Vouchers Via the Tax Code

To date, the great majority of voucher proposals have failed to win the support of voters and lawmakers. Tuition tax subsidy programs—which, as their name indicates, operate through the tax system—have been more successful, particularly in the last few years. By early 2003, such programs operated in six states (Arizona, Florida, Illinois, Iowa, Minnesota, and Pennsylvania), in comparison with voucher programs in four states, two of them limited to single cities. Many public school advocates consider tuition tax credits and tuition tax deductions, the two basic kind of tuition tax subsidies, nothing more than "backdoor" vouchers. Even voucher advocates acknowledge this point. "As many times as we had gone after a voucher program, we didn't get the votes," said the head of a Pennsylvania pro-voucher group. "We were looking for another way to skin the cat."[1]

Although voucher programs and tuition tax subsidy programs share the goal of diverting public dollars from public schools, they are set up differently. A voucher is a direct payment of taxpayer money, by the government, for a student's private school tuition. A tuition tax credit offsets expenditures for private school tuition by reducing a person's tax liability. For example, if Mr. Jones owes $2,000 in income taxes but can take a $1,000 tax credit for his son's private school tuition, he will then owe $1,000 in income taxes. A tuition tax deduction, by contrast, simply reduces a person's taxable income. If the same Mr. Jones has a taxable income of $50,000 but is eligible for a $1,000 tax deduction for his son's private school tuition, his taxable income is lowered to $49,000.

Until recently, most tuition tax credits were only large enough to offset some of the cost of tuition—perhaps $500 a year. Parents still had to pay the rest, and probably pay it up front. Recently, however, privatization advocates have begun pushing for tuition tax credits with the same rhetoric they use for vouchers. For example, they claim that tuition tax credits can be an avenue for increasing educational options and offering choices for low-income parents who otherwise cannot send their children to private schools. Since a yearly tax credit of $500 would do very little for a low-income family looking at a $4,000 tuition bill, tax credit proposals have changed. The newest model, exemplified by legislation passed in Arizona in 1997, offers *any* taxpayer a tax credit for donations he or she makes to third party organizations that fund private and religious school "scholarships." These outside organizations, sometimes called school tuition organizations, can, at least in theory, grant "scholarships" or tuition vouchers to lower-income students, though in many cases the tuition grants still may not fully cover a private school's tuition.

Existing Programs

Minnesota. This state, which has offered tuition tax subsidies since the 1950s, was the first to enact such a program.[2] The Minnesota law allows parents to claim a deduction on their state income tax for all kinds of education expenses, including tuition, textbooks, transportation, summer school, and enrichment materials such as computers and software. The deduction tops out at $1,625 per year for elementary school expenses and up to $2,500 a year for secondary school expenses.[3] The constitutionality of Minnesota's law was challenged in court in the early 1980s, but the U.S. Supreme Court found in its favor in *Mueller v. Allen* in 1983.[4]

Minnesota also offers an education tax credit of $1,000 per child up to a $2,000 maximum for families making $37,500 a year or less. The credit can be used for expenses such as computers or tutoring but not for tuition.[5]

Iowa. The Iowa Legislature enacted an education tax credit in 1996 and increased the amount of the credit in 1998. Any parent, regardless of income, is eligible to claim a state income tax credit of up to $250 for any education-related expenses, including tuition, at public, private, or religious schools. Amendments to the law also expanded the list of allowable expenses to cover those related to extracurricular activities.[6] Legislation to raise the amount of the tax credit to $500 a year failed in the 2001 session.[7]

Illinois. The Illinois Legislature enacted tuition tax credit legislation in 1999. Families are eligible for a credit of up to $500 for education-related expenses, including tuition at private and religious schools. To be eligible, parents must spend at least $250 on education expenses.

The Illinois legislation has faced a number of court challenges, all of which have failed. In 1999, just a few months after the law passed, a state court upheld its constitutionality, finding it nearly identical to the Minnesota law previously upheld by the U.S. Supreme Court. In 2000, another suit was dismissed. And in 2001, the law survived a challenge based on the separation of church and state. In this case, an Illinois appellate court ruled that, because taxpayers received a tax credit rather than cash, no money entered state control, and, therefore, no public funds were used for religious purposes. The court also concluded that no single group received preferential treatment because, technically, all taxpayers with children in either public or private and religious schools were eligible to receive the tax credit.

Attempts to add accountability measures to the tuition tax credit program have also failed. For example, legislation proposed in 2001 would have required taxpayers to state the name of the school for which the education expense is claimed. It also would have required any private school at which expenses are claimed to meet basic public school requirements, including academic standards, student testing, and admission requirements.[8]

Arizona. Arizona's program, enacted in 1997, represents a new type of tuition tax credit. The law permits any state taxpayer to receive a dollar-for-dollar tax credit, up to $500, for donations to third-party organizations that fund private and religious school "scholarships." A couple filing jointly can claim up to a $625 credit.[9] The donation cannot directly benefit the taxpayer's own child, nor can it be earmarked for a specific school—although state officials have acknowledged a loophole that allows such practices. Taxpayers also can receive a dollar-for-dollar tax credit of up to $200 for contributions to public schools for extracurricular activities. Couples filing jointly can claim a $250 credit.[10]

A school tuition organization must spend at least 90 percent of the contributions it receives on tuition grants, but it can spend the remaining 10 percent on administrative costs, marketing, advertising, or fees related to incorporating itself as a nonprofit organization.[11]

Florida. On the heels of the state's two voucher programs, the Florida legislature enacted a third voucher-like program in 2001, its corporate tax credit program. The law authorizes a dollar-for-dollar tax credit to corporations that contribute to a so-called scholarship funding organization, which, in turn, grants vouchers to students to attend private schools. Corporations can reduce their state taxes by up to 75 percent. The program has been capped, at least initially, at $50 million in total tax credits, available on a first-come, first-served basis.[12]

The scholarship funding organizations award vouchers of up to $3,500 to parents to pay for their child's private school tuition. Or they can award parents $500 to cover their child's transportation to a public school outside their district of residence.[13] Scholarship organizations are supposed to spend 100 percent of the contributions they receive from the corporate tax credit program on scholarships.[14]

To be eligible for a scholarship, students must qualify for the federal free or reduced-price lunch program, and, unless they are entering kindergarten or first grade, they are supposed to have been enrolled in a Florida public school the previous year. A wrinkle in the law allows any student who already attended a private school the previous year and who received a tuition grant from a scholarship organization to claim a scholarship through the corporate tax credit program. Many scholarship organizations did, in fact, exist before the state enacted the tax credit program. It is unclear how many students receiving a voucher through the corporate tax credit program were previously enrolled in private schools, however, and how many have since transferred out of public schools. Approximately 15,000 Florida students received a voucher through the corporate tax credit program in the 2002-03 school year.[15]

Pennsylvania. The Pennsylvania legislature also enacted a corporate tax credit program for private school tuition in 2001. Capped at an annual cost to the state of $30 million, it is a dual program that encourages businesses to contribute either to scholarship organizations that fund private school tuition, or to educational improvement organizations that make grants to public schools. Dozens of organizations in both categories are recognized by the state.[16]

Businesses can receive a credit of 75 cents for every dollar they contribute to an eligible organization, up to a maximum of $100,000 per year. If a business makes an up-front commitment to contribute the same amount of money for two consecutive years, the tax credit is worth 90 percent of the contribution—still capped at $100,000 per year. For example, a company that agrees to give a scholarship organization $111,111 each year for two consecutive years will receive a $100,000 a year tax credit from the state.[17]

Total tax credits for contributions to scholarship organizations are capped at $20 million a year, and total tax credits for contributions to education improvement organizations are capped at $10 million a year. At this writing, in early 2003, contributions to public schools have already reached the statutory limits, and scholarship organizations, with approximately $19.2 million in contributions, are close to doing so.[18]

Regulations governing the two types of organizations differ:

- **Scholarship organizations: Funding private school tuition.** The scholarship organizations award the grants to eligible students for their tuition at public schools and religious and other private schools. They cannot limit their tuition grants to a single school—a provision designed, apparently, to prevent private schools from forming their own scholarship organizations by soliciting businesses for contributions and then handing out grants to their existing students.[19] The scholarship organizations must be nonprofits and must distribute at least 80 percent of the contributions they receive in the form of tuition grants. They are free to determine the amount of the tuition grants, but a grant may not exceed the actual tuition of the school, including fees. They also can set their own criteria for awarding the grants, as long as the criteria do not conflict with state law. For example, under state law, student eligibility is income-based. A family with one child cannot have an annual income exceeding $60,000. The income limit increases by $10,000 for each additional dependent.[20]

- **Educational improvement organizations: Funding public school programs.** The educational improvement organizations also must be nonprofit, and they must use 80 percent of the contributions they receive to make grants to public schools for "innovative educational programs," including tutoring, teacher training, or preschool programs. These programs are intended to enhance the curriculum or academic program offered by a school, but they may not duplicate existing services.[21]

Both types of organization must provide the state with a statement prepared by an independent certified public accountant confirming the amount of the contributions received and the fact that at least 80 percent of the contributions were distributed appropriately.[22]

Some Questions about Tax-Code Vouchers

Who benefits in Illinois? Although school privatization advocates portray tuition tax credit programs as a way of helping low-income families send their children to private schools, the Illinois program has primarily benefited middle- and upper-income families. Because there is no income cap on the program, any family paying private school tuition is eligible for the credit—even those who pay nearly $13,000 a year for kindergarten tuition at an elite North Side Chicago school.[23] As a result, almost half of the tax credits have gone to families making more than $80,000 a year, and less than 3 percent to families making less than $20,000 a year. And, although the credit is available to any parent, the reality is that few public school parents benefit, because the credit does not kick in until they have put out $250 for education expenses, which few apparently do.[24]

The tuition tax credit "probably has not served its intended purpose," Max McGee, Illinois' former education superintendent, admits. "I said this was going to benefit poor kids. I think primarily it has benefited the middle-class families that had already made the decision to send their kids to private schools."[25]

In addition to not serving "its intended purpose," the Illinois tuition tax credit may also be taking money away from public education. Like lawmakers in many states, those in Illinois recently had to make budget cuts in the face of shrinking revenues. The state's public schools have not been spared, suffering a $64.5 million cut in state funds in 2002. Is it a coincidence that the state had granted $65.9 million in tuition tax credits for the 2001 tax year?[26] State officials deny a direct link between the lost revenue from the tax credit program and the subsequent funding cuts to public schools, but it is worth noting that education has been receiving roughly half of all new state revenues in recent years, so the tax credit program clearly has meant fewer dollars available for public schools.

And what about Arizona? In Arizona, too, tuition tax credits, available to people who contribute to private scholarship-granting organizations, were once talked up as a way of helping poor children attend private schools. However, they have largely benefited middle- and upper-income families. Approximately 76 cents of every dollar of the grants awarded through the program have gone to families whose children already attended private schools.[27] That may be because poor families generally can't afford to take advantage of a tuition grant. At an average of $856, a grant represents only a fraction of the average tuition at Arizona private schools ($3,994 for elementary school and $6,664 for high school).[28]

"Has it only helped them [low-income families] more than moderate and wealthy families? Probably not," the president of a pro-school privatization organization in Arizona says. And she adds, dismissively, "If it was sold that way, it's only an angle."[29]

By its fourth year, the program had cost the state $109 million in lost revenue.[30] Moreover, numerous reports, including an investigative series by a state newspaper, have documented a widespread lack of accountability in the program. For example, the organizations that award the tuition grants do not have to be audited or even registered with the state. So the state cannot determine who has contributed to a school tuition organization or how much—or whether a person who claims a tax break is even eligible for it. Nor does the state have any mechanism for investigating suspected fraud.[31]

Some of the safeguards the legislation does include can be easily circumvented and often are. Donations to tuition organizations are earmarked for students who are already enrolled in private schools, despite the fact that the law attempted to prevent this. For example, while taxpayers are barred from making the contribution for their own child's private school tuition, some private school parents write checks for their friends' or relatives' children and then have the favor reciprocated.[32] There also have been inequities in administering the section of the law pertaining to contributions to public schools for extracurricular activities, which allows a tax break for expenses such as band uniforms, science lab materials, or field trips. In the first three years of the law, the wealthiest 25 percent of the state's public schools received more than five times as much in contributions as the poorest 25 percent of public schools.[33]

In middle- and upper-class communities, where the public school credit is more likely to be used, stories abound of parents taking a tax break to help cover the cost of sending their children on out-of-state field trips or to athletic camps. One school administrator estimates that hundreds of thousands of dollars went to parents in his district as tax write-offs for various activities, including a school trip to Catalina Island off the California coast. In fact, Arizona's former state superintendent of education was among those claiming a $200 tax credit for her son's trip to Catalina. "The majority of this is going for tax relief. It's not going to the schools," the administrator said. And adding insult to injury, the schools have to pay to administer the program. The same administrator estimates that the district spent about $90,000 in overtime costs to school secretaries who had to make reports and draft countless receipts for parents.[34]

Déjà vu in Pennsylvania. Like the Arizona and Illinois programs, Pennsylvania's corporate tax credit program is mostly helping families whose children already attended private schools. Although businesses make their contributions to scholarship organizations that, in turn, distribute tuition grants to students, the businesses can earmark their donations for a particular school. In practice, many of those schools are located in middle-class or affluent communities, not in poor neighborhoods. Private school officials and administrators of scholarship organizations acknowledge this has helped to funnel most of the tuition grants to existing private school students, not new students.[35]

The Trouble with Tuition Tax Subsidies

1. Tuition tax credits and deductions are merely backdoor vouchers. Even voucher advocates acknowledge that tuition tax subsidy programs are vouchers in disguise. Both approaches divert public dollars from public schools to private ones. "The end goal is the same as a voucher; it's just a different way to come about it," the head of a national pro-voucher organization said.[36]

Recently enacted tuition tax credit programs—the ones involving organizations that use tax-subsidized contributions to make tuition grants to students who attend private school—closely resemble vouchers. Most of the tuition grants in newer programs, like Arizona's, have gone to students already attending private schools. "This has turned into something so close to vouchers, you almost can't tell the difference," an Arizona state senator and longtime voucher proponent said. Another leading proponent asked, "Why do we need vouchers at this point?"[37]

2. Tuition tax subsidy programs are no way to improve public education. Since evidence from current programs indicates that children who already attend private school are the biggest beneficiaries of tuition tax subsidies, it's obvious that these programs are a poor strategy for improving *public* education. They do little to help public school students, and they reduce state revenues that could be invested in public schools.

3. A dollar of lost revenue from tuition tax subsidies is a dollar not invested in the public schools. Tuition tax subsidy programs redirect to private schools dollars that otherwise would be available for public schools. States dedicate significant portions of their tax revenues for public education, and tuition tax subsidy programs reduce tax revenues. Arizona's education tax credit program diverted more than $100 million from state coffers in its first three years. Florida will forgo up to $50 million in revenue in 2002 through its new corporate tax credit program. Illinois' tuition tax credit program resulted in $65.9 million in lost state revenue in 2001, followed by $64.5 million in state funding cuts to public schools in 2002. The tens of millions or hundreds of millions of dollars in lost tax revenues that could be invested in public schools instead are funneled to private schools via tuition tax subsidy programs.

The programs also do little to save the public schools and the state money, since few of the students making use of the tax subsidies left the public schools as a result of the program. Moreover, before a school can save money by eliminating teaching positions, a substantial number of students in the same grade must transfer out. Fixed costs are unlikely to change when only a few students depart.

4. Tuition tax subsidy programs disproportionately benefit wealthier families, not low-income students. A detailed study by RAND, an independent research organization, concluded that tuition tax subsidies rarely benefit poor children and disproportionately serve middle- and upper-income families.[38] Evidence from the Arizona, Illinois, and Pennsylvania tuition tax credit programs reveals that wealthier families and those whose children already attend private schools are the biggest beneficiaries—not poor public school students, as tax subsidy advocates claim.

5. Private schools that receive tuition dollars via government tax subsidy programs can discriminate against certain students. In contrast to public schools, private schools—even those that receive tuition dollars through a government tax subsidy program—can select which students they want to admit and retain. Private schools that benefit from the Arizona tuition tax credit law, for example, can discriminate on the basis of a student's religion, gender, or academic abilities. The nonprofit organizations that distribute tuition grants also can decide which students receive grants and how much each applicant receives.[39]

6. Tuition tax subsidy programs lack public oversight and are ripe for fraud. Tuition tax subsidy programs, while depleting state revenues that could be invested in our increasingly accountable public schools, require little public oversight. Private schools do not have to report to the public about student achievement; they do not have to live up to the same academic standards as public schools; and they do not have to disclose budgetary information to the public. An investigative series by an Arizona newspaper uncovered a large number of shortcomings in Arizona's education tax credit program. Organizations that make tuition grants to students—via government tax subsidies—are not audited and do not have to register with the state. Arizona's Department of Revenue cannot even verify if some taxpayers who claim a tax credit actually made a donation to the program.

7. Tuition tax subsidy programs are fiscally irresponsible. Tuition tax subsidy programs are often open-ended, meaning there is no cap on how much money in lost revenue a state might suffer. The total isn't known until all the tax subsidies have been claimed. As a result, states are not able to forecast, from year to year, the extent to which tax subsidy programs will reduce state revenues. Even in prosperous times, this would be inconvenient, but in the tight fiscal times that many states continue to face, it is downright dangerous.

The former chair of Arizona's state budget committee, a Republican, recounts some of the difficulties tax credits have created for his state's finances: "Credits are horribly fiscally irresponsible. Their cost is unpredictable. They evade scrutiny. And just like a government-spending program, they develop their own constituency, which comes to expect the benefits. So you have all the bad parts of a spending program and none of the oversight."[40]

Note: For periodic updates to "Vouchers Via the Tax Code," please visit NSBA's Voucher Strategy Center Web site, www.nsba.org/novouchers.

Endnotes

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