



## **The Great Schools Tax Credit Program Act (Scholarship Tax Credits)**

### *Summary*

The Great Schools Tax Credit Program authorizes a tax credit for individual and corporate contributions to organizations that provide educational scholarships to eligible students so they can attend qualifying public or private elementary or secondary school of their parents' choice.

### *Model Legislation*

**Section 1: {Title}** Great Schools Tax Credit Program Act

**Section 2: {Definitions}**

A) "Program" means the Great Schools Tax Credit Program.

B) "Eligible student" means a student who:

1) is a member of a household whose total annual income during the year before he or she receives an educational scholarship under this program does not exceed an amount equal to 2.5 times the income standard used to qualify for a free or reduced price lunch under the national free or reduced-price lunch program established under 42 USC Section 1751 et seq. Once a student receives a scholarship under this program, the student will remain eligible regardless of household income until the student graduates high school or reaches 21 years of age;<sup>1</sup>

2) was eligible to attend a public school in the preceding semester or is starting school in our state for the first time;<sup>2</sup>

3) resides in our state while receiving an educational scholarship.

C) "Low-income eligible student" means a student who qualifies for free or reduced-price lunch under the national free or reduced-price lunch program established under 42 USC Section 1751 et seq.<sup>3</sup>

D) "Educational scholarships" means grants to students to cover all or part of the tuition and fees at either a qualified non-public school or a qualified public school, including transportation to a public school outside of a student's resident school district.

E) “Qualified school” means either a public elementary and/or secondary school outside of the district in which a student resides or a non-public elementary and/or secondary school in our state that complies with all of the requirements of the program.<sup>4</sup>

F) “Parent” includes a guardian, custodian or other person with authority to act on behalf of the child.

G) “Scholarship Granting Organization” means an organization that complies with the requirements of this program and provides education scholarships to students attending qualified schools of their parents’ choice.

H) “Department” means the state Department of Revenue.

### **Section 3: {Basic Elements of the Great Schools Tax Credit Program}**

A) A taxpayer who files a state income tax return and is not a dependent of another taxpayer may claim a credit for a contribution made to a scholarship granting organization.

B) The credit may be claimed by an individual taxpayer or a married couple filing jointly in an amount equal to the total contributions made to a scholarship granting organization during the taxable year for which the credit is claimed up to 50 percent of the taxpayer’s tax liability.<sup>5</sup>

C) An individual taxpayer or a married couple filing jointly may carry forward a tax credit under this program for three years.<sup>6</sup>

D) The credit may be claimed by a corporate taxpayer in an amount equal to the total contributions made to a scholarship granting organization for educational scholarships during the taxable year for which the credit is claimed up to 50 percent of the taxpayer’s tax liability.<sup>5</sup>

E) A corporate taxpayer may carry forward a tax credit under this program for three years.<sup>6</sup>

### **Section 4: {Responsibilities of Scholarship Granting Organizations}<sup>7</sup>**

A) Each scholarship granting organization shall:

1) notify the Department of its intent to provide educational scholarships to students attending qualified schools.

2) demonstrate to the Department that it has been granted exemption from the federal income tax as an organization described in Section 501(c)(3) of the Internal Revenue Code.

3) provide a Department-approved receipt to taxpayers for contributions made to the organization.

4) ensure that at least ninety percent of its revenue from donations is spent on educational scholarships, and that all revenue from interest or investments is spent on educational scholarships.

5) spend each year a portion of its expenditures on scholarships for low-income eligible students equal to the percentage of low-income eligible students in the county where the scholarship granting organization expends the majority of its scholarships.<sup>8</sup>

6) ensure that at least X percent of first time recipients of educational scholarships were not continuously enrolled in a non-public school during the previous year.<sup>9</sup>

7) distribute periodic scholarship payments as checks made out to a student's parent or guardian and mailed to the qualified school where the student is enrolled. The parent or guardian must endorse the check before it can be deposited.

8) cooperate with the Department to conduct criminal background checks on all of its employees and board members and exclude from employment or governance any individual(s) that might reasonably pose a risk to the appropriate use of contributed funds.<sup>10</sup>

9) ensure that scholarships are portable during the school year and can be used at any qualified school that accepts the eligible student according to a parent's wishes. If a student moves to a new qualified school during a school year, the scholarship amount may be prorated.

10) demonstrate its financial accountability by:<sup>10</sup>

a. submitting a financial information report for the organization that complies with uniform financial accounting standards established by the Department and conducted by a certified public accountant; and

b. having the auditor certify that the report is free of material misstatements.

11) demonstrate its financial viability, if they are to receive donations of \$50,000 or more during the school year, by:<sup>10</sup>

a. filing with the Department prior to the start of the school year a surety bond payable to the state in an amount equal to the aggregate amount of contributions expected to be received during the school year; or

b. filing with the Department prior to the start of the school year financial information that demonstrates the financial viability of the scholarship granting organization.

B) Each scholarship granting organization shall ensure that participating schools that accept its scholarship students will:

- 1) comply with all health and safety laws or codes that apply to non-public schools;
- 2) hold a valid occupancy permit if required by their municipality;
- 3) certify that they will not discriminate in admissions on the basis of race, color, national origin, religion or disability.<sup>11</sup>
- 4) provide academic accountability to parents of the students in the program by regularly reporting to the parent on the student's progress.<sup>12</sup>

C) Scholarship granting organizations shall not provide educational scholarships for students to attend any school with paid staff or board members, or relatives thereof, in common with the scholarship granting support organization.

D) A scholarship granting organization shall publicly report to the Department by June 1 of each year the following information prepared by a certified public accountant regarding their grants in the previous calendar year:

- 1) the name and address of the student support organization;
- 2) the total number and total dollar amount of contributions received during the previous calendar year; and
- 3) the total number and total dollar amount of educational scholarships awarded during the previous calendar year, the total number and total dollar amount of educational scholarships awarded during the previous year to students qualifying for the federal free and reduced lunch program, and the percentage of first time recipients of educational scholarships who were continuously enrolled in a public school during the previous year.

### **Section 5: {Responsibilities of the Department of Revenue}**

A) The Department shall adopt rules and procedures consistent with this act as necessary to implement the program.

B) The Department shall provide a standardized format for a receipt to be issued by a scholarship granting organization to a taxpayer to indicate the value of a contribution received. The department shall require a taxpayer to provide a copy of this receipt when claiming the Great Schools Tax Credit.

C) The Department shall provide a standardized format for scholarship granting organizations to report the information in section 4(C) above.

D) The Department shall have the authority to conduct either a financial review or audit of a student support organization if possessing evidence of fraud.

E) The Department may bar a scholarship granting organization from participating in the program if the Department establishes that the scholarship granting organization has intentionally and substantially failed to comply with the requirements in Section 4.

F) If the Department decides to bar a scholarship granting organization from the program, it shall notify affected scholarship students and their parents of this decision as quickly as possible.

G) The Department shall allow a taxpayer to divert a prorated amount of state income tax withholdings to a scholarship granting organization of the taxpayer's choice up to the maximum credit allowed by law, including carry-over credits. The Department shall have the authority to develop a procedure to facilitate this process.<sup>13</sup>

#### **Section 6: {Responsibilities of Qualifying Schools}**

A) All qualified schools shall be required to operate in our state.

B) All qualified schools shall comply with all state laws that apply to non-public schools regarding criminal background checks for employees and exclude from employment any people not permitted by state law to work in a non-public school.

**Section 7: {Effective Date}** The Great Schools Tax Credit may be first claimed in the next calendar year.

#### ***Endnotes***

These notes are intended to provide guidance to legislators on some of the key policy questions they will encounter in drafting and debating school choice tax credit legislation. In general, legislators and the public seek greater state regulation of programs directly funded by the government than of tax credit programs under the belief that tax credits are private funds kept by taxpayers rather than public funds expended by governments. However, insufficient accountability regulation can produce situations that undermine public and legislative support for the program. In recognition of this potential, we have chosen to recommend the establishment and state regulation of Scholarship Granting Organizations rather than heavy government regulation of private contributions and non-public schools.

1. The definition for an eligible student is limited to those children in a household whose annual income does not exceed an amount equal to 2.5 times the income standard used to qualify for the federal Free and Reduced-Price Lunch Program (FRL). The authors chose this standard for several reasons: 1) the FRL Program is familiar to both schools and many parents; 2) the verification procedures are simple and familiar to school administrators; 3) the income guidelines

are used for a number of existing state and federal programs; 4) the federal government annually adjusts the income guidelines; and 5) the income guidelines are adjusted for family size. The authors chose to use a multiple of this familiar income standard to recognize that many low and middle-income families cannot afford the choice of a non-public school. Experience suggests that most parents' ability to choose a non-public school is quite limited until the household income approaches \$75,000 for a family of four. We have chosen a multiple of 2.5 times the FRL standard to reflect this reality. Legislators may wish to use different multiples of this standard but should keep in mind the financial burden many middle class families face in paying for non-public schools.

2. The definition for an eligible student in this model legislation includes students presently enrolled in a non-public school. Drafted this way, the tax credit will necessarily reward many families who are already financing their child's education at a nonresident public school or a nonpublic school. For this reason some states with a scholarship tax credit program have chosen to place a cap on the total dollar amount of scholarships eligible for the tax credit. Alternatively, legislators wishing to draft a bill with a more modest fiscal impact may want to limit eligibility to students who attended a public school in the last year or are starting school in their state for the first time. In this case, there may actually be a savings for state taxpayers since a scholarship covering non-public school costs in many cases will be less than the cost of state support provided to students attending a public school.

3. This model legislation creates an additional class of eligible students who are from low-income families. Scholarship Granting Organizations are required to make sure that an appropriate proportion of their scholarship assistance reaches the poorest families in the state (see Section 4.A.5.). This ensures that assistance reaches the families who are least able to afford the school of their choice.

4. This model legislation allows students to use a scholarship to attend a public school outside their district as well as a non-public school. The authors support giving parents the widest possible array of choices so that they can choose the school that best meets their child's needs. Making sure parents can choose either a public or non-public school is not only the right policy but also the best legal strategy. The U.S. Supreme Court and various state courts have all cited this broad array of choices as an important part of the reason they have found school choice programs constitutional. The courts have reasoned that these scholarship programs are not an inappropriate subsidy of religious institutions because the purpose was secular (the education of children) and the parents were given many options including public schools, charter schools, non-public secular schools and non-public religious schools. If a state already has open enrollment or some other form of public school choice, then this legislation should be made consistent with the existing program. In fact, if a state already has a broad array of school choice options available to parents, then a state may be able to add an option for just non-public schools without encountering constitutional questions.

5. The bill limits the tax credit an individual, married couple or corporation can claim to 50 percent of their tax liability. While most states have chosen to implement a dollar cap on the tax credit available to each entity, this methodology is more equitable since it adjusts the cap to treat all taxpayers proportionately the same. The authors chose 50 percent because, in general, states spend about one-half of their income tax receipts on education. Allowing taxpayers to claim a tax credit for more than 50 percent of their liability opens the program up to charges that money is being diverted from non-education programs to support non-public schools.

6. The bill allows a taxpayer to carry forward any unused tax credits for up to three years. Individual incomes and corporate profits are often quite volatile. As a result, taxpayers may not have a liability against which to claim a credit in certain years. Yet the need for scholarship assistance by a student is likely to be relatively constant. Therefore, it is important to allow taxpayers to carry forward unused tax credits into other tax years to ensure that taxpayers have an incentive to continue to contribute to Scholarship Granting Organizations even in years in which the taxpayer has no tax liability.

7. The model legislation requires the establishment of Scholarship Granting Organizations to protect scholarship recipients, frustrate attempts at fraud, and measure the impact of the program without heavy government regulation of private contributions and non-public schools. We prefer rigorous self-regulation by taxpayers and independent regulation of non-public school participation by SGO's in lieu of intrusive government regulation.

8. The goal of this legislation is to provide every parent with the opportunity to send their child to the school that best meets their child's needs regardless of their family's income. The need for scholarship assistance is obviously greatest among low-income families. This requirement ensures that a proportionate amount of the scholarship assistance is given to the families financially least able to send their child to the school of their choice.

9. The goal of the program is to expand the number of families who can afford to send their children to the school of their choice. Therefore, legislators may wish to require that a certain percentage of the scholarship assistance go to children who were not already in non-public schools. This will also hold down the costs of the program and increase the efficiency of the financial incentive for expanding choice. This requirement will be particularly important in states that choose to place a total dollar cap on the tax credit program since a limited amount of tax credits could be claimed for scholarship assistance to students previously attending non-public schools.

10. The purpose of the criminal background checks, the financial information report and the demonstration of financial viability by the Scholarship Granting Organization is to protect both the contributors and recipients of scholarship assistance from potential fraud or mismanagement of the funds. The legislation gives the Scholarship Granting Organizations the responsibility to do background checks, the power to exclude potential risks from the organization, and the

liability for their employment decisions. The legislation does not call for an independent audit because this would be unnecessarily expensive and invasive for these non-public organizations. The model legislation provides for two methods for Scholarship Granting Organizations to demonstrate financial viability to ensure that scholarship funds are secure. The first method employs a market-based means of demonstrating viability. Non-public companies that issue surety bonds have a financial interest in making sure that the organizations can repay any funds that might be owed the state. They will therefore conduct the checks necessary to protect their financial interest as well as the financial interests of the contributors and recipients. Surety bonds can be expensive or invasive for some institutions so the legislation allows these organizations to demonstrate by some other means that they have the financial wherewithal to fulfill their scholarship obligations. This might include things like personal guarantees, reserve accounts or escrow accounts.

11. Private schools are already required to comply with nondiscrimination policies under federal law with respect to race, color, and national origin (42 USC 1981). In addition, if private schools are recipients of federal funds they are subject to nondiscrimination requirements under 42 USC 2000d (race, color, national origin) and 29 USC 794 (disability). The value of including a state prohibition based on religion and disability in this legislation is to head off arguments from school choice opponents that the private schools will “cream off” the best students or discriminate against students who don’t share their religious faith in admissions. These provisions may or may not be acceptable to some religious schools in a given state. Legislators may also wish to include language banning discrimination in hiring on the basis of race, color, national origin or disability. In doing so, however, legislators should take care not to interfere with the ability of religious institutions to hire individuals who share their religious beliefs.

12. We believe that empowered parents are best able to demand academic accountability. However, we recognize that some legislators may feel the need to demonstrate academic accountability to a wider audience. In that case we recommend that all participating schools be required to administer testing of scholarship students for grades that require testing under the state’s accountability testing laws. Students should take either the state achievement tests or a nationally recognized norm-referenced test in math and language arts or both. Testing should take place at a time comparable to when public schools conduct state achievement tests. Participating schools should provide the parents of each student with a copy of the results and should provide the results to the state evaluator described in the additional note below in a manner that protects the privacy of individual students. The purpose of the testing requirement should be to provide each parent with a measure of their student’s progress and to allow the taxpayers to measure the achievements of the program. The number and scope of the tests should be carefully limited to ensure that there is sufficient information to demonstrate the achievements of the program without being so exhaustive or prescriptive as to end up dictating the curriculum at participating schools. The costs of the testing requirements for a non-public school may be included in the scholarship amounts given to eligible students.

13. The legislation allows the Department to establish a mechanism that facilitates regular contributions from a taxpayer's income tax withholdings to a Scholarship Granting Organization in anticipation of the taxpayer claiming a tax credit. This would likely encourage greater contributions to Scholarship Granting Organizations. Additional Note: Some critics of school choice programs will demand that participating schools comply with all of the regulations placed on public schools in order to ensure "academic accountability" for the taxpayers. Of course, their real intent is to kill the program by driving schools from the program with burdensome regulations. Legislators sincerely wishing to demonstrate the program's academic success to taxpayers could require a scientific evaluation of the program using the testing data proposed in endnote 12. It is crucial that the legislature give the oversight responsibility for this study to a trusted objective nonpartisan source like a legislative service agency. We have provided model language for such an independent evaluation of the program below. The longitudinal study we have outlined would compare students in the choice program with a similar cohort in the public schools for the duration of their education from kindergarten through high school. Unfortunately, a 13-year longitudinal study is likely to be quite expensive. Accordingly, the legislation allows the legislature (or a legislative service agency) to accept private grants to completely fund such a study. In some, states, the legislature is not allowed to accept such grants and another trusted agency would have to be selected. It will be tempting for legislators to further define the details of the study but they should take care not to dictate the methodology or the results in order to maintain the credibility of the research.

#### **Section X: {Evaluation of the Great Schools Tax Credit Program}**

A) The Legislative Service Agency may contract with one or more qualified researchers who have previous experience evaluating school choice programs to conduct a study of the program with funds other than state funds.

B) The study shall assess:

- 1) the level of parental satisfaction with the program;
- 2) the level of participating students' satisfaction with the program;
- 3) the impact of the program and the resulting competition from non-public schools on the resident school districts, public school students, and quality of life in a community;
- 4) the impact of the program on public and non-public school capacity, availability and quality; and
- 5) participating student's academic performance and graduation rates in comparison to students who applied for a scholarship under this program but did not receive one because of random selection.

C) The researchers who conduct the study shall:

1) apply appropriate analytical and behavioral science methodologies to ensure public confidence in the study.

2) protect the identity of participating schools and students by, among other things, keeping anonymous all disaggregated data other than that for the categories of grade level, gender and race and ethnicity.

3) provide the Legislature with a final copy of the evaluation of the program.

D) The relevant public and participating non-public schools shall cooperate with the research effort by providing student assessment results and any other data necessary to complete this study.

E) The Legislative Service Agency may accept grants to assist in funding this study.

F) The study shall cover a period of thirteen years. The legislature may require periodic reports from the researchers. After publishing their results, the researchers shall make their data and methodology available for public review while complying with the requirements of FERPA (20 USC Section 1232g).

**Additional Note:**

It is fairly common for legislators to consider including severability clauses in new legislation. Legislators should make sure that if such clauses are included and exercised, the remaining legislation produces a program that is workable and achieves the original intent of the bill.