

Department of Legislative Services
 Maryland General Assembly
 2005 Session

FISCAL AND POLICY NOTE
Revised

House Bill 529

(Delegate Hixson, *et al.*)

Ways and Means

Budget and Taxation

Income Tax - Credit for Providing Adult Literacy Programs

This bill creates an adult literacy services tax credit program for a business or nonprofit organization that provides adult literacy services to its employees. The bill establishes an application and certification procedure and creates a reserve fund to which the Governor can appropriate funds in fiscal 2007, 2008, and 2009. The amount of credits that the State Superintendent can award in each of these fiscal years cannot exceed the lesser of \$2 million or the amount of money in the fund.

The bill takes effect July 1, 2005.

Fiscal Summary

State Effect: General fund expenditures could increase by \$2 million annually in FY 2007, 2008, and 2009 due to appropriations to the reserve fund. General fund expenditures would also increase by approximately \$63,300 in FY 2006, which includes one-time tax form changes and computer programming expenditures and administrative costs at the Maryland State Department of Education (MSDE). General fund revenues could increase by approximately \$120,000 annually in FY 2007 through 2009 and Transportation Trust Fund (TTF) revenues would decrease by a corresponding amount due to reserve fund transfers for credits claimed against the corporate income tax.

(\$ in millions)	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF Revenue	\$0	\$.1	\$.1	\$.1	\$0
SF Revenue	0	(.1)	(.1)	(.1)	0
GF Expenditure	.1	2.0	2.0	2.0	0
Net Effect	(\$.1)	(\$2.0)	(\$2.0)	(\$2.0)	\$0

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

Local Effect: If 25% of the credits were claimed against the corporate income tax, local highway user revenues would decrease by approximately \$36,000 annually in FY 2007 through 2009.

Small Business Effect: Minimal.

Analysis

Bill Summary: The value of the credit is equal to the lesser of: (1) 35% of the cost of adult literacy instruction provided by the business to its employees; (2) \$150 per employee that receives adult literacy instruction; or (3) \$25,000. A taxpayer claiming the credit can claim a refund in the amount by which the credit exceeds the tax liability in the tax year.

Taxpayers seeking the tax credit in each year must submit an application to the State Superintendent between April 1 and October 31 for the fiscal year that begins on July 1 of the year. The Superintendent would award an initial credit certificate between July 1 and December 31 of each fiscal year to each approved application based on the amount of estimated adult literacy expenditures. The Superintendent is to award credits based on “need and performance.” A maximum of 50% of the total initial credit certificates issued in a fiscal year can be allocated for projects located in one county or Baltimore City. The Superintendent would issue a final credit certificate based on the actual qualifying adult literacy expenditures incurred during the year.

The bill creates an adult literacy services tax credit reserve fund. The total amount of initial credit certificates issued by the Superintendent in each fiscal year cannot exceed the lesser of \$2 million or the amount appropriated to the reserve fund in the State budget. The bill states that the Governor may appropriate money to the reserve fund in fiscal 2007, 2008, and 2009. The bill does not require or specify a recommended amount that is to be appropriated to the fund. The Governor may not reduce an appropriation to the reserve fund that is approved by the General Assembly. For each fiscal year, if funds are transferred from the reserve fund as a result of any law, the amount of total credits that can be approved by the Superintendent is reduced by the amount of money transferred. Any amount of money in the fund that is not expended in the fiscal year can be rolled over into the next fiscal year.

Within 15 days of each calendar quarter, the Superintendent is required to notify the Comptroller the total number of credits that were certified during the quarter, the total amounts of the maximum credit amount stated in the initial credit certificates, and the total amounts of final certified credit amount. Upon this notification from the Superintendent, the Comptroller is required to transfer from the reserve fund to the

general fund the total amounts stated in the final credit certificates that were certified during the calendar quarter.

By October 1 of each year the Superintendent is required to (1) report to the Governor and the General Assembly on the administration of the tax credit; and (2) adopt regulations in order to carry out the provisions of the bill.

Current Law: No similar State tax credit of this type exists.

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 who have not earned a high school diploma or lack the skills to speak English well. Current adult education programs serve between 36,000 and 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 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 submit a methodology for determining the need and cost of adult education instruction to the Legislative Policy Committee by September 15, 2002. In its presentation to the committee, MSDE recommended that existing funding for adult education be compared to current needs to calculate an annual State appropriation. Using this approach, MSDE estimated that an additional \$36.1 million would be needed to serve all individuals currently receiving or seeking services. Due to the State's fiscal condition, MSDE recommended that the funding method be phased in over five years and then re-evaluated.

State funding for adult education services totals \$2.4 million in fiscal 2005, and federal funding totals approximately \$7.4 million. The proposed fiscal 2006 State budget includes a stable amount of funding from both sources. **Exhibit 1** shows the fiscal 2005 and 2006 levels of State and federal funding for adult education, by program.

Exhibit 1
State and Federal Funding for Adult Continuing Education
Fiscal 2005 and 2006

State Funding

Adult General Education	\$161,703
External Diploma Program	281,070
Literacy Works Grant	810,829
Adult Education and Literacy Works	<u>1,100,020</u>
<i>Subtotal – State Funding</i>	\$2,353,622

Federal Funding

Adult Ed – State-Administered Basic Grants	<u>\$7,448,618</u>
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Total Funding **\$9,802,240**

Source: *Maryland Operating Budget Book, Fiscal Year 2006*

MSDE advises that there were 4,925 individuals on adult education waiting lists as of December 31, 2004. Budget language in the 2004 *Joint Chairmen’s Report* expressed the General Assembly’s concern about the number of individuals on the waiting list for adult education services and required MSDE to submit a proposal for an ongoing adult education funding method by November 15, 2004. MSDE requested an extension in December 2004 and was given until March 15, 2005 to submit the proposal.

State Fiscal Effect:

Appropriations to the Reserve Fund

The bill provides that the Governor can appropriate funds to the reserve fund in fiscal 2007, 2008, and 2009. The bill does not require or suggest an amount that should be appropriated. The bill does state, however, that the Superintendent may not award more than \$2 million in credits in each fiscal year. Assuming a fully funded and viable program, State expenditures would increase by \$2 million annually in fiscal 2007 through 2009.

Revenue Effects from Reserve Fund Transfers

The bill requires the Comptroller to transfer money from the reserve fund to the general fund an amount that is anticipated to offset credits that would be claimed during the fiscal

year. It is assumed that the maximum \$2 million in credits would be claimed in each fiscal year. Based on existing tax credits, it is estimated that one-quarter of credits earned would be claimed against the corporate income tax. Twenty-four percent of corporate income tax revenue is distributed to the TTF. All of the money transferred from the reserve fund by the Comptroller in anticipation of credits being claimed is to be deposited in the general fund and losses to the TTF would not be offset. As a result, it is estimated that general fund revenues would increase and TTF revenues would decrease by approximately \$120,000 annually in fiscal 2007 through 2009 due to money being transferred back to the general fund for tax credits claimed against the corporate income tax.

It is assumed that the amount of credit claimed in each tax year would be equal to the amount stated in the initial credit certificate so that credits claimed in each tax year would be offset by a transfer from the reserve fund. The final amount of the credit, however, could be less than the amount stated on the initial credit certificate if actual adult literacy expenses are less than the estimated expenditures stated on the approved application. To the extent final credit amounts for adult literacy services are less than the amount stated on the initial credit certificate, revenues could increase in these fiscal years.

It is also assumed that taxpayers claim the credit in the tax year that corresponds to the fiscal year in which the Comptroller transfers funds to the general fund on notification of a certified credit. To the extent that taxpayers claim the credit in a tax year after the fiscal year in which the transfer is made, general fund revenues could increase in earlier fiscal years and potentially decrease by a corresponding amount in later fiscal years. The extent of this lag, if any, cannot be reliably estimated at this time. This timing issue, however, does not alter the total cost of the bill.

Administrative Costs

The Comptroller's Office reports that it would incur a one-time expenditure increase of \$44,400 to add the tax credit to the personal income tax form. This includes data processing changes to the SMART income tax return processing and imaging systems, and system testing.

MSDE reports that it would incur a general fund expenditure increase of approximately \$24,200 in fiscal 2006 due to the hiring of a part-time contractual employee to administer the program. Legislative Services advises that the additional workload generated by the bill cannot be reliably estimated and depends on the amount of money, if any, appropriated to the program in each fiscal year. Assuming a viable program that is funded in each fiscal year, MSDE would be required to hire a part-time contractual employee to administer the program. General fund expenditures could increase by

approximately \$18,800 in fiscal 2006, which reflects a 3-month implementation time before applications could be first received in April 2006.

This estimate includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Salary and Fringe Benefits	\$17,224
Equipment	1,500
Operating Expenses	<u>150</u>
MSDE Expenditures	\$18,874
Comptroller's Expenditures	\$44,400
Total FY 2006 State Expenditures	\$63,274

Additional Information

Prior Introductions: None.

Cross File: SB 597 (Senator Kramer, *et al.*) – Budget and Taxation.

Information Source(s): American Management Association, U.S. Census Bureau, Maryland State Department of Education, Department of Legislative Services

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