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Multistate Developments

Community-Oriented Credits

Litigation Arises Over Scholarship Credits' Blend of Education, Religion and Taxes

In a multitude of states, scholarship tax credits are fueling the debate about education and how it should be paid for. These tax credit programs have created a great divide among taxpayers, igniting litigation primarily over state constitutional questions and educational freedom.

Introduction. Scholarship or tuition tax credit programs allow businesses and individuals to claim tax credits in proportion to donations made to a qualified scholarship or tuition organization. Scholarships are then awarded to students by these third-party organizations through a selection mechanism such as a lottery.

Generally, scholarship tax credits are equal to a percentage of the taxpayer's donation, up to a specified threshold of the taxpayer's tax liability. Georgia's scholarship credit, for example, equals 100 percent of donations to a qualified scholarship organization, up to 75 percent of a corporate taxpayer's tax liability, with an aggregate statewide cap of \$58 million. Many states, such as Arizona, offer scholarship tax credits to both individuals and businesses. Other states, including Oklahoma, place a cap on the dollar amount of credits available to any one taxpayer.

For a list of states offering scholarship credits, see the chart below.

States also set limitations on who may qualify to receive a scholarship. "Ten of the 14 states with [scholarship tax credit (STC)] programs limit eligibility based on income," Josh Cunningham, an analyst covering school choice for the National Conference of State Legislatures, told Bloomberg BNA via e-mail Sept. 11. "Georgia is the only state that doesn't have some sort of income provision in its eligibility requirements," Cunningham said.

Constitutional Concerns. Challengers to state scholarship tax credits argue that these programs are unconstitutional.

"Numerous state constitutions strictly prohibit diversion of tax payments to religious schools" Alex Luchentser, an Associate Legal Director at Americans United for Separation of Church and State, told Bloomberg BNA via e-mail Sept. 9. "Scholarship tax credit pro-

grams take tax payments away from state treasuries and divert them principally to religious schools. The tax credit programs are identical to school-voucher programs—in effect they just use a more complex mechanism to accomplish the same thing,” Luchenitser said.

Supporters of the credits see a far different picture however. “The parents have the ability to choose secular or religious schools, so any money that flows to a religious institution is *indirect* and *incidental* to the parents’ choices,” Jason Bedrick, of the Center for Educational Freedom at the CATO Institute, told Bloomberg BNA via e-mail, Sept. 9.

“Both the Arizona Supreme Court [in *Kotterman v. Killian*, Ariz., No. CV-97-0412-SA, 1999] and the U.S. Supreme Court [in *Arizona Christian School Tuition Organization v. Winn*, U.S., No. 09-987, 2011] found that scholarship tax credits do not constitute ‘public funds’ because the money never enters the public treasury,” Bedrick added.

Freedom of Choice. Supporters of scholarship tax credits believe that they “are an effective way to promote educational freedom for low- and middle-income families,” Bedrick said. “There are currently 17 STC laws in 14 states. In 2013-14, more U.S. students attended the school of their choice using tax credit scholarships than vouchers (192,000 vs. 116,000),” Bedrick said. “The scholarships allow families to close the gap between what they can afford and the tuition at the school of their choice,” he added.

However, opponents of the programs believe that students are suffering in more ways than one. “Such programs harm public schools by taking money away from them, thereby harming the low- and moderate-income families who attend them,” Luchenitser said. Furthermore, Luchenitser noted that even with the aid of vouchers many families often can’t afford the high prices of secular private schools, and are left with no other choice but to have their children attend less expensive religious schools.

The New Hampshire Decision. On Aug. 28, the New Hampshire Supreme Court decided *Duncan v. New Hampshire*, N.H., No. 2013-455, 2014, a case involving a challenge to New Hampshire’s scholarship tax credit. The court determined that the statute, allowing New Hampshire taxpayers to sue the government without showing personal harm, under which the plaintiff filed his complaint, was unconstitutional. In finding that the plaintiff lacked standing, the court upheld the credit, but did not address the issue of its constitutionality.

“The question of legal standing in a challenge to a scholarship tax credit program is not new,” Cunningham said, as “[t]he U.S. Supreme Court ruled taxpayers don’t have legal standing, though for different reasons than in [Duncan], in the 2011 [Winn] case challenging Arizona’s scholarship tax credit program.” Luchenitser, the lead attorney for the plaintiff in *Duncan*, believes that the case will have no impact on scholarship tax credits in other states. “The decision did not address the legality of the program,” Luchenitser said. Furthermore, the plaintiffs in *Duncan* have filed a motion for reconsideration or rehearing of the decision, he added.

Florida Predictions. Several interest groups in Florida filed a complaint challenging the state’s scholarship tax credit on the same day that the *Duncan* decision was issued. In *McCall v. Scott*, Fla. Cir. Ct., No. 2014-CA-002282, *Complaint*, the petitioners claim that Florida’s scholarship tax credit is unconstitutional.

“Florida’s STC law is 13 years old, so it’s odd that opponents waited so long to challenge [it],” Bedrick said. Nevertheless, “the Florida Supreme Court will follow the precedent of the U.S. Supreme Court and the Arizona and New Hampshire Supreme Courts...,” he added.

Luchenitser however, believes that Florida’s scholarship tax credit is unconstitutional. The credit “takes revenue away from the state treasury and delivers that revenue to religious schools,” which is in clear violation of Florida’s Constitution, Luchenitser said.

Conclusions. Opponents of scholarship tax credits fear that they are simply a way around the protections against states and religion comingling, and that they provide students with an inferior education. Supporters of scholarship tax credits believe that these are private, not public, funds and that the competition for students will only raise the standards of the schools involved.

Full text of the *Duncan* decision is available at <http://www.courts.state.nh.us/supreme/opinions/2014/2014074duncan.pdf>.

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For a discussion of scholarship tax credits in Florida, see 1450-2nd T.M., *Credits and Incentives: AL Through HI*, at 1470.13. For additional discussion of the scholarship tax credit in Arizona, see *Individual Income Tax Navigator*, at Arizona 3.6.3.

State Scholarship Tax Credits				
State	Credit Amount for Individuals	Credit Amount for Corporations	Credit Cap	Statute
Alabama	■ 100 percent of donations, up to 50 percent of a taxpayer’s liability. There is a \$7,500 limit for any individual taxpayer or married couple filing jointly.	■ 100 percent of a donation, up to 50 percent of a corporate taxpayer’s tax liability.	■ \$25 million	■ Ala. Code § 16-6D-9

State Scholarship Tax Credits				
State	Credit Amount for Individuals	Credit Amount for Corporations	Credit Cap	Statute
Arizona	<ul style="list-style-type: none"> ■ 100 percent of a donation to a private school tuition organization, up to \$528 for a single taxpayer or \$1,056 for a married couple filing jointly. The amount is set to increase in 2015. ■ 100 percent of donations to a certified school tuition organization, up to \$525 for a single taxpayer or \$1,050 for a married couple filing jointly. Amount is set to increase in 2015. 	<ul style="list-style-type: none"> ■ 100 percent of a donation, up to 100 percent of a corporate taxpayer's tax liability. ■ 100 percent of a donation, up to 100 percent of the corporate taxpayer's tax liability, for donations to scholarship organizations dealing with disabled or displaced students. 	<ul style="list-style-type: none"> ■ \$35.8 million as of the 2013-2014 fiscal year (\$10 million subject to annual increases of 20 percent since fiscal year 2007-2008) ■ \$5 million. 	<ul style="list-style-type: none"> ■ Ariz. Rev. Stat. Ann. §§43-1089 and -1089.03; ■ Ariz. Rev. Stat. Ann. §§43-1183 and 1184
Florida	<ul style="list-style-type: none"> ■ Florida does not impose a personal income tax. 	<ul style="list-style-type: none"> ■ 100 percent of a donation. 	<ul style="list-style-type: none"> ■ \$286.25 million, as of the 2013-2014 fiscal year. 	<ul style="list-style-type: none"> ■ Fla. Stat. §§1002.395; 220.1875; and 624.51055.
Georgia	<ul style="list-style-type: none"> ■ 100 percent of a donation. An individual may only claim up to \$1,000. A married couple filing jointly may only claim up to \$2,500. An individual who is a shareholder in an S corporation or a partner in a partnership may only claim up to \$10,000. 	<ul style="list-style-type: none"> ■ 100 percent of a donation, up to 75 percent of a corporate taxpayer's tax liability. 	<ul style="list-style-type: none"> ■ \$58 million 	<ul style="list-style-type: none"> ■ Ga. Code Ann. §48-7-29.16
Indiana	<ul style="list-style-type: none"> ■ 50 percent of a donation. 	<ul style="list-style-type: none"> ■ 50 percent of a donation. 	<ul style="list-style-type: none"> ■ \$7.5 million 	<ul style="list-style-type: none"> ■ Ind. Code Ann. §§6-3.1-30.5-1 to -15
Iowa	<ul style="list-style-type: none"> ■ 65 percent of a donation. Only available to shareholders in an S corporation, partner in a partnership, limited liability company, or an estate of trust. 	<ul style="list-style-type: none"> ■ 65 percent of donations. Corporations may only receive up to 25 percent of the total aggregate credit amount available. 	<ul style="list-style-type: none"> ■ \$12 million 	<ul style="list-style-type: none"> ■ Iowa Code Ann. §422.11S ■ Iowa Code Ann. §422.33(28)
Kansas	<ul style="list-style-type: none"> ■ Not available for individuals. 	<ul style="list-style-type: none"> ■ 70 percent of donations. 	<ul style="list-style-type: none"> ■ \$10 million 	<ul style="list-style-type: none"> ■ 2014 H.B. 2506, effective May 1, 2014.
Louisiana	<ul style="list-style-type: none"> ■ 100 percent of a donation, up to 100 percent of a taxpayer's tax liability. 	<ul style="list-style-type: none"> ■ 100 percent of a donation, up to 100 percent of a taxpayer's tax liability. 	<ul style="list-style-type: none"> ■ None 	<ul style="list-style-type: none"> ■ La. Rev. Stat. Ann. §47:6301
New Hampshire	<ul style="list-style-type: none"> ■ Not available for individuals. 	<ul style="list-style-type: none"> ■ 85 percent of a donation, up to 100 percent of a taxpayer's tax liability, not to exceed 10 percent of the total amount of credits available. 	<ul style="list-style-type: none"> ■ 5.1 million, as of the 2013-2014 fiscal year. 	<ul style="list-style-type: none"> ■ N.H. Rev. Stat. Ann. §§77-G:1; through G:10

State Scholarship Tax Credits				
State	Credit Amount for Individuals	Credit Amount for Corporations	Credit Cap	Statute
Oklahoma	<ul style="list-style-type: none"> ■ 50 percent of donations, up to \$1,000 for an individual or \$2,000 for a married couple filing jointly. ■ For taxpayers making contributions to educational improvement funds, there is an additional credit of 75 percent if the taxpayer agrees to make the contribution for two additional years. 	<ul style="list-style-type: none"> ■ 50 percent of donations, up to \$100,000. ■ For taxpayers making contributions to educational improvement funds, there is an additional credit of 75 percent if the taxpayer agrees to make the contribution for two additional years. 	<ul style="list-style-type: none"> ■ \$3.5 million (with \$1.75 million reserved for individual taxpayers and \$1.75 million reserved for corporate taxpayers.) 	<ul style="list-style-type: none"> ■ Okla. Stat. Ann. tit. 68, §68-2357.206
Pennsylvania	<ul style="list-style-type: none"> ■ 75 percent of donations, up to \$750,000, from a business to an educational improvement or scholarship organization. The credit increases to 90 percent if the taxpayer commits in writing to make the contribution in two consecutive years. ■ A credit for contributions from a business to a pre-kindergarten organizations. This credit 100 percent of the first \$10,000, not to exceed \$150,000 per business. ■ 75 percent of donations. 	<ul style="list-style-type: none"> ■ 75 percent of donations, up to \$750,000, from a business to an educational improvement or scholarship organization. The credit increases to 90 percent if the taxpayer commits in writing to make the contribution in two consecutive years. ■ A credit for contributions from a business to a pre-kindergarten organizations. This credit 100 percent of the first \$10,000, not to exceed \$150,000 per business. ■ 75 percent of donations up to \$750,000. The credit increases to 90 percent if the taxpayer commits in writing to make the contribution in two consecutive years. 	<ul style="list-style-type: none"> ■ \$100 million (with at least \$60 million reserved for scholarship organizations and \$30 million reserved for educational improvement organizations). ■ \$10 million ■ \$50 million 	<ul style="list-style-type: none"> ■ 72 Pa. Cons. Stat. §§8701-F to 8708-F ■ 72 Pa. Stat. §§1701-G.1 to 1710-G.1
Rhode Island	<ul style="list-style-type: none"> ■ 75 percent of donations. The credit increases to 90 percent if the taxpayer commits in writing to make the contribution in two consecutive years, and the second year contribution is at least 80 percent of the first years. 	<ul style="list-style-type: none"> ■ 75 percent of donations, up to \$100,000. The credit increases to 90 percent if the taxpayer commits in writing to make the contribution in two consecutive years, and the second year contribution is at least 80 percent of the first years. 	<ul style="list-style-type: none"> ■ \$1.5 million 	<ul style="list-style-type: none"> ■ R.I. Gen. Laws §§44-62-1 to -7

State Scholarship Tax Credits				
State	Credit Amount for Individuals	Credit Amount for Corporations	Credit Cap	Statute
South Carolina	<ul style="list-style-type: none"> ■ 100 percent of donations, up to 60 percent of a taxpayer's tax liability. A married couple filing separately may not each claim the full amount of the credit, but only their half of the credit had they filed jointly. 	<ul style="list-style-type: none"> ■ 100 percent of donations, up to 60 percent of a taxpayer's tax liability. 	<ul style="list-style-type: none"> ■ \$8 million 	<ul style="list-style-type: none"> ■ 2014 H.B. 4701, effective July 1, 2014.
Virginia	<ul style="list-style-type: none"> ■ 65 percent of donations equal to \$500 or greater, and less than or equal to \$125,000. 	<ul style="list-style-type: none"> ■ 65 percent of donations. 	<ul style="list-style-type: none"> ■ \$25 million 	<ul style="list-style-type: none"> ■ Va. Code Ann. §58.1-439.26