Education Tax Credits in a Post-*Zelman* Era:
Legal, Political and Policy Alternatives to Vouchers?

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Abstract: This article examines an emerging preference for education tax credit programs in a post-*Zelman* era. First, we detail the origin of tax credits and the types of existing plans. Second, we review the assumptions underlying the supposed advantages that may favor tax credits as a feasible alternative to vouchers. Third, we analyze legal, political, and policy implications of this form of school choice. We review evidence from recent research on tax credit programs and analyze new evidence collected for this article on the Minnesota Tax Credits and Deduction Program. We posit that while education tax credit plans may be more widely accepted than education vouchers, substantial obstacles may still restrict their implementation.

KEYWORDS: education tax credits, education tax deductions, vouchers, school choice, school reform, education policy

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Introduction

Following the U.S. Supreme Court's ruling that the Cleveland Scholarship and Tuition Program did not violate the First Amendment of the Constitution of the United Sates (see *Zelman v. Simmons-Harris*, 2002), many proponents of private school choice expected voucher programs to sprout throughout the country after the constitutional flood gates had been opened. However, four years after the *Zelman* ruling we have not seen an outpouring of new state or federally sponsored voucher programs. Instead, the attention of school choice advocates, and the legislators they hope to influence, has shifted to education tax credit programs[1] which have steadily expanded at the state-level and been the focus of several federal bills.

At first glance, there appear to be few differences in support for vouchers and tax credits. The same politically conservative (or liberal) interest groups generally support (or oppose) both efforts to privatize education. Arguments espousing the benefits of increased consumer choice and competition, as well as the right of parents to direct their child's education, are similarly used. Further, equal numbers of states operate voucher and tax credit programs. Six states operate publicly funded voucher programs that allow students to attend both sectarian and non-sectarian schools.[2] Three new voucher programs have been successfully implemented since *Zelman*: Arizona's Scholarship for Pupils with Disabilities Program (ASPDP), Washington

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[1] We will use the descriptor "tax credits" throughout this article to identify tuition subsidy programs in general. However, when speaking about specific programs, we will differentiate between the unique mechanisms of tuition tax credits, tuition tax deductions and corporate tax credits. It is important to clarify differences between tax *credits* and tax *deductions.* Even though both credits and deductions effectively lower a parent's net schooling expenses, a credit is directly subtracted from one's tax liability and provides a larger subsidy for the proportion of tuition and educational expenses paid by parents. There are two types of tax credits. A refundable credit is a dollar-for-dollar credit and is not dependent or limited by a taxpayer's liability. A non-refundable credit is limited to taxpayers with a tax liability and reduces one's tax bill up to the given credit amount. In contrast, tax deductions reduce the amount of income against which a tax is imposed and is limited to taxpayers with a liability. The total benefit of a deduction is dependent on the taxpayer's marginal tax rate. Income thresholds for eligibility are commonly applied to both education tax credit and deduction programs.

[2] Voucher programs are currently operational in Arizona, Florida, Ohio, Utah, Wisconsin, and Washington D.C., serving about 35,000 students (National Center for Education Statistics, 2006)

D.C.'s Opportunity Scholarship Program (WOSP) and Utah's Carson Smith Scholarships for Students with Special Needs (USSSN). Six states support tax credit programs[3], of which three have been created or amended since the *Zelman* decision.

Deeper inquiry reveals that tax credits may have significant legal advantages that may favor tax credits as a feasible alternative to vouchers. Recently enacted voucher programs may be the result of special circumstances. In Washington D.C., a federally sponsored initiative avoided the scrutiny of state courts that remain free to apply far stricter anti-establishment provisions contained in state constitutions. Specifically, thirty-seven states have constitutional restrictions against providing public monies to sectarian institutions in the form of Blaine Amendments.[4] Voucher in Colorado, Florida, Vermont, and Washington have been challenged on grounds of violating state anti-establishment provisions and have been declared unconstitutional on this and other legal grounds, including compelled support clauses, uniform education and local control provisions that bar the use of public money for religious and other nonpublic schools (see *Owens v. Colorado Congress of Parents, Teachers and Students*, 2004; *Bush v. Holmes*, 2006; *Witters v. Washington Department of Services,* 1986; *Chittenden Town School District v. Vermont Department of Education*, 1999).[5] In addition, vouchers may lack

[3] Tax credit programs are currently operational in Arizona, Florida, Illinois, Iowa, Minnesota, and Pennsylvania.

[4] In 1875, Representative James Blaine of Maine proposed an amendment to the U.S. Constitution to prevent public funding of Catholic schools. The "Blaine Amendment" failed to gain a two-thirds majority in U.S. Senate (by only 4 votes), but a number of states adopted elements of the proposal. Florida, Georgia, Michigan, Montana, New York, and Oklahoma prohibit direct or indirect aid to religious private schools. California, Colorado, Delaware, Illinois, Minnesota, Missouri, North Dakota, South Dakota, and Wyoming prohibit assistance that "supports or sustains" religious private schools. Hawaii and Kansas prohibit public support for all private schools, religious or not. The Massachusetts Constitution requires public monies to be spent on public schools only (Kemerer, 2002).

[5] Compelled consent clauses in state constitutions prohibit laws that force citizens to attend or support any place of worship or participate in any religious service against their consent, as well as laws that give preference to a specific faith or religious sect. These protections may extend to the use of taxpayer dollars. For example, the Vermont Supreme Court ruled that vouchers could not be redeemed at sectarian schools, because taxpayers could not consent to the use of their monies by private schools, which violates the Vermont Constitution's compelled support clause (*Chittenden Town School District v. Vermont Department of Education*, 1999).

popular support as evidenced by recent failed attempts to pass statewide ballot initiatives in California and Michigan (see California Proposition 38, 2000; Michigan Proposal 1, 2000). Voucher programs, especially those that target disadvantaged students, challenge not only the norms of public education, but also threaten the investments of suburban residents. Unfettered student movement may alter enrollment patterns, lower housing prices, and undermine community-oriented social capital accrued through neighborhood schools. And lastly, voucher advocates have yet to resolve several policy-related issues linked to the monetary costs of voucher programs, the mechanisms by which voucher monies are distributed, and the supply-side response from private schools that may or may not choose to accept new students who exit the public school system. These salient topics will be discussed in later sections of this article

In contrast, tax credit programs have been successfully enacted in several states that had previously failed to implement voucher reform, including Arizona, Pennsylvania, Florida, and Minnesota. These programs employ a variety of alternative mechanisms that may present feasible legal, political and policy alternatives to the complicated issues that are associated with vouchers. From a legal perspective, tax credits may avoid the religious entanglement issues associated with some state–level Blaine Amendments that restrict the use of public funding for religious institutions. From a political perspective, complicated debates may be circumvented. School vouchers are generally seen as an education policy which provokes controversy. Tax credits might instead be interpreted simply as subsidies associated with tax policy and more palatable to voters. Voters may also see tax credits as more universal and as a direct return on their tax efforts, instead of a redistributive policy associated with means-tested or targeted voucher programs that limit eligibility based on income threshold. From a policy perspective, the school establishment may offer less opposition because funding for tax credits is drawn from general state revenues instead of education budgets, thus potentially resulting in a fiscally neutral policy in relation to effects on state education budgets.[6] Tax credit programs also provide the most indirect path of public money to private schools. Thus, policymakers may feel less inclined to impose state regulations on private schools that enroll tax credit beneficiaries than voucher recipients.[7]

In this article, we examine an emerging preference for tax credits in a post-*Zelman* era. We proceed in three steps. First, we detail the origin of tuition tax subsidies and the types of plans that have been enacted. Second, we review the assumptions underlying the supposed advantages that may favor tax credits as a feasible alternative to vouchers and assess their validity. Third, we analyze legal, political, and policy implications of this form of private school choice. We also review evidence that has emerged from recent research on tax credit programs and present new evidence collected for this article on the Minnesota Tax Credits and Deduction Program. Our analysis of emerging evidence will focus on three important research questions. First, which families benefit from tax credits? Second, do credits advance parental choice? Third, do tax credits provide private schools with incentives to raise tuition or increase supply? We posit that while education tax credit plans may be more widely accepted than education vouchers, substantial obstacles may still restrict their implementation.

[6] Ultimately all public programs draw from a general state budget, yet the immediate direct effect of a tax credit on education budgets may be limited. We will discuss this issue in more detail in a later section of this article.

[7] Tax credit legislation aimed at individual families in Arizona, Illinois, Iowa, and Minnesota place no regulations on non-profit private schools. Corporate tax credit legislation in Pennsylvania does not place additional state regulations on participating private schools, but legislation in Arizona and Florida requires private schools to report the scores of scholarship recipients on nationally norm-referenced tests among other requirements.

Origins of Tax Credits Programs

Proposals to advance parental choice via tax credits surfaced at state and federal levels in the late 1960s. By the mid-1970s a total of 13 state legislatures enacted tax credits to aid families with children attending private schools or colleges. However, most of these plans were overturned as state courts ruled that they provided public aid directly to religious schools (Walch, 1984; Fuller, Burr, Huerta, Puryear & Wexler, 1999). At the federal level, prior to 1978, six tuition tax credit proposals had passed the U.S. Senate (Catteral, 1984). Yet none of the bills ever became law. In 1978, the Senate passed the Packwood-Moynihan Bill (1978) which proposed a $500 tax credit for tuition and educational expenses at private schools, as well as offsetting college costs. But the House's version of the bill eventually floundered when it failed to gain support for the elementary and secondary school provisions under the Democratic controlled House (Catteral, 1984; Augenblick & McGuire, 1982).

In the early 1980s, the Reagan Administration proposed various K–12 tax credit plans, all of which were defeated by the Democratic Congress. Then, surprising some, the Clinton Administration backed college tax credits in 1997, embedded within the omnibus Taxpayer Relief Act of 1997. Known as Hope Scholarships, Lifetime Learning Credits, and Education IRAs, the plans provide tax breaks for families and are aimed at expanding access to college by making tuition more affordable. Benefits of these federal programs were initially limited to higher education expenses and excluded K-12 education expenses. However, in 2001, Congress expanded the education IRA component (now known as the Coverdell Education Savings Accounts) to include K-12 expenses. Most recently, since the enactment of the No Child Left Behind Act of 2002, both Congress and the Bush administration have proposed numerous proposals to create a federal-level tax credit program.[8]

At the state level, tax credit programs have been proposed in over 40 states and are operating in six states (Arizona, Florida, Illinois, Iowa, Minnesota and Pennsylvania). Most of the existing programs became operational in the late 1990s and have expanded significantly over the last five years. The types of programs are identified by the following mechanisms that grant benefits to individuals, families or corporations, according to their education expenses or their contributions to public schools or school tuition organizations:

(a.) **Education Tax Credits for Expenses** – Examples include a non-refundable credit granted to families who claim public or private school expenses, including tuition (Illinois, Iowa); a refundable credit for public or private school expenses, excluding tuition (Minnesota); and a non-refundable credit for contributions by individuals to public schools (Arizona).

(b.) **Education Tax Deductions for Expenses** – A deduction is granted to families who claim public and private school expenses, including tuition (Minnesota).

(c.) **Education Tax Credits for Contributions to School Tuition Organization (STO)** – A non-refundable credit is granted to individuals or corporations who make charitable contributions to non-profit STOs. The STOs distribute tuition scholarships to families who sign-up to receive a scholarship for their children (Arizona, Pennsylvania, Florida).

These mechanisms are important to consider when evaluating the efficacy of each program in expanding school choice options to more families, a discussion that we will explore later. A full description of existing tax credit plans is provided in Table 1.

[8] See H.R. 499 (Education, Achievement and Opportunity Act of 2003); H.R. 612 (Early Education Freedom Act of 2003); Section 503 of S.B. 4 (Give Back to Parents Act of 2003). In addition, for fiscal years 2003 and 2004 the Administration proposed a refundable tax credit for qualifying educational expenses in the amount of 50% of the first $5,000 of qualified expenses incurred for tuition and other costs associated with attendance in a public, private or home school. The proposed credit would have been limited to children assigned to public schools that did not meet adequate yearly progress benchmarks on state assessments. None of the above bills or proposals were adopted by Congress (Levine & Smole, 2003).

Table 1: General and Tuition Tax Credit and Deduction Programs Within the United States, 2006

	Arizona			Florida	Illinois	Iowa	Minnesota		Pennsylvania
Type	Private School TTC	Public School TC	Corporate TTC	Corporate TTC	TTC	TTC	TC	Tax Deduction	Corporate TTC
Authorized	1997	1997	2006	2001	1999	1987	1997	1955	2001
Last Amended	2000	2000	NA	2003	NA	1998	2001	2001	2003
Amount per									
family		$200 ($400 for joint returns)			$500 (up to 25% of tax liability)		$2,000[a] (up to 75% of education costs)	$2,500 ($1,625 for students in K-6)	
student						$250 (25% of first $1000)	$1,000		
taxpaying individual	$500 ($1000 for joint returns)								
taxpaying business			Indeterminate (aggregate annual cap of $5 mil.)	$5 mil. (up to 75% of tax liability)					$200,000
Refundable for zero expenditure	No	No	No	No	No	No	Yes	No	No
Means-tested	No	No	Yes	Yes	No	No	For incomes < $37,500b	No	Yes
Legitimate Expenses									
tuition	Yes (for others)	No	Yes	Yes	Yes	Yes	No	Yes	Yes
educational materials	No	No	No	Yes	Yes	Yes	Yes	Yes	Yes
additional school expenses	No	Yes (Character Education)	No	Yes	Yes	Yes	Yes	Yes	Yes
extracurricular activities	No	Yes	No	No	No	Yes	Yes	Yes	Yes
supplemental education services	No	No	No	No	No	No	Yes	Yes	No
Agencies to Redeem Credits	School Tuition Organizations	Public Schools	School Tuition Organizations	School Tuition Organizations[c]	Public, Independent, Religious schools	Independent Schools	Public, Independent, religious schools		School Tuition Organizations[d]

Sources: Belfield, C. (2001). Tuition Tax Credits: What We Know so Far? NCSPE. Retrieved June 6, 2006, from http://www.ncspe.org/list-papers.php; Ziebarth, T. (2003). Vouchers, Tax Credits, and Tax Deductions. ECS. Retrieved June 6, 2006, from http://www.ecs.org/clearinghouse/14/44/1444.htm]; Alliance for School Choice. (2006). School Choice Programs Around the Country. Retrieved June 6, 2006, from http://www.allianceforschoolchoice.org/school_choice_states.aspx; People for the American Way. (2006). Existing Vouchers and Tax Credit Programs. Retrieved June 6, 2006, from http://www.pfaw.org/pfaw/general/default.aspx?oId=10387.

[a] Eligibility is per student or per family. [b] A credit up to $2,000 may be claimed by families with incomes not exceeding $33,500. The maximum credit is reduced by $1.00 per child and $2.00 per family for each $4.00 over $33,500. [c] Scholarships may only be provided to students eligible for free and reduced lunch programs. Scholarships for students enrolling in nonpublic schools may not exceed $3,500, and scholarships for student transferring to out-of-district public schools may not exceed $500. [d] At least 66% of total expenditures must be for scholarships to private schools for low-income students.

Tax credits are also expanding in other education-related sectors, beyond the new federal tax credit and education IRAs. For example, the federal government and many state legislatures have created tax credits to offset the private cost of child-care and preschool programs. Tax expenditures linked to the federal child-care credit now equal about $3.5 billion annually (Republican Policy Committee, 2004). The more general Earned Income Tax Credit (EITC), providing refundable cash credits for working-poor families, pays out almost $39 billion annually to households (Department of Treasury, 2005). In this context, the present push of Congress to enact K–12 tax credits is not surprising, although the actual effects of these various tax plans on parents' behavior and choices remain unclear.

Claims and Assumptions

Tax credit programs are raising important questions linked to legal, political and policy implications that require further exploration. For example, which families benefit most from tax credit and deduction programs? Proponents argue that tax subsidies will provide all families with the necessary financial means to exercise school choice (Committee on Education and the Workforce, 2002; Keegan, 2001). Opponents point out that such subsidies typically benefit higher income families who have larger tax bills and whose children may already attend a private school (People for the American Way, 2003). This leads to the question of whether tax credits broaden choice for more parents or simply provide tax relief to families who already can afford to choose. Political debates might be influenced by recent poll data that indicates that tax credits are preferred over voucher programs (Rose, L. and A. Gallup, 1999). Savvy politicians and policymakers are likely to capitalize on voter preferences in their attempts to expand private school choice. The expansion of tax credit programs may also be hastened by the legal gateways that have resulted from several cases that have ruled tax credit programs permissible and free from religious entanglement statues in both state and federal Constitutions.

The claims of tax credit proponents are similar to those of voucher proponents. They contend that awarding school aid directly to parents—rather than to local school bureaucracies—will set in motion market pressures that encourage competition among private and public schools, and push educational quality upward (Coulson, 2004). One major difference, however, is that most voucher experiments are now targeting aid to low-income families or students in perpetually failing schools. Tax credits, in contrast, usually benefit parents with significant tax liabilities, as we will detail below. But first we discuss briefly the claims advanced by both proponents and critical observers of tax credits and outline some of the pivotal assumptions of these claims.

> *Tax credits are robust alternatives to vouchers that do not violate religious entanglement clauses in state constitutions* (Coulson, 2001). This claim assumes that state constitution clauses that bar public moneys from support of religious schools will not prohibit the expansion of tax credit programs (Bolick, 2004). But recent analysis of Blaine Amendments within state constitutions reveal that there is a wide variance in the level and explicitness of prohibitive language that may make both vouchers and tax credit programs constitutionally unacceptable in many states (Kemerer, 1998, 2002).

> *Tax credits are a more politically palatable alternative to vouchers because they provide benefits to a wider array of constituents without affecting general education budgets* (Coulson, 2004). This claim assumes that all voters understand the mechanisms (or that politicians take advantage of voters' lack of understanding) by which tax credits are distributed and the state revenues from which benefits are drawn. Yet, while education budgets may not be directly affected, all state programs may have to compete for limited state resources which are all drawn from state treasuries.

Tax credits will enhance school choice by making private school tuition more affordable for all parents (Lips & Jacoby, 2001). This claim assumes that tax credits offer an adequate economic incentive to offset the price of private school tuition for all families. That is, the credit allows additional parents to exit their neighborhood school and enter a private school. But the claim assumes that all parents will understand tuition tax laws and will be adequately informed to use increased after-tax income for private schooling.

Tax credits increase competition between public and private schools, leading to increased quality and efficiency among all schools (Goldwater Institute, 2003). This claim assumes that private schools will effectively lure students from public schools at such a rate that all schools will compete for clients. More liberalized tax benefits could increase the demand for private schooling. But whether private schools will respond by increasing their capacity to educate greater numbers of students is an empirical question. Private schools might respond, instead, by boosting tuition levels, rather than admitting additional students.

Tax credits are being promoted as a viable legal, political and policy alternative to vouchers both at the state and federal levels, yet research measuring the effects of tax credit programs has not kept pace with their expansion. The extent to which these assumptions can be substantiated is dependent on the evidence that exists which describes the effects of tax credit programs. In the following section, we analyze the legal, political and policy implications associated with the expansion of tax credit programs, including an analysis of new data prepared for this article and existing evidence from recent research into existing tax credit programs.

Legal Implications

In *Mueller v. Allen* (1983) the U.S. Supreme Court upheld the Minnesota education tax deduction law, ruling that the program did not violate the Establishment Clause of the First

Amendment. The majority opinion explained that the law allowed “aid to parochial schools only as a result of decisions of individual parents rather than directly from the State to the schools themselves” (*Mueller v. Allen,* p.388). In addition, the Court emphasized that the deduction was neutral with respect to religion because it was “available for educational expenses incurred by all parents, including those whose children attend public schools and those whose children attend nonsectarian private schools or sectarian private schools” (*Mueller v. Allen*, pg 397).

The *Mueller* precedent, which found the mechanism of indirect aid through parents rather than direct aid to religious institutions constitutionally permissible, was revisited in the *Zelman* case. This precedent was the most cited case in the *Zelman* decision and was instrumental in supporting the constitutionality of the Cleveland voucher program. Yet, the landmark precedent in *Zelman* has been noted by some as only the first battle won in a larger conflict that will be fought in state courts when new voucher programs emerge (see Kemerer, 2002, Viteritti, 2002). The focus of constitutional scholars and legal strategists has turned to Blaine Amendments, compelled support clauses, uniform education and local control provisions that prohibit the use of public funds at nonpublic institutions (private or secular), either through direct or indirect means (Pew Charitable Trusts, 2002; Bolick, 2004, Kemerer, 2002).[9] Vouchers and other programs like tax credits that subsidize private school tuition, are subject to being challenged on grounds that they violate these restrictive state laws, regardless of the federal constitutional precedent of the *Zelman* case.

Already voucher programs in Florida and Colorado have been challenged on claims that they violate church–state provisions prohibiting the use of public money for religious institutions in accordance with state constitutions. In Colorado, a voucher program that was enacted in

[9] Thirty-seven states have so-called Blaine amendment language, and 29 have prohibitive "compelled support" provisions.

2003—the first state voucher law passed after the *Zelman* decision— was challenged by opponents who claimed the voucher law violated the state's Blaine Amendment which expressly prohibits the state from "…paying from any public fund or moneys…anything in aid of any church or sectarian society, or for any sectarian purpose, or to help support or sustain any school ... controlled by any church or sectarian denomination whatsoever" (Colorado Constitution Article IX, § 7). The program was also challenged on grounds that it violated the state constitution's local control provision, which was interpreted by the court to mean that "local school districts must retain control over any instruction paid for with locally-raised funds (p.7)." In *Colorado Congress of Parents, Teachers & Students v. Owens* (2004) both the lower court and the Colorado Supreme Court sidestepped the issue of the state establishment clause violations and instead ruled on the less controversial issue of local control of schools. The violation of the Blaine Amendment that was argued in the lower courts was not even mentioned in the higher court's decision.

In Florida, the A+ Opportunity Scholarship Program was initially challenged by groups that claimed the program violated the Blaine Amendment provisions in the state constitution that bar public aid to religious schools. Specifically the provision states that "no revenue of the state or any political subdivision or agency thereof shall ever be taken from the public treasury directly or indirectly in aid of any church, sect, or religious denomination or in aid of any sectarian institution" (Florida Constitution Article 1, § 3). After two lower courts found that the voucher program violated the state's Blaine Amendment, the case was appealed to the Florida Supreme Court. Ultimately the Supreme Court in *Bush v. Holmes* (2006) ruled the voucher program unconstitutional, but not in violation of the state's establishment provisions. Instead the law was found to be in violation of the state's uniform education clause which indicates that “adequate provision shall be made by law for a uniform, efficient, safe, secure, and high quality system of free public schools [Florida Constitution Article IX, § 1(a)].” Because the program was found unconstitutional on grounds that it violated the uniform education clause, the higher court did not consider whether it violated the state’s Blaine amendment.

The decisions of the courts in both of these cases indicate that voucher programs might not be protected by the federal precedent set by *Zelman*, when Blaine Amendments, compelled support clauses, uniform education and local control provisions that bar the use of public money for religious and other nonpublic schools, are contained within state constitutions. These cases send the clear signal that proponents of voucher programs may need to seek legal alternatives to vouchers. Tax credit programs may be the most viable alternative to the legal issues that are prompted by voucher programs. Some have described tax credits as “back-door” vouchers, pointing out that tax credits yield the same benefit to parents—in the form of public money for private school tuition—but do so simply through a different mechanism. As Welner (2000) points out in his analysis of the Arizona tax credit program: “Legally, the transformation from voucher to tax credit constitutes, the argument goes, a distinction without a difference (p. 3).” Yet, while the resulting benefit may be similar, the mechanism is what makes a tax credit different and potentially a more legally feasible school choice program. While vouchers employ a mechanism where public and private schools (religious and secular) receive public money indirectly through the private choices made by beneficiaries of the stipend, tax credit programs add “multiple layers of private choice” (*Kotterman v. Killian*, p. 13), increasing the level of indirectness and minimizing constitutional objections. Essentially, parents are reimbursed through a tax credit after they have expended their own private funds and exercised their private choice in selecting a school for their children. This second layer of private choice may be interpreted by the courts as an additional layer of religious neutrality, further reifying church–state separation issues.

The potential of tax credit programs to endure state constitutional challenges is evidenced in three important cases. In each of these cases, state constitutions contained Blaine Amendments and/or compelled support clauses, yet the rulings deemed tax credit programs permissible under state religious establishment provisions. In *Luthens v. Bair* (1992), a U.S. District Court ruled that the Iowa tax credit—similar to the deduction program in Minnesota that was upheld in *Mueller*—was constitutional because benefits flowed indirectly to parents rather then to schools. The program (at the time of the suit) provided parents with a non-refundable tax credit up to $100 (10% of the first $1,000 of expenses) for private school tuition and textbooks expenses. The state court upheld this tuition tax program even though the state constitution contains a Blaine Amendment that reads: "The general assembly shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; nor shall any person be compelled to attend any place of worship, pay tithes, taxes, or other rates for building or repairing places of worship, or the maintenance of any minister, or ministry (Iowa Constitution Article I, § 3)."

In Arizona, the State Supreme Court upheld a tuition tax credit program that grants tuition scholarships to students through school tuition organizations (STO). The program provides individuals a refundable credit up to a maximum of $650 for their charitable donations to STOs. The STOs then distribute the contributions in the form of scholarships to eligible students. The tax credit program was challenged in a suit that was filed directly to the Arizona Supreme Court (*Kotterman v. Killian*, 1999). The claimants charged that the program violated both state and federal constitutional prohibitions of state aid to religious institutions. A portion of the Blaine Amendment in the Arizona State Constitution reads: “No tax shall be laid or appropriation of public money made in aid of any church, or private or sectarian school, or any public service corporation” (Arizona Constitution Article 9, § 10). Yet, in a 3-2 decision the court upheld the tax program. The court explained that the program was both religiously neutral with respect to the class of schools that scholarship recipients can choose, and also with respect to the wide class of citizens who participate, stating that “schools are no more than indirect recipients of taxpayer contributions, with the final destination of these funds being determined by individual parents (*Kotterman v. Killian*, 1999, p. 14).” The court’s decision stated that it would not allow the religious bigotry linked to Blaine Amendments—as interpreted by the court—to take precedent in this case.[10] The court challenged the notion that the Arizona establishment clause had any connection to the original Blaine Amendment movement of the late 1800s, and noted that regardless if it were connected, the court “would be hard pressed to divorce the amendment's language from the insidious discriminatory intent that prompted it (*Kotterman v. Killian*, 1999, p.36)." The plaintiffs asked the U.S. Supreme Court to review this decision on claims that it violated the Establishment Clause of the First Amendment, but in October of 1999, the Court refused to review the case and let stand the state court’s decision.

Lastly, in a third case that considered the constitutionality of tax credits in a state with a Blaine Amendment, the Illinois tax credit program was challenged in 2001. After six decisions were rendered in two different cases, the program was finally ruled permissible. Similar to the Minnesota and Iowa tax credit program, the Illinois program provides a non-refundable credit for educational expenses, including private school tuition or public school expenses, of up to $500. The legal challenges of this program are important because the Illinois constitution contains both

[10] Representative Blaine’s proposal to prohibit funding to Catholic schools was fueled by nativist and anti-Catholic sentiments and a desire to ensure that all students learned Protestant religious teachings, which were integral to public school curriculums at this time.

a Blaine Amendment and a compelled support clause barring church state entanglement. The state constitution would seem to foreclose any chance of a voucher or tax credit program from being permissible, with language that explicitly prohibits all state entities from making "any appropriation or pay from any public fund whatever, anything in aid of any church or sectarian purpose, or to help support or sustain any school, academy, seminary, college, university, or other literary or scientific institution, controlled by any church or sectarian denomination (Illinois Constitution, Article 10, § 3)." In addition the state's "compelled consent" clause stipulates that "no person shall be required to attend or support any ministry or place of worship against his consent, nor shall any preference be given by law to any religious denomination or mode of worship (Illinois Constitution, Article I, § 4)." Yet, the courts ruled the Illinois tax credit program to be constitutional, finding that it was fiscally and religiously neutral because it was available to all parents of public and private school children (religious or secular). The ruling also indicated that "taxes unpaid by taxpayers cannot be found to be money rightfully belonging to the state, any of that money which is used to pay for a child's parochial education is not public money, hence public support does not exist (*Griffith v. Bower*, 2001, p.3)."

It is not certain that all state constitutions with Blaine Amendments, compelled support clauses, uniform education and local control provisions will prohibit vouchers and permit tax credits. Both the Ohio and Wisconsin constitutions contain anti-establishment provisions (Godwin, R. and F. Kemerer, 2002) and their voucher plans have survived judicial scrutiny by state Supreme Courts (the Milwaukee voucher program only after being declared unconstitutional by a lower court). However, it is evident from several cases that we have reviewed above that tax credits programs may provide a more legally expedient alternative to voucher programs. Yet the legal implications of tax credit programs are not the only hurdle that state and federal legislatures must clear in promoting this type of school choice policy. In the following section, we examine political barriers to tax credit programs.

Political Implications

Polemic debates void of evidence

The political debate on tax credit programs hinges on the same divergent views for improving public education that dominate the debate on education vouchers. Specifically, proponents argue that market competition will remove a public monopoly on education and revitalize a system that has become reliant on large, inefficient bureaucracies. Public subsidies for private school tuition (either through tax credits or vouchers) allow families to choose learning environments that match their preferences (Chubb and Moe, 1990). As a result, schools are forced to compete for clients (students) and increase the quality of their educational offerings (Friedman, 1955). The counter argument follows that the state must protect important public goals that privatization threatens to eliminate (Apple & Pedroni, 2005). For example, schools are expected to produce productive and democratic citizens (Labaree, 1997). Research into the potential of school choice programs to deliver on these elusive goals is mixed and hotly contested (Carnoy, 2001; Gill, et al., 2001; Krueger & Pei, 2003; McEwan, 2004, Witte, 2000).

Current evidence does indicate that participants in voucher programs are generally satisfied (Howell & Peterson, 2000).[11] Quasi-experimental evaluations of private voucher programs in Dayton, Ohio, New York City, and Washington D.C. report large gaps between treatment and control groups assign to their children's schools (Gill, et al., 2001). In Dayton, 47 percent of voucher families gave their child's school an A grade. Only 8 percent of the control

[11] It is important to note that parents who choose to participate in voucher or other school choice programs, have self-selected to exit the school that they were dissatisfied with and seek alternative choices.

group gave a similar grade (Howell & Peterson, 2000). In New York City, 38 percent of voucher families gave their child's school an A grade, compared to 9 percent of the control group (Wolf, Howell, & Peterson, 2000). However, parental satisfaction is a poor measure of the effectiveness of school choice programs. Parents that play an active role in choosing a particular school are more likely to be satisfied with their final decision.

Measures of other outcomes are less convincing. A recent study of student performance on the 2003 National Assessment of Educational Progress (NAEP) found that public school students in the fourth grade outperformed private school students in the fourth grade once student background characteristics were taken into account (Lubienski & Lubienski, 2005). Moreover, increasing competition and expanding the private sector is unlikely to dramatically change these results. Comprehensive reviews of the literature on school choice by Belfield and Levin (2005) and McEwan (2004) suggest that competition has a (small) positive and non-substantive effect on public education outcomes. Belfield and Levin (2005) conclude that, "a one standard deviation increase in competition would probably increase test scores by approximately .1 standard deviations or about four percentiles (p. 139)." A lack of evidence demonstrating the potential of private school choice to substantially raise student test scores may result in voucher and tax credit programs being justified on other grounds. Primarily, legislative and popular support for (or opposition to) all forms of private school choice is determined by ideology. However, key differences exist in how vouchers and tax credits are provided and used. Thus, while arguments in favor of tax credits echo previous calls for privatization, the public may draw important distinctions. In turn, policymakers may view tax credits as an attractive and politically viable alternative to vouchers.

The mobilization of ideological arguments in support of tax credits is best evidenced by the actions of political elites. For example, the 1997 amendment to Minnesota's tax credit law was spearheaded by Governor Arne Carlson. He publicly espoused his wish that all poor children be afforded the same opportunity to attend private schools that he was given as a child. The repeated failure of voucher legislation in Minnesota, in part, pushed Carlson toward alternative strategies and he vowed to veto any education bill that did not include a "package of tax credits and deductions that parents could use to offset the cost of sending their children to private schools (Bradley, 1998)." The Governor's campaigning proved effective. In June of 1997, a new education bill reached his desk, after being approved by a Democrat-controlled state legislature. The new law nearly tripled the existing tax deduction amount, and created a more progressive credit component that was limited to pubic school expenses (see Table 1 for details on programs). Upon signing the bill, Carlson jubilantly stated that "through the expanded deduction and new education tax credit, all families will have the opportunity to take advantage of additional educational choices" (*School Reform News,* 1997a).

Similar arguments have been championed in other states and at the federal level. When Arizona enacted a tuition tax credit program in 1997, Governor J. Fife Symington expressed strong support for the legislation and stated that the bill "would provide more choice for Arizona children, because competition is the driving force behind quality in education" (School Reform News, 1997b). At the national level, federal tax credit proposals were included in the administration's budgets for fiscal years 2003 and 2004. The proposals included offering a refundable tax credit up to $2500 (50% of first $5,000 in expenses) for private school tuition, home schooling and other educational expenses including transportation to a private or public choice school. The credit would be limited to children in chronically failing schools. In support of the proposal, Representative John Boehner, chairman of the House Committee on Education and the Workforce proclaimed how:

> Giving parents this choice will broaden the escape route for students trapped in failing schools. It will also energize the public education system and spur struggling schools to succeed. For low-income parents, this could mean the difference between keeping a child trapped in a failing school that refuses to change, or sending a child to a better-achieving school that offers hope (Committee on Education and the Workforce, 2002).

The federal tax credit programs were defeated. But, the arguments expressed by advocates of privatization have worked to change popular understandings of equity. The right of parents to direct their child's education is consistently framed as an issue of justice, necessary to provide all families, especially disadvantaged families, with fair education opportunities.

Interest Groups Politics

Tax credit programs are also heavily influenced by interest groups. Governor Carlson's efforts were supported by parent organizations and sectarian institutions, such as the Minnesota Catholic Conference, which prompted national attention to surface. While promoting tax credits, Carlson was invited to Washington D.C. to meet with then House Majority Leader Dick Armey and former Secretary of Education Bill Bennett. He spoke at the Heritage Foundation, the National Press Club, and on conservative radio shows. Rumors circulated that he was a leading candidate to become chairman of the National Governors Association's Education Policy Panel (Smith, 1997).

Interest groups heavily vested in public education have, in most states, vigorously opposed tax credits. In Minnesota, teacher organizations and the Minnesota School Boards Association, argued that expanded deductions and new credits would hurt the public schools by stripping money from the state's budget that could otherwise be used for public schools (MEA, 1997). The estimated cost of the final bill was reduced to \$53 million: \$38.5 million for the credit and $14.5 million for deductions (Minnesota Department of Revenue, 1997b). As we will outline in the next section, the two programs have amounted to an annual cost of $34.7 million.

Interest groups also pursue material gains through tax credit programs. In Iowa, parochial schools played a prominent role in expanding the state's tuition tax credit program. Soon after a new tuition tax credit program was enacted in 1996 (replacing the old deduction program), the Iowa Catholic Conference launched a campaign aimed at further increasing the tax credit benefit. The campaign focused on increasing the maximum credit from $100 to $500 per child in K–8 education and $1,000 per child enrolled in high school. The Catholic Conference's proposal would make the credit refundable for families without a tax liability, extending the credit to blue-collar families who might migrate to parochial schools. The Catholic Conference ran their campaign platform on a two-prong approach promoting tax credits as an issue of justice for taxpayers and fiscal savings for the state. The associate director of the Iowa Catholic Conference proclaimed that "justice can best be served by giving a little bit of tax relief to those [Catholic] parents (Krapfl, Dec 4, 1996)." And his claim of fiscal savings was based on the assumption that "if the state had to educate the 45,000 students now in private grade schools and high schools…it would increase the state's education budget by $225 million per year" (Krapfl, Dec 4, 1996). Pubic education interests groups opposed the proposal stating how it would "negatively impact the already limited resources available to Iowa's public school students and teachers (Krapfl, Jan 3, 1997)."

Strongly backed by Governor Branstad, a new tax credit proposal advanced through the Iowa Legislature during the 1997 session. But legislative debate over the bill's cost resulted in a delay, and the bill was held over for the 1998 session. The final legislation was scaled back to increase the tuition tax credit to a maximum of $250 (25% of first $1000 in expenses). It does not include language allowing a refundable credit, but does expand credits for expenses beyond textbooks, including public school extra-curricular activities.

The arguments made and actions taken by advocates of tax credits do not differ markedly from attempts to enact other privatization reforms. But they are notable, because a number of states have recently and successfully passed tax credit laws.[12] These same arguments may not lead to the passage of voucher legislation for three reasons. First, vouchers are inextricably linked to polemics that set market based reforms at odds with a more democratic vision of public schooling. Debate centered on vouchers has existed for a long time and been closely covered by the media. As a result, vouchers are immediately associated in the public mind with efforts to undermine public education. Second, voucher programs are often associated with increased costs for public education. Levin and Driver (1997) estimate that the costs of record-keeping and monitoring students, transportation, adjudication, and information services for a statewide voucher program could total as much as one-fourth of existing per-pupil expenditures. Tax credit programs also present additional costs, because they reduce state revenues (Belfield, 2001), but such net loses are rarely interpreted by the public as raising the cost of public education. Thus, new programs are often forced to compete for funding with already existing programs, making implementation difficult. Third, the threat of public revenues exiting the public education system in support of private schools via vouchers, more directly attacks the material interests of individuals and groups invested in public schools.

Tax Policy v. Education Policy

Tax credit programs may be more palatable than vouchers, because they are frequently presented as a tax policy, and not an education policy. This approach allows policymakers to

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[12] It is important to note that several states have rejected strong repeated campaigns to pass tax credit legislation, notably South Carolina and Utah.

minimize political debate and present tax credits as neutral changes to the tax code. Unlike vouchers which are viewed as public monies, the public commonly believes that tax credits simply give families greater control over their own resources. This perspective leads to two assumptions. First, tax credits do not place further burdens on the public education system. Urban Institute economist Eric Toder explains that credits may be more politically feasible because they can be disguised as "social policy without apparent spending increases" (Toder cited in Schick, 2003). Second, families are entitled to use private monies as they see fit. This important point is reinforced by the Arizona Supreme Court's decision which upheld the state's tax credit program that distributes benefits via the mechanism of school tuition organizations. The majority explained how "no money ever [*Court's emphasis*] enters the state's control as a result of this tax credit… Thus, under any common understanding of the words, we are not here dealing with 'public money'" (*Kotterman v. Killian*, p.23). A similar definition of "public money" was offered by the Illinois Appeals Court in upholding that state's tuition tax credit program (see *Griffith v. Bower*, 2001).[13]

It is important to note that while the private money of tax credit beneficiaries that flows to private schools may not initially constitute "public money" and thus circumvent the definition of public spending, the ultimate credit that is returned to the taxpayer must be paid from state treasuries. Total public revenues are decreased, which adversely impacts both state and education budgets. We will return to this issue and discuss the costs of tax credits programs in the next section.

[13] No money ever enters the state's control as a result of this tax credit. Rather, the Act allows Illinois parents to keep more of their own money to spend on the education of their children as they see fit and thereby seeks to assist those parents in meeting the rising costs of educating their children (*Griffith v. Bower*, 747 N.E. 2d 423. IL App. Ct. 2001)."

Public Perception and Preferences on Tax Credits

The assumption that tax credits are family-controlled resources may lead to greater political support among the public, parents, and private schools. In addition, tax credit programs minimize associations between the government and religious schools. Choice schools are more likely to be seen as consistent with family preferences, and not the result of external pressure to adopt specific values and beliefs. Various polls, taken when the Minnesota tax credit program was enacted, showed that the majority of Minnesota voters favored higher tax benefits for private school tuition (*School Reform News,*1997c; Johnston, 1997). These findings have been repeated on a national scale. The PDK/Gallup Poll included questions specific to tax credit programs in 1998 and 1999. The data for 1999 indicates that tax credits for full tuition were favored by 57% of respondents compared to 48% in favor of full tuition vouchers, while partial tuition tax credits were favored by 66% of respondents, compared to 52% in favor of partial tuition vouchers. These data indicate that tuition tax credit programs are favored over voucher programs.

Missing from assessments of popular support for tax credits is how different types of programs impact popular opinion. For example, the PDK/Gallup Poll (1999) results show that respondents prefer tax credits that cover only a part of private school tuitions, not the entire amount. The public appears to support that parents who choose to enroll a child in a private school should absorb some of the cost. Whether a tax credit offers a deduction, a refundable or non-refundable credit, or a credit for a donation to a school tuition organization may also influence public support. A final point of controversy may be whether a tax credit program targets a specific class of beneficiaries, such as students in low-performing schools or from families with lower-incomes, or is a universal credit that is open to everyone. These are important issues that lawmakers must resolve before they can offer tax credits as politically feasible alternatives to vouchers.

A majority of parents with school age children may also prefer tax credits as opposed to vouchers, because all families may potentially share in the benefits. Out of the six states that have enacted tax credit programs, only one state limits participation to low-income families. In Minnesota, household incomes cannot exceed $37,500 dollars to be eligible for an education tax credit. In contrast, Arizona allows even non-student households to claim a tax credit by making a donation to an STO. Further, general tax credit programs in Florida and Pennsylvania allow corporations to claim tax credits by making a donation to an STO, increasing support for privatization within the business community. Tax credit programs that pool money in a scholarship fund may be more equitable than individual tax credit programs (Godwin and Kemerer, 2002), and still be capable of satisfying parents' demands. All families are potentially eligible to participate in and benefit from this type of reform, but greater sums of money are allocated to at-risk students.

It is important to note that tax credits may not be the most feasible reform for serving low-income and minority households. In recent years, privatization advocates have made strong efforts to entice families frustrated by the shortcomings of public schools to support vouchers. In fact, all six voucher programs that have been successfully enacted target disadvantaged students. In contrast, only Minnesota provides a refundable tax credit for zero expenditure. This means that in most states low-income families without tax liabilities cannot claim a tax credit. Low-income families may also struggle to understand the tax code and claim benefits. And finally, tax credits are generally much smaller than vouchers and paid long after the school year begins, making them more difficult for families without disposable incomes to use.

Regulatory Freedom

Private schools themselves may prefer tax credits to vouchers, because they are subject to less regulation. As Godwin and Kemerer (2002) note, "because [tuition tax credits] are not government funds in the same sense of vouchers, they are less likely to be accompanied by restrictive regulatory measures imposed on schools (p. 165)." In contrast, policymakers generally believe that schools participating in voucher programs should provide assurances that student achievement is improving. For example, Wisconsin recently enacted legislation that required voucher schools to meet a host of accountability demands (Roebelen, 2006). Private school administrators are wary of such regulations, fearing that they will subvert core values and beliefs. Shortly after the *Zelman* decision, some church officials openly worried that vouchers would subvert their faith-based mission and prevent criticism of government officials (Roebelen, 2002). Tax credits have yet to prompt similar fears.

Policy Implications

Support for tax credit policies depends heavily on the benefits made available to education consumers and private schools, as well as the costs anticipated by policymakers. In this section, we analyze evidence from new and amended programs that have emerged over the last decade. Our principal focus is Minnesota. We present new evidence, collected from the Minnesota Department of Revenue, which builds on earlier work by Darling-Hammond and colleagues (1985). Recent studies of tax credit programs in Arizona, Illinois, and Iowa are also considered to establish overarching trends. Our intent is to shed light on three important research questions. First, which families benefit from tax credits? Second, do credits advance parental choice? Third, do tax credits provide private schools with incentives to raise tuition or increase supply?

Minnesota Tax Deductions and Credits.

In 1997, Minnesota nearly tripled the benefit amount of its existing tax deduction program from $650 to $1,625 for kindergarten through sixth grade, and from $1000 to $2,500 for seventh grade through high school completion. In addition, a tuition tax credit program was enacted that allows a $1,000 per child ($2,000 per family) refundable tax credit equal to 75% of qualified education expenses for families with an annual income below $37,500.[14] The credit is fully refundable and eligibility does not require families to itemize returns. Qualifying expenses for both the tax deduction and credit include: tutoring, educational enrichment programs, academic summer camps, transportation expenses, textbooks and materials used during the normal school day (excluding religious textbooks), computer equipment (limited to $200), and home schooling expenses. An important restriction is that the cost of private school tuition can only be offset by a deduction, not by the credit feature of the program.

Which families benefit from tax deductions and credits?

To identify which families benefit most from tax subsidies, it is necessary to review how credits and deductions are allocated. In tax year 1997, prior to the expansion of the deduction program, an estimated 92,579 taxpayers in Minnesota filed for an education tax deduction (see Table 2).[15] Roughly 88% of families filing for the deduction earned above $40,000 per year, accounting for $4 million of the total $4.4 million allocated in tax benefits (Minnesota

[14] In years 1998-2001 the credit was a dollar-for-dollar benefit equal to $1000 in expenses, however, because of state budget cuts, after 2001 the legislature limited the credit to 75% of qualified expenses up to $1000. Also, in 2003, the state expanded the income threshold for the tax credit by $2000 dollars for every additional qualifying child beginning with the third child.

[15] The Minnesota Department of Revenue does not keep records of the exact number of taxpayers that actually take the education tax deduction. Deductions are not coded individually by the Department of Revenue, but rather are recorded as a sum of all deductions. The estimate is based on a random sample of returns where deductions are coded by deduction category and then recorded (Minnesota Department of Revenue, 1997a).

Department of Revenue, 1997a). Unfortunately, the state does not record the description of itemized deduction expenses. Thus, we cannot determine whether deduction expenses were used for private school tuition or public school expenses. However, a Department of Revenue report prepared for the Legislature in 1997 during debates on whether to expand the deduction program, estimated that 51,500 private school families would file for the deduction in 1997 (nearly 60% of actual total claims) (Minnesota Department of Revenue, 1997b).

Table 2: Minnesota Education Tax Deduction: Distribution and Cost

Tax Year	1997	1998	1999	2000	2002	2003	2004
# of state tax returns claiming deduction	92,579	148,478	188,752	207,311	225,423	233,336	229,471
total cost to state	$4.4 million	$11.5 million	$14.2 million	$16.1 million	$18.1 million	$18.7 million	$18.8 million
% of families with income greater than $40K/year (FAGI)	88%	85%	86%	84%	89%	87%	89%
% of cost distribution to families with income greater than $40K/year (FAGI)	90%	91%	91%	88%	93%	91%	93%

Source: Minnesota Department of Revenue (2006). No data was available for tax year 2001.

Following the increase of the tax deduction benefit, the number of taxpayers filing for a deduction increased by over 60% in 1998. Participation has grown steadily and the corresponding costs have increased by nearly 400% in the first six years of operation. In the 2004 tax year, 229,471 families filed for a deduction. The program now costs Minnesota $18.8 million, with 93% of this sum distributed in benefits to families who earn over $40K annually.[16] These cost distribution figures are consistent with previous analyses of Minnesota's tax

[16] The rate of return on the tax deduction program is dependent on the taxpayer's marginal tax rate. In Minnesota marginal tax rates are progressive and range from 5.35% to 7.85% and are variable based on income range and filing status. A taxpayer with a marginal rate of 7.85% who files for a $2,500 education expenses deduction will yield a $196.25 benefit.

deduction plan, as well as studies of tax credit programs in other states. Darling-Hammond, et al. (1985) examined Minnesota's tax deduction plan using information provided by the revenue department for the 1978 and 1980 tax years. They reported that parents' propensity to use the tax deduction increases with income, as does the size of the claim. They concluded that "rather than expanding choice for those parents at the margin, the deduction appears to subsidize the choices of those who have already selected private schools and who can profit from this type of subsidy (p. 51)."

Tax credit programs that do not target low-income families have also been shown to disproportionately benefit wealthier families. In Illinois, all taxpayers are eligible for a nonrefundable credit of up to $500 (with a minimum expense of $250). Approximately 80% of the $68.4 million distributed through the program in 2002 went to taxpayers earning over $40,000 dollars annually (People for the American Way, 2003). Similarly, in Arizona where taxpayers are eligible to receive up to a $500 non-refundable credit ($1,000 for joint returns) for donations to school tuition organizations, the distribution of benefits also disproportionately favored wealthy families. In an analysis of the first three years of the state's tax credit program, Wilson (2002) explains that 84% of the families who claimed the credit earned over $50,000 annually (see also Wilson, 2000). This skewed distribution is consistent with early research that estimated the potential distribution of benefits from national tax credit proposals. For example, in an analysis of tax credit programs during the Reagan Administration, Jacobs (1980) explained that families with annual incomes greater than $25,000 (in 1980 dollars) were over-represented in the private school population, at a rate five times higher than families with annual incomes less than $5,000. According to Jacobs, children from families with annual incomes greater than $25,000 "would generate a share of credits roughly twice as large as their representation in the school-aged population (p. 241).” Catterall (1983) studied several of the same proposals and his findings resulted in similar conclusions. He reported that affluent families would disproportionately benefit from federal tax subsidies because of their higher utilization of private schools and the fact that their higher tax liabilities would increase their eligibility to participate in the programs (Catterall, 1983).

In contrast, Minnesota’s tax credit program does target low-income families and accordingly has had a different effect. It has benefited fewer taxpayers, but at a much higher benefit per taxpayer ($1,000 per child, up to $2,000 per family). In 1998, the first tax year after the new law was enacted, an estimated 39,477 taxpayers filed for the credit, at a cost of $13.9 million (see Table 3). These numbers were well below the Department of Revenue’s projections, which anticipated over 192,000 claims (Minnesota Department of Revenue, 1997b). By 2004, the program was benefiting 61,499 taxpayers (less than one third of the projected amount) at a cost of $15.9 million.[17] While the take-up rate has increased steadily, the number of families filing for the credit has consistently amounted to 75% fewer families than those filing for the deduction. The program has not offset the inequities found in Minnesota’s tax deduction program.

[17] The program is paid by general State Treasury revenues instead of the education budget, thus the immediate impact on schools and other public services may not be direct. However, because public service revenues are paid for from state treasuries, the impact on schools or other services is inevitable.

Table 3: Minnesota Education Tax Credit: Distribution and Cost

Tax Year	1998	1999	2000	2002	2003	2004
# of state tax returns claiming credit	39,477	57,083	51,080	50,743	60,942	61,499
total cost to state	$13.9 million	$20.2 million	$19.1 million	$13.9 million[a]	$19 million	$15.9 million
% of families with income level greater than 20K/year (FAGI)	46%	57%	61%	69%	60%	56%
% of cost distribution to families with income level greater than $20K/year (FAGI)	53%	63%	66%	69%	57%	54%

Source: Minnesota Department of Revenue (2006). No date was available for tax year 2001.
[a] The large decrease in the cost of the program may be attributed to budget cuts in 2001 which limited the credit to 75% of qualified expenses up to $1000.

It appears that several barriers prevent low-income families from claiming tax credits. For example, families must pay for goods and services in advance of receiving a tax credit benefit. It is unlikely that families with annual incomes of less than $37,500 will have sufficient disposable income for private school tuitions or children's supplemental educational expenses. This important issue was informally addressed in the early years of the tax credit program. School choice advocacy organizations lobbied banks to partner with community groups and public schools educated low-income families about the tax credit and encouraged them to take advantage of the benefits offered by the program. Several banks created revolving fund accounts from which they would provide interest-free or low interest loans. Essentially, families received a cash advance, known as a "bridge loan," to purchase educational materials or services, with an agreement that the loans would be paid back upon receiving a tax credit from the state (O'Conner, 1998; Hotakainen, 1998). In 2003, the state created the Assignment Loan Program, where families were permitted to file a tax form that redirected a portion of their return and deposited their loan repayment directly with a lender. This state-sanctioned program was both an attempt to encourage lenders to create more bridge loan programs and to add a level of assurance that loans would be repaid, as well as protect taxpayers from potential fraud. Yet, during its first three years of operation from 2003-2005, less than 90 taxpayers state-wide filed for the assignment loan program (Minnesota Department of Revenue, 2006).

The above scenario illustrates the importance of disseminating information about tax credit programs to low-income families. Without information, eligible taxpayers may not file for benefits. In an earlier study of the Minnesota deduction program, Darling-Hammond et al. (1984) found that "knowledge and use of the deduction are strongly related to parents' income," where "low-income and minority households are significantly less likely to use the tax deduction (p. 84)." At the federal level, unequal utilization rates for the Earned Income Tax Credit (EITC)—a refundable tax credit program that assists low-income working families—are also pertinent and may predict how low-income families will react to state-level education tax credit programs. An estimated 20-25% of low-income taxpayers eligible for the EITC do not file (Scholz, 1994; GAO, 2001). Utilization rates of programs that are aimed at low-income families will depend greatly on the amount and quality of information that is disseminated.

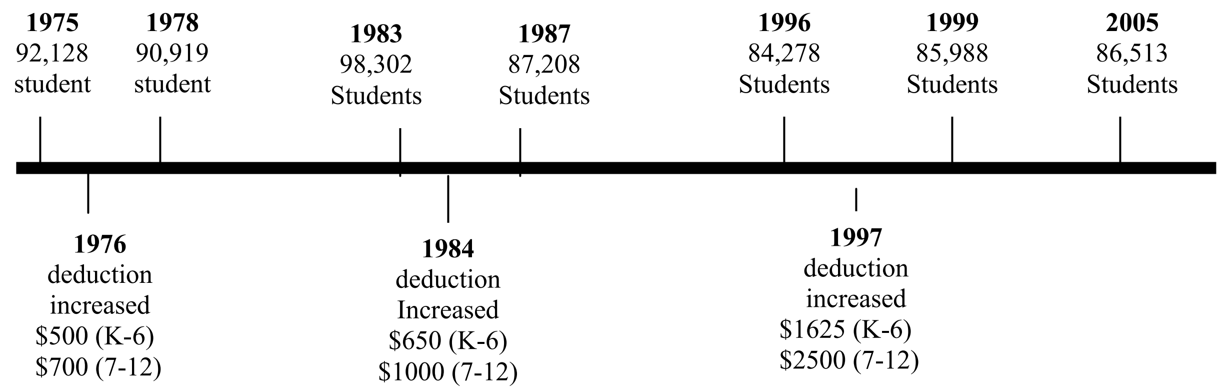
The available evidence concludes that tax deduction programs disproportionately benefit wealthier families, while tax credit programs that target low-income families may address inequality, but at an added cost to the state. Further, without well-crafted outreach strategies, a significant number of eligible families may fail to claim tax credits.

Do tax credits encourage families to shift their children to private schools?

Predicting how families will react to tax deductions or credits is difficult. Darling-Hammond, et al. (1985) reported that "the tuition tax deduction, by itself, appears to have little or no effect on parental choice (p. 84).” Instead, parents and private school administrators reported that direct aid to private schools was valued more than direct aid to parents (Darling-Hammond et al., 1985). Minnesota provides subsidies to both private schools and families for a number of school-related activities. Examples include: student transportation, textbooks, instructional aides, health services, education for LEP children, guidance and counseling services, and subsidized lunch programs. These subsidies directly and indirectly influence parent decision-making. For example, 22% of parents indicated that without the state transportation subsidy they would not have chosen a private school. In contrast, when parents were asked about the benefits of the tuition tax subsidy, “98% of those who had ever claimed the deduction said they would still have sent their children to private schools (Darling-Hammond et al., 1985, p. 84).” Private school administrators also indicated that without state funds they would be forced to raise school tuition.

A closer look at how private school enrollments respond to the creation or expansion of tax subsidies supports the above conclusions. The Minnesota tuition tax deduction, originally enacted in 1956, was increased in 1976, 1984, and 1997. In 1976, the Minnesota legislature also passed the Minnesota School Aid Bill, which provided many of the additional private school subsidies discussed above. No substantial changes were observed in private school enrollments in the years prior to and immediately following changes to Minnesota’s tax deduction program (see Figure 1). A comparison of enrollment figures from 1975 to 1978 indicates a 1% *drop* in enrollment after the deduction amount was increased by $300 (Minnesota Department of Education, 2005). A review of enrollment figures following the deduction increase in 1984 (from 1983 to 1987) indicates a subsequent 2% drop in enrollment. In 1997, after the deduction amount was nearly tripled, private school enrollment only increased by an additional 1,710 students (less than 3% of the total non-public school enrollment).

Figure 1: Effects of Minnesota Deduction Program on Nonpublic School Enrollment



Source: Minnesota Department of Revenue (2006) and Minnesota Department of Education (2005)

Private school enrollments in Iowa suggest a similar pattern. A tuition tax credit and deduction program was introduced in 1987. Between 1985 and 1988, private school enrollment decreased by 5% (Iowa Department of Education, 1998). In 1996, Iowa eliminated the earlier deduction plan and increased the credit from $50 to $100. Around this time, private school enrollment decreased by another 2% statewide. In Arizona, Wilson (2002) reports that the average tuition grant from school tuition organizations during the first three years of the program (1998-2000) amounted to $806, and that approximately 76 percent of the grants were distributed to students currently enrolled in private schools.[18] Wilson(2002) contends that the tuition grants are insufficient to encourage families with children in public schools to transfer their children to private schools.[19] Thus, even with a potentially larger net benefit to families under the Arizona tax credit program (as compared to Minnesota and Iowa) there is no significant migration of students from public to private schools.

In sum, current tax credit programs do not appear to have led to an increase in private

[18] The exact number of scholarship grants distributed to students who have transferred from public schools is impossible to calculate because the state does not require STOs to collect or report such information (Wilson, 2002).
[19] The Arizona Department of Revenue reported a state-wide average tuition grant of $1.370 for the fiscal year 2005 (Arizona Department of Revenue, 2006).

school enrollments. Their main function appears to be to provide tax relief to parents who have already enrolled, or intend to enroll their child in a private school; these families are disproportionately middle-class and affluent taxpayers. However, it is likely that the primary reason for this outcome is that tax credit and deduction benefits remain modest. Even the Minnesota tax deduction, which offers the largest direct benefit of any existing state tax credit program, a family in the highest income bracket with the highest marginal tax rate would realize a benefit of less than $200 per qualifying dependent child.[20] Yet it is not known whether larger tax credits may prompt more families to switch to private education. In the next section we discuss projected responses to larger tuition subsidies and discuss supply-side response and scale issues.

Do tax credits encourage tuition hikes or increase the supply of private schools?

Evidence describing the effects of tax subsidies on the elasticity of tuition prices is limited. Data is scarce and current programs do not appear to offer tax credits large enough to stimulate responses from private schools. However, several researchers have estimated the effects of proposed tuition credit programs that would alter the affordability of private schools. (Jacobs, 1980; Augenblick & McGuire, 1982; Longanecker, 1982; Gemello & Osman, 1982; Catteral & Levin, 1982). These studies conclude that substantial tax credits would increase demand for private schooling, and that schools would respond by raising tuition. Even if only a few additional families enter private schools, higher tuitions ensure that schools capture state tax benefits for currently enrolled children and families. For example, in a review of the implementation implications of various national tax credit proposals prior to and during the

[20] A family who claims a $2500 deduction for education expenses (maximum allowed for student in grades 7-12) with an income over $112,910 (filing a married joint return) will yield a benefit of $196.25 at the given marginal tax rate of 7.85%.

Reagan Administration, Augenblick and McGuire (1982) explain how “the larger the tax credit, the larger would be the price-response of private schools, since the schools would be able to raise tuitions without adversely affecting the net tuition cost to parents” (p. 15). Similarly, in a review of the assumptions of the same proposals, Longanecker (1982) concluded that “under a generous tuition tax credit plan, schools would remain a principal beneficiary because they could charge appreciably higher tuitions without increasing the net price to families with children in their schools (p. 128)” And finally, Catteral and Levin (1982), in a review of the important report titled “Public and Private Schools” by James Coleman and colleagues (Coleman, Hoffer and Kilgore, 1981), which proposed a tuition tax credit as a mechanism for improving equity and access to quality schooling for low income and minority students, concluded that “private schools may raise their tuition fees as a result of a tax credit, and thereby dampen the potential expansion effect of such a policy (p.147).”

The conclusions of the studies above relied mostly on the assumptions linked to tax credit proposals that were introduced in the late 1970s and early 1980s, with benefits that were significantly higher than those offered by any current programs (in proportion to the national average tuition costs). The Packwood-Moynihan Bill was the most prominent proposal of the era and was first introduced in 1978. The failed initiative was reintroduced in 1981, and was again defeated in 1983.[21] This progressive proposal would have provided families with a federal tax credit worth up to 50% of first $500 in tuition expenses, with subsequent year increases up to 50% of $1,000 in tuition expenses. The benefit was refundable for low-income families with tax liabilities lower than the credit amount. It is important to point out that the generous benefit of

[21] The idea, however, would remain alive during the early years of the Reagan administration. In 1983, President Reagan introduced the 14th and final proposal of the era, which would also fail (between 1967 and 1983 fourteen proposals had failed to pass in Congress) (West, 1985). The proposals from the Reagan Administration were modeled closely after the Packwood-Moynihan bills.

the proposed bills would have initially provided an amount equal to one-fourth of the national average private school tuition cost ($981 in 1983, see West, 1985) and eventually would have raised the benefit to an amount equal to one half of the national average. In comparison, the Minnesota education program which yields a maximum benefit of around $200 amounts to only 5% of the national average private school tuition cost.[22]

More recent research has analyzed the effects of federal tax credits for higher education. Long (2004) concludes that college tuition for low cost colleges may increase as a result of the Hope Scholarship and Lifelong Learning Credits introduced by the Clinton Administration in 1997. Long (2004) found that public two-year colleges raised tuition prices in response to tax credit incentives. She explains that "colleges that cost between $1,000 and $2,000 and had many credit-eligible students did experience 18% faster growth in tuition prices relative to schools with fewer potential recipients or a more expensive price (Long, 2004, p.43)." Long (2004) also found that states lowered their funding appropriations in response to the lower marginal cost of tuition faced by students. And lastly, Long (2004) concluded that the federal higher education tax credits "do not appear to have encouraged additional postsecondary enrollment" (p.47). These findings illustrate the potential effects of tuition tax credit programs in K-12 education and reinforce previous research findings which share similar conclusions about the elasticity of tuition prices under tax credit programs.

Another relevant issue is whether private schools have the capacity to respond to increased demand if tax credits are scaled-up (the supply-side response) and whether a pent-up demand for private school options exists from parents (the demand–side response). A report published by a consortium of pro-school choice parent organizations in Minnesota revealed that

[22] The national average private school tuition for 1999-2000 was $4,689 (see Table 61, Digest of Education Statistics 2002, National Center for Education Statistics).

in 1996, private schools were enrolled at 83% capacity, with an estimated 10,180 vacant spaces available (Minnesota Independent School Forum, 1996). Yet, enrollment changes from 1996 to 2005 indicate an increase of only 2,235 students (a total demand-side increase of less than 3% even after the deduction benefit was tripled in 1997). A more recent survey of nonpublic schools conducted by the Minnesota Catholic Conference indicates that in 2005 there were an estimated 6,000 vacant seats in the state's private schools (Minnesota Catholic Conference, 2005). Thus, it is safe to conclude that the Minnesota Education Tax Deduction has not increased the demand for private schooling in Minnesota, nor has it prompted a substantial increase in private school capacity.

This raises the question of how large a benefit is needed to elicit a response from both private schools and the parents who may want to enroll their children in these schools. While the Catholic Conference has been very active in lobbying for tuition subsidies, it is also realistic in acknowledging that a much larger benefit is needed to entice families to exit public schools. Peter Noll, the Education Director for the Minnesota Catholic Conference explains that a "$4,600 tax benefit or voucher (an amount equivalent to the state's current public school basic aid grant) would be satisfactory but not optimal" in prompting a migration of families from public to private schools (Noll, personal communication May 18, 2006). Catholic schools could only begin to increase the supply of available seats through capital expansion if subsidy amounts were in the range of $12,000 to $14,000. However, Noll also states that "the limitations for expansion are sometimes independent of fiscal issues and more dependent on self-imposed policies of growth that respect school missions (Noll, personal communication May 18, 2006)." In other words, a school's quality is heavily influenced by its size. Private schools may not want to scale-up even if an adequate subsidy amount were provided by the state.

Conclusion

The experiences of the six states that operate tax credit programs vary, yet they all suggest a shift in attention away from vouchers and toward other forms of privatization. As we discussed, tax credits and vouchers may be distinguished by the legal, political, and policy implications they raise. Policymakers may find tax credit programs easier to authorize and implement, leading to their proliferation across states and at the national level. However, some of the distinctions that have made tax credit options more viable may become less important with time. For example, tax credits have a strong political advantage over vouchers because they are not yet closely linked to the polemics that set market-based reforms at odds with democratic visions of public schooling. This distinction is fueled by the public's perception that tax credits are tax policy and not education policy, and that education budgets are not competing with the revenues that support tax credit programs. Thus, the flow of public money to private schools may be seen as less threatening to the material interests of those who support public schooling, consistent with the rights of families to control private resources, and neutral with respect to church-state entanglement issues. Legal decisions in Illinois and Arizona reinforce this perception in their declaration that tax credit benefits are not "public money" because the money does not enter the state's control, nor are the private decisions made by parents in how they spend their money influenced by the state (see *Killian v. Kotterman*, 1999 and *Griffith v. Bower*, 2001).

However, over time the costs of tax credit programs will invariably stretch budgets for education and other public services and public awareness will increase. Perhaps most threatening are universal tax credit and deduction programs that disproportionately benefit wealthy taxpayers, most of whom already send their children to private schools. An educated public may object to this outcome. Further, tax credit proponents will be challenged to justify claims that tax credits are expending educational opportunities to all children. Two solutions have been offered to better target low-income students, but both present new problems. First, Minnesota's tax credit program limits participation to families with incomes that do not exceed $37,500 and tuition expenses are restricted. Unfortunately, as discussed above, participation in this program is limited. Low-income families struggle to pay for services in advance and then wait to be reimbursed. Second, general tax credit programs allow taxpayers to make donations to STOs. Scholarships are then distributed to low-income families. However, the structure of these programs most closely resembles vouchers in the public mind. If general tax credit programs expand, they may encourage widespread participation, placing even greater demands on state budgets. Ultimately, concerns over equity, cost, and the public good make it likely that tax credits will be opposed on the same grounds as vouchers and be forced to defend the promises of market-based reforms.

The inertia that has propelled the creation and expansion of tax credit programs over the last decade has set tax credit programs apart as viable legal, political and policy alternatives to voucher programs. Undoubtedly, tax credits have some advantages over vouchers. But, the current popularity of tax credit programs is also due to limited knowledge among the public and policymakers as to program outcomes. The longevity of current reforms will be determined by their ability to reconcile the promises of market-based reform with traditional democratic visions of schooling.

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