

**Department of Legislative Services**  
2015 Session

**FISCAL AND POLICY NOTE**

Senate Bill 405

(Senator DeGrange, *et al.*)

Budget and Taxation

**Maryland Education Credit**

This bill creates a State income tax credit for 60% of the contributions made by a business entity or nonprofit organization to an eligible nonprofit organization that provides specified financial assistance to students at public or eligible nonpublic K-12 schools and preK programs. The amount of credits that the Department of Business and Economic Development (DBED) can award in each year cannot exceed the amount of money appropriated to a reserve fund established by the bill. The bill states that it is the intent of the General Assembly that the appropriation to the reserve fund may not exceed \$15 million in a fiscal year.

The bill takes effect July 1, 2015, and applies to tax year 2015 and beyond.

**Fiscal Summary**

**State Effect:** Potential significant general fund expenditure increase beginning in FY 2016. The amount of the expenditure increase depends on the amount of money, if any, appropriated to the reserve fund each year. If the credit is funded at \$15.0 million, general fund expenditures will increase by \$15.0 million annually. Administrative costs increase by \$135,300 in FY 2016 and by \$116,700 in FY 2020. Potential decrease in general fund expenditures for State education aid beginning in FY 2017. Revenues are not materially affected.

(\$ in millions)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	15.1	15.1	15.1	15.1	15.1
Net Effect	(\$15.1)	(\$15.1)	(\$15.1)	(\$15.1)	(\$15.1)

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

**Local Effect:** Local highway user revenues distributed from the Transportation Trust Fund will decrease beginning in FY 2016 as a result of credits claimed against the corporate income tax. Local income tax revenues increase beginning in FY 2016 due to the

requirement that taxpayers add back any amount of credit claimed. Local expenditures are not affected.

**Small Business Effect:** Minimal.

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## Analysis

**Bill Summary:** The bill establishes a Maryland Education Tax Credit Reserve Fund. The total amount of initial tax credit certificates issued by DBED in each fiscal year cannot exceed the amount appropriated to the reserve fund in the State budget. The Governor may appropriate money to the reserve fund but the bill does not require an amount. The bill states that it is the intent of the General Assembly that any appropriation to the reserve fund may not exceed \$15 million. Any amount of money in the fund that is not expended in the fiscal year remains in the fund and must be rolled over into the next fiscal year.

### *Tax Credits*

Businesses can claim credits for monetary donations to eligible student assistance organizations (SAOs). The value of the credit is equal to 60% of the eligible contribution, not to exceed \$200,000. Businesses claiming the credit are required to add back the amount of the contribution for which a credit is claimed to Maryland adjusted gross income or Maryland modified income. Businesses seeking the tax credit must apply to DBED for each contribution it intends to make in the tax year; applications are approved on a first-come, first-served basis until the total cap for the year is reached. In order for a contribution to qualify for the tax credit, the contribution must be made to an organization approved by DBED. The bill establishes the procedures for claiming the credit, required notification and contribution deadlines, and a process for rescinding the credit if these requirements are not met.

### *Student Assistance Organizations*

SAOs are nonprofit organizations that provide financial assistance for the qualified education expenses of students attending eligible preK programs and K-12 schools. Qualified education expenses include education expenses as defined in Section 530(B)(3)(A) of the Internal Revenue Code and include tuition and fees, academic tutoring, books and supplies, computer equipment or Internet access, transportation, special needs services, and required uniforms.

SAOs must (1) be a 501 (c)(3) organization; (2) contribute or irrevocably encumber at least 90% of the contributions received for which a tax credit is claimed; (3) provide financial assistance on a priority basis to students who are eligible for free and reduced-priced meals

under the National School Lunch Program; (4) provide financial assistance to at least four different eligible schools in each calendar year; and (5) apply to DBED for approval in each year and submit other required information that verifies eligibility for the program. The application must state whether the organization will provide financial assistance to students at public or nonpublic schools.

### *Eligible Schools*

Eligible schools include public and private preK programs and K-12 schools. Nonpublic schools must (1) be certified by or registered with the State Board of Education; (2) not charge tuition that is greater than the specified statewide average per pupil expenditure by the local education agencies, as calculated by the Maryland State Department of Education; (3) administer a nationally acknowledged achievement student test; and (4) comply with Title VI of the Civil Rights Act of 1964, as amended. PreK programs must have obtained a license, letter of compliance, or certificate of approval from the State Board of Education.

### *DBED Administration*

DBED is required to administer the program and must (1) approve tax credit applications; (2) process SAO applications and publish an annual list of eligible SAOs; (3) adopt regulations implementing the bill; and (4) report annually specified information about the tax credit. DBED may approve a maximum of 60% of the total amount appropriated to the reserve fund for donations to SAOs that provide financial assistance to students in eligible nonpublic programs and schools and 40% to SAOs that provide assistance to students in eligible public schools. However, if the total amount of approved credits to public schools is less than 40% of the total amount appropriated to the fund, the excess amount may be used to approve credits for eligible nonpublic schools.

**Current Law:** No similar tax credit exists, although businesses can typically deduct contributions for scholarships as charitable donations, which typically lowers federal and State income tax liability.

**Background:** According to the National Conference of State Legislatures, 14 states have established a tuition tax credit program as of April 2014. These programs, also known as scholarship tax credit programs, allow individuals and corporations to allocate a portion of state taxes to private nonprofit school tuition organizations that issue scholarships to eligible students. The scholarship allows a student to choose among a list of private schools, and sometimes public schools outside of the district, approved by the school tuition organization. The scholarship is used to pay tuition, fees, and other related expenses.

Of Maryland's surrounding states, Virginia and Pennsylvania offer similar tax credit programs. The Pennsylvania Opportunity Scholarship Tax Credit Program provides tax credits to eligible businesses contributing to Opportunity Scholarship Organizations. These organizations use these contributions to provide tuition assistance to eligible students residing within underperforming school districts to attend another public school outside of the district or an eligible nonpublic school. Tax credits are equal to 75% of the contribution up to a maximum of \$750,000 per tax year; this amount can be increased to 90% if a business agrees to provide the same amount for two consecutive tax years. The program provided a maximum of \$50 million in tax credits in fiscal 2014. Scholarship organizations can provide tuition assistance to K-12 students or preK students.

The Virginia Education Improvement Scholarships Tax Credits Program provides tax credits for persons or businesses who donate to approved scholarship foundations that provide scholarships to eligible students attending certain nonpublic schools. The tax credit is equal to 65% of the donation. A total of \$25 million in tax credits may be issued in each fiscal year.

### **State Fiscal Effect:**

#### *Appropriations to the Reserve Fund*

The bill provides that the Governor may appropriate funds to the reserve fund but does not require an amount that should be appropriated. The bill does, however, state that it is the intent of the General Assembly that the amount appropriated to the fund not exceed \$15 million in a fiscal year. If the program is funded at this level, general fund expenditures will increase by \$15 million annually.

To the extent that the Governor provides less or no money to the reserve fund in any year, the increase in general fund expenditures will be less. However, there is no limit on the amount that can be appropriated to the reserve fund. The Department of Legislative Services notes that programs in neighboring states receive significantly higher levels of funding; accordingly, general fund expenditures would be significantly greater if the program is funded at a similar level.

#### *State Education Aid Impact*

A portion of the credits that can be claimed are for contributions made to an eligible nonprofit organization that provides financial assistance to students at an eligible nonpublic K-12 school. To the extent that this financial assistance reduces public school enrollment beginning with the 2015-2016 school year, general fund expenditures for State education aid may decrease beginning in fiscal 2017. The actual amount of the decrease, if any, depends on the amount of credits that can be awarded in each fiscal year and the portion of

credits that are for financial assistance for students attending nonpublic schools. A significant number of students who currently attend nonpublic schools would qualify under the bill. The impact of the bill will also depend on the extent to which the financial assistance results in additional students attending nonpublic schools as opposed to providing assistance to students who would otherwise attend a nonpublic school in the absence of the credit.

*Administrative Costs*

General fund expenditures increase by \$135,300 in fiscal 2016 due to implementation costs at DBED and the Comptroller’s Office, as described below.

The Department of Legislative Services estimates that DBED will need one administrator to implement and administer the program. General fund expenditures will increase by an estimated \$104,300 in fiscal 2016, which reflects the bill’s July 1, 2015 effective date. This estimate includes a salary, fringe benefits, and ongoing operating expenses.

The Comptroller’s Office reports that it will incur a one-time expenditure increase of \$31,000 in fiscal 2016 to add the credit to the personal and corporate income tax forms. This amount includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

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Salary and Fringe Benefits	\$99,385
Operating Expenses	<u>4,870</u>
<b>DBED Expenditures</b>	<b>\$104,255</b>
<b>Comptroller Expenditures</b>	<b><u>31,000</u></b>
<b>Total FY 2016 Expenditures</b>	<b>\$135,255</b>

Future year expenditures reflect a full salary with annual increases and employee turnover as well as annual increases in ongoing operating expenses.

**Local Revenues:** Local highway user revenues will decrease as a result of credits claimed against the corporate income tax. Local income tax revenues will increase due to the bill’s add-back requirement. If \$15.0 million in credits are claimed in each year with 90% of this amount claimed against the corporate income tax, local income tax revenues may increase by \$46,500 annually and local highway user revenues will decrease by \$196,700 annually.

## **Additional Information**

**Prior Introductions:** Similar legislation was introduced in the 2014 and 2012 sessions. SB 633 of 2014 and SB 844 of 2012 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. The cross files, HB 1262 of 2014 and HB 1216 of 2012, received a hearing in the House Ways and Means Committee, but no further action was taken.

**Cross File:** None.

**Information Source(s):** Department of Business and Economic Development, Maryland State Department of Education, Comptroller's Office, National Conference of State Legislatures, Pennsylvania Department of Community and Economic Development, Virginia Department of Community and Economic Development, Department of Legislative Services

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