

# spotlight

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## SPECIAL-NEEDS TAX CREDITS

Giving parents a choice in education

**KEY FACTS:** • Our public schools are struggling to meet the needs of special-needs students throughout North Carolina. During 2006-07 school year, less than 50 percent of high-school students with disabilities graduated in four years.

• A legislative analysis found that the state would save at least \$3 million a year in the cost of educating special-needs students, so long as at least five percent of the special-needs students in public schools transfer to a private provider or facility.

• Studies have found that parents of special-needs children are much more satisfied with their choice of school, compared to their assigned public school. In addition, research confirms that private schools offer a superior learning environment for special-needs students.

• The state can save money and provide quality education for special-needs children by providing a tax credit to parents and other individuals interested in helping special-needs students.

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**m**ost funding for special-needs students comes from the state and federal government. In 2007-08, North Carolina received approximately \$297 million in Individuals with Disabilities Education Act (IDEA) funds. On the other hand, last year, the NC General Assembly allotted over \$663 million in funds for students with special needs. That means that the state's public schools spent over \$960 million on staff and services for students with physical, emotional, or educational disabilities during this school year.<sup>1</sup>

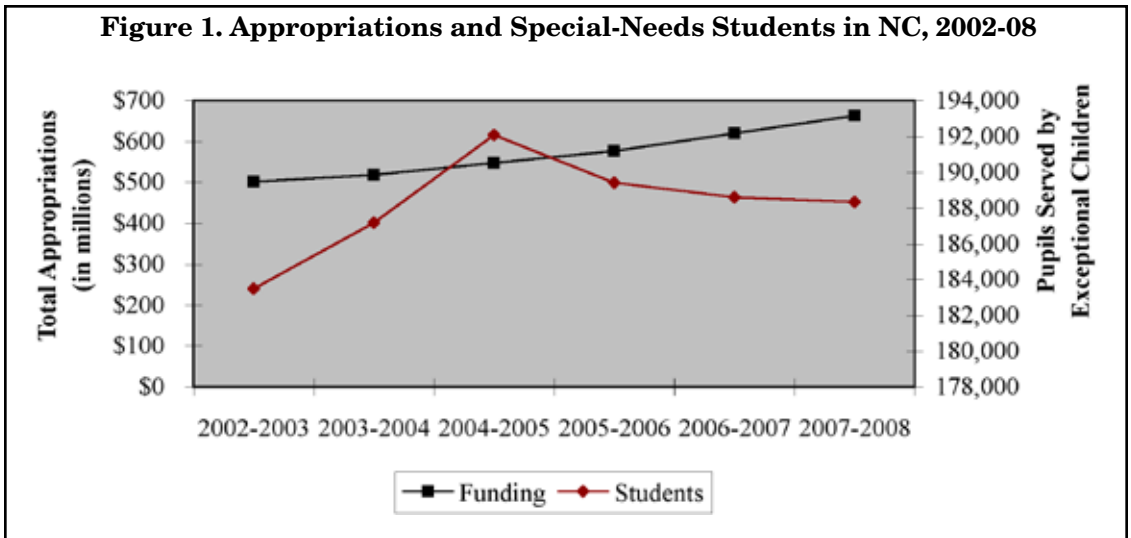
Over the last six years, state funding for special education has steadily increased from \$501 million in 2001-02 to \$663 million in 2007-08. On the other hand, the number of special-needs children in North Carolina has been on the decline since the 2003-04 school year (see Figure 1). In fact, the state serves over 3,700 fewer special-needs students today than in 2004.<sup>2</sup>

The amount of money that school systems receive for special-needs students is contingent on budgets passed by the General Assembly and the federal government. For the 2007-08 school year, public school systems received

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\$3,348.47 per special-needs child, regardless of the nature or severity of their disability. However, programs designed to meet the needs of special-needs students may receive funding independent of the per-student allotment. The Department of Public Instruction also maintains a reserve fund to cover the cost of educating severely disabled



students and ensure adequate funding in the midst of unexpected enrollment growth. Reserve funds are not included in the per student allotment.<sup>3</sup>

Interestingly, under the North Carolina General Statutes, school systems “may contract with private special education facilities or service providers to furnish any of these services that the public providers are unable to furnish.”<sup>4</sup> Unfortunately, school systems rarely provide parents of special-needs children the option to utilize a private facility or provider, even when the school system is ill equipped to educate a child with a unique or severe disability.<sup>5</sup>

It is not difficult to understand why school systems deny parents the right to employ a private provider for special education services. School systems receive state funds based on the number of eligible special-needs children enrolled. As a result, school systems have a financial incentive to retain as many special-needs students in the system, up to the statutory cap of 12.5 percent of special-needs students they will fund in any school system per year.<sup>6</sup>

### Does North Carolina Need a Special-Needs Tax Credit?

Clearly, North Carolina’s public schools are struggling to meet the needs of special needs. During 2006-07 school year, 49.5 percent of high school students with disabilities graduated in four years, nearly the same percentage as the year before. In addition, only 40.7 percent of elementary and middle school students with disabilities were proficient in math, while 57.6 percent were proficient in reading. The gap in proficiency between students with disabilities and students with no disability was a staggering 29.5 percent in math and 32 percent in reading.<sup>7</sup>

More importantly, a vast majority of parents would like the option to send their special-needs children to the school or facility of their choice. In a May 2008 poll of 521 likely North Carolina voters, 76 percent favored a tax credit that would allow special-needs children to go to the school of their choice, and 80 percent supported the special-needs tax credit legislation recently proposed by state legislators. Similarly, 74 percent of respondents favored a scholarship for special-needs children. Overall, there was very strong support for tax credits and scholarships for special-needs children, and that support was consistent across political party lines and among various demographic groups.<sup>8</sup>

### The Prospect for a Special-Needs Tax Credit in North Carolina

North Carolina’s tax code already allows taxpayers to claim tax credits for those caring for a disabled dependent or spouse. The state also gives tax credits to those who build multi-family rental units that are handicapped accessible

(see Table 1). While North Carolina's tax code covers the care and housing needs of individuals with special needs, the education of special-needs children, which (unlike care and housing) is required under law, is notably missing.<sup>9</sup>

In 2007, there was a bipartisan effort to create an education tax credit targeted toward children with special needs. According to the proposed legislation, the refundable tax credit would be equal to the amount the taxpayer paid for tuition and other educational and therapeutic expenses, not to exceed three thousand dol-

lars (\$3,000) per semester. To qualify for the credit, students would have to be enrolled in a public school for at least two semesters and have an individualized education program (IEP) that requires at least daily special instructional or therapeutic services received outside the regular classroom.<sup>10</sup>

The sponsors and co-sponsors of the bill serve districts that span the political spectrum, suggesting that in North Carolina special-needs tax credits appeals to a wide range of political perspectives (see Table 2). Indeed, those in predominantly Democratic legislative districts (Larry Womble and Michael Wray, for example) and predominantly Republican legislative districts (Larry Brown and Mark Hilton, for example) can still find common ground on the needs to extend special-needs tax credits to North Carolina's families.<sup>11</sup>

According to an analysis of HB 388 by the NC General Assembly's Fiscal Research Division, the more parents of

**Table 1. NC Tax Credits for Care of Special-Needs Population**

<i>Title</i>	<i>NC Department of Revenue Description</i>
Credit for Disabled Taxpayer, Dependent, or Spouse	If you claimed an income tax credit on your federal tax return for being permanently and totally disabled, you are entitled to a tax credit on your North Carolina return equal to one-third (1/3) of the amount of the federal tax credit. Although the federal tax credit is also allowed for being age 65 or older, no portion of the tax credit is allowed on the North Carolina return for being age 65 or older. You may also be entitled to a tax credit if a dependent or spouse for whom you are allowed an exemption on your federal return is permanently and totally disabled.
Credit for Construction of Dwelling Units for the Handicapped	You are allowed a tax credit for constructing multi-family rental units located in North Carolina which conform to Volume I-C of the North Carolina Building Code. The credit is \$550 for each dwelling unit completed during the taxable year.

**Table 2. Sponsors of House Bill 388 (2007): Tax Credits for Children with Special Needs**

	<i>Democrats</i>	<i>Partisan Index</i>	<i>Republicans</i>	<i>Partisan Index</i>
Primary Sponsors	Rick Glazier (Cumberland)	D+1	Paul Stam (Wake)	R+7
	Marvin Lucas (Cumberland)	D+11	Laura Wiley (Guilford)	R+7
Co-Sponsors	Martha Alexander (Mecklenburg)	D+8	Jeff Barnhart (Cabarrus)	R+10
	Bill Faison (Caswell, Orange)	D+6	Larry Brown (Davidson, Forsyth)	R+17
	Pricey Harrison (Guilford)	D+8	George Cleveland (Onslow)	R+7
	Grier Martin (Wake)	D+2	Mark Hilton (Catawba)	R+15
	William Wainwright (Craven, Lenoir)	D+15	Bill McGee (Forsyth)	R+10
	Larry Womble (Forsyth)	D+21	Ruth Samuelson (Mecklenburg)	R+13
Michael Wray (Northampton, Vance, Warren)	D+23	Thom Tillis (Mecklenburg)	R+11	

Note: The higher the Partisan Index number, the more likely voters in that district vote for Democrats (D) or Republicans (R).

special-needs students that would take advantage of the tax credit, the more money the state would save. However, savings would only occur if the public school students that take advantage of the program significantly outnumber participating home and private school students, who represent the so-called “deadweight” cost of the plan.

Because private and home school students “are not currently in the public schools, the effect of their families’ participation in the credit program would not produce any reduced public expenditures.”<sup>12</sup> In other words, these parents would be entitled to claim a tax credit for a qualified special-needs child. Their child’s schooling does not incur public expense, but the tax credit they receive does. Therefore, there would be a net loss to the state. As a result, if only one percent of qualified special-needs students in public schools transfer to a private provider, that will not be a sufficient number of students

to compensate for the deadweight cost. In other words, there would be a net loss to the state (see Tables 3 and 4).<sup>13</sup>

On the other hand, if five or 10 percent of public school special-needs students transfer, then the savings realized by the state would more than compensate for the deadweight cost. Thus, the state would save at least \$3 million a year in the cost of educating special-needs students, so long as at least five percent of the special-needs students in public schools transfer to a private provider or facility. The savings would ultimately depend on the number of special-needs students that qualify for the tax credit. Obviously, a larger percentage of students eligible for the credit would yield greater savings for the state (see Figure 2).<sup>14</sup>

**Table 3. Cost and Saving Estimates of a Special-Needs Tax Credit (20 Percent of Students with Individualized Education Programs Qualify)**

	<i>Potential Public School Transfers: 2007-08</i>		
	<i>1 percent</i>	<i>5 percent</i>	<i>10 percent</i>
<i>Cost of Tax Credit</i>	(\$2,370,768)	(\$11,853,840)	(\$23,707,680)
<i>Total State Government Savings</i>	\$2,809,498	\$14,047,492	\$28,094,984
<i>Net State Government Savings</i>	\$438,730	\$2,193,652	\$4,387,304
<i>Total Local Government Savings</i>	\$3,238,003	\$16,190,014	\$32,380,028
<i>Net Local Government Savings</i>	\$867,235	\$4,336,174	\$8,672,348
<i>Net State and Local Savings</i>	\$1,305,965	\$6,529,826	\$13,059,652
<i>Home and Private School Students</i>	(\$3,468,000)	(\$3,468,000)	(\$3,468,000)
<i>Total Savings</i>	(\$2,162,035)	\$3,061,826	\$9,591,652

Note: Consistent with the fiscal note and DPI estimates, this model assumes that 20 percent of students in public schools who have been identified as having special needs would require special instructional and/or therapeutic services outside the regular classroom at least daily.

**Table 4. Cost and Saving Estimates of a Special-Needs Tax Credit (40 Percent of Students with Individualized Education Programs Qualify)**

	<i>Potential Public School Transfers: 2007-08</i>		
	<i>1 percent</i>	<i>5 percent</i>	<i>10 percent</i>
<i>Cost of Tax Credit</i>	(\$4,741,536)	(\$23,707,680)	(\$47,415,360)
<i>Total State Government Savings</i>	\$5,618,997	\$28,094,984	\$56,189,967
<i>Net State Government Savings</i>	\$877,461	\$4,387,304	\$8,774,607
<i>Total Local Government Savings</i>	\$6,476,006	\$32,380,028	\$64,760,057
<i>Net Local Government Savings</i>	\$1,734,470	\$8,672,348	\$17,344,697
<i>Net State and Local Savings</i>	\$2,611,931	\$13,059,652	\$26,119,304
<i>Home and Private School Students</i>	(\$6,936,000)	(\$6,936,000)	(\$6,936,000)
<i>Total Savings</i>	(\$4,324,069)	\$6,123,652	\$19,183,304

Note: Consistent with the fiscal note and DPI estimates, this model assumes that 40 percent of students in public schools who have been identified as having special needs would require special instructional and/or therapeutic services outside the regular classroom at least daily.

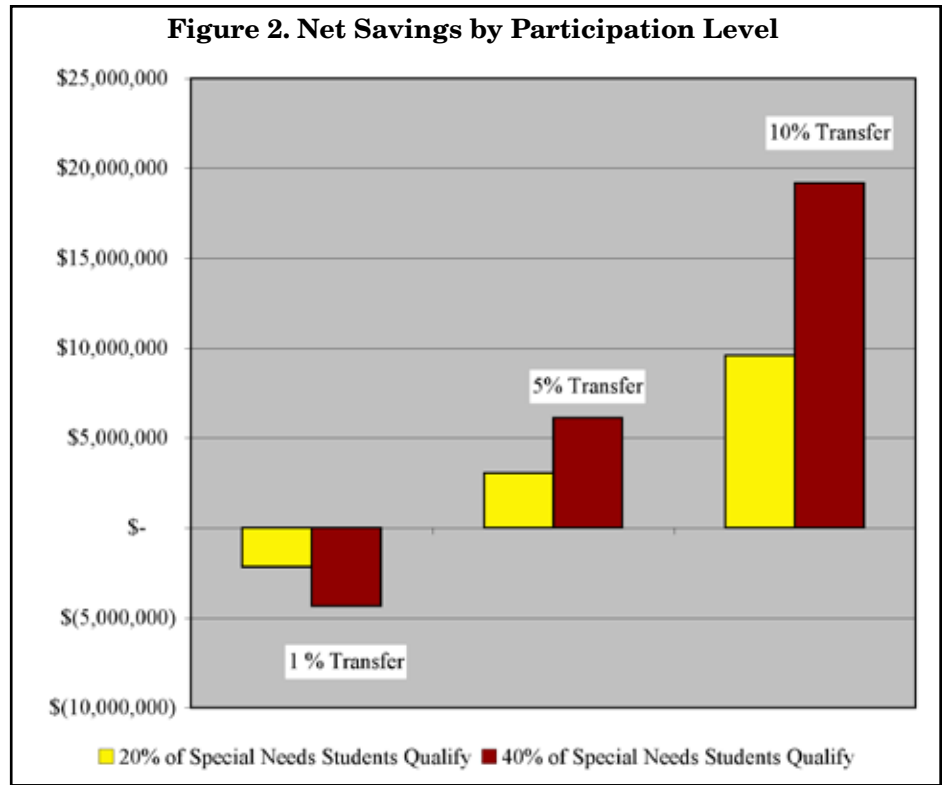
### Choice for Special-Needs Students in Other States

Currently, five states offer a scholarship program for special-needs students (see Table 5). Rather than a tax credit, these scholarship programs provide direct payment to schools of choice on behalf of families. Special-needs scholarships have had a record of success that provides insight into the kinds of benefits that a special-needs tax credit could bring to North Carolina. While North Carolina legislators may want to consider a scholarship program for special-needs students in the future, the tax credit proposal appears to be most viable option in our current political environment. A tax credit program would also not require a special administrative bureaucracy.<sup>15</sup>

Florida’s McKay scholarship is the oldest and largest program of its kind. An evaluation of the McKay scholarship program concluded that parents are much more satisfied with their choice of school, compared to their assigned public school. In addition, private schools chosen by parents under the McKay program (hereafter “McKay schools”) offered a superior learning environment for special-needs students, as measured by physical assaults, level of services, behavioral problems, and class size.<sup>16</sup>

Findings from the study of Florida’s special-needs scholarship include the following:

- 92.7% of McKay scholarship parents were satisfied or very satisfied with their child’s new school; only 32.7% were similarly satisfied with their public schools.
- Those participants also saw class size drop dramatically, from an average of 25.1 students per class in public schools to 12.8 students per class in private schools that receive McKay scholarships.
- In public schools, 46.8% were bothered often and 24.7% were physically assaulted, while in McKay schools 5.3% were bothered often and 6.0% were assaulted.
- Only 30.2% of current participants say they received all services required under federal law from their public school,



**Table 5. Scholarship Programs for Special-Needs Students**

Name	State	Established	Scholarship Amount	Participants
McKay Scholarship for Students with Disabilities	Florida	1999	\$4,805 – \$20,703	19,631
Autism Scholarship Program	Ohio	2003	Up to \$20,000	534
Carson Smith Special Needs Scholarship	Utah	2005	\$3,625.50 – \$6,042.50	308
Scholarship for Pupils with Disabilities	Arizona	2006	Varies	141
Special Needs Scholarship	Georgia	2007	Varies	899

while 86.0% report their McKay school has provided all the services they promised to provide.

- 40.3% of current participants said their special-needs children exhibited behavior problems in the public school, but only 18.8% report such behavior in McKay schools.
- 62.3% were satisfied with their McKay school, while only 45.2% were satisfied with their old public school. Their class sizes also dropped from an average of 21.8 students to 12.7 students.
- Over 90% of parents who have left the program believe it should continue to be available to those who wish to use it.<sup>17</sup>

A follow-up study of the McKay Scholarship Program found that “greater exposure to the McKay program — measured as the number of voucher accepting private schools within a certain radius of a public school — leads to a substantial improvement in the test scores of disabled students” that remain in the public school system.<sup>18</sup>

## Conclusion

Thousands of students across North Carolina would benefit from a special-needs tax credit. Thousands of special-needs students struggle in our state’s public schools, but, regrettably, parents have little choice but to continue to send their children to educational environments that are not designed to meet their needs. After all, if a one-size-fits-all public school is an unproductive environment for mainstream children, it is even more detrimental for students who require an alternative or adapted educational environment.

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## End Notes

1. North Carolina Department of Public Instruction (NC DPI), Financial and Business Services, “Highlights of the North Carolina Public School Budget,” February 2008, pp. 6, 37. This figure does not include local funds for additional special education staff, construction or modification of facilities, and the purchase of equipment and educational materials.
2. North Carolina General Assembly, Fiscal Research Division (NCGA), “Education of Children with Disabilities,” December 13, 2007. NC DPI, “Statistical Profiles, Pupils In Membership Being Served By Exceptional Children Programs,” 2003-07.
3. NCGA, Fiscal Research Division, “Education of Children with Disabilities.”
4. North Carolina General Statute § 115C-111.2. Contracts with private service providers.
5. The state also reimburses school systems for students placed in group homes, foster homes, or similar facilities.
6. NCGA, Fiscal Research Division, “Education of Children with Disabilities.”
7. NC DPI, Accountability Services, “State / LEA and School Test Performance,” [www.ncpublicschools.org/accountability/reporting/leaperformancearchive](http://www.ncpublicschools.org/accountability/reporting/leaperformancearchive). See also NC DPI, “Report on Educational Performance of Children with Disabilities, Report to the Joint Legislative Education Oversight Committee,” October 15, 2007.
8. Public Policy Polling, “Educational Issues Poll,” conducted May 12-13, 2008, released on May 28, 2008. See also Robert C. Enlow, “Georgia’s Opinion on School Vouchers,” Milton and Rose D. Friedman Foundation, April 9, 2007. In this poll, 59 percent of respondents supported a special-needs scholarship program in Georgia, while 20 percent did not favor the program. Moreover, a majority of the respondents said that private schools do a better job educating special-needs students than public schools, while only eight percent claimed that private schools do a worse job.
9. North Carolina Department of Revenue, “Rules and Bulletins Taxable Years 2007 and 2008,” [www.dor.state.nc.us](http://www.dor.state.nc.us).
10. NCGA, “HB 388: Tax Credits for Children with Special Needs,” 2007.
11. *Ibid.*; also see John W. Pope Civitas Institute, “Assessing Voter Partisanship: A New Model for North Carolina,” February 28, 2008, [www.nccivitas.org/media/publication-archive/policy-brief/assessing-voter-partisanship-new-model-north-carolina](http://www.nccivitas.org/media/publication-archive/policy-brief/assessing-voter-partisanship-new-model-north-carolina).
12. Adam Levinson and Brenna Erford, NCGA, Fiscal Research Division, “General Assembly of North Carolina, Legislative Fiscal Note for House Bill 388,” March 28, 2007, p. 2.
13. *Ibid.*
14. *Ibid.*
15. Alliance for School Choice, “The Promise of Special Needs Scholarships,” May 2007; The Heartland Institute, “Special-Needs Vouchers,” May 2007; see also Nate Bohlander and Andrew T. LeFevre, “Improving Educational Options for Pennsylvania’s Special Needs Students,” Reach Foundation *Issue Analysis*, Vol. 1, No. 3, August 2007.
16. Jay P. Greene and Greg Forster, “Vouchers for Special Education Students: An Evaluation of Florida’s McKay Scholarship Program,” executive summary, *Civic Report* No. 38, Manhattan Institute, June 2003.
17. *Ibid.* Likewise, an early evaluation of Ohio’s Autism Scholarship Program has found that parents are satisfied with the program’s administration, as well as the services provided by schools of choice. See also Legislative Office of Education Oversight, “Formative Evaluation of Ohio’s Autism Scholarship,” 2005.
18. Jay P. Greene and Marcus A. Winters, “The Effect of Special Education Vouchers on Public School Achievement: Evidence from Florida’s McKay Scholarship Program,” Department of Education Reform, University of Arkansas, April 2008.