

# Estimating the Savings to Arizona Taxpayers of the Private School Tuition Tax Credit

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(These comments are offered in my private capacity and not as a representative of Baylor University. The opinions expressed are my own and do not necessarily represent the opinions of Baylor University or its administration.)

## Introduction

In 1997, the Arizona Legislature authorized an individual income tax credit for donations made to school tuition organizations (STOs). Under Arizona law, an STO is a 501(c)(3) charitable organization that allocates at least 90 percent of its annual revenue for educational scholarships or tuition grants to allow children to attend any qualified private K-12 school of their parents' choice. At present, the maximum allowable tax credit is \$1,000 per year for taxpayers filing jointly and \$500 for other taxpayers. The most recent data indicate that, in calendar year 2008, STOs reported donations of approximately \$55.3 million and awarded \$54.1 million in scholarships.

This report assesses the net effect of the individual tax credit on the overall tax burden on Arizona taxpayers.<sup>1</sup> I conclude the following:

- It would cost the state, county, and local governments \$241.5 million to provide a public education for all of the private school students who received scholarships from STOs in 2008. This cost is more than four times the amount of revenue foregone under the tuition tax credits program.
- A conservative estimate of the number of students who are able to enroll in private schools only because of the tax credit scholarships is 11,697 students. The cost to the state, county, and local governments to provide these students with a public school education would be \$99.8 million per year, almost double the tax revenue passed up because of the tuition tax credit.
- Overall, the Private School Tuition Tax Credit saves Arizona taxpayers somewhere from \$99.8 million to \$241.5 million due to students enrolling in private rather than public schools. The revenue reduction of only \$55.3 million from the tax credit program is substantially less. The program is win-win for taxpayers and the children of Arizona.

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<sup>1</sup> I do not analyze the corporate income tax credit. However, given the income limitation that program places on scholarship recipients, it is likely that the program generates a substantial net savings for Arizona taxpayers.

- Throughout the current decade, private school enrollment has grown in Arizona despite healthy competition from charter schools and in contrast to a nationwide decline in private school enrollments. Thus, analyses of the tax credit program based only on the change in Arizona private school enrollment likely understate the cost-saving effect of the tax credit scholarship program.

### **Overall Taxpayer Savings from Private School Scholarships**

Every student in a private school lowers the amount that Arizona's taxpayers pay for public education. According to the Joint Legislative Budget Committee, the total dollars spent on public K-12 education by Arizona's state, county, and local governments in FY 2008 was \$8.91 billion. This is an average cost per public school student of \$8,528 for all levels of government.

In 2008, STOs awarded 28,321 scholarships for students to attend private schools. Had these students been in public schools, Arizona taxpayers would have spent an additional \$241.5 million on public education. These numbers dwarf the \$55.3 million in tax revenues foregone as a result of the individual tax credit program. Arizona taxpayers come out ahead when students choose to attend private schools.

### **Taxpayer Savings from "Switchers"**

Another way of examining the tax savings generated by private school tuition tax credits is to consider only "switchers" – those students who are able to afford a private school education only because of STO scholarships. In this section of the report, I show that tax credits save taxpayer money even if only the switchers are considered.

Some critics of the tuition tax credit have asserted that students receiving STO scholarships to attend private schools would enroll in private schools even without the scholarships. As a result, such critics claim that the program does not save the state money. These critiques are likely wrong.

- At least 14 of the largest STOs place substantial emphasis (including six that place sole emphasis) on financial need in deciding on scholarship awards.<sup>2</sup> These 14 STOs account for 18,452 (or 65.2 percent) of the 28,321 scholarships awarded in 2008. They also accounted for \$37.6 million (or 69.5 percent) of the \$54.1 million in scholarships awarded on 2008. It is likely that a large number of recipients of scholarships from these STOs would not be able to attend private schools without their scholarships.

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<sup>2</sup> I searched the websites of most large STOs to determine the relative importance they place on financial need as a criterion in awarding scholarships, as well as their policies and practices regarding recommendations. The following STOs place heavy emphasis (and even sole emphasis) on financial need: Arizona Christian School Tuition Organization, Arizona Episcopal Schools Foundation, Arizona Independent Schools Scholarship Foundation, Arizona School Choice Trust, Arizona Tuition Organization, Brophy Community Foundation, Catholic Tuition Organization of the Diocese of Phoenix, Catholic Tuition Support Organization for the Diocese of Tucson, Cheder Scholarship Organization, Christian Scholarship Fund of Arizona, Jewish Tuition Organization, Lutheran Education Foundation, Orme-Primavera Schools Foundation, and Tuition Organization for Private Schools. This list is not exhaustive; there may be other STOs that also place substantial weight on financial need but who do not explicitly say so in their website or other materials available to me. Most of the STOs just listed also do not accept recommendations; those that do so often receive recommendations for needy students.

- Recommendations are often made to benefit low-income students, not just wealthy ones as newspaper accounts have suggested. In fact, recommendations can allow someone with financial need to cobble together donations from multiple individuals, thereby allowing them to afford a private school education.
- It is likely that at least half of all recipients of need-based scholarships would not be able to attend private schools without those scholarships, and that about a fourth of all other scholarship recipients also would not be able to attend private schools without those scholarships.

Taken together, it is reasonable to estimate that, across all STOs, at least 41.3 percent of scholarship students (i.e., 11,697 students) would not be able to pay for private school without the scholarship program and would thus return to public schools if the program were ended. The cost to state, county, and local governments for 11,697 students returning to public school would be \$99.8 million, almost double the amount of revenue foregone because of the entire individual tax credit program.

An alternative way to conduct this analysis is to compare the tax credit per scholarship to the average cost of educating a public school student. According to the Arizona Department of Revenue's report for 2008, the average STO scholarship award was \$1,909. Of course, because of administrative costs, most STOs must bring in more than \$1,909 in order to give an award of \$1,909. To make my analysis as conservative as possible, I will assume that the average administrative cost is the full 10 percent allowed by law. (Many STOs keep their expenses lower than 10 percent, so that my assumption will overestimate the "cost" of the tax credit program.) To raise enough money to award a scholarship of \$1,909, an STO spending the full 10 percent on administrative costs would have to raise \$2,121 in donations. Assuming that all donations to STOs are eligible for the tax credit,<sup>3</sup> then the foregone revenue from an average scholarship is equal to that \$2,121.

The next step in the analysis is to compare the (over-)estimated \$2,121 in tax revenue foregone to the \$8,528 that would otherwise be spent per public school student. Dividing the former number by the latter yields 24.9 percent. What this means is that the taxpayers of Arizona experience net cost savings from tuition tax credits so long as at least one of every four scholarship recipients would switch to public school without the scholarship. As already explained above, it is reasonable to assume that at least one in four scholarship recipients would not be in private school without an STO scholarship.

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<sup>3</sup> This is another conservative assumption. Any couple who gives more than \$1,000 will not be able to take a credit for the excess donation. They will only be able to take the excess above \$1,000 as a charitable deduction. Thus, not every dollar donated to an STO is likely to be a dollar-for-dollar reduction in state tax revenues.

## Enrollment Changes in Arizona Private Schools

Some analysts have contended that enrollment gains in Arizona private schools since the advent of tuition tax credits have only been modest, pointing to statistics from the National Center for Education Statistics at the U.S. Department of Education.<sup>4</sup> Such claims ignore some important trends related to private school enrollment statistics:

- NCES statistics show that the supposedly slow growth in private school enrollment in Arizona is actually in marked contrast to the overall patterns in national private school enrollment. From 1995-96 to 2001-02, private school enrollment nationwide increased steadily from 5,032,200 to 5,341,516, while Arizona's private school enrollment was essentially flat at around 44,000 students. But from 2001-02 to 2007-08, nationwide private school enrollment fell from a peak of 5,341,516 to 5,072,451, while Arizona's private school enrollment grew from 44,360 to 51,590.
- Charter school enrollment in Arizona has exploded, probably drawing away a significant number of students who might otherwise have attended private schools. Arizona Department of Education statistics show that charter school enrollment was 43,600 in 1999-2000, 65,769 in 2001-02, and 99,634 in 2007-08.

Arizona's variation from the national private school enrollment trend suggests that something unusual is happening in Arizona. As national private school enrollment was declining, two things were happening simultaneously in Arizona: (1) Arizona's private school enrollment grew by 16.3 percent over six years; and (2) the maximum amount of the tax credit increased in steps from \$625 to \$1,000 for taxpayers filing joint. While there are probably other factors in play as well, the tax credit scholarships are likely one important piece in explaining why Arizona's private school enrollment has grown at the same time that private school enrollment in other states has declined and charter school enrollment in Arizona has grown rapidly.

### Conclusion

The private school tuition scholarship program provides access to private schools for thousands of students. By allowing children from low-income families the freedom to choose where to go to school, the program has a primary effect of increasing the fairness of the educational system. Rather than "costing" Arizona taxpayers \$55 million per year, the program actually saves Arizona taxpayers far more by eliminating the expense of providing a free public education to those students.

More freedom, fairness, and choice, at a lower cost to taxpayers – that is what the Private School Tuition Tax Credit delivers.

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<sup>4</sup> For example, the *Arizona Republic* determined that private school enrollment in Arizona had increased by 7,530 students between 1999-2000 and 2007-2008, and attributed all of that enrollment growth to the tax credit scholarships. Based on these assumptions, the *Republic* concluded that the tax credit scholarships saved at most \$8.3 million. It is significant that the *Republic's* analysis agrees with mine in finding that the tax credit program is not a net drain on Arizona's taxpayers.