

Department of Legislative Services
Maryland General Assembly
2015 Session

FISCAL AND POLICY NOTE

Senate Bill 2 (Senator McFadden)
Budget and Taxation

Higher Education Investment Tax Credit Program

This bill establishes the Higher Education Investment Tax Credit Program administered by the Maryland Higher Education Commission (MHEC). MHEC may allocate \$20.0 million annually in tax credits to “eligible higher education institutions.” An eligible institution must provide each eligible donor that makes a donation with tax credit certificates for up to 50% of the amount of the donation. Credits may be applied against the State income tax (personal or corporate), the public service company franchise tax, or the insurance premium tax.

The bill takes effect July 1, 2015, and applies to taxable years beginning after December 31, 2015.

Fiscal Summary

State Effect: General and special fund revenues decrease in total by approximately \$20.0 million annually beginning in FY 2017 from tax credits applied under the bill and deductions for charitable contributions. The actual annual cost and the allocation of the revenue decrease cannot be reliably estimated at this time; however, given the revenue structure of the four possible taxes to which the credit may apply, the majority of the revenue decrease is anticipated to be from the general fund. General fund expenditures increase by \$143,900 in FY 2016 for MHEC to hire staff to administer the program and for contractual services for application reviews. General fund expenditures increase by approximately \$32,000 in fiscal 2017 for the Comptroller’s Office to update its electronic filing and processing system. Future year expenditures reflect annualization and the elimination of one-time costs.

(in dollars)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
GF/SF Rev.	\$0	(\$20,000,000)	(\$20,000,000)	(\$20,000,000)	(\$20,000,000)
GF Expenditure	\$143,882	\$166,159	\$140,186	\$89,524	\$93,635
Net Effect	(\$143,882)	(\$20,166,159)	(\$20,140,186)	(\$20,089,524)	(\$20,093,635)

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

Local Effect: Itemized deductions for charitable contributions flow through to the local income tax, costing local governments an average of 3% of the increased amounts deducted beginning in FY 2017. Further, local highway user revenues potentially decrease beginning in FY 2017 from reduced corporate income tax (CIT) revenue.

Small Business Effect: Meaningful. Small businesses that make qualifying contributions benefit from a lower tax liability. Small businesses that are hired or contracted to work on a project or to provide services also benefit.

Analysis

Bill Summary: The purpose of the program is to support private nonprofit higher education institutions by providing State tax credits for use as incentives to attract donations from individuals and business entities to benefit the projects and services of the institutions.

Donations and Eligibility

“Donation” means an irrevocable gift worth at least \$25,000 of money, goods, or real property. It does not include a contribution of services or labor. “Eligible donor” means (1) a business entity that conducts a trade or business in the State or (2) an individual who pays State taxes and is either domiciled in the State on the last day of the taxable year or maintains a place of abode in the State for more than six months of the taxable year and is physically present in the State for at least 183 days during the taxable year.

“Eligible higher education institution” means an organization that (1) is exempt from taxation under § 501(c)(3) of the Internal Revenue Code; (2) engages in a project or an activity that is in or provides services to a community in a priority funding area; and (3) is in good standing with the Secretary of State and the State Department of Assessments and Taxation.

The project or services must benefit a priority funding area and may include activities that involve:

- access to baccalaureate or master’s degree programs;
- access to short-term certification training in high-demand trades;
- arts, culture, and historic preservation;
- assistance with technical assistance and capacity building through entrepreneurial training and workforce development;
- economic development and tourism promotion;

- management and maintenance of facilities; or
- services for at-risk populations.

The project or services must benefit individuals with income that does not exceed the greater of (1) the statewide median income for a household of four as reported by the U.S. Department of Housing and Urban Development or (2) the applicable metropolitan statistical area income for a household of four as reported and issued by the U.S. Department of Housing and Urban Development.

Tax Credit Certificates

MHEC must provide tax credit certificates to each eligible higher education institution that receives a tax credit allocation. An eligible higher education institution must provide each eligible donor that makes a donation with tax credit certificates that (1) certify the amount of the donation; (2) may be up to 50% of the amount of the donation; and (3) state the year the donation is made.

Before an eligible donor may make a donation of real property, MHEC must certify the value of the real property. The eligible higher education institution must notify the Comptroller of the amount of each tax credit certificate that each eligible donor receives.

The tax credit may be applied against:

- the State income tax (personal or corporate);
- the public service company franchise tax; or
- the insurance premium tax.

The allowed credit for any taxable year must be less than the total amount of tax otherwise payable by the eligible donor for the taxable year. Any excess may be applied as a credit for the next two taxable years.

Reporting Requirements and Regulations

By January 31 and July 31 each year, an eligible higher education institution must report to MHEC on (1) the status or activity of the projects or services; (2) the use of the donations and tax credits; and (3) the marketing of the tax credits. MHEC must submit an annual report to the Governor and the General Assembly summarizing the use of the donations and the tax credits authorized under the bill.

MHEC, in consultation with the Maryland State Department of Education and the Comptroller, must adopt regulations to implement the bill.

Current Law/Background: Generally, the tax credit is likely available to all private nonprofit institutions of higher education in the State, as either their primary campus or a satellite campus is located in a priority funding area.

Federal and State Tax Treatment of Charitable Contributions

Individuals who itemize deductions can deduct eligible charitable donations, which typically lowers federal and State income tax liability. Corporations (other than S corporations) can deduct charitable contributions on their income tax returns, subject to limitations. Sole proprietors, partners in a partnership, or shareholders in an S corporation may be able to deduct charitable contributions made by their business on the federal Schedule A form.

Corporate Income Tax

A CIT rate of 8.25% is applied to a corporation's Maryland taxable income. In general, the Maryland CIT is computed using federal provisions to determine income and deductions.

Every Maryland corporation and every corporation that conducts business within Maryland, including public service companies and financial institutions, are required to pay CIT. The majority of the tax revenue (77% to 79%) is distributed to the general fund, 6% is distributed to the Higher Education Investment Fund (HEIF), and 15% to 17% is distributed to the Transportation Trust Fund (TTF). Of the amount distributed to TTF, 9.6% goes to local governments as local highway user revenues. These percentages have fluctuated slightly in recent years. In fiscal 2014, net CIT revenues were \$982.8 million. Of that amount, \$761.2 million was general fund revenues, \$162.6 million was TTF revenues, and \$59.0 million was HEIF revenues.

Insurance Premium Tax

Unless subject to other specified taxes under insurance law, the Maryland Insurance Administration imposes a 2% tax on premiums derived from or reasonably attributable to insurance business in the State. Net general fund revenues from the insurance premium tax were \$334.8 million in fiscal 2014.

Public Service Company Franchise Tax

A 2% franchise tax, measured in gross receipts, is imposed on each public service company (1) engaged in the telephone business in the State or (2) engaged in the transmission, distribution, or delivery of electricity or natural gas in the State. It does not apply to a county, municipality, or a nonprofit electric cooperative. An additional tax is imposed on

public service companies engaged in the transmission, distribution, or delivery of natural gas in the State and is applied on a per-unit (kilowatt-hour or therm) basis. Net general fund revenues from the public service company franchise tax were \$139.3 million in fiscal 2014.

State Fiscal Effect: General and special fund revenues decrease in total by approximately \$20.0 million annually beginning in fiscal 2017 from tax credits applied to the personal income tax, CIT, the public service company franchise tax, and the insurance premium tax. The cost by fiscal year and fund, however, cannot be reliably determined.

The credit is limited to tax liability; therefore, the cost for any given fiscal year depends on the extent to which the credits are limited, excess credits are carried forward, and donations deducted. For these reasons, the cost for any fiscal year could be greater or less than \$20.0 million. The cost by fiscal year is also impacted by reduced tax liability due to higher charitable contribution deductions and changes to withholding and estimated payments. Given the large amount of the credit (*at least \$12,500 per donation*) and the large associated charitable donations, individuals are likely to reduce estimated and/or withholding tax payments to account for the anticipated lower tax liability. To the extent that individuals reduce estimated or withholding tax payments to account for the credit, revenue losses could occur earlier than estimated.

The allocation of the revenue decrease also cannot be reliably estimated at this time; however, given the revenue structure of the four possible taxes to which the credit may apply, the majority of the revenue decrease is anticipated to be from the general fund. Personal income tax revenues, public service company franchise tax revenues, and most insurance premium tax revenues accrue to the general fund, whereas 77% to 79% of CIT revenues accrue to the general fund, with the remainder going to HEIF (6%) and TTF. As the bill is intended to apply to *private* nonprofit institutions of higher education, higher education revenues are not affected.

MHEC Program Administration

MHEC must administer the tax credit program, which includes (1) reviewing and rating competitive applications for the credits from all institutions that apply and (2) allocating tax credits to those institutions. MHEC must also establish regulations pertaining to the program, ensure compliance with program requirements and regulations, certify the value of real property to be donated to qualifying institutions, and report on the program annually to the Governor and the General Assembly.

MHEC initially requires two additional staff – one regular and one contractual – to perform the functions required by the bill. However, once the program has commenced, MHEC anticipates that the contractual position can expire and the program can be

administered by the full-time staff. MHEC further anticipates paying a review panel \$2,400 annually for review of applications.

Accordingly, general fund expenditures increase by \$143,882 in fiscal 2016 for MHEC to hire regular and contractual staff to administer the tax credit program and for contractual services for application reviews. This estimate accounts for the bill's July 1, 2015 effective date. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Regular Position	1
Contractual Position	1
Salaries and Fringe Benefits	\$131,742
Other Operating Expenses	<u>12,140</u>
Total FY 2016 State Expenditures	\$143,882

Future year expenditures reflect full salaries with annual increases and employee turnover, annual increases in ongoing operating expenses, and the elimination of the contractual position in fiscal 2018.

This estimate does not include any health insurance costs that could be incurred for specified contractual employees under the State's implementation of the federal Patient Protection and Affordable Care Act.

Comptroller's Office

General fund expenditures increase by approximately \$32,000 in fiscal 2017 for one-time expenses for the Comptroller's Office to update its electronic filing and processing systems and instructions.

Local Revenues: Itemized deductions for charitable contributions flow through to the local income tax, costing local governments an average of 3% of the increased amounts deducted beginning in fiscal 2017. Further, local governments receive a portion of CIT revenues to support the construction and maintenance of local roads and other transportation facilities. Local highway user revenues potentially decrease beginning in fiscal 2017 from reduced CIT revenues.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Maryland Higher Education Commission, Comptroller's Office, Public Service Commission, Maryland Insurance Administration, State Department of Assessments and Taxation, Department of Legislative Services

Fiscal Note History: First Reader - February 2, 2015
md/rhh

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