DEPARTMENT OF TAXATION
2012 Fiscal Impact Statement

1. **Patron** Mark D. Obenshain

2. **Bill Number** SB 241

   House of Origin:
   X **Introduced**
   _____ **Substitute**
   _____ **Engrossed**

   Second House:
   _____ **In Committee**
   _____ **Substitute**
   _____ **Enrolled**

3. **Committee** Senate Finance

4. **Title** Income tax; educational improvement scholarships tax credits

5. **Summary/Purpose:**

This bill would expand the Neighborhood Assistance Act Tax Credit program by increasing the tax credit percentage from 40 percent to 64 percent of the value of donations. This bill would also expand the requirements for neighborhood organizations to include assistance provided to an individual with a family annual household income not in excess of 300 percent of the current poverty guidelines, or an eligible student with a disability. Additionally, this bill would eliminate the sunset date for the Neighborhood Assistance Act Tax Credit program. The effective date for the provisions relating to the Neighborhood Assistance Act Tax Credit is not specified.

This bill would allow businesses to claim a credit against the corporate income, bank franchise, and insurance premiums license taxes for contributions to approved scholarship foundations that provide scholarships to students in the Commonwealth with the intent to reduce state expenditures required for K-12 education. The total amount of credits available in any given fiscal year would be capped at $50 million. Any unused tax credits would be refundable. This credit would be effective for taxable years beginning on and after January 1, 2012.

This is an Executive bill.

6. **Budget amendment necessary:** No.

7. **Fiscal Impact Estimates are:** Not available. (See Line 8.)

8. **Fiscal implications:**

<u>Administrative Costs</u>

The Department of Taxation ("the Department") considers implementation of this bill as routine, and does not require additional funding.

Revenue Impact - Neighborhood Assistance Act Tax Credits

The provisions of this bill regarding the Neighborhood Assistance Act Tax Credit program would have no revenue impact. Increasing the tax credit percentage from 40 percent to 64 percent of the value of donations would have no revenue impact because the credit cap is unchanged. Expanding the program to include additional qualifying organizations could potentially decrease the amount of funding available for distribution by organizations that currently qualify. The extension or elimination of the sunset date is included in the official General Fund revenue forecast.

Revenue Impact - Educational Improvement Scholarships Tax Credits

This bill would have an unknown revenue impact. The maximum amount of credits that could be issued annually would be $50 million. The introduced Executive Budget includes $10 million in Fiscal Year 2014 to offset the potential negative revenue impact from this bill. However, if more than 20 percent of the available credits are claimed in Fiscal Year 2014, a budget amendment may be necessary to account for the difference.

Expenditure Impact - Educational Improvement Scholarships Tax Credits

The potential revenue impact from this bill may be offset by a decrease in education expenditures. Donations would be used to fund scholarships, which would result in reduced state expenditures for public K-12 education. Whether such cost reduction would completely offset the costs of the credit would depend on the number and timing of scholarships versus the timing of claims for the tax credit and the location of students accepting the scholarships. State funding is distributed to local school divisions on a per pupil basis using the number of students enrolled, and the per pupil funding amounts and composite index calculated for the division. Due to the composite index, state per pupil funding varies across school divisions. For Fiscal Year 2014, the weighted average per pupil funding amount for students who qualify for the Federal Free and Reduced Lunch Program is projected to be $3,422. The actual figures vary across divisions and would likely range from $1,152 to $5,717 for the lowest and highest divisions.

Assuming that the maximum amount of credits ($50 million) is issued, approximately 14,612 scholarships would need to be distributed by the beginning of the first academic year following the year during which contributions are made in order to achieve a sufficient decrease in education expenditures to break even and offset the cost of the credits. This figure represents approximately 3.18 percent of students who are estimated to qualify for the Federal Free and Reduced Lunch Program in Fiscal Year 2014.

The effectiveness of this bill in offsetting the costs of the credit with the reduced education expenses depends on the timing of contributions and scholarship distributions. This bill requires scholarship foundations to annually distribute 90 percent of tax credit-derived funds as scholarships. The timing of such distribution may depend on when contributions are made, as well as the availability of scholarship recipients. Public schools must report enrollment as of September 30 of the current school year. This figure is used to project March 31 average daily membership (ADM), which is used to determine the amount of funding for budget purposes. Accordingly, students still enrolled in public school as of September 30 would be included in the number of students for purposes of appropriating funds to their respective school divisions. Depending on the timing of contributions made by corporations under this bill, amounts contributed would not necessarily be distributed to scholarship recipients by September of the following school year.

Because scholarships may not be issued until after tax credits are received, this bill may have an initial negative revenue impact. To help resolve this timing issue, this bill provides that the credit may be claimed for the taxable year following the year of contribution. So, if a corporation makes a contribution during Taxable Year 2012, it would be able to claim a tax credit on its Taxable Year 2013 return, which would be filed during Fiscal Year 2014. This delay will allow scholarship foundations time to receive preauthorization from the Department of Education, solicit donations, and provide scholarships to children.

Even with this provision, there is a potential for the amount of tax credits granted to exceed the amount of savings, since there is no guarantee that all scholarships will be awarded during the first year and it will take time for schools to recognize savings. For example, a contribution made in December 2012 would not necessarily be distributed to a student by the beginning of the following school year, but could be distributed mid-school year. A calendar year corporation making this contribution would be entitled to claim a credit on its Taxable Year 2013 return, filed during Fiscal Year 2014. However, if the contribution is distributed as a scholarship in December 2013, such scholarship would not reduce the amount of funding for budget purposes until the 2014-2015 school year, which is in Fiscal Year 2015. To offset this effect in the initial year during which the credit may be claimed, the introduced Executive Budget includes $10 million in Fiscal Year 2014. This budget item is part of the Governor’s expansion of educational options for Virginia students.

In summary, the extent of whether there are costs or savings from this bill depends on the number of scholarships given, the location of students receiving them, and the timing of when the tax credits are taken versus when the scholarships are given. Based on where students eligible for free or reduced lunch now reside, approximately 7,302 students would have to get scholarships to break even. Moreover, the scholarships would have to be awarded by the scholarship foundations fairly soon after receipt of the corporate contributions or there would likely be a fiscal impact caused by timing differences with contributing corporations taking a tax credit in one year and the student savings for public schools showing up in the following year. Because of the potential variation of such impacts, tracking the students involved with these scholarships will be of the utmost importance to ascertain the final impact of the bill (costs or savings).

Finally, it should be noted that state appropriated amounts for public schools are likely to increase in the future, regardless of the enactment of this legislation due to increases in prevailing per pupil cost and enrollment. To the extent that this legislation is successful, it will result in future funding increases being less for public education than would otherwise be the case.

9. Specific agency or political subdivisions affected:

Department of Taxation
Department of Education
All local school divisions

10. Technical amendment necessary: Yes.

To clarify the timing of credits and the required addition to income, the following technical amendments are suggested:

Line 220, after may
Strike: receive
Insert: earn

Line 225, after contribution.
Insert: This credit shall be prorated equally against the corporation's estimated payments made in the third and fourth quarters of the taxable year in which the credit may be claimed and the final tax payment.

Although scholarship foundations are required to conduct an annual audit of tax credit-derived funds and provide summary information to the Department of Education upon request, as well as provide information regarding achievement test results for scholarship recipients, such information would not be adequate for the Department of Education to compute annual savings. To ensure enough information is available for the Department of Education to track the effectiveness of this program, the following technical amendment is suggested:

Line 259, after shall
Strike: over the long term disburse an amount that is not less than 90 percent of its tax-credit-derived funds for qualified educational expenses through scholarships to eligible students.
Insert: disburse at least 90 percent of the amount of each donation for which a tax credit may be received under this Article within one year of such donation for qualified educational expenses through scholarships to eligible students.

Line 262, after foundation.
Insert: Any scholarship foundation that fails to disburse at least 90 percent of any donated amount within one year shall be removed from the annual list published pursuant to this section and shall not be entitled to request preauthorization for additional tax credits, nor shall it be entitled to receive and administer additional tax credit-derived funds. By September 30 of each year, the scholarship foundation shall provide the following information to the Department of Education: (1) the total number and dollar amount of contributions received between September 1 of the prior calendar year and September 1 of the current calendar year, (2) the dates when such contributions were received, and (3) the total number and dollar amount of qualified educational expenses scholarships awarded for the school year that begins during the current calendar year. Any scholarship foundation that fails to provide this report by September 30 shall be removed from the annual list published pursuant to this section

and shall not be entitled to request preauthorization for additional tax credits, nor shall it be entitled to receive and administer additional tax credit-derived funds.

One additional technical amendment is suggested:

Line 282, after on
Insert: an

11. Other comments:

<u>Current Law – Neighborhood Assistance Act Tax Credit</u>

The Virginia Neighborhood Assistance Act provides an income tax credit to businesses and individuals that donate to neighborhood organizations for approved programs that benefit impoverished people. Under this Act, a neighborhood organization is allocated funding through the Neighborhood Assistance Act Program. The Department of Social Services and the Department of Education are responsible for approving the programs and allocating the tax credits to the neighborhood organizations. An individual or business that donates to an organization that qualifies as a neighborhood organization is then eligible to receive an income tax credit from that neighborhood organization.

A neighborhood organization is defined as any local, regional or statewide organization whose primary function is providing neighborhood assistance for impoverished people, and holding a ruling from the Internal Revenue Service of the United States Department of the Treasury that the organization is exempt from income taxation under the provisions of IRC §§ 501(c)(3) and 501(c)(4), or any organization defined as a community action agency in the Economic Opportunity Act of 1964 (42 U.S.C. § 2701 et seq.), or any housing authority as defined in *Va. Code* § 36-3. To qualify for this credit, at least 50 percent of the persons served by the organization must be impoverished people with annual family income not in excess of 200 percent of the current poverty guidelines.

A business contributing to an approved Neighborhood Assistance Act Program organization is eligible for an income tax credit equal to 40 percent of the contribution. However, the 2010-2012 Appropriation Act allows businesses to claim a credit equal to 45 percent of the qualifying donations. The minimum tax credit that may be issued to a business contribution is $400. A contributing business may take a maximum of $175,000 Neighborhood Assistance Act Program credits in a taxable year.

An individual who contributes directly to an approved Neighborhood Assistance Act Program organization is also eligible for an income tax credit equal to 40 percent of the contribution. The minimum donation by an individual must be at least $500, and the maximum tax credit is $50,000.

The total amount of credits that may be granted for each fiscal year is $11.9 million. Out of this amount $4.9 million is allocated to education proposals, while the remaining $7 million is allocated to all other proposals. Education proposals are defined those that provide as any type of scholastic instruction or scholastic assistance to an individual who is impoverished with family income not in excess of 200 percent of the current poverty guidelines. Under current law, no credits may be issued after July 1, 2014.

Proposed Legislation – Neighborhood Assistance Act Tax Credit

This bill would expand the Neighborhood Assistance Act Tax Credit program by increasing the tax credit percentage from to 64 percent of the value of the money, property, professional services, and contracting services donated by a business firm, or 64 percent of the monetary donation or donation of marketable securities made by an individual.

Currently, to qualify as a neighborhood organization, at least 50 percent of the persons served by the organization must be impoverished people with annual family income not in excess of 200 percent of the current poverty guidelines. Additionally, education proposals are considered to be any type of scholastic instruction or scholastic assistance to an individual with family income not in excess of 200 percent of the current poverty guidelines. This bill would expand these requirements to include assistance provided to an individual with a family annual household income not in excess of 300 percent of the current poverty guidelines, or an eligible student with a disability. For purposes of this bill, an "eligible student with a disability" would be defined as a student (i) for whom an individualized educational program has been written and finalized in accordance with the federal Individuals with Disabilities Education Act (IDEA), regulations promulgated pursuant to IDEA, and regulations of the Board of Education, and (ii) whose family's annual household income is not in excess of 400 percent of the current poverty guidelines.

This bill would also eliminate the sunset date for the Neighborhood Assistance Act Tax Credit program. The effective date for the provisions relating to the Neighborhood Assistance Act Tax Credit is not specified.

Proposed Legislation – Education Improvement Scholarships Tax Credit

Under this bill, a business entity would be able to earn a credit against the corporate income tax, bank franchise tax, and insurance premiums license tax equal to 84 percent of its contributions to a scholarship foundation. The credit would be allowed to be claimed for the taxable year following the year of contribution.

Tax credits would be awarded to businesses on a first-come, first-served basis in accordance with procedures established by the Department of Education. The total amount of credits available in any given fiscal year would be capped at $50 million. Any unused tax credits would be refundable.

Business entities would be required to request and receive preauthorization for a specified tax credit amount from the Superintendent of Public Instruction. The preauthorization notice would accompany the donation from the business entity to the scholarship foundation. The scholarship foundation would be required to return the notice to the Department of Education within 20 days certifying the amount of the donation and date received. A business entity would be required to make the preauthorized contribution within 60 days of issuance of the notice.

In addition to being preauthorized, business entities claiming credit for a contribution would be required to submit verification from each scholarship foundation to which monetary donations have been made. (Note: The receiving scholarship foundation would have to be on the annual list of approved scholarship foundations published pursuant to the legislation in order for the tax credit to be approved.)

Proposed Legislation – Requirements for Scholarship Foundations

Scholarship foundations would be required to apply to the Department of Education in order to be approved to receive and administer tax credit-approved funds. The Department of Education would be required to issue a notice of approval or denial, including reasons for denial to the applicant within 60 days after the application is submitted. A "scholarship foundation" would be defined as a nonstock, nonprofit corporation that is exempt from taxation under IRC § 501(c)(3), that has been approved by the Department of Education, and that is established to provide financial aid for the education of students residing in the Commonwealth.

This bill requires that a qualified scholarship foundation be organized as a § 501(c)(3) tax-exempt charity. To qualify as a tax-exempt charity, an organization must be organized and operated exclusively for one or more of the following exempt purposes: religious, charitable, scientific, testing for public safety, literary, educational, national or international amateur sports competition, and the prevention of cruelty to children or animals. The charity must also meet several other stringent requirements, including that no part of the net earnings of the organization may inure to the benefit of any private individuals; the organization must serve a public interest, rather than benefit a private individual or entity; the organization may not become heavily involved in disseminating propaganda or influencing legislation; and the organization may not participate or intervene in political campaigns. Additionally, the organization must benefit a charitable class, rather than specified individuals, and must not be operated contrary to public policy.

To receive tax-exempt status, an organization must file a 30-page application with the IRS, in which the organization must provide information demonstrating that it has met the above requirements. Upon recognition as a tax-exempt entity, the organization is then required to file an annual information return with the IRS, in which the organization must answer questions to show that it is continuing to comply with these requirements. A non-profit that fails to meet any requirement may be subject to the revocation of its tax-exempt status, meaning that it would no longer be considered a qualified scholarship foundation under this bill.

A scholarship foundation would be required to disburse at least 90 percent of its tax-credit-derived funds over the long term for "qualified educational expenses" through scholarships. Tax credit-derived funds not used for such scholarships would be permitted to be used only for the administrative expenses of the scholarship foundation. "Qualified educational expenses" would mean school-related tuition and instructional fees and materials, including textbooks, workbooks, and supplies used solely for school-related work. Scholarship foundations would be required to provide receipts to individual taxpayers for their contributions.

In awarding scholarships from tax credit-derived funds, the scholarship foundation would be required to (i) provide scholarships to any student whose family's annual household income is not in excess of 300 percent of the current poverty guidelines or any eligible student with a disability; (ii) not limit scholarships to students of one school; and (iii) comply with Title VI of the Civil Rights Act of 1964. Because data about which students qualify for the federal program is confidential, scholarship foundations would need to obtain consent from parents to access data about whether the student qualifies for this program. In mailing scholarship payments, the eligible scholarship foundation would be required to include a written notice to the eligible school that the source of the scholarship was donations made by business entities receiving tax credits.

Scholarship foundations would also be required to ensure that schools selected by scholarship students (i) are in compliance with the Commonwealth's and locality's health and safety laws and codes; (ii) hold a valid occupancy permit as required by the locality; (iii) comply with Title VI of the Civil Rights Act of 1964; and (iv) comply with nonpublic school accreditation requirements administered by the Virginia Council for Private Education or maintain an assessment system that annually measures scholarship students' progress in reading and math using a national norm-referenced achievement test.

Eligible schools would be required to compile the results of any national norm-referenced achievement test for each of its students receiving tax credit-derived scholarships and provide the respective parents or legal guardians of such students with a copy of the results on an annual basis, beginning with the first year of testing of the student. Such schools would also be required to provide the Department of Education the annual achievement test results for each student, as well as student information that would allow the Department to aggregate the achievement test results by grade level, gender, family income level, number of years of participation in the scholarship program, and race. Beginning with the third year of testing of each such student and test-related data collection, the Department of Education would be required to publish the achievement test results and associated learning gains on the Department of Education's website in accordance with such classifications and in an aggregate form as to prevent the identification of any student. Eligible schools would be required to provide to the Superintendent of Public Instruction graduation rates of its students participating in the scholarship program in a manner consistent with nationally recognized standards. In publishing and disseminating achievement test results and other information, the Superintendent of Public Instruction and the Department of Education would be required to comply with all student privacy laws.

The amount of the scholarship provided to any child for any single school year by all eligible scholarship foundations from eligible contributions would not be allowed to exceed the lesser of: (i) the actual qualified educational expenses, or (ii) 100 percent of the per-pupil amount distributed to each local school division as the state's share of the standards of quality costs using the composite index of ability to pay as defined in the general Appropriations Act.

Scholarship foundations would be required to develop procedures for disbursing scholarships in periodic payments throughout the school year to ensure scholarships are portable.

This credit would be effective for taxable years beginning on and after January 1, 2012.

Florida Tax Credit Scholarship Program

Florida offers a similar tax credit for corporations equal to the amount of eligible contributions made to nonprofit scholarship funding organizations. The credit may not exceed 75 percent of the tax due after applying other allowable credits. Additionally, any scholarships generated by this program are capped at $4,100 per student.

For the 2011 fiscal year, this credit was limited to $140 million. For all fiscal years thereafter, the credit cap is equal to the credit cap amount in the prior fiscal year, but is increased by 25 percent in any fiscal year when the annual tax credit amount claimed for the prior year is at least 90 percent of the tax credit cap amount.

Any unused credit amount may be carried forward for three years. The credit is not transferable or refundable.

Several studies have demonstrated the savings generated from the Florida program. In a research memorandum on the fiscal impact of the tax credit scholarship program in FY 2009, the Florida Office of Program Policy Analysis and Government Accountability (OPPAGA) estimated that the scholarship program saved $36.2 million. In a 2008 report on the tax credit scholarship program, OPPAGA had previously estimated that the number of scholarship recipients had increased over time, from 11,550 in FY 2004 to 21,493 in FY 2008. Additionally, in the 2008 report, OPPAGA estimated a net savings of $38.9 million in FY 2008.

Likewise, in its report entitled "The Florida Corporate Income Tax Credit Scholarship Program: Updated Fiscal Analysis, February 2007," the Collins Center for Public Policy concluded that general revenue funds for K-12 public education did not decline as a result of the tax credit scholarship program, but actually increased more than $2 billion over a three year period, from $13.6 billion in FY 2002 to $15.7 billion in FY 2004. The study also found that Florida had accrued nearly $140 million in public school revenues since 2002 as a result of the savings generated by the difference between the scholarship and the value of per pupil state and local revenue for K-12 education.

In its 2008 report, OPPAGA reported that 75 percent of the scholarship recipients were minority students. According to this report, 34 percent of participating students were African American, 35 percent were Hispanic, 25 percent were Caucasian, 2 percent were Asian, and the remaining 4 percent were other ethnicities. A 2010 study conducted by the University of Florida indicated that Florida's program is attracting students who have significant academic problems in public schools.

According to the Thomas Jefferson Institute, the Florida scholarship program generated 15,585 scholarships during the first year of operation, which was approximately 1.4 percent of eligible students. Participation declined slightly during the following two years, but rose to 1.2 percent in the fourth year and has continued to increase every year since. During the 2010-2011 academic year, 34,550 scholarships were awarded, with a participation rate of 2.3 percent of eligible students.

Similar Legislation

House Bill 321 and **Senate Bill 131** would create similar tax credits.

Senate Bill 368 would expand the professional services eligible for tax credits under the Neighborhood Assistance Act to include services provided by mediators certified by the Judicial Council of Virginia.

Senate Bill 680 would expand the definition of "impoverished people" for purposes of the Neighborhood Assistance Act Tax Credit program to include any resident of a nursing home or assisted living facility who is a Medicaid recipient and would decrease the minimum percentage of impoverished persons that a neighborhood organization must serve from 50 to 40 percent.

cc : Secretary of Finance

Date: 2/7/2012 KLC
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