

Department of Legislative Services
 Maryland General Assembly
 2019 Session

FISCAL AND POLICY NOTE
 Third Reader

Senate Bill 400 (Senator Pinsky, *et al.*)
 Education, Health, and Environmental Affairs

Appropriations

Maryland Higher Education Commission - Private Nonprofit Institutions of
 Higher Education - Regulation (Private Nonprofit Institution of Higher
 Education Protection Act of 2019)

This bill alters the definition of “private nonprofit institution of higher education” to mean, in addition to current criteria, that the institution (1) benefits no person through any part of its net earnings; (2) is legally authorized to operate as a nonprofit organization in each state in which it is physically located; and (3) is determined by the Internal Revenue Service (IRS) to be an organization to which contributions are tax deductible. The bill requires the Maryland Higher Education Commission (MHEC) to determine whether an incident constitutes private inurement if a private nonprofit institution of higher education engages in a reportable incident as defined by the bill. By July, 1, 2019, MHEC, jointly with the Office of the Attorney General, must develop a procedure for determining and enforcing the classification of institutions of higher education as enacted by the bill. **The bill takes effect June 1, 2019.**

Fiscal Summary

State Effect: General fund expenditures increase by \$36,500 in FY 2020 for MHEC to hire additional personnel. Future year expenditures reflect annualization, inflation, and ongoing expenses. Revenues are not affected.

(in dollars)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	36,500	42,400	43,800	45,300	46,900
Net Effect	(\$36,500)	(\$42,400)	(\$43,800)	(\$45,300)	(\$46,900)

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

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary: Under the bill, “reportable incident” means any of the following as reportable on a private nonprofit institution of higher education’s IRS form 990:

- the engagement in an excess benefit transaction with a disqualified person;
- the providing of a grant or other assistance by the institution to a member of the governing body;
- the reporting of receivables from or payables to a member of the governing body;
- the institution was a party to a business transaction connected to a member of the institution’s governing body;
- the institution was party to a prohibited tax shelter transaction;
- the institution participated in an equity-based compensation arrangement; or
- the institution paid compensation contingent on the revenue of the institution or any related organization.

By December 1, 2019, MHEC must adopt regulations relating to institutions of higher education that would be impacted by the bill.

Current Law: “Private nonprofit institution of higher education” is defined as a private nonprofit institution of higher education that generally limits enrollment to graduates of secondary schools and awards degrees at the associate, baccalaureate, or graduate level. “Private nonprofit institution” includes an independent institution of higher education.

“Private inurement” is when a 501(c)(3) nonprofit’s money is devoted to private uses instead of charitable purposes. There is no strict definition of “private inurement,” but it is generally understood as providing unjust enrichment from the organization’s gross or net earnings to another party. The doctrine comes directly from the language of section 501 of the Internal Revenue Code that only organizations “no part of the net earnings of which inures to the benefit of any private shareholder or individual” may be exempt under section 501(c)(3). A 501(c)(3) organization that violates the private inurement doctrine fails to be operated exclusively for one or more exempt purposes and is subject to revocation of its tax-exempt status.

Background: In recent years, several for-profit institutions of higher education have pursued plans to become nonprofit institutions. In March 2018, the Higher Learning Commission (HLC), an accreditor, approved the proposals of two institutions (Purdue-Kaplan and Grand Canyon) to become nonprofit institutions. These reclassifications were allowed because HLC changed their guidelines to allow for an arrangement in which an institution set up as a nonprofit may outsource a range of services

to a separate for-profit company. These changes come at a time when IRS is devoting fewer resources to reviewing nonprofit applications for compliance.

As of January 2019, there are 38 private nonprofit institutions with a physical presence in the State. Of those 22 are “in-state” institutions and 16 are out-of-state institutions. In addition there are 18 out-of-state online institutions that are registered with MHEC to enroll Maryland residents in their online courses.

State Expenditures: General fund expenditures increase by \$36,525 in fiscal 2020, which assumes a start date of October 1, 2019, following the bill’s June 1, 2019 effective date. This estimate reflects the cost of hiring a half-time staff specialist to review and analyze the necessary financial material to identify reportable incidents and determine if the reportable incidents constitute private inurement. This will be an ongoing effort with annual deadlines. Procedures similar to an audit will need to be developed and appropriate expertise will be needed to carry out those procedures. Additionally, any sanctions or consequences of such determinations will necessitate follow-up with the institution. The estimate includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Permanent Position	0.5
Salary and Fringe Benefits	\$31,400
One-time Start-up Expenses	4,890
Ongoing Operating Expenses	<u>235</u>
Total FY 2020 General Fund Expenditures	\$36,525

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

Additional Information

Prior Introductions: None.

Cross File: HB 461 (Delegate Hettleman, *et al.*) - Appropriations.

Information Source(s): Office of the Attorney General (Consumer Protection Division); Maryland Higher Education Commission; Maryland Independent College and University Association; Inside Higher Ed; Department of Legislative Services

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Analysis by: Caroline L. Boice

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