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Education Tax Credits

Restoring Trust in Families

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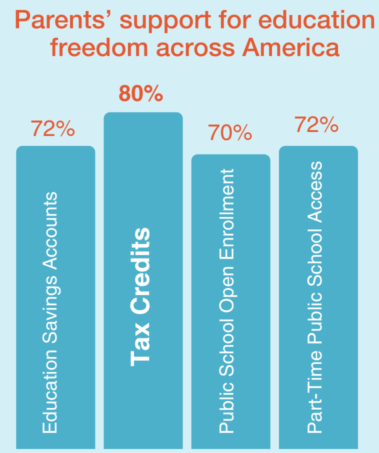


Survey of 1,000 US adults by yes. every kid. foundation. and YouGov, September 20-25, 2023. Margin of error ± 3.42%.

EXECUTIVE SUMMARY

Personal education tax credits may be the future of education freedom policy.

Tax credits are broadly popular across the nation and can quickly and easily serve families looking to build their kids' unique educational experience outside of the traditional public school system.

Education tax credit policies trust families. That may be why, according to a recent poll by yes. every kid. foundation. and YouGov, two-thirds of Americans – including a whopping 80% of K-12 parents – support it.

This report offers a family-first perspective on both policy development and implementation of education tax credits, which should help to inform lawmakers across the nation as they seize this national moment for educational freedom.

States looking to enact a strong education tax credit policy should ensure that it:

- applies to all families,
- retains family autonomy,
- ensures administrative efficiency,
- and is built on a sustainable basis.

This report also provides a case study celebrating **Oklahoma's first-in-the-nation universal tax credit** and charts a course to how other states can build even better policy solutions to remove barriers for families. Lawmakers and policy professionals should utilize it as a technical "how-to" guide to protect the rights of families while expanding educational choices for every kid.

Education Tax Credits

INTRODUCTION

Education tax credit programs are a policy option for states to empower families to select the best education that suits their child's unique passions and interests. This policy adaptation should not be confused with tax-credit scholarships, education savings accounts, or vouchers. Personal education tax credits are different and more direct. They require less administration, no third-party contracts, and are grounded in trusting families.

While personal education tax credits are not a completely new idea, they can offer an alternative approach to the education choice policies that have been frequently discussed and adopted across the country before and, especially, since the pandemic.

Personal education tax credits are tax credits received by a parent or guardian for educating his or her student outside of the existing public school system. They are a simple way to give families support to offset the cost of educational expenses by returning their taxes to them and, in some cases, providing them with a refund.

Education tax credits currently exist in seven states, with the first program starting in 1987. Most of these programs are limited in scope and in dollars. This year Oklahoma established something different, the Parental Choice Tax Credit. This program aims to be the largest education tax credit program in the country by total size and per student.

> Education tax credits trust families to chart the course of their kids' education, tailored to their unique needs.

How does a personal education tax credit program work?

Ideally, an education tax credit allows a parent or guardian to receive a credit when they educate their children in a nonpublic setting, on a full-time or part-time basis. To receive the credit, the parent should simply indicate on their tax form or an application that they have dependents who are not enrolled in public school. Once acknowledged by the state tax commission or department of revenue, the parent would receive a transfer or deposit similarly to how one would for a tax return. Education tax credit programs tend to be cost-efficient and require minimal administrative burden, as they are simple to operate and manage. A tax credit program can be implemented almost immediately for families' benefit.

Education Tax Credits

THE CASE FOR EDUCATION TAX CREDITS

Education tax credits offer a unique way to allow funding for education to flow directly to families and minimize regulations placed on families. Specifically, education tax credits:

1. **Allow for a streamlined structure and high family autonomy**
   Families know what is best for their children. By designing a program that funds families directly, states can save time and resources while also providing a straightforward system for families to navigate. Tax credits can remove the middleman between families and provide support for them to choose educational options for their children.

2. **Establish flexible funding streams**
   In contrast to other programs that depend on potentially uncertain legislative appropriations or state education funding systems, this program can leverage pre-existing tax mechanisms for its funding. While personal tax credits have typically been financed by deducting from a taxpayer's income taxes, tax credits can and have been developed from other revenue sources like sales tax and property tax. This unique financing structure sets it apart from other programs.

3. **Provide a sustainable foundation**
   Other programs that fund families often face legal challenges from critics who argue that public funds should not be allocated to families seeking alternative educational options. However, personal tax credit programs overcome these legal hurdles by not sourcing funding directly from the education budget. As a result, these programs are less vulnerable to additional regulations and legal disputes, ensuring a more stable and sustainable means of financial support for families.

4. **Fund students efficiently**
   A program that prioritizes the funding of students ahead of institutions can result in potential cost savings for a state while simultaneously giving families greater opportunities to choose the education their children need. Providing education tax credits to families will still be funding each child's education at a lower cost to the state than if the child were to enter the public school system.

5. **Retain built-in accountability**
   It is common practice that when one files their taxes, they are susceptible to being audited. Audits are standardized, efficient, and they work. Personal tax credit programs come with the same built-in accountability that come with any other tax benefit.

ELEMENTS TO CONSIDER WHEN CREATING PERSONAL EDUCATION TAX CREDIT

Top five elements for policymakers to consider when creating a **personal education tax credit policy**:

1. The program should be **universal** to all students eligible to enroll in the public school system who are not enrolled full time in a public school.
2. Families should be the **receiver** of their individual student's tax credit to allow for maximum autonomy in driving the child's education.
3. The amount of an education tax credit should be as close as possible to **100%** of the amount the state spends per pupil or would spend on a specific pupil based on his or her individual characteristics.
    - A program should allow for a prorated amount for students partially enrolled in a public school.
    - A program should be available to all students who choose to not enroll in a public school, but could weigh the credit amount based on a parent or guardian's tax bracket.
4. Tax credits can be **refundable** to allow low-income families to truly benefit from the program.
5. There should be a mechanism to allow for **early claims** of the tax credits.

Program Highlight: Oklahoma

In 2023, Oklahoma passed House Bill 1934, the largest and most expansive education tax credit program to date. The funding for the tax credit reserved for private school students is capped at $150 million in 2024 and will increase to $200 million in 2025 and $250 million in 2026. The cap for home school students will stay steady at $5 million and will not grow in subsequent years. This program will provide families with an opportunity to receive a significant amount of funds to make real changes for their kid's education.

Oklahoma's Parental Choice Tax Credit is a first-of-its kind universal education tax credit program.

Program Highlight: Oklahoma

DETAILS OF THE PARENTAL CHOICE TAX CREDIT

The program is **universal for all children** who are enrolled in a private school or home schooled and eligible to enter grades K-12 in the state.

Taxpayers can receive a credit back from their owed state income taxes. The program specifically outlines that taxpayers shall receive a refund to use towards educating their student if their designated credit amount is greater than their state income tax burden.

The amount each parent or guardian can receive for a qualifying dependent child in an accredited private school is based on the total adjusted gross income of the family, with those earning less being eligible to receive more. Parents of students enrolled in private school can receive between $5,000 and $7,500 annually. Parents of students enrolled in a home school or in an uncredited private school can receive $1,000 annually, regardless of adjusted gross income of the family.

Eligible expenses for those enrolled or planning to enroll in an accredited private school include tuition expenses and fees. Eligible expenses for those enrolled or planning to enroll in a non-accredited private school or homeschool can include tuition and fees, tutoring costs, textbook expenses, curriculum costs, and fees for nationally standardized assessments.

The Oklahoma Tax Commission will create an application for families to receive their qualified credit amount in two installments prior to submitting their taxes.

Education Tax Credits

FAQs

FREQUENTLY ASKED QUESTIONS ABOUT PERSONAL EDUCATION TAX CREDITS

How is this different from a tax credit scholarship or an education savings account?

Education tax credits provide families direct funding with little bureaucratic interference and allows families to spend these funds in the most flexible way; they should not require a middleman between families and funds.

- A tax credit scholarship provides students with scholarships to attend an approved nonpublic school from funds donated by individuals, corporations, or other taxable entities in exchange for a tax credit.
- An education savings account is a government spending account containing funds designated for use on eligible educational expenses, often with restrictions on how the money can be spent and how the program operates.

What about individuals who do not have a tax burden high enough to deduct the full credit?

These measures can be refunded. For example, if the credit for a nonpublic student is $12 and a family's tax burden is $5, then that family can receive their tax dollars back plus $7 to educate their kid.

How does this help those most in need that cannot wait until they file their taxes to receive funds?

A tax credit policy can allow families to fill out a form to receive the funding up front. Programs can be designed to prioritize early funding for families most in need of financial assistance.

How do we know funds are being spent on educational expenses?

Like any tax credit or deduction, families are required to keep their receipts in case of an audit. Each state treasury department can audit parents and families at their discretion. Flexibility in what a family can purchase will allow them to have the greatest autonomy in serving their child. If a program decides to name education service providers, there should be a low barrier to entry for providers to ensure maximum options for students. Eligible expenses can include:

- Tuition and fees for nonpublic schools, in-person or online, including private schools, home schools, micro-schools, learning pods, co-ops, and other educational environments.
- Any other cost related to a child's education including textbooks, curriculum, tutoring, therapies, and transportation.

Could states use other tax streams to operate an education tax credit program?

There are numerous ways to provide people of all socioeconomic statuses with refundable credits if they choose to educate their child in a nonpublic setting and want support. States can consider multiple tax streams to offer families tax credits. Income tax and sales taxes are two of the simplest forms of taxes from which to deduct a credit. Property taxes also offer a stream to which taxpayers could claim credit.

Education Tax Credits

Tax Credit* vs. Tax Deduction

Education tax credits can often be confused with a tax deduction. Currently, seven states have education tax credit programs, and four states have tax deduction programs.

Tax **deduction** applies here

Example:

Taxable Income: $60,000

Deduction: $10,000

Updated Taxable Income: **$50,000**

Taxable Income

Amount of income subject to taxation, after deductions

Updated Taxable Income: $50,000

Assumed Tax Rate:10%

Taxes Owed: $5,000

Taxes Owed

Taxable income multiplied by tax rate

Example:

Taxes Owed: $5,000

Credit: $10,000

Updated Taxes Owed: **-$5,000**

Tax **credit** applies here

*A note about refundable credits: A credit reduces the amount of taxes owed. In some cases, a tax credit can be refundable, meaning that if the credit exceeds the tax liability, the excess amount can be paid to the taxpayer as a refund. Unlike a tax credit, a deduction reduces the taxable income, which in turn reduces the amount of taxes owed but does not result in a direct payment to the taxpayer.

Education Tax Credits

PROGRAM IMPLEMENTATION

To ensure that every citizen has access to quality education, tax credits can emerge as a powerful tool for families. Success of an education tax credit program hinges on taxpayers being aware of the benefits, processes, and eligibility requirements.

A complicated process can deter families. Consider incorporating these features for effective implementation of an education tax credit program:

Timely and Adequate Information for Taxpayers

Example: Illinois offers explicit guidelines for qualifying education expenses for their Education Expense Credit, which provides taxpayers clarity and reduces ambiguity.

Avoid Over-Regulation

Hassle-Free Claim Process

Example: South Carolina's comprehensive tutorial video simplifies the tax claim process, guiding taxpayers step-by-step.

South Carolina also allows taxpayers to reserve their tax credit in advance and provides the taxpayer with confirmation that their credit has been reserved so long as the cap has not been met. View South Carolina's example.

Collaborative Engagement with Stakeholders

Open Channels for Taxpayer Feedback

Provide Periodic Evaluation of Efficacy

Case Study: The Federal Child Tax Credit

The 2021 extension of the United States' federal Child Tax Credit was an effort to simply provide families funds to spend on what they choose to for the betterment of their children. Upon passage, 86% of Democrats and 64% of Republicans in Congress voted in favor to extend the targeted, temporary public benefit.

The federal Child Tax Credit program offers families a tax benefit of up to $2,000 for families with children seventeen and younger, with up to $1,500 of this amount being refundable. In 2021 the program was extended through the American Rescue Plan to allow families with little or no taxable income to receive the full amount regardless of their tax burden and to increase the credit amount to up to $3,600 for certain dependents.

Over time, this program has garnered widespread popularity. A 2022 survey from the Economic Security Project revealed that, upon understanding the benefits of the tax credit, 75% of respondents expressed support for the program.[1]

The functionality of the federal Child Tax Credit closely mirrors that of an education tax credit, though it was not established to fund education. According to the U.S. Census Bureau, three in 10 families that received advance monthly tax credit payments spent them on kids' school expenses. Given the wide acceptance of the federal Child Tax Credit, policymakers can have confidence in the success and popularity of implementing similar education tax credits.[2]

[1] "Public Opinion on the Child Tax Credit." Economic Security Project, September 12, 2022: https://economicsecurityproject.org/resource/public-opinion-on-the-child-tax-credit/
[2] "Parents With Young Children Used Child Tax Credit Payments for Child Care." U.S. Census Bureau, October 26, 2021: https://www.census.gov/library/stories/2021/10/nearly-a-third-of-parents-spent-child-tax-credit-on-school-expenses.html"

Education Tax Credits

EXISTING EDUCATION TAX CREDIT PROGRAMS

Alabama's Failing Schools Tax Credit provides a refundable tax credit to students attending failing schools to cover the cost of attending a private school or nonfailing public school. The credit amount is up to 80% of the average annual student per-pupil amount and is to be used on tuition and mandatory fees at the student's new school since the state has strict open enrollment laws that allow public schools to charge families tuition. Ala. Code § 16-6D 1-9

Illinois' Education Expense Credit is a tax credit for joint filers making less than $500,000 a year or single filers making less than $250,000 a year. Families can claim a credit of 25% of qualified education expenses. The credit cannot exceed $750. Qualified expenses include tuition, book fees, and lab fees. The tax credit is not refundable. 35 ILCS5/201(m)

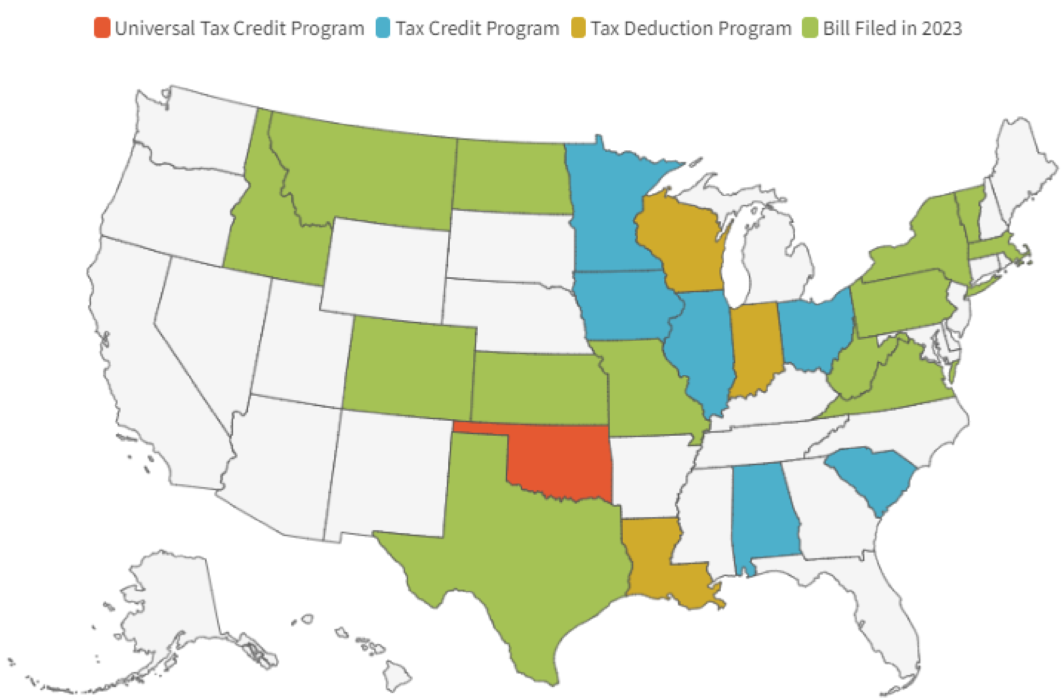
Iowa offers a non-refundable education tax credit for students enrolled in a private school or an accredited nonprofit public school. Parents or guardians can claim 25% of the amount they spend toward tuition and textbooks per dependent. The program allows for a maximum of $500 to be credited once a family spends $2,000 on qualified expenses. Iowa Code § 422

Minnesota offers a refundable, universal education tax credit for any private or public student. The credit amount is capped at $1,000 per dependent for families making less than $33,500 a year or a reduced amount for families making more. Expenses can include tutoring, after school programs, books, technology and other educational expenses, but cannot include fees for religious schools. Minn. Stat. § 290.0674

Ohio offers two education tax credit programs. The first provides families with homeschooled dependents a non-refundable tax credit of up to $250. Qualified expenses include books, supplementary materials, supplies, computer software, applications, or subscriptions. Ohio Rev. Code § 5747.72. The second is for families with dependents attending nonpublic, noncharter schools. Families whose adjusted income is between $50,000 to $100,000 annually may receive a non-refundable tax credit of $1,500. If the family makes less than $50,000 a year, they can receive $1,000. Qualified expenses are not explicitly stated. Ohio Rev. Code § 5747.75

Oklahoma's newly created Parental Choice Tax Credit Program is funded at $150 million in the first year to allow families with students attending a private school to receive a refundable tax credit on income taxes, the private student cap will increase to $200 million and in 2026 to $250 million. The program also provides $5 million annually for home school students. Credits for dependents enrolled in a private school are based on a families adjusted gross income allowing up to $7,500 to be received. Credits for students enrolled in a home school are worth $1,000. Okla. Stat. tit. 70 § 28.101

South Carolina has a tax credit program for special needs students. Families with dependent children with special needs are eligible to receive a refundable tax credit of $11,000 to use for tuition at eligible nonpublic schools. There are no income requirements for families to receive the tax credit. S.C. Code Ann. § 12-6 -3790(H)(2)



CONCLUSION

Policymakers should empower families to customize their children's education. While traditional public schools should continue to be an option for all students to receive a tuition-free education, families should be able to choose other schooling opportunities and have their child's state-allocated funds follow their child wherever best fits his or her needs.

Each child's learning needs are unique, and a personal education tax credit can significantly enhance a family's ability to find the educational option that best fits their child's specific needs. This policy provides a direct, flexible, and efficient channel for funding. Additionally, it offers a robust legal footing by overcoming legal challenges commonly directed at policies that seek to empower families. The federal Child Tax Credit has set a strong precedent for creating bipartisan tax credits for families and showing that by simply providing families with funds, they are better able to meet their diverse needs.

Following Oklahoma's lead, policymakers in other states should consider education tax credits a viable solution for the lack of options that families have nationwide.

Education tax credits can be a vital component in empowering every child with the opportunity to thrive in an environment tailored to fit their specific learning needs.

ABOUT THE AUTHORS

Lily Landry *is the senior legislative analyst with yes. every kid., aiding the advancement of student-centered policies in the states. In addition to authoring this report, Lily recently co-authored Public Education Your Way, a review of state policies that remove barriers to students' flexible access to public education.*

Prior to joining yes. every kid., Lily served as the Advocacy Program Manager for ExcelinEd. She completed her undergraduate degree in Child and Family Studies and a master's degree in public administration focusing on public policy and nonprofit advocacy from Louisiana State University. Lily has previously worked in U.S. Senate congressional offices as an intern and a staff assistant in Washington, D.C. Throughout her time in graduate school, she worked as a graduate assistant at the Student Financial Management Center and at the Louisiana Board of Regents. She resides in Austin, Texas.

Sam Niederholzer *is a former government affairs associate at yes. every kid. He supported bill analysis, review, and legislative research. In addition to authoring this report, Sam recently co-authored Public Education Your Way, a review of state policies that remove barriers to students' flexible access to public education. Sammy graduated from the University of California, Davis with honors in history and philosophy.*