

## The Alabama Accountability Act: 2017 Amendments

### Introduction

Four years ago, the Alabama Legislature passed the Alabama Accountability Act (AAA).<sup>1</sup> Now, legislation is being considered that would amend it.<sup>2</sup>

This *Guide* explains what the AAA is, and how the AAA would be changed by the amendments.

### Background: The Alabama Accountability Act

The AAA reformed the public-education system of Alabama in several ways,<sup>3</sup> but perhaps its most important reforms were the creation of scholarships for students and tax credits for parents—both of which allow students to escape the state’s worst schools.

#### Student Scholarships

The AAA enables students in Alabama’s worst-performing schools to receive a scholarship to cover the costs of attending a better school.

These scholarships can be awarded to students *before* costs have been incurred—that is, before students have begun attending a new school.<sup>4</sup> Unlike the AAA’s tax credits for parents (discussed below), the AAA’s scholarships for students *do* have an income requirement. There are three general requirements:

1. The student must live in Alabama.<sup>5</sup>
2. The student must be zoned for a “failing school.”<sup>6</sup>
3. The student must be a member of a family whose income is less than 185% of the federal poverty level,<sup>7</sup> which is about \$45,500 for a family of four.<sup>8</sup>

A “failing school” is a public school that, based on the test scores of its students, ranks among the worst 6% of all public schools in scholastic achievement.<sup>9</sup>

### ISSUE SNAPSHOT

The amendments that have been proposed for the Alabama Accountability Act (AAA) would:

- ★ Raise the limits on the amount of tax credits that could be claimed for donating to student scholarships: to 100% of the income tax owed by individuals (not to exceed \$100,000); and to 75% of the income tax owed by corporations.
- ★ Expand the pool of donations by adding a new tax credit applicable to utility gross-receipts tax.
- ★ Expand the pool of donors by allowing trusts and estates to participate.
- ★ Keep the cumulative cap on donations the same at \$30 million, but reserve half—\$15 million—for individual donors.

Students can apply for a scholarship to one of the scholarship-granting organizations (SGOs)—the nonprofit entities chiefly responsible for administering and awarding the AAA’s scholarships for students.<sup>10</sup>

Those scholarships are funded by private donations from individuals and corporations to SGOs,<sup>11</sup> which must award at least 95% of all donations they receive to students.<sup>12</sup> When individuals or corporations donate to the scholarship fund of an SGO, they are entitled to claim a tax credit—that is, to subtract that amount, dollar for dollar, from what they owe in income taxes—in return for their donation.<sup>13</sup> There are annual limits, however:

- ▶ For an individual, the tax credit can equal up to 50% of the amount owed in income tax, not to exceed \$50,000.<sup>14</sup>

# GUIDE TO THE ISSUES

- ▶ For a corporation, the tax credit can equal up to 50% of the amount owed in income tax.<sup>15</sup>
- ▶ The cumulative amount of tax credits claimed by individuals and corporations is capped at \$30 million.<sup>16</sup>

Thus, the maximum amount of scholarships that could be awarded to students each year is \$30 million.<sup>17</sup> If there are still unawarded scholarship funds at the start of August, those funds can be made available to students meeting the residency and income requirements, even if those students do not meet the zoning requirement.<sup>18</sup> Always, however, students zoned for failing schools are given priority.<sup>19</sup>

## Parent Tax Credits

The AAA enables the parents of students in Alabama's worst-performing schools to receive a tax credit to cover the costs of sending their students to a better school.

These tax credits can be claimed by parents *after* costs have been incurred—that is, after their students have attended a new school.<sup>20</sup> Unlike the AAA's scholarships for students (discussed above), the AAA's tax credits for parents *do not* have an income requirement. There are three general requirements:

1. The parent must claim the student as a dependent.<sup>21</sup>
2. The student must be zoned for a “failing school.”<sup>22</sup>
3. The parent must transfer the student to a “nonfailing public school” or “qualifying nonpublic school,” at the parent's expense.<sup>23</sup>

A “failing school” is a public school that, based on the test scores of its students, ranks among the worst 6% of all public schools in scholastic achievement.<sup>24</sup> A “nonfailing public school” is the opposite.<sup>25</sup> A “qualifying nonpublic school” is a private school, operating in Alabama, that is accredited and complies with all applicable state laws, including “exclud[ing] from employment any person not permitted by state law to work in a public school.”<sup>26</sup>

Parents can apply for a tax credit to the Alabama

Department of Revenue—the state agency responsible for governing the AAA's tax credits for parents.<sup>27</sup> Those tax credits are applied, dollar for dollar, to the income taxes of parents.<sup>28</sup> The maximum tax credit that parents may claim is the lesser of the following:

- ▶ An amount equal to 80% of the average cost for a student to attend public school in Alabama.<sup>29</sup>
- ▶ An amount equal to the tuition and fees of the new school attended by the student.<sup>30</sup>

## Discussion: The 2017 Amendments

The primary purpose of the proposed amendments is to address the AAA's funding deficiencies,<sup>31</sup> which resulted in donations dropping nearly \$6 million last year.<sup>32</sup> Accordingly, the most significant changes proposed by the amendments are related to funding.<sup>33</sup>

### Changes to Funding of Student Scholarships

The amendments would raise the limits on the amount of tax credits that could be claimed by donors in a single year, while leaving in place the cumulative cap:

- ▶ For an individual, the tax credit could equal up to 100% [*currently: 50%*] of the amount owed in income tax, not to exceed \$100,000 [*currently: \$50,000*].<sup>34</sup>
- ▶ For a corporation, the tax credit could equal up to 75% [*currently: 50%*] of the amount owed in income tax.<sup>35</sup>
- ▶ The cumulative amount of tax credits claimed by individuals and corporations would be capped at \$30 million [*currently: same*].<sup>36</sup>

Right now, income-tax credits are the only type of tax credits available to donors. The amendments would add a second type: a tax credit that could be applied to “utility gross-receipts tax”—a tax paid on all utility services, such as electricity and water, by consumers.<sup>37</sup> For reasons of administrative efficiency, this tax credit would be limited to taxpayers (generally, manufacturers and other businesses) owing a large amount in utility gross-receipts tax.<sup>38</sup> It would also have an annual limit:

# GUIDE TO THE ISSUES

- ▶ For taxpayers owing at least \$100,000 in utility gross-receipts tax, the tax credit could equal up to 75% of the amount owed in that tax.<sup>39</sup>

The amendments would allow trusts and estates to also donate to SGOs and claim tax credits.<sup>40</sup> The pool of potential donors would, therefore, include individuals, corporations, trusts, and estates paying income tax or utility gross-receipts tax.<sup>41</sup>

Lastly, the amendments would reserve half of the cumulative cap on tax credits—\$15 million of \$30 million—for individual donors.<sup>42</sup> Any portion of that amount remaining at the end of the year would then be made available to other donors.<sup>43</sup>

## Changes to Requirements of Student Scholarships

The AAA's scholarships for students have an income requirement that every applicant is subject to.<sup>44</sup> The amendments would provide an exception for foster children, who would be completely exempted from the income requirement.<sup>45</sup>

## Changes to Accountability Measures

The AAA requires that each SGO demonstrate its financial accountability through the yearly submission of a “financial information report.”<sup>46</sup> The amendments would revise this requirement, clarifying and strengthening its language, and replacing the report with a certified financial statement.<sup>47</sup>

Furthermore, the amendments would require mandatory, periodic audits of the SGOs. Under the current law, the Alabama Department of Revenue is allowed to conduct a “financial review or audit” of an SGO, but it is never required to do so.<sup>48</sup> The amendments would change the law to mandate that SGOs be audited every three years, at their own expense, “to determine compliance with administrative and financial accountability standards.”<sup>49</sup>

## Changes to Terminology

The AAA uses the term “failing school” prominently, several dozen times in total.<sup>50</sup> The amendments would replace all instances of “failing school” with

“underperforming school.”<sup>51</sup> Likewise, “nonfailing school” would be replaced by “nonunderperforming school.”<sup>52</sup>

## Conclusion

Last year, donations to the scholarship funds of SGOs fell from \$25.8 million to \$19.9 million—a drop of \$5.9 million, more than one-fifth of all donations.<sup>53</sup> Not only is this bad for students who want scholarships, it is bad for students who already have scholarships: if their scholarships cannot continue to be funded, they could be forced to return to the schools they left.

The proposed amendments to the Alabama Accountability Act address this funding problem. The result should be a bigger pool of donors and donations, and—most importantly—more school choice for students who otherwise would have none.

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1 Alabama Accountability Act of 2013, No. 64, 2013 Ala. Acts 112 (codified as amended at Ala. Code §§ 16-6D-1 to -9). The AAA was amended the same year it was passed, and then again two years later. See Act of May 20, 2013, No. 265, 2013 Ala. Acts 894; Act of June 9, 2015, No. 434, 2015 Ala. Acts \_\_\_. The legislation that is the focus of this *Guide*, see *infra* note 2, would amend the AAA a third time.

2 That legislation, Senate Bill 123, has been passed by the Alabama Senate and is pending in the Alabama House of Representatives. See S. 123, 2017 Leg., Reg. Sess. (Ala. 2017) (as passed by Senate, Feb. 23, 2017), <http://alisondb.legislature.state.al.us/ALISON/SearchableInstruments/2017RS/PrintFiles/SB123-eng.pdf> [<http://perma.cc/F6MA-KKRD>] (amending Alabama Accountability Act of 2013, Ala. Code §§ 16-6D-1 to -9).

3 The Alabama Accountability Act began as the “Local Control School Flexibility Act.” See Local Control School Flexibility Act of 2013, H.R. 84, 2013 Leg., Reg. Sess. (Ala. 2013) (as introduced, Feb. 5, 2013), <http://alisondb.legislature.state.al.us/ALISON/SearchableInstruments/2013RS/PrintFiles/HB84-int.pdf> [<http://perma.cc/L2NE-GTV4>]. The original title is representative of the original purpose: “to advance the benefits of local school and school[-]system autonomy in innovation and creativity by allowing flexibility from state laws, regulations, and policies.” *Id.* The bill’s focus was later expanded to include school choice in addition to school flexibility, with the enacted bill retaining provisions very similar to—often identical to—those of the original bill. Compare Alabama Accountability Act of 2013 §§ 1–7, with Local Control School Flexibility Act of 2013 §§ 1–7.

4 See Ala. Code § 16-6D-9(b)(1)(g).

5 *Id.* § 16-6D-4(a)(3).

6 *Id.* §§ 16-6D-4(a)(2), -9(b)(1)(o).

7 *Id.* § 16-6D-4(a)(1).

8 See Annual Update of the HHS Poverty Guidelines, 82 Fed. Reg. 8831, 8832 (Jan. 31, 2017) (providing the 2017 guidelines for the federal poverty level).

9 Ala. Code § 16-6D-4(5).

# GUIDE TO THE ISSUES

10 See *id.* § 16-6D-9(a)–(c). The administration of the AAA’s scholarship program by the SGOs is regulated by the Alabama Department of Revenue, see *id.* § 16-6D-9(d), with the schools participating in the scholarship program also having administrative duties and responsibilities, see *id.* § 16-6D-9(e).

11 *Id.* § 16-6D-9(a)(1)–(3).

12 *Id.* § 16-6D-9(b)(1)(f).

13 See *id.* § 16-6D-9(a)(1)–(3).

14 *Id.* § 16-6D-9(a)(2).

15 *Id.* § 16-6D-9(a)(3).

16 *Id.* § 16-6D-9(a)(5).

17 See *id.*

18 See *id.* § 16-6D-9(b)(1)(o). At present, about one-third of scholarships are awarded under the AAA to students zoned for failing schools. See Trisha Powell Crain, “Few Alabama Students Use Choice Given Under Accountability Act,” *AL.com* (Feb. 9, 2017), [http://www.al.com/news/montgomery/index.ssf/2017/02/few\\_alabama\\_students\\_use\\_choic.html](http://www.al.com/news/montgomery/index.ssf/2017/02/few_alabama_students_use_choic.html) [<http://perma.cc/8RGK-QC7A>].

19 Ala. Code § 16-6D-9(b)(1)(o); see also *id.* § 16-6D-9(b)(1)(q).

20 See Ala. Admin. Code r. 810-3-60-.01(3)(d).

21 Ala. Code § 16-6D-4(12).

22 *Id.* § 16-6D-8(a)(1).

23 *Id.*; see also *id.* § 16-6D-4(13); Ala. Admin. Code r. 810-3-60-.01(3)(d).

24 Ala. Code § 16-6D-4(5).

25 See *id.* § 16-6D-8(b)(3).

26 *Id.* §§ 16-6D-4(13), -9(b)(2)(b)–(c)(3)(a), -9(d)(5), -9(e)(1)–(3); see also Ala. Admin. Code r. 810-3-60-.02(2).

27 Ala. Code § 16-6D-8(a)(2), (4).

28 *Id.* § 16-6D-8(a)(1).

29 *Id.*

30 *Id.*

31 Senator Del Marsh, Remarks on Senate Bill 123 from the Floor of the Alabama Senate (Feb. 23, 2017); see also Tim Lockette, “Bill Proposed by Sen. Marsh Would Increase Tax Credits,” *Anniston Star*, Feb. 14, 2017, at 1A.

32 See Fiscal Note for S. 123, 2017 Leg., Reg. Sess. (Ala. 2017) (as introduced, Feb. 9, 2017), <http://alisondb.legislature.state.al.us/ALISON/SearchableInstruments/2017RS/FiscalNotes/FN-36159.htm> [<http://perma.cc/X5ZK-3QG5>].

33 See generally S. 123, 2017 Leg., Reg. Sess. (Ala. 2017) (as passed by Senate, Feb. 23, 2017), <http://alisondb.legislature.state.al.us/ALISON/SearchableInstruments/2017RS/PrintFiles/SB123-eng.pdf> [<http://perma.cc/F6MA-KKRD>] (amending Alabama Accountability Act of 2013, Ala. Code §§ 16-6D-1 to -9).

34 *Id.*

35 *Id.*

36 *Id.*

37 More accurately defined, “utility gross-receipts tax” is a tax on a utility’s total amount of revenues received from the furnishing of utility services, without a deduction for the costs of the utility services sold, or allowance for any other expenses or deductions. See Ala. Code § 40-21-80(3) (defining “gross receipts,” in the statute setting forth Alabama’s utility gross-receipts tax). In other words, it is “a privilege tax on every utility . . . furnishing utility services in Alabama.” Legislative Fiscal Office, *A Legislator’s Guide to Alabama’s Taxes* 442 (23rd ed. 2017), [http://www.lfo.state.al.us/PDFs/TaxGuide/2017\\_Tax\\_Guide.pdf](http://www.lfo.state.al.us/PDFs/TaxGuide/2017_Tax_Guide.pdf) [<http://perma.cc/RV9C-6RSQ>]. Alabama’s utility gross-receipts tax, therefore, would appear on its face to be an indirect tax, not a direct tax. Compare “Direct Tax,” *Black’s Law Dictionary* (10th ed. 2014) (“A tax that is imposed on property, as distinguished from a tax on a right or privilege. . . . A direct tax is presumed to be borne by the person upon whom it is assessed, and not ‘passed on’ to some other person.”), with “Indirect Tax,” *Black’s Law Dictionary* (10th ed. 2014) (“A tax on a right or privilege. . . . An indirect tax is often presumed to be partly or wholly passed on from the nominal taxpayer to another person.”). Alabama law, however, prescribes that utility gross-receipts tax “shall be conclusively presumed a direct tax on the purchaser precollected for the purpose of convenience and facility only.” Ala. Code § 40-21-86. Hence, a tax credit that could be applied to utility gross-receipts tax, as per the proposed amendments to the AAA, would be claimed by purchasers of utility services rather than providers of utility services.

38 Telephone Conversation with Ryan Cantrell, Regional Advocacy and Political Director, American Federation for Children (Mar. 8, 2017). For the tax-liability requirement, see *infra* note 39 and accompanying text.

39 S. 123. Specifically, to claim a tax credit of up to 75% of the amount owed in utility gross-receipts tax, a taxpayer would have had to have paid at least \$100,000 in utility gross-receipts tax in the previous twelve months. *Id.* The taxpayer would also be required to have a direct-pay permit from the Alabama Department of Revenue, but this requirement could be met at any time. *Id.*

40 *Id.* Both resident and nonresident trusts and estates would be able to claim income-tax credits for donations to SGO scholarship funds. *Id.*

41 *Id.*

42 *Id.*

43 *Id.* The amendments specify that tax credits claimed on the remainder of the \$15 million reserve would have to be applied to utility gross-receipts tax. *Id.*

44 See *supra* text accompanying note 8.

45 S. 123.

46 Ala. Code § 16-6D-9(b)(2)(a).

47 See S. 123. The term used in the amendments is “audited financial statements,” not “certified financial statements,” but the surrounding text suggests that the meaning is the same. Cf. “Certified Financial Statement,” *Black’s Law Dictionary* (10th ed. 2014).

48 Ala. Code § 16-6D-9(b)(2)(a)(2).

49 See S. 123.

50 See generally Ala. Code §§ 16-6D-4, -6, -8, -9.

51 S. 123.

52 *Id.*

53 See Fiscal Note for S. 123, 2017 Leg., Reg. Sess. (Ala. 2017) (as introduced, Feb. 9, 2017), <http://alisondb.legislature.state.al.us/ALISON/SearchableInstruments/2017RS/FiscalNotes/FN-36159.htm> [<http://perma.cc/X5ZK-3QG5>].