amounts used for room and board are not exempt and are therefore included in federal adjusted gross income. Because federal adjusted gross income is the starting number for determining an individual's Ohio tax liability, amounts used for room and board are subject to Ohio income taxation.

The deduction applies to taxable years ending on or after the effective date of the bill. If the Pell Grant recipient is a spouse or a dependent of a taxpayer, the taxpayer may exclude the applicable Pell Grant amount from his/her Ohio taxable income.

Fiscal effect

Recent changes in the distribution formula for the OCOG substantially impact the degree to which Pell Grants will be used for room and board. Because of laws enacted by the current biennial operating budget, Pell Grants will be increasingly used to cover the cost of tuition. Presently, OCOG funds are restricted to tuition and general fees. As a result, the income tax exemption of OCOG funds would have no fiscal impact.[1] If, in the future, room and board expenses are included in the OCOG award, the proposed income tax exemption may have an effect. Therefore, LSC staff estimates that H.B. 419 would reduce personal income tax revenue by less than $3 million in tax year (TY) 2010, assuming the H.B. 419 provisions were in effect then.

Federal Pell Grants are direct grants awarded through participating institutions to students with financial need who have not received their first bachelor's degree or who are enrolled in certain postbaccalaureate programs that lead to teacher certification

[1] Under current law, there is one exception to the OCOG limitations, affecting only a small group of students. The Chancellor is permitted to award OCOG funds to pay housing costs if a student is enrolled in a two-year institution and is eligible for an Education and Training Voucher available to students currently or formerly in the foster care system. However, OCOG-eligible living expenses for these students would be unlikely to qualify for the tax exemption because the exemption is limited to funds used for room and board furnished by the student's institution and very few two-year institutions offer on-campus housing and meal plans.

or licensure. Data from the Ohio Board of Regents indicate that Ohio institutions received $469.2 million for the 2006-2007 academic year through the Federal Pell Grant Program, and the average award was $2,281. For the most part, educational institutions that have their own room and board facilities are four-year institutions. The average Pell Grant award at public four-year institutions in 2006-2007 was $2,459, and 71,238 students received this award. For private four-year institutions, there were 28,113 recipients receiving an average award of $2,453.

Changes in the most recent operating budget made it so Pell Grants are less likely to be used toward the cost of room or board furnished by an educational institution. The OCOG is the only state-funded need-based financial aid program for students in postsecondary education. According to H.B. 1 of the 128th General Assembly, students attending all public and private nonprofit institutions are eligible for OCOG. The new OCOG distribution formula specifies that OCOG awards are determined based on the student's remaining "state cost of attendance" after the student's federal Pell Grant and expected family contribution (EFC) are applied. EFC is determined based on the Federal Application for Free Student Aid (FAFSA), which also determines Pell eligibility. The "state cost of attendance" is established by the Chancellor of the Board of Regents and is calculated for each campus individually based on tuition, fees, and other expected educational costs, including books and transportation. Because the new OCOG distribution formula is predicated on the presence of Pell Grants and EFC, the Pell Grants will supplant OCOG awards in paying for tuition. Therefore, this new H.B. 1 provision has the effect of limiting the use of Pell Grants to room and board expenses. OCOG awards based on state cost of attendance are more restrictive than Pell Grants because, while OCOG can be applied only to instructional costs, the Pell Grant may be used for things like living expenses. Due to federal Pell Grant increases, students of Ohio's community colleges, state community colleges, and technical colleges will have a state cost of attendance that is completely covered by Pell Grants and EFC, and will not receive OCOG awards in FY 2010. Students of many branch campuses will also be ineligible due to low state cost of attendance. Thus, the likeliest Pell Grant recipients to utilize this tax provision are those at four-year colleges, and specifically, public four-year colleges given that those institutions generally have lower tuition than private four-year colleges.

According to the National Center for Education Statistics (NCES), the majority of Pell Grants valued at $1,500 or more awarded to dependent students are awarded to students from households with annual incomes below $32,000. However, most of the Pell Grants valued at $1,499 or less awarded to dependent students are awarded to those from households with incomes between $32,000 and $59,999 (refer to Table 1). The highest Pell Grant awards for students with independent filing status and those that file returns with a spouse are concentrated in lower income classifications (refer to Table 2), i.e., annual incomes below $27,000.

Table 1: Pell Grant Awards by Household Income of Student with Dependent Status

Pell Grant Award	Less than $32,000	$32,000-59,999	$60,000-91,999	$92,000 or more	Total
$1-1,499	39.4%	56.0%	4.6%	0.0%	100%
$1,500-2,499	62.7%	36.0%	1.3%	0.0%	100%
$2,500-3,999	79.1%	20.5%	0.4%	0.0%	100%
$4,000 or more	95.6%	4.0%	0.4%	0.0%	100%

Source: U.S. Department of Education, National Center for Education Statistics, 2003–2004 National Postsecondary Student Aid Study (NPSAS:04).

Table 2: Pell Grant Awards by Household Income of Student with Independent Status or Filing Jointly with Spouse

Pell Grant Award	Less than $12,000	$12,000-26,999	$27,000-48,699	$48,700 or more	Total
$1-1,499	31.2%	36.8%	28.8%	3.2%	100%
$1,500-2,499	47.9%	32.2%	19.2%	0.7%	100%
$2,500-3,999	48.6%	37.1%	13.9%	0.4%	100%
$4,000 or more	64.6%	32.2%	3.1%	0.2%	100%

Source: U.S. Department of Education, National Center for Education Statistics, 2003–2004 National Postsecondary Student Aid Study (NPSAS:04).

According to information from the Ohio Department of Taxation, the average effective tax rate for those households with a Federal Adjusted Gross Income (FAGI) below $35,000 is 1.20%.[2] That effective tax rate corresponds with higher statutory tax rates for tax year 2007. H.B. 66 of the 126th General Assembly and H.B. 318 of the 128th General Assembly reduced personal income tax rates by 16.8% over five years. Adjusting for the reduction in tax rates, a TY 2007 effective tax rate of 1.20% is comparable to a TY 2010 tax rate of 1.15%. A slightly lower effective tax rate will be applicable for TY 2011 and all years thereafter once personal income tax rates are further reduced by 4.2%.

In order to account for the changes to OCOG funding enacted by H.B. 1, only Pell Grant recipients at four-year institutions are included in this fiscal analysis. It is highly likely that Pell Grants will be infrequently used for room and board at other types of institutions. Table 3 below estimates the maximum revenue loss for TY 2010 assuming that every Pell Grant recipient at a four-year institution uses their entire award for room and board. The actual revenue loss would likely be lower because many students at four-year colleges will use their Pell Grant toward tuition, and even those that use them toward the cost of room and board may not choose to live on campus. Nevertheless,

[2] NCES data indicate that a majority (54%) of Pell Grants valued at and above $2,500 are awarded to recipients with independent tax status. A substantial majority of these recipients earn less than $27,000 and most have an effective tax rate less than 1.0%. On the other hand, the dependent students coming from households with incomes above $32,000 receive a meaningful portion of the larger Pell Grant awards, so LSC staff utilizes the income brackets between $0 and $35,000 to approximate the household income of Pell Grant recipients.

data are unavailable for LSC staff to estimate the impact of these two factors. Thus, a maximum annual revenue loss estimate is provided below. The foregone revenue is equal to the award amount multiplied by 1.15% (*in order to account for the income tax receipts lost by the exclusion of the award from taxable income*) and the product is multiplied by the number of award recipients. This analysis assumes the number of recipients and the average amount of the Pell Grant awards are equal to 2006-2007 levels. Also, the estimate assumes that no taxpayer has more than one Pell Grant recipient in their household.

Table 3: Estimated Revenue Loss by Type of Educational Institution

Educational Institution	Number of Pell Grant Recipients	Average Award	Foregone Personal Income Tax Revenue
Public, Four-Year Total	71,238	$2,459	$2.0 million
Private, Four-Year Total	28,113	$2,453	$0.8 million
All Four-Year Total	99,351	$2,457[3]	$2.8 million

School district income taxes are based on either Ohio taxable income of taxpayers residing in the school district or on the portion of that income that is earned income, generally limited to wages and self-employment income. School boards and voters of individual school districts choose whether to enact income taxes in their districts and which of these two tax bases to use. For school districts in which Ohio taxable income serves as the starting point for calculation of school district income taxes, exclusion from Ohio taxable income of Pell Grant and OCOG awards will reduce school district income tax revenues. LSC does not have an estimate of the amount of this reduction. As of January 2010, 178 school districts levied an income tax. During FY 2009, school districts raised $322.6 million through school district income taxes. The amount of the local revenue reduction for each respective school district depends on the number (if any) of Pell Grant and OCOG recipients living in that district who use the awards to pay room and board for a postsecondary student.

In conclusion, the proposal set forth in H.B. 419 to exclude from taxable income any federal Pell Grant amounts used for room or board at the institution's facilities would reduce personal income tax revenue by a sum less than $3 million in TY 2010. During the FY 2010-2011 biennium, the GRF will bear 94.35% of the total revenue loss and the Local Government Fund (LGF) and Public Library Fund (PLF) would bear 3.68% and 1.97%, respectively. Upon expiration of temporary law authorized by Am. Sub. H.B. 1 of the 128th General Assembly, the PLF will resume its statutory share of personal income tax revenue, which is 2.22%. Thus, beginning in FY 2012, the GRF will bear 94.1% of the total revenue loss.

HB0419IN / sle

[3] Weighted average of Pell Grant awards at both types of educational institutions.