ISSUE

Private School Scholarship Tax Credits

RECOMMENDATION:

Reject private school scholarship tax credits.

OVERVIEW

Under scholarship tax credit programs, the state would forgo revenue to provide a tax benefit to those who make donations to private school scholarship-granting organizations (SGOs), which, in turn, provide scholarships to students in private K-12 schools. Bills to enact scholarship tax credits create much greater tax benefits for donations to SGOs, as compared to all other nonprofits. Furthermore, scholarship tax credits can make it possible for some wealthy donors to profit by way of the tax code.

SCHOLARSHIP TAX CREDITS MORE LUCRATIVE THAN OTHER DONATIONS

Tax credits enhance the tax benefit of donating to scholarship-granting organizations, as opposed to tax deductions for other types of charitable donations. Providing a 100 percent credit for such a donation – as a bill considered by lawmakers in the 2018 session[1] would have done – can result in a dollar-for-dollar reduction in the amount of taxes owed.[2] All other charitable donations reduce taxable income through deductions, which means the tax benefit is worth the amount of deduction multiplied by the tax rate in the tax bracket in which one's income would have fallen prior to the deduction. (See sidebar for example.)

SCHOLARSHIP TAX CREDITS CAN ALLOW WEALTHY DONORS TO PROFIT

The impact of a private school scholarship tax credit combined with the federal tax deduction would allow some Nebraska taxpayers to actually profit from making such donations. This scenario already occurs in nine states. In some, like South Carolina and Georgia, various scholarship organizations advertise the credits as money-making opportunities.[3] For example, a K-12 private school in Georgia writes on its website that donors can "'profit' up to 29 percent on the amount donated."[4]

HOW DONORS CAN TURN PROFITS

Profits under such tax credits could occur when taxpayers' state and local taxes exceed the $10,000 federal deduction for state and local taxes (SALT)

A tale of two donations

If a married couple filing jointly makes a $10,000 donation to an SGO under a 100 percent credit, they could reduce their state taxes owed by $10,000. Or, if they owe less than $10,000 in state taxes, they could reduce their state tax liability to $0. On the other hand, if the same couple makes a $10,000 donation to a non-profit private or public school foundation, and they pay the state's top income tax rate of 6.84 percent, their donation would reduce their state taxes owed by $684.

and they are able to claim deductions at the federal level. For example, if the hypothetical married couple above has $20,000 in state tax liability, they could make a $10,000 donation to a scholarship-granting organization and offset their state tax liability by the full amount of the donation. This is a $10,000 value in tax benefits for their $10,000 donation. Then, at the federal level, they could claim their scholarship tax credit gift as a $10,000 charitable donation[5] on their federal tax returns, which if claimed at the top federal tax rate of 37 percent, would provide the couple with a $3,700 tax deduction. That means this couple would experience a combined state and federal tax savings of $13,700 from their $10,000 donation, a profit of $3,700.

CREDIT WOULD DIVERT PUBLIC DOLLARS THAT CAN BE USED TO SUPPORT AND IMPROVE PUBLIC EDUCATION

Creating a scholarship tax credit now would come at a time when our state's school funding needs are increasing and when state funding of K-12 education has been constrained due to budget shortfalls.[6] This low level of state support leads to a heavy reliance on property taxes to fund schools. Diverting more state resources for scholarship tax credits will make it harder to address state public education needs and will increasingly shift the cost of funding K-12 onto property taxpayers.

SCHOLARSHIP TAX CREDITS NOT LIKELY TO CREATE SAVINGS FOR STATE

It's highly unlikely the credit would sway enough children to switch to private schools to create savings in public schools. In order to generate savings for the state in reduced public school costs, not only would a significant number of students need to switch from public to private school, but those students would need to be highly concentrated in certain school buildings. A large percentage of public school costs are fixed and can't be reduced without a large reduction in enrollment. For example, if one or two students in a public school classroom leave and go to private school, the public school must still pay the teacher and maintain the facilities in the same way it would have before the students changed schools.

CONCLUSION

Scholarship tax credits stand to divert state revenue at a time when we are experiencing revenue struggles. Enacting such measures could force lawmakers to make cuts to vital services such as public K-12 education or shift more of the load of funding our schools on to property taxpayers. In light of these factors, we have serious concerns about creating a new tax credit that would reduce state revenue and allow wealthy Nebraskans to turn profits by way of the tax code.

Low-income students not targeted

Under the bill considered in 2018, students at 370 percent of the federal poverty level (FPL) would have been eligible for scholarships under the programs. This means that in 2018 a family of four could make up to $92,870 – putting them in the top 40 percent of Nebraska earners – and still qualify for the scholarships. This eligibility expansion beyond the traditional definition of low-income is consistent with programs in some other states. For example, a study of a scholarship tax credit in Arizona found about 76 percent of the scholarships went to students who already had the means to attend private school.[7]

REFERENCES

[1] Nebraska Legislature, "LB 295," downloaded from https://nebraskalegislature.gov/bills/view_bill.php?DocumentID=30926 on April 19, 2018.
[2] A non-refundable tax credit will provide a dollar-for-dollar tax credit, as long as the amount of the tax credit is less than their total tax liability. If the amount of the tax credit exceeds their tax liability, the credit will reduce their tax liability to $0 in a given tax year. However, any amount of the tax credit that is unused may be carried forward and applied against the taxpayer's income tax liability for the next five years immediately following the tax year in which the credit is first allowed.
[3] AASA and the Institute on Taxation and Economic Policy, "Public Loss, Private Gain," downloaded from http://www.aasa.org/vouchertaxshelter/, on Aug. 7, 2017.
[4] The Wood Acres School, "GA Private School Tax Credit Information," downloaded from https://woodacresschool.org/ga-private-school-tax-credit-information/ on Feb. 1, 2018.
[5] Without a commensurate reduction in their SALT federal tax deduction because they have already hit the SALT cap.
[6] LB 409 (2017) made changes to the TEEOSA formula to reduce school funding by $123 million in FY 18-19.
[7] Glen Wilson, "The Equity Impact of Arizona's Education Tax Credit Program: A Review of the First Three Years," downloaded from http://epsl.asu.edu/epru/documents/EPRU%202002-110/epru-0203-110.htm, on Aug. 7, 2017.