



TAX-CREDIT SCHOLARSHIPS

Model Policy

ExcelinEd Policy Toolkit - 2018

This document contains a model policy for tax-credit scholarship (TCS) programs, which incentivize donations to nonprofit organizations that provide tuition scholarships to students.

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SUMMARY

The Tax-Credit Scholarship Act incentivizes individuals and businesses to donate to nonprofit organizations that provide tuition scholarships to eligible students. In exchange for their donations, donors receive a tax credit from the state. Through this process, tax-credit scholarship programs use entirely private funds to offer private school scholarships to families. The Act identifies student eligibility for the Tax-Credit Scholarship program. The Act establishes administrative and financial accountability measures for scholarship granting organizations and qualifying schools. The Act also establishes procedures for a state agency to oversee the Tax-Credit Scholarship program.

MODEL POLICY - THE TAX-CREDIT SCHOLARSHIP ACT

Section 1. {Title}

(A) This Act shall be named the “Tax-Credit Scholarship Act.”

Section 2. {Definitions.}

(A) “Department” means the state Department of Revenue.

(B) “Educational scholarships” means grants to students to cover all or part of the tuition and fees at a qualifying school, including transportation.

(C) “Eligible student” means:

(1) A student who:

- i. 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.¹ 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; and
- ii. was eligible to attend a public school in the preceding semester or is starting school in [state] for the first time²; and
- iii. resides in [state] while receiving an educational scholarship; or

(2) A student who is a sibling of a student already enrolled in the program who resides in [state] while receiving an educational scholarship.

(D) “Parent” means a resident of this state who is a parent, guardian, custodian or other person with the authority to act on behalf of the child.

(E) “Program” means the Tax-Credit Scholarship Program created in this Act.



- (F) “Qualifying school” means 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.³
- (G) “Scholarship Granting Organization” means an organization that complies with the requirements of the state’s tax-credit scholarship program and is approved to provide educational scholarships to students attending qualifying schools of their parents’ choice.⁴
- (H) “Test” means either the state achievement test or nationally norm-referenced test chosen by the qualifying school.

Section 3. {Basic Elements of the Tax-Credit Scholarship Act}

- (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. The taxpayer may not also claim a tax deduction against the taxpayer’s state tax liability for the same contribution for which the taxpayer claimed a credit.⁵
- (B) The tax credit may be claimed by an individual, a married couple filing jointly or a corporate taxpayer in an amount equal⁶ to the total contributions made to a scholarship granting organization for educational scholarships during the taxable year for which the credit is claimed.
- (C) The tax credit may be claimed up to 100 percent of the taxpayer’s tax liability.⁷
- (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.⁸

Section 4. {Responsibilities of Scholarship Granting Organizations}

- (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) allocate periodic scholarship payments to a student’s parent or on the parent’s behalf to the qualifying school where the student is enrolled;
 - (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 scholarships⁹;
 - (6) not grant multiyear scholarships to participating students in one approval process¹⁰;
 - (7) ensure that the average scholarship amount granted does not exceed the average per-pupil revenue provided by the state.¹¹
 - (8) carry forward no more than 40 percent of their revenue from donations from the state fiscal year in which they were received to the following state fiscal year;



- (9) cooperate with the Department to conduct criminal background checks on all 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;¹²
- (10) 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 remainder of the scholarship shall be paid to the new qualifying school¹³;
- (11) 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:
 - i. the name and address of the scholarship granting organization;
 - ii. the total number and total dollar amount of contributions received during the previous calendar year; and
 - iii. 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,¹⁴ and the percentage of first-time recipients of educational scholarships who were enrolled in a public school during the previous year or who were entering school for the first time.
- (12) 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.

- (1) All scholarship granting organizations shall demonstrate financial accountability by:
 - 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. provide to the Department a report on the results of an annual financial audit of the organization or its relevant accounts and records pertaining to tax-credit eligible donations 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. 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 within 180 days after completion of the scholarship granting organization's fiscal year. The Department shall review all audit reports submitted pursuant to this paragraph. The Department shall request any significant items that were omitted in violation of a rule adopted by the Department. The items must be provided within 45 days after the date of the request.
- (2) All participating private schools shall demonstrate financial viability¹⁵, if they are to receive donations of \$100,000 or more during the school year, by:
 - i. 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
 - ii. filing with the scholarship granting organization prior to the start of the school year financial information that demonstrates the financial viability of the qualifying school.



Section 5. {Program Oversight of Qualifying Schools}

(A) Each scholarship granting organization shall ensure that qualifying 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;¹⁶ and
- (4) conduct criminal background checks on employees and then:
 - i. exclude from employment any people not permitted by state law to work in a private school; and
 - ii. exclude from employment any people that might reasonably pose a threat to the safety of students.¹⁷

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

- (1) each scholarship granting organization shall ensure that qualifying schools that accept its scholarship shall:¹⁸
 - i. annually administer either the state achievement tests or nationally norm-referenced tests that measure learning gains in math and language arts, and may provide for value-added assessment, to all participating students in grades that require testing under the state's accountability testing laws for public schools;
 - ii. 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;
 - iii. provide the test results to the Department or an organization chosen by the state¹⁹ on an annual basis, beginning with the first year of testing;
 - iv. report student information that would allow state to aggregate data by grade level, gender, family income level and race;
 - v. for secondary schools, provide rates of high school graduation for participating students to the Department or an organization chosen by the state in a manner consistent with nationally recognized standards; and
 - vi. 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, if applicable;



2. Their satisfaction with school safety at the school their child attends, including school safety at the school their child attended through the scholarship program versus safety at the school previously attended, if applicable; and
3. Their opinions on other topics, items, or issues that the department finds would elicit information about the effectiveness of the scholarship program.²⁰

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

- (1) ensure compliance with all student privacy laws;
- (2) collect all test results; and
- (3) 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.²¹ 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.²²

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 tax credit.

(C) The Department shall provide a standardized format for a scholarship granting organizations to report the information in Section 4(A)(11).

(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) If the Department determines that the scholarship granting organization has intentionally and substantially failed to comply with the requirements in this Act, the Department shall send written notice to the scholarship granting organization.

- (1) A scholarship granting organization that receives written notice of a violation will have 60 days from receipt of notice to correct the violation.
- (2) If a scholarship granting organization fails or refuses to comply after 60 days, the Department may bar the scholarship granting organization from participating in the program.
- (3) Scholarship granting organizations may appeal the Department's decision pursuant to [the state's] administrative hearing act.
- (4) A scholarship granting organization whose certification has been revoked under this section shall not accept any further contributions for funding scholarships, including during the pendency of any appeal, but it shall continue administering scholarships with previously donated funds during the pendency of the appeal.

Section 7. {Responsibilities of Qualifying Schools}

(A) All qualifying 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}

- (A) The Tax-Credit Scholarship Act will be in effect beginning with the fall semester of next year.²³

ENDNOTES

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). This standard is selected for several reasons: 1) the FRL program is familiar to both schools and parents; 2) the verification procedures are simple and familiar to school administrators; 3) the income guidelines are used for many existing state and federal programs; 4) the federal government annually adjusts the income guidelines; and 5) the income guidelines are adjusted for family size.

² The definition of an eligible student includes students presently enrolled in a private school. Drafted this way, the tax credit will 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 tax-credit scholarship program place a cap on the total dollar amount eligible for the tax credit. If legislators decide to include a statewide cap, it is strongly recommended that language be added to automatically allow the cap to increase by 25 percent in any year after 90 percent of the cap was reached in the previous year.

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; who are starting school in their state for the first time; or who were not enrolled in a public school in the previous year and are beginning entry point grade levels (for example, kindergarten and grades 1, 6 and 9). In this case, there may 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 Additionally, some states permit transportation grants to attend public school outside the district of residence.

⁴ States may permit "parent-driven" or "mission-specific" scholarship granting organizations (SGOs) to administer tax-credit scholarships. Parent-driven SGOs provide scholarships to any participating school, while mission-specific SGOs provide scholarships to a limited network of participating schools. Parent-driven SGOs level the playing field between schools with established fundraising networks and schools with less of an existing fundraising base. Mission-driven SGOs allow for scholarship administration to be organized around common objectives. Section 4(A)(10) of this model policy suggests a "parent-driven" approach.

⁵ This provision is intended to prevent taxpayers from "double-dipping" by claiming both a state tax credit and a state tax deduction. Some will point to the availability of federal tax incentives that donors could also receive for the same donation as a potential double benefit. However, this is true of *all* donation tax incentives at the state level. How the federal tax code treats these donations is a matter for federal policymakers. If legislators feel the need to act at the state level to address this federal problem, they could require that taxpayers may only claim a state tax credit for that portion of their contribution for which they do not intend to claim a federal tax deduction. However, policymakers should be aware that doing so might disadvantage the scholarship tax credit and make it non-uniform relative to other tax credits in the state.

⁶ The value of the tax-credit should be for 100% of the contribution. However, some states limit the value of the tax-credit to an amount less than 100%. Note that an amount below 80% will be less attractive to potential contributors. A small tax-credit percentage will cause SGOs to raise less funding and distribute fewer scholarships.



⁷ The bill allows an individual, married couple, or corporation to claim a tax credit up to 100 percent of their tax liability. A few states limit the amount of credits taxpayers can claim up to a certain percentage of their tax liability, but such restrictions make it harder for scholarship organizations to raise funds. 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: insurance premium tax, alcohol beverage excise tax, sales and use tax, and oil and gas severance tax liability.

⁸ The bill allows a taxpayer to carry forward any unused tax credits for up to three years. Individual incomes and corporate profits are often 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 of years should match the existing state standard for tax deduction and carry forwards.

⁹ Up to 10 percent is the acceptable norm for nonprofit organizations to spend on administrative costs.

¹⁰ Multiyear scholarships limit the number of families who may benefit from educational choice in the current school year.

¹¹ This provision accomplishes two goals: provides flexibility to SGOs in awarding scholarship amounts *and* ensures that the program is revenue-neutral to state government. If the average scholarship amount were to exceed per-pupil state revenue (i.e. no local funds), the program could have a negative fiscal impact on state government.

¹² 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.

¹³ Many states require quarterly payments to avoid issues with scholarship proration.

¹⁴ 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 tax-credit scholarship programs. These income guidelines are broadly known and already used in private schools.

¹⁵ 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 funds. The legislation provides for two methods for qualifying 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.

¹⁶ Under 42 USC 1981, private schools are already prohibited from discriminating with respect to race, color and national origin.

¹⁷ 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.

¹⁸ Clear information about the academic performance of participating students will empower parents and provide the public and policymakers with the information they need to evaluate the effectiveness of the program and qualifying schools. Therefore, all qualifying 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.

Qualifying schools should provide the parents 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 19, in a manner that protects the identity and privacy of individual students. 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 qualifying schools.

¹⁹ 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. In these cases, test results could be reported to a consumer organization, such as GreatSchools.net, where parents can assess qualifying schools' test results and compare schools to which they may send their children.

²⁰ 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.

²¹ Learning gains can only be demonstrated when the public has access to multiple school years' worth of data. When this information is made public in the first year, 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 qualifying school counterparts, and it will take them a few years to catch up to grade level.

There are multiple ways to achieve academic accountability in school choice programs. 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 qualifying school outputs as a tool to help parents choose the best school, scores should be released by qualifying 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.

²² Legislators 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. Model language for such an independent evaluation of the program is included in Section 9 below. 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 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 may 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 to maintain the credibility of the research.

²³ The program should launch in the fall to correspond with the beginning of the school year. Launching a new program in January, or any time mid-year, is needlessly complex.



Section 9. {Evaluation of the Tax-Credit Scholarship 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;
 - (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; and
 - (7) college attendance and college graduation for participating students in a manner consistent with nationally recognized standards.
- (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 qualifying 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 qualifying 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. The study shall cover a period of 3 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).