

EdChoice Policy Toolkit

Tax-Credit Scholarships: A Primer on Policy Options

Although more students nationwide access school choice via tax-credit scholarship (TCS) policies than school vouchers and education savings accounts combined, they remain the least understood of the school choice policies.¹ Under a TCS policy, individual and/or corporate taxpayers receive tax credits in return for contributions to registered, nonprofit scholarship granting organizations (SGO) that help families afford private school tuition. There are currently 18 states with TCS policies. These policies vary considerably in terms of eligibility, testing, and numerous other regulations. This section addresses policy choices unique to TCS policies.

Tax Credit Value

Currently, the tax credit values vary from 50 percent to 100 percent of the taxpayer's contribution to a scholarship granting organization. Lower credit values are intended to produce greater savings, but it comes at the cost of reducing the incentive to contribute to an SGO. Since the purpose of TCS policies is to expand educational opportunity for as many children as possible, ideally the tax credit value will be as close to 100 percent as possible.

Tax Credit Caps

In order to help manage the fiscal impact of a tax credit, policymakers often place caps on the amount of tax credits an individual donor can receive or a cap on the total amount of tax credits available.² Policymakers should keep in mind that, due to inflation, fixed caps have the effect of reducing the total available funds for scholarships over time. Ideally, policymakers would include an “escalator clause” that increases the total amount of tax credits over time in order to meet rising demand. At the very least, policymakers should ensure that caps on either the total tax credits available or the tax credits per donor are pegged to inflation.

Scholarship Granting Organizations

SGOs foster stronger communities by bringing together scholarship families, private schools, and individual and corporate donors to expand educational opportunity. SGOs are nonprofit organizations registered under a state's TCS policy. They grant scholarships to eligible students, and donors to the SGOs receive tax credits against certain state taxes. SGOs often have to meet certain reporting requirements or undergo regular audits.

Most states respect the right of these nonprofit SGOs to define their own missions, so long as they grant scholarships to students eligible under the state law. Some SGOs have a religious mission; others support students attending schools with particular pedagogical approaches (e.g., Montessori) or schools in a particular network or region. Many SGOs support students attending any school their parents choose. The vast majority of SGOs prioritize scholarship awards based on the financial need of the applicants, even beyond what the state laws require. Donors have the freedom to support SGOs whose missions align with their values.

Some states' TCS policies restrict tax-credit eligible contributions to SGOs that fund scholarships to children attending any school of their family's choice. Although this is a worthwhile model, it is not the only worthy model. Many of the mission-based SGOs long predated the enactment of TCS policies, sometimes by more than a century. SGOs have a plurality of missions that reflect the diversity of our plural society. They are an important part of the social fabric, and they should not be excluded from TCS programs merely because they do not operate like a state-run voucher program would. Moreover, restricting their ability to determine their own particular missions may even be counter-productive, as it would prevent donors from supporting organizations whose values align with their own, having the net effect of shrinking the pie of available donations.

Administrative Expenses

In order to provide scholarships, scholarship granting organizations need funds to cover administrative costs such as staff salaries, marketing, printing, and website maintenance. Most states' TCS policies allow SGOs to keep up to 10 percent of the tax-credit eligible contributions they receive, although some states restrict administrative costs even further. Several states have a sliding scale that reduces the administrative allowance as the SGO collects more money. Although there is no magic number, policymakers should avoid restricting the administrative allowance so much that it is difficult for people to create or run SGOs.

Ultimately, the purpose of SGOs is to help as many students as possible gain access to greater educational opportunity. Policymakers should seek to craft policies that aid them in that mission.

¹ EdChoice, "What Is a Tax-Credit Scholarship?", www.edchoice.org/school-choice/types-of-school-choice/tax-credit-scholarship/.

² Martin Lueken, "The Tax-Credit Scholarship Audit," EdChoice, October 31, 2016, www.edchoice.org/research/tax-credit-scholarship-audit/.