Department of Legislative Services

Maryland General Assembly
2024 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 675 (Delegate Grammer, *et al.*)
Appropriations

Primary and Secondary Education - Education Savings Account Program - Established (Maryland Universal School Choice Act)

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 amounts of per pupil State and local education aid 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 ESAs, but a reliable estimate is not feasible. General and special fund expenditures increase, likely by $1.0 billion or more beginning as early as FY 2025, due to students enrolled in nonpublic schools (including those who were previously either home schooled or in public school) participating in ESA; general and special fund expenditures increase beginning in FY 2026 due to those students being included 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 by $1.0 billion or more beginning as early as FY 2025, due to students enrolled in nonpublic schools (including those who were previously either home schooled or in public school) participating in ESA. Local school system revenues decline, potentially significantly, beginning in FY 2025 by the amount of per pupil aid paid to ESAs instead of the school system for each student who disenrolls to participate in ESA. However, a more reliable estimate is not feasible, as discussed below. **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.

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. 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

On a quarterly basis, the State must deposit, into an account of an eligible student, 100% of the per pupil amount of State and local funds for each education program in the resident school district for which the eligible student would be included in the enrollment count under State school finance laws. 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; each county must reimburse the State for the local share of the amount deposited into an eligible student's account.

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 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 takes effect July 1, 2024, which means the first year it impacts the amount of State (and local) education formula funding is fiscal 2026 because the fiscal 2026 formulas use the enrollment counts from the 2024-2025 school year. Nevertheless, State costs to contribute to ESAs may increase beginning as early as fiscal 2025.

State Education Funding

The program has no effect on State education aid for students already enrolled in public schools as they are already included in the enrollment counts used to calculate State education aid. However, by defining eligible students as students who are *eligible* to enroll in public schools, the bill likely increases the number of students included in the calculation of State aid to education in two ways. First, it includes in those counts students who currently attend nonpublic schools and enroll in the program. Second, it includes in the calculation students who are currently home schooled and enroll in the program. Both sets of students are eligible to enroll in public schools but have previously elected not to, so they increase the pupil counts used to calculate State education aid. Families of these students would be very motivated to join the program as it would essentially compensate them for nonpublic school tuition; as home school programs are not qualifying schools, home-schooled children are only counted if they enroll in a qualifying nonpublic school, which can include nonpublic online learning programs.

The number of home-schooled students remained relatively constant at about 25,000 annually for many years. However, during the COVID-19 pandemic, that number nearly doubled; for the 2022-2023 school year, there were approximately 39,500 home-schooled students. In addition, K-12 enrollment in nonpublic schools (not including church-exempt schools) during the 2022-2023 school year was more than 65,000 students and more than 44,000 in church-exempt schools. Therefore, there are potentially approximately 148,500 students who could be added to the enrollment counts for the calculation of State education aid.

The 2024-2025 school year is the first year that students may participate in ESA, assuming MSDE can launch the program that early. Thus, the State must make payments to ESA accounts as early as fiscal 2025, including for students who were previously home schooled or enrolled in nonpublic schools and, thus, are not included in the enrollment counts for that year.

The statewide average per-pupil funding amount is projected to be $15,177 in fiscal 2025, roughly evenly divided between the State and local governments. Thus, assuming an average State aid contribution of about $7,600 per student (representing roughly one-half of total education aid per student), State general and special fund expenditures could increase by as much as $1.1 billion beginning in fiscal 2025, depending on the number and demographic characteristics of the students who enroll in the program. As these students were not previously enrolled in public schools, the additional State (and local) expenditures made on their behalf do not represent lost revenue for local school systems. If the ESA program does not begin until fiscal 2026, when the average State aid contribution is projected to be $15,788 per student, the cost increases to as much as $1.2 billion. In either event, State general and special fund expenditures increase annually beginning in fiscal 2026 due to the inclusion of students who were previously home schooled or enrolled in nonpublic schools in public school enrollment counts.

Education Savings Account Program

Beginning as early as fiscal 2025, for any public school students who disenroll to participate in ESA, local school system revenues for those students are redirected to their accounts. Likewise, even before the funding formula changes take effect, the State must begin to, on a quarterly basis, contribute to those accounts.

For participating students who were previously enrolled in public schools, the bill requires that (1) State contributions to eligible accounts be deducted from State education aid payments that would be paid to local school systems for those students and (2) counties reimburse the State for the local share of the contributions to eligible ESA accounts. Therefore, State and local funding for public schools *decreases* by the per pupil amounts *redirected* to ESA accounts to offset expenditures for nonpublic schools. On a statewide basis, this is projected to be approximately $15,100 per student in fiscal 2025 and $15,800 per student in fiscal 2026, but amounts vary by county, with the State and counties each paying about 50% of the cost on a statewide basis.

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 three factors that cannot be known in advance: (1) the number of current public school students who elect to participate in the program; (2) the local school system in which each student is currently enrolled; and (3) whether the student qualifies for special services (*e.g.*, special education).

For illustrative purposes only, **Exhibit 1** shows the varying amounts of State and local per pupil payments that would be made to ESA accounts for each eligible student, broken out by type of aid in fiscal 2026. For instance, a student who qualifies for compensatory education and is an English language learner in Baltimore City would receive $25,826 ($9,226+$7,559+$9,041). However, a student from Worcester County who does not qualify for any special services would receive only the foundation amount of $11,602. 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, and their relevant educational needs, a reliable estimate is not possible. However, the number is likely significant. Again, assuming an average State payment of about $8,000, the amount of State funds diverted to ESA accounts totals $800,000 for every 100 students currently enrolled in public schools that participate.

Exhibit 1
Estimated Payments to Education Savings Account Program Accounts
Per Student, by Jurisdiction and Student Needs
Fiscal 2026 – Projected

	State and Local Foundation	State and Local Compensatory	State and Local Special Education	State and Local English Learner
Allegany	$9,226	$7,842	$9,503	$9,041
Anne Arundel	9,226	8,058	9,566	9,041
Baltimore City	9,226	7,559	9,503	9,041
Baltimore	9,226	7,559	9,503	9,041
Calvert	9,226	7,970	9,503	9,041
Caroline	9,226	7,842	9,503	9,041
Carroll	9,226	7,842	9,503	9,041
Cecil	9,226	7,842	9,503	9,041
Charles	9,226	7,842	9,503	9,041
Dorchester	9,226	7,842	9,503	9,041
Frederick	9,226	7,842	9,503	9,041
Garrett	9,226	7,842	9,503	9,041
Harford	9,226	7,842	9,503	9,041
Howard	9,226	7,864	9,503	9,041
Kent	9,226	7,842	9,503	9,041
Montgomery	9,226	8,445	10,062	9,519
Prince George’s	9,226	7,842	9,503	9,041
Queen Anne’s	9,226	8,267	9,834	9,299
St. Mary’s	9,226	7,842	9,503	9,041
Somerset	9,226	7,842	9,503	9,041
Talbot	9,226	7,842	9,503	9,041
Washington	9,226	7,842	9,503	9,041
Wicomico	9,226	7,842	9,503	9,041
Worcester	11,602	9,420	11,309	10,727

Source: Department of Legislative Services

Maryland State Department of Education Administrative Expenses

MSDE incurs costs to manage the program and conduct annual audits of ESA accounts. As the bill allows MSDE to establish reasonable fees based on market rates, MSDE envisions contracting with a third-party to administer the program and covering the costs of the contract and audits through a modest fee on ESA accounts. 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, local expenditures for public schools increase significantly beginning in fiscal 2025 to cover the local share of education aid for students who are home schooled or enrolled in nonpublic schools who elect to participate in ESA, assuming MSDE can launch the program that early. Local expenditures increase annually beginning in fiscal 2026 due to the addition of nonpublic school students and previously home-schooled students to the enrollment counts used to calculate local shares of education funding. A precise estimate is not feasible for the reasons given above but could exceed $1.0 billion. As noted above, State expenditures for students currently home schooled or enrolled in nonpublic schools could also increase by $1.0 billion or more, so combined State and local expenditures for these students could increase by more than $2.0 billion and are deposited into ESA accounts, assuming the vast majority of those students participate in ESA.

To the extent students currently enrolled in public schools elect to participate in ESA, local school systems no longer receive per pupil aid for those students. As a result, local school system revenues decrease beginning as early as fiscal 2025, if MSDE can launch the program that early. The amount of lost revenue is equal to the per pupil funding provided for each student who disenrolls to participate in ESA, but a reliable estimate is not feasible in the absence of experience with the program. However, the amount of lost revenue is potentially significant.

Additional Comments: The bill requires that “on a quarterly basis the State shall deposit into an account of an eligible student an amount equivalent to 100% of the per pupil amount of State and local funds for each education program....” This analysis has interpreted that provision to mean that 100% of per pupil aid is divided into four quarterly payments. However, the language in the bill can also be interpreted to mean four payments each of 100% of per pupil aid (*i.e.*, 400% of per pupil aid). If the bill is interpreted in that manner, State and local expenditures increase potentially by billions of dollars, depending on enrollment in the program.

Additional Information

Recent Prior Introductions: Similar bills have been introduced within the last three years. See HB 569 of 2023; HB 1156 of 2022; and HB 1113 of 2021.

Designated Cross File: None.

Information Source(s): Baltimore City; 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; Montgomery County Public Schools; Department of Legislative Services

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