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OFFICE OF PROGRAM POLICY ANALYSIS
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Legislature Should Examine Several Issues When Considering a Tax Credit Program for Business Donations to Public Schools

at a glance

Two states, Pennsylvania and Arizona, offer tax credits for donations to fund public school programs. Pennsylvania offers businesses a tax credit for donations to fund innovative, advanced educational programs in public schools. Arizona provides a personal tax credit for donations made to public schools to support extracurricular activities or character education programs.

If the Florida Legislature were to implement a business tax credit program for contributions to public schools, it should address several issues. These include considering the program's impact on state revenues and Florida's Tax Credit Scholarship Program, defining the program's purpose and eligibility requirements, establishing mechanisms for raising and allocating program funds, and establishing fiscal and program accountability mechanisms.

Scope

As directed by the Legislature, this report examines tax credit programs in other states that fund educational enhancement programs for public school students through private donations. The report addresses two questions.

- How many states offer tax credit programs for donations to public schools, and how do these programs operate?
- What issues would Florida need to consider if it were to implement a tax credit program for donations to public schools?

Background

Several states have established programs in which corporations and individuals may receive tax credits for donations made to K-12 educational programs. Florida is one of five states that offer businesses tax credits for donations to organizations that offer scholarships to low-income students who attend non-public schools.

The Florida Tax Credit Scholarship Program funds scholarships that enable low-income students to attend private schools in the state.[1] The program is funded through contributions made by businesses that receive state tax credits equal to the amount of their contributions, with a statewide cap on these tax credits of $118 million.[2] The other states that offer corporate tax credit programs that support students attending non-public schools are Arizona, Georgia, Pennsylvania, and Rhode Island.

In addition, some states offer business and/or personal tax incentive programs for donations to public school educational programs. Some states, including Illinois and Minnesota, also offer parents a personal income tax credit that offsets a portion of the costs of their individual children's public school supplies or private school tuition.

Questions and Answers—

How many states offer tax credit programs for donations to public schools, and how do these programs operate?

Two states, Pennsylvania and Arizona, offer tax credits for donations to public school programs. Pennsylvania offers businesses a tax credit for donations that fund innovative, advanced educational programs in public schools. Arizona offers a personal tax credit for donations made to public schools to support extracurricular activities or character education programs.

Pennsylvania offers businesses tax credits for donations to public school programs. Pennsylvania's Educational Improvement Tax Credit Program, established in 2001, authorizes tax credits to businesses equal to 75% of the value of their single-year contributions to public schools, with a maximum tax credit of $300,000.[3] The tax credit level may be increased to 90% if the business agrees to a two-year donation. In 2008-09, Pennsylvania program staff estimate that public schools received $25.6 million in pledges through this program.[4]

Pennsylvania businesses can make donations to one of approximately 503 educational improvement organizations that fund programs for public school students.[5] These organizations must be registered and approved by the Pennsylvania Department of Community and Economic Development, which manages the program at the state level. Pennsylvania law requires that educational improvement organizations distribute 80% of annual receipts to public schools for innovative, advanced educational programs that meet the requirements of state law.[6] The organizations may retain

[1] Until 2009, Florida's program was called the Corporate Income Tax Credit Scholarship Program. See Ch. 2009-108, *Laws of Florida*.

[2] For more information on Florida's tax credit scholarship program see *The Corporate Income Tax Credit Scholarship Program Saves State Dollars,* OPPAGA Report No. 08-68, December 2008.

[3] Pennsylvania business may claim tax credits against corporate net income tax, capital stock and franchise tax, bank and trust company shares tax, title insurance companies shares tax, insurance premiums tax, and mutual thrift institutions taxes. As of July 9, 2008, Subchapter S corporations and other pass-through entities that pay their state business taxes under the personal income tax on business income can also participate in the program.

[4] Pennsylvania's Educational Improvement Tax Credit Program includes a prekindergarten component which provides scholarships to students to attend qualifying public or nonpublic prekindergarten programs. In 2008-09, staff estimate that prekindergarten programs received $8.6 million in pledges.

[5] Pennsylvania businesses may also make donations to scholarship organizations which award scholarships for public school students to attend a private school or scholarships for prekindergarten programs.

[6] According to Pennsylvania's March 2009 Organization Guidelines and Application, eligible programs must not be part of public schools' regular academic programs but must enhance the school's academic program.

up to 20% of the funds they raise for administrative and operational expenses.

In 2008-09, Pennsylvania reported that the program funded approximately 1,000 public school educational activities such as museum and zoo tours, mentoring programs for underprivileged students, and sports camps. The state allows educational improvement organizations to offer these educational programs directly or to contract with a third party to offer the programs. To be eligible to participate, students must be enrolled in a school located in Pennsylvania and be a member of a household with an annual household income of not more than $50,000 with some exceptions.[7]

Arizona offers individual income tax credits for donations to public schools. Arizona's public school tax credit program, established in 1997, allows married taxpayers to claim a $400 non-refundable state income tax credit ($200 for single/head of household taxpayers) for fees or cash contributions paid to public schools to support extracurricular activities or character education programs.[8] To receive the credit, Arizona taxpayers must make these contributions directly to a public school or school district, which must issue a receipt for the amount paid and describe the activity supported.

In 2008, the Arizona Department of Revenue, which manages the program, reported public schools received $45 million in contributions from 233,517 taxpayers to support extracurricular activities or character education programs. The program funds activities such as student participation in sports, visual and performing arts, field trips, school-based clubs, and outdoor education, and programs that teach values such as honesty and respect. Arizona has not established income eligibility requirements that limit students who may participate in program activities. In addition, the state does not track the number of students who participate in its program.

What issues would Florida need to consider if it were to implement a tax credit program for donations to public schools?

If the Florida Legislature were to implement a tax credit program for contributions to public schools, there are several issues it may wish to consider. These include considering the program's impact on state revenues and Florida's Tax Credit Scholarship Program, defining the program's purpose and eligibility requirements, determining how to allocate program funds, and establishing fiscal and program accountability mechanisms.

The program would reduce state revenues. As Florida does not have a personal income tax, a tax credit program for public schools would likely be funded through business tax credits.[9] However, unlike Florida's current Tax Credit Scholarship Program, a program that awards business tax credits for contributions to public schools would result in a loss of state tax revenue without generating a corresponding savings. OPPAGA's 2008 report found that although Florida's Tax Credit Scholarship Program reduces the amount of corporate

[7] There is an additional income allowance of $10,000 for the student and for each additional dependent defined as living within the same household by the Internal Revenue Service.

[8] *Arizona Revised Statutes* 15-719. Individuals may also receive a tax credit ($500 single/$1000 married) for donations to a student funding organization to support private school scholarships.

[9] Offering sales tax credits would not be feasible as these taxes are paid by individuals but are collected and remitted by the businesses that sell taxable goods. Consequently, taxpayers cannot feasibly direct that the sales taxes they pay be directed to specific programs.

tax revenues received by the state, it produces a net fiscal benefit. This occurs because state education spending for students who receive scholarships to attend private schools is reduced by more than the amount of revenue lost.[10] In contrast, creating a similar program for public schools would result in a net loss of state tax revenue because the funds would supplement and not supplant current state educational funding. Student beneficiaries would remain in public schools and continue to be funded at the same level.

The program could negatively affect the corporate tax credit scholarship program. Creating a business tax credit program for public schools could adversely affect the Tax Credit Scholarship Program. This could occur if businesses that now contribute to the program instead make donations to the new public school program. As a result, fewer funds would be available for scholarships that enable students to attend private schools.

To address this problem, the Legislature could establish a lower tax credit for contributions to public schools than to the Tax Credit Scholarship Program. For example, business donations to a public school program could receive a tax credit for 75% of their donations, as is done in Pennsylvania, rather than 100% as is offered by the Tax Credit Scholarship Program. Thus, a corporation would receive a $750 tax credit for a $1,000 donation to the public school program, rather than the $1,000 credit it would receive for donations to the Tax Credit Scholarship Program. This would help avoid the program creating a net fiscal loss to the state, but could also discourage businesses from making donations to the program.

The program's purpose, activities, and services would need to be defined. Pennsylvania and Arizona officials indicated it is important to establish a clear purpose for a public school contribution tax credit program and criteria for the type of services to be supported. Pennsylvania program administrators noted that their state's definition of 'innovative educational program' is too broad and has allowed a wide variety of educational activities and services to be funded that might not meet their legislature's intent.[11] Arizona officials raised similar concerns about the types of activities that have been funded through its program.

To address this issue, the Florida Legislature may wish to establish a clear statutory purpose of a public school contribution tax credit program and a list of authorized activities and services that could be funded through the program.

Program eligibility requirements would need to be considered. In designing a public school contribution tax credit program, the Legislature could authorize all public school students and public schools to participate or it may wish to restrict eligibility. Pennsylvania limits its program to services for low-income students. Establishing a similar restriction would enable the Florida Legislature to target services to students who are academically at-risk. For example, services could be restricted to students who are eligible for

[10] OPPAGA reported that in Fiscal Year 2007-08 the tax credit scholarship program saved $1.49 in state education funding for every dollar loss in corporate income tax credits. For further information see *The Corporate Income Tax Credit Scholarship Program Saves State Dollars*, OPPAGA Report No. 08-68, December 2008.

[11] Pennsylvania's Educational Improvement Tax Credit Program defines an 'innovative educational program' as an advanced or similar program that is not part of the regular curriculum, but enhances the curriculum or academic program of a public school.

free or reduced price lunches through the National School Lunch Program.[12] Research suggests that these students are at-risk for academic failure and might benefit the most from funded mentoring, tutoring, or extended day programs. Alternatively, the Legislature could limit services to high poverty schools in which 80% or more of the students are eligible for free or reduced price meals, or to students who attend low performing schools.[13]

Florida Department of Education officials caution that it would be important that the program not duplicate services provided to low income students through the federal Title I Program. This program funds school-wide and targeted assistance programs (focused on reading and math) for at-risk students and those in high poverty schools.[14] Federal regulations prohibit states from using Title I funds for services already provided from state or local sources.[15] A new tax credit program for contributions to public schools would thus need to offer services that are distinct from those provided through Title I to avoid jeopardizing these federal funds.

Program fundraising mechanisms would need to be designated. The Legislature also would need to specify what entities could solicit businesses to make contributions to public schools. Officials in Pennsylvania cautioned that using numerous fundraising organizations can make the program difficult to manage and increase the need for state-level oversight. Thus, the Legislature may wish to limit the number of organizations it authorizes to raise program funds. For example, it could assign these responsibilities to the same organization that operates the Florida Tax Credit Scholarship Program, which would make use of the organization's experience and established business relationships. Alternatively, the Legislature could authorize school district foundations to receive program donations. These foundations operate in 61 school districts as not-for-profit entities that solicit corporate and community donations to support district schools. If it chooses this option, the Legislature may wish to establish a mechanism for the remaining six school districts that currently do not have education foundations.

A process for distributing program funds would need to be defined. The Legislature could structure a public school contribution tax credit program to distribute funds through a state funding formula or through local entities. A statewide allocation system would help avoid potential funding disparities between districts but could hinder district efforts to solicit contributions from local businesses.

In Pennsylvania and Arizona, contributions are received and retained at the local district level and are not redistributed proportionally among school districts. As a result, the programs have produced funding disparities because urban districts have more fundraising opportunities than do rural districts. For example, Arizona officials reported that the majority of its contributions are received by schools in a

[12] Florida students are eligible for free lunch if their four-person household income does not exceed 130% of the federal poverty level ($28,665 in Fiscal Year 2009-10). A student is eligible for a reduced price lunch if their four-person household income does not exceed 185% of the federal poverty level ($40,793). In Fiscal Year 2008-09, slightly more than half (52% or 1.4 million) of Florida public school children qualified for free or reduced price lunches.

[13] In Fiscal Year 2008-09, approximately 15% (396,222) of Florida's 2.6 million public school students attended a high poverty school. During that year, 9% (246,603) of students attended a school that received either a D or F" under Florida's A++ Program.

[14] Public Law 107-110, Sections 1114 and 1115.

[15] This is commonly referred to as supplanting.

single county which is one of the wealthiest areas in the state.

Florida Department of Education administrators caution that differences in contribution levels throughout the state could undermine Florida's efforts to ensure that education funding is equitably allocated. Since 1973, the state has distributed educational funding to school districts through the Florida Education Finance Program (FEFP).[16] The FEFP adjusts education funding to meet the particular needs and conditions of individual students and each of Florida's 67 counties in order to provide equal educational opportunities for all children. Florida could thus allocate contributions received through the program using a distribution formula based on the eligible students in each district in a manner similar to the FEFP.[17]

However, such an allocation mechanism could create two problems. First, if the level of contributions were relatively low, the formula-based system would allocate too few dollars to districts, particularly small districts, to produce a significant impact for students. Second, a statewide allocation system could make it harder to solicit contributions from businesses that would prefer to support public schools in their own communities.

As an alternative, the Legislature could allocate contributions though a competitive process in which districts would submit grant applications to the Department of Education. This could maximize the effect of limited program resources by directing funds to activities that have the best chance of improving student outcomes in local schools. However, it would not enable businesses to target contributions to their local schools.

Accountability structures would need to be established. Pennsylvania and Arizona officials emphasized the importance of establishing mechanisms that ensure tax credits are issued in accordance with state law, program funds are being spent as intended, and programs are meeting stated objectives. Pennsylvania and Arizona have assigned accountability responsibilities to state economic development and revenue departments, which primarily focus on ensuring that tax credits are awarded and used appropriately. Administrators in both states report that it is often difficult for them to assess whether schools are using program funds for services that are consistent with legislative intent because their agencies lack expertise in educational policy and school operations.

To avoid this problem, the Legislature could assign fiscal oversight responsibilities to the Department of Revenue and program activity oversight to the Department of Education. The Department of Revenue would conduct oversight activities similar to those it performs for the Tax Credit Scholarship Program - verifying businesses' eligibility to participate in the program, ensuring that business donations do not exceed tax liabilities, and monitoring to ensure that annual donations do not exceed the state cap. The Florida Department of Education would be charged with periodically reviewing and reporting the number and types of students who receive program

[16] In 1973 the Florida Legislature enacted the FEFP and established the state policy on equalized funding to guarantee to each student in the Florida public education system the availability of programs and services appropriate to his or her educational needs that are substantially equal to those available to any similar student notwithstanding geographic differences and varying local economic factors.

[17] Iowa created a similar formula to equalize fundraising for its private scholarship program.

services, the types of activities and services provided by districts, and the effectiveness of these programs in improving student performance.

Agency Response

A draft of our report was submitted to the Commissioner of Education and to the Executive Director of the Department of Revenue for their review and feedback; neither agency provided a formal response although they suggested technical wording changes to some portions of the report.

The Florida Legislature

Office of Program Policy Analysis and Government Accountability

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