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ABSTRACT

Approaches for using the federal income tax system to aid families of pupils attending private schools include: tax credits, tax deductions, tax deferrals, and education savings incentives. Tax credit structures can be made refundable and made sensitive to taxpayers' income levels, the level of education expenditures, and designated costs. Proponents claim tax credits would provide some choice to families in the selection of schools and, because of competition, improve the quality and efficiency of public schools. Opponents claim tax credits would help wealthy families more than low income families; could result in segregated private schools; and could cause public school systems to lose families with a high interest in education and gain a higher proportion of children with special needs. Policy decisions concerning tax credits include questions of cost, responses expected from families and institutions, distribution among families, and their constitutionality. (MLF)

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19. Tuition Tax Credits

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19. Tuition Tax Credits

The Issue

Federal policy makers have long sought ways to help families meet the costs of sending their children to private education institutions. For the past decade, federal financial aid has supported students attending public and private postsecondary institutions. Over the past 30 years, various approaches using the federal income tax system have been discussed to aid families of pupils attending private elementary/secondary schools. The Reagan Administration has proposed that a tax credit be given to taxpayers with children enrolled in private schools. Whether to provide tax credits and how to structure a tax credit if it is to be provided are sensitive policy questions that education policy makers are facing.

Alternative Tax System Approaches

A tax credit is one of several approaches that could be used if the federal income tax system were to be made sensitive to the expenses incurred by taxpayers in sending their children to private schools.

o Tax credits provide direct reductions in income taxes for a specified portion of eligible education expenses.

- A second approach is the tax deduction. A tax deduction is any reduction in taxable income made prior to the calculation of tax liability. A tax deduction would only be available to those taxpayers who itemized their deductions. For such taxpayers, an eligible deduction could be a portion of the tuition or related education expenses incurred by family members.

- A third approach is the tax deferral. Under this approach, eligible education expenses are deductible in the year they are incurred, although they will be taxed at some time in the future. This approach minimizes the long-term loss of revenue to the government while providing parents benefits, in the form of reduced taxes, when they most need them.

- A fourth approach is education savings incentives. Using this approach, taxpayers can shelter specified amounts from taxation until the accrued amount is spent.

Alternative Tax Credit Structures

There are numerous ways to design a tax credit so that it is targeted for specific types of taxpayers, education expenses or schools. Different structures have a large impact on the total cost of a tax credit program and on the distribution of its benefits.

- Tax credits can be made sensitive to the income levels of taxpayers. Using a maximum income cutoff, it is possible to deny tax credits to taxpayers with incomes above a specified level. Sliding scales can be used so that the value of the credit decreases as the income of a taxpayer increases.

- Tax credits can be provided to families with no income tax liability by making them refundable. Without refundability, a family that owes no taxes would not receive a tax credit. With refundability, a taxpayer with an income tax liability lower than the value of the credit would pay no tax and would receive a check for the difference between the specified tax credit and the amount of calculated income tax.

- Tax credits can be made sensitive to the level of education expenditures. Typically, tax credit plans specify maximum credit levels and, regardless of a family's expenditures, the credit cannot exceed the limit. It is not unusual for a tax credit to be limited to a proportion of education expenditures. This is accomplished by specifying a fixed proportion of education expenditures as the credit limit. It is also possible to vary the tax credit depending on the level of expenditures. Under such an approach, the tax credit could be limited to, for instance, 50 percent of the first $500 of expenditures and 25 percent of the next $1,000 of expenditures, with a maximum credit of $500.

- Tax credits can be provided only for designated education costs, such as tuition, or for other costs including room, board, materials or transportation.
- Tax credits can be limited to expenditures incurred at specified types of institutions, such as nonprofit institutions that do not have discriminatory admissions procedures. Credits could be made available to offset costs of proprietary schools, preschools, or institutions offering special services, such as tutoring or test preparation.

The Pros and Cons of Tax Credits

Proponents of tax credits support them for a number of reasons.

- Tax credits would reduce the cost of enrolling children in private schools, thereby providing some choice to families in the selection of a school. Currently, it is argued, only relatively wealthy families can choose to send their children to private schools charging tuition. Tax credits would permit low income families to make a similar choice.
- Indirectly, the provision of tax credits would improve the quality of the public school system by making it become competitive for pupils.
- Tax credits would improve the efficiency of the entire education system. They would eliminate what some refer to as "double taxation" of taxpayers whose children attend private schools. Tax credits would promote competition among schools that would result, it is claimed, in increased quality at competitive prices.

Opponents of tax credits feel that the possible negative implications of providing them outweigh the positive effects they might have.

- Tax credits, unless carefully designed, would help wealthy families more than low income families.

- The promotion of unregulated choice could result in segregated private schools, reducing the pluralism of the education system.

- The public schools would likely end up serving a larger proportion of children with special needs who might not be served by private schools.

- The public school system would be threatened by a loss of those families with the highest level of interest in education.

Evaluating Tax Credit Proposals

It is difficult to evaluate a tax credit proposal because little is known about the likely behavior of families in response to their availability. The following policy questions are useful ones to ask in examining any proposal to use the federal tax system to provide aid for education expenditures.

- How much will the proposal cost? It is difficult to estimate the total cost of tax credits except for those families with children currently enrolled in private schools. Tax credits would provide between $1 billion and $4 billion as a windfall for such families. This loss in revenue would have to be made up by either increasing federal revenues or by reducing federal expenditures, probably in other programs that support education.

- How would families and education institutions respond to tax credits? Unless the level of the credit is high relative to the average cost of attending a private school, it is unlikely to stimulate much movement of children out of public schools and into private schools. Assuming a relatively small credit (less than $500), it is possible that private schools will raise their tuitions to obtain at least a portion of the value of the credit.

- What would be the distribution of tax credits among families? Given current private school enrollment patterns, minority and low income families would receive a small proportion of all benefits. Families of pupils attending private schools would, on average, receive more federal support through tax credits than families of pupils attending public schools receive as a result of current federal education aid programs. Regionally, more benefits would flow to families in New England states and Great Lakes states than in other parts of the country.

- <u>Are tax credits constitutional?</u> This subject has been debated but a test is required to answer the question definitively. In Minnesota, the only state that provides tax deductions, the use of the tax system to support the education expenditures of families has been upheld as constitutional by the Minnesota Supreme Court. This issue is now before the U.S. Supreme Court.

The Administration's Tax Credit Proposal

In June 1982, Senator Dole, on behalf of President Reagan, introduced S. 2673, the Educational Opportunity and Equity Act of 1982, for consideration by the U.S. Congress. This proposal would provide a tax credit to families with children enrolled full-time in private elementary/secondary schools offering education in grades 1 through 12. Over a three-year phase-in period, the maximum value of the credit would increase from $100 to $500, with a limitation that the value of the credit could not exceed 50 percent of tuition. Tax credits would not be available to families with incomes in excess of $75,000. For families with incomes between $50,000 and $75,000, the maximum value of the credit would decrease from the maximum level to zero as income increased. The credit would not be refundable. In September 1982, this proposal was modified by the Senate Finance Committee, which reduced the maximum value of the credit to $300, limited the availability of the credit to families with incomes of less than $40,000, and made the credit refundable. This proposal never reached the floor for action. However, it is anticipated that similar legislation will be introduced in the 98th congress.

What to Read

American Enterprise Institute for Public Policy Research. "Tuition Tax Credits and Alternatives," Washington, D.C.: 1978.

Augenblick, John and C. Kent McGuire. <u>Tuition Tax Credits: Their Impact on the States</u>. Denver, Colo.: Education Commission of the States, October 1982. $4.00

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Institute for Research on Education Finance and Governance (IFG). "Choice in Education: Are Tuition Tax Credits the Answer?" IFG Policy Notes, vol. 3, no. 1, Winter 1982.

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