



Education Tax Credits in North Carolina

Innovation *in* Education

A POLICY REPORT BY THE NORTH CAROLINA EDUCATION ALLIANCE



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As one of the oldest forms of school choice in the United States, education tax credits empower low- and middle-income parents to choose schools that best meet their children's needs. Cost-effective, constitutional, and consistent with federal and state tax policy, tax credits enjoy bipartisan support among education reformers and parents; in fact, the number of states with education tax credits has tripled over the past ten years. Tax credits create a vibrant education marketplace by making private schooling affordable for low- and middle-income families seeking a fresh start for their children.

Executive Summary



For North Carolina, education tax credits provide a solution to the problem of low achievement and limited school options. More than two-thirds of the state's fourth graders are not reading at grade level, according to federal government statistics.¹ Among fourth graders from low-income families, a mere 16 percent are proficient in reading. Over half score below the "basic" level, meaning they can barely read at all. Even a quarter of students from middle- and upper-income families have the same difficulties with language.²

Many struggling students attend poor-performing schools – over half of North Carolina schools did not make Adequate Yearly Progress (AYP) in 2006 toward meeting state standards in math or reading.³ Some of these students, however, attended good schools but did not get what they needed to succeed. After all, even a great school is not the right fit for every student. Sometimes children need a new opportunity to succeed.

Unfortunately, changing public schools in North Carolina is difficult. There is no statewide law enabling students to transfer to other public schools, and only a few districts have instituted public school choice programs or magnet schools.⁴ Just under half of the state's counties have public charter schools.⁵ These independent, innovative public schools provide parents with a measure of school choice. Despite their popularity, however, they cannot meet the rising demand. Legislative restrictions prohibit expanding the number of schools of choice, meaning more than 5,000 children are left to languish on waiting lists.⁶

Independent, non-public schools, on the other hand, can accommodate additional students. Unlike public schools, private schools receive minimal or no government funding and must charge tuition. Although private school tuition is lower, on average, than the state per pupil cost, many low- and middle-income families struggle to pay for a good education for their children.⁷

There is a solution for North Carolina families that is fair, fiscally responsible, and constitutional. Through education tax incentives, the state can provide opportunities for even the neediest students. Two types of tax credits or deductions help students attend a school of choice:

- ✿ Family education tax deductions or credits enable parents to receive a deduction or credit against their state income taxes for a portion of their children's education expenses. Depending on state law, allowable expenses can include tuition and fees, as well as books, tutoring, and education technology, thereby providing benefits to public school and home schooling parents.
- ✿ Philanthropy education tax credits provide income tax credits for individuals or businesses that donate to scholarship organizations that, in turn, give scholarships to low-income students to attend a school of choice.

Because tax incentives have been in existence for more than 50 years, researchers have had an opportunity to study their impact. In addition to helping families afford a good education, researchers have found that credits save states millions of dollars. Because the per pupil cost to educate students in public schools is higher than available tax credits, public school systems retain the difference, enabling them to spend even more on students who remain in public schools. Tax credit programs in Pennsylvania, Arizona, and Florida have saved these states \$204 million since the programs started.⁸

Education tax credits and deductions have also been upheld as constitutional by state supreme courts and by the US Supreme Court. Decisions upholding tax credits in Arizona, Iowa, Illinois, and Minnesota have set important precedents. Opponents have not challenged credits in Florida or Pennsylvania, or new programs in Iowa and Rhode Island. Legal scholars have noted that opponents would have little ground in which to sue in North Carolina, given existing precedents and North Carolina's unique constitutional advantages.⁹

Education tax credits are also consistent with North Carolina tax law. The state currently provides families and businesses with a variety of tax credits for beneficial activities such as conservation, parenting, restoration of historical buildings, and helping the poor. The addition of an education tax credit would build upon this legacy to help school children. By empowering low- and middle-income families to do what the wealthy have always done – choose a school that best meets their children's needs – education tax incentives give all children the chance to succeed. ♦

Chapter 1:

What Are Education Tax Credits?



Tax incentives for education are one of the fastest growing and most popular reforms at the state and federal levels. Bipartisan, constitutional, and cost effective, tax credits provide students with choices in education.

At the federal level, Congress has established several tax incentives for K-12 and higher education expenses. Families may earn tax-free interest on education savings accounts for students in kindergarten through higher education, or take tax deductions and credits for college expenses.¹⁰

At the state level, tax incentives for education date back to 1955, when Minnesota lawmakers enacted the nation's first tax deduction for education expenses including tuition. Since then, six more states have adopted tax incentives for education. Iowa and Illinois enable parents to take a tax credit for a portion of the amount they spend on their children's education.¹¹ The credit is available to parents regardless of whether their children attend traditional public, public charter, private, or home schools. Together, these laws have enabled more than half a million families to defray some of the costs of educating their children.¹²

More recently, five states have adopted a different kind of tax incentive for education – one that rewards education philanthropy. Since parental tax credits are not refundable, they are unavailable to families too poor to have a tax liability. To address this issue, education reformers developed a tax credit that would help low-income families afford tuition at independent schools by incentivizing education philanthropy. Donors receive a tax credit when they contribute to organizations that offer low-income students scholarships.

Organizations that provide scholarships, called Scholarship Organizations (SOs), Scholarship Funding Organizations (SFOs), or School Tuition Organizations (STOs) depending on the state, predate tax credit laws.

Since 1992, when the first of such organizations opened in Indianapolis, SOs have helped over 100,000 low-income students afford tuition at private schools. The Children's Scholarship Fund, for example, offers scholarships to 278 low-income students in Charlotte, North Carolina.¹³ Prior to the first philanthropy education tax credit law, donors could take a deduction. The establishment of philanthropy tax credits presents a stronger incentive for businesses and individuals to donate to this vital cause.

In Arizona, the first state with a philanthropy education tax credit, individual taxpayers may take a tax credit of up to \$500 for donations to scholarship organizations.¹⁴ Since Arizona adopted its tax credit, four additional states have enacted tax credits for education philanthropy. Florida, Pennsylvania, and Rhode Island enable corporations to take a tax credit for donations to scholarship organizations.¹⁵ Iowa has adopted an individual donor tax credit.¹⁶ Arizona has subsequently adopted a corporate tax credit in addition to its personal tax credit.¹⁷

In all but one case, SOs participating in the tax credit programs must award scholarships to low-income families. Arizona's individual tax credit is the exception to this rule, since it does not require income eligibility for scholarships; however, in practice, the majority of SOs award scholarships based on need.

While each philanthropy and family tax incentive law differs in the details, all enable families to afford opportunities they might not otherwise have. According to the most recent statistics, 222,000 Minnesotans took \$15.8 million in deductions for education expenses.¹⁸ In Iowa, 171,600 families saved \$14.3 million. More than half of the credits were used by families with incomes under \$50,000.¹⁹ In Illinois, 194,923 families saved \$67.1 million in tax payments.²⁰ In states where tax policy encourages donations to scholarship organizations, scholarship aid is increasing as more families seize the opportunity to improve their



children's education. In 1998, the first year of the Arizona tax credit, 195 low-income students received scholarships.²¹ Today, over 24,000 such students have scholarships. In the 2006-2007 school year, 33,400 scholarships were awarded in Pennsylvania.²² The Florida program has grown to help more than 17,000 children attend a school of their choice.²³ Iowa's and Rhode Island's programs are too new for analysis.

Tax credits are also an increasingly popular philanthropic choice for both individuals and corporations. In the Arizona program's inaugural year, state residents made 4,248 donations worth \$1,816,799 to scholarship organizations.²⁴ Seven years later, taxpayers made 69,232 donations worth \$42,191,748.²⁵ In Pennsylvania, lawmakers have raised the maximum amount of tax credits the state can award multiple times, bringing the total from \$20 million to \$44.7 million.²⁶

Tax credits enjoy support across party lines. Laws have passed in Republican-leaning states like Arizona and Florida, in Democrat-leaning states like Rhode Island, Illinois, and Pennsylvania, and in swing states like Minnesota and Iowa. Tax credits have even become law in states where one party holds the governorship and the other controls the

legislature. In 2006, Governor Janet Napolitano of Arizona, a Democrat, signed the corporate tax credit bill passed by the Republican-controlled legislature. The Pennsylvania tax credit limit has increased under a Democratic governor and a legislature with a Republican-controlled Senate and a Democrat-controlled House of Representatives.²⁷

The 2007 legislative session brought new examples of bipartisan support for education tax incentives. In New York, the Democratic governor included a \$1,000 tax deduction per student for private school tuition in his education budget proposal.²⁸ The Democrat-controlled Louisiana legislature passed a tax deduction for tuition. Although vetoed, the Democratic sponsor intends to introduce it again in the future.²⁹

The widespread support of tax credits derives, in part, from their proven track record. Education tax incentives not only increase the range of educational choices for families, they save states millions of dollars that can be reinvested in public schools. They are consistent with federal and state tax policies and have been upheld in federal and state courts. ♦

Chapter 2:

Constitutionality of Tax Credits



The US Supreme Court and state supreme courts have upheld education tax credits. Analysis of existing court precedents and the North Carolina Constitution indicate the courts would uphold tax credits in the Tar Heel State.

In past court cases, opponents of school choice have contended that tax credits and voucher programs violate one or more of the following constitutional provisions:

- Federal Establishment Clause
- State Establishment Clause
- State Blaine Amendment
- State Compelled Support Clause
- State Uniformity Clause

School choice opponents have lost all of the recent tax credit cases and most of the voucher cases. In other words, school choice is constitutional.

SCHOOL CHOICE AND THE US CONSTITUTION

The Establishment Clause of the First Amendment to the US Constitution states, “Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof...”

In 1971, the US Supreme Court set an important precedent that established guidelines for future school choice programs. In the landmark case, *Lemon v. Kurtzman*, the Court instituted criteria for determining whether a government program establishes religion in violation of the Constitution.³⁰ At issue were two state programs providing salary supports for teachers in private schools. In striking down these programs, the Court created a three-part test – often called the Lemon Test – to determine the constitutionality of state actions. A government program “must have a secular legislative purpose... its principal or primary effect must be one that neither advances nor inhibits religion... [and] the statute must not foster ‘an excessive government entanglement with religion.’”³¹ Since then, direct funding

of private schools through programs like AmeriCorps, for example, or indirect funding through school choice, must exist within the parameters of the Lemon Test.

Subsequent court decisions have built upon this precedent. In 1983, the Court determined that Minnesota’s tax deduction for education expenses met the three-part Lemon Test in *Mueller v. Allen*.³² The Court stressed that since “aid to parochial schools is available only as a result of decisions of individual parents, no ‘imprimatur of state approval,’... can be deemed to have been conferred on any particular religion, or on religion generally.”³³

A US District Court later cited *Mueller* when upholding the Iowa tax credit in *Luthens v. Bair*. The court noted that “benefits... go to the parents of school children rather than to the schools... the nature of the aid is clearly benign in terms of Establishment Clause concerns.”³⁴ Subsequent decisions have also stressed the importance of the private choices of parents central to the argument in *Mueller v. Allen*.

SCHOOL CHOICE AND STATE CONSTITUTIONS

State constitutions also contain provisions that can impact the adoption of school choice policies. These include Establishment Clauses similar to the Establishment Clause in the US Constitution, Blaine Amendments, and Compelled Support Clauses. Compelled Support Clauses ban obligatory support of a church or religious ministry without an individual’s consent. Blaine Amendments prohibit public funds to aid “sectarian” institutions, including schools. Unlike the other two provisions, Blaine Amendments are tainted by the anti-immigrant and anti-Catholic bigotry that inspired them. The “shameful pedigree” of these provisions has been acknowledged by the US Supreme Court.³⁵ Nevertheless, they continue to be used to challenge school choice programs.

Opponents of Arizona’s and Illinois’s tax credits lost suits against these programs alleging violation of state and federal constitutional prohibitions. In 1999, the Arizona Supreme

Court upheld the state's philanthropy education tax credit in *Kotterman v. Killian*.³⁶ Opponents claimed that it violated the US Constitution and the Arizona State Constitution's Establishment Clause. In its decision, the court compared Arizona's tax credit to Minnesota's deduction, stating:

We see little difference in the levels of choice available to parents under the Minnesota and Arizona plans. In both, parents are free to participate or not, to choose the schools their children will attend, and to take advantage of all other available benefits under the state tax scheme. Moreover, these programs will undoubtedly bring new options to many parents. Basic education is compulsory for children in Arizona, A.R.S. § 15-802(A), but until now low-income parents may have been coerced into accepting public education. These citizens

have had few choices and little control over the nature and quality of their children's schooling because they have been unable to afford a private education that may be more compatible with their own values and beliefs. Arizona's tax credit achieves a higher degree of parity by making private schools more accessible and providing alternatives to public education.³⁷

Additionally, the credit does not violate the state constitution which states that no "public money or property shall be appropriated for or applied to any religious worship, exercise, or instruction, or to the support of any religious establishment" because the justices did not consider money raised by the tax credit to be "public money."³⁸ The US Supreme Court supported the Arizona court's decision.



In *Griffith v. Bower* and *Toney v. Bower*, state appeals courts dismissed similar challenges to the Illinois family education tax credit. The courts ruled that the credit was not an expenditure of public money.³⁹

Justice Rita Garman, Appellate Court for the Fourth Judicial District, acknowledged the value of the credit to the individual and state: "By creating the credit, the legislature has recognized that parents who send their children to private schools often do so at considerable expense to themselves and that they provide a benefit to the State treasury by relieving the State and local taxpayers of the expense of educating their children." In 2001, the Illinois Supreme Court refused to consider the two district appeals court rulings.

These state cases stress two aspects of tax credits: 1) Tax credits are constitutional because any funding that reaches private schools does so through the private choices of parents. Private choices do not in any way constitute a government stamp of approval or prejudice against religion. 2) Tax credits are never public funds. The second reason sets tax incentives apart from vouchers. While voucher programs have been upheld by the US Supreme Court and several state supreme courts under the first reason, the second reason does not apply because vouchers are considered public expenditures.

UNIFORMITY CLAUSES

Opponents have challenged school choice programs under state constitutions that require states to provide a "uniform" system of free public schools. Although this tactic has been used primarily against voucher and public charter school programs, opponents could attempt to use it against tax credits. State courts have issued different decisions regarding "uniformity clauses." The Wisconsin Supreme Court, for example, upheld the Milwaukee voucher program in *Davis v. Grover*, finding it improved the state's fulfillment of its duty in accordance with the "uniformity clause." Florida's Supreme Court, however, struck down Florida's Opportunity Scholarship Program in *Bush v. Holmes*, ruling that the state cannot offer taxpayer-supported options outside of the public system. These court decisions have less bearing on tax credits because funds derived from tax credits are not public funds.

NORTH CAROLINA CONSTITUTION

North Carolina's Constitution is unique in that it has no Blaine Amendment, Compelled Support Clause, or Establishment Clause. Opponents cannot then challenge a tax credit program under such provisions. Moreover, the North Carolina Supreme Court has interpreted the state's uniformity clause differently than the courts in Wisconsin or Florida. The public school system itself has to be of "like kind throughout all sections of the state and available to all of the school population of the territories contributing to their support."⁴⁰ According to legal scholars at the Institute for Justice, this means, "As long as the General Assembly has met this obligation, there is no reason for North Carolina courts to hold that a school choice program raises concerns based on this state's uniformity requirement."⁴¹ In other words, a challenge under the uniformity clause is unlikely to succeed because the North Carolina Supreme Court has interpreted this provision as a minimum standard upon which the state may build.

The state has already built upon the standard by adding charter schools. The creation of tax credits would add independent schools to the list of options beyond the standard.

For all these reasons, the Institute for Justice has concluded that:

School choice is an innovative, equitable solution to the question of how North Carolina's legislature can fulfill its constitutional mandate to provide all of its students the opportunity for the best available education. As has been demonstrated above, a well-crafted school choice program is extremely likely to survive judicial scrutiny under the relevant provisions of the state and federal constitutions. North Carolina's citizens and elected officials should carefully consider the opportunities that such a program would present for the state's schoolchildren and their families, as well as the overall benefits that school choice potentially holds for the quality of publicly funded education in the state.⁴² ♦

Chapter 3:

How Do Tax Credits Save States Millions?



Research shows that tax credits save states millions of dollars every year. Over the lifetime of the tax credit programs, Pennsylvania has saved \$144 million, Arizona \$18 million, and Florida \$42 million.⁴³ Although Arizona’s and Rhode Island’s corporate tax credit and Iowa’s individual tax credit laws are new and have not been evaluated, substantial savings are likely in those states because the programs are modeled after existing programs with proven financial benefits.

Research on proposed tax credit legislation shows similar results. Clemson University Professor Cotton M. Lindsay’s analysis of the South Carolina Put Parents in Charge Act

(PPIC) found that the legislation would have enabled the state to conserve at least \$471.6 million during the first five years. The bill included two tax credits: one for parents for tuition costs and one for donations to scholarship funds.⁴⁴ Similarly, research published by the Milton and Rose D. Friedman Foundation demonstrated that philanthropy education tax credits in New Mexico would enable school districts to net eight million dollars annually by the 10th year of implementation.⁴⁵

Researchers have not analyzed the impact of parental tax credits for education expenses on state coffers, but it is likely parental tax credits would have an effect comparable to philanthropy education tax credits.

Chart 1: **PHILANTHROPY TAX CREDIT PROGRAMS**

State	Average or Maximum Scholarship Amount	State Per Pupil Expenditure (2004-2005)
AZ Individual Tax Credit	\$1,370	\$6,374
AZ Corporate Tax Credit	\$4,200 for grades K-8 \$5,500 for 9-12/ cap will raise \$100 per year	\$6,374
FL Corporate Tax Credit	\$3,750	\$7,359
IA Individual Tax Credit	New program	\$7,913
PA Corporate Tax Credit	\$1,000	\$10,274
RI Corporate Tax Credit	New program	\$11,456

Source: Alliance for School Choice, Milton and Rose D. Friedman Foundation, and US Department of Education

Chart 2: **FAMILY TAX CREDIT PROGRAMS**

State	Parental Tax Credit/Deduction Per Child	State Per Pupil Expenditure (2004-2005)
Illinois	\$500	\$8,880
Iowa	\$250	\$7,913
Minnesota	\$176.25 ⁴⁶	\$8,673

Source: Milton and Rose D. Friedman Foundation and US Department of Education

How do tax credits save taxpayers money? In a nutshell, states conserve money because tax credits cost less than what it costs to educate a student in public schools.

As Charts 1 and 2 show, the average scholarship is substantially less than the cost to educate a student in public schools (In Pennsylvania's and Arizona's corporate tax credits, there are no limits on the amount of the scholarship, so average amounts reported by the Alliance for School Choice are included here). Figures used in this comparison are underestimated because only 2004-2005 public figures were available for public spending while tax credit figures reflect recent trends. The difference between them is likely much greater since public per pupil amounts increase every year.

Similarly, the maximum family tax credit or estimated average deduction is considerably lower than the per pupil expenditures in public schools. Here too, the difference in the figures is underrepresented because statistics for public expenses were taken from the 2004-2005 school year.

The difference between the scholarship amount or family tax credit/deduction and the per pupil amount is what generates the cost savings to states and districts. When a student leaves a public school to attend an independent school with the help of a scholarship or family tax credit, the state recoups the cost to educate the student minus the scholarship. The school system keeps thousands of dollars for every student who exercises school choice.⁴⁷ The establishment of tax credits helps not only families who choose independent schools, but also those who choose public schools.

School choice opponents have alleged that tax credits deplete public school funding. Clearly, the opposite is true. In fact, the more students leave the public system for private schools, the more the state and local school districts save. Even when fixed costs are taken into consideration, the savings remain substantial, according to Susan Aud, Ph.D., who has pioneered research into education tax credits.⁴⁸

For example, if North Carolina offered parents a \$3,000 scholarship (generated by a philanthropy tax credit), the state would save approximately \$1,450 for every student who left the public school system, and the student's school district would save an average of \$2,385.

State formula expenditure to educate a student in North Carolina	\$4,450
State cost of a scholarship for a student who transfers to an independent school	– \$3,000
State cost savings	\$1,450
District expenditure to educate a student in North Carolina	\$2,385
District cost of a scholarship for a student who transfers to an independent school	– \$ 0
District cost savings	\$2,385

According to the North Carolina Department of Public Instruction, North Carolina spent an average \$7,328 per pupil (2004-2005).⁴⁹ This total comes from three sources: 67.46 percent from state tax dollars, 24.28 percent from local, and 8.26 percent from federal.⁵⁰ If the state enacted a philanthropy tax credit that generated \$3,000 scholarships for students, the tax credits would reduce the amount of money flowing into state coffers. The per pupil impact of a student taking a scholarship would be a \$3,000 subtraction from state revenue. This subtraction is offset, however, by the \$4,450 the state saves that would have been spent on that student. The state, therefore, nets an average \$1,450 per student.

In fact, the state would likely save more. This analysis uses the state's per pupil base funding of \$4,450 to generate a very conservative cost savings average. North Carolina spends more money per student by adding to the base additional funds for student-specific characteristics such as low-income or limited English proficiency.⁵¹

District savings are much easier to calculate. Local taxation would not be affected by a state-level philanthropy tax credit. If a student left the public system, the district would retain all of the funding it would have spent to educate the student. The district would also retain all or most of the federal funding for that student. Many federal programs

have “hold harmless” provisions that prevent funding from decreasing even when eligible student populations decline. Funding for the largest federal program – Title I – is based in part on regional poverty calculated by the US Census. Students who transfer from public schools continue to live in the neighborhood and therefore remain part of the public school Title I formula allotment.⁵²

Structuring a philanthropy tax credit that will simultaneously help low-income families and save money requires several calculations. Lawmakers will need to estimate the number of individuals or businesses that will take the credit to calculate the amount of revenue generated. Secondly, they will need to determine the amount of the scholarship. The larger the scholarship, the greater the likelihood that a low-income family will be able to use it.

A certain number of students will need to leave the public system for the state to break even or gain a cost savings. Arizona’s and Florida’s corporate tax credit programs limit

student participation to students enrolled in public schools or just entering school. While this discriminates against parents whose children are enrolled in private schools, it does guarantee cost savings to the state.

In structuring a family tax credit, the challenge for lawmakers is to establish a credit that is large enough to make private schooling affordable, but small enough to save the public school system money. A credit that is too small will not sufficiently defray the cost of tuition. Parents will stay with the public system and use the credit for books and tutoring, a choice that will reduce revenue to the state but provide no cost savings. On the other hand, a credit that is equal to the public per pupil funding will cause the system to break even. To determine the potential impact of a family tax credit, lawmakers will need to determine the average cost of tuition at North Carolina’s private schools and estimate what amount of cost savings will enable the average moderate- and low-income family to choose a private school option. ♦

Chapter 4:

Tax Incentives in North Carolina



Like other states, North Carolina allows taxpayers to take credits against their tax liability for specific expenses. Through credits, the North Carolina tax code acknowledges the societal value of certain activities such as charitable giving, parenting, historical restoration, economic growth and conservation, and enables taxpayers to engage in these activities to a greater degree.

Tax credits for education are a natural addition to North Carolina’s tax incentives for individuals and businesses. They are consistent with existing tax strategies for encouraging activities that are beneficial to the state.

TAX CREDITS AVAILABLE TO INDIVIDUALS IN NORTH CAROLINA⁵³

Children and Child Care

Parents may claim a tax credit of \$100 per dependent child. An income maximum of \$100,000 for married parents and \$60,000 for single parents applies. Parents may also take a tax credit equal to seven to nine percent of child care expenses for children over the age of seven. They may take a credit of 10-13 percent of expenses for children under seven and dependents who are physically or mentally unable to care for themselves. The exact percentage depends on the filing status and gross income level.

Charitable Contributions

Individuals who used the standard deduction on their federal tax return may claim a tax credit for charitable contributions

on their state tax return. In order to take the credit worth seven percent of the contributions, the taxpayer must have donated at least two percent of his or her gross income.

Disabled Taxpayer, Dependent, or Spouse

Individuals who are permanently and totally disabled may take a tax credit equal to one-third (1/3) of the amount of the credit taken on the federal tax return. A taxpayer with a spouse who is disabled and cannot work is also eligible for a tax credit.

Certain Real Property Donations

Taxpayers may take a tax credit for donating the use of their North Carolina property for public beach, trail or water access or conservation purposes. The credit is equal to 25 percent of the market value of the property up to \$250,000. A certification from the Department of Environment and Natural Resources must be included with the tax return.

10

Rehabilitation of an Historic Structure

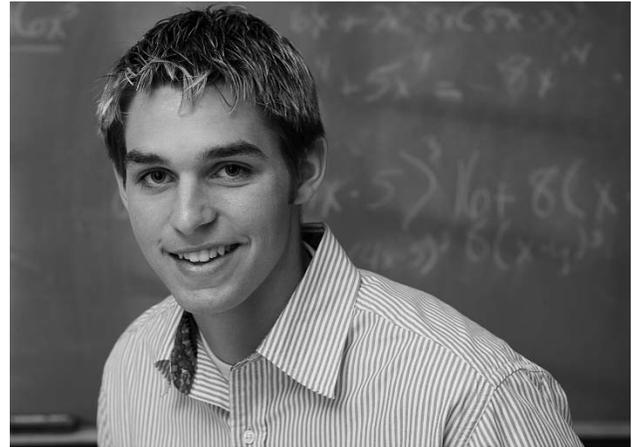
Individuals who are eligible to take a federal income tax credit for rehabilitating a certified historic building that is income producing may take a credit worth 20 percent of the rehabilitation expenses. Taxpayers who rehabilitate a non-income producing historic building and are not eligible to take a federal tax credit may take a 30 percent credit. The taxpayer must have expenses in excess of \$25,000 over two years and must present a certification by a State Historic Preservation Officer. The taxpayer may take a 40 percent tax credit if the property (whether income producing or not) was once a state training school for juvenile offenders. Credits are also available for the rehabilitation of historic mill property.

Construction of Handicapped Dwelling Units

Taxpayers may take a tax credit of \$550 for qualified multi-family rental units for people with disabilities.

Recycling Oyster Shells

North Carolinians may take a credit of one dollar per bushel of oyster shells donated to the Division of Marine Fisheries of the Department of Environment and Natural Resources.



TAX CREDITS AVAILABLE TO BUSINESSES AND FARMS IN NORTH CAROLINA

Qualified Business Investments

Businesses may take a credit of up to \$50,000 for investments in equity securities or subordinated debt of a qualified business venture, qualified grantee business, or a qualified licensee business.

Business Tax Credits

Businesses may take credits for investing in central office or aircraft building property, training, research and development, machinery and equipment, job creation, North Carolina port use, technology commercialization, development zone ventures, and investment in renewable energy.

Gleaned Crops

Farmers may take a 10 percent credit of the value of unharvested crops donated to qualified charities.

Conservation Tillage Equipment

Farmers may take a credit of 25 percent of the cost to purchase conservation tillage equipment not to exceed \$2,500 a year.

Property Taxes Paid by a Farmer on Farm Machinery

Farmers may take a credit of up to \$1,000 for the amount of property taxes paid on farm equipment.

Construction of Poultry Composting Facility

Farmers may take a credit of up to 25 percent of the cost to build a poultry composting facility in North Carolina, not to exceed \$1,000. ♦

Chapter 5:

Tax Incentives Around the Nation



As of 2007, seven states had enacted nine tax credits/deductions. The laws differ in terms of who is eligible, the amount, and other details. As with other public policies, the structure of each state law has advantages and disadvantages. The following section provides an analysis of each law.

ARIZONA INDIVIDUAL SCHOOL TUITION ORGANIZATION TAX CREDIT (Chart 3)

In 1997, the Arizona legislature adopted House Bill 2074 to provide a tax credit for individuals who donate to School Tuition Organizations (STOs). Single individuals may take a dollar-for-dollar credit of up to \$500 and married couples filing jointly may take a credit of up to \$1,000. The tax credit is not refundable; however, the taxpayer may carry over the credit for five consecutive years. A taxpayer may not take a credit for a donation designated for his or her own child.⁵⁵

In order to qualify under the law, each School Tuition Organization must be exempt from federal taxation (i.e. nonprofit), allocate at least 90 percent of its revenue to scholarships, and serve students in more than one school. Each STO must report the following information to the government by February 28 each year: the name, address, contact name of the organization, the number and amount of contributions, the number of scholarships and students served, the names and addresses of the schools, and the number and amount of scholarships they received from students.⁵⁶ At present, there are 56 STOs.⁵⁷



A qualified school under the law must be a nongovernmental primary or secondary school in Arizona that does not discriminate on the “basis of race, color, handicap, familial status, or national origin.”⁵⁸ In 2006, 357 schools participated.⁵⁹

While STOs set their own student eligibility criteria, most base it entirely on financial need.⁶⁰ In the 2006 school year, donations exceeded \$51 million, funding 24,678 scholarships.⁶¹ The average scholarship amount was \$1,370.⁶² Scholarships usually cover 50-80 percent of tuition.⁶³

The only changes to the law since enactment have been to remove the “marriage penalty,” a provision that did not allow married individuals to receive a full credit for donations.⁶⁴ A separate provision of the law allows up to \$200 in credits for contributions to or student fees for extracurricular activities or character education programs.

Chart 3: ARIZONA INDIVIDUAL SCHOOL TUITION ORGANIZATION TAX CREDIT

Type	Amount	Amount Contributed (most recent year)	Number of Scholarships (most recent year)	Aggregate Maximum
Individual philanthropy tax credit	Dollar-for-dollar up to \$500	\$51 million (2006)	24,678 (2006)	None

Source: Alliance for School Choice and Arizona Department of Revenue.⁵⁴

Chart 4: ARIZONA CORPORATE SCHOOL TUITION ORGANIZATION TAX CREDIT

Type	Amount	Amount Contributed (most recent year)	Number of Scholarships (most recent year)	Aggregate Maximum
Corporate philanthropy tax credit	Dollar-for-dollar	New program	New program	\$10 million in the first year, increased by 20% per year

Source: Alliance for School Choice

ARIZONA CORPORATE SCHOOL TUITION ORGANIZATION TAX CREDIT (Chart 4)

In 2006, Arizona built on the legacy of its individual tax credit for contributions to scholarship organizations by adding a corporate tax credit under Senate Bill 1499. The purpose, according to the legislation, is “to encourage businesses to direct a portion of their taxes by contributing to school tuition organizations in order to improve education by raising tuition scholarships for children in this state.”⁶⁵ Capped at a statewide annual total of \$10 million, Arizona awards dollar-for-dollar tax credits to corporations that donate to STOs. The annual limit increases by 20 percent each year.⁶⁶

The new program has the same provisions as the individual tax credit regarding STO qualifications and reporting. There are additional requirements on participating private schools. While both programs have nondiscrimination requirements, schools participating in the corporate tax credit program must administer a nationally standardized norm-referenced achievement test or the state’s Arizona Instrument to Measure Standards test annually and make the aggregate test scores of their students available to the public. Schools must also have their personnel fingerprinted.⁶⁷

The programs also differ with respect to student eligibility and scholarship amounts. The scholarship is limited to students whose families have incomes below 185 percent of the poverty level. Students must be starting kindergarten or have previously attended a public school. The scholarship is capped at \$4,200 for grades K-8 and \$5,500 for high school. The limit rises each year by \$100.⁶⁸

The Alliance for School Choice estimates that between 510,000 and 560,000 students are eligible for a scholarship under this program.⁶⁹

FLORIDA STEP UP FOR STUDENTS CORPORATE TAX CREDIT SCHOLARSHIP PROGRAM (Chart 5)

Enacted in 2001, Florida’s Step Up for Students tax credit enables corporations to donate up to 75 percent of their tax liability to Scholarship Funding Organizations (SFOs), up to \$5 million per SFO. The SFOs provide low-income students with scholarships of up to \$3,750 or the cost of tuition, whichever is less.⁷⁰ Seventy-five percent of the scholarship must be spent on tuition and the remainder may go toward books or transportation.⁷¹ Alternatively, a student may choose a voucher worth up to \$500 to attend a public school outside of his or her school district.⁷²

Chart 5: FLORIDA STEP UP FOR STUDENTS CORPORATE TAX CREDIT SCHOLARSHIP PROGRAM

Type	Amount	Amount Contributed (most recent year)	Number of Scholarships (most recent year)	Aggregate Maximum
Corporate philanthropy tax credit	Dollar-for-dollar up to 75% of a corporation’s tax liability	\$86,382,722 (2006)	17,000 (2006)	\$88 million

Source: Step Up for Students

Chart 6: ILLINOIS TAX CREDITS FOR EDUCATIONAL EXPENSES

Type	Amount	Amount Credited	Families Taking Credit
Parental tax credit	25% on expenses over \$250 spent per child, maximum \$500	\$67.1 million (2003)	194,923 (2003)

Source: Milton and Rose D. Friedman Foundation

To receive a scholarship, a student must qualify for the federal Free and Reduced Lunch Program (185 percent of the poverty level). If a participating family's income rises, the student may remain in the program as long as the family's income does not surpass 200 percent of the poverty level. Students who lost their scholarships when the Florida Supreme Court struck down the A+ Opportunity Scholarship Program are eligible for a scholarship under the tax credit program. The student must have attended a public school or be entering kindergarten or first grade.⁷³

The law requires SFOs to be nonprofit organizations incorporated in Florida. They must award 100 percent of donations secured under this program for scholarships and submit to a yearly independent audit. Donations may not benefit the donor's child. SFO personnel must submit to background checks and fingerprinting.⁷⁴

Participating schools must administer a state-approved, nationally recognized norm-referenced test to scholarship students and report the scores to their parents and a Florida Department of Education-selected research organization. Schools must also report to the state that they have secured background checks for school personnel, demonstrated fiscal integrity, and met state and local

health and safety laws. In 2006, 879 schools accepted scholarships under the program.⁷⁵

ILLINOIS TAX CREDITS FOR EDUCATIONAL EXPENSES (Chart 6)

In 1999, the legislature enacted Senate Bill 1075 to provide parents a tax credit worth 25 percent of the amount spent on tuition, book rental fees, and lab fees that exceed \$250. The maximum credit is \$500.⁷⁶ Eligible schools include all public and independent schools in compliance with the state's truancy law and the Civil Rights Act of 1964. Parents must send in receipts with tax forms.⁷⁷

IOWA TUITION AND TEXTBOOK CREDIT (Chart 7)

Created in 1987, the Tuition and Textbook Credit provides Iowa families with a tax credit of 25 percent on the first \$1,000 spent on tuition and textbooks for each child up to \$250. According to the most recent state government statistics, 183,600 taxpayers took \$15.2 million in tax credits.⁷⁸ According to an analysis of 2004 tax statistics by the Milton and Rose D. Friedman Foundation, over half of the credits taken went to families with incomes below \$50,000.⁷⁹

Chart 7: IOWA TUITION AND TEXTBOOK CREDIT

Type	Amount	Amount Credited	Families Taking Credit
Parental tax credit	25% on the first \$1,000 spent per child	\$15.2 million (2005)	183,600 (2005)

Source: Iowa Department of Revenue

Chart 8: IOWA SCHOOL TUITION ORGANIZATION CREDIT

Type	Amount	Amount Contributed (most recent year)	Number of Scholarships (most recent year)	Aggregate Maximum
Individual philanthropy tax credit	65% of the donation	New program	New program	\$2.5 million in 2006, \$5 million in 2007, \$7.5 million thereafter

Source: Milton and Rose D. Friedman Foundation

For parents to claim the credit, their child must attend a school that is nonprofit, accredited, and compliant with the US Civil Rights Act of 1964. Funds used for food, lodging, clothing, transportation or religious instruction are not subject to a credit.⁸⁰

IOWA SCHOOL TUITION ORGANIZATION CREDIT (Chart 8)

In 2006, the Iowa legislature enacted Iowa Senate File 2409 to give individual taxpayers a tax credit worth 65 percent of the donation to School Tuition Organizations (STOs). The tax credit is not refundable; however, the taxpayer may carry over the credit for five consecutive years.⁸¹

STOs provide scholarships to students from families whose income is less than 300 percent of the federal poverty line. About half of the school children in Iowa qualify. Under the law, STOs must use at least 90 percent of donations for scholarships and register with the state showing that the organization has at least seven board members and is a nonprofit. The STO must also supply a list of schools with which the STO works.⁸² Schools enrolling students who receive scholarships must be accredited, abide by the US Civil Rights Act of 1964, and annually report information about enrollment and the STOs with which they work to the state.⁸³

MINNESOTA TAX DEDUCTIONS FOR EDUCATIONAL EXPENSES (Chart 9)

In 1955, the Minnesota legislature enacted the first tax deduction for education expenses. Since then, the legislature has increased the amount of the deduction three times. Today families may take a deduction up to \$2,500 for each child in grades 7-12 and up to \$1,625 for children in the elementary grades. Parents may deduct expenses for the following: tuition, after-school programs, academic summer camps, music lessons, musical instrument rental and purchase, tutoring, instructional materials and supplies, textbooks, and up to \$200 for computer hardware and education-related software. How much money families save depends on their tax bracket. Most Minnesotans are in the 7.05 percent bracket and save approximately \$176.25 in taxes for each \$2,500.⁸⁴

In tax year 2008, Minnesota House of Representatives analysts estimate 222,000 tax returns will save \$16.1 million.⁸⁵ The state also has an income tax credit for education expenses excluding tuition for lower-income families. The credit is for 75 percent of expenses up to \$1,000 per child in grades K-12.

Chart 9: MINNESOTA TAX DEDUCTIONS FOR EDUCATIONAL EXPENSES

Type	Amount	Amount Saved	Families Taking Deduction
Parental tax deduction	May deduct up to \$2,500 for children in grades 7–12 and \$1,625 for children in grades K-6	\$16.1 million (2008)	222,000 (2008)

Source: Milton and Rose D. Friedman Foundation and Minnesota House of Representatives

Chart 10: PENNSYLVANIA EDUCATIONAL IMPROVEMENT TAX CREDIT

Type	Amount	Amount Contributed (most recent year)	Number of Scholarships (most recent year)	Aggregate Maximum
Corporate philanthropy tax credit	75–90% of donation up to \$200,000 annually	Cap met each year	33,400 (2006-2007)	\$44.7 million

Source: Milton and Rose D. Friedman Foundation

PENNSYLVANIA EDUCATIONAL IMPROVEMENT TAX CREDIT (Chart 10)

In 2001, legislators passed House Bill 966 to give corporations a tax credit for donations to Scholarship Organizations (SOs) or Educational Improvement Organizations (EIOs). The credit is worth 75 percent of the donation for a one year contribution and 90 percent for a two year gift.⁸⁶ Corporations may donate up to \$200,000 annually and the state may award a maximum of \$44.7 million in credits a year.⁸⁷ In addition to the scholarship provision, the law also allows tax credits for contributions to Educational Improvement Organizations (EIOs) that work with public schools to fund programs. The state awards up to \$23.3 million in credits to EIOs. The cap on both programs has been expanded multiple times in response to business demand.⁸⁸ More than 2,300 businesses have contributed approximately \$260 million to SOs or EIOs since 2001.⁸⁹

To participate, SOs must use 80 percent of their donations for scholarships, have nonprofit tax status, and report the number and amount of scholarships to the state. SOs must also have an application and review process for students and work with more than one school.⁹⁰

An eligible student’s family must have an income of less than \$50,000 a year (the amount increases by \$10,000 for each additional child). Over one million students are eligible to receive a scholarship under this program.⁹¹ Schools eligible to participate in the program must meet compulsory attendance requirements and the Civil Rights Act of 1964.⁹²

RHODE ISLAND CORPORATE SCHOLARSHIP TAX CREDIT PROGRAM (Chart 11)

In 2006, Rhode Island enacted a law to give corporations a tax credit of up to \$100,000 for donations to Scholarship Organizations (SOs). The credit is worth 75 percent of the donation. If the corporation donates for two years and the second year donation is worth at least 80 percent of the first, the business may take a credit of 90 percent. The state may not award more than \$1 million in credits per year.⁹³

SOs must use 90 percent of donations for scholarships, work with more than one school, and report to the state the number and amount of scholarships, application criteria, school information, and student geographical information. Eligible families must have an income less than 250 percent of the federal poverty line.⁹⁴

Chart 11: RHODE ISLAND CORPORATE SCHOLARSHIP TAX CREDIT PROGRAM

Type	Amount	Amount Contributed (most recent year)	Number of Scholarships (most recent year)	Aggregate Maximum
Corporate philanthropy tax credit	75–90% of donation up to \$100,000 annually	New program	New program	\$1 million

Source: Milton and Rose D. Friedman Foundation

Chart 12: **TAX CREDIT PROGRAM COMPARISON OF FAMILY EDUCATION TAX CREDITS**

State	Type	Amount	Allowable Expenses	Limitations
Iowa	Credit	25% on the first \$1,000 spent per child, maximum \$250	Tuition, textbooks	School must be nonprofit, accredited, and compliant with the US Civil Rights Act of 1964
Illinois	Credit	25% on expenses over \$250 spent per child, maximum \$500	Tuition, book rental fees, and lab fees	Compliance with the state's truancy law and the Civil Rights Act of 1964
Minnesota	Deduction	May deduct up to \$2,500 for children in grades 7-12 and \$1,625 for children in grades K-6	Tuition, after-school programs, academic summer camps, music lessons, musical instrument rental and purchase of tutoring, instructional materials and supplies, textbooks, portion of computer technology	None

Chart 13: **TAX CREDIT PROGRAM COMPARISON OF PHILANTHROPY EDUCATION TAX CREDITS**

State	Type	Amount	Aggregate Maximum	Scholarship Amount
Arizona	Individual	Dollar-for-dollar up to \$500	None	None
Arizona	Corporate	Dollar-for-dollar	\$10 million in the first year, increased by 20% per year	Capped at \$4,200 for grades K-8 and \$5,550 for high school. The limit rises each year by \$100
Florida	Corporate	Dollar-for-dollar up to 75% of a corporation's tax liability	\$88 million	\$3,750 or the cost of tuition, whichever is less
Iowa	Individual	65% of donation	\$2.5 million in 2006 \$5 million in 2007 \$7.5 million thereafter	None
Pennsylvania	Corporate	75-90% of donation up to \$200,000 annually	\$44.7 million	None
Rhode Island	Corporate	75-90% of donation up to \$100,000 annually	\$1 million	None

TAX CREDIT PROGRAM COMPARISON OF FAMILY EDUCATION TAX CREDITS (Chart 12)

A comparison of the nation’s three family tax credits/ deductions for education reveals certain general trends.

- ✿ This type of tax incentive places no limitations on schools beyond compliance with existing laws.
- ✿ Minnesota’s tax deduction has the widest range of allowable expenses.
- ✿ The deduction and credits provide only a small amount of tax relief to defray the cost of independent school tuition or other expenses incurred by students at public or private schools.
- ✿ Since tax credits are not refundable, parents whose incomes are too low to incur a tax liability do not benefit.

The greatest shortcoming of existing tax incentives is that they defray only a very small portion of the cost to educate

a child. While the average tuition at private schools is less than what it costs to educate a child in a public school, it is still too expensive for many low- and middle-income families. A tax credit that defrays \$500 from a \$4,000 tuition bill is helpful but not substantial. While this may still be a burden to a family of modest means, it may be altogether unaffordable for low-income parents, even if they were eligible for a credit. Many low-income families have no tax liability and therefore are ineligible for tax credits.

These two concerns must be met in order to help the greatest number of families afford a school that meets their children’s needs. Raising the limit of the credit closer to the cost of education would make private school a more affordable and realistic option for families with modest incomes. Even a high limit will not help those who have little or no income tax liability. To help low-income families through this type of tax credit, lawmakers would need to make credits refundable.

Student Requirements	School Requirements	Scholarship Organization Requirements
None	Nondiscrimination	Nonprofit, minimum 90% of revenue to scholarships, work with more than one school, state reporting
Income below 185% of the poverty level, starting in kindergarten or previously enrolled in a public school	Nondiscrimination, testing, reporting, fingerprinting of personnel	Nonprofit, minimum 90% of revenue to scholarships, work with more than one school, annual reporting
Qualify for the federal Free and Reduced Lunch Program (may remain in program if family income rises to 200% of poverty level) or had been in A+ Opportunity Scholarship program; previously attended a public school or entering kindergarten or first grade	Nondiscrimination, testing, reporting, background checks, demonstrated fiscal integrity, state and local health and safety laws	Nonprofit, incorporated in Florida, 100% of revenue to scholarships, yearly independent audit, SFO personnel background checks/fingerprinting, state reporting
Income below 300% of the federal poverty line	Nondiscrimination, accreditation	Nonprofit, minimum 90% of donations for scholarships, state reporting, at least seven board members
Less than \$50,000 a year (the amount increases by \$10,000 for each additional child)	Compulsory attendance, nondiscrimination	Nonprofit, minimum 80% of their donations for scholarships, reporting to state, review process, work with more than one school
Income less than 250% of federal poverty line	Located in Rhode Island, meets state law requirements for private schools	Minimum 90% of donations for scholarships, work with more than one school, reporting to state

TAX CREDIT PROGRAM COMPARISON OF PHILANTHROPY EDUCATION TAX CREDITS (Chart 13)

A comparison of the nation's six philanthropy tax credits for education also reveals certain general trends.

- ✿ Two states provide dollar-for-dollar credits for contributions while three states' laws give corporations a credit for a relatively high percentage of their donations.
- ✿ Corporate tax credits are slightly more common than individual tax credits. Florida has no personal income tax so a corporate tax credit is the only option. There is no recent trend toward one type; the two most recent states to adopt education tax credits, Rhode Island and Iowa, each adopted different kinds.
- ✿ Four out of six programs place no limit on the size of scholarships.
- ✿ All but one program limit the scholarships to low- or modest-income students. In practice, the remaining program allocates most scholarships based on income. Arizona's corporate tax credit has the most restrictive family income eligibility requirement.
- ✿ Only two programs place additional requirements beyond existing law such as testing, reporting, and background checks on schools.
- ✿ Only one state (FL) requires 100 percent of revenue derived from the program to be used on scholarships, forcing scholarship organizations to raise administration funds separately. Among the three oldest programs, Pennsylvania has the highest number of scholarship organizations (183)⁹⁵, followed by Arizona (56) and Florida (4).⁹⁶
- ✿ Only Florida's program allows low-income families to increase their incomes slightly without losing eligibility.
- ✿ Pennsylvania awards the highest number of scholarships (33,400), followed by Arizona (24,678) and Florida (17,000).
- ✿ Florida and Pennsylvania have raised their statewide caps in response to demand. Arizona's personal income tax credit has no statewide limit and the other three programs are new.⁹⁷

- ✿ Laws in Arizona, Florida, and Pennsylvania have a public school component.

As with any law, the size and structure of education tax credits have an impact on how many children can benefit. In 2003, the Milton and Rose D. Friedman Foundation published a report evaluating the efficacy and openness of school choice programs across the country.⁹⁸ While the report did not include analysis of the nation's three newest programs, it still provides insight into the strengths and weaknesses of the remaining six education tax incentives. The report rated school choice laws on three criteria – student eligibility, purchasing power, and school restrictions – and awarded the highest grades to programs that gave the highest number of students the most choices. While the report acknowledged that some choice is better than none, it stressed that “more freedom is superior to less.”⁹⁹

A- Arizona Individual School Tuition Organization Tax Credit

The Foundation found the Arizona program to be well-structured and faulted only “the low amounts of money taxpayers are able to donate” since individuals may only donate a maximum of \$500.

B+ Pennsylvania Educational Improvement Tax Credit

This program received high marks for placing few restrictions on how scholarship organizations award students. The program's principal disadvantage is its limits on credits; businesses do not receive full credit for their donations and they are limited to \$200,000 a year.

C+ Florida's Step Up for Students Corporate Tax Credit Scholarship Program

The Foundation identified the generous size of the program as a strength. The weaknesses of the program are that it is restricted to students in the federal Free and Reduced Lunch program and the scholarship amount does not provide parents with sufficient purchasing power.

C Illinois Tax Credits for Educational Expenses

The primary weakness of the Illinois tax credit is its small size. The amount a family saves does not come close to the price of tuition, families do not get full credit for their



purchases, and low-income families who do not earn enough to pay taxes are ineligible. The report acknowledged the lack of restrictions on schools as a strength.

C Minnesota Tax Deductions for Educational Expenses

Like Illinois's tax credit, Minnesota's tax deduction received low grades for purchasing power. A deduction defrays a very small amount of money. The lack of school restrictions was deemed a strength.

C- Iowa Tuition and Textbook Credit

Like the Illinois and Minnesota tax incentives, Iowa's tax credit earned low marks for purchasing power. Parents do not receive full credit for their expenses and are limited by a low credit maximum. Unlike the other two family education tax credits, the Iowa credit places additional restrictions; it does not apply to the portion of tuition that supports religious instruction. ♦

Chapter 6:

How Will a Tax Credit Impact Independent Schools in North Carolina?



In the 2006-2007 school year, 94,785 students were enrolled in 671 North Carolina private schools. Schools classified as religious accounted for 71.5 percent of the total with the remainder classified as independent. Private schools are available in all but 15 of North Carolina's 100 counties.¹⁰⁰

By law, non-public schools must meet the following requirements:¹⁰¹

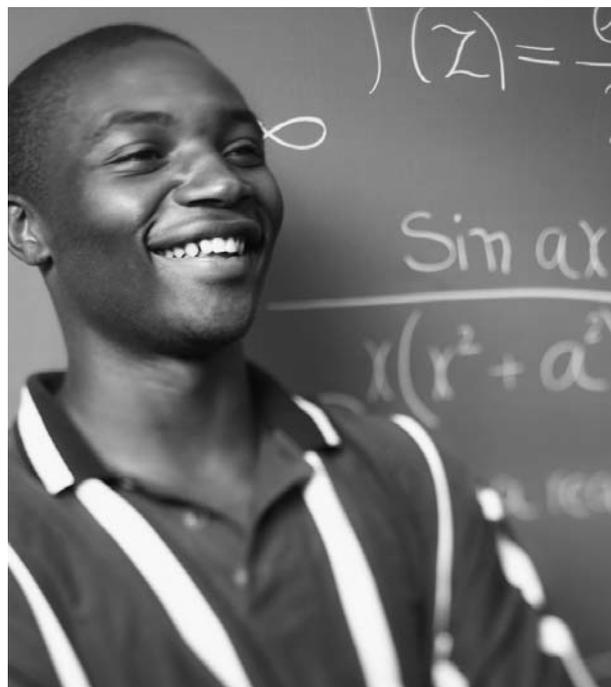
Compulsory Attendance: The school must maintain yearly attendance and disease immunization records for each enrolled pupil and operate at least nine months of the year.

Fire, Health, and Safety Code: Schools are subject to state, county, and municipal inspections.

Testing: Schools must administer a nationally standardized test chosen by the school each year. The test must be given to all students in grades three, six, and nine, and measure achievement in English grammar, reading, spelling and mathematics. The school must maintain testing records in the office and make them available for state inspection. High schools must administer a nationally standardized test selected by the school to all 11th grade students each year. The test must assess competencies in the verbal and quantitative areas. The school must establish a minimum score to be attained in order for students to graduate. Records must be kept and made available for inspection.

Notification: Schools must notify the state upon opening or closing.

A tax credit could be structured to place no further restrictions on private schools than those already required by law.



Current law requires schools to test students in essential academic disciplines. The law also requires that schools follow compulsory attendance laws and safety codes. Thus, under current law, parents are guaranteed a safe environment that tests their children's progress in critical academic subjects. The state is empowered to check for violations of state law.

Given these requirements, new restrictions under a tax credit law would not be necessary. As additional requirements might compel some schools to leave the program, thus reducing the range of choice, legislators should carefully consider the impact of additional regulations for schools taking scholarship students. Such requirements will adversely impact families by reducing their options. ♦

Chapter 7:

Frequently Asked Questions



What are family education tax incentives?

Family education tax incentives enable parents to receive a credit or deduction against their state income taxes for a portion of their children's education expenses. Depending on state law, allowable expenses can include tuition and fees as well as books, tutoring and education technology, thereby providing benefits to public school and home schooling parents.

What are philanthropy education tax incentives?

Philanthropy education tax credits provide income tax credits for individuals or businesses that donate to scholarship organizations that, in turn, give scholarships to low-income students to attend a school of choice.

What are scholarship organizations?

Scholarship Organizations (SOs), also called School Tuition Organizations (STOs), or Scholarship Funding Organizations (SFOs) depending on the state, provide students with scholarships to attend a school of choice.

Are education tax incentives constitutional?

Tax credits and deductions have been upheld by the US Supreme Court and state supreme courts against challenges that they violate the Establishment Clause and provisions regarding funding of religious institutions. Because North Carolina lacks these constitutional provisions, opponents would have no argument. A complaint that a tax credit violates the North Carolina "Uniformity Clause" is likewise unlikely to succeed given the North Carolina court's past interpretation.

Does North Carolina currently provide tax credits for philanthropy or the costs associated with rearing children?

North Carolina allows individuals and businesses to take credits against their tax liability for specific expenses. Through credits, the North Carolina tax code acknowledges the societal value of certain activities such as charitable

giving, parenting, historical restoration, economic growth, and conservation, enabling taxpayers to engage in these activities to a greater degree.

Do tax credits drain money from public schools?

States with education tax credits save millions of dollars because the scholarships they generate cost less than the state pays to educate a student in public schools. When a student leaves a public school to attend an independent school with the help of a scholarship or family tax credit, the state recoups the cost to educate the student in the public system minus the scholarship. The public school system keeps thousands of dollars for every student who exercises school choice.

Where are education tax credits available?

Families in Minnesota benefit from a tax deduction for education expenses. Parents in Illinois and Iowa may take a tax credit for education expenses. Students in Arizona, Florida, Iowa, Pennsylvania, and Rhode Island benefit from scholarships generated by tax-advantaged donations from businesses and individuals.

Are tax credits the same as vouchers?

While tax credits and vouchers both provide educational choice, they are not the same. Tax credit derived funds never become "public funds." As such, they more easily avoid conflict with state and federal constitutions. Although vouchers have been upheld in the US Supreme Court and several state courts, they have been struck down in others. Vouchers for eligible students are available in a growing number of states including Arizona, Florida, Georgia, Maine, Ohio, Utah, Vermont, Wisconsin, as well as the District of Columbia.

How are private schools held accountable?

Independent schools in North Carolina must comply with state law regarding compulsory attendance, fire, health, and safety, annual testing, and state notification.

Don't North Carolina families already have plenty of school choices?

North Carolina does not have a statewide law enabling students to transfer to other public schools. Public charter schools are an option for some families but not others. More than half of the state's counties do not have charter schools. Many charter schools have waiting lists to get in.

Are parents who choose public schools eligible for tax incentives?

A family tax credit or deduction can be structured to cover public and home schooling expenses such as books, tutoring, and enrichment activities such as music lessons. A philanthropy tax credit, like those in Arizona and Pennsylvania, could include a credit for contributions to public school improvements or extracurricular activities. ♦

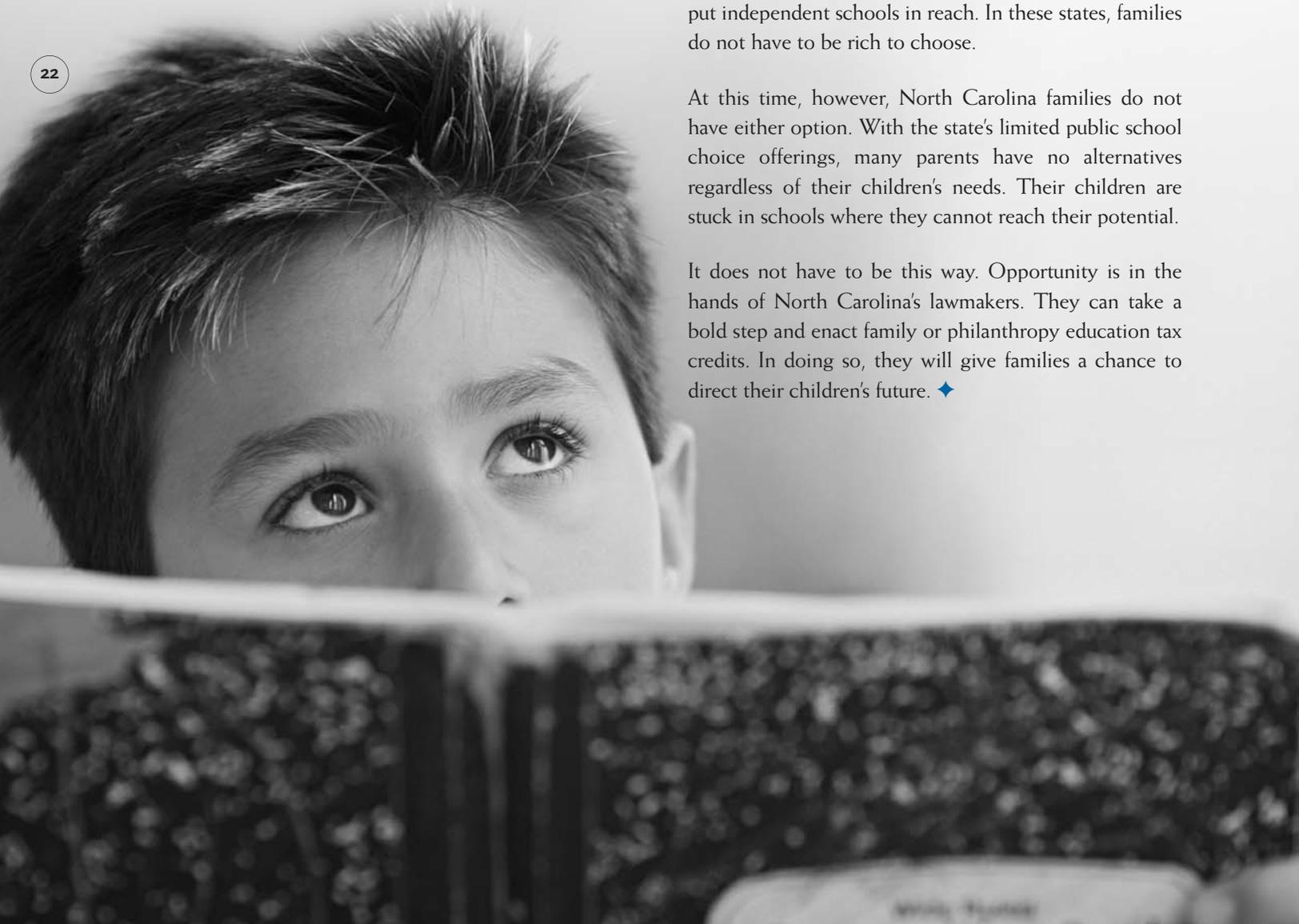
Conclusion

 Both types of education tax credits have won the support of parents and students, businesses and individual taxpayers, education reformers, and political leaders on both sides of the aisle because they benefit the individual as well as the community. Constitutional and consistent with state and federal tax law, tax credits reward philanthropic and parental investments in education while saving states and districts millions of dollars.

Most importantly, education tax credits give the power of choice to low- and middle-income parents and give their children a chance to succeed. Family tax credits in Minnesota, Iowa, and Illinois make tuition at independent schools a bit more affordable. Philanthropy tax credits in Arizona, Florida, Iowa, Pennsylvania, and Rhode Island put independent schools in reach. In these states, families do not have to be rich to choose.

At this time, however, North Carolina families do not have either option. With the state's limited public school choice offerings, many parents have no alternatives regardless of their children's needs. Their children are stuck in schools where they cannot reach their potential.

It does not have to be this way. Opportunity is in the hands of North Carolina's lawmakers. They can take a bold step and enact family or philanthropy education tax credits. In doing so, they will give families a chance to direct their children's future. ♦



Resources

NORTH CAROLINA

North Carolina Education Alliance
200 W. Morgan Street, Suite 200
Raleigh, NC 27601
704.231.9767
www.nceducationalliance.org

Parents for Educational Freedom in North Carolina
4924 Windy Hill Dr. Suite B
Raleigh, NC 27609
919.871.1084
www.pefnc.org

NATIONAL

Alliance for School Choice
1660 L Street, NW, Suite 1000
Washington, DC 20036
202.280.1990
www.allianceforschoolchoice.org

Black Alliance for Educational Options
1710 Rhode Island Avenue, NW, Floor 12
Washington, DC 20036
202.429.2236
www.baec.org

Center for Education Reform
1001 Connecticut Avenue, NW, Suite 204
Washington, DC 20036
202.822.9000
www.edreform.com

The Heritage Foundation
214 Massachusetts Ave NE
Washington DC 20002
202.546.4400
www.heritage.org

Institute for Justice
1717 Pennsylvania Avenue, NW, Suite 200
Washington, DC 20006
202.955.1300
www.ij.org

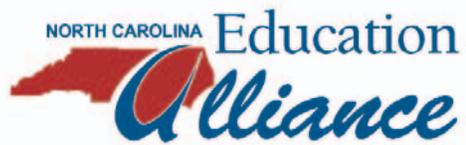
Milton and Rose D. Friedman Foundation
One American Square, Suite 1750
Box 82078
Indianapolis, IN 46282
317.681.0745
www.friedmanfoundation.org

- ¹ US Department of Education, National Center for Education Statistics, National Assessment of Educational Progress, State Profiles: North Carolina, at <http://nces.ed.gov/nationsreportcard/states/>.
- ² US Department of Education, National Center for Education Statistics, National Assessment of Educational Progress, State Reading 2005 Snapshot Report: North Carolina, at <http://nces.ed.gov/nationsreportcard/pdf/stt2005/2006452NC4.pdf>.
- ³ North Carolina Department of Public Instruction, "North Carolina NCLB News," November 2006 at www.ncpublicschools.org/docs/nclb/news/2006/200611.pdf.
- ⁴ Education Commission of the States, Open Enrollment Online Database, at <http://mb2.ecs.org/reports/Report.aspx?id=269> (September 14, 2007).
- ⁵ North Carolina Center for Public Policy Research, "Research Center Says Keep Cap on Charter Schools Until Performance Improves," News Release, June 6, 2007, at www.nccppr.org/charter%20school%20press%20release.pdf.
- ⁶ Richard G. Neal, "North Carolina Faces Opposition to Charters," *School Reform News*, Vol. 11, No. 6, August 2007, p.16.
- ⁷ David Salisbury, "Private Schools Cost Less Than You May Think," Cato Institute, September 8, 2003, at www.cato.org/dailys/09-08-03.html.
- ⁸ Susan L. Aud, Ph.D., "Education by the Numbers: The Fiscal Effect of School Choice Programs, 1990-2006," Milton and Rose D. Friedman Foundation, at May 09, 2007 at www.friedmanfoundation.org/friedman/downloadFile.do?id=24.
- ⁹ David Roland, "School Choice and the North Carolina Constitution," Institute for Justice, Presented to the North Carolina Education Alliance, April 2006 at www.johnlocke.org/site-docs/NCEA/School%20Choice-Constitution.pdf.
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- ¹¹ Iowa Code § 422.9, 12; 35 Illinois Compiled Statutes 5/201m.
- ¹² Milton and Rose D. Friedman Foundation, "School Choice Programs," at www.friedmanfoundation.org/friedman/schoolchoice/ShowProgram.do.
- ¹³ Children's Scholarship Fund at www.scholarshipfund.org/index.asp.
- ¹⁴ Arizona Revised Statutes § 43-1089.01-02.
- ¹⁵ Iowa Code § 422.11M; 24 Pennsylvania Code § 20-2001-B-2008-B; Rhode Island General Laws § 44-62-1-7.
- ¹⁶ Iowa Code Section 422.11M.
- ¹⁷ Arizona Revised Statutes § 43-1183.
- ¹⁸ School Choice Programs: Minnesota, Milton and Rose D. Friedman Foundation at www.friedmanfoundation.org/friedman/schoolchoice/ShowProgramItem.do?id=24.
- ¹⁹ School Choice Programs: Iowa, Milton and Rose D. Friedman Foundation at www.friedmanfoundation.org/friedman/schoolchoice/ShowProgramItem.do?id=21.
- ²⁰ School Choice Programs: Illinois, Milton and Rose D. Friedman Foundation at www.friedmanfoundation.org/friedman/schoolchoice/ShowProgramItem.do?id=20.

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