THE CENTER FOR LEGISLATIVE ANALYSIS
...a project of
THE THOMAS JEFFERSON INSTITUTE FOR PUBLIC POLICY

LEGISLATIVE POLICY ANALYSIS

The Virginia Education Improvement Scholarship Tax Credit:
<u>Helping Children, Saving Tax Dollars</u>

By Christian N. Braunlich

Executive Summary

2/2/2016 -- In 2014-2015, the Education Improvement Scholarship Tax Credit offered nearly 1,400 low and moderate income students the opportunity for a better educational placement. At the same time, it saved the Commonwealth of Virginia nearly $3 million in state Standards of Quality funding as those students left the public system to attend a private school.

With a 65 percent tax credit, Virginia's tax credit scholarship program offers one of the smallest credits in the nation. Raising the credit to 90 percent would stimulate more donations to scholarship foundations, relieve family financial strains by providing higher scholarships to poorer students and offer more choices to educationally at-risk children.

Education Choice: New Opportunities for Students

Nation-wide, the use of education choice to provide new opportunities to deserving students has expanded dramatically. In the past five years alone, 21 states enacted 33 different education choice programs. By far the most successful education choice program has been tax credit scholarships, with nearly 200,000 students nationally using these privately-financed scholarships to receive a better education. More than 80,000 students use publicly-financed education vouchers to find the best educational options. Another 7,000 use Education Savings Accounts (ESAs) to choose a private school.

Virginia's "Blaine Amendment" prohibiting the use of public money for sectarian or church-based schools complicates the argument for the use of vouchers or ESAs in Virginia. Tax credit scholarships do not use public funds, thus avoiding entanglements with public money. Instead, private donors utilizing the tax credit contribute to scholarship organizations that, in turn, provide scholarships to deserving students. The privatized funding mechanism of the tax credit scholarships creates a sustainable mechanism offering Virginia's less fortunate children and families more educational choices.

The Virginia Education Improvement Scholarship Tax Credit (EISTC)

In 2012, the Virginia General Assembly approved and Governor Bob McDonnell signed into law the Education Improvement Scholarships Tax Credit (EISTC).

The EISTC offers a 65 percent state tax credit to those donating to eligible scholarship foundations that, in turn, provide a scholarship to low or moderate income public school students so they can attend a private school that better fits the student's needs. Scholarship foundations must use at least 90 percent of each donation to provide the scholarship, and the size of the scholarship is capped at the amount the state would have spent on the student's public school education in their school division of residence.

For every 65 cents the state lost in revenue, it was expected that the state would also save 90 cents in state education expenses – a net savings to state taxpayers.

School year 2014-2015 marked the third year students received scholarships. So what *was* the actual effect?

Calculating the Fiscal Effects

While many studies have reviewed how scholarship programs work in *theory*, this paper is intended to examine the *actual* fiscal effects of the EISTC on state revenue.

In concept, calculating the fiscal effect of the EISTC is simple: The state loses the revenue resulting from giving a tax credit to the donating taxpayer. The state also saves the cost of educating a student in a public school. As long as the amount of the savings is more than the amount of the lost revenue, state taxpayers are winners! The equation looks something like this:

Cost of Student Removed From State	***MINUS***	**Lost Revenue From Tax Credit To Taxpayer**	***EQUALS***	**Savings to State Treasury**

What can complicate the task of calculating the fiscal effects, however, are other factors that can affect the results –

- Eligibility for a scholarship tax credit may include some students who would have enrolled in a private school even without a scholarship. It would be wrong to assume a state "savings" for these students since they would not have attended public school anyway. This "private school propensity" effect is taken into account in this paper.

- It's important to count students, not scholarships. A student can theoretically accept more than one scholarship as long as the total amount of scholarship funds he or she receives is not more than the state aid provided in his or her school division. For example, a student could accept two $2,200 scholarships if the state aid in his or her school division is $4,500. Indeed, in 2014-2015 there were 1,598 scholarships awarded to 1,368 students.

- The size of the scholarship varies by student, and the "cap" in each school division differs. This study uses *actual* figures and accounts for these differences.

- While the EISTC program removes the state share of education expenses, it leaves other key components for local school systems to continue using. These include federal aid, state sales tax distribution and local funding. While these remaining funds, combined with certain fixed costs such as buildings and transportation, have both a positive and negative effect on local school division per pupil costs, a consideration of those effects is beyond the scope of this paper at this time.

Just as the Virginia Department of Planning and Budget provides Fiscal Impact Statements offering the fiscal implications only on state government, this paper examines the actual fiscal impact of the EISTC only on the Commonwealth's budget.

To determine the impact, this paper relies on annual reports provided to the Virginia Department of Education by the scholarship foundations granting scholarships. Among other data, these foundations are required to report --

- The number of donations received each year, the aggregate donation amount, and the aggregate tax credit amount claimed by the taxpayer;
- The amount of each scholarship and the school division in which the scholarship recipient resides (in order to determine the "cap" for each scholarship); and
- The name of the private school that the scholarship recipient attended (in order to ensure no student goes over the "cap").

No personally identifiable information is provided, and the Virginia Department of Education aggregates all information, so personal information cannot be otherwise determined.

Although scholarship foundations are permitted to offer scholarships up to the state's cost for educating a public school child in his/her own school division, the average scholarship offered students is significantly less. Scholarship foundations report this is a consequence of limited financial funds, constrained by a smaller tax credit. <u>In 2014-2015, the average scholarship size was $2,535 per child – even as the scholarship eliminated state expenses of $5,052 per pupil.</u> This means the state will "profit" from the tax credit – to the tune of $2,945,949 for just 1,368 scholarships. A brief chart summarizes the effect:

Number of students awarded scholarships[1]	1,368
Total Scholarship dollars awarded[2]	$3,468,357
Average scholarship Amount per student	$2,535
SOQ Savings to State[3]	$6,927,465
Adjustment for kindergarten & first grade students who would have attended private school without the EISTC[4]	($21,828)
Final SOQ Savings to State[5]	**6,905,637**
Amount donated[6]	$6,091,827
Tax credit cost of donation to the state[7]	$3,959,688
Total savings to the state[8]	**$2,945,949**

There are important *caveats* to consider in these calculations, because there is a misalignment between scholarship awards and when donations are received. Tax credits are taken on the basis of a calendar year (January 1 through December 31). Scholarships, on the other hand, are awarded on the basis of a school year (July 1 through June 30).

As an example, a donation received in December 2014 will likely (but not necessarily) be used for a 2015-2016 school year scholarship. The student will be "removed" from the state Average Daily Membership for the 2015-2016 school year, but because the General Assembly bases its budget on the preceding year's head count, the effect on state funding will not occur until the 2016-2017 school year. For most Virginia taxpayers that December 2014 donation will, in turn, mean a credit against taxes due in May 2015. Corporate or high-income taxpayers may receive a credit against estimated taxes.

On the other hand, a donation received in May 2014 will likely (but not necessarily) be used for a 2014-2015 school year scholarship. The student will be "removed" from the state Average Daily Membership for that school year, and the state funding effect will occur in the 2015-2016 school year. The donor will still receive a credit against taxes due for 2014.

---

[1] As reported by scholarship foundations and school reports to the Virginia Department of Education

[2] As reported by scholarship foundations to the Virginia Department of Education

[3] Based on 100 percent of Standards of Quality State Share Funding for each school division in which a scholarship recipient resides but is no longer attending public school.

[4] Assumes a propensity that some students not enrolled in public schools would attend a private school even without financial assistance from the EISTC program. For determining the propensity, we thank Dr. Marty Lueken, Director of Fiscal Policy and Analysis at the Friedman Foundation for Educational Choice. Propensity is calculated by obtaining the total public and private school students in Virginia based on National Center for Education Statistics and Virginia Department of Education figures (1,284,680 public and 98,439 private school students), and estimating the percentage of private school students in kindergarten or first grade (14.99 percent or 14,756 students, based on public school demographics). This group of 14,756 students is 1.07 percent of all student public and private school students in Virginia. Next, we estimate that 7.1 percent of all students in Virginia are enrolled in private school. In an abundance of caution, this rate is doubled to 14.2 percent, and assumes this is the propensity for all students enrolling in private school without financial assistance. Finally, this rate is applied to the percentage of eligible private school students in kindergarten and first grade (14.2% x 1.07%)) to arrive at a final estimate of 0.2 percent of private school students would likely enroll in a private school without financial assistance. We then assumed that these students would reside in school divisions with the highest level of state support.

[5] Savings to the state minus an adjustment for kindergarten and first grade students receiving scholarships who would have attended private school without a scholarship.

[6] As reported by scholarship foundations to the Virginia Department of Education. Donations are typically used for scholarships during the next school year.

[7] As reported by scholarship foundations to the Virginia Department of Education.

[8] Based on the difference between state share of SOQ funding in each school division minus the tax credit cost to the state (SOQ savings to the state – tax credit cost to the state = total savings to the state).

It's important, then, to look at the numbers in the same way the state counts student enrollment – as part of a three year rolling average. But while no single year will provide a *complete* picture, as the program grows the size of the savings will also continue to grow.

The inescapable conclusion is clear: At a 65 percent tax credit the Commonwealth is actually *making* money. Although the Virginia budget assumes the tax credit will "cost" up to $25 million, in actuality it is bringing in nearly $3 million in additional revenue.

How Can We Help More Students?

In the Thomas Jefferson Institute's initial study proposing an Education Improvement Scholarship Tax Credit, a 90 percent was proposed. What would the results have been in 2014-2015 if the credit had indeed been 90 percent?

This question is an important one. The most successful of these tax credit programs in other states provide a 90 or 100 percent tax credit to donors. Of 17 other tax credit scholarship programs, 14 provide a tax credit amount higher than 65 percent.

While Virginia has raised $6 million through its program, in Florida, with a 100 percent credit against state taxes, nearly $358 million is raised each year to help nearly 78,000 low-income students. In Georgia, also with a 100 percent credit, $58 million is raised and more than 13,000 students served. In Pennsylvania, where donors receive a 90 percent credit if they donate in two successive years, $100 million is raised to assist more than 38,000 children.

The effect of a higher tax credit has a profound impact on the lives of the state's students. With more funds raised, scholarship amounts to students could be higher, and more students with even lower incomes can be given added opportunities to attend a school that better fits their needs.

What would a higher tax credit raise? Much of it depends upon the "cost to donors" – the amount they would actually have to pay for a donation to a scholarship foundation.

In 2014-2015, the "cost to donors" for approximately $6 million in donations was a little over $2 million. This is the amount of the donations that remain taxable. Assuming that students received the maximum possible scholarship (the maximum SOQ funding for their school division, based on the 2014-2015 profile), the results with a 65 percent tax credit would generate approximately 1,086 scholarships at $5,047 each. However, a 90 percent would generate more than 3,800 scholarships of the same amount. Here is a comparison demonstrating the funds raised and number of students helped under a 65 percent tax credit and the funds raised and students assisted under a 90 percent tax credit:

	Results with a 65% Tax Credit	Results at A 90% tax Credit
Cost of Donation to Donor[9]	$2,132,139	$2,132,139
Donations Generated	$6,091,127	$21,321,390
Funds available for scholarships[10]	$5,482,014	$19,189,251
State SOQ funding per student eliminated[11]	$5,047	$5,047
Number of Scholarships	1,086	3,802

This suggests quite clearly that raising the size of the tax credit to 90 percent would generate new funds that would, in turn, assist more educationally at-risk children. In fact, the funds generated would be sufficient not only to assist more students, but to provide them greater scholarships and relieve further financial burdens on their families. In fact, the average scholarship size could be raised from $2,535 to $5,047 and still increase the number of students receiving assistance.

This naturally leads to the next question: Would there be a cost to the state treasury?

	State Treasury cost assuming maximum average scholarship
Number of students awarded scholarships	3,802
Total Scholarship dollars awarded[12]	$19,189,251
Average scholarship Amount	$5,047
SOQ Savings to State	$19,189,251
Adjustment for kindergarten & first grade students who would have attended private school without the EISTC	($41,000)
Final SOQ Savings to State	**19,148,251**
Amount donated	$21,321,390
Tax credit cost of donation to the state	$19,189,251
Total savings to the state	**($41,000)**

Under our calculations, there would be a relatively minor cost to the state – essentially that of eligible kindergarten and first graders who received a scholarship but likely would have otherwise gone to private school without financial help. This figure represents less than one-fifth of one percent (.19) of the entire program's revenue.

More importantly, **it is very unlikely that all students would receive funding at the maximum amount, and more likely that there would continue to be a net positive impact on state finances.** The reality is that private schools typically operate as colleges do: Students

[9] Federal and state tax deductions are also available but depend upon the individual circumstances of each taxpayer and are beyond the scope of this paper.
[10] Assumes 10 percent of donations used by scholarship foundations for overhead and administration.
[11] Assumes the SOQ funding per student retains the same profile as actual in 2014-2015.
[12] All numbers are founded off, leading to minor discrepancies.

attending a private school typically have a range of financial offers, including in-school tuition reductions, scholarships directed only to students at that school (illegal under the EISTC program), and work programs available to parents. The result is that it is not always necessary for a student to receive the maximum EISTC award in order to afford a small, private school.

Of course, as with our chart demonstrating the actual results of the EISTC in 2014-2015, the same *caveats* must be assumed: Because of the misalignment between when donations are made and spent, it is important to look at the numbers as part of a three year rolling average. But, just as before, while no single year will provide a complete picture, this snapshot makes clear that the real cost of helping more than 3,800 at-risk students is extremely low.

Conclusion

In 2014-2015, the Virginia Education Improvement Scholarship Tax Credit served 1,368 students by providing scholarships worth a little more than half of the average state per pupil funding.

If the tax credit were raised to 90 percent, it would generate sufficient funds to assist private donors help more than two and a half times the number of students, and provide larger scholarships – thus relieving the financial strain on their families.

Virginia's public education system remains among the best in the nation. But a continuing gap exists: While a majority of middle income students score at "Proficient" on Reading and Math NAEP exams, fewer than a quarter of low-income students do so. Those gaps – economic and racial – are echoed in Virginia's own Standards of Learning exams, and can be seen in any number of school divisions where student performance has been in the tank for nearly two decades.

These children continue to struggle in a "one-size-fits-all" system. And while Virginia's may be a great system it is, at heart, a "system" and, by definition, a "system" cannot meet the need of every individual child coming through its doors.

One clear option is to increase opportunities for students and their parents to find the right placement. Raising the tax credit would increase the ability of scholarship foundations to offer badly needed assistance to low and moderate income families, providing those students with a better educational placement that better suits their needs.

Without a good education, the next generation has no real chance to engage in the process of transforming their … and our … world. We owe it to them to provide the best we can, and expansion of the Virginia Educational Improvement Scholarship Tax Credit is an important path to the best.

Chris Braunlich is vice president of the Thomas Jefferson Institute for Public Policy and immediate past president of the Virginia State Board of Education. *The opinions expressed here are his own and do not necessarily represent the views of the Thomas Jefferson Institute or its Board of Directors. Nothing in this analysis should be construed as an attempt to hinder or aid any legislation.*