DEPARTMENT OF TAXATION
2011 Fiscal Impact Statement

1. **Patron** James P. "Jimmie" Massie, III

2. **Bill Number** HB 2314
House of Origin:
_____ **Introduced**
_____ **Substitute**
_____ **Engrossed**

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

3. **Committee** Senate Finance

4. **Title** Education Improvement Scholarships; tax credit for donations by business entities.

5. **Summary/Purpose:**

This bill would allow businesses to claim a credit against the corporate income tax for contributions to TAX-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 $25 million. Any unused tax credits would be refundable.

This bill 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>

TAX considers implementation of this bill as routine, and does not require additional funding.

<u>Revenue Impact</u>

The number of Virginia companies that would donate to non-profits and meet the requirements of this bill is unknown, as is the amount they would donate. Because donations would be used to fund scholarships that would reduce state expenditures for K-12 education, the net impact on the amount of General Fund revenue available for appropriation may be less than the amount of tax credits claimed. Thus, although the maximum amount of credits that could be claimed is $25 million, the net impact may be less than that, except in the unlikely scenario that there are no participants in the scholarship program.

Expenditure Impact

The intent of this bill is to create an offset in state expenditures for K-12 education. According to the Department of Education ("DOE"), there is no estimate for the number of eligible students who would receive scholarships under the bill, or in what localities of the Commonwealth these students would reside. The number of students receiving scholarships would depend on the amount of contributions received by the scholarship foundations each year, the level of student utilization of the scholarships, and the per pupil value of the scholarships provided. It is estimated that 467,016 Virginia students would be eligible to receive a scholarship under the income criterion of the bill (annual family household income not to exceed the income amount required for a student to qualify for the federal Free and Reduced Lunch program). For a family of four, this income limit is $40,793 for the higher reduced price lunch income threshold. A similar scholarship program in Florida has approximately 30,000 students participating with similar income eligibility requirements as proposed in the bill.

Under the bill, the scholarship amount provided is the lesser of the actual qualified educational expenses (i.e., tuition, supplies, etc.) or the per pupil amount of state Standards of Quality (SOQ) funding provided to the locality. State funding for the SOQ 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 SOQ funding varies across school divisions. For FY12, state per pupil SOQ funding averages $4,100 statewide; however, due to the composite index, the per pupil amounts vary across divisions and range from $1,300 to $6,700 for the lowest and highest divisions.

If eligible students already enrolled in public school were to attend private school using a scholarship, DOE indicates there would be some state General Fund cost reduction resulting from students moving from public to private schools. These students would no longer be counted in the average daily membership of the school division for the purpose of driving state SOQ funding. Also, the state would avoid the per student cost for eligible kindergarten and first grade students not yet enrolled in public school who use a scholarship to initially enroll in private school. However, DOE cannot estimate the number of students enrolled in public school who would attend private school using the scholarship or the number that would initially enroll in private school, and is unable to make a fiscal estimate until such a program is in operation and such enrollments are taking place. A key factor affecting state cost reduction would be whether there is full utilization each year of the scholarships awarded to students such that the students awarded scholarships move from public to private school or initially enroll in private school, and thus eliminate or avoid the per pupil state cost. This is critical since it is assumed the full value of the tax credit will be taken on the contributions made each year, with the loss of state revenue assumed to be fixed each year based on the level of contributions made.

The bill may need to clarify the income limit used for student eligibility. Since the income limits for reduced price lunch eligibility (185% of federal poverty level) are higher than the limits for free lunch eligibility (130% of federal poverty level), the bill could clarify eligibility is to be based on the higher income limits for reduce price lunch only since that appears to be what is intended.

9. Specific agency or political subdivisions affected:

Department of Taxation
Department of Education

10. Technical amendment necessary: No.

11. Other comments:

<u>Proposed Legislation – Corporate Income Tax Credit</u>

Under this bill, a business entity would be able to earn a corporate income tax credit equal to 70% 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 TAX. The total amount of credits available in any given fiscal year would be capped at $25 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 TAX. 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 TAX 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 receipts from each scholarship foundation verifying such contribution.

A business entity would not be permitted to claim this credit if it is also allowed a federal income tax deduction for a charitable contribution unless the business entity adds the amount of the federal deduction to its Virginia taxable income.

<u>Proposed Legislation – Requirements for Scholarship Foundations</u>

Scholarship foundations would be required to apply to TAX in order to be approved to receive and administer tax credit-approved funds. TAX 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) and 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 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% of its tax-credit-derived funds for “qualified educational expenses” through scholarships. "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, the scholarship foundation would be required to (i) provide scholarships to any student whose family's annual household income is equal to or less than the amount required to qualify for the federal Free and Reduced Lunch Program; (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.

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.

The amount of the scholarship provided to any child for any single school year by all eligible nonprofit 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 appropriation 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 bill 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 is 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.

cc : Secretary of Finance

Date: 2/10/2011 KLC
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