PUBLIC LOSS PRIVATE GAIN:

HOW VOUCHER TAX SHELTERS UNDERMINE PUBLIC EDUCATION

Overview of Report and Presentation

I. Primer on tax policy

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A quick primer on tax policy

This report focuses on a voucher tax scheme. To understand the scheme, it's important to know the difference between a tax credit and a tax deduction.

A **tax *deduction*** reduces your taxable income.

Ex: A $1,000 tax deduction in a 35% tax bracket saves you $350 in taxes

A **tax *credit*** reduces your income tax.

Ex: A $1,000 tax credit in any tax bracket saves you $1,000 in taxes.

Therefore, tax credit > tax deduction.

This voucher scheme hinges on claiming both **tax credits** and **tax deductions.**

What is a Tuition-Tax Credit (TTC) voucher?

Taxes owed to a state by individuals or corporations can be diverted into charitable donations to nonprofit entities that then bundle the donations and distribute tuition checks to families to use to attend private schools.

18 states have tuition tax credit programs

- States offer TTCs on 50% of the contribution amount (IN, OK)
  - A donor who gives $100 to a charity can receive a $50 tax benefit on their donation.
- States offer TTCs on 100% of the contribution amount (AL, FL, GA, MT, NE, SC).
  - A donor who gives $100 to a charity can receive $100 in tax benefits.
- Some states offer credits in between 50-100%

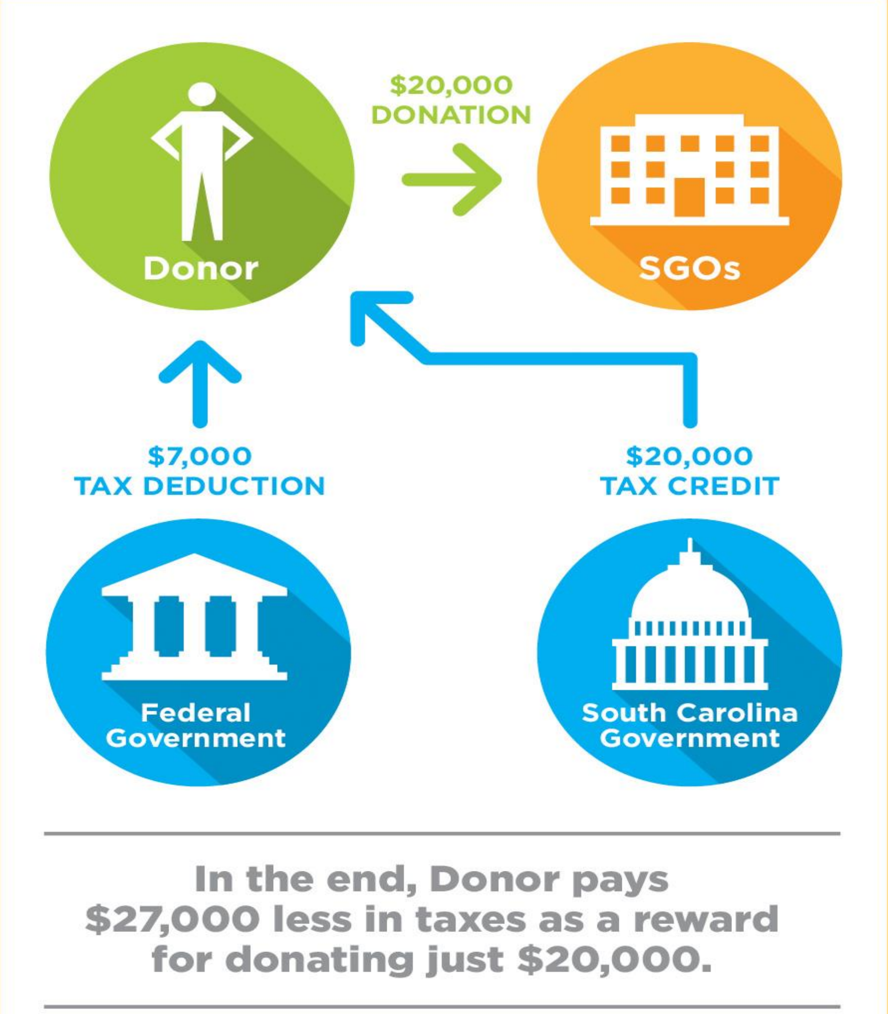
100% tax credits

- Credits = 100% of the contribution are designed to redirect tax payments toward private charities/institutions at NO cost to the donor.
- Dollar-for-dollar tax credits are a more unusual tax provision because they can be very costly for the state or federal government since every dollar donated must be reimbursed to the donor by the government.
- When some dollar-for-dollar state tax credits are combined with a federal deduction, donors in some states TURN A PROFIT by making donations to voucher nonprofits.

Not every donor can profit from a dollar-for-dollar tax credit. Donors subject to the federal "alternative minimum tax" (AMT), who typically earn over $200,000 per year, are the only ones who truly profit.

Under the AMT, taxpayers cannot deduct state and local income tax from their taxes. But, because the IRS classifies a donation to a voucher nonprofit as charity (even though it results in a dollar-for-dollar benefit), the AMT taxpayer can deduct it from their taxes.

FIGURE 1:
Donors Can Profit from Participating in Tuition Tax Credit Schemes



Note: Calculation assumes that Donor is subject to the Federal Alternative Minimum Tax (AMT) at a rate of 35% and has sufficient tax liability to use all available credits and deductions. A $20,000 tax deduction taken

A disadvantage for other nonprofits

When someone donates to a homeless shelter, foodbank, veterans group, etc. they receive **tax deductions** that are **worth between 10 and 50 cents on each dollar donated.** This is a generous tax incentive designed to encourage charitable giving.

When someone donates to a voucher nonprofit, they receive **tax credits and tax deductions worth between 50 and 135 cents on each dollar donated.**

This privileges donations to a voucher nonprofit above all other charitable entities.

How long has this been happening?

- TTC programs began in 1997
- Since at least 2011, the IRS has sanctioned allowing taxpayers claim a federal charitable deduction for donating to voucher nonprofits even when they received a dollar-for-dollar tax credit.
- As a result, wealth management organizations, voucher nonprofits, and individual private schools promote how these donations allow an individual or company to <u>PROFIT</u> off the donation.

Examples of Promoting Tax Shelters

- Whitefield Academy, which describes itself as a "Christ-Centered Preparatory School," maintains a list of frequently asked questions about Georgia's tuition tax credit and states that, for some donors, <u>**"you actually stand to make money on this program."**</u>
- Pay it Forward Scholarships, which describes itself as "the largest, easiest and fastest scholarship organization in Georgia" makes clear to donors that stacking state credits and federal deductions on the same donation means that <u>**"you will end with more money than when you started."**</u>
- A SGO in Alabama called the Alabama Scholarship Fund states that donors can receive a <u>**"net cash benefit of 28% of their donation."**</u>

State Policy Overview

- There are different types of tax credits.
- There are different types of voucher nonprofit organizations and different rules they must follow.
- There are different types of students eligible for vouchers from the voucher nonprofits.

Differences in tax policy w/in 18 states

- 7 states only allow businesses to receive TTCs
- 11 states allow businesses and individuals to claim TTCs
- Oklahoma caps TTC program at $3.4 million per year. Florida caps TTC program at $700 million.
- Montana only allows donations up to $300 for couples
- Louisiana and South Carolina allow individuals and businesses to receive tax credits of ANY SIZE

Participation differences in TTC programs

Voucher nonprofits are often referred to as "scholarship granting organizations" or SGOs

- All states require the creation of a voucher nonprofit (501(c)3) that manages the donations received and distributes scholarships to needy students
- These SGOs can operate statewide or regionally. They can be affiliated with a specific school/type-of-schools or a specific faith.
- Student eligibility varies: 4 states allow a student (regardless of wealth) to receive a TTC voucher. 8 states allow families making up to $48,500 to be eligible for vouchers.
- Private schools affiliated with SGOs/voucher nonprofits may have to meet certain criteria. Ex: 10 states require state testing.

The Educational Opportunities Act (H.R. 895/S.148)

- Introduced for past 3 Congresses by Rep. Todd Rokita (IN) and Sen. Marco Rubio (FL)
- Provides a federal dollar-for-dollar tax credit (100%) for donations to voucher nonprofits ("scholarship granting organizations")
- Limits eligibility to low-income students: less than 250% of poverty line or families making less than $60,750 a year.
- Limits tax credit benefit to $4,500 per year for individuals/couples and $100,000 for corporations
- Any taxpayer can benefit – you do not have to have a state TTC program to contribute

What does this mean? 2 new tax shelters

Tax Shelter #1

- If you live in a state with a dollar-for-dollar tax credit, you send $1 dollar to a voucher nonprofit and receive $1 dollar back from the state AND $1 dollar back from the federal government. $1 donation = $2 back!
- **Risk free 100% profit up to $4,500 a year for individuals and $100,000 for corporations**

Tax Shelter #2

- Taxpayers who donate stock rather than cash can avoid capital gains tax. Allows investors to receive same benefit as if they sold their stock without having to do so. **Huge windfall for savvy investors, hedge funds, etc.**

EOA requires SGOs to:

First, the SGO must be considered a **section 501(c)(3) nonprofit a**nd exempt from tax under section 501(a) of the federal tax code. Second, the organization can provide grants only to schools that **charge tuition and comply with all applicable State laws**, including laws relating to unlawful discrimination, health and safety requirements, and criminal background checks of employees. Third**, participating schools must agree to provide annual reports to the SGO** and to parents of students receiving a scholarship about the student's academic achievement compared to her peers in the same grade or school who receive a scholarship and **disaggregate either state test scores or nationally norm-referenced test results by race, ethnicity and grade level**. Fourth, the **SGO cannot funnel funds to only one school or one student; it must distribute dollars to more than one student and to different students attending more than one school.** Fifth, **the SGO cannot earmark or set-aside contributions for scholarships on behalf of any specific student or group of students**. Sixth, the SGO must take steps to **verify the annual household income** for participating students and **submit to annual audits** from an independent certified public accountant to demonstrate appropriate accountability for the funds.

Bottom line: sounds tough, but it's not.

Things SGO private schools don’t have to do:

- Comply with civil rights laws, IDEA, 504, ADA
- Accept all kids (regardless of reading level, discipline history, ability to speak English, ability to pay full tuition, ability to find transportation to school, etc.)
- Take the same test as their peers in public school to measure academic achievement accurately
- Report graduation rates, teacher qualifications, ensure access to SISPs, etc.
- Be transparent about who receives a voucher/who does not and why
- Prohibit self-dealing so administrators of voucher programs or private schools don’t profit from public donations

EOA big-picture policy implications

- There are already national voucher nonprofits: they are ready to step in and set-up SGOs in every state (and can accept donations from any state)
- This will propel state TTC policy forward. Why would a taxpayer not want to take advantage of this big benefit?
- Kids never have to try a public school before attending a private school subsidized by the taxpayers.
- Significant "transfer of wealth" from the public school system to the private school system.

Shortcomings of TTC vouchers

Drains funding for public schools

- There is a current tax shelter for wealthy individuals in nine states. This creates a new tax shelter and expands it to every state.
- Less federal revenues generally mean less money for schools overall.

TTC vouchers fail to improve student achievement

- Florida's TTC program, the largest in the nation, failed to show that students in program had meaningful gains in test scores. Low-income students who accepted a voucher via TTC fared worse academically when they returned to their public school.

Publicly funds religion

- Publicly funded voucher can fund religious activities in private schools

Leaves low-income families behind

- Florida TTC has average voucher of $5,458. Nationally, average price of private elementary school is $7,770 and private high school is $13,030.

Action at the federal and state level

Federal level

Oppose the Educational Opportunities Act

Support the *Public Dollars for Public Schools Act*

- Closes tax shelter in 9 states that allows donors to profit from tax credits
- Closes separate tax shelter applicable that allows folks to donate stock to SGOs and not get taxed on capital gains (huge windfall)
- Redirects all money to IDEA

State level

Lawmakers in states with existing TTC programs should scale back or eliminate credits to put voucher nonprofits on more equal footing with other nonprofit organizations.

In states, where voucher nonprofits are being subsidized with state tax credits and state deductions, lawmakers should make taxpayers choose between receiving one benefit or the other rather than allow double-dipping.

Want more?
Read the report.