Under scholarship tax credit programs as created by LB 295, public tax dollars are used to provide a tax benefit to those who make donations to private school scholarship-granting organizations (SGOs), which in turn, provide scholarships to students in private K-12 schools. LB 295 creates much greater tax benefits for donations to SGOs, as compared to all other nonprofits. Furthermore, scholarship tax credits can make it possible for some wealthy donors to profit by way of the tax code.

Scholarship tax credits much more lucrative than other types of donations

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

A tale of two charitable donations – tax credits and tax deductions

If a married couple filing jointly makes a $10,000 donation to a SGO under LB 295, they can reduce their state taxes owed by $10,000. Or, if they owe less than $10,000 in state taxes, they can reduce their state tax liability to $0.

If the same couple makes a donation to a non-profit private or public school foundation, on the other hand, they can reduce their taxable income by the amount of their donation. The potential value of their tax benefit will be the amount of their donation ($10,000) multiplied by their tax rate in the bracket in which that income would have fallen. If that income falls in the state's top income tax bracket of 6.84 percent, the tax savings would be $684.

Scholarship tax credits can allow wealthy donors to profit from tax code

When the impact of the state tax credit proposed in the Legislature is combined with federal tax deductions, some Nebraska taxpayers will be able to actually profit from making such donations. This scenario already occurs in nine states and in some, like South Carolina and Georgia, various scholarship organizations advertise these credits as money-making opportunities.[2] For example, a K-12 private school in Georgia on its website writes that donors can "'profit' up to 29 percent on the amount donated."[3]

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[1] A non-refundable tax credit will provide a dollar-for-dollar tax credit, as long as the amount of the tax credit is less than their total tax liability. If the amount of the tax credit exceeds their tax liability, the credit will reduce their tax liability to $0.
[2] AASA and the Institute on Taxation and Economic Policy, "Public Loss, Private Gain," downloaded from http://www.aasa.org/vouchertaxshelter/, on Aug. 7, 2017.
[3] The Wood Acres School, "GA Private School Tax Credit Information," downloaded from https://woodacresschool.org/ga-private-school-tax-credit-information/ on Feb. 1, 2018.

How LB 295 would let donors turn profits

Profits under LB 295 can occur when taxpayers' state and local taxes exceed the $10,000 federal deduction for state and local taxes (SALT) and when they have at least $10,000 in state tax liability. For example, if the hypothetical married couple above has $20,000 in state tax liability, they can make a $10,000 donation to a scholarship-granting organization and offset their state tax liability by the full amount of the donation. This is a $10,000 value in tax benefits for their $10,000 donation. Then, at the federal level, they can claim their Scholarship Tax Credit gift as a $10,000 charitable donation[4] on their federal tax returns, which if claimed at the top federal tax rate of 37 percent, would provide the couple with a $3,700 tax deduction. That means this couple would experience a combined state and federal tax savings of $13,700 from their $10,000 donation.

New credit would divert public dollars that can be used to support and improve public education

Creating a scholarship tax credit now would come at a time when our state's school funding needs are increasing and when state funding of K-12 education has been constrained due to budget shortfalls.[5] This low level of state support leads to a heavy reliance on property taxes to fund schools. Diverting more state resources for scholarship tax credits will make it harder to address state public education needs and increasingly shift the cost of funding K-12 onto property taxpayers.

Tax credit scholarships are not targeted to low-income students

Because the eligibility is not targeted to the lowest-income students, the scholarship tax credits could potentially subsidize the private education of students who would have attended private schools anyway. Under LB 295, students at 370 percent of the federal poverty level (FPL) would be eligible to qualify for scholarships offered under the programs. This means that in 2016, a family of four could have made up to $89,725 – putting them in the top 40 percent of Nebraska earners -- and still qualified for the scholarships. For context, 370 percent of the FPL is double the eligibility level for free and reduced meals, which is the standard that our public school system considers low-income. This eligibility expansion beyond the traditional definition of low-income students also is consistent with tax credit programs in some other states. For example, a study of a scholarship tax credit in Arizona found about 76 percent of the scholarships went to students who already had the means to attend private school.[6]

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[4] Without a commensurate reduction in their SALT federal tax deduction because they have already hit the SALT cap.
[5] LB 409 (2017) made changes to the TEEOSA formula to reduce school funding by $123 million in FY 18-19.
[6] Glen Wilson, "The Equity Impact of Arizona's Education Tax Credit Program: A Review of the First Three Years," downloaded from http://epsl.asu.edu/epru/documents/EPRU%202002-110/epru-0203-110.htm, on Aug. 7, 2017.

Scholarship tax credits not likely to create savings for the state

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

Conclusion

Scholarship tax credits like the one proposed in LB 295 stand to divert state revenue at a time when we are experiencing revenue struggles. Enacting this measure could force lawmakers to make cuts to vital services such as public K-12 education or shift more of the load of funding our schools on to property taxpayers. In light of these factors, we have serious concerns about creating a new tax credit that would reduce state revenue and allow wealthy Nebraskans to turn profits by way of the tax code.