Department of Legislative Services

Maryland General Assembly
2024 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 704 (Delegate Wivell, *et al.*)
Appropriations

Primary and Secondary Education – Education Savings Account Program – Established

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This bill creates the Education Savings Account (ESA) program in the Maryland State Department of Education (MSDE) to provide grants to families to defray specified costs related to nonpublic schooling for eligible students. Participating students are included in the enrollment count used to calculate required State and local education aid for local school systems. The State must deposit specified portions of per pupil State and local education aid, depending on family income, in each participating student's account, with each county reimbursing the State for the local share deposited. The bill establishes a subtraction modification from the State income tax for contributions to an eligible ESA, beginning in tax year 2024. **The bill takes effect July 1, 2024.**

Fiscal Summary

State Effect: General fund revenues decrease beginning as early as FY 2025 due to the subtraction modification for contributions to ESA accounts, but a reliable estimate is not feasible as discussed below. General and special fund expenditures increase, likely minimally, due to the participation of previously home-schooled students in ESA, as early as FY 2025. General and special fund expenditures increase further beginning in FY 2026 due to their inclusion in public school enrollment counts. **This bill increases a mandated appropriation beginning in FY 2026.**

Local Effect: Local expenditures for public school aid increase, likely minimally, due to the participation of previously home-school students in ESA, beginning as early as FY 2025; revenues for local school systems increase by a portion of those payments. However, at least one-half of local per pupil revenues for public education for participating students is redirected to ESA accounts, likely resulting in a net decrease in local school system revenue. **This bill imposes a mandate on a unit of local government.**

Small Business Effect: Potential minimal.

Analysis

Bill Summary:

Eligible Students and Qualifying Schools

"Eligible student" means a student eligible to enroll in a public school in Maryland and who attended a public, charter, or home school for at least 100 days in the immediately preceding fiscal year. It includes a student of an active-duty military member stationed in the State regardless of prior school attendance.

In order to qualify for an ESA grant, an eligible student's parent must sign an agreement with MSDE with specified provisions, including that participating children will take all assessments required by the State and that all funds provided by ESA will be used only for specified expenses.

The bill establishes educational, legal, and reporting requirements for "qualifying schools," which are defined as nonpublic schools that meet specified conditions; a home school program is not a qualifying school. Resident school districts must provide a qualifying school or other specified providers with a complete copy of a student's record in compliance with federal law.

Contributions to Eligible Accounts

For students whose family income is less than or equal to 500% of the federal poverty level (FPL), the State must deposit into an ESA account, on a quarterly basis, 75% of the per pupil amount of State and local funds for each education program for which the student would be included in the resident school district enrollment count. For students whose family income exceeds 500% of FPL, the contribution is 50% of per pupil education funding, also on a quarterly basis. Any funding deposited into an eligible student's ESA account must be deducted from the amount of State and local funds provided to the resident school district under the State's K-12 funding formulas. In 2024, the federal poverty threshold for a family of four is $31,200, making 500% of that level equal to $156,000. Actual thresholds used for the program will vary by the size of each participating family.

Any unused funds when the student achieves a high school diploma or is no longer enrolled in a qualifying school must be returned to the State.

Eligible Expenses

Parents of eligible students may use funds in the account only for the following expenses:

- tuition and fees at a qualifying school;

- textbooks or uniforms required by a qualifying school;
- private tutoring;
- the purchase of curriculum and instructional materials;
- tuition or fees for a nonpublic online learning program;
- fees for specified exams;
- education services from a licensed or accredited provider of services for students with special needs or disabilities;
- contracted education services provided at a public school;
- Internet service provider or online learning fees, if applicable; and
- any other expenses approved by MSDE.

Maryland State Department of Education Responsibilities

MSDE must qualify private financial management firms or similar entities to manage accounts and establish reasonable fees based on market rates. It may conduct or contract for the auditing of accounts, but at a minimum, a random sampling of accounts must be audited annually. MSDE must provide written notice to parents on eligible uses of funds, parental responsibilities, and duties of the department, and must develop regulations to implement the bill. MSDE may determine a parent to be ineligible based on misuse of funds.

Subtraction Modification

Parents of an eligible student may deposit additional funds to an account on a pre-tax basis. Any such contributions by a parent (but not by the program) are eligible for a subtraction modification in the calculation of Maryland adjusted gross income for the purpose of calculating State income tax payments.

Current Law:

State Aid to Education – Generally

The great majority of direct State aid to public schools (excluding teachers' retirement) is determined by funding formulas found in Title 5, Subtitle 2 of the Education Article. These funding formulas were originally set forth in the Bridge to Excellence in Public Schools Act (Chapter 288 of 2002); they were substantially altered and expanded by the Blueprint for Maryland's Future – Implementation (Chapter 36 of 2021). The formulas are in part based on three components. The first is a uniform base cost per pupil that is necessary to provide general education services to students in every school system. The second component involves adjustments for the additional costs associated with educating at-risk student populations, including special education students, students eligible for free and reduced-price meals, and English language learners. The third component is an adjustment that accounts for differences in the local costs of educational resources. Chapter 36 altered these formulas and established new formulas and programs to implement the final recommendations of the Commission on Innovation and Excellence in Education to provide a world-class education to Maryland students.

The majority of State education aid formulas also entail wealth equalization across counties, compensating for differences in local wealth by providing less aid per pupil to more wealthy counties and more aid per pupil to less wealthy counties. Although most State aid formulas are designed to have the State pay roughly one-half of program costs statewide, the State's share for the less wealthy counties is higher than 50%, and the State's share for more wealthy counties is lower than 50%.

Maryland 529 Plans

Qualified tuition plans, also known as 529 plans, are State programs that allow an individual to contribute to an account established for paying a student's qualified education expenses at an eligible educational institution. Withdrawals from a plan are tax free if used for qualified higher education expenses. The State Treasurer's Office currently operates the Maryland College Investment Plan.

The federal Tax Cuts and Jobs Act of 2017 (Public Law 115-97) was signed into law on December 22, 2017, and expands the permissible use of 529 plans by amending "qualified higher education expense" to include expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, nonpublic, or religious school. An account holder can withdraw up to $10,000 each year for expenses associated with enrollment at these schools.

A person may claim a subtraction modification for an amount contributed to the Maryland College Investment Plan. The subtraction modification claimed by a taxpayer may not exceed $2,500 per beneficiary of the Maryland College Investment Plan. This limitation is increased to $5,000 for married individuals who file jointly. Any unused amount of the subtraction modification can be carried forward to future tax years for up to 10 tax years for contributions to the Maryland College Investment Plan. An investment plan account holder is not eligible for the subtraction modification for contributions to an investment account in any year in which the account holder receives funds under the State Contribution Program.

State Revenues: General fund revenues decrease beginning in fiscal 2025 due to the subtraction modification decreasing taxable income for some participating families, but a reliable estimate is not feasible. The number of participating families cannot be known in advance; moreover, it is not known what percentage of participating families will make their own tax-exempt contributions to ESAs in excess of contributions by the State and local school systems. As Maryland taxpayers can already claim a subtraction modification for contributions to 529 plans, which can also be used for eligible expenses related to nonpublic school enrollment, the number of families that also make contributions to ESAs may be limited. Families that wish to make contributions that exceed the caps on the subtraction modification for 529 plans are the most likely to also make contributions to ESAs so they can claim additional tax deductions.

State Expenditures: The bill requires that students who participate in the ESA program must have attended a public, charter, or home school for at least 100 days in the prior fiscal year, and the bill takes effect July 1, 2024. Therefore, general and special fund expenditures increase as early as fiscal 2025 to the extent that previously home-schooled students participate in ESA (because they are not currently included in public school enrollment counts). If MSDE is not able to launch the program that quickly, the fiscal effect is delayed until fiscal 2026. Nevertheless, previously home-schooled students are assumed to first be included in public school enrollment counts in fiscal 2025, which determines State (and local) education aid payments in fiscal 2026.

State Education Funding

The bill requires that all students who participate in the ESA program must have attended a public, charter, or home school for at least 100 days in the prior year; accordingly, this analysis assumes that, with the exception of home-schooled students, all participating students were included in the enrollment count for the (prior) 2023-2024 school year. With the exception of home-schooled students, this means that there is no change in State education aid for these students because they were counted in the prior year and are still counted in fiscal 2025. However, in fiscal 2025, a portion of State and local education aid that would normally be paid to local school systems for these students is instead paid to ESA accounts.

Home-schooled students are not currently included in public school enrollment counts, and there were approximately 39,500 home-schooled students during the 2022-2023 school year, the most recent data available. This analysis assumes that approximately 40,000 students were home schooled during the 2023-2024 school year. Assuming MSDE is able to launch the ESA program in fiscal 2025, for every previously home-schooled student who elects to participate in ESA during the 2024-2025 school year (fiscal 2025), the State and local governments must pay the appropriate amount (based on their individual educational needs and family income) into ESA accounts. The amounts will vary tremendously but are assumed to average about $10,000 per student and represent new expenditures for the State and local governments because these students are not reflected in enrollment counts that determine education aid for fiscal 2025. General and special fund expenditures increase annually thereafter once the students are included in the annual public school enrollment counts.

However, participation in ESA is likely severely restricted by the bill's definition of "eligible student" wherein a student may receive an ESA grant in a given year only if the student attended a public, charter, or home school for *at least 100 days in the prior year*. But to receive an ESA grant, the student must also agree to enroll in a nonpublic school. In short, participation in ESA one year disqualifies a student from participating the following year by virtue of being enrolled in a nonpublic school. It is possible that some students bounce in and out of public schools to qualify for ESA every other year, but more likely, parents choose not to participate if it means they have to pick up the full tuition cost of a nonpublic school after one year. This likely limits the fiscal effect on State aid formulas.

The bill's requirement that participating home-schooled students be (newly) included in student enrollment counts has the potential to increase general fund expenditures for education aid because home-schooled students are not otherwise included in enrollment counts, but the definition of "eligible student" also likely severely limits participation by home-schooled students. As with a student who previously attended a public school, a home-schooled student who enrolls in ESA must enroll in a nonpublic school (a home school is not a qualifying school), which renders that student ineligible to participate the following year. In all likelihood, most parents of home-schooled children elect not to enroll in the program if it means disrupting their children's education.

Education Savings Account Program

To the extent that eligible students do participate in ESA, a reliable estimate of the amount of State (and local) K-12 education funding that is redirected to ESA accounts is not feasible because it depends on at least four factors that cannot be known in advance: (1) the number of current public school students who elect to participate in the program; (2) the family income of the students who elect to participate; (3) the local school system in which each student is currently enrolled; and (4) whether the student qualifies for special services (*e.g.*, special education). Since the vast majority of students currently enrolled in nonpublic schools are not eligible to participate in ESA, current enrollment in nonpublic schools is not indicative or illustrative of the bill's potential effects.

Per pupil funding levels vary widely in the State. For fiscal 2025, the combined State and local per pupil funding ranges from $12,169 in Carroll County to $18,041 in Baltimore City, as shown in **Exhibit 1**. *For illustrative purposes only*, the exhibit shows the variation in the amounts of State and local per pupil payments for fiscal 2025 that may be made to ESA accounts for each eligible student from families with incomes at or below 500% of FPL and those with incomes above that level. These amounts represent the average per pupil expenditures based on the number of students eligible for different weighted payments based on their educational needs. Actual amounts paid will vary based on the specific programs for which each participating student qualifies. Thus, State and local contributions to eligible ESA accounts vary tremendously under the bill; without information on the number of students from each jurisdiction that elect to participate, their family incomes, or their educational needs, a reliable estimate is not possible.

Exhibit 1
Estimated Payments to Education Savings Accounts
Fiscal 2025

	State and Local Per Pupil Funding	50% ESA Payment	75% ESA Payment
Allegany	$15,023	$7,512	$11,267
Anne Arundel	14,063	7,032	10,547
Baltimore City	18,041	9,020	13,530
Baltimore	15,285	7,642	11,464
Calvert	12,291	6,145	9,218
Caroline	15,340	7,670	11,505
Carroll	12,169	6,085	9,127
Cecil	14,816	7,408	11,112
Charles	14,257	7,128	10,693
Dorchester	16,900	8,450	12,675
Frederick	13,152	6,576	9,864
Garrett	14,122	7,061	10,591
Harford	13,553	6,776	10,165
Howard	12,800	6,400	9,600
Kent	15,969	7,985	11,977
Montgomery	15,640	7,820	11,730
Prince George’s	17,325	8,663	12,994
Queen Anne’s	13,520	6,760	10,140
St. Mary’s	13,008	6,504	9,756
Somerset	16,618	8,309	12,464
Talbot	15,741	7,871	11,806
Washington	14,950	7,475	11,212
Wicomico	15,332	7,666	11,499
Worcester	16,932	8,466	12,699

ESA: Education Savings Account

Note: This estimate is based on fiscal 2025 projections; actual amounts will vary somewhat.

Source: Department of Legislative Services

Due to the definition of "eligible student" a limited number of students may qualify. If the definition were to change, or if the bill is interpreted to allow students to remain in ESA once they become participants without regard to the bill's eligibility requirement, participation likely increases substantially and the negative effects on State education aid payments are likely significant. Assuming an average payment of about $10,000, the amount of public funds diverted to ESA accounts totals $1.0 million for every 100 students that participate.

Maryland State Department of Education Administrative Expenses

MSDE incurs costs to manage the program and conduct annual audits of ESA accounts. As the bill requires MSDE to establish reasonable fees based on market rates, MSDE envisions covering these costs through a modest fee on ESA accounts, including costs associated with hiring a third-party administrator to manage the program and paying for the annual audits. This is consistent with the practice of Maryland's 529 plans and supplemental retirement plans, both of which use third-party program and asset managers that are reimbursed by fees based on a percentage of assets. Therefore, there is no net cost to MSDE for administrative expenses.

Local Fiscal Effect: As with the State, county expenditures for public schools increase beginning in fiscal 2025 to the extent that previously home-schooled students participate in ESA during the 2024-2025 school year. They increase further beginning in fiscal 2026 when those students are added to the enrollment counts used to determine local education aid.

For participating students, the bill requires that (1) State contributions to eligible accounts be deducted from State education aid payments to local school systems and (2) counties reimburse the State for the local share of the contributions to eligible ESA accounts. Therefore, beginning in fiscal 2025, local school system revenues *decrease* by the amount of State and county education aid that is redirected to ESA accounts for participating students to offset expenditures for nonpublic schools. However, local school systems continue to receive either 25% or 50% of per pupil funding for students who are no longer enrolled (and for previously home-schooled students) because they are participating in ESA, so the net *per pupil* revenue effect for local school systems is positive, even if total revenues decrease.

The overall effect on county expenditures and local school system revenues is expected to be minimal due to limited participation in ESA, as discussed above. However, if the bill is interpreted to allow students to remain in ESA once they become participants without regard to the bill's eligibility requirement, the potential negative effects on county education aid payments and local school system revenues are significant, likely in the tens of millions of dollars.

Additional Comments: As noted above, the fiscal impact under the bill is limited, primarily due to the definition of "eligible student" which is not specified as establishing *initial* eligibility only. Accordingly, the bill does not promote continuous enrollment in a nonpublic school since eligibility for ESA is tied to having attended a public, charter, or home school for at least 100 days in the immediately preceding fiscal year.

Additional Information

Recent Prior Introductions: Similar legislation has been introduced within the last three years. See HB 649 of 2023; HB 1156 of 2022; and HB 1113 of 2021.

Designated Cross File: None.

Information Source(s): Kent and Montgomery counties; Maryland Association of Counties; Comptroller's Office; Maryland State Department of Education; Department of Budget and Management; Baltimore City Public Schools; Baltimore County Public Schools; Anne Arundel County Public Schools; Montgomery County Public Schools; U.S. Department of Health and Human Services; Department of Legislative Services

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