

Legislative Analysis



INCOME TAX CREDIT: EDUCATIONAL FOUNDATIONS

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House Bill 4357 (Substitute H-3)
Sponsor: Rep. Edward Gaffney
Committee: Tax Policy
First Analysis (5-20-04)

BRIEF SUMMARY: The bill would amend the Income Tax Act to provide a credit for donations to educational foundations.

FISCAL IMPACT: Because the number of taxpayers that would qualify for the credit it is not known, it is not possible to determine an exact fiscal impact. However, based on similar credits that are already included in the Income tax Act, a very preliminary analysis suggests that income tax revenues could be reduced by approximately \$60 million to \$75 million per year.

THE APPARENT PROBLEM:

One way that a community can support its public schools is through fund-raising and private donations, either directly to a program or district, or to an educational foundation. In some areas of the state, educational foundations have become important in providing schools with resources that would otherwise not be available and in enhancing educational opportunities for students and teachers alike. This kind of activity has become more important since the passage of Proposal A in 1994, which created the state's new school financing system. The new system restricts the ability of local taxpayers to increase their school taxes. In some districts that once routinely raised their taxes to provide extra resources for schools, people are now instead promoting private fund-raising and investment. Some people believe the state tax system should promote and reward this kind of investment in both public and private schools. Under the state's Income Tax Act, people who make contributions to colleges and universities, public libraries, public television, the state museum, and similar entities can claim a tax credit. Legislation has been introduced that would treat contributions to school districts and educational foundations in the same way.

THE CONTENT OF THE BILL:

The bill would amend the Income Tax Act to provide a nonrefundable credit equal to one-half of the amount a taxpayer contributes during the tax year to an educational foundation, not to exceed \$100 for a single return or \$200 for a joint return. The bill would apply to tax years beginning after December 31, 2004. (A credit is a direct reduction in tax liability.)

The term "educational foundation" would mean an organization that applied to the Department of Treasury for certification on or before April 1 of the tax year for which the

taxpayer was claiming a credit; that annually submitted documentation to the department demonstrating continued compliance with the requirements of the bill; and that the department certified for that tax year as meeting all of the following requirements:

- qualified for exemption from federal income taxation under Section 501(c)(3) of the Internal Revenue Code;
- maintained an ongoing program to attract new funds by seeking gifts and bequests from a wide range of potential donors in the community or area served;
- dedicated all funds, gifts, and bequests to a school district, nonpublic elementary or secondary school, public school academy (charter school), or public school;
- was publicly supported as defined by the regulations of the United States Department of Treasury; and
- met the requirements for treatment as a single entity contained in federal treasury regulations.

The term “school district” in the bill would mean a school district, local act school district, or intermediate school district as those terms are defined in the Revised School Code. Generally, it refers to a general powers school district or a first class school district (Detroit), and school districts governed by a special or local act. In the Revised School Code, the term “public school” refers, generally speaking, to elementary and secondary schools operated by school districts, public school academy corporations, strict discipline academy corporations, the Department of Education, or the State Board of Education, and includes a university laboratory school.

MCL 206.270

BACKGROUND INFORMATION:

Article 8, Section 2 of the state constitution provides, in part, “[n]o public monies or property shall be appropriated or paid or any public credit utilized, by the legislature or any other political subdivision or agency of the state directly or indirectly to aid or maintain any private, denominational or other nonpublic, pre-elementary, elementary, or secondary school. No payment, credit, tax benefit, exemption or deductions, tuition voucher, subsidy, grant or loan of public monies or property shall be provided, directly or indirectly, to support the attendance of any student or the employment of any person at any such nonpublic school or at any location or institution where instruction is offered in whole or in part to such nonpublic school students. The legislature may provide for the transportation of students to and from any school.”

ARGUMENTS:

For:

The bill will encourage private investment in public education programs and provide a tax benefit to supporters of private education. In some school districts, private fund-raising has replaced the voting of extra tax dollars for schools, because the current school financing system prevents districts from increasing school taxes. Education foundations are making substantial annual grants to enhance school programs, such as computer technology, special education programs, music instruments, arts supplies, and numerous other programs that benefit classroom instruction in our schools. In many instances, educational foundations provide programs and services that the districts would not normally provide in this time of increasing financial constraints.

Response:

There is some concern that the bill benefits high-spending, high-income districts more so than the school districts of urban and rural communities. To the extent that it does so, the bill contravenes one of the principal purposes of Proposal A: the equalization of school funding. Research has indicated that districts with foundations tend to be more affluent, have a lower percentage of children eligible for free or reduced lunch, have greater per pupil revenue from traditional tax sources, and have higher achievement than districts without educational foundations, all of which further exacerbates inequities between rich and poor districts.

Rebuttal:

Generally speaking, the amount of money raised by educational foundations is not terribly large, which mitigates most of the “de-equalizing” aspects of Proposal A. Moreover, Proposal A sought to equalize school funding not by punishing high-spending districts, but by bringing up low-spending districts.

Against:

There is some question over the constitutionality of providing a credit for donations made to non-public schools, particularly parochial schools. The state constitution provides in part, “[n]o payment, credit, tax benefit, exemption or deductions, tuition voucher, subsidy, grant or loan of public monies or property shall be provided, directly or indirectly, to support the attendance of any student or the employment of any person at any such nonpublic school or at any location or institution where instruction is offered in whole or in part to such nonpublic school students.” One could reasonably argue that the credit offered by the bill (with respect to educational foundations that support parochial schools) violates the state constitution.

Against:

The bill would decrease state revenue at a time when it can least afford it. While it is certainly laudable to assist schools in their efforts to seek alternative and creative sources of funding, the direct financial implications of the bill on the state budget necessitate its defeat. Moreover, this credit further erodes the base of the income tax. Rather than proliferating exemptions and credits that complicate the state tax code and shift tax burdens, the legislature should work toward simplifying the tax and lowering the overall rate.

POSITIONS:

The Michigan Catholic Conference supports the substitute bill. (5-19-04)

The Department of Treasury is opposed to the bill. (5-20-04)

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