

Department of Legislative Services
 Maryland General Assembly
 2003 Session

FISCAL AND POLICY NOTE
Revised

House Bill 648
 Ways and Means

(Delegate Hixson, *et al.*)

Budget and Taxation

Adult Education and Literacy Services - Income Tax Subtraction Modification

This bill provides a subtraction modification under the Maryland income tax for 100% of the expenses that a business entity incurs to provide adult education and literacy services to its employees or to other individuals.

The bill takes effect July 1, 2003 and is applicable to all taxable years beginning after December 31, 2002.

Fiscal Summary

State Effect: General fund revenues could decrease by \$26,900 and State Transportation Trust Fund (TTF) revenues could decrease by \$3,100 in FY 2004. Future year revenue decreases reflect growth in the number of businesses applying for the tax modification. State expenditures would not be materially affected.

(in dollars)	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
GF Revenue	(\$26,900)	(\$28,000)	(\$29,100)	(\$30,400)	(\$31,700)
TTF Revenue	(3,100)	(3,300)	(3,400)	(3,600)	(3,700)
Expenditure	0	0	0	0	0
Net Effect	(\$30,000)	(\$31,300)	(\$32,500)	(\$34,000)	(\$35,400)

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

Local Effect: Local revenues could decrease by \$9,100 annually. Local expenditures would not be affected.

Small Business Effect: Minimal.

Analysis

Current Law: The State provides funding for adult education services through four programs: adult general education, external diploma program, literacy works grant, and adult education and literacy works.

Background: A task force was established at the 2001 session to study adult education services in Maryland. The task force determined that there is a significant need for adult education services in Maryland, with 700,000 to 900,000 adults without a high school diploma or lacking the skills to speak English well. Current adult education programs serve between 36,000 to 38,000 individuals annually, or 5% of the individuals in need. The demand for literacy services varies across Maryland. Statewide about 20% of adults function at the lowest literacy level; however, this percentage ranges from 10% in Carroll and Frederick counties to 38% in Baltimore City.

Chapter 185 of 2002 that required the Maryland State Department of Education (MSDE) to distribute competitive grants for adult education services according to the State plan for adult education and family literacy. MSDE was required to develop and submit the methodology for determining the need and cost of adult education instruction to the Legislative Policy Committee by September 15, 2002. MSDE presented a method to calculate the adult education state appropriation to the Legislative Policy Committee on November 15, 2002. MSDE recommended that an asset to needs determination be used to calculate the annual funding appropriation for adult education. Due to the State's current fiscal condition, MSDE recommended that the funding method be phased in over five years and then re-evaluated.

State Funding for Adult Education Services

State funding for adult education services totals \$2.4 million in fiscal 2003 and 2004 and federal funding totals approximately \$6.6 million in fiscal 2003 and \$8.2 million in fiscal 2004. The State's support for adult education totals approximately \$45 per student, which is lower than any state along the East Coast. State funding totals \$132 per student in Virginia and \$610 per student in Delaware. **Exhibit 1** shows the level of State and federal funding for adult education by program and **Exhibit 2** shows the level of State funding in relation to other states on the East Coast.

Exhibit 1
State and Federal Funding for Adult Continuing Education
Fiscal 2003 and 2004

State Funding	<u>FY 2003</u>	<u>FY 2004</u>
Adult General Education	\$161,703	161,703
External Diploma Program	281,070	281,070
Literacy Works Grant	810,829	810,829
Bridge to Excellence Funds	1,100,020	0
Adult Education and Literacy Works	0	1,100,020
<i>Subtotal – State Funding</i>	\$2,353,622	\$2,353,622
Federal Funding		
Adult Education – State-Administered Basic Grant Program	\$6,595,172	\$8,173,185
Total Funding	\$8,948,794	\$10,526,807

Exhibit 2
State Funding for Adult Education Services – Fiscal 2001

<u>State</u>	<u>Total Funding</u>	<u>Per Student Funding</u>	<u>State</u>	<u>Total Funding</u>	<u>Per Student Funding</u>
Florida	\$240,579,467	\$602	Maine	\$4,100,000	\$418
New York	104,300,000	538	West Virginia	2,743,941	122
Massachusetts	37,000,000	1,506	Washington D.C.	2,500,000	884
North Carolina	30,504,068	197	New Jersey	2,448,000	55
Pennsylvania	17,979,000	384	Vermont	2,419,927	546
South Carolina	16,333,227	123	Delaware	2,000,000	610
Georgia	10,000,000	93	Maryland	1,253,000	45
Connecticut	7,920,000	286	New Hampshire	500,000	91
Virginia	4,124,106	132	Rhode Island	450,000	57

Source: MSDE Survey of States, U.S. Department of Education

Economic Impact of Adult Education Services

Individuals who leave school without a high school diploma pay a substantial penalty throughout their lives. About 16% of the State's adult population do not have a high school diploma. A family headed by a high school dropout earned about 50% less than a family headed by an individual with a high school diploma. Over 50% of current public assistance recipients were dropouts and only 11% of dropouts were able to find a full-time job paying more than a poverty wage.

State Fiscal Effect: MSDE presented a report to the Legislative Policy Committee on November 15, 2002 outlining the need for additional State investment in adult education and literacy programs. According to the report, approximately 50,300 individuals in Maryland are in need of adult education and literacy services. The report assumed that 100 hours is the minimum number of instructional hours required to make significant progress in literacy skills during a semester and that the average instructional cost totals \$10.70 an hour or \$1,070 for 100 hours of instruction.

While employers benefit when their employees gain basic skills that enable them to work more effectively, it is assumed that relatively few employers would take advantage of this income tax subtraction modification since the actual tax savings is relatively low when compared to the overall cost of an adult education class. The income tax subtraction modification would primarily benefit businesses or individuals that already provide adult education and literacy services to their employees.

For purposes of the fiscal note, it is assumed that 500 individuals would receive adult education and literacy services from their employer as a result of the income tax subtraction modification. This represents approximately 1% of the total number of Marylanders in need of adult education and literacy services. As shown in **Exhibit 3**, State general fund revenues could decrease by \$26,900, State TTF revenues could decrease by \$3,100, and local revenues could decrease by \$9,000. In sum, State and local revenues could decrease by about \$39,100 annually. This estimate is based on the following assumptions:

- 500 individuals would receive adult education and literacy services annually;
- average annual cost for adult education and literacy services is \$1,070 per person;
- 50% of the claims would be against individual income taxes and 50% would be against corporate income taxes; and

- 76% of corporate income tax revenues are distributed to the State general fund, and 24% are distributed to the TTF. Of the 24% distributed to the TTF, 30% goes to local jurisdictions in the form of local highway user revenues.

Exhibit 3
Potential Impact on State and Local Revenues From Subtraction Modification

	<u>Individual Income Tax</u>	<u>Corporate Income Tax</u>	<u>Total</u>
Individuals Receiving Instruction	250	250	500
Average Cost Per Individual	\$1,070	\$1,070	\$1,070
Employer Cost for Instruction	\$267,500	\$267,500	\$535,000
State Income Tax Rate	4.75%	7.00%	
Aggregate Local Income Tax Rate	2.88%	0.00%	
State Cost Per Individual	\$50.83	\$69.51	
Local Cost Per Individual	\$30.82	\$5.39	
Impact on State GF Revenues	\$12,706	\$14,231	\$26,937
Impact on State TTF Revenues	\$0	\$3,146	\$3,146
Impact on Local Revenues	\$7,704	\$1,348	\$9,052
Total State and Local Impact	\$20,410	\$18,725	\$39,135

Small Business Effect: Both national and State employers indicate that they have a need for increased basic skills in their workers. The *American Management Association's Annual Survey of Workplace Testing* found that 36% of job applicants tested by major U.S. firms in 1998 lacked the reading and math skills to do the job they sought. This is up from 23% in 1997 and 19% in 1996. Employers overwhelmingly reported increased profits and other bottom line benefits when their employees gained basic skills that enabled them to work more effectively. Benefits reported included improved work quality, better team performance, improved capacity to cope with change and ability to use new technology, and a reduction in errors and waste.

While employers benefit from adult education and literacy programs, it is assumed that relatively few employers would take advantage of this income tax subtraction modification since the actual tax savings is relatively low when compared to the overall cost of an adult education class. The income tax subtraction modification would

primarily benefit businesses or individuals that already provide adult education and literacy services to their employees.

Additional Information

Prior Introductions: None.

Cross File: SB 562 (Senator Middleton – Budget and Taxation) is designated as a cross file but the two bills are substantially different. SB 562 incorporates a completely different approach in providing adult education and literacy services.

Information Source(s): Maryland State Department of Education, Department of Legislative Services

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