

Department of Legislative Services
 Maryland General Assembly
 2005 Session

FISCAL AND POLICY NOTE

House Bill 998 (Delegate Boteler, *et al.*)
 Ways and Means

Family Education Tax Credit Program

This bill creates tax credits related to: (1) tuition and fees paid on behalf of children in primary or secondary education that are attending a nonpublic school, a home schooling program, or attending a public school that is not in the student’s district; and (2) contributions to organizations that provide scholarships to students attending qualifying nonpublic schools and public schools outside the student’s district.

The bill takes effect July 1, 2005 and applies to tax year 2005 and beyond.

Fiscal Summary

State Effect: General fund revenues could decrease by approximately \$241.7 million in FY 2006 due to credits claimed for students attending nonpublic schools and home schooled programs. General fund revenues and Transportation Trust Fund (TTF) revenues could decrease by \$20 million in FY 2006 due to contributions to organizations that provide scholarships. General fund expenditures could increase by \$302,500 in FY 2006 for administrative costs at the Comptroller’s Office. These expenditures do not include significant one-time computer programming expenses in FY 2006.

| (\$ in millions) | FY 2006 | FY 2007 | FY 2008 | FY 2009 | FY 2010 |
|------------------|-----------|-----------|-----------|-----------|-----------|
| GF Revenue | (\$241.7) | (\$253.7) | (\$266.4) | (\$279.5) | (\$293.2) |
| GF/SF Rev. | (20.0) | (20.0) | (20.0) | (20.0) | (20.0) |
| GF Expenditure | .3 | .3 | .3 | .3 | .3 |
| Net Effect | (\$262.0) | (\$274.0) | (\$286.7) | (\$299.8) | (\$313.6) |

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local government revenues would decrease as a result of tax credit claims against the corporate income tax. Seventy-six percent of corporate income tax revenues is distributed to the general fund, and 24% is distributed to the TTF. Of the 24%

distributed to the TTF, approximately 30% is distributed to local jurisdictions in the form of local highway user revenues.

Small Business Effect: Meaningful.

Analysis

Bill Summary: The bill provides for tax credits for the eligible tuition and fees paid by parents of eligible students attending qualifying schools or are in a home school program. In addition, the bill provides for a tax credit for individuals or corporations who contribution to organizations that provide specified scholarships.

Tax Credit for Students Attending Qualifying Schools or Home School Program

Tax credits can be claimed for expenses incurred for eligible students that are attending a qualifying school or a home school program. In order to qualify for a tax credit, the bill establishes an income threshold for the family of the student. The “student’s family” taxable income in the preceding year cannot exceed 2.5 times the income standard used to qualify for a reduced lunch program established by the National Free or Reduced Lunch Program. In addition to this income threshold, the student must be enrolled full-time in a qualifying school or in a State-approved home school program, be a resident of the State, and not have graduated high school or reached 21 years of age.

For parents claiming the credit for home-schooled children, eligible expenses include tutoring and academic lessons (to the extent not conducted by the parent), textbooks, school supplies, and membership fees in an organization that sets academic standards or provides educational curricula for home schooling students. Eligible expenses for parents of eligible children attending qualifying schools include tuition and fees, administrative expenses, transportation costs, and academic program fees. A taxpayer can claim a separate tax credit for expenses incurred for each eligible child. Taxpayers can assign the tax credit to the student’s qualifying school. The value of the credit is equal to the eligible expenses incurred for each child. The bill establishes that for an individual who is claiming the credit, if the “income of the individual” does not exceed the income threshold established by the bill, the tax credit is refundable.

Tax Credits for Contributions to Scholarship Granting Organizations

The bill provides that individuals and corporations can claim tax credits for contributions to a scholarship granting organization (SGO). SGOs are defined as organizations that provide educational scholarships to elementary and secondary students attending either a qualifying nonpublic school or a public school outside of the student’s district. The value

of the credit is equal to the amount contributed, not to exceed 50% of the taxpayer's total State income tax liability. The credit is nonrefundable and can be carried forward three tax years. Educational scholarships can be used to defray the costs of tuition and fees at a qualifying school including transportation to a public school outside the student's district.

SGOs are required to: (1) notify the Comptroller of its intent to provide educational scholarships; (2) demonstrate its bona fide nonprofit status; (3) distribute scholarship payments endorsed by the qualifying student directly to the student's school; (4) distribute as scholarships a minimum of 90% of its total donations and all of the organization's investment income; (5) spend in each year a portion of its scholarships equal to the percentage of low-income individuals in the county where the majority of the SGO expends its scholarships on eligible low-income individuals; (6) verify that a student receiving a scholarship resides in a household with income less than the income threshold; submit to the Comptroller annually an audited financial report; (7) if it is expected to receive more than \$50,000 in donations in the coming year: (a) file a surety bond payable to the State equal to the amount of expected annual contributions; and (b) file with the Comptroller financial information that demonstrates its financial viability; and (8) ensure that a school receiving scholarship money: (a) complies with applicable health and safety codes; (b) holds a valid occupancy permit if required; (c) has a nondiscriminatory admissions policy; and (d) provides regular student progress reports to parents.

Comptroller Requirements

The Comptroller is required to: (1) disseminate information on the tax credit; (2) establish guidelines for parents to easily transfer tax credits to a student's qualifying school; (3) require SGOs to register and submit annual reports; (4) report annually to the General Assembly on SGOs and the amount of credits claimed by eligible parents; and (5) adopt regulations that allow for a taxpayer to divert a prorated amount of State income withholdings to an SGO of the taxpayers choice up to the maximum credit allowed.

Current Law: No similar State tax credit exists.

Background: Several states have similar tax credit programs, although not as extensive as proposed under HB 998. According to information from the Education Commission of the States and the U.S. Department of Education and a review of state statutes by the Department of Legislative Services, eight states are providing tax incentives for private school tuition or scholarship donations.

Three states (Arizona, Florida, and Pennsylvania) provide tax credits for contributions to nonprofit organizations for scholarships to attend private schools. Contributions for

certain costs related to public schools are eligible for the credit in all three states. Public schools in Arizona and Pennsylvania are eligible to receive funds for extra-curricular programs, while in Florida grants are provided to defray transportation costs of a student attending a public school outside the district in which the student lives. The nonprofit organizations are required to spend minimum proportions on scholarships or grants ranging from 80 to 100%. Florida and Pennsylvania have income limits for student participation and provide the tax credit to businesses. Arizona gives the credit to individuals. A December 2003 audit of Florida's program found a critical lack of program control and accountability that could lead to fraud and abuse. As a result of the audit, the chief executive officer of one of the nonprofit organizations was arrested for alleged grand theft.

North Dakota allows a maximum credit of \$2,500 for charitable contributions to schools for both the financial institutions tax and the income tax.

Four states (Arizona, Illinois, Iowa, and Minnesota) provide a tax credit for private school tuition and other qualified expenses, which in some cases include public school expenses. For example, Illinois provides a credit of up to \$500 or 25% of expenses over \$250 for tuition, books, and lab fees at public and private schools. Iowa allows parents to claim a tax credit of 25% for the first \$1,000 spent on private school tuition and nonreligious textbooks.

Two states (Minnesota and New York) allow tax deductions. Minnesota allows a tax deduction for tuition, textbooks, and transportation for nonpublic and public school students of up to \$1,625 for each dependent in grades K-6 and \$2,500 in grades 7-12. A refundable tax credit is available for families with incomes under \$33,500. The Minnesota Department of Revenue estimates that 273,000 taxpayers will claim the deduction/credit for a total of \$14.5 million annually.

New York provides an income tax deduction of \$1,000 per dependent for eligible tuition expenses for families with income under \$25,000.

State Revenues: Tax credits could be earned beginning in tax year 2005 for: (1) tuition and fees paid on behalf of eligible students that are home schooled or in a qualifying nonpublic or public school; and (2) contributions to SGOs. **Exhibit 1** lists the estimated fiscal impact of the bill.

Exhibit 1
HB 998 Fiscal Impact
(\$ in Millions)

| | <u>FY 06</u> | <u>FY 07</u> | <u>FY 08</u> | <u>FY 09</u> | <u>FY 10</u> |
|--------------|----------------|----------------|----------------|----------------|----------------|
| Nonpublic | \$227.9 | \$239.3 | \$251.3 | \$263.9 | \$277.1 |
| Homeschool | 13.8 | 14.3 | 15.1 | 15.7 | 16.2 |
| SGOs | 20.0 | 20.0 | 20.0 | 20.0 | 20.0 |
| Total | \$261.7 | \$273.7 | \$286.4 | \$299.5 | \$313.2 |

This estimate is based on the following facts and assumptions.

Tax Credit for Children in Home School Programs: (1) 20,676 children in the State received home instruction in the 2002-2003 school year; (2) according to the Census Bureau, the average number of children for families with children is 1.8; (3) the number of children receiving home instruction increases by approximately 4% annually; (4) research and articles estimate that home instruction costs per family range from \$1,000 to \$3,200; it is estimated that each family would have \$2,000 in eligible expenses annually; and (5) 40% of families would not qualify due to the income threshold established by the bill.

Tax Credit for Children in Qualifying Nonpublic Schools: (1) According the Maryland State Department of Education, there were 126,636 students attending primary and secondary nonpublic schools; (2) expenses for 40% of these students would not qualify due to the income threshold established by the bill; (3) eligible expenses for each student total \$3,000 annually; and (4) total eligible expenditures increase 5% annually.

Tax Credit for SGO Contributions: This estimate is based on the experience of other states that award similar tax credits and adjusted for State population and differences in credit amounts that can be claimed. The revenue loss estimated could be larger due to the large amount of tax credits that could be claimed by individuals or corporations. The exact distribution between credits claimed against the corporate and personal income tax cannot be reliably estimated.

The Maryland State Department of Education was unable to provide an estimate of the number of individuals who are attending a public school outside of the individual's school district.

State Expenditures: Special fund expenditures could increase by an estimated \$302,530 in fiscal 2006, which accounts for the bill's July 1, 2005 effective date. This estimate reflects the cost of hiring six individuals within the Comptroller's Office to analyze tax credit data and prepare required reports, to verify the financial accountability of and collect related data from scholarship granting organizations, and to develop a program to divert a prorated amount of tax withholdings to a scholarship granting organization. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses. Future year expenditures reflect: (1) full salaries with 4.6% annual increases and 3% employee turnover; and (2) 1% annual increases in ongoing operating expenses.

| | |
|---|------------------|
| Salaries and Fringe Benefits | \$274,300 |
| Equipment | 27,420 |
| Other Operating Expenses | 810 |
| Total FY 2006 State Expenditures | \$302,530 |

These personnel costs are in addition to significant one-time computer programming expenses that would be incurred in fiscal 2006. These expenses cannot be reliably estimated at this time.

Small Business Effect: Small businesses could incur substantial expenditures in order to be able to divert an employee's withholdings to a qualifying school under provided under the bill.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Census Bureau, Comptroller's Office, United States Department of Agriculture, Department of Legislative Services

Fiscal Note History: First Reader - March 6, 2005
mam/hlb

Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510