



AN EXAMINATION OF COLORADO'S TUITION TAX CREDIT PROPOSAL

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Introduction

For most of the past century, the concept *public school* was easily characterized. Attendance was free, admission was open to all, instruction included no overt teaching of religion, and enrollment in a specific building was almost always based on the location of a child's residence. In Colorado, open enrollment and charter schools have revolutionized this last element; parents are now allowed to choose from a variety of schools for reasons other than location. But the other characteristics of public schools have largely remained intact.

New legislation seeks to change this, moving the state toward an educational system driven less by traditional democratic principles and more by market forces. One bill, SB03-077 from Sen. Jones, would create a limited voucher system, focusing on low-income students in schools with lower student test scores, and has already been voted out of the Senate education committee. A different but comparable voucher bill (HB03-1160), centered on Denver Public Schools, has been proposed in the House by Rep. Spence, and has been voted out of the House education committee. Two additional bills, SB03-001, from Sen. Cairns as well as HB03-1137 authored by Rep. King and Sen. Hagedorn, rely on tax credits. These credits are designed to create voucher-like grants to pay nonpublic (i.e., sectarian religious and non-sectarian private) school tuition for low-income children. HB-1137, which has been voted out of the House education committee, is the focus of this report.¹

¹ SB-1 has been voted out of the Senate Education committee. It closely resembles Arizona's tax credit laws, discussed later in this report (see A.R.S. § 43-1089 and § 43-1089.01), with the primary difference being that the credit is on

Tuition tax credit legislation has been introduced repeatedly in Colorado over the past several years, including last year's HB02-1309 from Rep. Spence, which was endorsed by the *Denver Post's* editorial board. The appeal of such legislation is straightforward. Nationally, children of low-income families generally attend public schools with the least experienced and least trained teachers, with the most school overcrowding, with the worst facilities, and generally with the least challenging classes. These families are therefore the most in need of schooling alternatives. Yet they can least afford to choose the option of nonpublic schools. Since vouchers are of questionable legality in Colorado and have been turned down by voters, a tuition tax credit policy appears to offer the most practical way to assist low-income parents who want to choose nonpublic schools for their children.

This Colorado tax credit legislation is loosely modeled on a similar policy that has been in effect for the past five years in Arizona, where the legislature embraced tax credits as a means of avoiding the legal and political hurdles of vouchers. Pro-voucher Arizonans have not been disappointed. As stated by John Huppenthal, the chair of the Arizona Senate's Education Committee and a longtime voucher supporter: "This has turned into something so close to vouchers you almost can't tell the difference"²

property taxes rather than state income taxes. Many of the issues discussed in this report apply to SB-1, but that legislation is not expressly analyzed herein.

² Bland, K. (2000, April 9). "School tax credits wide open to abuse." *The Arizona Republic*, p. A22.

In many ways, the legislation recently introduced in Colorado is a refinement and improvement on the Arizona law. King and Hagedorn deserve praise for crafting provisions making the law more equitable and less damaging to public education. Yet substantial concerns remain about the law's effects and legality. This report examines these issues, offers suggestions for additional improvements, and considers the policy's merit.

The Basic Statutory Structure

The legislation includes both public school and nonpublic school provisions. From each tax-credited donation, 60%-75% shall go to help pay nonpublic school tuition. The remaining 25%-40% shall go to help students in public schools designated as "low" or "unsatisfactory" in the CSAP-based school accountability reports or, alternatively, to help any low-income student defray "education-related" costs.

For both types of contributions, tax credits are given at the rate of 50%, meaning that for every dollar donated, the donor's state income tax obligation is reduced by fifty cents. Donations must be given within following ranges to qualify for the credit:

1. For individuals: At least \$25 and no more than \$25,000;
2. For 2 individuals filing jointly: At least \$50 and no more than \$50,000;
3. For non-individuals (e.g., corporations): At least \$1,000 and no more than \$50,000.

The tax credits would be non-refundable. A "refundable" credit is one that allows low-income families that do not pay

enough taxes to receive a tax refund from the state, theoretically giving them the same economic benefits as those in higher tax brackets. The proposed legislation forecloses this possibility.

The law would authorize the creation of two types of 501(c)(3) organizations: (1) "Certified Nonprofit Educational Assistance Organizations" (CNEAOs), which would be the ultimate designees of donations and which shall disburse those donations to assist students in both the nonpublic and public school contexts, and (2) a single "Designated Nonprofit Organization" (DNO), which would enter into a contract with the state's Department of Revenue to essentially serve as the clearinghouse for donations to CNEAOs.³ To be certified, a CNEAO must, among other things, "work with" low-income populations.

The procedure set forth in the legislation provides that taxpayers' donations be made to the DNO. At the time of the donation, the taxpayer is required to specify the CNEAO to which the DNO shall then forward the money minus an administrative fee (not more than 2% of each donation⁴). The total amount of credits (that is, half the amount

³ Paragraph (4)(b) of the bill seems to call on the DNO to recruit CNEAOs. The language requires the DNO to "have the administrative capability to promote the success of the credit" by "recruiting" CNEAOs. If the DNO, which serves as a clearinghouse taking on administrative duties of the state, is in the business of recruiting, and if (as the below analysis would indicate) the vast majority of CNEAOs would be affiliated with sectarian schools, this raises a constitutional issue of excessive entanglement. To what extent should the DNO be obligated to ensure a balance between sectarian and nonsectarian? Might its recruiting activities be challenged by religious (or nonreligious) groups that feel slighted?

⁴ For the first year, this fee may be 2.5%.

of contributions) shall not exceed \$3,000,000 initially, increasing to \$10,000,000 by 2010. A key part of the DNO's task is to cut off the allocation of credits after the limit is reached for a given year. Qualified taxpayer donations would be granted on a first-come, first-served basis until the annual limit is reached.

The Nonpublic-School Component. Each CNEAO is required to grant from 60% to 75% of its revenue "for the purpose of providing scholarships to income-qualified students who attend eligible schools." Notwithstanding this "scholarship" terminology, the statutory language includes no academic restrictions or guidelines for selecting grant recipients. Instead, the language restricts recipients based on two non-academic criteria: (1) a percentage of the students must have been enrolled in a public school (including a charter school) in the year prior to receipt of his or her first CNEAO grant; and (2) the student's household income must be within 200% of the federal poverty level.

Further, the legislation states that, in order for a student to qualify as a "public-to-private student" (a certain minimum number of grants each year must go to such students), the CNEAO grant to that student must be for at least 30% of the student's annual tuition. For instance, if the student is attending a nonpublic school with annual tuition of \$5,000, the CNEAO grant must be for at least \$1,500. In addition, the nonpublic school, to be eligible to enroll students using the CNEAO grants, must enter into an agreement with the Colorado Commissioner of Education consenting to administer annual tests to the grant-recipient students. The tests shall measure

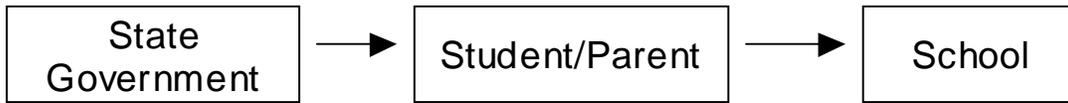
"academic achievement and growth" using specific approaches set forth in the agreement. (That is, the tests need not be the Colorado Student Assessment Program, or "CSAP", tests required of public school students.) Eligible schools include any nonpublic elementary or secondary school, or a certified "Educational Clinic."⁵

In short, the mechanism proposed in the Colorado legislation tells those who owe state taxes that they may reallocate some of that money from the state general fund to nonpublic schools. Whereas voucher plans entail granting state-allocated funds to schools through the private decisions of parents, the Colorado plan inserts three intermediate steps into the process. First, the grants are issued by privately-created, non-profit CNEAOs, rather than directly by the government. Second, the taxpayers' direct dealings are with a privately-created, non-profit DNO, which then follows the taxpayers' directives in allocating this money to CNEAOs. Third, the state allocation is achieved through a 50% tax credit given to donating taxpayers. The following charts, showing the flow of money, illustrate the added steps (see Figure 1). Note that the law itself does not specify the mechanism through which CNEAO money gets to the schools, stating only that the CNEAOs shall provide "scholarships to income-qualified students to attend eligible schools."

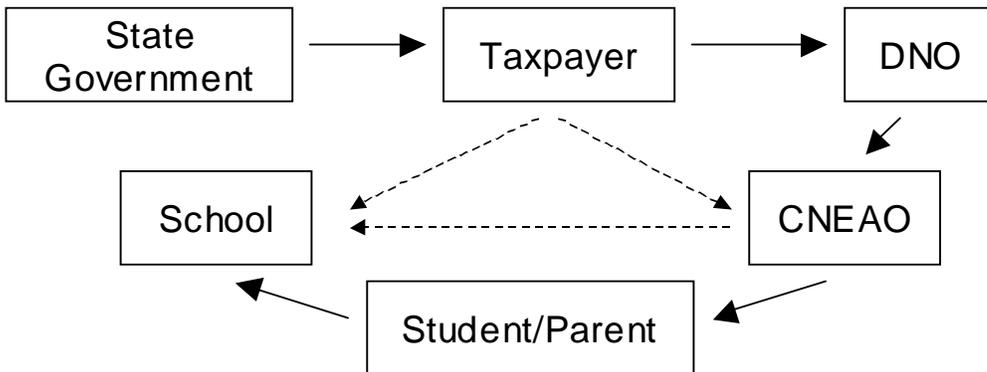
⁵ "Educational Clinic" is defined in the state's education code as a "clinical, client-centered" private educational institution operated on a profit or nonprofit basis, and which teaches "basic academic skills with an emphasis on improvement of the students' motivation for achievement and teaches employment orientation or public school reentry orientation" (C.R.S. 22-27-102(2)).

Figure 1

Vouchers



Colorado Tax Credit



Although each taxpayer's direct dealing is with the DNO, she or he (or it) is entitled to designate the CNEAO to which the DNO then distributes the money. Moreover, because CNEAOs are likely to be affiliated with a given nonpublic school (as discussed later in this Occasional Paper), the taxpayer can effectively designate the school that ultimately benefits from the donation. The dashed lines show this close relationship between the Taxpayer, School, and CNEAO.

This Colorado system results in the government footing half the bill for all

the grants – through directly foregone revenues. But control over the funding is taken from the government and given to two other parties: (a) individual taxpayers, who can decide upon the CNEAOs (and thereby, in theory, the schools) to which they will allocate the funds; and (b) individual CNEAOs, which can decide the grant recipient families and effectively decide the recipient schools.

The Public-School Component. Each CNEAO is required to give from 25% to 40% of its revenue in the form of grants to “qualified school district foundations”

(QSDFs) or to assist “income qualified-students who attend public elementary schools or public secondary schools in Colorado in defraying education-related costs.” This latter category includes, but is not limited to, the following: nonpublic- or public-school tutoring and tutoring supplies, inter-district transportation, and public school “tuition” and fees.⁶

“Qualified School District Foundations” are non-profits (501(c)(3) organizations) created by school districts. They must promise to use their donations to improve the academic performance of students in schools designated as “low” or “unsatisfactory” in their School Accountability Reports of the donation year or one of the preceding three years.

Implementation Projection

Notwithstanding many open questions about the degree and types of use likely to follow from passage of this legislation, it is possible to offer some informed predictions.

Cost to Public Schools. For each student who attends a nonpublic school rather than a public school, the public school appropriation is reduced by approximately \$5,800. One can expect increasing reductions in public school appropriations as the ceiling for total tax credits increases from \$3 million to \$10 million by 2010. Although these reductions may correspond with decreased school enrollment and corresponding costs, the relationship between these two variables is not likely to be direct or linear. In part, this is because schools have fixed costs, including facility maintenance, that do not change in direct proportion to decreased enrollment. In fact, school districts

⁶ Notwithstanding the inclusion of this term, no public schools can or do charge “tuition,” to the best of my knowledge.

throughout the state are experiencing their lowest enrollment increases in years, meaning that the effect of departing students could be particularly detrimental, perhaps forcing school closures.⁷

The minimum number of “funded public-to-private students” that must receive CNEAO grants is determined by a formula set forth in subparagraph V of the legislation.⁸

Assuming that the \$3,000,000 tax credit limit is reached in the first year, 1,034 funded public-to-private students must be served by the program in 2003.⁹ Carrying this assumption into future

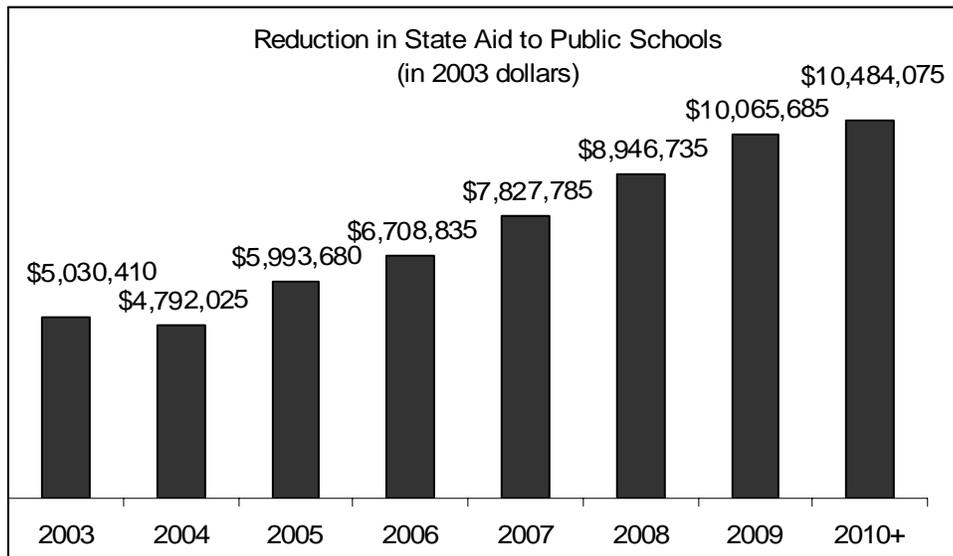
⁷ See http://www.bouldernews.com/bdc/state_news/article/0,1713,BDC_2419_1748858,00.html.

⁸ This provision limits a CNEAO’s total received contributions to twice the “amount of the product of state savings per pupil and the number of funded public-to-private students assisted by the [CNEAO], counting any funded public-to-private student who is a child with disabilities” as two public-to-private students. For this section, “state savings per pupil” is defined as the total program cost, which is the amount of the total program of all students in the state for any budget year, divided by the total funded pupil count of all school districts for the budget year (yielding the average per pupil operating revenue) and then multiplied by a percentage. This percentage is 50% for 2003, 70% for 2004 and 2005, 75% for 2006-2009, and 80% thereafter. Colorado’s approximate average per pupil operating revenue is currently \$5,800. Therefore, the “state savings per pupil” is defined (calculated) as follows: 50% is \$2,900, 70% is \$4,060, 75% is \$4,350, and 80% is \$4,640.

⁹ \$3,000,000 divided by \$2,900. Further calculations can be made, based on the rough assumption that the per pupil operating revenue will remain at \$5,800:

2004: 985 funded public-to-private students (\$4,000,000 divided by \$4,060);
2005: 1,232 (\$5,000,000 divided by \$4,060);
2006: 1,379 (\$6,000,000 divided by \$4,350);
2007: 1,609 (\$7,000,000 divided by \$4,350);
2008: 1,839 (\$8,000,000 divided by \$4,350);
2009: 2,069 (\$9,000,000 divided by \$4,350);
and
2010 and thereafter: 2155 (\$10,000,000 divided by \$4,640).

Figure 2



years, one can calculate the approximate reductions in state aid to public schools. This calculation predicts a loss of 84% of per pupil operating revenue for each funded public-to-private student, yielding the annual figures set forth in Figure 2.¹⁰

this assumption, as well as an assumption of a 25% distribution for “education-related” costs of public school students,¹¹ one can make the following projections for annual distributions by CNEAOs (see Figure 3).

Expenditures by CNEAOs. A funded public-to-private student can receive a CNEAO grant that covers anywhere from 30% to 100% of his or her tuition. The Legislative Council assumes an average grant in the amount of \$2,500. Based on

¹⁰ As noted by the Colorado Legislative Council in its initial Fiscal Note for HB 1137, a portion of the funded public-to-private students would have attended a non-public school the following year with or without the CNEAO funding. That is, if we imagine a pool of 100 students who apply for (and receive) CNEAO funding, we can speculate as to what this group would have done had HB 1137 never become law. Many would have remained in public school, but some would have left public school, moving to a non-public school, home-schooling, or dropping out. The calculation used by the Legislative Council assumes an average reduction in state aid of \$4,865 (83.9% of \$5,800), which yields the annual figures set forth in Figure 2.

¹¹ This 25% assumption is explored in greater detail later in this occasional paper.

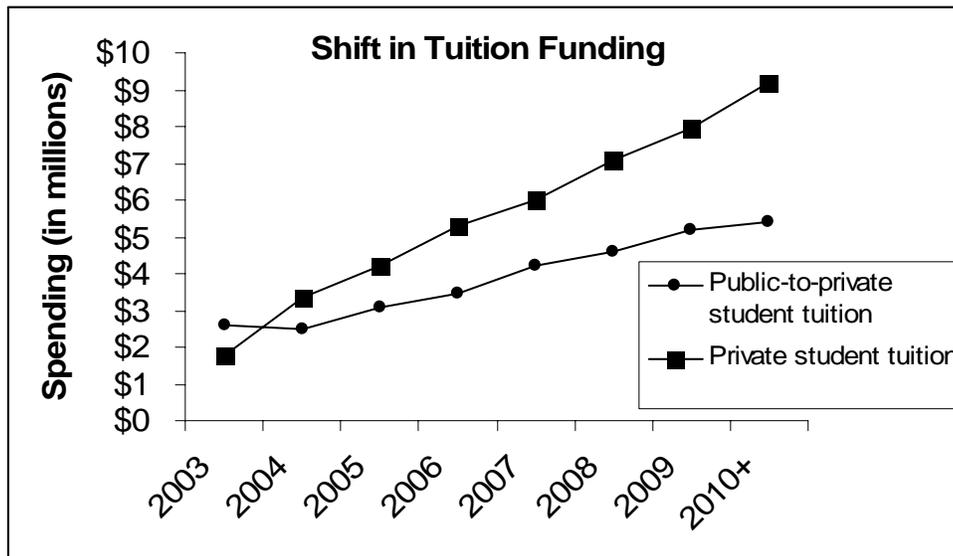
Figure 3

Year	Categories of Expenditures	Spending per Category
2003	• Public-to-private student tuition	\$2,585,000
	• 25% allocated for “education-related” costs of public school students	1,500,000
	• Private student tuition	1,765,000
	• Administrative expenses (2.5%)	150,000
	Total	\$6,000,000
2004	• Public-to-private student tuition	\$2,462,500
	• 25% allocated for “education-related” costs of public school students	2,000,000
	• Private student tuition	3,377,500
	• Administrative expenses (2%)	160,000
	Total	\$8,000,000
2005	• Public-to-private student tuition	\$3,080,000
	• 25% allocated for “education-related” costs of public school students	2,500,000
	• Private student tuition	4,220,000
	• Administrative expenses (2%)	200,000
	Total	\$10,000,000
2006	• Public-to-private student tuition	\$3,447,500
	• 25% allocated for “education-related” costs of public school students	3,000,000
	• Private student tuition	5,312,500
	• Administrative expenses (2%)	240,000
	Total	\$12,000,000
2007	• Public-to-private student tuition	\$4,225,000
	• 25% allocated for “education-related” costs of public school students	3,500,000
	• Private student tuition	5,995,000
	• Administrative expenses (2%)	280,000
	Total	\$14,000,000
2008	• Public-to-private student tuition	\$4,597,500
	• 25% allocated for “education-related” costs of public school students	4,000,000
	• Private student tuition	7,082,500
	• Administrative expenses (2%)	320,000
	Total	\$16,000,000
2009	• Public-to-private student tuition	\$5,172,500
	• 25% allocated for “education-related” costs of public school students	4,500,000
	• Private student tuition	7,967,500
	• Administrative expenses (2%)	360,000
	Total	\$18,000,000
2010+	• Public-to-private student tuition	\$5,387,500
	• 25% allocated for “education-related” costs of public school students	5,000,000
	• Private student tuition	9,212,500
	• Administrative expenses (2%)	400,000
	Total	\$20,000,000

Two of these items, “education-related” costs and administrative expenses, remain relatively steady over the life of the program. The other two items, tuition for public-to-private students and for students who are already in private

schools, shift considerably over this time. This shift is shown in Figure 4.

Figure 4



The change in expenditures favoring private student tuition at the expense of public-to-private student tuition can be justified based on the likelihood that families inclined to send their children to private school arrive at this inclination even before sending their children to public school. That is, many of the families initially taking advantage of the opportunity to switch from public to private would have, if given the financial support, elected to enroll their children in private school at the beginning of those children's formal schooling. For instance, in 2007, families whose children are in 4th grade would have had the opportunity when those children began in kindergarten. Five cohorts of children, by that point, would have begun their education after HB 1137 took effect. Among those children are some whose parents decided to switch to private school after becoming disappointed with public school, while many others probably decided upon private school from the outset. In this latter group are those who would have, in the absence of HB 1137,

sent their children to public school simply because private school was not affordable. It is this subgroup of families that increases each year and offers some justification for the increases in the portion of CNEAO money devoted to tuition for students who do not start out in public school.

The Need for a Minimum. The rationale for this provision, requiring a minimum number of funded public-to-private students, is apparent when one considers the likely distribution of the money in its absence. Arizona does not require the reporting of the data needed to authoritatively determine who is receiving tuition grants under that state's program. However, even advocates of the plan acknowledge that the overwhelming majority of the money has gone to students who began in nonpublic schools. Switchers from public schools likely have accounted for no more (and probably much less) than 20%.¹² The public-to-

¹² See Lips, C. and Jacoby, J. (2001). *The Arizona education tax credit: Giving parents choices*,

private provision in HB 1137 will therefore cause a somewhat greater amount of grants to be made to these students than would otherwise be expected if the distribution were left completely to the free market. At the beginning of the program, these grants will account for 43%, and they will steadily decrease down to 27%, by the time the program is fully mature.

Which Taxpayers Will Take the Credit?
An individual taxpayer cannot take the tax credit if he or she does not itemize deductions. Lower-income Colorado families can benefit from the tax credit policy, as recipients of CNEAO grants, but they are cannot play a part in the earlier, decision-making (directing donations to a particular CNEAO) process unless they owe state taxes and itemize deductions in their tax returns.

Less than 44% of Colorado's returns in the year 1999 (the last year for which I found data) were itemized. This means that more than half the state's taxpayers would be effectively barred from participating *as donors* in the tax credit system. These non-itemizers are concentrated at the low end of the economic spectrum. Figure 5 shows this distribution for Colorado's 1999 tax year. A Cato Institute analysis showed a similar pattern for taxpayers utilizing Arizona's private school tuition tax credit.¹³

saving taxpayers money. No. 414. Cato Institute. p.8. See also Wilson, G. Y. (2000). *Effects on Funding Equity of the Arizona Tax Credit Law*. [On-line]. Available: <http://epaa.asu.edu/epaa/v8n38.html>; Wilson, G. Y. (2002). *The Equity Impact of Arizona's Education Tax Credit Program: A Review of The First Three Years (1998-2000)*. [On-line]. Available: <http://www.asu.edu/educ/eps/EPRU/documents/EPRU%202002-110/epru-0203-110.htm>.

¹³ Lips, C. and Jacoby, J. (2001). *The Arizona education tax credit: Giving parents choices,*

Using \$35,000 as a rough dividing line, we can make several generalized statements. Those making less than this amount constitute 51.6% of all filers. Their average Colorado tax owed was \$380. And they are 4.3 times less likely to be itemizers – to be in a position to take advantage of the tax credit – than are taxpayers making above \$35,000.¹⁴

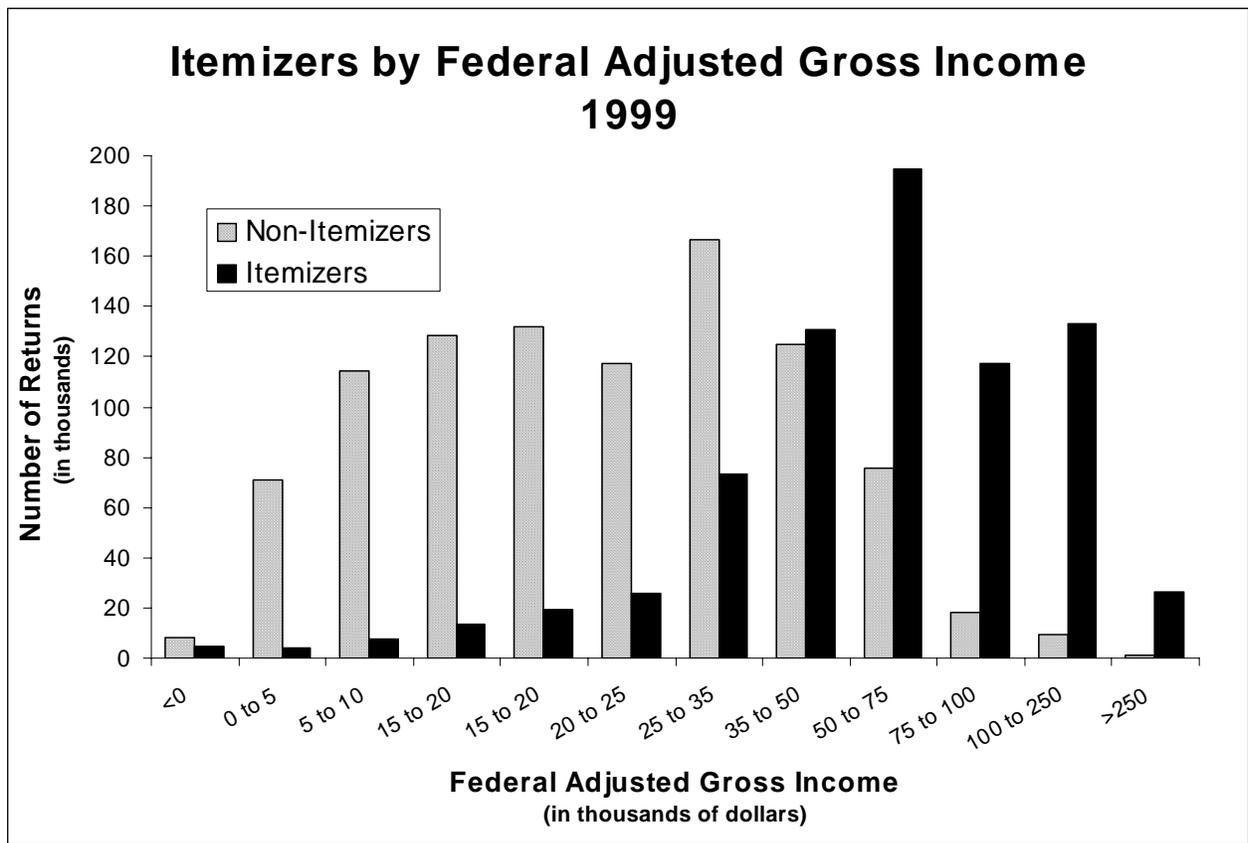
Even assuming that a larger percentage of future Colorado taxpayers opt to itemize as a result of this new credit being offered, lower-income residents will clearly be at a disadvantage with regard to donating and taking the tuition tax credit. For example, the average tax owed by a taxpayer in the \$20-\$25 thousand Federal Adjusted Gross Income range owes state taxes of only \$465, meaning that the largest donation this family could make and still take full advantage of the tax credit would be \$930. In contrast, the average taxpayer in the \$75-\$100 thousand range could make a donation up to \$5,765 and still take full advantage of the credit.

Making the tax credit refundable would move it in a more equitable direction. Yet even this change would leave other barriers in the path of the less wealthy. Glen Wilson, a researcher at Arizona State University, identifies five such barriers: (1) transportation availability and cost, (2) religion match between school and student, (3) selective admissions, (4) tuition costs above the state subsidy, and (5) other fees and costs

saving taxpayers money. No. 414. Cato Institute. p.13, Table 4.

¹⁴ Epidemiologists often use this type of comparison, called an "odds ratio," which is the ratio of the odds of an occurrence for the first group relative to the odds of occurrence for the second group.

Figure 5



(uniforms, books, etc.).¹⁵ Low-income families also often face general issues in the realm of what sociologists call “social capital” – which would include knowing how to navigate the system for the educational benefit of one’s children. And, of course, a refundable tax credit does a family little good if it simply is unable to afford the up-front payment of tuition, while awaiting the refund.

The proposed tax credit would include corporations and partnerships as well as individuals. One would expect that this feature would result in an additional tilt toward Colorado’s wealthiest

taxpayers – in particular, those with governance positions in business enterprises.

Students and Schools. According to figures cited in a 1998 *Denver Post* editorial, there were 418 nonpublic schools in Colorado, of which 329 (73%) were church-supported.¹⁶ But many independent, non-sectarian schools would be beyond the financial reach of the low-income families targeted by HB 1137. Although some Catholic elementary schools cost less than \$3,000 for parishioners, these independent schools have annual tuition that can exceed \$26,000. Given this range, perhaps the most relevant cost figure comes from the

¹⁵ Wilson, G. Y. (2002). *The Equity Impact Of Arizona’s Education Tax Credit Program: A Review of The First Three Years (1998-2000)*.

¹⁶ Ausfahl, B. (1998, September 20). Public schools stand to lose. *Denver Post*.

Alliance for Choice in Education, as reported in a recent story in the *Rocky Mountain News*. The alliance grants scholarships to low-income Denver families, comparable to the main activity that HB 1137 proposes for CNEAOs. According to the *News*, “At the inner-city schools many alliance scholarship recipients attend, tuition is generally less than \$6,000 annually.”¹⁷ In considering these numbers, policy makers should keep two variables in mind. First, secondary education tends to be substantially more expensive than does elementary (K-6). In Arizona, for instance, the median tuition for elementary schools in 2000-2001 was \$3,175, while the median tuition for high schools was \$5,850. Second, according to basic market principles, the price of nonpublic schooling will increase in response to the state subsidy and to increased demand. A school charging tuition of \$4,000 before the tax credit may be able to charge \$4,500 or so after the tax credit plan is in place.

Assuming a tuition range of \$3,000 to \$6,000, and CNEAO grants of 50% of tuition (recall that the grants must be at least 30% of tuition), families must be able to pay \$1,500 to \$3,000 per child – in tuition alone – to take advantage of the system. These costs would place a financial strain on Colorado’s most needy families, effectively eliminating this group from extensive participation.

Further narrowing of likely recipients can be expected to arise from CNEAO priorities. For the 60%-75% of its revenue that a CNEAO would grant as student “scholarships,” the legislation places no explicit limitations on the CNEAO’s discretion, other than with regard to the determination of non-eligible students. Again, the language in the

statute is very basic: Each CNEAO is required to grant from 60% to 75% of its revenue “for the purpose of providing scholarships to income-qualified students who attend eligible schools.”

Within the population of low-income students including a minimum number of public-to-private students, the CNEAO may pick and choose. It can choose to screen out students based on their test scores, their grades, or more arbitrary factors. Although preexisting anti-discrimination laws may prevent overt screening based on race and sex, one may expect overt or covert discrimination on the basis of disability, primary language spoken, sexual orientation and religion. Regarding the latter, nothing in the legislation appears to prevent or limit a CNEAO from requiring a certain church affiliation or requiring applicant students to take an oath professing certain beliefs or promising to engage in certain religious practices. Moreover, the legislation places no restrictions on the admission requirements or processes of participating nonpublic schools, so these schools might also engage in such discrimination.

Further, each CNEAO appears entitled to favor children based on their attendance at, their desire to attend, or their admission into, a given school. This is likely to become a widespread usage – perhaps the dominant feature of CNEAOs. Many or most CNEAOs would be created and designed in order to service a nonpublic school or group of nonpublic schools. A given school would solicit donations to its CNEAO to help fund tuition for lower-income children attending or wishing to attend that school.

Given this mission, one can expect a school-affiliated CNEAO to exercise its discretion in particular ways. Most obviously, it will decide on a 75% vs. 25% allocation, choosing to devote the

¹⁷ Yettick, H. (2003, January 28). Fewer pupils at inner-city private schools. *Rocky Mountain News*.

most money allowed to tuition grants. This 75% would then be given to support students attending the affiliated school or schools. If the CNEAO is set up by the Denver Archdiocese of the Catholic Church, the pool of potential schools and students would include 39 elementary schools and five secondary schools, together serving about 16,000 students. For others, the pool would be much smaller.

In selecting recipient students, each CNEAO will again likely refer back to its basic mission. If it is serving a Jewish day school, it may require that all recipients be Jewish. It may require admission to the school. Similarly, if it is serving a fundamentalist Christian or Muslim school, it may require adherence to those beliefs, affiliation with a given church or mosque, or admission to the particular school -- which may itself include religion-based prerequisites. These schools may segregate or deny admission based on gender, disability, or primary language spoken. Many can be expected to discriminate based on sexual orientation.

Raising these possibilities is not intended as a criticism of the state's nonpublic schools. It is reasonable and appropriate that, e.g., a Jewish day school will serve children from Jewish families and who desire Jewish religious learning as part of their education. Yet state policy makers should be aware of the legislation's straightforward effect in financially facilitating attendance at nonpublic schools and movement of children from public schools to these nonpublic schools, as well as the corresponding changes in the curriculum, environment, and civil rights protections afforded these children. In addition, increased movement away from a common school environment carries a risk

of Balkanization. As Justice Stevens noted in his dissent in the Milwaukee voucher case (*Zelman v. Simmons-Harris*),

I have been influenced by my understanding of the impact of religious strife on the decisions of our forbears to migrate to this continent, and on the decisions of neighbors in the Balkans, Northern Ireland, and the Middle East to mistrust one another. Whenever we remove a brick from the wall that was designed to separate religion and government, we increase the risk of religious strife and weaken the foundation of our democracy.¹⁸

Shifting our attention to the portion of contributions that CNEAOs are required to grant for the benefit of public school students, the legislation again offers wide discretion. It requires only that 25%-40% of the money be granted to either QSDFs or to assist "income qualified-students who attend public elementary schools or public secondary schools in Colorado in defraying education-related costs." Among these costs might be tutoring provided by religious or other private organizations.

One can reasonably speculate, therefore, that many CNEAOs created to serve sectarian, religious schools would (as noted above) opt to devote only 25% toward this category of expenditure and would further opt to put this 25% toward subsidizing tutoring offered by the affiliated school or schools. This possibility raises the question of the extent to which QSDFs -- which appear to be the primarily intended beneficiary of this aspect of the legislation -- will receive CNEAO grants. The entire amount of

¹⁸ *Zelman v. Simmons-Harris*, 122 S.Ct. 2460, 2485 (2002).

contributions received by many CNEAOs would likely be devoted to the affiliated nonpublic school or schools. In this regard, it is important to note that the legislation places no express limitations on the “education-related costs” to be defrayed by the CNEAO grants. The education provided could relate to core academic subjects or could be religious education. The discretion is left with the CNEAO and the school.

The above discussion assumes that the vast majority of CNEAOs will be created to serve nonpublic schools. Another alternative would involve the creation of CNEAOs to serve public schools. Each CNEAO could devote up to 40% of their received contributions to assist low-income students, either directly defraying education-related costs or indirectly passing on the money to a QSDF. Yet such a CNEAO would also be required to use 60% of their received contributions to facilitate student movement from public to nonpublic schools – an unlikely goal for a CNEAO created to serve public schools. Consider the situation faced by a taxpayer considering a donation to such a CNEAO. For each dollar donated, the taxpayer is effectively paying 50 cents (the state pays the other 50 cents, through the tax credit). As a result of that 50 cent investment, approximately 40 cents will benefit public schools. If the taxpayer instead makes a charitable donation of one dollar to a given school and treats the donation as a regular tax deduction, it will cost the taxpayer about 70 cents (assuming a 30% marginal tax rate), but the public school receives the full dollar. For a supporter of public schools, this latter option is clearly preferable: a 79% greater return on the taxpayer’s investment.

Based on this rationale, one would expect few successful public-school

oriented CNEAOs. One would also expect that the distribution range of 60%-75% is superfluous; CNEAOs affiliated with nonpublic schools will focus as much as possible on defraying tuition costs. Finally, one would expect that any money that does reach a QSDF would not be distributed equally or according to overall need. That is, the fund-raising ability of a QSDF would likely be greater for some school districts than for others, and these differences may not reflect actual school need.

Comparing the Arizona Experience

Colorado’s legislation follows in the wake of similar laws enacted in Arizona and, more recently, in Pennsylvania and Florida. The Arizona law, passed in 1997, provides a 100% tax credit of up to \$625 per taxpaying couple. This credit is available to individuals, but not corporations, and the donations must be made to school tuition organizations (STOs),¹⁹ rather than directly to the schools. The Pennsylvania and Florida laws were recently passed (in 2001) and therefore have no significant track record, but they differ from the Colorado legislation in that they provide credits only to corporations, not individuals. Similarly, Arizona differs in that only individuals – not corporations – are included. Like the Colorado proposal, the laws in all three of these states include provisions designed to benefit public schools as well as nonpublic schools.²⁰

The Arizona law places only two notable limitations on its tuition tax credit system. The tax credit “is not allowed if

¹⁹ Arizona’s “School Tuition Organizations” play a role similar to Colorado’s proposed CNEAOs.

²⁰ Most notably, Arizona concurrently created a tax credit for donations to public schools, to support extracurricular activities (A.R.S. § 43-1089.01).

the taxpayer designates the taxpayer's donation to the school tuition organization for the direct benefit of any dependent of the taxpayer." Also, the law prohibits the recipient schools from discriminating "on the basis of race, color, handicap, familial status or national origin." The Colorado proposal includes a stronger version of this first limitation but, as noted earlier, excludes the second. With regard to discrimination, while it is surprising that the proposed law includes no express provision purporting to prohibit recipient nonpublic schools from, e.g., overtly rejecting applications from students of color and students with disabilities, Colorado or federal civil rights laws may nonetheless impose such restrictions upon the CNEOs as well as upon nonpublic schools once they accept public funding.²¹

By including a stronger version of the first limitation – concerning the earmarking of a donation for the benefit of the taxpayer's dependent – the authors of Colorado's bill have avoided one of the most glaring problems with the Arizona law. Although Arizona bars the earmarking of a donation to one's own dependant, there is no prohibition against designating the schoolmate or neighbor of one's child. And, in fact, according to an article in the *Arizona Republic*, "parents are writing ... checks for their friends' kids and asking them to do the same for theirs."²² The newspaper identified one fund for which 96% of all donations were earmarked for specific private school

students. Colorado's legislation includes a complete prohibition on earmarking.

Another conspicuous improvement upon Arizona's law is the allowance of a tax credit for only 50% of a donation. Arizona provides a 100% (dollar-for-dollar) tax credit. A 100% credit isn't charity; it simply gives to taxpayers the authority, otherwise invested in elected officials, to determine how putative tax revenues will be spent. Effectively, this is an attack on the one-person, one-vote principle, since only wealthy taxpayers have an effectual vote in these spending decisions. By reducing the tax credit to 50%, the authors of Colorado's legislation have not changed the subpopulation of taxpayers who can take advantage of the credit, but they have changed the nature of the donation – adding a charitable element.

Two other differences are worth noting between the Arizona statute and Colorado's HB 1137. First, eligibility for Arizona's "scholarships" is not means-tested. Wealthy students can and do receive grants. Second, students who began in nonpublic schools are fully eligible to receive Arizona grants. That is, the Arizona law includes no requirement that the recipients move from public to nonpublic schools. Colorado's legislation includes restrictions in both these important areas, although the CNEAO grant money devoted to students beginning in private schools is likely to eclipse public-to-private grant money by the second year of the program.

The Constitutionality of the Proposed Tax Credit Policy

In the wake of the recent U.S. Supreme Court decision in *Zelman v. Simmons-Harris*,²³ – rejecting a challenge,

²¹ Note that neither the Arizona law nor the Colorado proposal addresses discrimination based on religion, which concerns the core mission of many private schools. Nor does either address discrimination based on academic performance or behavioral issues, which draws a clear contrast between these schools and traditional public schools.

²² Bland, K. (2000, April 9). School tax credits wide open to abuse. *The Arizona Republic*, p. A22.

²³ *Zelman v. Simmons-Harris*, 122 S.Ct. 2460 (2002).

based on the federal constitution's establishment clause, to the constitutionality of school vouchers – one might expect privatization advocates to be actively introducing voucher legislation from coast to coast. Yet, while experts do expect an increase in such legislation and while several vouchers bills were recently introduced in Colorado, many proponents of privatization are eschewing vouchers in favor of tuition tax credit policies similar to that proposed in Colorado.²⁴ The reason for this preference lies in a distinction that might be drawn between the following: (a) an expenditure of public money from a state's general fund, and (b) a private expenditure by a taxpayer that results in a decrease in taxes owed by that taxpayer. This distinction may result in enormous differences in the policies' legality *under state constitutions* as well as the potential for state regulation of the recipient schools.

Colorado's state constitution includes a provision expressly prohibiting the use of public monies to fund religious schools.²⁵ Article IX, section 7 of the

Colorado Constitution includes a so-called "Blaine Amendment," named after the initiator of a failed 1875 effort to amend the U.S. Constitution to preclude grants or appropriations to sectarian institutions or organizations.²⁶ This provision in Colorado prohibits the state from, among other things, making "any appropriation, or pay from any public fund or moneys whatever, anything in aid of any church or sectarian society, or for any sectarian purpose, or to help support or sustain any school, academy, seminary, college, university or other literary or scientific institution, controlled by any church or sectarian denomination whatsoever." Similarly, Article V, Section 34 provides, "No appropriation shall be made for charitable, industrial, educational or benevolent purposes to any person, corporation or community not under the absolute control of the state, nor to any denominational or sectarian institution or association."

Notwithstanding the extremely broad language of the Blaine Amendment (note the repeated use of terms such as "any", "whatever", and "whatsoever"), an educational grant program that was broadly available to students at both private and public higher education institutions was held by the Colorado Supreme Court to not violate either of

²⁴ The Supreme Court's holding in *Zelman*, grounded in a rationale of religious neutrality plus "genuine and independent private choice," is straightforwardly extendable from vouchers to the type of tax credits found in Arizona and now proposed in Colorado. That is, there is no solid basis for distinguishing such tax credit policies as less neutral or less grounded in independent private choice. Therefore, these tax credit policies are likely to survive a federal establishment clause challenge.

²⁵ See Colo. Const. art. IX, § 7. See also Ariz. Const. art. II, ' 12 & art. IX, ' 10; Alaska Const. art. VII, § 1; Cal. Const. art. XVI, § 5; Del. Const. art. X, § 3; Fla. Const. art. I, § 3; Ga. Const. art. I, § 2, para. 7; Haw. Const. art. X, § 1; Idaho Const. art. IX, § 5; Ill. Const. art. X, § 3; Ind. Const. art. I, § 6; Mass. Const. amend. art. XVIII, § 2; Mich. Const. art. I, § 4; Minn. Const. art. I, § 16; Miss. Const. art. VIII, § 208; Mo. Const. art. IX, § 8; Mont. Const. art. X, § 6; Neb. Const. art. VII, § 11; N.H. Const. Pt. II, art. 83; N.Y. Const. art. XI,

§ 3; Okla. Const. art. II, § 5; Or. Const. art. I, § 5; Pa. Const. art. III, § 29; S.C. Const. art. XI, § 4; S.D. Const. art. VI, § 3; Tex. Const. art. I, § 7; Utah Const. arts. I, § 4 and X, § 9; Va. Const. art. IV, § 16; Wash. Const. art. I, § 11; Wis. Const. art. I, § 18; Wyo. Const. art. I, § 19.

²⁶ The federal proposal was introduced by Maine Congressman James Blaine. The movement to include these Blaine Amendments in state constitutions took place around 1875-1900 and was indisputably tied to anti-Catholic sentiment. See Viteritti, J. P. (1996). *Choosing Equality: Religious Freedom and Educational Opportunity Under Constitutional Federalism*, *Yale Law and Policy Review*, 15, 113, 144.

these two provisions. The program, the court held, did not amount to constitutionally significant aid to a sectarian educational institution.²⁷ Yet the court's decision identified two factors that likely distinguish this case from k-12 voucher and tax credit situations. The court focused on the Blaine Amendment's intent to avoid any ideological control endangering the secular nature of publicly funded education. And, in this regard, it also noted that the financial assistance was available only to students attending institutions of higher education.

These two provisions will likely prevent Colorado from successfully implementing a k-12 voucher policy. The constitution expressly prevents the state from allocating public money to a private, religious school. Yet, notwithstanding this prohibition, other forms of state aid are allowable. For instance, the state can allow a tax deduction for a charitable donation to a church or a religious school. A tax credit policy falls somewhere in the middle. It may survive constitutional scrutiny, since the assistance of the state is somewhat attenuated. Accordingly, even though Arizona's state constitution includes a Blaine Amendment, similar to Colorado's, Arizona's Supreme Court issued a 3-2 decision upholding that state's tax credit policy.

The Arizona law (A.R.S. § 43-1089) was passed in 1997 and immediately challenged in state court.²⁸ One of the grounds for that challenge was the Blaine Amendment language in the

Arizona constitution.²⁹ But the supporters of the tax credit argued that the language was inapplicable because a tax credit is simply not an appropriation of public money. The plaintiffs (the party challenging the law's legality), on the other hand argued that there is no meaningful difference between a formal allocation and a tax credit. The tax credit mechanism effectively tells Arizonans who owe state taxes that they may reallocate some of that money from the state general fund to an STO.³⁰

This contention of the essential equivalence between allocations and tax credits is known in legal circles as the "tax expenditure" doctrine. A tax expenditure is generally defined as a law providing for a tax exemption, exclusion, deduction or credit, that is designed to achieve various social and economic objectives and which results in a loss of tax revenues.³¹ The fiscal impact of a tax expenditure is largely indistinguishable from a direct expenditure of state funds.

This tax expenditure approach was rejected by the majority of a divided Arizona supreme court in *Kotterman v. Killian* (1999), which reasoned, "no

²⁷ *Americans United for Separation of Church & State Fund, Inc. v. State*, 648 P.2d 1072 (Colo. 1982).

²⁸ For an additional discussion of this law and its effects, see Robinson, A. (2000). Risky Credit: Tuition Tax Credits and Issues of Accountability and Equity. *Stanford Law & Policy Review*, 11, 253.

²⁹ The Arizona language mirrors that of Colorado. Article II, § 12 states in part: "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." Article IX, § 10 states, "No tax shall be laid or appropriation of public money made in aid of any ... private or sectarian school ..."

³⁰ This tax credit mechanism may also be essentially neutral for purposes of federal income tax liability, since charitable donations to 501(c)(3) organizations and state income tax liability both qualify as deductions. Given the lack of any financial sacrifice, there is little in this procedure that falls under the generally accepted idea of 'charity.'

³¹ Surrey, S. S. (1970). Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures, *Harvard Law Review*, 83, 705.

money ever enters the state's control as a result of this tax credit. Nothing is deposited in the state treasury or other accounts under the management or possession of governmental agencies or public officials. Thus, under any common understanding of the words, we are not here dealing with 'public money.'"³² The dissenting judges attacked this reasoning, arguing that it has little support from other jurisdictions: "Other courts, state and federal, have long viewed 'tax subsidies or tax expenditures [similar to Arizona's tax credit as] the practical equivalent of direct government grants'"³³ By allowing the use tax credits to subvert the constitutional ban on the state support of religious institutions, the court majority elevated form over substance. The original, direct ban became meaningless.

Among the lessons from this decision are the following two. First, tax credit policies can withstand court scrutiny, even in states with constitutions containing Blaine language. Second, Blaine language can nonetheless be grounds for striking down tax credits (as seen in the "tax expenditure" reasoning of the two dissenting judges). The Arizona decision is not binding on other state courts, and the tax expenditure approach

has widespread usage and support in budgetary and legal circles.³⁴

Accountability

Expenditures of government money usually come with regulatory strings attached. When asked about vouchers, Americans overwhelmingly favor requiring recipient schools to comply with a variety of requirements such as meeting state curriculum standards (88%) and hiring only certified teachers (86%).³⁵ Yet many or most private schools would not be willing to accept such conditions.³⁶

This tension suggests a political hurdle that some voucher plans may not be able to clear. In contrast, tax credit policies may never – at least from a legal perspective – face such a challenge. Assuming that a tax credit law passes muster through a Blaine Amendment challenge, the state's highest court has likely already determined that the tax credits do not constitute a "tax expenditure." Once these credits have been characterized as involving no expenditure of state money, they are less likely to have associated regulations attached.

The proposed Colorado tax credit plan does include a provision requiring participating private schools to agree with

³² *Kotterman v. Killian*, 972 P.2d 606, 618 (1999). While the tax credit policy narrowly survived the scrutiny of the Arizona supreme court, the reasoning used by that court cannot be extended to vouchers, which are clearly funded through government revenues. A voucher defense would therefore have to return to religious neutrality arguments, which seem much more relevant to establishment clause claims than to claims grounded in Blaine language. That is, a voucher supports or aids a private school even if a parent, rather than the state, selects the recipient school.

³³ *Kotterman*, 1999, at 641, quoting a Massachusetts case.

³⁴ In fact, the tax expenditure approach has been applied (implicitly by the majority and explicitly in a concurrence) by the U.S. Supreme Court in an establishment clause case. See *Rosenberger v. Rector & Visitors*, 515 U.S. 819, 842-43 (1995), and at 861 n.5 (Thomas, J., concurring).

³⁵ Peter D. Hart Research Associates. (1998). *Public Attitudes on School Choice and Vouchers*. Commissioned by the American Federation of Teachers. Available on-line at <http://www.aft.org/vouchers/dilemma/page3.htm>.

³⁶ Muraskin, L. (1998). *Barriers, Benefits, and Costs of Using Private Schools to Alleviate Overcrowding in Public Schools*. U.S. Department of Education. Planning and Evaluation Service, p. 49, exhibit 32.

the state to require students who receive CNEAO grants “to be annually tested by a recognized testing firm to measure academic achievement and growth in a manner specified in the agreement.” But this requirement is a bit misleading.

The requirement does not obligate the nonpublic school to participate in Colorado’s CSAP state assessment. CSAP is not generally administered by a recognized testing firm. Moreover, the provision only requires the testing of students receiving a CNEAO grant – not the entire student body. Since the requirement will most likely be complied with by administering the SAT9, ITBS, or similar assessment, the tests will allow a student to be located within national percentiles, but they will do little to facilitate comparisons with neighboring Colorado public schools (unless those schools coincidentally administer the same test). This failure to hold publicly funded schools accountable using the state exam is substantially at odds with current state and federal policy.

Amending the Legislation to Enhance Equity

Finally, there is the question of whether the tax credit legislation can be amended to be made more equitable. What follows are nine suggestions for possible improvements.

1. Add express anti-discrimination provisions applicable to CNEAO grants and to nonpublic school admissions and educational policies.
2. Structure the benefit as a refundable tax credit, with no itemization requirement. This will allow greater participation by less wealthy Colorado taxpayers.
3. Increase the minimum portion of CNEAO distributions directed to public-to-private students, begin-

ning with 100% in 2003 and tailing off to 40% by 2010. Particularly at a time of a tight state budget, potential tax revenue should not be diverted to subsidize tuition of children already in private schools.

4. Tie availability of the tax credit to the state’s budgetary health. For instance, the tax credit should not be available unless the state budget is at least at the previous year’s level. HB02-1309, last year’s bill by Rep. Spence, included a provision tying the credit to budget health. But this year’s bill opted to remove it.
5. Lower the upper limits for contributions eligible for tax credits, as follows:
 - a. For individuals: At least \$25 and no more than \$2,000;
 - b. For 2 individuals filing jointly: At least \$50 and no more than \$4,000;
 - c. For non-individuals (e.g., corporations): At least \$1,000 and no more than \$4,000.

The high limits in the present legislation give disproportionate influence over the receipt and distribution of donations to the very wealthiest Colorado taxpayers.

6. Restructure the distribution aspects of the legislation to create the likelihood that public school educational opportunities and resources would benefit from donations. For instance, require that 40% of every donation be allocated to an organization that would distribute the funds equally to “unsatisfactory” schools throughout Colorado.

7. Require recipient private schools to teach to state curriculum standards, administer the CSAP test, and hire only certified teachers. As noted earlier, Americans overwhelmingly favor requiring schools receiving vouchers to meet a variety of requirements, such as following state curriculum standards (88%) and hiring only certified teachers (86%). Given the firm Colorado (and national) policy favoring standards-based accountability, nonpublic schools choosing to benefit from public financial backing should be brought within this system.
8. Remove the eligibility of “educational clinics,” unless they agree to comply with the same state curriculum standards.
9. Require more and better data gathering and reporting, regarding such matters as the family income and residence of recipients and donors, and the prior public school of recipient students, the distribution of CNEAO grants, the admission policies of participating nonpublic schools, the specific “education-related” costs defrayed pursuant to the public-school aspect of the grants, and the rules and procedures CNEAOs use to determine grants. Paragraph (7) of HB 1137 contains an auditing requirement, but the provision fails to require the auditor specifically to include any of this crucial information.

Conclusion

As a means of providing equity and improving achievement for impoverished students currently enrolled in the state’s public education systems,

Colorado’s educational tax credit proposal is fundamentally flawed. While possible changes in the legislation may make it more equitable, such amendments cannot rescue the policy from its inherent inability to accomplish the stated goal of its architects: improving education for impoverished students. Only policies that improve all public schools – where the vast majority of those students will continue to be enrolled – can do so.

Even assuming that the plan would yield a better education for participating students, is it proper for the state to accomplish this goal through a policy that requires low-income parents to pay 30-50% of the education’s cost? Why would Colorado want to move poor families from a system that covers the entire cost of their education into one where only about half is covered? In public schools, families are not asked to pay tuition, and students cannot be turned away because they are too poor, too disabled, or of the wrong religion. Before seriously considering this policy option, must the state have already concluded that it cannot realistically provide a quality education, through the free public school system, to all children? Answers to these questions are beyond the scope of this report, but they raise important issues to be considered by any policy maker considering the tuition tax credit legislation.