

Department of Legislative Services  
 Maryland General Assembly  
 2016 Session

FISCAL AND POLICY NOTE  
 First Reader

House Bill 1343 (Delegate Hayes, *et al.*)  
 Ways and Means

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 a student assistance organization that provides specified financial assistance to students attending eligible nonpublic preK programs and K-12 schools or to support innovative educational programs for students at eligible public schools. A student assistance organization also includes a State-aided educational institution. The amount of credits that the Department of Commerce can award in each year cannot exceed the amount of money appropriated to a reserve fund established by the bill.

The bill takes effect July 1, 2016, and applies to tax year 2016 and beyond.

Fiscal Summary

**State Effect:** Potential significant general fund expenditure increase beginning in FY 2017. 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 the amount specified by the intent of the legislation, general fund expenditures will increase by \$15.0 million annually beginning in FY 2017. Administrative costs increase by \$140,400 in FY 2017 and by \$116,700 in FY 2021. Potential decrease in general fund expenditures for State education aid beginning in FY 2018. Revenues are not materially affected.

| (\$ in millions) | FY 2017  | FY 2018  | FY 2019  | FY 2020  | FY 2021  |
|------------------|----------|----------|----------|----------|----------|
| 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 2017 as a result of credits claimed against the corporate income tax. Local income tax revenues increase beginning in FY 2017 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 the Department of Commerce 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 the appropriation to the reserve fund may not exceed \$15 million in each fiscal year. 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 the Department of Commerce 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. The application must state the type of financial assistance provided by the SAO. In order for a contribution to qualify for the tax credit, the contribution must be made to an organization approved by the Department of Commerce. 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 must be 501(c)(3) nonprofit organizations that (1) provide financial assistance to students attending eligible nonpublic preK programs and K-12 schools on a priority basis to students who are eligible for free and reduced-price meals under the National School Lunch Program; (2) provide innovative educational programs to public school students or provide grants to public schools to support innovative educational programs that are not a

part of the regular academic program in order to achieve the goals of the Bridge to Excellence in Public Schools Act of 2002, as amended; or (3) qualify as a State-aided educational institution under Section 5-501 of the Education Article. Currently, there are about 40 State-aided educational institutions comprised of museums, zoos, learning centers, theatres, and an orchestra.

SAOs must (1) contribute or irrevocably encumber at least 90% of the contributions received for which a tax credit is claimed; (2) provide financial assistance or grants to at least four different eligible schools or to students attending at least four different schools in each calendar year; and (3) apply to the Department of Commerce for approval in each year and submit other required information that verifies eligibility for the program. The application must state the type of financial assistance the organization will provide.

### *Eligible Schools*

Eligible schools include public and nonpublic 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 test; (4) comply with Title VI of the Civil Rights Act of 1964, as amended; (5) comply with Title 20, Subtitle 6 of the State Government Article; and (6) not discriminate in student admissions on the basis of race, color, national origin, or sexual orientation. PreK programs must have obtained a license, letter of compliance, or certificate of approval from the State Board of Education.

### *Credit Administration*

The Department of Commerce 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; and (4) report annually specified information about the tax credit. The department 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 schools and 40% to SAOs that provide assistance to 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 in the next calendar year.

**Current Law:** No similar tax credit exists, although businesses can generally 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, 16 states have established a tuition tax credit program as of January 2016. These programs, also known as scholarship tax credit programs, allow individuals and corporations to claim tax credits for donations 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, Pennsylvania and Virginia 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 student's district or an eligible nonpublic school. Pennsylvania's Educational Improvement Tax Credit Program provides tax credits for businesses that contribute to eligible scholarship organizations at nonpublic schools or educational improvement organizations for "innovative programs" at public schools. A total of \$50 million in opportunity scholarship tax credits and \$100 million in educational improvement tax credits can be issued in each fiscal year.

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 Funding in Fiscal 2017 Budget*

The fiscal 2017 State budget includes \$5 million for grants to business entities equal to no more than 50% of the amount contributed by the business to an SAO that provides financial assistance to students attending nonpublic schools. The nonpublic schools must meet the eligibility requirements to participate in the aid to the nonpublic schools program for textbooks and computer hardware and software. The grants are funded from the Cigarette Restitution Fund. Similar to this bill, an SAO must spend not less than 95% of grant eligible funds on financial assistance for qualified education expenses, provide funds to at least four eligible schools, and give priority to students eligible for free and reduced-price meals. The Department of Commerce is designated to administer the grant program. The funding is not contingent on legislation.

## **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 annually. If the program is funded at this level, general fund expenditures will increase by \$15 million annually beginning in fiscal 2017.

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 2016-2017 school year, general fund expenditures for State education aid may decrease beginning in fiscal 2018. 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 \$140,355 in fiscal 2017 due to implementation costs at the Department of Commerce and the Comptroller's Office, as described below.

The Department of Legislative Services estimates that the Department of Commerce will need one administrator to implement and administer the program. General fund expenditures will increase by an estimated \$108,400 in fiscal 2017, which reflects the bill's July 1, 2016 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 \$32,000 in fiscal 2017 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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|-----------------------------------|----------------------|
| Position                          | 1                    |
| Salary and Fringe Benefits        | \$103,390            |
| Operating Expenses                | <u>4,965</u>         |
| <b>Commerce Expenditures</b>      | <b>\$108,355</b>     |
| <b>Comptroller Expenditures</b>   | <b><u>32,000</u></b> |
| <b>Total FY 2017 Expenditures</b> | <b>\$140,355</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 beginning in fiscal 2017 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 2015, 2014, and 2012 sessions. HB 487 of 2015 received a hearing in the House Ways and Means Committee, but no further action was taken. 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:** SB 706 (Senator DeGrange, *et al.*) - Budget and Taxation.

**Information Source(s):** Department of Commerce, 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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Analysis by: Robert J. Rehrmann

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