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# BTC Brief

► NC BUDGET & TAX CENTER

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*Timely,  
accessible,  
and credible  
analysis of  
state and local  
budget and tax  
issues*

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## SCHOLARSHIP FUNDING CORPORATE TAX CREDIT

HB 1104 unlikely to yield cost savings and would reduce available funds for educating all North Carolina's children

### KEY FINDINGS:

- **House Bill 1104, Scholarship Funding Corporate Tax Credit, would create a dollar-for-dollar tax credit for corporations that make donations to organizations that grant scholarships to eligible students to attend private schools rather than public schools.**
- **The most likely fiscal impact of this policy would be to decrease available funding for public education.**
- **Seven other states offer corporate income tax credits for donations to scholarship-funding organizations: Arizona, Florida, Pennsylvania, Rhode Island, Georgia, Indiana, and Oklahoma. Out of these seven states, four experienced steady growth in public school enrollment between FY2007-08 and FY2011-12, and all but one experienced a drop in estimated private school enrollment between FY2006-07 and FY2008-09.**
- **Further analysis of the credit in Arizona shows that it may have increased total private school enrollment in that state by just 1 percent, or 468 students, as a direct result of the scholarships generated by the credit. That number of students represented only a 0.05% drop in Arizona's total public school enrollment – an amount insufficient to generate state savings given fixed costs implicit in per-pupil expenditure figures.**
- **Estimates of the fiscal impact of this program that utilize per-pupil expenditures must control for the fact that fixed costs included in per-pupil spending figures will not decrease proportionally for every single student that leaves public schools for private schools. Unless a very significant number of students leave public schools – and charter schools – for private schools, savings are unlikely to materialize.**

### Overview of the Corporate Tax Credit

House Bill 1104, Scholarship Funding Corporate Tax Credit, would create a dollar-for-dollar tax credit for corporations that make donations to organizations that grant scholarships to eligible students to attend private schools rather than public schools.<sup>1</sup> The credit could be claimed against the state corporate income tax, franchise tax, or insurance gross premiums tax. This analysis is limited to consideration of the tax mechanism and fiscal implications of the bill, and as such it does not examine the considerable education policy implications of creating such a credit.

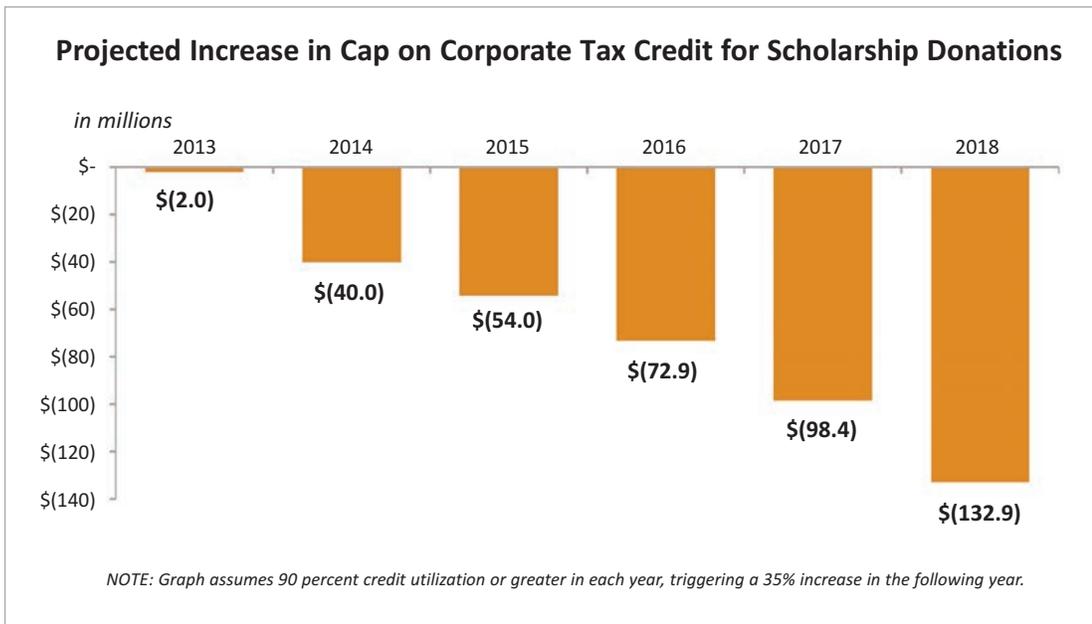
The House budget included a \$617,379 reduction to General Fund availability in anticipation of the bill's passage. The recently introduced Senate budget does not currently set funding aside for this program. As such, it is unclear if the legislation will progress in the current legislative short session.

Under the bill, the Division of Nonpublic Education, part of the Department of Administration, would certify scholarship-funding organizations, which would then be able to accept corporate donations eligible for the credit. The organizations could award scholarships of no more than \$4,000. Eligible students would have to be either entering kindergarten or first grade or transferring their enrollment from a public to a nonprivate school, and come from a household with income not in excess of 225 percent of the federal poverty level.

Supporters of tax credits for private-school scholarships argue these programs save states money by enabling students who would otherwise attend state-funded district or charter schools to attend private schools. They contend the cost of the tax credits to the state budget is more than offset by savings from not having to pay per-student funding.<sup>2,3</sup>

Opponents argue these programs are another form of vouchers and the tax credit is simply a mechanism to circumvent the constitutional prohibition on directing public money to private schools

under the Establishment Clause. They also say the cost savings claimed by supporters are overstated and that these programs are often a net cost to the state. Furthermore, opponents contend these programs frequently function as a cost subsidy to families that have the means to send their children to private schools even without the credit.



The tax credit would be capped at a total dollar amount for each tax year, with corporate taxpayers able to apply for the credit on a first-come, first-served basis. House Bill 1104 would cap the total credit at \$2 million in FY2012-13, but the cap would increase to \$40 million for the full 2013 tax year. A trigger mechanism in the law would automatically increase the cap on the credit by 35 percent for the following tax year any time 90 percent of the credit is claimed. For example, as soon as corporations claim \$36 million in credits for tax year 2014, the cap for the total credit for tax year 2015 would automatically increase to \$54 million.

There is no disincentive for profitable corporations to claim this credit to reduce their total tax liability, and North Carolina's total annual corporate tax revenues, at approximately \$1 billion annually, are well in excess of the value of the credit. Therefore, in order to responsibly budget for this policy, a conservative fiscal analysis should assume that the full value of the credit would be claimed in any given tax year until actual experience proves otherwise.<sup>4</sup>

Additionally, corporations that claim tax credits may carry forward the balance of the credit earned if they are not able to claim its full value in that tax year. For example, if a corporation donates \$50,000 to a scholarship-funding organization in 2013 but has only \$25,000 in corporate tax liability that year,

it could carry forward the unused \$25,000 tax credit to reduce its tax liability in 2014. Credits earned under this program could be carried forward for up to five years under House Bill 1104.

### Experience in Other States

Seven states currently offer similar corporate income tax credits for donations to scholarship-granting organizations: Arizona, Florida, Pennsylvania, Rhode Island, Georgia, Indiana, and Oklahoma.<sup>5</sup> While limitations on the amount of the credit available to any individual taxpayer vary by state, all seven states cap the total value of the credit in any given year.

Several states release annual reports on their credits that include the costs in foregone state revenues and information about scholarships granted. In Arizona, which offers both corporate and individual tax credits for donations to private-school scholarship-granting organizations, corporations claimed more than 90 percent of the allowable credit in the first two years it was available, with the value of credits claimed equaling between 1 percent and 2 percent of total state corporate income tax revenues.<sup>6</sup> In subsequent years, total credits claimed fell below 90 percent of the statutory cap. Some research suggests that Arizona's large charter-school program is competitive with private schools in the state, with the effect of decreasing demand for scholarships provided via the state's tax credit program.<sup>7</sup>

Supporters often cite Florida's tax credit program as the model other states should duplicate. The credit is sizeable, as is the number of scholarships granted in recent years. For FY2012-13, the Florida corporate tax credit is capped at \$175 million; however, state fiscal analysts estimate only \$71.8 million in credits will be claimed in that year.<sup>8</sup>

### Estimating the Fiscal Impact of Tax Credits for Private-School Scholarships

Supporters often point to per-pupil state spending on education as the basis for their calculation of net savings to the state from scholarship tax credits. In North Carolina, per-pupil state spending for students in public schools was \$5,162 in FY2010-11, and total spending from state, federal, and local sources was \$8,414.<sup>9</sup> Supporters calculate state savings from the corporate tax credit scholarship program as \$4,000 in state expenditures per scholarship less state per-pupil spending of \$5,162, for a net per-pupil savings of \$1,162 for the state.

The problem with using per-pupil spending as the basis of estimating cost savings is that this figure includes costs that do not decrease proportionally for each student who leaves the system, such as school buildings, infrastructure, and the expense of maintaining student-teacher ratios. Savings projected by supporters of these programs are heavily predicated on the assumption that a sizeable number of students will shift to private schools from public schools as a result of the scholarship incentive. Regression analysis of the Arizona corporate tax credit for scholarships program found that private school enrollment in that state increased by just 1 percent, or 468 students, as a direct result of the scholarships generated by the credit.<sup>10</sup> The study concluded that the program is operated at a net cost to the state rather than a net savings.

Moreover, school data over the implementation of these credits shows that 4 of the 7 states with tax credit scholarship programs experienced steady growth in public school enrollment between FY2007-08 and FY2011-12.<sup>11</sup> Interestingly, all but one state (Indiana) experienced a drop in estimated private school enrollment between FY2006-07 and FY2008-09.<sup>12</sup>

House Bill 1104 would allow scholarship-granting organizations to retain up to 9 percent of contributions for administrative overhead. Assuming the cap would be met in the 2013 tax year, that would be \$3.6 million that would go neither toward educating students nor state coffers – an amount equal to the annual cost of transporting approximately 7,400 public-school students by bus or replacing 60,000 outdated high school science textbooks in the 2011-12 school year.<sup>13</sup>

## Even With Scholarship Aid, Private School Would Remain Out of Reach for Many Low-Income Students

Knowing how the amount of the scholarships relates to the actual cost of private school tuition is essential to creating a scholarship program that makes private schools accessible to low- and moderate-income families.

At this time there is no reliable, public source of information on the cost of private schooling in North Carolina. The Division of Nonpublic Education maintains estimates of total nonpublic school enrollment but does not collect or publish data on tuition and fees for those schools. Nationwide data on private school tuition reported by the National Center for Education Statistics (NCES) shows that average annual tuition at a private elementary school in FY2007-08 was \$6,733 (\$7,248 when adjusted for inflation<sup>14</sup>), but more than 88 percent of all private elementary schools reported charging tuition higher than that amount in that year.<sup>15</sup> While this national data may not necessarily reflect the average cost of private school tuition in North Carolina, it strongly suggests that the \$4,000 scholarship provided under this legislation would be insufficient to pay the total tuition, let alone student fees and other associated costs of attendance, at a great number of private schools.

## Conclusion

All North Carolina's children are entitled to a quality education. That promise is undermined when resources are diverted in ways that decrease, rather than increase, all students' access to a quality education. The experiences of other states that have instituted corporate tax credits for private school scholarships have been costly and, in some cases, contrary to the stated policy purposes of the programs. Georgia's corporate tax credit for scholarship donations was the subject of a recent New York Times report focusing on widespread abuses of the program, particularly through its provisions for individual donations.<sup>16</sup>

Although the legislation under consideration in North Carolina addresses some of the major weaknesses of programs in other states, it would nonetheless be a significant potential drain on state revenues supporting public education.

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- 1 The bill would allow scholarship funding organizations to grant \$4,000 scholarships to students from families earning 225% of the federal poverty limit. A student from a family of four earning \$51,862 in gross annual income would be eligible for one of these scholarships.
  - 2 Stoops, Terry, April 2008. Education Tax Credits in North Carolina: Innovation in Education. John Locke Foundation Research: Raleigh, NC. Available at <http://www.johnlocke.org/research/show/policy%20reports/149>
  - 3 See "Off the Waiting List: School Choice Bills Pass Through the Senate, Onto the House," Center for Arizona Policy: January 19, 2012. Also Hansen, Robert J. and Kossan, Pat. "Professor puts savings for state at up to \$186 million." The Arizona Republic: Nov. 17, 2009. Available at <http://www.azcentral.com/news/articles/2009/11/17/20091117sto-gopmeeting1117.html>
  - 4 The amount of actual corporate tax credits claimed in Arizona and Florida leveled off after the first few years of their respective programs, with total credits claimed equivalent to approximately 2 percent of total corporate tax collections in Arizona and approximately 4.5 percent of total corporate tax revenue in Florida. Despite this phenomenon, it remains appropriate for fiscal analysis of this legislation to assume full utilization of the credit in future years until actual experience suggests a different set of forecasting assumptions.
  - 5 The tax credit is allowed to individuals as well as corporations in Arizona and Georgia. The state of Iowa offers a tax credit for individual donations to private school scholarship organizations, but this credit is not available to corporations.
  - 6 Meyer, Georganna, and Karen Jacobs. "Private School Tuition Organization Income Tax Credits in Arizona: A summary of activity FY 2011." Arizona Department of Revenue, Office of Economic Research and Analysis. January 2012. Available at <http://www.azdor.gov/Portals/0/Reports/2011-Private-School-Tuition-Organization-Individual-and-Corporate-Income-Tax-Credit-Report.pdf>
  - 7 Wells, Dave, February 2010. Arizona's Tuition Tax Credit Program and Private School Enrollment. Arizona State University: Phoenix, AZ. Available at <http://www.public.asu.edu/~wellsda/research/ArizonasTuitionTaxCreditProgramandPrivateSchoolEnrollment.pdf>
  - 8 SOURCE: FLORIDA REVENUE ESTIMATING CONFERENCE 2011 FLORIDA TAX HANDBOOK Including Fiscal Impact of Potential Changes <http://edr.state.fl.us/content/revenues/reports/tax-handbook/taxhandbook2011.pdf>
  - 9 NC Department of Public Instruction, Facts and Figures 2011. Available at <http://www.ncpublicschools.org/docs/fbs/resources/data/factsfigures/2011-12figures.pdf>
  - 10 Wells, Dave, February 2010. Arizona's Tuition Tax Credit Program and Private School Enrollment. Arizona State University: Phoenix, AZ. Available at <http://www.public.asu.edu/~wellsda/research/ArizonasTuitionTaxCreditProgramandPrivateSchoolEnrollment.pdf>
  - 11 National Educators Association, "NEA Rankings and Estimates" for years 2008 through 2012.
  - 12 See National Center for Education Statistics, "Characteristics of Private Schools in the United States: Results From the 2007-08 Private School Universe Survey" and National Center for Education Statistics, "Characteristics of Private Schools in the United States: Results From the 2009-10 Private School Universe Survey."
  - 13 BTC calculation of \$3.6 million in school expenditures on student transportation and textbook replacement is based on information taken from NC Department of Public Instruction data released in "Facts and Figures FY2011-12." Available at <http://www.ncpublicschools.org/docs/fbs/resources/data/factsfigures/2011-12figures.pdf>
  - 14 National Center for Education Statistics, Digest of Education Statistics 2011: Table 64. Private elementary and secondary enrollment, number of schools, and average tuition, by school level, orientation, and tuition: 1999-2000, 2003-04, and 2007-08. Available at [http://nces.ed.gov/programs/digest/d11/tables/dt11\\_064.asp](http://nces.ed.gov/programs/digest/d11/tables/dt11_064.asp)
  - 15 U.S. Department of Education, National Center for Education Statistics, Schools and Staffing Survey (SASS), "Private School Questionnaire," 1999-2000, 2003-04, and 2007-08.
  - 16 Saul, Stephanie. "Public money finds back door to private schools." The New York Times: May 21, 2012. Available at <http://www.nytimes.com/2012/05/22/education/scholarship-funds-meant-for-needy-benefit-private-schools.html?hpw>