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## INCOME TAX CREDIT: EDUCATIONAL FOUNDATIONS

### House Bill 4072 (Substitute H-2) First Analysis (2-21-02)

**Sponsor: Rep. Michael Bishop**  
**Committee: Tax Policy**

#### ***THE APPARENT PROBLEM:***

One way that a community can support its public schools is through fundraising 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 fundraising 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 include educational foundations that support public and private schools, as well as some public school programs, in the list of eligible institutions.

#### ***THE CONTENT OF THE BILL:***

The bill would amend the Income Tax Act to provide a credit equal to 50 percent of the amount a taxpayer contributes during the tax year to an educational facility or organization, not to exceed \$100 or, for a husband and wife filing jointly, \$200. The term "educational facility or organization" would mean either 1) an educational foundation or 2) a continuing education, community education, or adult education program operated by a school district.

A resident estate or trust's credit could not exceed 10 percent of the year's tax liability or \$5,000, whichever was less, and the contribution could not have been deducted in arriving at federal taxable income.

The bill would amend Section 260 of the act and put contributions to an educational facility or organization in the same category as contributions to public libraries, public broadcast stations, institutions of higher learning, the Michigan Colleges Foundation, various public artwork donations, the state museum, and the state archives. The contribution limit applies to the aggregate amount given to all such organizations.

The bill specifies that a contribution to a community foundation under Section 261 that was dedicated to (or earmarked for) an educational facility or organization could not be used to calculate a credit under the bill. Section 261 contains existing credits for contributions to community foundations, as well as to shelters for homeless persons, food kitchens, food banks, and other entities in the state whose purpose is to provide overnight accommodation, food, or meals to the indigent. The credit limit in that section is separate from the credit limit in Section 260.

**Educational Foundation.** An educational foundation would mean an organization that applied 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 of Treasury 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;

\* exclusively dedicated all funds, gifts, and bequests to a school district or state-approved nonpublic school or to a foundation described in Sections 509(a)(1) or 509(a)(3) of the Internal Revenue Code that was located

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in the community or area served and located in the state;

\* was publicly supported as defined by the regulations of the United States Department of Treasury;

\* met the requirements for treatment as a single entity contained in federal treasury regulations;

\* was incorporated or established as a trust at least six months before the beginning of the tax year for which the credit was being claimed;

\* had an independent governing body representing the general public's interest and that was not appointed by a single outside entity; and

\*was subject to a program review each year and an independent financial audit every three years and provided copies of the reviews and audits to the Department of Treasury not more than three months after the review or audit was completed.

The term "school district" would be defined in the bill to mean a school district, local act school district, or intermediate school district as those terms are defined in the Revised School Code. (This is understood to exclude public school academies or charter schools.) In the Revised School Code, a "school district" is defined a general powers school district or a district of the first class (Detroit).

MCL 206.260

### ***FISCAL IMPLICATIONS:***

The House Fiscal Agency estimates that the bill would lower income tax revenues by about \$15 million during the first year and by \$20 million annually in subsequent years. The HFA says that, based on 2000 tax year data, the current credit is claimed by about 284,000 filers and reduces income tax revenue by about \$25 million annually. About 25 percent of those claiming the credit reach the \$100/\$200 limit. (HFA fiscal note dated 2-15-02)

### ***ARGUMENTS:***

#### ***For:***

The bill would treat contributions to educational foundations supporting public and private schools and certain school district programs in the same way that contributions to institutions of higher education and public libraries, public television stations, municipal art

donations, and a number of other public organizations are treated under the state's Income Tax Act. Why shouldn't they be on an equal footing? This will encourage private investment in public education programs and provide a tax benefit to supporters of private schools. In some school districts, private fundraising has replaced the voting of extra tax dollars for schools, because the school financing system prevents districts from increasing school taxes. Educational foundations are making substantial annual grants to enhance school programs, from computer technology to special education team building, from reading programs to land use education, from scholarships to marketing internships, from music royalties to debating supplies. They are providing programs and services that the districts cannot provide for themselves, as well as sponsoring innovation. Representatives of one educational foundation, from Rochester, said in its year 2000 report that it has raised nearly \$1.8 million over its five-year history and over one-half of a million dollars last year. The bill, it should be noted, puts in place requirements on educational foundations similar to those found in the Income Tax Act for community foundations to ensure that these are legitimate organizations.

#### ***Response:***

The bill apparently would not apply to public school academies (charter schools) or foundations supporting those institutions. Is this fair? After all, charter schools are considered public schools and, indeed, are considered as school districts for some purposes.

#### ***Against:***

The traditional criticisms of expansions of the income tax credit are 1) the cost to general fund revenues; and 2) the inequitable treatment of those organizations left out. Why should contributors to educational foundations, community education programs, and the like be eligible for a tax credit when contributions to other worthy organizations do not qualify? The groups the bill benefits are no doubt engaged in worthwhile endeavors. But so are the Girl Scouts, the Red Cross, the United Way, Habitat for Humanity, churches, and many other nonprofit charitable organizations. Perhaps the issue of tax credits for charitable giving should be re-evaluated and examined comprehensively. It should be noted that the bill will result in lower general fund revenues at a time when the state budget is under severe strain. These are dollars that could be spent on other state programs serving other human needs.

#### ***Response:***

Aren't groups engaged in efforts to support elementary and secondary education more like entities supporting higher education than like other nonprofit charities?

Aren't educational foundations, particularly with the stiff requirements of this legislation, more like community foundations? If so, this justifies providing them with this special treatment.

***POSITIONS:***

The Oakland Schools supports the bill. (2-20-02)

Representatives of the Rochester Community Schools Foundation and the Novi Education Foundation testified in support of the bill. (2-20-02)

The Michigan Catholic Conference supports the substitute. (2-20-02)

The Michigan Association of Non-Public Schools supports the substitute. (2-20-02)

The Michigan Association of Public School Academies supports the concept and desires to be included. (2-20-02)

The Department of Treasury is opposed to the bill. (2-20-02)

The Michigan League for Human Services testified in opposition to the bill. (2-13-02)

Analyst: C. Couch

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.