

Department of Legislative Services
2010 Session

FISCAL AND POLICY NOTE

House Bill 952
Ways and Means

(Delegate Bates, *et al.*)

Great Preschools Tax Credit Program

This bill creates an income tax credit for contributions made by a business or individual to an eligible nonprofit organization that provides scholarships to children (1) whose family income is below specified income thresholds; and (2) who attend either a qualifying nonpublic school approved by the Maryland State Department of Education (MSDE) to provide prekindergarten program services, or a child care center. The tax credit may not exceed 50% of the State income tax for that year. The Comptroller’s Office is required to adopt regulations to implement the program and report specified information about the program to the Governor and the General Assembly by October 1 of each year.

The bill takes effect July 1, 2010, and applies to tax year 2010 and beyond.

Fiscal Summary

State Effect: Based on similar programs in other states, general fund revenues may decrease by \$10.5 million beginning in FY 2011 and Transportation Trust Fund (TTF) revenues may decrease by \$1.5 million annually. Revenue losses may be substantially higher. General fund expenditures increase by \$37,400 in FY 2011 due to one-time tax form and computer programming expenses at the Comptroller’s Office.

(\$ in millions)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
GF Revenue	(\$10.5)	(\$10.5)	(\$10.5)	(\$10.5)	(\$10.5)
SF Revenue	(\$1.5)	(\$1.5)	(\$1.5)	(\$1.5)	(\$1.5)
GF Expenditure	\$0	\$0	\$0	\$0	\$0
Net Effect	(\$12.0)	(\$12.0)	(\$12.0)	(\$12.0)	(\$12.0)

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

Local Effect: Local highway user revenues will decrease as a result of credits being claimed against the corporate income tax. Based on the assumptions above, local highway user revenues will decrease by an average of \$423,400 annually beginning in FY 2011. Expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Bill Summary: The bill creates a tax credit equal to the contributions made by a business or individual to an eligible nonprofit organization that provides scholarships to eligible lower-income children. The amount of the credit may not exceed 50% of the tax liability in the year, and any unused amount may be carried forward three tax years. There is no cap on the maximum value of the credit.

In order to qualify, the child's household income may not exceed an amount equal to 2.5 times the income standard used to qualify for a reduced price lunch under the National Free or Reduced Price Lunch Program.

A qualifying school is a State or nationally accredited child care center or nonpublic school approved by MSDE to provide prekindergarten program services. A qualifying school must (1) comply with all health and safety laws or codes that apply to nonpublic preschools; (2) hold a valid occupancy permit if required by the county or municipal corporation where the school is located; (3) certify that it will not discriminate in admissions; and (4) provide academic accountability to parents of the children.

The Comptroller's Office must maintain oversight of the program, including verifying that organizations are (1) distributing as scholarships a minimum of 90% of its total revenue; (2) eligible 501(c)(3) organizations; and (3) providing scholarships only to children who qualify.

Current Law: No similar tax credit exists, although businesses can deduct contributions for scholarships as charitable donations, which typically lowers federal and State income tax liability.

Background: Similar tax credit programs exist in several other states, including Arizona, Florida, Georgia, Iowa, Pennsylvania, and Rhode Island. A brief discussion on the programs in Pennsylvania and Arizona is provided below.

Pennsylvania

Act 4 of 2001 established Pennsylvania's Educational Improvement Tax Credit for businesses that contribute to eligible scholarship organizations at nonpublic schools or educational improvement organizations for "innovative programs" at public schools. Subsequent legislation has increased the annual amount of authorized credits from \$30 million to \$75 million. The credit is equal to 75% of the contribution made, not to exceed \$300,000 (\$150,000 for prekindergarten school contributions). The value of the credit can be increased to 90% of the contribution, if business agrees to provide same amount for two consecutive tax years. For contributions to prekindergarten scholarship organizations, a business may receive a tax credit equal to 100% of the first \$10,000 contributed and up to 90% of the remaining amount contributed – for a maximum credit of \$150,000 annually.

In fiscal 2008 and 2009, a total of \$75 million in credits were available under the program: \$44.7 million was allocated to scholarship organizations; \$22.3 million to improvement organizations; and \$8.0 million to prekindergarten scholarship organizations. The total amount of credits was reduced to \$60.0 million in fiscal 2010 and \$50.0 million in fiscal 2011. All of the credits are typically awarded in each fiscal year.

Arizona

In 1997, Arizona enacted two education-related tax credits. An individual may claim a credit for making contributions or paying fees to a public school for support of extra curricular activities or character education programs. The maximum credit is \$200 for individuals (\$400 for joint filers). An individual may also claim a credit for making a donation to a qualified organization that provides scholarships for students attending nonpublic schools. The maximum credit for individuals is \$500 (\$1,000 for joint filers).

In tax year 2007, 204,000 taxpayers claimed a total of \$95 million in credits. Of this amount, 76,000 taxpayers donated a total of \$54.3 million to 55 private scholarship organizations in calendar 2007. The average donation was \$714. Scholarship organizations awarded 27,153 scholarships in calendar 2007 (the number of students could be less as multiple scholarships can be awarded to a student). Of the \$556 million in credits that have been awarded in the 10 years of the program, \$263 million (42%) has been claimed for donations to nonpublic schools. Both of the credits are available for K-12 education only.

In 2006, Arizona enacted a credit that allowed corporations to claim credits for contributions to qualifying scholarship organizations. A maximum amount of \$10 million in credits may be awarded in fiscal 2007. This limit will increase by 20%

annually, totaling \$20.7 million in fiscal 2011. In fiscal 2009, \$10.8 million in credits were awarded.

Income Threshold for Qualifying Students

Under the National Free or Reduced Price Lunch Program, children from families with incomes below specified thresholds are eligible for free or reduced priced school meals. **Exhibit 1** lists the qualifying income for a reduced lunch in effect from July 1, 2009 to June 30, 2010, and the income threshold that cannot be exceeded in order for a family to qualify for the tax credit under the bill.

Exhibit 1
Qualifying Income Threshold – National Free or Reduced Price Lunch Program

<u>Family Size</u>	<u>Reduced Lunch</u>	<u>Income Threshold under the Bill</u>
1	\$20,036	\$50,090
2	26,955	67,388
3	33,874	84,685
4	40,793	101,983
5	47,712	119,280

State Revenues: Tax credits can be claimed beginning in tax year 2010. Based on existing programs in other states and the value of the credit, State revenues may decrease by at least \$12 million annually. This estimate is based on the personal income tax credit in Arizona (available for K-12 education only) and corporate income tax programs in Pennsylvania (which allows contributions for preK organizations), adjusted for differences between existing programs and the program proposed by the bill and factors that influence charitable giving and differences in population and economic activity in Maryland and these states.

The credit is limited by the taxpayer's tax liability, but unused amounts can be carried forward. As a result, revenue losses are likely to be greater beginning in fiscal 2012 as taxpayers claim credits carried forward from previous tax years.

In addition, the bill provides a substantial incentive to make a qualifying contribution and claim a credit. Taxpayers can make contributions and claim a credit for up to 50% of the State income tax for that year in addition to deducting the contribution for federal and State income tax purposes. As a result of this incentive, revenue losses may be significantly higher than estimated.

It is also assumed that it is the intent of the bill to limit scholarships and tax credits to children in prekindergarten or child care programs. To the extent that under the bill tax credits are claimed on behalf of scholarships to children enrolled in grades K-12 at a school that offers prekindergarten programs, the revenue loss will be significantly higher than estimated.

State Expenditures: The Comptroller's Office reports that it would incur a one-time expenditure increase of \$37,400 in fiscal 2011 to add the credit to the personal income tax form. This amount includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

Additional Information

Prior Introductions: HB 603 of 2009 was not reported from the House Ways and Means Committee. HB 186 of 2008 received an unfavorable report from the House Ways and Means Committee.

Cross File: None.

Information Source(s): Arizona Department of Revenue, Pennsylvania Department of Revenue, Comptroller's Office, Maryland State Department of Education, Department of Legislative Services

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