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Espinoza v. Montana Department of Revenue: *Pulling Back the Curtain on Tax Expenditure Spending*

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COMMENTS

ESPINOZA V. MONTANA DEPARTMENT OF REVENUE: PULLING BACK THE CURTAIN ON TAX EXPENDITURE SPENDING

Katy Lindberg*

I. INTRODUCTION

Milton Friedman’s essay, *The Role of Government in Education*, popularized the concept of allowing the free market to dictate where parents send their children to school.¹ A free market, Friedman argued, would create competition for public education funds, thus driving schools to increase academic standards to compete for those funds.² As Friedman predicted, some parents have rejected public education and have turned to private schools to educate their children.³ In the early 1990s, the modern school choice movement began to take form, and many states began adopting voucher programs.⁴ Voucher programs allow parents to “direct” state funds to a private school of the parents’ choice.⁵ Although there are many reasons to send a

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1. Milton Friedman, *The Role of Government in Education*, in *ECONOMICS AND THE PUBLIC INTEREST* 4, 123–144 (Robert A. Solo ed., 1955), <https://perma.cc/M4WX-F7T2>.

2. *Id.*

3. Nat’l Ctr. for Educ. Statistics, *School Choice in the United States: 2019*, at 20, <https://perma.cc/TAH8-MGEJ> (last visited Oct. 26, 2020). In the fall of 2015, 5.8 million students attended private schools, accounting for approximately 10.2% of all elementary and secondary school enrollment.

4. Adam Mengler, *Public Dollars, Private Discrimination: Protecting LGBT Students from School Voucher Discrimination*, 87 *FORDHAM L. REV.* 1251, 1258 (2018).

5. Julie F. Mead, *The Right to an Education or the Right to Shop for Schooling: Examining Voucher Programs in Relation to State Constitutional Guarantees*, 42 *FORDHAM URB. L.J.* 703, 706 (2015).

child to a private school, religious education is a priority for many parents.⁶ As the public school system has become increasingly secular, the demand for religious education has grown among religious adherents who oppose the secularization of public education and want a faith-based education for their children.⁷ Many of these parents look to state governments to help offset the cost.⁸ Today, around 90% of states have some variety of a state-supported school choice program.⁹ These programs must follow the protections guaranteed by the Establishment Clause, Free Exercise Clause, and state constitutions.

The Montana Legislature enacted its school choice program in 2015 through offering a tax credit.¹⁰ The Tax Credit Program (“Program”) provides a tax credit for donations to private school scholarship funds.¹¹ The Legislature required the Montana Department of Revenue (“Department”) to administer the tax credit in “compliance with . . . Article X, Section 6 of the Montana Constitution,”¹² which prohibits the state from aiding religious schools.¹³

The Legislature’s enactment of the Program was unprecedented in Montana tax law. The Program provided a dollar-for-dollar tax credit that capped at \$3 million per year, increasing by 10% each year the cap is met.¹⁴ The Legislature referred to this as a “tax replacement program.”¹⁵ To comply with the Legislature’s guidance, the Department issued an administrative rule prohibiting religious schools from receiving aid.¹⁶ Parents seeking

6. Nicole Stelle Garnett, *Post-Accountability Accountability*, 52 U. MICH. J.L. REFORM 157, 200 (2018). In 2015, over 67% of private schools were religiously affiliated, and 76% of students enrolled in private schools attended a religious school. Nat’l Ctr. for Educ. Statistics, *supra* note 3, at 20.

7. Brad J. Davidson, Comment, *Balancing Parental Choice, State Interest, and the Establishment Clause: Constitutional Guidelines for States’ School-Choice Legislation*, 33 TEX. TECH L. REV. 435, 437 (2002).

8. *Id.*

9. *Scholarship Tax Credits*, NAT’L CONFERENCE OF STATE LEGISLATURES, <https://perma.cc/NY2Q-ZXEQ> (last visited Oct. 10, 2020) (explaining that seventeen states have scholarship tax credit programs in 2017); Josh Cunningham, *School Vouchers*, NAT’L CONFERENCE OF STATE LEGISLATURES (Dec. 1, 2016), <https://perma.cc/C3FA-E9J3> (explaining that twenty-seven states have school voucher programs); Benjamin Olneck-Brown, *Charter Schools: Overview*, NAT’L CONFERENCE OF STATE LEGISLATURES (Mar. 1, 2019) <https://perma.cc/4G64-9RRF> (explaining that forty-three states have charter school programs).

10. *See infra* Parts II(A) and II(B).

11. MONT. CODE ANN. § 15-30-3111(1) (2019).

12. *Id.* § 15-30-3101.

13. MONT. CONST. art. X, § 6.

14. MONT. CODE ANN. § 15-30-3111(5)(a) (2019).

15. *Id.* § 15-30-3101.

16. ADMIN. R. MONT. 42.4.802. *See also infra* Part II(C) (discussing the Department’s enactment of Rule 1).

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scholarships for their children to attend a religious school sued to enjoin the Department.¹⁷

In *Espinoza v. Montana Department of Revenue*, the Montana Supreme Court, faced with the Program's unique characteristics, found the effect of the tax credit was to subsidize private religious schools.¹⁸ This subsidy was unconstitutional under Article X, Section 6 of the Montana Constitution.¹⁹ Although the Court's application of Article X, Section 6 was overturned by the United States Supreme Court,²⁰ the Montana Supreme Court's definition of a tax credit still stands.²¹

A tax credit, like the one created by the Program, is a form of tax expenditure.²² Tax expenditures are a popular alternative to direct spending measures but face far less scrutiny.²³ Because tax expenditures are often not thought of as spending provisions, but as tax cuts,²⁴ most tax expenditures are not subject to annual or bi-annual scrutiny.²⁵ In reality, tax expenditures cost the state hundreds of millions of dollars in diverted tax revenue per year and create administrative costs.²⁶ Unlike direct spending measures, tax expenditures silently siphon money from the general fund by decreasing tax revenue.²⁷ Tax expenditures are an important tool for legislative bodies, yet the provisions should be subject to the same review as any other spending measure.

The Montana Supreme Court's analysis of the Program demonstrates this principle, reflecting why tax expenditures should be treated not as tax cuts but as government subsidies. By defining a tax expenditure as an indirect payment, the Montana Supreme Court pulled back the curtain on tax expenditure spending. Its analysis exposed the Program's true economic

17. Complaint ¶¶ 7–9, *Espinoza v. Montana Dep't of Revenue*, 2015 WL 13821199 (D. Mont. Dec. 16, 2015) (No. DV-15-1152). *See also infra* Part II(C) (discussing the Rule 1 litigation).

18. *Espinoza v. Montana Dep't of Revenue*, 435 P.3d 603, 612–14 (Mont. 2018). *See also infra* Part II(C)(1) (summarizing the Montana Supreme Court's decision).

19. *Id.* at 614–15.

20. *Espinoza v. Montana Dep't of Revenue*, 140 S. Ct. 2246, 2256–2263 (2020).

21. *Id.* at 2254.

22. STEPHANIE HUNTER McMAHON, *PRINCIPLES OF TAX POLICY* 473–75 (2d ed. 2018).

23. Michael Leachman, Dylan Grundman & Nicholas Johnson, *Promoting State Budget Accountability Through Tax Expenditure Reporting*, CENTER ON BUDGET AND POLICY PRIORITIES (May 24, 2011), <https://perma.cc/KME4-R849>.

24. McMAHON, *supra* note 22, at 474.

25. Leachman, Grundman & Johnson, *supra* note 23.

26. Montana Dep't of Revenue, 2018 Biennial Report: Tax Expenditures, 275, 281–82 [hereinafter Biennial Report]; *Where is the Money Going? It is Time to Look at Montana's Tax Expenditures*, MONTANA BUDGET & POLICY CENTER (Aug. 2019), <https://perma.cc/5YZF-F7KX> [hereinafter *Where is the Money Going?*].

27. *What Are Tax Expenditures?*, TAX POLICY CENTER (May 2020), <https://perma.cc/N5CG-SUPD> [hereinafter *What Are Tax Expenditures?*].

cost and revealed the Legislature's attempt to avoid the prohibitions of Article X, Section 6.

This Note is organized as follows: Part II provides background on school choice policy, including Montana's school tax credit program, and discusses the constitutional challenges school choice programs face under the Religion Clauses of the First Amendment to the federal Constitution. Part II then discusses the Montana State Constitution's No-Aid Clause, its complex background, and the Montana Department of Revenue's attempt to administer the Program in accordance with the No-Aid Clause through the Department's promulgation of Rule 1. Part II concludes by setting out the legal challenge to the Department's Rule 1, the Montana Supreme Court's holding that the Program was unconstitutional, and the United States Supreme Court's overturning of the Montana Supreme Court's decision. Part III begins with an explanation of the function and effect of tax expenditures, and the reasons policymakers use tax expenditures. Part III then discusses the criticisms of legislative bodies' heavy reliance on tax expenditures. Next, Part III discusses how the Montana Supreme Court's novel interpretation of a tax credit as an indirect payment was correct given current tax expenditure spending trends and tax credits' fiscal reality. Finally, Part IV argues for a shift in thinking regarding tax expenditures and urges public policymakers to treat tax expenditures like appropriations, subject to the same scrutiny as direct spending measures.

II. BACKGROUND

A. School Choice

Since the early 1990s, school choice programs have proliferated across the country.²⁸ School choice programs function by diverting public education funds to private schools, allowing the funds to "follow" students to a school of their parent's choice.²⁹ There are various approaches to school choice: charter schools³⁰ and school voucher programs are prevalent nationwide;³¹ however, scholarship tax credit programs are becoming a popular alternative.³² Tax credit programs incentivize taxpayers to donate to schol-

28. Garnett, *supra* note 6, at 159–160.

29. *What is School Choice?*, EdCHOICE, <https://perma.cc/N6BD-CAVL> (last visited Oct. 17, 2020).

30. Benjamin Olneck-Brown, *Charter Schools: Overview*, NAT'L CONFERENCE OF STATE LEGISLATURES (Mar. 1, 2019) <https://perma.cc/4G64-9RRF>.

31. Josh Cunningham, *School Vouchers*, NAT'L CONFERENCE OF STATE LEGISLATURES (Dec. 1, 2016), <https://perma.cc/C3FA-E9J3>.

32. *Scholarship Tax Credits*, NAT'L CONFERENCE OF STATE LEGISLATURES, <https://perma.cc/NY2Q-ZXEQ> (last visited Oct. 10, 2020) (showing that seventeen states had scholarship tax credit programs in 2017); *What is a Tax-Credit Scholarship?*, EdCHOICE, <https://perma.cc/NZM8-L7AC> (last visited Oct. 10, 2020) (showing that, as of 2020, eighteen states have scholarship tax credit programs).

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arship funds by supplying a tax credit for their donations.³³ The scholarship funds then provide parents with tuition aid for private schools, many of which are religious.³⁴

During the 2015 legislative session, the Montana Legislature enacted the Program,³⁵ providing taxpayers with a dollar-for-dollar tax credit of up to \$150 per year for a donation to a Student Scholarship Organization (“SSO”).³⁶ With these donations, the SSO grants scholarships to children attending a Qualified Education Provider.³⁷ The Program prohibits a taxpayer from directing funds to a specific student or school.³⁸ Instead, the SSO takes the contribution, awards a scholarship to a student, and pays the scholarship directly to the student’s school.³⁹ Although a parent cannot donate \$150 and direct it to go to their child, the parent can donate \$150, receive a \$150 tax credit, be awarded a \$150 scholarship by an SSO, reducing their tuition burden.⁴⁰

After receiving a donation, the SSO pays a Qualified Education Provider on behalf of a student.⁴¹ A Qualified Education Provider must be a private school and must follow certain requirements to receive funds under the Program, including maintaining accreditation, meeting health and safety standards, and administering standardized tests.⁴² Only one SSO, Big Sky Scholarships, has been formed under the Program.⁴³ Out of ten schools receiving scholarships under Big Sky Scholarships, nine are religiously affiliated.⁴⁴

School choice programs have been fully embraced by parents seeking a religious education for their children.⁴⁵ The United States Supreme Court has long recognized that a parent has the right to choose where their child receives an education and shepherd their child’s “religious upbringing” by sending them to a religious school.⁴⁶ Given that public schools have be-

33. Garnett, *supra* note 6, at 170.

34. *Id.*

35. S. 410, 2015 Leg., 64th Reg. Sess. (Mont. 2015).

36. MONT. CODE ANN. § 15-30-3111(1) (2019).

37. *Id.* § 15-30-3104(1).

38. *Id.* § 15-30-3111(1).

39. *Id.* § 15-30-3104(1).

40. *Id.* § 15-30-3104(1). See also Montana Dep’t of Revenue, Fiscal Note, S. 410, 2015 Leg., 64th Reg. Sess. at 2, <https://perma.cc/6X7Z-GEEZ> [hereinafter “Fiscal Note”]. This is in addition to any federal charitable contribution tax credit.

41. MONT. CODE ANN. § 15-30-3104(1) (2019).

42. *Id.* § 15-30-3102(7).

43. See *Montana Education Donations Portal*, <https://perma.cc/B884-FSP7> (last visited Oct. 10, 2020).

44. BIG SKY SCHOLARSHIPS, <https://perma.cc/8W5F-YU4U> (last visited Oct. 10, 2020).

45. Davidson, *supra* note 7.

46. Wisconsin v. Yoder, 406 U.S. 205, 213–14 (1972); Pierce v. Soc’y of Sisters, 268 U.S. 510, 534–35 (1925).

come increasingly secular, many parents want their children to learn in an environment that intertwines education with religion.⁴⁷ Parents may also want to avoid topics taught in public schools, like evolution or sex education, that conflict with their religious beliefs.⁴⁸ That said, the religious nature of many private schools may create constitutional issues when the schools receive state funding or subsidies through school choice programs.

B. Constitutional Limits of State Support for Religious Education

This subsection first summarizes the challenges faced by school choice programs under the Religion Clauses of the First Amendment. The subsection then discusses state limits on school choice, including Montana's No-Aid Clause. The origins of Article X, Section 6, and its inclusion in the 1972 Constitution are also discussed.

1. Religion Clauses

School choice programs have been challenged under both the Establishment and the Free Exercise Clauses of the First Amendment, but rarely were the cases clear cut. Many school choice programs fall between “the joints” of what the Establishment Clause forbids and the Free Exercise Clause mandates.⁴⁹

The Establishment Clause of the First Amendment prohibits a state or the federal government from enacting a law that has “the ‘purpose’ or ‘effect’ of advancing or inhibiting religion.[⁵⁰]” Historically, the Court applied the *Lemon* test to determine whether a law violated the Establishment Clause;⁵¹ however, the current Court has “shelved” this test and might narrow its scope further in the near future.⁵² Under current Establishment Clause jurisprudence, a school choice program does not violate the Estab-

47. Davidson, *supra* note 7, at 437.

48. *Id.* at 437–38.

49. *Trinity Lutheran Church of Columbia, Inc. v. Comer*, 137 S. Ct. 2012, 2019–20 (2017) (quoting *Locke v. Davey*, 540 U.S. 712, 718 (2004)).

50. U.S. CONST. amend. I; *Zelman v. Simmons-Harris*, 536 U.S. 639, 648–49 (2002).

51. Under the *Lemon* test, a law violates the Establishment Clause when it (1) does not “clearly reflect a secular legislative purpose,” (2) “advances” or “inhibits” religion, and (3) excessively “entangles” the government with religion. *Comm. for Public Educ. & Religious Liberty v. Nyquist*, 413 U.S. 756, 772–73 (1973) (internal citations omitted).

52. *But see American Legion v. American Humanist Ass’n*, 139 S. Ct. 2067, 2102 (2019) (Gorsuch, J., concurring) (stating that the *Lemon* test is “now shelved”); *see also Espinoza v. Montana Dep’t of Revenue*, 140 S. Ct. 2246, 2264 (2020) (Thomas, J., concurring to argue the Establishment Clause only applies against the federal government, and is only intended to prevent religious “coercion” or forced “financial support” of religion).

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lishment Clause if the program is “neutral” with respect to religion or if aid goes to a religious school based only on parental choice.⁵³

For example, a Minnesota law allowing taxpayers to deduct their children’s educational expenses from their state income taxes was upheld by the United States Supreme Court, even though 95% of the beneficiaries sent their children to religious schools.⁵⁴ The Court explained that the Minnesota law neutrally benefitted parents of both religiously and non-religiously educated children.⁵⁵ The Court also found the program only aided religious schools because of a parent’s independent choice to send their children to a religious school.⁵⁶

School choice programs also face Free Exercise Clause challenges.⁵⁷ The Free Exercise Clause of the First Amendment bars state and federal governments from “prohibiting the free exercise” of religion.⁵⁸ The Supreme Court has found a state violates the Free Exercise Clause when it denies a generally available, non-religious benefit to an individual or group solely because of their religious affiliation.⁵⁹ Still, when a state has a substantial interest in not funding a religious pursuit, or when the recipient is using the aid for religious use, the state may decline aid under the Free Exercise Clause.⁶⁰

In *Locke v. Davey*, the Supreme Court held a publicly funded Washington State scholarship program could refuse aid to a student seeking a devotional theology degree to become a minister.⁶¹ The State had a substantial interest in not funding students’ theological education, and the Court found the State’s compelling interest to not aid churches under the Establishment Clause outweighed the student’s rights under the Free Exercise Clause.⁶² The student in *Locke* “was denied a scholarship because of what

53. See *Espinoza*, 140 S. Ct. at 2254. See also *Mueller v. Allen*, 463 U.S. 388, 397–99 (1983) (a tax deduction program, primarily used by parents of children attending religious schools, did not violate the Establishment Clause because the program neutrally benefitted parents of children attending religious and non-religious schools, and because the funds only benefitted religious schools because of parental choice); *Zobrest v. Catalina Foothills Sch. Dist.*, 509 U.S. 1, 10 (1993) (a religious school could receive a government benefit when the benefit was neutral, and when the school received the benefit solely because of the parent’s choice); *Zelman*, 536 U.S. at 653 (following *Mueller* and *Zobrest* to uphold a school voucher program that neutrally benefitted religious and nonreligious schools, and that only benefitted religious schools because of a parent’s choice).

54. *Mueller*, 463 U.S. at 390–91.

55. *Id.* at 397.

56. *Id.* at 399.

57. *Trinity Lutheran Church of Columbia, Inc. v. Comer*, 137 S. Ct. 2012, 2019 (2017); *Locke v. Davey*, 540 U.S. 712, 718 (2004).

58. U.S. CONST. amend. I.

59. *Trinity Lutheran*, 137 S. Ct. at 2019–21; *Church of Lukumi Babalu Aye, Inc. v. Hialeah*, 508 U.S. 520, 533, 542–43 (1993).

60. *Locke*, 540 U.S. at 725.

61. *Id.*

62. *Id.* at 722–25.

he proposed to do—use the funds to prepare for the ministry,” not because of his religious status.⁶³

The current Court’s more recent Free Exercise jurisprudence suggests that *Locke* is an anomaly, however.⁶⁴ In *Trinity Lutheran*, the Missouri Department of Natural Resources’ decision to deny Trinity Lutheran Church preschool and daycare center a grant providing funding for a rubber playground surface violated the Free Exercise Clause.⁶⁵ The Court found Missouri had discriminated against Trinity Lutheran because it denied the church neutral aid solely based on its religious status.⁶⁶ According to the Court, Missouri had forced Trinity Lutheran to choose between its religious practice and receiving the grant.⁶⁷

2. Montana’s No-Aid Clause

School choice programs may also face challenges under state constitutions. A state’s constitution could traditionally create more separation of church and state than the First Amendment.⁶⁸ To accomplish this, many state constitutions contain a no-aid clause. Historically, the Montana Constitution contained one of the strongest no-aid provisions in the country.⁶⁹ Article X, Section 6 of the Montana Constitution prohibited the use of “any direct or indirect appropriation or payment from any public fund or monies” to benefit a religious purpose or organization.⁷⁰

States began prohibiting religious schools from receiving state funding in the mid-1820s.⁷¹ In 1835, Michigan was the first state to add a no-aid provision to its constitution,⁷² and several states followed suit.⁷³ States’ early efforts to limit state funding in religious education stemmed from a

63. *Trinity Lutheran*, 137 S. Ct. at 2023–24.

64. See *Espinoza v. Montana Dep’t of Revenue*, 140 S. Ct. 2246, 2257–58, 2262–63 (2020) (explaining that *Locke* created a “narrow restriction” allowing states to prohibit funds to be used for “religious use”); see also *Trinity Lutheran*, 137 S. Ct. at 2023 (following this reasoning).

65. *Trinity Lutheran*, 137 S. Ct. at 2017, 2021–22.

66. *Id.* at 2024 n.3.

67. *Id.* at 2024.

68. This maxim has been called into question by the United States Supreme Court’s decision in *Espinoza*, 140 S. Ct. at 2260.

69. *Espinoza v. Montana Dep’t of Revenue*, 435 P.3d 603, 610 n.3 (Mont. 2018) (citing 6 MONTANA CONSTITUTIONAL CONVENTION VERBATIM TRANSCRIPT 2008, 2011 (1972) available at <http://perma.cc/5ZWU-XQUL> [hereinafter 6 CONSTITUTIONAL CONVENTION TRANSCRIPT]). In *Espinoza*, 140 S. Ct. at 2262–63, the United States Supreme Court held Montana’s No-Aid Clause violated the Free Exercise Clause, and the provision is no longer valid.

70. MONT. CONST. art. X, § 6(1).

71. Steven K. Green, *The Insignificance of the Blaine Amendment*, 2008 B.Y.U. L. REV. 295, 311–12 (2008) (discussing New York State’s decisions in 1824 and 1830 to deny a Baptist school and a Methodist school state funding, and an 1827 Massachusetts law prohibiting the same).

72. MICH. CONST. OF 1835, art. I, §§ 4, 5. See also Ballotpedia, *Blaine Amendments in State Constitutions*, <https://perma.cc/DYG2-Y6VF> (last visited Dec. 23, 2020).

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desire to prevent government entanglement in religion and to decrease “competition” for school funding.⁷⁴ However, some states’ motives shifted by the 1850s, when conflict emerged between a growing Catholic population and the Protestant majority.⁷⁵ In 1875, James Blaine, a congressperson from Maine, introduced a constitutional amendment that prohibited state funds from supporting religious schools.⁷⁶ Congressman Blaine introduced the amendment to combat rising tensions—mainly centering on education—between Catholics and Protestants.⁷⁷ At the time, public schools were immersed in the Protestant tradition, and Catholic parents did not want their children to be subjected to Protestant teachings.⁷⁸ Catholic parents and religious leaders sought government funding to establish Catholic schools and provide Catholic children with a parochial education.⁷⁹ Congressman Blaine’s amendment reacted to this push for Catholic schools, but his amendment failed to pass both houses of Congress.⁸⁰ Despite failing at the federal level, many states adopted their own version of a “Blaine Amendment” in their constitutions, including Montana.⁸¹

Although Montana’s first No-Aid Clause was rooted in anti-Catholic sentiment, the provision was included in the 1972 Constitution for entirely different reasons.⁸² At the 1972 Constitutional Convention, maintaining the separation of religion and public education was crucial to the delegates.⁸³ The delegates wanted the Montana Constitution to ensure that religious schools would not receive public funds.⁸⁴ The delegates acknowledged the bigoted roots of Montana’s No-Aid Clause;⁸⁵ however, they agreed the No-

73. See OHIO CONST. OF 1851, art. VI, § 2; OR. CONST. OF 1857, art. I, § 5; KAN. CONST. OF 1858, art. VI, § 8 (1859).

74. Green, *supra* note 71, at 310–12, 315.

75. Jay S. Bybee & David W. Newton, *Of Orphans and Vouchers: Nevada’s “Little Blaine Amendment” and the Future of Religious Participation in Public Programs*, 2 NEV. L.J. 551, 554–55 (2002). Schooling was not the only source of conflict. The anti-immigrant and anti-Catholic sentiment “seeped into politics” and society as a whole. Michael P. Dougherty, *Montana’s Constitutional Prohibition on Aid to Sectarian Schools: “Badge of Bigotry” or National Model for the Separation of Church and State?*, 77 MONT. L. REV. 41, 44 (2016); Edward DeForrest, *An Overview and Evaluation of State Blaine Amendments: Origins, Scope, and First Amendment Concerns*, 26 HARV. J.L. & PUB. POL’Y 551, 560 (2003).

76. Bybee & Newton, *supra* note 75, at 551–52, 557.

77. *Id.* at 554–55.

78. Dougherty, *supra* note 75, at 43.

79. *Id.*; DeForrest, *supra* note 75, at 560.

80. Dougherty, *supra* note 75, at 44.

81. *Id.* at 44–45. At statehood, Montana’s enabling act required that the state Constitution contained a provision prohibiting public funding for religious schools. Enabling Act of Feb. 22, 1889 §§ 4, 14, 25 Stat. 676, 677, 680.

82. 6 CONSTITUTIONAL CONVENTION TRANSCRIPT, *supra* note 69, at 2008–09, 2016–19.

83. *Id.* at 2008, 2012.

84. *Id.* at 2016–18.

85. *Id.* at 2010.

Aid Clause was essential and voted to keep the provision in the new Constitution to ensure separation of church and state.⁸⁶ Voters ratified the Constitution the same year by popular vote, approving the No-Aid Clause—Article X, Section 6.⁸⁷

C. Rule 1 as a Remedy to the Program's Constitutional Defect

The Legislature and the Department both recognized the Program implicated the No-Aid Clause. The Program is a unique tax credit, containing many unprecedented provisions in Montana's tax code. These provisions and the Montana Constitution's limitations prompted extensive litigation, leading to a final resolution at the United States Supreme Court. This section first discusses the Program and its novel provisions, including the Department's attempt to administer the Program in accordance with Montana's No-Aid Clause through Rule 1. The section then explores the litigation over the Department's promulgation of Rule 1 and the Montana Supreme Court's conclusion that the Program created an unconstitutional indirect payment to religious schools. This section concludes with an overview of the United States Supreme Court's decision, holding Article X, Section 6 violated the Free Exercise Clause.

The statutory framework of the Program contains restrictions on who can use the tax credit and who can benefit from the scholarships created by the Program.⁸⁸ Unlike other tax credits in the Montana tax code, the Program provides a dollar-for-dollar tax credit for donations to an SSO,⁸⁹ caps the tax credit at \$3 million,⁹⁰ and mandates it be administered in the Montana Constitution.⁹¹

Taxpayers, beneficiary students, and schools must follow the Program's specific process. Under the statute, the tax credit is matched up to a \$150 donation,⁹² as long as the taxpayer has at least \$150 in tax liability.⁹³ When donating to an SSO, taxpayers cannot direct their donation to a spe-

86. Delegate Maurice Driscoll, a parent to children attending religious schools, explained the 1972 No-Aid Clause was meant to replace the "archaic" original provision. *Id.* at 2012, 2026. Other Catholic delegates supported the measure as well, including Delegates Schlitz and McNeil (a Protestant with a Catholic wife and children). *Id.* at 2012, 2016.

87. Tyler M. Stockton, Comment, *Originalism and the Montana Constitution*, 77 MONT. L. REV. 117, 124 (2016).

88. MONT. CODE ANN. §§ 15-30-3101 to 15-30-3104, 15-30-3111 (2019).

89. *Id.* § 15-30-3111(1). Compare with § 15-30-2326 (college contribution tax credit); § 15-30-2366 (elderly care tax credit); § 15-31-131 (dependent care tax credit); § 15-30-2364 (adoption tax credit).

90. *Id.* § 15-30-3111(5)(a).

91. *Id.* § 15-30-3101.

92. *Id.* § 15-30-3111(1).

93. *Id.* § 15-30-3111(3).

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cific student or school.⁹⁴ Instead, after a taxpayer donates, the SSO “deliver[s] the scholarship funds directly to the qualified education provider” to benefit the designated student.⁹⁵ An SSO is limited to providing scholarships equal to or less than 50% of the “per-pupil average of total public school expenditures.”⁹⁶ The Program itself caps at \$3 million but increases by 10% for each year the cap is reached.⁹⁷

The Montana Legislature also included a provision mandating that the Department administer the Program in accordance with Article X, Section 6.⁹⁸ The Legislature included this seemingly common-sense provision because it recognized that the Program’s characteristics and the fiscal impact could implicate the No-Aid Clause. The Program’s unprecedented dollar-for-dollar tax credit and \$3 million cap are characteristics more akin to a direct spending measure than a tax expenditure. The calculated costs of the Program include a potential \$9.6 million decrease in revenue to the General Fund and estimated direct costs of over \$11 million by the fiscal year 2022.⁹⁹ The effect of the Program on the state’s General Fund is estimated to be over \$20 million by 2022.¹⁰⁰

Because of the Program’s structure and cost, the Department found that it unconstitutionally appropriated indirect aid in violation of Article X, Section 6 of the Montana Constitution.¹⁰¹ To cure these constitutional defects, the Department adopted Rule 1.¹⁰² It reasoned that the Program violated the No-Aid Clause because it subsidized religious schools by providing an offsetting tax credit for donations to the SSO.¹⁰³ Further, the Program’s economic effect on the General Fund was substantial.¹⁰⁴ Rule 1 redefined “Qualified Education Provider” to exclude religiously affiliated

94. MONT. CODE ANN. § 15-30-3111(1); § 15-30-3103(1)(b).

95. *Id.* § 15-30-3104(1).

96. *Id.* § 15-30-3103(1)(d); § 15-30-3104(2).

97. *Id.* § 15-30-3111(5)(a).

98. *Id.* § 15-30-3101.

99. Fiscal Note, *supra* note 40, at 2; *Espinoza v. Montana Dep’t of Revenue*, 435 P.3d 603, 617 n.3 (Mont. 2018).

100. Fiscal Note, *supra* note 40, at 2.

101. Notice of Public Hearing, Montana Administrative Register Notice 42-2-939 (Oct. 15, 2015).

102. ADMIN. R. MONT. 42.4.802. Rule 1 provides that a “qualified education provider . . . may not be: (a) a church, school, academy, seminary, college, university, literary or scientific institution, or any other sectarian institution owned or controlled in whole or in part by any church, religious sect, or denomination; or (b) an individual who is employed by a church, school, academy, seminary, college, university, literary or scientific institution, or any other sectarian institution owned or controlled in whole or in part by any church, religious sect, or denomination when providing those services.”

103. *See* Brief in Opposition to Plaintiffs’ Motion for Summary Judgment, *Espinoza v. Montana Dep’t of Revenue*, 2016 WL 11608964 (D. Mont. Jul. 8, 2016) (No. DV-15-1152A) (illustrating the Department’s position regarding the Program without Rule 1).

104. Fiscal Note, *supra* note 40, at 2.

schools from receiving aid, narrowing the Program to allow only secular schools to participate.¹⁰⁵

Parents of children attending Stillwater Christian School sued the Department, seeking an injunction preventing Rule 1 from being enforced.¹⁰⁶ Plaintiffs Espinoza, Anderson, and Schaefer argued the tax credit was not an indirect appropriation or payment in violation of the Montana Constitution, and that the Department had acted improperly.¹⁰⁷ Plaintiffs also argued Rule 1 violated the Free Exercise and Establishment Clauses of the United States and Montana Constitutions.¹⁰⁸

The Department responded, arguing the tax credit created an indirect payment to religious schools in violation of Montana's No-Aid Clause.¹⁰⁹ Highlighting that the Program mandates SSOs pay the tax credit scholarship directly to the recipient school, the Department argued an indirect payment "directly benefit[s] the school."¹¹⁰ The Department asserted the Program could only be implemented constitutionally with Rule 1 and Rule 1's limitation on Qualified Education Providers was constitutional under the First Amendment's Religion Clauses.¹¹¹

The district court granted Plaintiffs' injunction, finding the tax credit was not an appropriation or payment, and that the Program was constitutional without Rule 1.¹¹² The court held tax credits were not money in the treasury, and the Legislature was not expending public funds, so the tax credit was not an appropriation or payment subject to Article X, Section 6 of the Montana Constitution.¹¹³

The Department appealed the district court's ruling, arguing the court erred in finding the tax credit was not an indirect payment.¹¹⁴ It asked the Montana Supreme Court to consider whether the No-Aid Clause required Rule 1 and whether the Department could enact it.¹¹⁵ In response, the parents argued that the tax credit was not a direct or indirect appropriation or payment and that the tax credit did not aid religious schools.¹¹⁶

105. ADMIN. R. MONT. 42.4.802.

106. Complaint ¶¶ 7–9, 140 Espinoza v. Montana Dep't of Revenue, 2015 WL 13821199 (D. Mont. Dec. 16, 2015) (No. DV-15-1152).

107. Plaintiff's Brief in Support of their Motion for Preliminary Injunction, Espinoza v. Montana Dep't of Revenue, 2016 WL 11608960 (D. Mont. Jan. 29, 2016) (No. DV-15-1152A).

108. *Id.*

109. Brief in Opposition to Plaintiffs' Motion for Summary Judgment, *supra* note 103.

110. *Id.*

111. *Id.*

112. Espinoza v. Montana Dep't of Revenue, 435 P.3d 603, 608 (Mont. 2018).

113. Brief in Opposition to Plaintiffs' Motion for Summary Judgment, *supra* note 103.

114. Brief for Appellants at 1–2, 7–8, Espinoza v. Montana Dep't of Revenue, 2018 WL 949265 (Mont. Feb. 12, 2018) (No. DA 17-0492).

115. *Id.* at 1–2.

116. Appellees' Answer Brief at 9–10, Espinoza v. Montana Dep't of Revenue, 2018 WL 7351707 (Mont. Jan. 19, 2018) (No. DA 17-0492).

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The Montana Supreme Court held the Program was unconstitutional under Article X, Section 6, because the Program allowed the Legislature to indirectly aid religious schools by providing a tax credit for scholarship donations.¹¹⁷ Noting the Montana No-Aid Clause’s strength, the Court found the Program allowed the Legislature to indirectly pay tuition for children attending religiously affiliated schools.¹¹⁸

The Court explained that the tax credit created by the Program was a subsidy, and thus an indirect payment to religious schools because it allowed parents to receive a dollar-for-dollar reduction in their taxes for their donation to an SSO.¹¹⁹ Further, the Program provided parents with a \$150 reduction in tuition burden when their child received a scholarship from an SSO.¹²⁰ The tax credit combined with the reduction in tuition burden allowed the Legislature to “indirectly pay[] tuition at private, religiously-affiliated schools.”¹²¹ Because the vast majority of the Qualified Education Providers were religiously affiliated and taxpayers could not direct funds to a specific school, there was no way the Legislature could ensure the indirect funds were not going to a religious school.¹²² If the funds did end up at a religious school, the majority explained, there was no way to know “where the secular purpose ended, and the sectarian began.”¹²³

In support of its holding, the Court discussed the Montana No-Aid Clause’s history and the intent of its drafters.¹²⁴ Although the Montana Constitution has contained a No-Aid Clause since statehood, the Court pointed to the 1972 Constitutional Convention, where the provision was ratified in Montana’s new Constitution.¹²⁵ The Court explained that the delegates had manifested a clear intent that no aid—direct or indirect—should flow from the state to sectarian schools.¹²⁶ The delegates’ purpose in including the No-Aid Clause was not bigotry but to prevent “religious entanglement” in public education.¹²⁷

Justice Gustafson concurred with the majority to expand on the Court’s tax expenditure analysis and to explain why the Program violated

117. *Espinoza*, 435 P.3d at 612–13, 615.

118. *Id.* at 612.

119. *Id.* at 612–13.

120. *Id.*

121. *Id.* at 612.

122. *Id.* at 613.

123. *Id.* at 611, 613 (citing *State ex rel. Chambers v. Sch. Dist. No. 10 of Deer Lodge Cty.*, 472 P.2d 1013, 1021 (Mont. 1970)).

124. *Id.* at 611–15.

125. *Id.* at 610; *see also* MONT. CONST. art. X, § 6(1).

126. *Espinoza*, 435 P.3d at 610.

127. *Id.*

both Religion Clauses of the First Amendment.¹²⁸ She reasoned the Program violated the Establishment Clause because the Program denied taxpayers the ability to choose whether their funds supported a religious school.¹²⁹ She also asserted the Program violated the Free Exercise Clause of the First Amendment because taxpayers were forced to support religious schools to receive the tax credit.¹³⁰ She agreed with the majority's holding that the Program constituted an indirect payment and explained how the tax credit diverted funds from the General Fund.¹³¹ Her analysis of the Program showed how the "economic effect" of the tax credit is to give aid "directly to the [religious] school[s]."¹³²

Justice Baker raised two concerns with the majority's opinion. She argued characterizing a tax credit as an indirect payment was a "diverg[ence]" from the language of the Constitution.¹³³ She also explained that a tax credit cannot be an indirect payment because the Program "diverts" the money before it becomes public funds.¹³⁴ Additionally, Justice Baker critiqued the majority for not analyzing the Program under the Free Exercise Clause of the First Amendment, arguing an analysis under both the Montana and United States Constitutions was needed to justify the majority's elimination of the Program in its entirety.¹³⁵

The parents appealed the Montana Supreme Court's decision to the United States Supreme Court¹³⁶ and were granted certiorari.¹³⁷

2. *United States Supreme Court*

On appeal, the Petitioners argued the Montana Supreme Court invalidated the Program under the Montana Constitution in violation of the Religion Clauses of the First Amendment and the Fourteenth Amendment's Equal Protection Clause.¹³⁸ The Petitioners asserted the Montana Supreme Court's application of the No-Aid Clause violated the Free Exercise Clause

128. *Id.* at 617–21 (Gustafson, J., concurring).

129. *Id.* at 620–21 (Gustafson, J., concurring).

130. *Id.* at 621.

131. *Id.* at 617.

132. *Id.* at 618.

133. *Id.* at 627 (Baker, J., dissenting).

134. *Id.* at 626–30.

135. *Id.* Justice Rice dissented as well, foreshadowing the United States Supreme Court's decision. He argued the Program was constitutional under both the Montana and United States Constitutions because the Program benefited the children and families who received the scholarship, not the religious organizations. Further, he disagreed with the majority's characterization of tax credits as public funds.

136. Petition for a Writ of Certiorari, *Espinoza v. Montana Dep't of Revenue* (U.S. Mar. 12, 2019) (No. 18-1195).

137. *Espinoza v. Montana Dep't of Revenue*, 139 S. Ct. 2777 (2019) (granting certiorari).

138. Brief for Petitioners' at 13, *Espinoza v. Montana Dep't of Revenue* (U.S. Sept. 11, 2019) (No. 18-1195).

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by discriminating against the parents' and schools' religious beliefs, conduct, and status.¹³⁹ The Petitioners pointed to the origins of the No-Aid Clause and argued that, because it was enacted out of animus toward Catholics, its application violated the Equal Protection Clause.¹⁴⁰

The Department focused its argument on the Free Exercise Clause.¹⁴¹ Because the Montana Supreme Court's decision eliminated the Program, the Department argued that Qualified Education Providers and students were not forced to choose between their religious affiliation or receiving funding.¹⁴² The Department also argued Montana's No-Aid Clause did not violate the Equal Protection Clause because it was enacted to protect religious freedom and maintain separation of church and state.¹⁴³

The majority reversed the Montana Supreme Court's decision and held that Article X, Section 6 violated the Free Exercise Clause.¹⁴⁴ The majority found the Montana Supreme Court's decision improperly turned on the religious status of the schools seeking aid under the Program.¹⁴⁵

Briefly addressing the Establishment Clause, the majority found the Program, without Rule 1, was indeed constitutional.¹⁴⁶ The Program neutrally benefitted both religious schools and secular schools, and it aided religious schools only because of a parent's independent choice.¹⁴⁷ As a result, the Program did not violate the Establishment Clause.¹⁴⁸

Next, the majority analyzed the Montana Supreme Court's application of Article X, Section 6 under the Free Exercise Clause.¹⁴⁹ The Free Exercise Clause prohibits a state from denying a person or religious organization a public benefit "solely because of their religious character."¹⁵⁰ The majority explained programs that require schools and parents to "divorce" themselves from their religious affiliation to receive state benefits are "odious to our Constitution" and are strictly prohibited.¹⁵¹ Further, the majority found the Montana Supreme Court's application of Article X, Section 6 "turn[ed] expressly on religious status and not religious use," in violation of the Free

139. *Id.* at 17–20.

140. *Id.* at 44–45.

141. Brief of Respondents' at 10–49, *Espinoza v. Montana Dep't of Revenue* (U.S. Nov. 8, 2019) (No. 18-1195).

142. *Id.* at 10–49.

143. *Id.* at 17–36.

144. *Espinoza v. Montana Dep't of Revenue*, 140 S. Ct. 2246, 2255–56, 2263 (2020).

145. *Id.* at 2256.

146. *Id.* at 2254.

147. *Id.* at 2253 (citing *Trinity Lutheran Church of Columbia, Inc. v. Comer*, 137 S. Ct. 2012, 2019–20 (2017); *Locke v. Davey*, 540 U.S. 712, 719 (2004); *Zelman v. Simmons-Harris*, 536 U.S. 639, 649–53 (2002)).

148. *Id.*

149. *Id.* at 2254.

150. *Id.* at 2255 (citing *Trinity Lutheran*, 1374 S. Ct. at 2021).

151. *Id.* at 2255–56 (citing *Trinity Lutheran*, 1374 S. Ct. at 2025).

Exercise Clause.¹⁵² The title and text of Montana’s No-Aid Clause¹⁵³ “bar[red] religious schools from public benefits solely because of the religious character of the schools.”¹⁵⁴ Likewise, parents seeking benefits for their children’s education at a religious school were prohibited from using the aid only because of the education’s religious character.¹⁵⁵

Distinguishing its reasoning from *Locke*, the majority highlighted that the program in *Locke* turned on religious use, not religious status.¹⁵⁶ Unlike the Program, which denied aid based on an institution’s religious status, in *Locke*, Washington State “merely” chose not to fund the training of a minister—an “essentially religious endeavor.”¹⁵⁷ *Locke* was denied aid because of how he chose to use the funds, not because of his religious status.¹⁵⁸

Further, the majority explained that Washington State had a “historic and substantial” interest in not funding clerical training, while Montana had no similar interest in not funding religious schools.¹⁵⁹ Unlike providing state aid to train clergy, the majority explained that states and the federal government funded religious schools in the 1700s and 1800s.¹⁶⁰ Additionally, Montana’s No-Aid Clause was “born of bigotry” toward Catholics.¹⁶¹ Thus, the majority found Montana had no “historic and substantial” interest in barring religious schools from receiving state aid.¹⁶²

The majority applied strict scrutiny to the Montana Supreme Court’s application of the No-Aid Clause because the decision turned on religious status.¹⁶³ The Department argued the Montana Supreme Court had three compelling state interests in denying religious schools aid: (1) stricter separation of church and state;¹⁶⁴ (2) promoting religious freedom by protecting taxpayers’ rights not to fund religious groups;¹⁶⁵ and (3) supporting public

152. *Id.* at 2256.

153. Article X, Section 6 is titled: Aid prohibited to sectarian schools. The provision provides that “[t]he legislature, counties, cities, towns, school districts, and public corporations shall not make any direct or indirect appropriation or payment from any public fund or monies, or any grant of lands or other property for any sectarian purpose or to aid any church, school, academy, seminary, college, university, or other literary or scientific institution, controlled in whole or in part by any church, sect, or denomination.” MONT. CONST. art. X, § 6(1).

154. *Espinoza*, 140 S. Ct. at 2255.

155. *Id.*

156. *Id.* at 2257.

157. *Id.* (citing *Locke v. Davey*, 540 U.S. 712, 721 (2004)).

158. *Id.* (citing *Trinity Lutheran Church of Columbia, Inc. v. Comer*, 137 S. Ct. 2012, 2023–24 (2017)).

159. *Id.* at 2258.

160. *Id.*

161. *Id.* at 2259.

162. *Id.* at 2258–59.

163. *Id.* at 2260.

164. *Id.*

165. *Id.* at 2260–61.

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education.¹⁶⁶ The majority found none of these reasons to be compelling.¹⁶⁷ As to the first and second interests, promoting religious freedom by infringing on others' rights is not a compelling state interest.¹⁶⁸ The third interest, protecting public schools, was not compelling either, because only religious schools were barred from receiving aid, not all private schools.¹⁶⁹

Finally, the majority held the Montana Supreme Court's decision to invalidate the entire program did not remedy any potential violation of the Religion Clauses.¹⁷⁰ Because the Montana Supreme Court based its decision on a constitutional provision that "expressly discriminates on the basis of religious status," it was irrelevant that the entire program was eliminated.¹⁷¹

Three Justices concurred with the majority, each concurring to elaborate on their views of the Religion Clauses.¹⁷² Three Justices dissented, writing to criticize the majority for reaching the constitutionality of Article X, Section 6 and arguing the majority wrongly expanded the Free Exercise Clause's mandate.¹⁷³

By overturning the Montana Supreme Court's decision and finding that Article X, Section 6 of the Montana Constitution violated the Free Exercise Clause, the Roberts Court expanded its Free Exercise jurisprudence. Advancing its reasoning in *Trinity Lutheran*, the Supreme Court in *Espinosa* limited even more the amount of "play in the joints" between the Free Exercise and Establishment Clauses, narrowing the circumstances under which a state can bar a religious organization from receiving state aid.

166. *Id.* at 2261.

167. *Id.* at 2260–61.

168. *Id.*

169. *Id.* at 2261.

170. *Id.* at 2261–62.

171. *Id.* at 2262.

172. Justice Thomas concurred to explain he believes the Establishment Clause only applies against the Federal Government, not the states, and that the Clause is only meant to prohibit coercion of orthodoxy or financial support of a religious group by force of law or threat of penalty. *Id.* at 2263–65 (Thomas, J., concurring). Justice Gorsuch also concurred, arguing that discrimination under the Free Exercise Clause should not turn on religious use or religious status, but instead on whether a "condition on a public benefit discriminates against the free exercise of religion." *Id.* at 2278 (Gorsuch, J., concurring). Justice Alito concurred to provide additional background on the biased origins of no-aid clauses in state constitutions. *Id.* at 2267–74 (Alito, J., concurring).

173. Justice Ginsburg dissented to argue that the majority "had no call" to address the constitutionality of Montana's No-Aid Clause because the petitioners "disavowed a facial . . . challenge," and because the Montana Supreme Court never addressed the provision's constitutionality. *Id.* at 2280–81 (Ginsburg, J., dissenting). Justice Sotomayor dissented for similar reasons, arguing the majority impermissibly "re-frame[d] the case" to find Article X, Section 6 invalid. *Id.* at 2292–93 (Sotomayor, J., dissenting). Justice Sotomayor also argued the majority's reading of the Free Exercise Clause to require states to fund religious activity was in error. *Id.* at 2283. Justice Breyer dissented on similar grounds. *Id.* at 2282–83 (Breyer, J., dissenting).

III. TAX EXPENDITURE ANALYSIS

Although the United States Supreme Court overturned the Montana Supreme Court's decision, the Montana Supreme Court's holding that a tax credit is an indirect payment still stands.¹⁷⁴ This part discusses the Montana Supreme Court's analysis and explains why the Montana Supreme Court's holding was correct. First, this part provides background on tax expenditures, explaining how they function, the purpose they serve, and how they differ from direct appropriations. Next, this part outlines the many criticisms of current tax expenditure policy. Finally, this part argues that the Montana Supreme Court's analysis—defining a tax credit as an indirect payment—accurately reflects tax expenditures' true nature and should be the predominant view.

A. *What is a Tax Expenditure?*

A tax expenditure is a provision that decreases the tax liability of an individual or entity, which, in turn, decreases the tax revenue the state would have otherwise collected from the taxpayer.¹⁷⁵ A tax expenditure is a government subsidy,¹⁷⁶ and after receiving the benefit, the taxpayer has more money in its pocket because its tax liability has been reduced.¹⁷⁷ Tax expenditures come in many forms, including deductions, exclusions, preferential rates, and credits.¹⁷⁸ The most valuable tax expenditure for a taxpayer is a dollar-for-dollar tax credit because the taxpayer receives a one-to-one deduction in his or her tax liability for engaging in the activity the tax credit encourages.¹⁷⁹

Tax expenditures are an important fiscal tool for policymakers.¹⁸⁰ Tax expenditures allow policymakers to incentivize behavior, and they provide a less cumbersome avenue for appropriating funding.¹⁸¹ A legislative body can encourage specific behavior from taxpayers by providing a financial

174. *Id.* at 2254 (majority opinion).

175. MONT. CODE ANN. § 5-4-104(2) (2019) (defining "tax expenditures" as "those revenue losses attributable to provisions of Montana tax laws that allow a special exclusion, exemption, or deduction from gross income or that provide a special credit").

176. McMAHON, *supra* note 22, at 474.

177. Christopher Howard, *Testing the Tools Approach: Tax Expenditures versus Direct Expenditures*, 55 PUB. ADMIN. REV. 439, 440 (1995).

178. *Where is the Money Going?*, *supra* note 26.

179. McMAHON, *supra* note 22, at 479.

180. *See generally* McMAHON, *supra* note 22, at 473–75.

181. JOEL SLEMROD & JON BAKIJA, *TAXING OURSELVES: A CITIZEN'S GUIDE TO THE DEBATE OVER TAXES* 169 (4th ed. 2008); McMAHON, *supra* note 22, at 473. *See also* National Fed'n of Indep. Bus. v. Sebelius, 567 U.S. 519, 567 (2012) (quoting JOSEPH STORY, 2 COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES § 962, 434 (1833) ("The taxing power is often, very often, applied for other purposes, than revenue.")).

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incentive through a tax expenditure.¹⁸² For example, Congress and state legislatures incentivize taxpayers to invest in capital assets and markets by providing a preferential rate on long-term capital gains.¹⁸³ The Montana Legislature, in enacting the Program, also encouraged specific behavior by creating a mechanism to lower the cost of a private school education.¹⁸⁴ The dollar-for-dollar tax credit and promise of a tuition reduction made it more affordable to send children to private schools and therefore encouraged parents to do so.¹⁸⁵

Tax expenditures also provide a less cumbersome way to appropriate funds. Unlike direct spending,¹⁸⁶ tax expenditures do not require administrative spending programs.¹⁸⁷ Tax expenditures are administered through the state's Department of Revenue or, on the federal side, through the Internal Revenue Service.¹⁸⁸ Tax agencies have a preexisting infrastructure, making it easier for the agency to run a tax expenditure program smoothly.¹⁸⁹ Tax expenditures face fewer hurdles than direct spending measures do during the legislative process as well.¹⁹⁰ Most programs, once passed, are not reviewed regularly.¹⁹¹ Tax expenditures also are not required to undergo the extensive appropriations process, because they are often treated as tax cuts instead of appropriations.¹⁹²

For these reasons, tax expenditures are a widely popular alternative to direct spending. Tax expenditures are currently the “dominant instruments for implementing new discretionary spending policies” at the federal level.¹⁹³ In Montana, between 2016 and 2017, tax expenditures led to a

182. Frank Sammartino & Eric Toder, *Tax Expenditure Basics* 4, TAX POLICY CENTER (Jan. 22, 2020), <https://perma.cc/PU44-8R2D>.

183. SLEMROD & BAKIJA, *supra* note 181, at 280.

184. Fiscal Note, *supra* note 40, at 2–3 (explaining the decrease in tuition attributable to availability is estimated to result in a private school enrollment increase of 403 students by 2018).

185. See Testimony of Sen. Llew Jones, Hearing on SB 410 Before the Sen. Comm. on Finance and Claims, 2015 Leg., 64th Sess., at 17:11:00–17:13:00 (testifying that the bill would “enhance student opportunity,” and increase the number of educational options “on the menu”); see also Fiscal Note, *supra* note 40, at 2–3.

186. Direct spending occurs when a legislative body passes a bill to expend money from the state's treasury. An executive can also directly spend money through his or her emergency spending powers. Congressional Research Service, *Spending and Tax Expenditures: Distinctions and Major Programs*, at 1, <https://perma.cc/H997-YLNN> (last visited Oct. 31, 2020).

187. *Id.* at 3–4.

188. Edward Kleinbard, *The Congress Within the Congress: How Tax Expenditures Distort Our Budget and Our Political Processes*, 36 OHIO N.U.L. REV. 1, 16 (2010).

189. *Id.* at 16; SLEMROD & BAKIJA, *supra* note 182, at 169.

190. Kleinbard, *supra* note 188 at 21–22; Congressional Research Service, *supra* note 186, at 3–4.

191. Congressional Research Service, *supra* note 186, at 3–4.

192. Sammartino & Toder, *supra* note 182, at 4.

193. Kleinbard, *supra* note 188, at 3; McMAHON, *supra* note 22, at 774–75.

\$300 million decrease in state revenue.¹⁹⁴ This is equivalent to approximately 12% of the state's General Fund revenue for the fiscal year 2018.¹⁹⁵

Although tax expenditures and direct spending measures differ in form, the effect of both provisions is the same—less money in the treasury.¹⁹⁶ Unlike direct spending, however, a tax expenditure gives the appearance of a “tax cut.”¹⁹⁷ Still, the result is identical.

B. Criticisms of Tax Expenditures

Many experts criticize policymakers for their heavy reliance on tax expenditures.¹⁹⁸ Tax expenditures lack the same transparency and review that direct spending measures face, weaken markets, and obscure government size.¹⁹⁹ This subpart discusses each criticism in turn and addresses those that are particularly relevant in Montana.

1. Legislative Scrutiny

First, tax expenditures are subject to less scrutiny than direct spending.²⁰⁰ Direct spending is subject to each legislative session's appropriation process, where each appropriation is thoroughly examined and debated.²⁰¹ Tax expenditures, on the other hand, are typically not reexamined each legislative session.²⁰² Although some tax expenditures do sunset after a specified period, the majority are permanent.²⁰³ The costs of these tax expenditures are not reviewed under customary budgeting processes each legislative session and become “silent spending” provisions, flying under the radar of legislative scrutiny.²⁰⁴

194. *Where is the Money Going?*, *supra* note 26.

195. *Id.*

196. Biennial Report, *supra* note 26, at 275, 281–82; *see also* Arizona Christian Sch. Tuition Org. v. Winn, 131 S. Ct. 1436, 1456–57 (2011) (Kagan, J., dissenting).

197. McMAHON, *supra* note 22, at 474.

198. Kleinbard, *supra* note 188, at 16–22.

199. Sammartino & Toder, *supra* note 182, at 4.

200. Leachman, Grundman & Johnson, *supra* note 23; *What Are Tax Expenditures?*, *supra* note 27.

201. Leachman, Grundman & Johnson, *supra* note 23; *What Are Tax Expenditures?*, *supra* note 27.

202. Kleinbard, *supra* note 188, at 21–22 (discussing federal tax expenditures); Leachman, Grundman & Johnson, *supra* note 201 (discussing state tax expenditures).

203. *Where is the Money Going?*, *supra* note 26; Kleinbard, *supra* note 188, at 21–22 (discussing federal tax expenditures); Leachman, Grundman & Johnson, *supra* note 23 (discussing state tax expenditures).

204. *Where is the Money Going?*, *supra* note 26.

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Second, many tax expenditures, especially tax credits, can create negative externalities in the economy.²⁰⁵ When a government provides a tax incentive for a specific industry, the “intended effect” is to increase the production and consumption of the industry’s goods.²⁰⁶ This disrupts the free market and can lead to an inefficient allocation of resources.²⁰⁷ Further, to account for the decrease in revenue, a government may impose a higher tax rate on other industries that were not as successful in lobbying for a tax incentive.²⁰⁸ Each subsidy must be met with a tax rate increase or a decrease in spending; either way, a tax expenditure creates “a penalty for someone else.”²⁰⁹ This leads to further economic distortion, increasing deadweight loss—the societal cost of market inefficiency attributable to higher taxes.²¹⁰

3. *Obfuscation of the Size of Government*

Third, the use of tax expenditures distorts the size and scope of the government.²¹¹ Because a government does not reflect tax expenditures in its annual or bi-annual budget, the costs of a government’s activities become obfuscated.²¹² When a government enacts a tax expenditure, rather than treating it as a spending mechanism, which would require a line item and administrative spending program, legislators promote the expenditure as a tax cut.²¹³ Legislators get to pat themselves on the back for decreasing taxpayers’ tax burdens and for supporting a “smaller government.”²¹⁴ In reality, the opposite is true.²¹⁵ A tax expenditure is an increase in discretionary spending, and, over time, these subsidies create a larger, more complex government.²¹⁶

205. Kleinbard, *supra* note 188, at 8. *But see* SLEMROD & BAKIJA, *supra* note 181, at 169.

206. Kleinbard, *supra* note 188, at 8.

207. *Id.* *See also* McMAHON, *supra* note 22, at 482. Free market economists believe the market allocates resources effectively. When an industry is incentivized through a tax credit to create more of a specific good, that industry is no longer responding to market forces and as a result, may create a surplus.

208. Kleinbard, *supra* note 188, at 8–9.

209. SLEMROD & BAKIJA, *supra* note 181, at 217; *see also* McMAHON, *supra* note 22, at 475.

210. Mark Lester L. Aure, *Deadweight Loss and Taxation*, 24 NTRC TAX RES. J. 1 (2012), <https://perma.cc/KV57-EJLS>; Mirit Eyal-Cohen, *The Cost of Inexperience*, 69 ALLR 859, 907–08 (2018).

211. Kleinbard, *supra* note 188, at 21; SLEMROD & BAKIJA, *supra* note 181, at 216–17; McMAHON, *supra* note 22, at 477.

212. Leachman, Grundman & Johnson, *supra* note 23; Biennial Report, *supra* note 26, at 275.

213. Biennial Report, *supra* note 26, at 275; McMAHON, *supra* note 22, at 474.

214. Kleinbard, *supra* note 188, at 18.

215. Biennial Report, *supra* note 26, at 275; McMAHON, *supra* note 22, at 474.

216. Kleinbard, *supra* note 188, at 18, 21; Sammartino & Toder, *supra* note 182, at 4; McMAHON, *supra* note 22, at 474.

The spending effect of tax expenditures is especially true in state governments, like Montana, where the legislature is constitutionally mandated to balance each legislative session's budget.²¹⁷ Unlike the federal government, where Congress can run a deficit, the Montana Legislature must offset each direct expenditure.²¹⁸ When the Montana Legislature passes a tax credit or provides other tax benefits, it decreases the treasury's amount of revenue. The Montana Legislature must offset that decrease in revenue with either an increase in taxes, or a cut in spending.²¹⁹

The Montana Legislature has acknowledged that tax expenditures and direct spending are both appropriation mechanisms affecting the state's bottom line.²²⁰ The definition of "State Expenditures" includes "money appropriated for tax relief," showing that the Legislature recognizes that a tax expenditure is a form of government subsidy.²²¹ The Legislature has also enacted programs that treat tax expenditures and direct payments equivalently. For example, the now repealed Insure Montana Program created a health insurance pool for small businesses²²² and allowed a business to choose whether to receive a direct payment or a tax credit to offset its tax liability.²²³ By giving beneficiaries a choice between a tax credit or a direct payment, the Legislature recognized that the result was the same—a government subsidy for the beneficiary. Despite the Legislature's recognition that the spending mechanisms lead to the same effect, direct spending and tax expenditures are still considered differently.

4. *Government Transparency*

Fourth, tax expenditures hinder one of the mainstays of democracy—public discourse, debate, and transparency.²²⁴ Most tax expenditures automatically renew each year and do not come before the Legislature during the appropriations process.²²⁵ Unlike direct spending, a tax expenditure is often only subject to debate and voting by legislators at its enactment, yet they continue to appropriate funds like direct spending measures.²²⁶ These

217. Appropriations by the legislature shall not exceed anticipated revenue. MONT. CONST. art. 8, § 9.

218. *Id.*

219. Biennial Report, *supra* note 26, at 275.

220. See MONT. CODE ANN. § 17-7-502(3) (2019), listing laws that contain statutory appropriations. The Program is included in this list.

221. *Id.* § 17-8-105(g).

222. *Id.* § 33-22-2001, repealed by Laws 2017, ch. 151, § 54, eff. Oct. 1, 2017. (view at <https://perma.cc/X5QR-3EMJ>).

223. MONT. CODE ANN. § 33-22-2006, repealed by Laws 2017, ch. 151, § 54, eff. Oct. 1, 2017.

224. Leachman, Grundman & Johnson, *supra* note 23.

225. McMAHON, *supra* note 22, at 481.

226. Kleinbard, *supra* note 188, at 21.

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provisions bypass the traditional appropriations process put in place to ensure the people dictate how their tax dollars are spent.²²⁷ Further, tax expenditures typically exist within a complex tax code and are not easily visible to reporters, politicians, and constituents.²²⁸ This leads to a lack of transparency in both the appropriations process and the tax code, and makes it difficult for the provisions to face outside scrutiny.²²⁹

Governments have worked to clarify the tax expenditure process in recent years. The federal government and 44 state governments provide yearly tax expenditure reports, which describe each expenditure, identify provision costs, and identify the number of taxpayers using it.²³⁰ Montana publishes a biennial tax expenditure report—“one of the most thorough in the nation.”²³¹ However, this is only because the Department of Revenue chooses to include more information than mandated by statute.²³² Recently, the Legislature has also mandated additional review for tax credit programs. House Bill 723, passed in 2019, requires the interim revenue committee to review specific tax credits for each biennium until 2027.²³³ Along with the tax expenditure budget, this provision helps increase transparency with tax expenditures,²³⁴ but these measures are not enough. To make substantive change, tax expenditures must be considered and treated as government subsidies that indirectly appropriate state funds.

C. *Tax Expenditures are Indirect Payments*

The Montana Supreme Court’s interpretation of a tax credit correctly reflects a tax credit’s true nature as a subsidy, and therefore as a payment.²³⁵ The Montana Supreme Court’s decision recognized that the fiscal impact of providing a tax credit is no different from the Legislature appropriating tax dollars and directly paying schools to provide scholarships for private school students.²³⁶ All legislative bodies should follow the Montana

227. McMAHON, *supra* note 22, at 481.

228. *Id.*; Kleinbard, *supra* note 188, at 21.

229. McMAHON, *supra* note 22, at 475–78, 484; Kleinbard, *supra* note 188, at 21–22.

230. *Where is the Money Going?*, *supra* note 26; Leachman, Grundman & Johnson, *supra* note 23.

231. *Where is the Money Going?*, *supra* note 26.

232. Compare MONT. CODE ANN. § 15-1-205(3) with Biennial Report, *supra* note 26, at 287–360.

233. *Id.* § 15-30-2303; *Where is the Money Going?*, *supra* note 26. Additionally, § 5-4-104(1) “encourages” the legislature to “provide an explicit purpose of a tax expenditure” and to “terminat[e]” the provisions within “6 years” of enactment. Most provisions do not follow this suggestion, however. *See* § 15-30-2301 (capital gains credit); § 15-30-2131 (deductions from net income); § 15-30-2318 (earned income tax credit).

234. *Where is the Money Going?*, *supra* note 26.

235. *See Arizona Christian Sch. Tuition Org. v. Winn*, 131 S. Ct. 1436, 1450 (2011) (Kagan, J., dissenting, explaining that “[c]ash grants and targeted tax breaks are means of accomplishing the same government objective—to provide financial support to select individuals or organizations”).

236. *Espinoza v. Montana Dept. of Revenue*, 435 P.3d, 612–13 (Mont. 2018).

Supreme Court's lead and treat tax credits and other tax expenditures as government subsidies. As the Montana Supreme Court's analysis shows, subjecting tax expenditures to the same scrutiny as direct spending measures explains who and what the provision benefits and ensures the Legislature acts constitutionally.

In the majority opinion, the Montana Supreme Court draws a direct line from the Program to the religious schools that benefit from it, showing how the Legislature sought to use a tax expenditure to bypass constitutional prohibitions.²³⁷ The Program is a tax replacement program and “permits the Legislature to indirectly pay [for] tuition” at private religious schools through the dollar-for-dollar tax credit.²³⁸ Parents who donate to an SSO receive both a 100% offset of their tax liability and an equal decrease in their tuition obligation.²³⁹ In other words, after a parent has received the tax credit, their tuition burden is decreased by \$150 at no cost to them.²⁴⁰ The state, and other taxpayers, carry the economic incidence of a portion of the tuition, rather than the parent.²⁴¹

A direct payment program providing scholarships to religious schools would have violated Article X, Section 6, yet the Program, a tax expenditure, yielded the same result.²⁴² The Legislature, by enacting a dollar-for-dollar tax credit program, “involved itself” in charitable giving to religious schools and “encourage[d]” it.²⁴³ As Justice McKinnon acknowledged, the Program allowed the Legislature to “subsidize” the cost of religious education²⁴⁴ and excessively entangled the state with religious schools—exactly what Article X, Section 6 sought to prevent.²⁴⁵

In Justice Baker's dissent, she disagreed with the majority's holding that the Program created an indirect payment, violating the No-Aid Clause.²⁴⁶ While she acknowledged that the majority's “indirect impact” theory “may be correct,” she criticized the majority's reading of the No-Aid Clause, arguing that it “diverge[d] from the constitutional text.”²⁴⁷ She also argued that only the Executive Branch can make a payment, not the Legis-

237. *Id.* at 612–14.

238. *Id.* at 612.

239. *Id.* Although the parent is donating and receiving a tuition decrease through a third party SSO, the Court explained that “an indirect payment still exists.”

240. *Id.*

241. *Id.* at 613. *But See* SLEMROD & BAKIJA, *supra* note 181, at 217; McMAHON, *supra* note 22, at 475.

242. *Espinoza*, 435 P.3d at 613.

243. *Id.* at 612.

244. *Id.* at 613.

245. *Id.* at 613–14.

246. *Id.* at 626–30 (Baker, J., dissenting).

247. *Id.* at 627.

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lature.²⁴⁸ Finally, she asserted that the majority’s interpretation of “payment” deviated from the 1972 Constitutional delegates’ intent.²⁴⁹ For these reasons, Justice Baker characterized the Program as an “indirect transfer of benefit” instead of an indirect payment.²⁵⁰

Although Justice Baker’s reading of Article X, Section 6 has merit, her dissent fails to recognize that the Program provides a government subsidy for private, mostly religious, education. This economic impact is exactly what the No-Aid Clause sought to prevent. The majority acknowledged the Program’s actual fiscal impact by defining the provision as an indirect payment. Unlike a direct spending measure, a tax expenditure “diverts” tax revenue before it reaches the general fund.²⁵¹ Rather than collecting tax revenue and spending those funds on a religious school, the Program allows the Legislature to skip the government middleman.²⁵² Taxpayers instead “assign a portion of [their] tax liability” to an SSO, where the money will directly aid religious schools.²⁵³ The Program could divert \$9.6 million in tax revenue by fiscal year 2022.²⁵⁴

The economic cost of tax expenditures is not limited to diverted tax revenue. These provisions also create administrative costs, which further contribute to tax expenditures’ direct effect on state budgets. The Program, aside from diverting tax revenue from the General Fund, comes with its own direct costs.²⁵⁵ The fiscal note accompanying Senate Bill 410 outlined these administrative costs, including hiring two FTE employees at the Department, and one FTE at the Office of Public Instruction to administer the program.²⁵⁶ The Legislature also earmarked \$3 million for “the anticipated revenue shortfall” the Program caused in its first year.²⁵⁷ These costs are not illusory—they are accompanied by either an increase in taxes, or a decrease in state services to balance the state’s budget.²⁵⁸

Like all tax expenditures, the Program comes at a real cost to the state’s General Fund and, as a result, to Montana taxpayers and citizens. While politicians treat tax expenditures as free money to the taxpayer benefiting from the provision, this is not the case. In reality, fellow taxpayers are left to pick up the check. Additionally, state services available to citi-

248. *Id.* at 626.

249. *Id.* at 628.

250. *Id.* at 627–28.

251. *Id.* at 616–17 (Gustafson, J., concurring).

252. *Id.* at 616.

253. *Id.* at 617.

254. Fiscal Note, *supra* note 40, at 5.

255. *Id.* at 2; *see also* MONT. CODE ANN. § 17-7-502(3) (2019), listing laws that contain statutory appropriations. The Program is included in this list.

256. Fiscal Note, *supra* note 40, at 4.

257. *Espinoza*, 435 P.3d at 617 (Gustafson, J., concurring).

258. SLEMIER & BAKIJA, *supra* note 181, at 217; *see also* McMAHON, *supra* note 22, 475.

zens may face cuts because of a fall in revenue, impacting the most vulnerable Montanans. The Montana Supreme Court recognized the fiscal impact of tax expenditure programs and appropriately treated the Program as an indirect appropriation to accurately reflect its impact. Instead of allowing tax expenditures to silently drain the general fund year after year, legislative bodies and courts should follow the Montana Supreme Court's lead and treat these programs as payments, receiving the same heightened scrutiny and analysis as direct spending measures.

IV. CONCLUSION

While the United States Supreme Court overturned the bulk of the Montana Supreme Court's decision in *Espinoza*, the Court's inclusion of a tax credit under the indirect payment umbrella will have a lasting effect on the state. The Court's analysis demonstrates a shift in thinking surrounding tax expenditure spending, which will lead, in time, to more accountable and transparent government spending.