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BACKGROUNDER

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Why a Federal Tax-Credit Scholarship Program Will Not Advance School Choice in America

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Abstract

In March 2019, Senator Ted Cruz (R-TX) introduced a proposal to establish a new, nationwide federal tax-credit scholarship program. Representative Bradley Byrne (R-AL) introduced a companion proposal in the House. Although Congress' support of school choice is praiseworthy, a federal tax-credit scholarship program poses a threat to education choice in the states, and undermines the goal of a streamlined federal tax code. The federal government does not have the constitutional authority to create such a program, which would establish massive new federal spending and would likely subject private schools to future regulations from an Administration and Congress less friendly to education choice. State governments do have the constitutional authority to enact school choice policies, and have been the catalyst for the impressive growth in school choice over the past two decades in the United States.

During the 2019 State of the Union address, President Donald Trump called on Congress to "pass school choice for America's children." Senator Ted Cruz (R–TX) has introduced a proposal—the Education Freedom Scholarships and Opportunity Act—that would establish a new, nationwide federal tax-credit scholarship program allowing federal taxpayers to receive a dollar-for-dollar federal tax credit for contributions made to nonprofit scholarship-granting organizations (SGOs), which would in turn provide scholarships for eligible children. The proposal would also provide funding for workforce training purposes. The U.S. Department of Education and the U.S. Department of the Treasury would dually manage the program.

Although the Administration and Congress' support of school choice is praiseworthy, a federal tax-credit scholarship program

Key Points

- Education choice is an important policy goal, but a federal tax-credit scholarship program would threaten education choice in the states, and undermine the goal of a streamlined federal tax code.
- Education is not an enumerated power of the federal government in the U.S. Constitution, and as such, there is no constitutional warrant for the creation of a federal tax-credit scholarship program.
- It is far easier to reverse or prevent bad regulations at the state level than at the federal level. If one state overregulates its private school sector, it does not affect schools in the other 49 states. No such safeguards exist for a nationwide program.
- Using the tax code for a nationwide scholarship program further entrenches the current dysfunctional tax system, creating barriers to tax reform that could benefit all taxpayers.

This paper, in its entirety, can be found at **http://report.heritage.org/bg3395**

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poses a threat to education choice in the states, and undermines the goal of a streamlined federal tax code. The federal government does not have the constitutional authority to create such a program, which would establish massive new federal spending and would likely subject private schools to future regulations from an Administration and Congress less friendly to education choice.

By contrast, state governments *do* have the constitutional authority to enact school choice policies, and any new expenditures are more than offset by corresponding reductions in existing state spending.[1] Moreover, federal tax credits are poor tax policy, adding complexity to the federal tax code and making it more difficult to pursue future tax reform that achieves lower rates and simplicity for all Americans.

Instead of establishing a new federal tax-credit scholarship program, the Administration and Congress should work together to advance education choice through use of their bully pulpits, and by creating education choice in those areas in which it has a constitutional warrant: for children from military families, Native American students on tribal lands, and students living in Washington, DC. Such a federal focus would pay dividends for the school choice movement, while leaving additional education choice programs to the states, which have been the catalyst for the impressive growth in school choice over the past two decades.

The Education Freedom Scholarships and Opportunity Act. The Education Freedom Scholarships and Opportunity Act, introduced by Senator Cruz in March 2019, would amend the Internal Revenue Code of 1986 to establish individual and corporate tax credits for contributions to scholarship granting organizations and to workforce training organizations. The proposal would provide dollar-for-dollar tax credits against individuals' federal income tax obligations for contributions to SGOs or workforce training organizations, capped at 10 percent of the individual's adjusted gross income for the taxable year. Likewise, corporate contributions would be dollar-for-dollar, capped at 5 percent of the taxable income of a domestic corporation for the taxable year. The proposed tax credit would be non-refundable. Eligible students (as defined by the state) would then have access to scholarships to offset the cost of private school tuition and related services. The program would be capped initially at $10 billion annually (with $5 billion available for scholarship granting organizations. Eligible expenses would include the following:

- Elementary and secondary education expenses;
- College expenses and career and technical education costs; and
- Expenses associated with vocational education and training, workforce development, apprenticeship programs, and industry certifications.

Eligible scholarship granting organizations are non-profits that provide scholarships to students who reside within the state in which the SGO operates or is recognized, must be an SGO reported from the state to the U.S. Secretary of Education, and allocate at least 90 percent of their funding to scholarships or related education expenses. Workforce training organizations, as defined by the proposal, can include community colleges, workforce training programs operated by a state agency, career and technical-oriented organizations, union and industry credentialing programs and apprenticeships, and other community organizations.

A Federal Tax-Credit Scholarship Program—Poor Education Policy

Although the Administration's support for school choice, along with the support by some Members of Congress, is commendable, advancing nationwide education choice policies at the federal level may ultimately undermine the hard-fought gains of education choice in the states. Anyone interested in reducing—rather than increasing—federal intervention in K–12 education should recognize the potential unintended consequences, in the form of possible future regulations, of a new federal tax-credit scholarship program.

1. Martin F. Lueken, "Fiscal Effects of School Vouchers: Examining the Savings and Costs of America's Private School Voucher Programs," EdChoice, September 2018, https://www.edchoice.org/wp-content/uploads/2018/09/Fiscal-Effects-of-School-Vouchers-by-Martin-Lueken.pdf (accessed February 1, 2019), and Martin F. Lueken, "The Tax-Credit Scholarship Audit: Do Publicly Funded Private School Choice Programs Save Money?" EdChoice, October 2017, https://www.edchoice.org/wp-content/uploads/2017/03/Tax-Credit-Scholarship-Audit-by-Martin-F.-Lueken-UPDATED.pdf (accessed February 4, 2019).

School Choice Not a Federal Issue. Education is not an enumerated power of the federal government in the U.S. Constitution, and as such, there is no constitutional warrant for the creation of a federal tax-credit scholarship program. School choice measures pertaining to populations over which the federal government does have a constitutional warrant, such as students of families in the armed services and those living in the nation's capital, would be appropriate. For example, the federal government has an exclusive mandate and responsibility to oversee the national defense (Article 1, Section 9; Article 4, Section 4; and Article 1, Section 10 of the Constitution).[2] Likewise, Congress has the power to "exercise exclusive Legislation in all Cases whatsoever, over such District [of Columbia]" (Article I, Section 8, Clause 17),[3] and the Constitution "establishes a structure for federal-tribal relations."[4]

Congress not only has a responsibility to students living in the District of Columbia, children from military families, and Native American students living on tribal lands, it is also the only governing body that can legally create a nationwide school choice option for these students. Areas over which the federal government has authority per the U.S. Constitution are areas in which the federal government could implement or expand school choice policies. A blanket, nationwide tax-credit scholarship program is outside the scope of enumerated powers.

The Founders designed a system of federalism that delegates many important decisions, including education, to the states. A broad-based federal tax-credit scholarship program fundamentally goes in the wrong direction: It would expand, not shrink, federal intervention in K–12 education.

School Choice Important Policy Goal—But Not at Federal Level. Tax-credit scholarship programs are smart state-level education policy. The public education trifecta that defines state education systems—that education is publicly funded, compulsory, and assigned based on a family's zip code—makes the pursuit of education choice policies critical. State-based tax-credit scholarship programs and their cousins—voucher options and education savings accounts (ESAs)—achieve what Nobel Prize–winning economist Milton Friedman recommended: separating the financing of public education from the delivery of services. As Friedman observed, the government "administration of schools is neither required by the financing of education, nor justifiable in its own right in a predominantly free enterprise society."[5]

School choice is one of the most important policies that state and local leaders can pursue in order to advance educational opportunity. But creating a new federal tax-credit scholarship program risks causing long-term detriment to the school choice movement. Americans were rightly frustrated by the federal government's heavy-handed role in pushing Common Core. Through a combination of federal inducements, President Barack Obama pushed states to adopt a policy his Administration preferred—national standards and tests—which ultimately led to a major nationwide backlash against what had previously been a state-led initiative.

Education choice is good policy. But using the federal government to push it risks sparking a similar backlash. A national tax-credit scholarship program risks upsetting the hard-won local coalitions that have emerged from the bottom up over the course of decades.

New Federal Education Spending. The creation of such a program would also violate an important aspect of good governance: Policymakers should avoid collecting revenue at one level of government—in this case, the federal level—and dispensing it at another, the state level. When state policymakers enact tax-credit scholarship programs, as has been

2. James Talent, "A Constitutional Basis for Defense," Heritage Foundation *America at Risk Memo* No. 10-06, June 1, 2010, http://www.heritage.org/defense/report/constitutional-basis-defense.
3. Lee A. Casey, "The Constitution and the District of Columbia," Heritage Foundation *WebMemo* No. 1404, March 22, 2007, https://www.heritage.org/report/the-constitution-and-the-district-columbia.
4. Angela R. Riley, "Native Nations and the Constitution: An Inquiry into 'Extra-Constitutionality,'" *Harvard Law Review*, Vol. 130, No. 6 (April 2017), https://harvardlawreview.org/2017/04/native-nations-and-the-constitution-an-inquiry-into-extra-constitutionality/ (accessed February 1, 2019).
5. Milton Friedman, "The Role of Government in Education," 1955, http://la.utexas.edu/users/hcleaver/330T/350kPEEFriedmanRoleOfGovttable.pdf (accessed February 1, 2019).

the case in 18 states to date,[6] funding comes from state-level resources, and is offset by state-based tax credits. A new federal tax-credit scholarship program would also create a large new entitlement. As Senator Cruz stated during the proposal's roll-out at the U.S. Department of Education in early March, the effort represents "$100 billion over 10 years going to expand educational options...even in Washington, that's a lot of money."[7] Some officials have suggested reforms to existing tax credits to offset the cost of the proposed tax-credit scholarships. Generally, existing federal tax credits should be repealed or reformed, but the additional revenue should not be used for a new flawed federal K–12 education subsidy.[8]

It also remains an open question as to the extent to which this new spending could be directed by states to bolster *public school* spending. States have the authority under the proposal to decide what constitutes eligible education expenses and providers. For example, in an oped published by Cruz, Representative Bradley Byrne, and Secretary of Education Betsy DeVos, they note:

> Scholarships could help students access a whole menu of opportunities, including dual enrollment, special education services, advanced or elective courses not available in their assigned school buildings, transportation to out-of-zone opportunities, among many others.[9]

No Way to Prevent Future Regulations. A new federal tax-credit scholarship program would make private schools increasingly dependent on federal funds (which, as of 2019, constituted just 8.5 percent of all K–12 education funding), greatly expanding Washington's reach into K–12 education generally, and private school education, specifically.

The proposal, in its current form, keeps regulations at a minimum—a smart policy approach when crafting any school choice program—giving federal agencies no new regulatory authority. Although federal agencies do not receive any additional regulatory power, it is impossible to prevent subsequent Administrations or Congresses from attaching new regulations to the program. Future regulations could take the form of dictating schools' admissions policies; "accountability"[10] procedures, such as testing and reporting; academic content; and federally determined bathroom policy.[11]

At a future point, if the U.S. Department of Education is under the control of an Administration less friendly to education choice than the present one, participating schools could be subjected to other executive orders and agency rules. If history is any guide, it is unlikely that a program of this magnitude, even with tax credits, would remain unburdened by onerous or unfair government regulations.

Attempts to Limit Regulation Could be Sidestepped. The Cruz proposal includes the following language in Section 25E:

> Nothing in this Act shall be construed to permit, allow, encourage, or authorize any Federal control over any aspect of any private, religious, or

6. Alabama, Arizona, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Louisiana, Montana, New Hampshire, Nevada, Oklahoma, Pennsylvania, Rhode Island, South Carolina, South Dakota, and Virginia currently have tax-credit scholarship programs. See EdChoice: https://www.edchoice.org/school-choice/types-of-school-choice/tax-credit-scholarship/ (accessed February 4, 2019).
7. U.S. Department of Education, "U.S. Secretary of Education Betsy DeVos Unveils Plan for Historic Investment in America's Students through #EducationFreedom Scholarships," https://www.facebook.com/ED.gov/videos/408625746607271/ (accessed March 13, 2013).
8. The AOTC is a $2,500 credit, available for the first four years of higher education. If one has a zero tax liability, up to $1,000 of the credit is "refundable," meaning that it becomes a direct transfer payment. The LLC is a nonrefundable $2,000 credit. Taxpayers cannot claim both credits in the same year, and each has income thresholds at which the benefits phase out.
9. Betsy DeVos, Ted Cruz and Bradley Byrne, "America's Students Deserve Freedom to Choose Their Education Options: DeVos, Cruz, Byrne," February 28, 2019, https://www.usatoday.com/story/opinion/2019/02/28/trump-school-choice-students-education-options-scholarships-tax-credits-column/3002868002/ (accessed March 12, 2018).
10. James V. Shuls, "Accountability Has Built a Regulatory Iron Curtain Around Schools that Shuts Out a Child's Most Important Teachers: Parents," *The 74*, January 27, 2019, https://www.the74million.org/article/shuls-accountability-has-built-a-regulatory-iron-curtain-around-schools-that-shuts-out-a-childs-most-important-teachers-parents/ (accessed February 1, 2019).
11. The Obama Administration issued federal guidance in 2016 stating that schools had to "treat a student's gender identity as the student's sex for purposes of Title IX and its implementing regulations. This means that a school must not treat a transgender student differently from the way it treats other students of the same gender identity," including allowing students to "participate in such activities and access such facilities consistent with their gender identity." See "Dear Colleague Letter on Transgender Students," U.S. Department of Justice and U.S. Department of Education, May 13, 2016, https://www.justice.gov/opa/file/850986/download (accessed February 4, 2019).

> home education provider, whether or not a home education provider is treated as a private school or home school under State law...Nothing in this Act shall be construed to permit, allow, encourage, or authorize an entity submitting a list of eligible scholarship-granting organizations or eligible workforce training organizations on behalf of a State to mandate, direct, or control any aspect of a private or home education provider, regardless of whether or not a home education provider is treated as a private school under state law. No participating State or entity acting on behalf of a State shall exclude, discriminate against, or otherwise disadvantage any education provider with respect to programs or services under this Act based in whole or in part on the provider's religious education character or affiliation, including religiously- or mission-based policies or practices.

Although this language is praiseworthy, it is unlikely to act as the barrier to future regulations or administrative overreach. Similar language is already found in three existing federal laws—(1) the General Education Provisions Act, (2) the Department of Education Organization Act, and (3) the Elementary and Secondary Education Act—each of which prohibits the federal government from prescribing or dictating curriculum and standards. Yet, the Obama Administration effectively ignored these prohibitions, offering billions in federal grants and waivers from the federal No Child Left Behind law to states willing to adopt Common Core national standards and tests.

The Common Core effort parallels the current debate over the wisdom of a federal tax-credit scholarship program. The critique of the effort to create Common Core national standards and tests by Jay Greene, professor of education reform at the University of Arkansas, is instructive:

> [T]o the extent that there will be change in a nationalized system of standards, curriculum, and assessments, it will be directed by the most powerful organized interests in education, and probably not by reformers.... In general, it is unwise to build a national church if you are a minority religion. Reformers should recognize that they are the political minority and should avoid building a nationalized system that the unions and other forces of the status quo will likely control.[12]

Proponents of school choice have long been in the minority, attempting to move away from a system of government-assigned district schooling that has been in place for more than a century. A new federal program will enable opponents of education choice to concentrate their efforts in a way that is not advantageous to school choice in the long term. At the federal level, there will be continual pressure from special interest groups opposed to school choice to imbue the program with regulations to control or even undermine private schools. It is far easier to reverse or prevent bad regulations at the state level than at the federal level. If one state overregulates its private school sector, it does not affect schools in the other 49 states. No such safeguards exist for a nationwide program.

School Choice Making Great Strides in the States. Since the year 2000, the number of school choice programs has grown from just 10 programs in four states to 65 programs in 29 states, Washington, DC, and Puerto Rico. Nearly 500,000 students across the country are exercising private school choice.[13] Notably, the first modern-day school choice program did not exist until 1991, when the Milwaukee Parental Choice Scholarship program was established in Wisconsin. Considering that school choice is a relatively new policy, its advances have been meteoric. States and localities have led this effort, and have done so with great success without federal inducements.

A federal education tax credit scholarship program could crowd out state level programs, with potentially devastating long-run effects. Unlike the 100 percent proposed federal credit, most states offer less than full reimbursement for donations. A new, more generous, federal program will shift these donations to the federal credit and away from the state systems. Similarly, individual taxpayers who are denied a federal deduction for state level donations to SGOs in lieu of taxes will shift their donations to the federal credit, even if the state credit is dollar-for-dollar. Under proposed rules, about 10 percent of taxpayers, those who

12. Jay P. Greene, "My Testimony on National Standards Before the US House," Jay P. Greene's Blog, September 21, 2011, https://jaypgreene.com/2011/09/21/my-testimony-on-national-standards-before-us-house/ (accessed February 1, 2019).
13. Ed Choice, "The ABCs of School Choice: The Comprehensive Guide to Every Private School Choice Program in America," 2019, https://www.edchoice.org/wp-content/uploads/2019/01/The-ABCs-of-School-Choice-2019-Edition.pdf (accessed February 1, 2019).

do not max out the new $10,000 SALT deduction, will face an increase in their donation costs from zero to as much as 37 percent of the donation amount.[14]

To the extent that this new program crowds out state-level credits, when the inevitable federal regulations are imposed on the state SGOs, the currently robust state programs will have atrophied. Federalizing school choice will weaken state level efforts.

A Federal Tax-Credit Scholarship Program Is Also Poor Tax Policy

Each year, Congress uses the tax code to hand out billions of dollars in subsidies to politically connected interests, picking winners and losers and distorting free markets.[15] This spending persists without systematic review or annual appropriation. Tax-credit programs operate like mandatory spending, permanent programs that Congress rarely reviews. A federal tax-credit scholarship program would add new complexity to the tax code, impede future efforts to reform the tax code, and undermine other important federal priorities.

Tax Credits Add Complexity. Tax reform should simplify and streamline taxpaying. A new federal tax credit would do the opposite, and add yet another level of complexity to tax returns, making filing taxes even more burdensome and tax administration even more complex. There are about 30 existing individual and corporate tax credits which are ineffective or detrimental to the credit program's stated goals. Each of these credits expands the scope of Washington in the daily lives of Americans while also making it more difficult to comply with the already onerous tax code. Like each of the existing federal tax credits, a new federal tax-credit scholarship program would expand the authority of Washington bureaucrats to direct economic activity that is outside the scope of the federal government's constitutionally enumerated duties.

The federal proposal and all state programs cap the total value of available scholarship tax credits. Businesses and individuals must apply for these credits before they can be claimed. There will be significant additional complexity in having to apply for both state and federal credits, understanding the interactions between the 50 plus systems, and maximizing the donations. In the face of this complexity, taxpayers may abandon state program in favor of the federal system. This interaction may even diminish overall contributions as any donor denied a federal credit may not also want to go through the hassle of applying for the various state credits, which are also often not dollar-for-dollar credits.

Tax Credits Impede Reform. True tax reform requires eliminating narrowly tailored tax subsidies in favor of a lower tax rate for everyone. Each tax program garners a politically powerful constituency that stands in the way of tax reform for fear of losing its subsidy, even when there is broad agreement that the program is ineffective.[16] Using the tax code for a nationwide scholarship program further entrenches the current dysfunctional tax system, creating artificial barriers to tax reform that could benefit all taxpayers.

Other Priorities. The proposed scholarship tax credit would reduce federal revenue by between $50 billion and $100 billion over 10 years. That revenue could be used to lower tax rates for everyone, begin to make the 2017 tax cuts permanent, expand pro-growth reforms, or pay down the debt. Most K–12 education is outside the federal government's constitutionally prescribed duties, and any revenue reduction should go first toward the existing priorities that are within the scope of federal powers.

Conclusion: Leave School Choice to the States

Prudent tax policy—whether at the state or federal level—should maintain low tax rates on a tax base that does not discourage savings and investment. Complicating the tax code through myriad tax credits and

14. Adam Michel, Lindsey Burke and Jonathan Butcher, "A Technical Correction to Address the Impact of the State and Local Tax Deduction Cap on State-Based Tax Credit Scholarship Programs," Heritage Foundation *Backgrounder* No. 3350, September 12, 2018, https://www.heritage.org/education/report/technical-correction-address-the-impact-the-state-and-local-tax-deduction-cap.
15. The Heritage Foundation, "Reduce Spending Through the Tax Code," *Blueprint for Balance*, June 11, 2018, https://www.heritage.org/blueprint-balance/blueprint-balance/reduce-spending-through-the-tax-code.
16. For example, while the low-income housing tax credit is widely seen as ineffective in addressing low-income housing shortages, the subsidy continues to have strong political support. Adam N. Michel, Norbert J. Michel, and John L. Ligon, "To Reduce Corporate Welfare, Kill the Low-Income Housing Tax Credit," Heritage Foundation *Issue Brief* No. 4832, March 28, 2018, https://www.heritage.org/sites/default/files/2018-03/IB4832.pdf.

deductions can mask true government expenditures and insulate policymakers from pressure to keep rates low. A nationwide federal tax-credit scholarship program will, quite simply, threaten the long-term success of the school choice movement and impede future tax reform efforts.

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