



Incentives Watch: A New School Argument For An Old School Credit

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Scholarship or tuition tax credits have a way of staying in the public spotlight. Over the last several years, battles surrounding these credits have been waged in courtrooms, on the floors of state legislatures and in the public consciousness. A new front has emerged in this old fight as evidenced by the report “[Public Loss Private Gain: How School Voucher Tax Shelters Undermine Public Education](#),” issued by the School Superintendents Association, AASA, a-pro-public school organization in conjunction with the Institute on Taxation and Economic Policy.

What Is A Scholarship Tax Credit Exactly?

A frequent topic for Bloomberg BNA’s [SALT Talk Blog](#), scholarship tax credits are awarded to businesses and individuals making donations to qualified scholarship or tuition organizations, which in turn award scholarships to students that attend private secular and religious schools.

Opposition to scholarship tax credits usually takes the shape of three arguments. The first argument is that these programs take funding from public schools. The second argument is that these programs use what is essentially tax revenue to fund religious schools, violating the separation of church and state. The third argument is that private schools are not held to the same standards, both in terms of curriculum and acceptance, as public schools.

On the other hand, supporters see the credits as a way to give low- and moderate-income taxpayers the ability to make choices regarding their children’s education. Supporters argue that scholarships allow students to attend schools which they might not otherwise be able to afford while increasing both the availability and the quality of education.

Scholarship tax credit programs are currently seen as the most popular form of school choice, as reported by the [CATO Institute](#) in an Aug. 2016 blog about a survey conducted by [Education Next](#). More than half of those responding were in favor of scholarship tax credits for low-income individuals. Scholarship tax credits are currently available in 17 states, and have resulted in more than 250,000 scholarships being awarded, according to [Ed Choice](#), a pro school choice organization.

In contrast to traditional school voucher programs (another form of school choice which has been historically struck down by the courts), scholarship tax credits have generally won the legal challenges they have faced.

The Tax Shelter Argument

In addition to the traditional arguments against scholarship tax credits, the AASA highlights instances where high-net worth individuals may be able get tax benefits in excess of their donations.

Between the use of state tax credits and federal tax deductions for the same donation, described as “double dipping” in the report, certain high-net worth taxpayers subject to the federal alternative minimum tax may be able to reduce their tax liability by more than the amount of money they donated in nine of the 17 states offering tax credits.

The report characterizes this phenomena as a “voucher tax shelter,” and goes on to argue:

“since at least 2011, the IRS has essentially sanctioned allowing taxpayers to claim a federal charitable deduction for private school scholarship donations even when those donations are also subsidized with a state tax credit.”

A tax shelter is a tax avoidance scheme which uses a series of transactions, either lacking in economic substance or founded on misapplied legal principals, to lower a taxpayer’s tax liability without materially altering their real world financials.

Traditionally, taxing jurisdictions go to great lengths to identify and shutdown tax shelters. Taxpayers having been found participating in a tax shelter generally face large penalties in addition to having to pay the tax avoided by use of the shelter and any interest on the amount owed.

However, this report characterizes state scholarship tax credits as an approved “tax shelter,” benefiting wealthy taxpayers and broadens the use of the phrase.

The report also goes into great detail regarding a proposed federal scholarship tax credit which is currently before Congress. Should this federal credit legislation be enacted, the ability of wealthy taxpayers to use these programs as a way of lowering their taxes will be compounded, according to the report.

Characterizing scholarship tax credits as a “tax shelter” for the wealthy may signal a paradigm shift. Where these credits have traditionally survived previous legal challenges, framing them as “tax shelters” might have the potential to change how they are viewed both by the public and by taxing authorities.

However, not everyone is convinced about the merits of the AASA’s argument.

The primary purpose of these programs isn't to help the wealthy lower their tax bill, it is to provide scholarships to low-income families, according to one policy expert quoted in an article from [The New York Times](#). The expert went on to argue that it isn't the responsibility of the states to control the federal tax benefits afforded to taxpayers making donations.

Even so, donors receiving multiple benefits from a state and the federal government is an issue that can be fixed simply with legislation, said a spokesman from a school choice advocacy group also quoted in [The New York Times](#) article.

State legislators in states that offer scholarship tax credits have taken exception to the report's characterization.

John Carson (R), a member of the Georgia House of Representatives said it was 'irresponsible' for the report to use the phrase "tax shelter" to describe the credits, according to an article in [The Atlanta Journal-Constitution](#). His belief is that the benefit of the credit in his state is outweighed by the practicality of taxpayers using their money in other ways, according to the article.

Regardless of which side of the argument you are on, the term "tax shelter" invokes a powerful reaction. Whether this new front will change the tide may depend on if the characterization sticks.

*Continue the discussion on Bloomberg BNA's State Tax Group on [LinkedIn](#): Are scholarship tax credits an appropriate way to address the educational needs of students from low- to moderate-income families?