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An Overview of Scholarship Tax Credit Programs

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Private donors fund scholarship tax credit programs, which provide scholarships to students to attend private school.[1] In exchange for their contribution, donors receive a tax benefit from the state. These programs are generally managed by independent, state-approved nonprofit organizations called scholarship-granting organizations (SGOs).[2]

There are currently 22 scholarship tax credit programs in 17 states.[3] **Arizona**'s legislature created the first program — the Individual Income Tax Credit Scholarship Program — in 1997, and the most recent program is **Florida**'s Hope Scholarship Program, created by legislation in 2018. Three states — **Arizona**, **Florida** and **Pennsylvania** — have more than one program.

While not new, scholarship tax credit programs have been increasing in popularity among state leaders for the past few years. Some may find these programs a more palatable private choice option, as they do not directly draw money out of state education coffers in the same way as education savings accounts or voucher programs. However, each tax credit granted to donors amounts to a dollar-for-dollar reduction in state revenue. This will ultimately affect a state's budget, even if the effect appears indirect.

This report provides information about SGOs, the students who may participate, the donors who may contribute and the tax benefits available to donors.

Scholarship tax credit programs provide scholarships for students to **attend private school**. They are funded by **private donors**, who receive a **tax benefit** from the state in exchange for their donation.

There are currently **22 scholarship tax credit programs** in **17 states**.

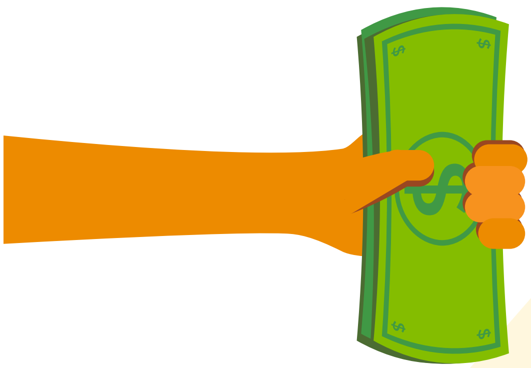
Students must meet **eligibility requirements** — most often based on household income. Many states' programs also give **scholarship award priority** to other student groups.

Public Choice and Private Choice Programs

There are two general categories of school choice: public and private. Public choice provides parents with educational choices within the public school sector and includes open enrollment, magnet schools and charter schools. Private choice programs allow public dollars to fund education options in the private sector, often at private schools. These programs include vouchers, education saving accounts and scholarship tax credits.

What Are Scholarship Tax Credits?

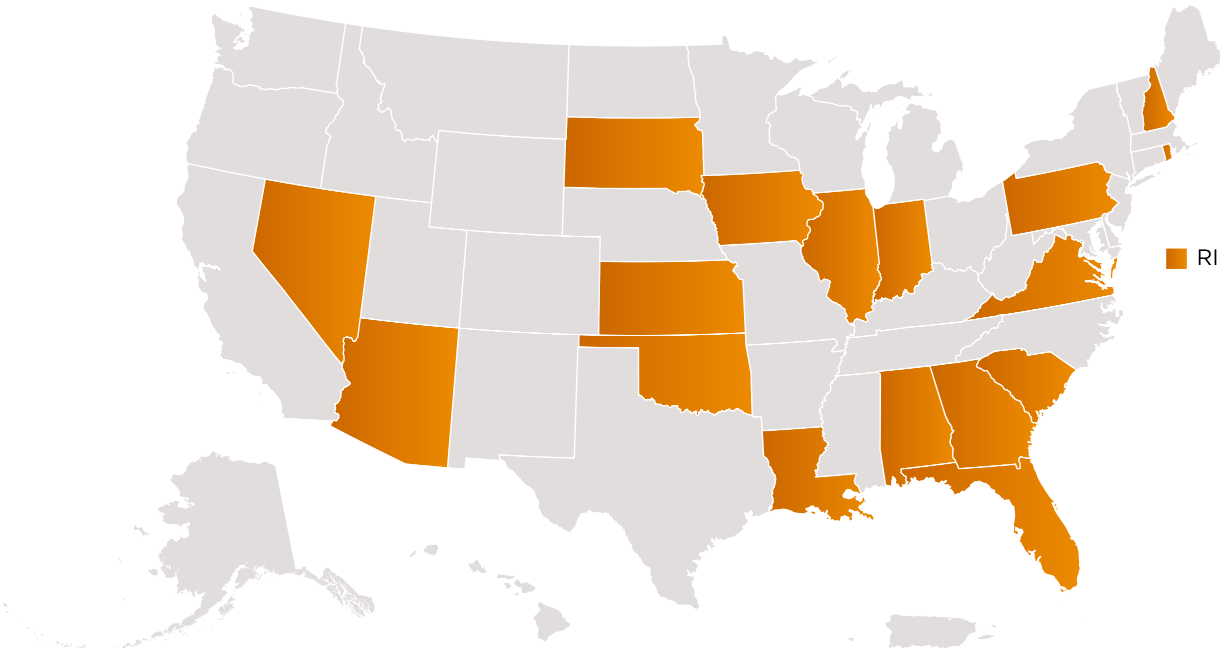
PRIVATE DONORS fund **scholarship tax credit programs**, which provide scholarships to students to attend PRIVATE SCHOOL.



SCHOLARSHIP-GRANTING ORGANIZATIONS **accept donations** from taxpayers, **manage applications** and **award scholarships** to ELIGIBLE STUDENTS.

IN EXCHANGE for their contribution, donors receive a **tax benefit** from THE STATE.

States With Scholarship Tax Credits



Who Distributes the Scholarships?

Applications from eligible students and scholarship awards from donated funds are managed by SGOs, which are generally nonprofit, third-party organizations. These organizations accept donations from taxpayers, take applications from eligible students and award scholarships.

SGOs have several common elements across programs and states. These include:

- **Nonprofit status.** All states require SGOs to have nonprofit status.
- **State application or notification process.** States generally require SGOs to go through an initial application process — or to at least notify the state before beginning operations — and to follow state laws regulating the program. The number of approved SGOs administering scholarships varies by state.[4]
- **Use of funds.** Most states require SGOs to use 90 to 98 percent of donations on scholarships.[5]
- **Reporting and compliance.** Most states require SGOs to comply with various governance and reporting provisions, generally by providing annual financial reports or audits, among other things.
- **Unused funds.** A few states allow SGOs to carry over all or a portion of unused donations to the next fiscal year. Other states require SGOs to turn over unused donations to the state to fund various education programs.
- **Other.** Other provisions include requiring SGOs to annually notify the state of an intent to operate, prohibiting SGO owners or operators with connections to participating private schools and requiring the state auditor to conduct an annual audit.

State Examples

Alabama law directs SGOs to turn over donations not used within a certain timeframe to the Alabama Department of Education to support underperforming schools.

Statutory provisions for all four of **Arizona**'s programs require SGOs to provide annual reports to the state, and any SGOs with more than $1 million in revenue must provide yearly financial audits.

Nevada law prohibits SGOs from owning or operating a school in the state, including a private school that receives scholarship money.

Which Students Are Eligible?

All states with scholarship tax credit programs have at least one student eligibility requirement. Some programs have multiple eligibility requirements, which vary in type and structure across programs and states. Additionally, states typically require eligible students to have residency in the state and to have either attended public school previously or to be entering school for the first time.

The most common student eligibility requirement is household income. Most programs tie household income restrictions to the income requirements for free and reduced-price meal programs or to federal poverty guidelines. Three programs — two in **Arizona** and one in **Georgia** — do not have income requirements but SGOs consider applicants' financial need in awarding scholarships. A few states' programs have eligibility requirements in addition to household income, such as students assigned to low-performing schools.

Finally, a small number of programs have eligibility requirements other than household income for students with a disability or students who have been victims of school-based violence.

State Examples

Programs in both **Illinois** and **Nevada** have household income limits for eligible students of 300 percent of federal poverty guidelines. In **Illinois**, an eligible student's household income may not exceed 400 percent of federal poverty guidelines while the student is a scholarship recipient.

Kansas' Tax Credit for Low-Income Students Scholarship program requires students to meet household income requirements and to have been previously enrolled in a low-performing public school.

Arizona and **South Carolina** both have programs specifically for students with a documented disability. Arizona's program — one of four in the state — also includes students who have been placed in foster care at any time before graduating from high school.

Florida's Hope Scholarship Program is restricted to students who have been subject to school-based bullying or other victimization.

Four states' programs — including one each in **New Hampshire** and **Oklahoma** and two each in **Arizona** and **Pennsylvania** — have income eligibility limits above the states' median incomes, according to a recent analysis from the United States Government Accountability Office. **Oklahoma's** income eligibility limit is substantially higher than the state's median household income.[6]

Priority Enrollment Requirements

In addition to eligibility requirements, just under half of states with scholarship tax credit programs direct SGOs to give priority to certain student groups when they are granting scholarships; most programs include multiple priority groups. They could include:

- Additional household income requirements.
- Returning students or their siblings.
- Students with a disability.
- Students assigned to low-performing schools.
- Children of active-duty military personnel.
- Students placed in foster care.

State Examples

Under **Arizona**'s Low-Income Corporate Income Tax Credit Scholarship program, SGOs must distribute 90 percent of scholarship funds to students who meet income requirements and meet at least one of three additional requirements.

Louisiana's program is limited to students meeting household income guidelines, but SGOs must give priority to returning scholarship recipients or students assigned to a low-performing school.

In **New Hampshire**, all eligible students must have household incomes under 300 percent of federal poverty guidelines. However, 40 percent of scholarships must be awarded to students who also qualified for the free or reduced-price meal program in the prior year.

More on Student Eligibility and Priority Enrollment

Income-eligible households: Sixteen programs in 15 states require students to live in a household with an income within a certain percentage of the federal poverty guidelines or requirements for free and reduced-price meals. Three programs in two states (**Arizona** and **Georgia**) require SGOs to consider students' financial need, although there are no set income restrictions. Five programs in as many states also direct SGOs to give priority to students meeting specific income guidelines.

Low-performing schools: One of multiple eligibility requirements in **Alabama** is for students who are assigned to a school with an academic performance rating below a certain performance threshold. Four programs in as many states direct SGOs to prioritize students assigned to a low-performing school.

School-based violence: One of **Florida's** two programs is only for students who have been subject to bullying or other school-based victimization. **Georgia's** program waives attendance requirements for students who have been victims of school-based violence.

Students with a disability: South Carolina's program eligibility is restricted to students with a documented disability. Having a disability is one of multiple eligibility requirement options in **Oklahoma's** program and in one of **Arizona's** four programs. **Virginia's** program and both of **Pennsylvania's** programs have broader household income eligibility requirements for students with a disability. Finally, three of **Arizona's** four programs give priority to students who previously attended a school that offers services to students with disabilities.

Priority categories: In addition to previously mentioned eligibility requirements, some states' programs require SGOs to give priority to specific categories of students. Priority categories include additional income requirements, school performance, school-based bullying or victimization, returning scholarship recipients or their siblings, students placed in foster care and children of active-duty military personnel.

How Much Money Do Eligible Students Receive?

While SGOs generally may determine the amount of an eligible student's scholarship, most states' programs have statutorily defined limits on the amount students may receive.[7] Most commonly, scholarship award amounts set in statute are the cost of private school tuition and fees, a specific dollar amount set in statute or an amount tied to the state's per-pupil funding. Seven programs in as many states specify that the scholarship amount must be the cost of private school tuition and fees or an amount set in statute, whichever is less. Five programs set award amounts based on grade level, with larger awards available to students in higher grades.

Average scholarship awards in 2016-17 ranged from $1,476 in one of **Arizona's** four programs to $5,468 in **Alabama**, according to a 2018 analysis by the U.S. Government Accountability Office.[8]

It is likely that at least in some states, the amount of money students receive in scholarships will not cover the full cost of tuition at a private school. Information about scholarship amounts and private school tuition costs is not widely available in most states. However, a 2017 analysis of **Iowa's** program found that over five school years (2012-17), scholarships paid for 48 to 61 percent of private school tuition, on average.[9] However, this may not be representative of all states, in part because statutes governing **Iowa's** program leave SGOs to determine award amounts.[10]

How Do Contributions Work?

There are many variations among state programs on who may contribute, how much they can contribute and the tax benefits available to donors. All states have limits on how much donors may contribute to a program, how much of their donation they may claim on state taxes or the dollar amount of credits available to all donors across the state.

Several states' programs allow all taxpayers to participate, including individuals and businesses. A few states limit participation to specific taxpayer classifications.

State Examples

In **Arizona**, individual taxpayers may participate in two of the state's four programs; the remaining two are reserved for business taxpayers.

In **South Dakota**'s Partners in Education Tax Credit Program, only businesses subject to the insurance company premium and annuity tax may participate.

Because **Florida**, **Nevada**, **New Hampshire** and **South Dakota** do not collect individual income taxes, only specified business taxpayers may participate in the program.

Donor Limits

Most programs (17 programs in 15 states) limit the value of the credit donors may claim on their taxes in one of the following ways: limiting the total dollar amount a donor may contribute or claim, limiting the percentage of the donation a donor may claim or a combination of both. All states but one prohibit donors from claiming a donation larger than what they owe in taxes.[11] Finally, some states allow taxpayers to carry forward an unused tax credit to future years.

Other states allow taxpayers to increase the percentage of their donation they may claim if they commit to making an equal contribution in one or more subsequent years. For example, donors in **Rhode Island** may claim a credit equal to 75 percent of their donation, subject to a dollar value cap, in a single year. However, donors may claim 90 percent of their donation if they commit to donating in two years, subject to the same dollar value cap.

State Examples

Individual and business donors in **Alabama** may claim a tax credit of 100 percent of their donation, but only up to 50 percent of what they owe in taxes. For individual taxpayers, the tax credit may not exceed $50,000.

Indiana's program does not have a limit on the amount a donor may contribute, but donors may only claim 50 percent of their donation on their taxes.

In **Virginia**, business taxpayers may claim 65 percent of their donation as a tax credit. Individual donors may also claim 65 percent of their donation but are subject to a tax credit limit of $125,000.

Scholarship Tax Credits in Action

If a hypothetical taxpayer owes $1,000 in taxes and makes a $1,500 donation, the donor generally may not claim a tax credit of more than $1,000. If the state only allows donors to claim a credit of 75 percent of their tax liability, the donor may only claim a credit of $750. If the state allows donors to carry unused tax credits to subsequent years, this donor may claim the $750 unused tax credit in the next tax year.

Statewide Limits

Many states limit the amount of tax credits available to donors statewide in a given year. Some states' programs have a statutory limit that does not change without legislative action. Eight state programs have statutory escalators, meaning the program cap increases in future years by statutorily determined amounts. A few states require that donations in the prior year meet a certain threshold before the program cap increase will take effect.

State Examples

Yearly statewide cap. Alabama has $30 million available in tax credits statewide, **Illinois** has a yearly cap of $75 million and **Rhode Island**'s cap is $1.5 million.

Escalators. Programs in **Georgia** and **Iowa** have statutory statewide limits on tax credits available to donors, and state policies outline periodic increases to the limits.

Automatic increases. If 90 percent of tax credits are claimed under **Florida**'s Tax Credit Scholarship Program, the cap automatically increases by 25 percent in the following year. Florida's tax credit cap for fiscal year 2018-19 is more than $873 million.[12]

Other. New Hampshire law prohibits a single donor from receiving more than 10 percent of the aggregate amount of available tax credits statewide.

The U.S. Government Accountability Office's 2018 report, *Private School Choice: Requirements for Students and Donors Participating in State Tax Credit Scholarship Programs*, provides additional in-depth analysis on states' scholarship tax credit programs.

Federal Taxes

In some cases, taxpayers may be able to claim a tax benefit on both their state and federal taxes, although not all states allow this practice. Whether or not a taxpayer may claim a federal tax deduction is dependent on the taxpayer's specific circumstances.[13]

In 2018, the Internal Revenue Service published proposed regulations that would limit the ability of taxpayers to claim both state and federal tax benefits for the same charitable donation.[14] Specifically, if a taxpayer receives a benefit on their state taxes in exchange for a donation to a charity, the value of that benefit would be subtracted from the taxpayer's federal tax return. These proposed regulations are currently going through the federal rule-making process and have not been adopted, as of publication.

ENDNOTES

1. In some cases, students may also use scholarships to pay tuition to attend a public school other than the school to which the student is assigned.
2. Scholarship-granting organizations may also be called school-tuition organizations or student-scholarship organizations.
3. Montana has a scholarship tax credit program in statute, but the program was found unconstitutional by the state Supreme Court in December 2018. Thus, it is not included in the count.
4. For example, only one SGO in South Carolina operates the state's program, while seven approved SGOs in Indiana distribute scholarships for the state's program.
5. Pennsylvania is the exception, requiring SGOs to use at least 80 percent of donations on scholarships.
6. Jacqueline M. Nowicki, *Private School Choice: Requirements for Students and Donors Participating in State Tax Credit Scholarship Programs* (Washington: United States Government Accountability Office, September 2018), 7-9, https://www.gao.gov/products/GAO-18-679.
7. The only state without a limit is Rhode Island.
8. Nowicki, *Private School Choice:* 28-30.
9. Anthony G. Girardi and Angela Gullickson, *Iowa's School Tuition Organization Tax Credit: Tax Credits Program Evaluation Study* (Des Moines: Iowa Department of Revenue, December 2017), 20-21 and 57, https://tax.iowa.gov/sites/files/idr/2017%20STO%20Tax%20Credit%20Evaluation%20Study%20%281%29.pdf.
10. Iowa Code Ann. § 422.11S.
11. Indiana is the only state that does not prohibit taxpayers from claiming a tax credit that is greater than their tax liability.
12. "Florida Tax Credit Scholarships," Florida Department of Education, accessed October 1, 2018, http://www.fldoe.org/schools/school-choice/k-12-scholarship-programs/ftc/.
13. Nowicki, *Private School Choice:* 16-18.
14. "Contributions in Exchange for State or Local Tax Credits (REG-112176-18)," Regulations.gov, accessed December 13, 2018, https://www.regulations.gov/document?D=IRS-2018-0025-0001.

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