

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 schools of their parents' choice.

Model Legislation

Section 1. {Title} The 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 the year before he or she receives an educational scholarship under this program does not exceed an amount equal to 2 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;¹

(2) was eligible to attend a public school in the preceding semester or is starting school in [state] for the first time;²

(3) Resides in [state] while receiving an educational scholarship.

OR

4) is starting school in [state] for the first time and is a sibling of a student already enrolled in the program.

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

(D) "Parent" includes a guardian, custodian, or other person with authority to act on behalf of the child.

(E) "Department" means the state Department of Revenue.

(F) “Qualifying school” means either a public school outside of the resident school district, or any private school that provides education to elementary and/or secondary students and has notified the Department of its intention to participate in the program and comply with the program’s requirements.⁴

(G) “Educational scholarships” means grants to students to cover all or part of the tuition and fees at either a qualifying private school or a qualifying public school, including transportation to a public school outside of a student’s resident school district.

(H) “Scholarship Granting Organization” means an organization that complies with the requirements of the state’s school scholarship tax credit program and provides or is approved to provide educational scholarships to students attending any qualifying schools of their parents’ choice.

(I) “Test” means either the state achievement test or nationally norm-referenced test chosen by the participating school.

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 tax 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 for educational scholarships during the taxable year for which the credit is claimed up to 100 percent of the taxpayer’s tax liability.⁵

(C) The tax 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 100 percent of the taxpayer’s tax liability.⁵

(D) A corporate taxpayer, an individual taxpayer, or a married couple filing jointly may carry forward a tax credit under this program for three years.⁶

Section 4. {Responsibilities of Scholarship Granting Organizations}⁷

(A) Administrative Accountability Standards. All scholarship granting organizations shall:

(1) notify the Department of their intent to provide educational scholarships to students attending qualifying schools;

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

- (3) distribute periodic scholarship payments as checks made out to a student's parent or guardian and mailed to the qualifying school where the student is enrolled. The parent or guardian must endorse the check before it can be deposited;
- (4) provide a Department-approved receipt to taxpayers for contributions made to the organization;
- (5) ensure that at least 90 percent of their revenue from donations is spent on educational scholarships, and that all revenue from interest or investments is spent on educational scholarships;
- (6) spend each year a portion of their expenditures on scholarships for low-income eligible students equal to or greater than the percentage of low-income eligible students in the county where the scholarship granting organization expends the majority of its scholarships;⁸
- (7) ensure that at least X percent of first-time recipients of educational scholarships were not continuously enrolled in a private school during the previous year;⁹
- (8) not grant scholarships based upon a student's race, color, creed or national origin and not grant multiyear scholarships to participating students in one approval process;
- (9) carry forward no more than 25 percent of their revenue from donations from the state fiscal year in which they were received to the following state fiscal year;
- (10) cooperate with the Department to conduct criminal background checks on all of their 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;¹⁰
- (11) provide scholarships for eligible students to attend any participating school of the parent's choosing, and not limit scholarships for attendance at only a subset of participating schools.
- (12) ensure that scholarships are portable during the school year and can be used at any qualifying school that accepts the eligible student according to a parent's wishes. If a student moves to a new qualifying school during a school year, the scholarship amount may be prorated.
- (13) 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:
 - (a) the name and address of the student support organization;

(b) the total number and total dollar amount of contributions received during the previous calendar year; and

(c) 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-price lunch program,¹¹ and the percentage of first-time recipients of educational scholarships who were enrolled in a public school during the previous year.

(14) ensure scholarships are not provided for students to attend a school with paid staff or board members, or relatives thereof, in common with the scholarship granting organization.

(B) Financial Accountability Standards.¹²

(1) All scholarship granting organizations shall demonstrate their financial accountability.:

(a) If a scholarship granting organization provides less than \$250,000 in scholarships to eligible students through this program, it shall:

(i) annually submitting to the Department 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

(ii) having the auditor certify that the report is free of material misstatements.

(b) If a scholarship granting organization provides \$250,000 or more in scholarships to eligible students through this program, it shall:

(i) provide to the Department of Revenue a report on the results of an annual financial audit of its accounts and records conducted by an independent certified public accountant in accordance with auditing standards generally accepted in the United States, government auditing standards, and rules promulgated by the Department of Revenue. The audit report must include a report on financial statements presented in accordance with generally accepted accounting principles. Audit reports must be provided to the Department of Revenue within 180 days after completion of the scholarship granting organization's fiscal year. The Department of Revenue shall review all audit reports submitted pursuant to this paragraph. The Department of Revenue shall request any significant items that were omitted in violation of a rule adopted by

the Department of Revenue. The items must be provided within 45 days after the date of the request.

(2) All participating private schools shall demonstrate financial viability, if they are to receive donations of \$50,000 or more during the school year, by:

(a) filing with the scholarship granting organization prior to the start of the school year a surety bond payable to the scholarship granting organization in an amount equal to the aggregate amount of contributions expected to be received during the school year; or

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

Section 5. {Program Oversight of Participating Schools}

(A) Each scholarship granting organization shall collect written verification from participating, private schools that accept its scholarship students that those schools:

(1) comply with all health and safety laws or codes that apply to private schools;

(2) hold a valid occupancy permit if required by their municipality;

(3) certify that they comply with the nondiscrimination policies set forth in 42 USC 1981;¹³ and

(4) conduct criminal background checks on employees and then:

(a) exclude from employment any people not permitted by state law to work in a private school; and

(b) exclude from employment any people that might reasonably pose a threat to the safety of students.¹⁴

(B) Academic Accountability Standards. There must be sufficient information about the academic impact scholarship tax credits have on participating students in order to allow parents and taxpayers to measure the achievements of the program, and therefore:

(1) each scholarship granting organization shall ensure that participating schools that accept its scholarship shall:¹⁵

(a) annually administer either the state achievement tests or nationally norm-referenced tests that measure learning gains in math and language arts, and provide for value-added assessment, to all participating students in grades that require testing under the state's accountability testing laws for public schools;

- (b) allow costs of the testing requirements to be covered by the scholarships distributed by the scholarship granting organizations;
- (c) provide the parents of each student who was tested with a copy of the results of the tests on an annual basis, beginning with the first year of testing;
- (d) provide the test results to the Department or an organization chosen by the state¹⁶ on an annual basis, beginning with the first year of testing;
- (e) report student information that would allow state to aggregate data by grade level, gender, family income level, and race;
- (f) provide rates of high school graduation, college attendance and college graduation for participating students to the Department or an organization chosen by the state in a manner consistent with nationally recognized standards; and
- (g) provide to the Department or an organization chosen by the state the results from an annual parental satisfaction survey, including information about the number of years that the parent's child has participated in the scholarship program. The annual satisfaction survey shall ask parents of scholarship students to express:
 - (1) Their satisfaction with their child's academic achievement, including academic achievement at the school their child attended through the scholarship program versus academic achievement at the school previously attended;
 - (2) Their satisfaction with school safety at the schools their child attends through the scholarship program versus safety at the schools previously attended;
 - (3) Whether their child would have been able to attend their school of choice without the scholarship; and
 - (4) Their opinions on other topics, items, or issues that the department finds would elicit information about the effectiveness of the scholarship program.¹⁷

(2) the Department or an organization chosen by the state shall:

- (a) ensure compliance with all student privacy laws;
- (b) collect all test results;

(c) provide the test results and associated learning gains to the public via a state Web site after the third year of test and test-related data collection.¹⁸ The findings shall be aggregated by the students' grade level, gender, family income level, number of years of participation in the scholarship program, and race;¹⁹ and

(d) provide graduation rates to the public via a state Web site after the third year of test and test-related data collection; and

Section 6. {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 a scholarship granting organizations to report the information in Section 4(A)(10) above.

(D) The Department shall have the authority to conduct either a financial review or audit of a scholarship granting 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 or Section 5.

(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.²⁰

Section 7. {Responsibilities of Qualifying Schools}

(A) All qualified schools shall be required to operate in [state].

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

Section 8. {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 private 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 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 private school. Experience suggests that most parents' ability to choose a private school is quite limited until the household income approaches \$75,000 for a family of four. We have chosen a multiple of 2 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 private schools.

2. The definition for an eligible student in this model legislation includes students presently enrolled in a private school. Drafted this way, the tax credit will necessarily reward many families who are already financing their child's education at a non-resident public school or a private school. For this reason some states with a scholarship tax credit program have chosen to place a cap on the total dollar amount eligible for the tax credit. If legislators decide to include a statewide tax credit cap in the legislation, the authors strongly recommend that language should be added to automatically allow the cap to increase by twenty-five (25) percent in any year after ninety (90) percent of the cap was reached in the previous year. Additionally, if legislators decide to include a statewide tax credit cap, we recommend creating priority status for siblings and children from families eligible for the free and reduced price lunch program.

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 private 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)(6)). 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 private 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 private 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, private secular schools, and private 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 private schools without encountering constitutional questions.

5. The bill allows an individual, married couple, or corporation to claim a tax credit up to 100 percent of their tax liability. Presently, Arizona, Florida, Iowa, Kansas, Louisiana, and Virginia allow taxpayers to claim a tax credit for donations to scholarship organizations equal to 100% of their tax liability. Georgia limits the tax credit to 75% of a taxpayer's liability while South Carolina chose 60% and Indiana and Alabama chose 50%. While most states have chosen to implement a cap on the dollar amount of the tax credit available to each taxpayer, this recommended methodology is more equitable since it adjusts the cap to treat all taxpayers proportionately the same.

Depending on the state, additional corporate revenue streams from which a credit may be claimed for a contribution made to a scholarship granting organization may be listed in legislation. For example, states may have the following tax revenue streams from which to draw: insurance premium tax, alcohol beverage excise tax, direct pay sales and use tax, and oil and gas severance tax liability.

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. The number does not have to be three years, but should match the existing state standard for tax deduction and carry forwards.

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 private schools. We prefer rigorous self-regulation by taxpayers and independent regulation of private 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 private 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 private schools.

10. The purpose of the criminal background checks 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, which gives them the power to exclude potential risks from the organization and alleviates-liability issues for their employment decisions.

11. Collecting information regarding how many scholarship students qualify for free and reduced-price lunch will give policymakers a sense of the students that are being served by scholarship tax credit programs. These income guidelines are broadly known and already used in private schools.

12. The purpose of the financial information report and the demonstration of financial viability is to protect both the contributors and recipients of scholarship assistance from potential fraud or mismanagement of the funds. The model legislation provides for two methods for participating schools to demonstrate financial viability to ensure that scholarship funds are secure. The first method employs a market-based means of demonstrating viability. Companies that issue surety bonds have a financial interest in making sure that the schools can repay any funds that might be owed to the scholarship granting organization. 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 schools 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. The legislation does not call for an independent audit because this would be unnecessarily expensive and invasive for these private organizations.

13. Under 42 USC 1981, private schools are already prohibited from discriminating with respect to race, color, and national origin. 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).

14. This language is valuable in two cases: 1) a small number of states prohibit discriminating against felons in hiring even for sensitive positions in schools, and this language would give schools clear authority to dismiss or not hire individuals who pose a risk to student safety; and 2) some religious schools see rehabilitation as part of their mission. In this case, the schools could hire someone with a criminal background who they believe is no longer a threat to students, such as someone who committed nonviolent crimes or has decades-old violations followed by a clean record. This language would give schools the responsibility to do background checks, the power to exclude potential risks from the school, and the liability for their employment decisions.

15. The authors believe that empowered parents are the best way to achieve academic accountability. Clear and consistent information about the academic performance of participating students will help empower parents and will also provide the public and policymakers with the information they need to evaluate the effectiveness of the program and participating schools. Therefore, all participating schools should be required to annually administer either the state achievement tests or nationally norm-referenced tests that demonstrate learning gains in math and language arts. Most private schools already administer such norm-referenced tests so this provision should not be seen as burdensome. It is important, however, to give schools the ability to choose between a state test and the nationally norm-referenced test. Many private schools would simply refuse to participate in the program if they were forced to administer the state tests, because it implies that they are no longer independent of the state. The reason many opponents to school choice promote state testing of private schools is, in fact, because they want to discourage school participation and quietly destroy the program.

Participating schools should provide the parents of each student with a copy of the results and should provide the results to the state or an organization chosen by the state, as described in Endnote 16, in a manner that protects the identity and privacy of individual students. The purpose of this 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. If legislators would like an extensive longitudinal study, refer to Endnote 18 and its suggested language to create such a review.

16. If legislators are concerned about the hostility the program would face from the existing state revenue department, they may choose to create a new small agency or

contract with a private nonprofit organization to oversee the academic accountability responsibilities of the state. Allowing an organization chosen by the state to oversee this program allows for the flexibility to implement market-based models of academic accountability. In these cases, test results could be reported to a consumer organization, such as GreatSchools.net, where parents can assess participating schools' test results and compare schools to which they may send their children.

17. If legislators are concerned that parents of participating students may not feel comfortable honestly answering a survey administered by a SGO through which their child receives a scholarship, they can require that the Department or an organization chosen by the state administer the parental satisfaction survey instead.

18. The purpose of administering tests is to create transparency in participating students' academic progress and to demonstrate learning gains. These learning gains can only be demonstrated when the public has access to more than one school year. When this information is made public in the first year, the media and opponents often attack school choice programs, noting that participating students are not performing as well as their public school counterparts. This effect is natural because often the students who participate in choice programs are not doing well in public schools and are academically far behind their participating school counterparts, and it will take them a few years to catch up to grade level.

It is important to note that there are multiple ways to achieve the goal of academic accountability in school choice programs. Policymakers must consider the goal of releasing the academic data in order to choose the most effective reporting process. For instance, if the goal is to see how the program is affecting participating students' learning gains, scores of participants statewide should be evaluated and released. If the goal is to evaluate participating school outputs as a tool to help parents choose the best school, scores should be released by the participating school. You might also consider a sliding scale approach, where the more participating students a school enrolls, the greater its obligations for transparency and accountability.

19. Legislators sincerely wishing to demonstrate the program's academic success to taxpayers could require a scientific evaluation of the program using the testing data established in Section 5(B). It is crucial that the legislature give the oversight responsibility for this study to a trusted objective nonpartisan source like a legislative service agency or a trusted research university department. We have provided model language for such an independent evaluation of the program in Section X below. The outlined research would evaluate not only whether students who participate in the program are better off but also, more importantly, whether the competition from private schools improves the performance of public schools. The outlined longitudinal study includes a comparison of students in the choice program with a similar cohort in the public schools for at least five years of their education. Unfortunately, a 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.

20. 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 support organizations.

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 participating students' satisfaction with the program;

(2) the level of parental satisfaction with the program;

(3) the fiscal impact to the state and resident school districts of the program;

(4) the resulting competition from private schools on the resident school districts, public school students, and quality of life in a community;

(5) the impact of the program on public and private school capacity, availability and quality; and

(6) participating students' 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; and

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

(D) The relevant public and private participating 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 13 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 the Family Educational Rights and Privacy Act (20 USC Section 1232 g).

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.