How the Arizona School Tuition Organization Tax Credits Save the State Money

By Deborah Sheasby

Executive Summary

Arizona has four programs that allow taxpayers to claim credits for donations to school tuition organizations that provide scholarships for students to attend private schools. The state realizes a savings for each student that attends private school in lieu of public school. Because the tax credit scholarship programs allow tens of thousands of students to attend private schools, the state saves at least $34.6 million, and potentially upwards of $285 million per year, compared to the cost of educating those students in public school.

Overview of Arizona's Tax Credit Programs

History

In 1997, Arizona passed its first tax credit for individual donations to private school tuition organizations.[1] A school tuition organization (STO) is a 501(c)(3) nonprofit organization that awards at least 90% of donations received as scholarships to students attending private schools. The program allows taxpayers to make a donation to an STO and claim a tax credit of $569 for an individual or $1,138 for a married couple for the current tax year (2019). The credit went into effect in FY1999 and has grown to around $70 million in donations and $64 million in scholarships in FY2018.[2] This credit is generally referred to as the "original" individual tax credit.

In 2005, a second program was created that allowed corporations to contribute funding for STO scholarships.[3] The recipients of scholarships under the corporate program must meet income limitations and must be switching from public to private school, attending kindergarten (or a preschool for students with disabilities), or be the dependent of an Arizona active-duty member of the military. Students who have received scholarships through the low-income corporate program (or the overflow program) may continue to receive scholarships in subsequent years if they remain enrolled in private school. The total scholarship amount that can be awarded per

academic year is also limited by statute. The amount of donations has an overall cap allocated on a first-come, first-served basis for corporate donors.

A second corporate program was added by the Legislature in 2009 in a special session to rescue children with special needs who had previously been eligible for a voucher program that was struck down in court. This credit, titled "Lexie's Law" after one of the participating students, allows donations up to a total of $5 million specifically for scholarships for students with special needs and students in foster care.[4]

Finally, in 2012, news reports brought to light the lengthy waiting lists that many STOs had for students wanting to switch from public to private schools. In response, the Legislature created a fourth program, the "overflow" credit for individual donations made to relieve those waiting lists. Scholarships provided under this program are prioritized to students who are changing from public to private schools and their siblings.[5] The credit is also called the "switcher" individual tax credit and allows a credit for donations beyond the original individual tax credit up to $566 for an individual and $1,131 for a married couple for the 2019 tax year.

Court challenges to these programs have been entirely unsuccessful. The original individual tax credit program was upheld by the Arizona Supreme Court in 1999.[6] The corporate tax credit program was upheld by the Arizona Court of Appeals in 2009, and the Arizona Supreme Court declined review.[7] Finally, the U.S. Supreme Court rejected a challenge to the original individual tax credit program in 2011.[8]

The tax credits have been reviewed by the Legislature and in-depth reporting to the Arizona Department of Revenue provides Arizonans an even clearer picture of how beneficial these programs really are.

Current Numbers
In FY2018, the four STO tax credit programs took in a collective $192 million and awarded $164 million in scholarships.

The original program took in $70.5 million in donations and awarded $64.3 million in

students received $74.5 million in donations and awarded $59.7 million in scholarships. The Lexie's Law program for students with special needs took in $5 million in donations and distributed $5.2 million in scholarships.[9]

Cost Analysis

Although the total cost for all of the private school scholarship tax credit programs is only about 3% of the $5+ billion public school appropriation,[10] the STO program's fiscal impact has been a subject of hot debate between supporters and opponents.

When the U.S. Supreme Court considered the effect of the individual tax credit program on Arizona taxpayers, the justices explained that looking at the dollar value of tax credits claimed is "just the beginning of the analysis."[11] Every student that is educated in private schools relieves some burden on Arizona's public schools.[12] Since "the average value of an STO scholarship may be far less than the average cost of educating an Arizona public school student," the Court concluded there was no basis to find that the programs had any cost to taxpayers at all.[13] The Court's analysis was brief because the savings issue was ultimately unnecessary to their decision to uphold the program. To flesh out that analysis, this paper compares the state cost for educating the students currently enrolled in private schools that participate in the STO program to the dollar amount of scholarships awarded to students of those schools.

The Cost of Public School Attendance

To understand the magnitude of savings that the state enjoys as a result of the program, the cost of the tax credit program must be weighed against the cost the state would incur to educate scholarship recipients who would otherwise attend public schools.

The numbers vary widely when it comes to the cost per public school student, depending on whether all sources of funds coming from federal, state, and local sources are included, what number is used for the student count (actual number of students versus the number used for calculation that counts students with special needs multiple times), estimated amounts versus amounts actually paid, and so on. Schools receive funds from the state for their ongoing maintenance and operation, which are calculated using a formula based on the enrollment in

each school district. Some districts receive a portion of their general funding from local property tax revenues, and the state funds some districts more than others to equalize that funding.

The breakdown between per student funding versus other funds public schools receive for capital expenses creates still more confusion about the true cost for each student. Schools receive funds for capital spending, such as building upkeep and physical infrastructure. Adding in local property taxes and grants for various programs from the federal government, the total per student easily reaches more than $10,000.[14]

To narrow down to a specific number, according to the Superintendent's Annual Report, Arizona's average spending per public school student in FY2018 was between $8,080 and $8,870, depending on the type of district.[15] The Joint Legislative Budget Committee (JLBC) staff estimates that funding for FY2018 from all sources (state, local, and federal) is $9,674.[16] When funds for capital expenditures are excluded, JLBC's estimate for spending per pupil from all sources is $8,310.[17] The portion of that non-capital spending that comes from the state is $4,537.[18] The most conservative number for per-student spending that comes directly from the state is the Base Support Level. For FY2018, that number was $3,683.[19]

Thankfully, tracing the full maze of public school funding is an exercise beyond the scope necessary for analysis of the tax credit scholarship program. The fact remains that, no matter how the funding sources are narrowed down, the students attending private schools save the state far more than it would cost to educate those children in traditional district schools or public charter schools.[20]

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[14] *See* 2017-18 Superintendent of Pub. Instruction Ann. Rep., Vol. I at 37-38, et seq.
[15] *Id.* at 43. There are differences between school districts that include high schools and those that do not include high schools.
[16] *All Funding*, Fiscal History: Education Spending Report, Joint Legislative Budget Committee (Ariz. 2019), *available at* https://www.azleg.gov/jlbc/allfunding.pdf.
[17] *Non-Capital Funding Only*, Fiscal History: Education Spending Report, Joint Legislative Budget Committee (Ariz. 2018), *available at* https://www.azleg.gov/jlbc/non-capitalfundingonly.pdf.
[18] *Id.*

Total Savings to the State from the Tax Credit Scholarship Program

Using the Base Support Level of $3,683 per student in private school to compare to the dollar amount of scholarships given to students through the tax credit scholarship program, at the very least, the state is saving $38.5 million per year.[21] Subtracting the allowed 10% cost of administering the STO program from the conservative estimate of savings, the state is still saving $34.6 million per year. Historically, the entire STO program has averaged only 8% for administration, so the true savings the state realizes are likely more than $35 million.

This estimate of savings is extremely conservative for several reasons.

First, this total includes savings for students with special needs, who could potentially receive up to eight times the Base Support Level of funding if those students were to attend traditional public district schools ($25,000+). Students attending specialized private schools for severe learning disabilities, plus some (likely small) percentage of the overall private school population, would be eligible for increased funding in public schools, so the state saves far more than just the Base Support Level for those students through the tax credit scholarship program.

Second, the calculation assumed zero savings for the private schools for which enrollment data was unverified or unavailable, which was 56 out of 348 schools. Considering that the average savings per private school is about $106,000 (with the highest saving nearly $1.7 million), those schools could easily account for several million dollars more in savings.

Finally, and most importantly, the Base Support Level is an unrealistically low estimate of the state's cost per public school student. With the slightly more realistic estimate of state-only, non-capital, per-student funding ($4,537), the savings is around $80 million per year.

When funding from all sources is taken into account ($9,674 per student), the cost to educate those private school students in traditional district schools would be approximately $477 million. Since the total donations to STOs was $192 million,[22] the bottom line for Arizona taxpayers is a

savings of around $285 million by enabling those students to attend private schools through the tax credit scholarship programs.

Moreover, the portion of public school funds that are not issued based on student counts stays with the public schools, even when students transfer to private schools, so the savings for the individual public schools are even more substantial.

Average Scholarship Per Student

As the various scholarship programs have developed, the analytical metric of comparing the average scholarship versus the cost to the state of educating the students in public schools has been questioned due to the fact that students may receive scholarships from more than one STO. By comparing the total number of scholarships to the enrollment at participating private schools, the true average scholarship for all tax credit programs is $2,889, with the average number of scholarships per student around 1.5. This is nearly $1,000 less than the per pupil state spending, by the most restrictive calculation, and, again, this includes the students who would receive considerably more in weighted funding for special needs if attending public schools.

Student Choices Without Tax Credit Scholarships

Critics of the scholarship tax credit have also claimed that the program does not actually save the state money, and may even result in a net cost to the state, as the scholarship recipients would likely attend private schools even in the absence of the program. This argument ignores the financial reality that the families of most scholarship recipients could not otherwise afford private school tuition. Though there is no way to prove what choices families would make in the absence of the tax credit scholarship program, family income is the closest proxy to determine whether a family would continue to choose private school without a scholarship. Based on data reported to the Department of Revenue by the STOs, approximately 60-70% of scholarships in the original and overflow programs are awarded to students with family income below 185% of the federal reduced price lunch income guideline.[23] Additionally, scholarships in three of the four programs (overflow, low-income corporate, and Lexie's Law) are primarily awarded to students who are switching from public schools. Therefore, it is likely that the tax credit scholarship program is the primary reason that about two-thirds of students are able to attend

would have attended a private school anyway, the state would still realize a net savings. Contrary to the criticism, the program achieves a budget-positive result.

Conclusion

The Legislature has created the tax credit scholarship program for the public policy goal of expanding options available to parents for educating their children. That public policy goal could be accomplished with or without saving the state money, but the Arizona credits have the added advantage of providing significant savings of at least $34.6 million, and as much as $285 million, to the state's bottom line each year, making the program a win-win for the children and the taxpayers of the Grand Canyon State.

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