DEPARTMENT OF TAXATION
2013 Fiscal Impact Statement

1. Patron Henry L. Marsh III

2. Bill Number SB 1000

House of Origin:
X Introduced
_____ Substitute
_____ Engrossed

Second House:
_____ In Committee
_____ Substitute
_____ Enrolled

3. Committee Senate Finance

4. Title Tax Credits for Donations to Scholarship Foundations

5. Summary/Purpose:

This bill would repeal the Education Improvement Scholarships Tax Credit. The effective date of this bill is not specified.

6. Budget amendment necessary: No.

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

8. Fiscal implications:

Administrative Costs

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

Revenue Impact

The repeal of the Educational Improvement Scholarships Tax Credit would have an unknown revenue impact, beginning in Fiscal Year 2015. The maximum amount of credits that may be issued annually under current law is $25 million.

Expenditure Impact

Under current law, the potential revenue impact of issuing Education Improvement Scholarships Tax Credits may potentially be offset by a decrease in education expenditures. Donations must be used to fund scholarships, which would result in reduced state expenditures for public K-12 education. Whether such cost reduction will completely offset the costs of the credit depends 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.

The costs or savings from this bill depend 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 7,306 students would have to get scholarships to break even. Because no credits have yet been claimed and no scholarships have yet been distributed under current law, the expenditure savings resulting from the credit remains unknown. Accordingly, the increased expenditures that would result from repealing the tax credit are also unknown.

9. Specific agency or political subdivisions affected:

Department of Taxation
Department of Education

10. Technical amendment necessary: Yes.

Because this bill does not specify an effective date, the bill would likely be effective July 1, 2013. This creates an issue because, although some taxpayers relying on current law may have made donations to scholarship foundations prior to July 1, 2013, the law permitting taxpayers to claim the credit in the following taxable year would be repealed before such taxpayers are able to claim the credit on their Taxable Year 2014 tax returns. Additionally, the requirements imposed on scholarship foundations for using tax credit-derived funds would be repealed prior to the time when such requirements must be met, potentially resulting in scholarship foundations using the tax credit-derived funds for purposes that are prohibited under current law.

Accordingly, the Department recommends a second enactment clause that would specify the effective date of this bill as taxable years beginning on or after January 1, 2013.

11. Other comments:

Current Law

Effective for the 2013 taxable year, taxpayers may earn an Educational Improvement Scholarships Tax Credit equal to 65 percent of the monetary donation made to a qualifying scholarship foundation. This credit may be claimed for the taxable year following the year of contribution, and may be applied against the individual income tax, corporate income tax, bank franchise tax, insurance premiums license tax, or tax on public service corporations. For taxpayers making estimated tax payments, the credit is prorated equally against estimated tax payments made in the third and fourth quarters of the taxable year in which the credit may be claimed, and the final tax payment.

Tax credits are awarded to taxpayers on a first-come, first-served basis. The total amount of credits available in any given fiscal year is capped at $25 million. No tax credit is allowed if the monetary donation is less than $500. No more than $50,000 in tax credits may be issued to an individual or to married persons in a taxable year. The $50,000 limitation does not apply to credits issued to any business entity, including a sole proprietorship. Any unused tax credits may be carried over for the next five succeeding taxable years or until the total amount of credit has been taken, whichever is sooner.

Taxpayers are required to request and receive preauthorization for a specified tax credit amount from the Superintendent of Public Instruction. The preauthorization notice must accompany the donation from the taxpayer to the scholarship foundation. The scholarship foundation is then required to return the notice to the Department of Education within 20 days certifying the amount of the donation and date received. A taxpayer is required to make the preauthorized contribution within 60 days of issuance of the notice. In addition to being preauthorized, taxpayers claiming credit for a contribution are required to submit verification from each scholarship foundation to which monetary donations have been made.

For purposes of this credit, a “scholarship foundation” is 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. In order to be approved to receive and administer tax credit-approved funds, scholarship foundations are required to apply to the Department of Education. The Department of Education is 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 is required to disburse at least 90 percent of the amount of each donation for which a tax credit may be received within one year of such donation for “qualified educational expenses” through scholarships. Tax credit-derived funds not used for such scholarships may 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 must provide receipts to individual taxpayers for their contributions.

By September 30 of each year, each scholarship foundation is required to provide the following information to the Department of Education:

- 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,
- The dates when such contributions were received, and
- The total number and dollar amount of qualified educational expenses scholarships awarded for the school year that began during the current calendar year

Any scholarship foundation that fails to disburse at least 90 percent of any donated amount within one year or that fails to provide the required report by September 30 is removed from the annual list published by the Department of Education and is not entitled to request preauthorization for additional tax credits, nor is it entitled to receive and administer additional tax credit-derived funds.

In awarding scholarships from tax credit-derived funds, the scholarship foundation is required to (i) provide scholarships for qualified educational expenses only to students 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. Scholarship foundations are also be required to ensure that schools selected by students to which tax credit-derived funds may be paid (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 aggregate amount of scholarships provided to each child for any single school year by all eligible scholarship foundations from eligible donations cannot be allowed to exceed the lesser of: (i) the actual qualified educational expenses, or (ii) 100 percent of the per-pupil amount distributed to the local school division in which the student resides 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.

Proposed Legislation

This bill would repeal the Education Improvement Scholarships Tax Credit. The effective date of this bill is not specified. However, the Department would interpret this bill as eliminating the possibility of taxpayers claiming the tax credit on their Taxable Year 2014 returns, thereby essentially invalidating the entire tax credit.

The Education Improvement Scholarships Tax Credit was enacted during the 2012 General Assembly session and may be earned beginning with the 2013 taxable year. Taxpayers may not claim the credit on their tax returns until the year following the year when the credit is earned. Accordingly, the first taxable year in which taxpayers will actually be able to claim the credit is the 2014 taxable year.

Because this bill does not specify an effective date, the bill would likely be effective July 1, 2013. This creates an issue because, although some taxpayers relying on current law may have made donations to scholarship foundations prior to July 1, 2013, the law permitting taxpayers to claim the credit in the following taxable year would be repealed before such taxpayers are able to claim the credit on their Taxable Year 2014 tax returns. Additionally, the requirements imposed on scholarship foundations for using tax credit-derived funds would be repealed prior to the time when such requirements must be met, potentially resulting in scholarship foundations using the tax credit-derived funds for purposes that are prohibited under current law.

Similar Legislation – Executive Bills

House Bill 1996 and **Senate Bill 1227** would expand the Education Improvement Scholarships Tax Credit to donations of marketable securities; would change the reporting requirements imposed on the Department of Education; would increase the maximum amount of donations by an individual for purposes of the Education Improvement Scholarships Tax Credit and Neighborhood Assistance Act Tax Credit to

$125,000; and would extend the expiration date for both programs through Taxable Year 2027.

Senate Bill 1206 would amend several of the requirements imposed on schools and scholarship foundations for purposes of the Education Improvement Scholarships Tax Credit.

Similar Legislation – Other Similar Bills

House Bill 1512 would create an income tax subtraction for income from the lease of a building to a local public school division.

House Bill 1767 would create an income tax credit for donations of machinery and equipment to a community college or vocational school that would be principally used in Virginia in teaching or training students.

Senate Bill 749 would create an income tax credit for contributions to STEM organizations for use in science, technology, engineering, and math (STEM) programs at qualified public schools.

Senate Bill 848 would create a tax credit for scholarships to students attending Virginia two-year colleges.

Senate Bill 1009 would make several changes to the Neighborhood Assistance Act Tax Credit.

cc : Secretary of Finance

Date: 1/21/2013 KLC
SB1000F161