PENNSYLVANIA
Budget and Policy Center

412 N. 3rd Street
Harrisburg, PA 17101
717-255-7156
www.pennbpc.org

June 25, 2012

Analysis of HB 2468

Individuals, Not Corporations, Pick Up the Tax Tab for EITC Scholarships

Corporations get triple dip deduction for contributions to private schools

Executive Summary

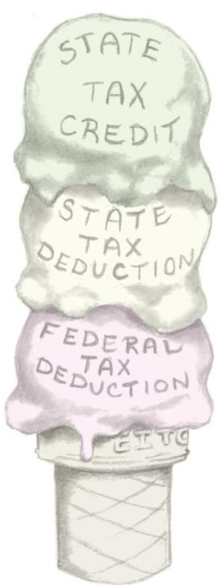
Individual taxpayers are footing the bill for $9 out of every $10 of corporate contributions for private and parochial school scholarships made through Pennsylvania's Educational Improvement Tax Credit (EITC).

The EITC allows businesses to recover 75% to 90% of the cost of contributing to an EITC-qualified organization. Companies can also take state and federal tax deductions for a "charitable" contribution, amounting to a "triple dip" tax reduction.

EITC Is a Minimal Cost to Companies, Making It Costly to PA Taxpayers

"One of the major advantages of the EITC is that for Pennsylvania corporations, the taxpayer receives the benefit of both the credit AND the charitable contribution deduction, making the true out-of-pocket cost minimal in many circumstances."

EisnerAmper Accountants & Advisors, *State and Local Tax Advisory*, June 2009



Companies Taking the EITC Credit Get a Triple Dip Tax Reduction

Altogether, a company making a $300,000 annual EITC contribution over two years will pay only $20 a year in out-of-pocket costs. For a company that contributes to a prekindergarten scholarship (which yields an even more generous credit), the tax benefit can be more than the total value of the "contribution."

The result — a minimal cost to companies, a substantial cost to taxpayers, and a further reduction in funding to support the quality public schools that Pennsylvania needs to build its economy.

The General Assembly is expected to vote on House Bill 2468 in late June, which will expand the EITC and create a new scholarship program – altogether raising the cost from $75 million in 2011-12 to $200 million in 2012-13.[i] Tax credits will be available to businesses on donations up to $400,000 in 2012-13 and up to $750,000 after that – up from the current $300,000 cap.

Proponents argue that expanding the EITC doesn't affect the budget because companies pay the bill; however, the opposite is true. Individual taxpayers will pay at least $9 of $10 in EITC funding.

The EITC program needs substantial program reform prior to any expansion. It is a costly program with little accountability that allows businesses to direct other taxpayers' money to favored organizations.

Expanding the EITC now will drain more state revenue away from public schools at a time when many are laying off teachers, cutting kindergarten or prekindergarten, and eliminating courses.

What is the Educational Improvement Tax Credit?

The Educational Improvement Tax Credit (EITC) provides tax subsidies to companies that contribute to non-profit organizations offering scholarships to students who attend private and religious schools or early childhood programs, or to organizations providing educational improvement activities. Since its inception in 2001, the EITC has cost $586 million[ii] in taxpayer subsidies.

Often touted as a charitable contribution program that costs taxpayers little,[iii] the EITC is actually quite expensive. Because it reduces available revenue that can fund public schools or human services, the EITC is counted, much like an expenditure, as a cost in the budget. In 2011-12, the cost of the EITC is $75 million, up from $60 million in 2010-11.

How Does It Work?

Through the EITC, businesses are able to obtain a credit against their Pennsylvania taxes in return for making a contribution of cash, personal property (cars, real estate, or stocks) or services to scholarship or educational improvement organizations. The credit may be used in the year the contribution is made and is capped at $300,000 per business each year.

A one-year contribution to a qualifying organization entitles the company to a tax credit equal to 75% of its contribution. If the company commits in writing to a two-year contribution, the tax credit increases to 90% of the contribution each year. A business can receive a 100% tax credit for the first $10,000 contributed to an approved prekindergarten scholarship program.[iv]

To receive the tax credit, a company applies to the Pennsylvania Department of Community and Economic Development (DCED). The credits are first awarded to companies in the second year of a two-year commitment, with the remaining credits granted on a first-come, first-serve basis.[v]

After the business is approved for a tax credit, it *then* makes the contribution to the approved organization. When the contribution is confirmed, the business receives the tax credit to apply against its business tax liability for that year. This reduces the state revenue collected by the same amount as the credit.

In addition to the tax credit, the company can deduct the "charitable" donation from its state and federal taxable income.[vi] The value of the contribution is fully deductible from state income and partially deductible from federal taxable income.[vii] This "triple dip" deduction means companies contribute little or nothing.

Example: Tax Credit and Deductions Combine to Make EITC Donation Virtually Free for Company

Acme Corporation agrees to make a contribution of $300,000 per year for two years to the Good Kid Scholarship Organization. Acme files an application with DCED and receives a tax credit of

$270,000 (90% of the contribution). Right off the bat, the net cost to the company decreases to $30,000.

The contribution also qualifies as a charitable deduction for federal and state[viii] corporate income taxes. After accounting for state and federal tax deductions, the net cost to the company for making a $300,000 contribution is only $20. This represents nearly a 100% return on the contribution for the company.

Acme Corporation Financial Summary

$300,000	Cost of donation to Good Kid Scholarship Organization
-$10	Federal tax benefit from deduction
-$29,970	State corporate net income tax benefit from deduction of EITC contribution from income
-$270,000	Pennsylvania taxes offset by EITC (90% of donation)
$20	**Net cost to company for donation**

The federal tax savings is more significant with a 75% EITC credit. In the Acme Corporation example, a one-year contribution of $300,000 with a 75% tax credit would yield a federal deduction of $15,310. The company's total tax savings would be 90.1% of the contribution.

Here is how the state tax benefits break down with the 90% EITC credit:

	PA Tax Paid by Acme Corp. Before EITC Contribution	**PA Tax Paid After EITC Contribution**
Total Income of Acme Corp.	$3 million	$3 million
Charitable Deduction	0	-$300,000
Net Taxable Income	$3 million	$2.7 million
PA Income Tax Due	$299,700	$269,730
Less EITC Tax Credit	0	-$270,000
Final PA Income Tax Due	**$299,700**	**-$270**[ix]

Here is a total tally on the state tax benefits:

	State Tax Benefit for Acme Corp.
PA income tax savings from the donation deduction	$29,970
PA taxes offset by EITC credit on a dollar-for-dollar basis	$270,000
Total PA tax savings for Acme Corp.	**$299,970**

The combination of federal and state tax deductions and the EITC tax credit reduces the cost to the company of contributions at the 75% rate, 90% rate and at the special prekindergarten scholarship rate.

Share of Contributions Reimbursed with Tax Benefits		
Donation Amount	**One-Year EITC Contribution (75% Tax Credit)**	**Two-Year EITC Contribution (90% Tax Credit)**
$10,000	90.9%	100%
$300,000	90.1%	100%
$150,000 to Pre-K Scholarships		100.4%

According to literature from the Bravo Foundation, a currently authorized Scholarship and Pre-K Scholarship Organization, S corporations see a similar share (96%) of the EITC contributions being reimbursed with state and federal tax benefits.[x]

More details of the above examples may be found in the Appendix.

Who Gets the EITC Contributions?

Three types of groups are eligible to receive EITC contributions: Scholarship Organizations (SOs) offering scholarships to middle- and lower-income students[xi] attending private or religious schools; Educational Improvement Organizations (EIOs) that provide grants to non-profits providing innovative education programs to public school students; and Pre-K Scholarship Organizations (PKSOs) that offer scholarships for prekindergarten programs.

As of 2008-09, a majority (56%) of the EITC contribution dollars and tax credits were awarded to companies making donations to scholarship organizations.

FY 2008-09 EITC Contributions and Tax Credits by Organization Type				
Organization	*Number of Contributions*	*Total Value of Contributions*	*Value of Tax Credits Awarded*	*Tax Credits as % of Contributions*
Scholarship Organizations	2,587	$42.0 million	$37.1 million	88.4%
Educational Improvement Organizations	2,225	$25.2 million	$21.8 million	86.8%
Pre-K Scholarship Organizations	603	$8.4 million	$7.7 million	92.4%
Total	5,415	$75.5 million	$66.7 million	88.3%
Source. DCED as reported by the Pennsylvania Legislative and Finance Committee (LBFC).[xii]				

All three types of organizations receiving the EITC contributions are only required to spend 80% of these donations on program activities, allowing up to 20% to be spent on administration, which never reaches the children.[xiii] Similar programs in Arizona, Florida, and Georgia cap administrative costs at 3% to 10%.[xiv]

The calculations above clearly demonstrate that individual and family taxpayers, rather than corporations, foot the bill for the EITC – with 90% to 100% of donations returned to the companies through tax benefits. The EITC allows corporations to pay less in taxes, transfer these dollars to private and religious schools, and reduce the state revenue available to support public schools, health care, public safety, and other core state services.

Little Public Accountability for EITC Funds

There are very few reporting requirements or accountability for the organizations receiving EITC donations. As the Keystone Research Center concluded in a 2011 study:

> “The state does not systematically collect information on how money is spent by either the private schools or the SOs (scholarship organizations) themselves. Roughly a third of a billion dollars in public subsidies for private schools since the program’s inception, and there is no central reckoning of administrative or program expenditure by either SOs or private schools.”[xv]

In the limited research that has been done on the EITC, problems have been found. The Pennsylvania Legislative Budget and Finance Committee found in a 2009 study that Educational Improvement Organizations were using EITC donations to fund programs that do not appear to qualify as eligible programs under the EITC statute.[xvi]

Efforts to monitor the program have been hamstrung by the General Assembly. Act 46 of 2005 limited the information DCED, the monitoring agency, is able to request from scholarship organizations.[xvii] Currently, scholarship organizations are only required to provide information on the number of awards, total and average amounts of scholarships, and the county (if available) where the scholarship was awarded.[xviii]

Corporations contributing to the EITC get the tax benefit whether the funds are used effectively or not, as there are no “clawback” provisions in the program.

Conclusion and Recommendations

The EITC allows corporations to support favored schools and educational activities but provides little accountability for how funds are used. Because the EITC is both a tax credit and a contribution, many, if not most, companies receive tax reductions worth at least $9 for every $10 dollars they pay out to eligible organizations. This forces individual and family taxpayers to fill in the gap in state revenue and drains state resources away from public schools at a time when many are laying off teachers and cutting programs to make ends meet amid state cuts.

The General Assembly should:

(a) Not increase the cost of the EITC at a time when funding is being cut to public schools.

(b) Not expand the EITC until reforms are made to the program for tax fairness and accountability.

(c) End the double-dip for corporations receiving the EITC tax credit. Companies that receive the credit should have to add back the value of the credit to Pennsylvania taxable income. The IRS requires companies receiving the tax credit to subtract the value of the credit from the federal deduction for state taxes paid, which vastly reduces the double dip. Pennsylvania should take a similar step.

(d) The tax credit amount should be reduced to 50% of the contribution made by a business. It could allow more companies to qualify for the credit and may ultimately provide more funds for EITC qualified organizations.

(e) The General Assembly should require detailed reporting from qualifying organizations on the use of funds and outcomes as well as audits of how scholarships are distributed.

The Pennsylvania Budget and Policy Center is a non-partisan policy research project that provides independent, credible analysis on state tax, budget and related policy matters, with attention to the impact of current or proposed policies on working families. Learn more at http://pennbpc.org.

Endnotes

[i] House Bill 2468, available online at http://www.legis.state.pa.us/cfdocs/billinfo/billinfo.cfm?syear=2011&sind=0&body=H&type=B&BN=2468

[ii] Commonwealth of Pennsylvania, *Governor's Executive Budget*, Tax Expenditure section, various years.

[iii] EITC recipients promote the tax advantage of the donation: "The EITC Program allows your company to support our programs at a minimal cost to you. Instead of sending your tax dollars to Harrisburg, companies can reallocate them to support innovative youth education programs in their own communities." http://franklincenter.org/get-involved-2/eitc-program/.

[iv] Pennsylvania Department of Community and Economic Development (DCED), "Educational Improvement Tax Credit Program," http://www.newpa.com/find-and-apply-for-funding/funding-and-program-finder/educational-improvement-tax-credit-program-eitc.

[v] Pennsylvania Department of Community and Economic Development, *Educational Improvement Tax Credit Program: Business Guidelines and Application*, April 2012, http://www.newpa.com/sites/default/files/uploads/EITC_Business_2012_F.pdf.

[vi] The IRS places some limits on companies' ability to deduct contributions from taxable income.

[vii] For federal tax purposes, state tax credits are treated as a reduction of state taxes paid, which is a deduction from federal taxable income before tax is calculated. The larger the state tax credit, the smaller the state income taxes paid becomes. At the same time, the contribution, itself, lowers taxable income. Overall, the combination of the contribution/credit lowers taxes paid at the federal level, but the amount varies based on the size of the tax credit received. When the EITC is for 75% of the contribution, the federal tax benefits appear to be larger.

[viii] https://revenue-pa.custhelp.com/app/answers/detail/a_id/839/kw/EITC/related/1

[ix] The company could apply the balance of the tax credit against other taxes, such as the capital stock and franchise tax.

[x] Bravo Foundation, "Sample Tax Calculations," accessed June 21, 2012, http://www.thebravofoundation.org/wp/wp-content/uploads/2010/08/taxcalc.pdf.

[xi] Household income of $60,000 plus $12,000 for each minor child.

[xii] Pennsylvania Legislative Budget and Finance Committee, *Preliminary Report on Pennsylvania's Educational Improvement Tax Credit Program*, June 2009. http://lbfc.legis.state.pa.us/reports/2009/40.PDF.

[xiii] Pennsylvania Department of Community and Economic Development, *EITC Program: Organizational Guidelines for Scholarship & Educational Improvement Organizations*, April 4, 2012, http://www.newpa.com/webfm_send/2132.

[xiv] Stephanie Saul, "Public Money Finds Back Door to Private Schools," *New York Times*, May 21, 2012, http://www.nytimes.com/2012/05/22/education/scholarship-funds-meant-for-needy-benefit-private-schools.html?_r=1&pagewanted=1&ref=us&pagewanted=all.

[xv] Stephen Herzenberg, *No Accountability: Pennsylvania's Track Record Using Tax Credits to Pay for Private and Religious School Tuition*, Keystone Research Center, April 7, 2011, http://keystoneresearch.org/sites/default/files/EITC%20Briefing%20Paper_0.pdf.

[xvi] Pennsylvania Legislative Budget and Finance Committee, *ibid*.

[xvii] Commonwealth of Pennsylvania, *Act 46 of 2005*, http://www.legis.state.pa.us/cfdocs/billinfo/billinfo.cfm?syear=2005&sind=0&body=H&type=B&bn=0628.

[xviii] Pennsylvania Department of Community and Economic Development, *EITC Program: Organizational Guidelines for Scholarship & Educational Improvement Organizations*, April 4, 2012, http://www.newpa.com/webfm_send/2132.

ADDENDIX: Corporate Income Tax Impact of Educational Improvement Tax Credit (EITC) Contributions

	$10,000 Contribution			$300,000 Contribution			$150,000 Pre-K Contribution	
	No EITC	75% EITC	90% EITC	No EITC	75% EITC	90% EITC	No EITC	First $10K @ 100%, rest @
Net Income	$ 220,000	$ 220,000	$ 220,000	$ 3,000,000	$ 3,000,000	$ 3,000,000	$ 1,500,000	$ 1,500,000
EITC contribution	$ -	$ 10,000	$ 10,000	$ -	$ 300,000	$ 300,000	$ -	$ 150,000
Fed tax income before PA Corp. Net Income Tax (CI	$ 220,000	$ 210,000	$ 210,000	$ 3,000,000	$ 2,700,000	$ 2,700,000	$ 1,500,000	$ 1,350,000
PA CNIT @ 9.99%	$ 21,978	$ 20,979	$ 20,979	$ 299,700	$ 269,730	$ 269,730	$ 149,850	$ 134,865
Federal Taxable Income after PA CNIT	$ 198,022	$ 189,021	$ 189,021	$ 2,700,300	$ 2,430,270	$ 2,430,270	$ 1,350,150	$ 1,215,135
PA CNIT savings (after deduction of donation)	$ -	$ 999	$ 999	$ -	$ 29,970	$ 29,970	$ -	$ 14,985
EITC applied against PA CNIT and/or CSFT	$ -	$ 7,500	$ 9,000	$ -	$ 225,000	$ 270,000	$ -	$ 136,000
PA tax savings - total	$ -	$ 8,499	$ 9,999	$ -	$ 254,970	$ 299,970	$ -	$ 150,985
Federal Taxable Income after PA taxes and credit	$ 198,022	$ 196,521	$ 198,021	$ 2,700,300	$ 2,655,270	$ 2,700,270	$ 1,350,150	$ 1,351,135
Federal Tax (2011 rates)	$ 60,479	$ 59,893	$ 60,478	$ 918,102	$ 902,792	$ 918,092	$ 459,051	$ 459,386
Federal Tax Savings	$ -	$ 586	$ 1	$ -	$ 15,310	$ 10	$ -	$ (335)
PA Tax Savings Total	$ -	$ 8,499	$ 9,999	$ -	$ 254,970	$ 299,970	$ -	$ 150,985
Federal Tax Savings	$ -	$ 586	$ 1	$ -	$ 15,310	$ 10	$ -	$ (335)
Total Tax Savings	$ -	$ 9,085	$ 10,000	$ -	$ 270,280	$ 299,980	$ -	$ 150,650
Annual cash required to contribute	NA	$ 915	$ -	NA	$ 29,720	$ 20	NA	$ (650)
Percentage effective total tax savings from EITC contribution		**90.9%**	**100.0%**		**90.1%**	**100.0%**		**100.4%**

Calculations based on schedule published by the Imani Christian Academy:
http://www.imanichristianacademy.org/documents/EITCPrestnforWebPage12-13_001.pdf

ADDENDIX: Corporate Income Tax Impact of Educational Improvement Tax Credit (EITC) Contributions

H.B. 2468, P.N. 3736 (CHRISTIANA) PER COMPANY LIMIT:	**FY 2013-14**	**$ 750,000**		W/Pre-K contribution 100% Credit for First $10,000 to Pre-K	
		75% EITC	90% EITC (2 year)	75% EITC	90% EITC (2 year)
Net Income	$ 10,000,000	$ 10,000,000	$ 10,000,000	$ 10,000,000	$ 10,000,000
EITC contribution	$ -	$ 750,000	$ 750,000	$ 750,000	$ 750,000
Fed tax income before PA Corp. Net Income Tax (CNIT)	$ 10,000,000	$ 9,250,000	$ 9,250,000	$ 9,250,000	$ 9,250,000
PA CNIT @ 9.99%	$ 999,000	$ 924,075	$ 924,075	$ 924,075	$ 924,075
Federal Taxable Income after PA CNIT	$ 9,001,000	$ 8,325,925	$ 8,325,925	$ 8,325,925	$ 8,325,925
PA CNIT savings (after deduction of donation)	$ -	$ 74,925	$ 74,925	$ 74,925	$ 74,925
EITC applied against PA CNIT and/or CSFT	$ -	$ 562,500	$ 675,000	$ 565,000	$ 676,000
PA tax savings - total	$ -	$ 637,425	$ 749,925	$ 639,925	$ 750,925
Federal Taxable Income after PA taxes and credit	$ 9,001,000	$ 8,888,425	$ 9,000,925	$ 8,890,925	$ 9,001,925
Federal Tax (2011 rates)	$ 3,060,340	$ 3,022,065	$ 3,060,315	$ 3,022,915	$ 3,060,655
Federal Tax Savings	$ -	$ 38,276	$ 26	$ 37,400	$ (340)
PA Tax Savings Total	$ -	$ 637,425	$ 749,925	$ 639,925	$ 750,925
Federal Tax Savings	$ -	$ 38,276	$ 26	$ 37,400	$ (340)
Total Tax Savings	$ -	$ 675,701	$ 749,951	$ 677,325	$ 750,585
Annual cash required to contribute	NA	$ 74,300	$ 50	$ 72,675	$ (585)
Percentage effective total tax savings from EITC contribution		**90.1%**	**100.0%**	**90.3%**	**100.1%**