



# TAX-CREDIT SCHOLARSHIPS

## *Policy Design Considerations*

*ExcelinEd Policy Toolkit - 2018*

### SUMMARY

Tax-credit scholarships (TCS) are among the fastest growing education choice programs. These programs incentivize 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—often a 100 percent, dollar-for-dollar credit.

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**Tax-credit scholarship programs use entirely private funds to offer private school scholarships to families.**

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Today, there are 22 TCS programs operating in 18 states<sup>1</sup> across the country. A growing body of research shows that these programs are effective at boosting the academic results of participating students as well as students who remain in public schools, provide participating students with long-term results like increased likelihood of college attendance, and save money for state and local taxpayers.

When designing a TCS program in your state, top considerations include: programmatic details, student eligibility, scholarship details, requirements on scholarship granting organizations and participating schools, and academic accountability provisions.<sup>2</sup>

### PROGRAMMATIC DETAILS

*Program design should incent participation from contributors (both individuals and businesses) to maximize the number of scholarships available for children.*

- **Eligible contributors:** Individuals and businesses may contribute.
- **Credit percent:** 100 percent of contribution is eligible for the credit.
- **Contributor cap:** The maximum allowable contribution for an individual or business is as high as politically feasible.<sup>3</sup>
- **Program cap:** No cap on the amount of credits available to be claimed is ideal. Otherwise, consider a cap that automatically increases if a certain percentage of the credits were claimed the prior year.
- **Program sunset:** No sunset provision for the program.<sup>4</sup>
- **Taxes eligible for credit:** Credits may be claimed against individual, corporate, and various excise taxes.

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<sup>1</sup> Tax-credit scholarships exist in: Alabama, Arizona, Florida, Georgia, Illinois, Iowa, Indiana, Kansas, Louisiana, Montana, New Hampshire, Nevada, Oklahoma, Pennsylvania, Rhode Island, South Carolina, South Dakota and Virginia.

<sup>2</sup> This document pertains to traditional TCS programs in which nonprofits provide tuition scholarships to eligible students. Some states are considering tax-credit funded education scholarship account (ESA) programs in which parents use funds in a flexible spending account (the ESA) on multiple approved educational expenses. For guidance on ESA policy design, please see ExcelinEd's [resources on ESAs](#).

<sup>3</sup> For reference, Florida has no contribution caps, but has a programmatic cap.

<sup>4</sup> If a sunset provision is politically necessary, the program duration should be as long as possible (5 years minimum).



## STUDENT ELIGIBILITY

*Education choice is a proven lifeline for students from all walks of life. Regardless of family income or unique circumstances, all children deserve access to education choice—with scholarship amounts that reflect their individual needs. However, if the conditions in your state require a more targeted program, we suggest designing a program that serves students with the greatest needs.*

Tax-Credit Scholarship Student Eligibility Considerations	
<b>Means-Tested</b>	Student is a member of a household whose total annual income does not exceed an amount set by the state, typically a multiplier of federal poverty (400% of federal poverty) or a multiplier of free or reduced-price lunch (two times free or reduced-price lunch).
<b>Special Needs</b>	Student has an Individualized Education Plan (IEP), has a 504 plan or is diagnosed with a disability by a licensed physician.
<b>Siblings</b>	Many states include siblings of participating students as an eligible category. The reason is simple: most families prefer their children be educated in the same school when possible. This is particularly true in programs that provide eligibility to students with special needs or those adopted from foster care.
<b>Unique Needs</b>	There are several other underserved populations with a demonstrated need for education choice. Some of these populations include: <ul style="list-style-type: none"> <li>• A child of a parent who is a member of the armed forces and who is on active duty or was killed in the line of duty.</li> <li>• A child who is adopted or is in the process of being adopted by a permanent guardian.</li> <li>• Students residing on Native American reservations.</li> <li>• Students who have been victims of bullying or assault.</li> <li>• Gifted and talented students.</li> </ul>
<b>Prior-Public School Enrollment</b>	In many states, lawmakers seek to avoid incurring costs for students already enrolled in private schools and require that eligible students have attended a district elementary or secondary school in the prior school year. <ul style="list-style-type: none"> <li>• A prior-public requirement reduces the cost to the state<sup>5</sup> but can cause disruptions for schools. For example, some parents may remove their child from private school and briefly place them in a district school only to gain eligibility for the program—causing problems for both schools. Thus, this requirement is often counterproductive.</li> <li>• If prior-public school enrollment is necessary, consider waiving the requirement for low-income students and students entering kindergarten, first grade, sixth grade, and/or ninth grade. These are each natural “decision points” for parents moving between elementary, middle and high school.</li> </ul>

<sup>5</sup> The savings to the state are often an estimate by those crafting fiscal notes in state legislatures. The actual cost or savings to taxpayers will depend on many factors. Including a prior-public school requirement increases the chances that taxpayers see savings but decreases the ability of all children to participate in the program.



**Failing Schools (not recommended)** Some are tempted to limit education choice to students in low-performing or “failing” schools. Although seemingly intuitive, *restricting eligibility to students in “failing schools” is not preferred policy for several reasons:*

- It makes the debate about schools, not children. “Failing school” designations contribute to unneeded hostility between private education choice and traditional public schools.
- Complexity of administration. Additionally, choice programs are easier to expand to new student populations when eligibility is determined by income rather than by school performance on state tests. School designations change over time or can be postponed or watered-down due to political circumstances not associated with education choice. It is easier to raise awareness about program eligibility based on a simple designation, like income.
- Choice is about fit, not failing schools. Reform advocates should not concede that education choice is only a means of reforming low-performing schools. Rather, reformers should keep the argument focused on empowering families to choose the school that best meets their children’s unique needs.

## SCHOLARSHIP DETAILS

*TCS amounts and terms should reflect individual student need and allow all students to access a variety of private schools in the state.*

### Scholarship Amounts

There are two approaches to setting scholarship amounts, fixed or determined by a scholarship granting organization (SGO). Regardless of the approach, scholarship amounts should reflect average total per-student revenue in traditional public schools, including weights for student need, but should not exceed the cost of tuition at the student’s participating private school. Larger scholarships should be available for students with special needs, low-income students, English language learners and other students with demonstrably higher needs.

Approach	Description	Pro	Con
<b>Fixed Amount</b>	The state sets scholarship amounts for participants, with additional weights for students with special needs.	Increases simplicity and program transparency and typically results in higher scholarship amounts across the board. Higher scholarship amounts better serve low-income families.	Could result in fewer total scholarships awarded.
<b>SGO-Determined Amount</b>	SGOs are given the freedom to determine scholarship amounts based on varying student needs and family situations.	More flexibility for SGOs to customize based on applicant pool and potentially spread limited funding across more students.	This has typically resulted in smaller scholarship funding amounts, which could reduce options for low-income students.



## Other Scholarship Terms

*There are several other factors worth considering regarding how scholarships may be used.*

- **Use of multiple scholarships:** Stacking scholarships from multiple SGOs or multiple private education choice programs should be permitted so long as total scholarship funds received do not exceed average total revenue per student, including student weights. The complexity of administering a stacked program may prove difficult, however.
- **Continued eligibility:** Changes in family income should not result in the loss of a scholarship. Once a child is granted participation in the program, he or she should be able to remain in the program if they would otherwise be eligible. Though a state may want to consider decreasing the size of a scholarship as family income increases.
- **Transportation:** Scholarship funds should be eligible for transportation to participating education providers when not provided by the public school district. The amount should not exceed \$1,000 per year.
- **Donor designation:** Donors should not be able to designate specific scholarship recipients or a single school.
- **Multi-year scholarships:** Not preferred, as they commit yet-to-be-raised funds and potentially reduce the number of possible scholarship recipients in any one year.

## SCHOLARSHIP GRANTING ORGANIZATION (SGO) DOCUMENTATION, REQUIREMENTS & TYPES

### Documentation for Original Application and Renewal

*SGOs should be subject to reasonable oversight and produce certain documents/policies when applying (and renewing an application).*

#### SGO Certification Original Applications: Required Documentation

- Proof of 501(c)(3) status.
- Statement of intention to serve more than one school.
- The criteria used to evaluate scholarship recipient eligibility.
- Description of application process for eligible scholarship recipients.
- Policies on conflicts of interest and whistleblowers.<sup>6</sup>
- A surety bond or letter of credit.

#### SGO Certification Renewal Applications: Required Documentation

- Certified audit.
- Form 990.
- Surety bond or letter of credit.
- Annual report on the number of students served with scholarships in the previous year, broken down by age and income-level.

<sup>6</sup> SGOs should not have owners or operators who also own or operate private schools that participate in the program.



## Requirements

SGOs should be required to implement certain best practices and policies when administering TCS programs.

- **Administrative expenses/fees:** SGOs should allocate no more than 10 percent of tax-credit contributions to administrative expenses.
- **"Double-dipping/benefit":** Contributors may not claim a state credit and state deduction for the same contribution.<sup>7</sup>
- **Priority scholarships:** SGOs should prioritize scholarship awards to students who received a scholarship the previous year, then on a first-come, first-serve basis with preference for need.
- **Penalties for program non-compliance:** SGOs that violate the tax-credit scholarship law should be barred from participation in the program.

## SGO Types: “Parent-Driven” or “Mission-Specific”

States may permit *parent-driven* or *mission-specific* SGOs to administer TCS. *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	Mission-Specific SGOs
Parents may use scholarships at any participating school in the state or within a specific geography. This may be especially important if the parent decides a different school is more suitable to their child's needs.	Parents can be restricted to schools that align with the SGO's mission, such as specific religion or educational approach.
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. Allowing donors to support education options that reflect their religion or preferred education approach (i.e. Montessori, classical education) may result in potentially greater fundraising.

<sup>7</sup> Claiming a federal credit or deduction for contributions for which a state credit has been claimed is an issue of federal law and is not appropriately addressed in state statute.



## OVERSIGHT & ACCOUNTABILITY WHILE ENSURING PARTICIPATING SCHOOL AUTONOMY

### Participating School Requirements

*TCS programs should provide for the well-being of students while also respecting private school autonomy. As such, participating schools should ensure the health, safety and welfare of the children they serve. Additionally, participating schools should demonstrate financial controls to protect against fraud.*

- **Accounting:** Participating schools that receive more than \$100,000 in tax-credit contributions should provide a report from a certified public accountant to all SGOs that grant scholarships used at the school. This report should include:
  - A demonstration of financial viability through a surety bond payable to the SGO *or* detailed financial information demonstrating the financial viability of the school.<sup>8</sup>
  - Adequate accounting system.
  - System of financial controls.
  - Process for deposit and classification of scholarship funds.
  - Background checks for all employees who encounter children.
  - That the school has properly expended scholarship funds for education-related expenses.
- **Discrimination:** Private schools may not discriminate based on race, color or national origin complying with 42 U.S.C. 1981.
- **Health and safety:** Private schools must meet all applicable state and local health and safety codes.
- **Enrollment:** Private schools should not be compelled to otherwise change their enrollment procedures.
- **Penalties for program non-compliance:** Participating schools that violate the TCS law should be barred from participation in the program.

### Academic Accountability

*Above all else, participating schools should regularly report to parents on a child's progress. Assessment requirements vary among states with TCS programs. Because these programs are funded through private donations, some TCS programs do not include formal testing mandates. However, it is reasonable to require participating students to take the private school's choice of norm-referenced tests. Rather than requiring the state test, this appropriately balances school autonomy with transparency.*

- **Testing:** Participating private schools should administer a nationally norm-referenced test to participating students in grades required by the state's accountability system.
- **Reporting:** These scores should be reported to an independent researcher (typically an in-state university) which issues a report on tax-credit scholarship recipients' proficiency and growth. Academic results should not be disclosed in a way that could reveal the academic performance of any individual student. The report should also include parent satisfaction, graduation rates and other criteria of interest to lawmakers and the public.

## HOW CAN I LEARN MORE?

For more information on tax-credit scholarships, please see additional resources on the [ExcelinEd website](#). Contact Adam Peshek ([Adam@ExcelinEd.org](mailto:Adam@ExcelinEd.org)), James Paul ([Jamesp@ExcelinEd.org](mailto:Jamesp@ExcelinEd.org)) or Tori Bell ([Victoria@ExcelinEd.org](mailto:Victoria@ExcelinEd.org)) with any questions.

<sup>8</sup> To be filed with the SGO prior to the start of the school year.