Fiscal Policy Institute

Tax Breaks for Wealthy Contributors to Private or Public Schools?

A Bad Idea Last Year—A Bad Idea This Year

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What if I told you I had a plan to allow the wealthy and large corporations to divert their own tax dollars to the private and parochial school scholarship programs of their choice? What if I then told you I was going to use half that money to fund scholarships for kids in families with incomes of $300,000-$550,000? You probably wouldn't think that was a very good plan, right? Welcome to the Parental Choice in Education Act, again.

The governor has again advanced a deeply problematic education tax credit (Parental Choice in Education Act—PCEA), a controversial proposal that was hotly debated and then defeated last session. The core component of this year's proposal is a 75 percent personal or corporate income tax credit for donations made to a private or public school. As in previous years, the proposal has the extraordinary feature of a credit of up to $1 million, meaning that it is clearly geared to the very rich. The education tax credit proposal allows, among other things, for public funding of private schools—it effectively allows private donors to force a three-to-one match of public funds to whatever school they choose.

The governor would allow $20 million in credits for public schools and $50 million in credits for private schools. Taxpayers must file applications to receive the credits, which effectively means they are allocated on a first come-first served basis because there are annual credit limits.

The governor's proposal adds two new features this year: a $200 refundable tax credit for teachers making out-of-pocket purchases of classroom supplies, and a refundable $500 credit per dependent for qualified private elementary or secondary school tuition geared to households with adjusted gross income of $60,000 or less. The governor's education tax credit proposal would reduce tax revenues by $150 million annually, beginning in FY 2019. In adequately funded schools, teachers should not have to reach into their own pockets to get school supplies. And, even if they do have to, a tax credit is not the ideal way to reimburse them, since it asks them to lay out the money ahead of time and get paid back in April. While less than ideal, however, this credit is not as objectionable as the back-door voucher.

Eager senate supporters of an even more generous education tax credit proposal, approved that legislation on January 11, 2016. The senate measure provides a 90 percent tax credit with a $1 million individual limit, and includes charter schools as eligible donation recipients. The senate bill would reduce taxes by an annual average of $225 million over the next three years.

Both the governor's proposal and the senate's represent misguided tax policy for a number of reasons:

- The PCEA represents a radical and unwise departure from existing state tax policy because it provides an unprecedented proportion (75 or 90 percent) of tax reduction relative to a contribution. It has the potential to lessen charitable contributions for a wide range of worthy causes.

- Because of how the allocation of credits is administered and the fact that the education tax credit skirts limits on charitable contributions for high-income taxpayers, there is nothing to prevent a situation where all or the lion's share of credits go to a relative handful of wealthy donors, corporations, or financial partnerships.

- The state is essentially delegating its spending authority to private individuals, departing from the well-established and constitutionally sound basis for allocating state education aid and potentially in violation of section 7 of Article 7 of the state constitution that requires all appropriations to be "distinctly specified."

Does This Really Help Poor Children?

The PCEA is purported to provide scholarships to poor children throughout New York State, although a review of the bill language tells a different story. The governor's proposal allows for half of the "scholarships" to go to children whose families make up to $300,000 and the senate version has a much higher household limit of $550,000. Given these high-income thresholds, these proposals are clearly not geared toward poor families.

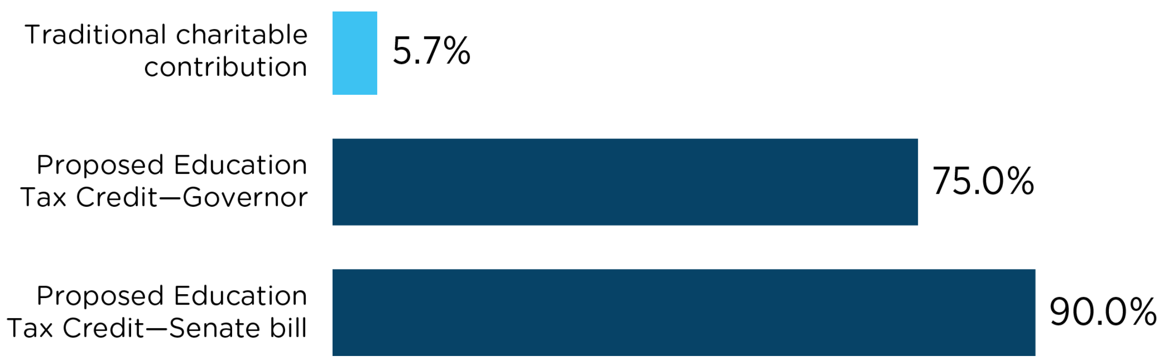
Most existing personal income tax credits in New York available to households are geared to low–income households, or have fairly low maximum credit amounts or income eligibility limits. For example:

- Earned Income Tax Credit: maximum income eligibility of $53,267 for 2015
- Household Credit: no credit for incomes over $32,000
- New York Child and Dependent Care Credit: NY's credit is determined as a percent of the federal credit and declines sharply for incomes over $50,000
- Empire State Child Credit: phases out beginning at $110,000

Unintended Consequences

Charitable contributions made by households are eligible for a deduction on state personal income tax returns. The effective value of the tax benefit for such deductions is a taxpayer's tax rate times the amount of the expense or contribution. Thus, at most, the effective "tax credit rate" for deductions is 8.82 percent, the state's top income tax rate. The state average effective income tax rate in 2011 was 5.7 percent—that is the benefit New Yorkers get on average for a charitable contribution.

The Benefit of the Proposed Education Tax Credit is Extremely Large Compared to the Average Tax Credit on Charitable Deductions.
TAX BENEFIT AS A SHARE OF CONTRIBUTION



Moreover, the state has acted in recent years to limit the itemized deductions and charitable contributions for high-income taxpayers. New York reduces the amount of itemized deductions by 25 percent for married couples filing jointly with incomes in excess of $200,000, and by 50 percent for such filers with adjusted gross incomes over $525,000. Beginning in 2013, for those with New York adjusted gross incomes over $10 million, the state limits the itemized deduction to 25 percent of the federal itemized deduction for charitable contributions, and all other federal itemized deductions are reduced to zero.

This unprecedented 75 percent tax reduction relative to a contribution has the potential to lessen charitable contributions for a range of worthy causes. If an individual or company can significantly reduce their tax liability by giving to a scholarship fund, they may be significantly more likely to do so instead of making a charitable contribution to a cause they have given to in the past.

Since the proposed ETC takes the form of a "tax credit" rather than a charitable deduction, it entirely skirts recently enacted state tax policy that limits the tax benefit available to high-income households for itemized deductions, including charitable deductions.

Consider this example for a married couple with $10 million in adjusted gross income making a $1 million charitable contribution. The state tax reduction would be:

$22,050 under ***existing state tax law***.

($1M contribution X 8.82% top NYS tax rate X 25% charitable limit)

VS

$750,000 under ***the PCEA***, 34 times the amount the state would otherwise permit for non-ETC charitable contributions.

($1M contribution X 75% Education Tax Credit)

Diverts Funding From Well-Established, Constitutionally-Required Education Funding Needs

While the governor's proposed legislation goes to some length in specifying the educational entities and purposes that can qualify for the credit, that does not alter the fact that the ultimate result could be to direct state revenues to purposes at odds with the general thrust of state education funding as required by the state constitution. Because New York State still heavily relies on local property taxes (outside of New York City) to support public schools, there are wide and alarming disparities in spending per pupil between property-rich downstate suburbs and many low-wealth school districts across the state.

In partial response to these disparities and in response to the Court of Appeals decision in the Campaign for Fiscal Equity case, the state adopted a school aid distribution formula in 2007 that gave extra weight to public school districts with high proportions of low-income and high-needs pupils and more to low-wealth districts based on relative incomes and full property valuations. It has been a long-standing state policy goal to provide school aid based on this formula, although the amount of aid provided in recent years has fallen short of the commitment made in 2007. The tax credit proposal completely disregards that policy priority, and it would divert funds that should be applied to the funding shortfall.

Furthermore, the state is essentially delegating its spending authority to private individuals, departing from the well-established and constitutionally sound basis for allocating state education aid and potentially in violation of section 7 of Article 7 of the state constitution that requires all appropriations to be "distinctly specified."

The Pennsylvania Experience with the Educational Improvement Tax Credit

The Educational Improvement Tax Credit (EITC) provides tax subsidies to companies that contribute to non-profit organizations offering scholarships to students who attend private and religious schools or early childhood programs, or to organizations providing educational improvement activities. Since its inception in 2001, the EITC has cost $586 million in taxpayer subsidies. The Pennsylvania EITC has a maximum credit of $300,000 and is only available to corporations.

According to a report by the Pennsylvania Budget and Policy Center, individual taxpayers are footing the bill for $9 out of every $10 of corporate contributions for private and parochial school scholarships made through Pennsylvania's Educational Improvement Tax Credit. The EITC allows businesses to recover 75 percent to 90 percent of the cost of contributing to an EITC-qualified organization. Companies can also take state and federal tax deductions for a "charitable" contribution, amounting to a "triple dip" tax reduction.

Altogether, a company making a $300,000 annual EITC contribution over two years will pay only $20 a year in out-of-pocket costs. For a company that contributes to a prekindergarten scholarship (which yields an even more generous credit), the tax benefit can be more than the total value of the "contribution." The result is a minimal cost to companies, a substantial cost to taxpayers, and a further reduction in funding to support the quality public schools that Pennsylvania needs to build its economy.

Don't take our word that this EITC is a minimal cost to companies, making it costly to Pennsylvania taxpayers: "One of the major advantages of the EITC is that for Pennsylvania corporations, the taxpayer receives the benefit of both the credit AND the charitable contribution deduction, making the true out of pocket costs minimal in many circumstances," concluded Eisner Amper Accountants & Advisors, State and Local Tax Advisory, June 2009.

A Better Approach to Helping Economically Disadvantaged Students

The PCEA amounts to a $150 million or more diversion of taxpayer resources to privately determined educational uses. It would provide an unprecedented 75 percent tax reduction relative to a contribution and has the potential to lessen charitable contributions for a range of worthy causes. There is no provision to avert a situation where wealthy donors, corporations, and financial partnerships would claim all or a lion's share of the credits. These funds would be better invested in expanding the governor's positive proposal to increase the number of community schools, a proven way to give real opportunities to students in struggling schools.

A primary cause of poor school performance is high levels of child poverty. Students who grow up poor do less well in school than those from more advantaged households, a considerable body of research shows. New York is no exception.

In our priority/struggling schools, three times as many children live in families below the poverty line than those in non-priority districts. Over three-fourths of the students in priority schools are eligible for the federal free or reduced price lunch program, another important indicator of economic hardship. More than nine out of 10 are students of color (compared to 52 percent in non-priority schools) and, for a higher proportion than is average for New York, English is not their primary language.

The Education Tax Credit proposal allows, among other things, for public funding of private schools—it effectively allows private donors to force a three-to-one match of public funds to whatever school they choose. And, while select public schools would also benefit from the credit, additional public funding of public schools should be allocated through a direct increase in school aid. Putting the $150 million allocated for this tax credit into community schools would be a much more effective way to direct these educational resources to economically disadvantaged students.

The Fiscal Policy Institute (www.fiscalpolicy.org) is an independent, nonpartisan, nonprofit research and education organization committed to improving public policies and private practices to better the economic and social conditions of all New Yorkers. Founded in 1991, FPI works to create a strong economy in which prosperity is broadly shared.