

Department of Legislative Services
 Maryland General Assembly
 2010 Session

FISCAL AND POLICY NOTE

House Bill 1214 (Delegate Ross, *et al.*)
 Ways and Means

Equity in Education Funding Act of 2010

This bill requires education aid formulas that include a wealth component to be calculated twice, once using a net taxable income amount based on tax returns filed by September 1 and once using a net taxable income amount based on returns filed by November 1. Each local school system then receives the greater of the two calculations to the extent funding is provided in the State budget. Any federal funds provided for education through a federal stimulus package should be used to fund the new calculations if it is an eligible use of the funds. The bill also alters the disparity grant formula to calculate annual State aid amounts based on net taxable income from returns filed by November 1 rather than August 15.

The bill takes effect July 1, 2010, and applies to calculations of State aid beginning in fiscal 2012.

Fiscal Summary

State Effect: General fund expenditures for education aid increase by an estimated \$39.6 million in FY 2012 if funding is provided in the State budget to support the second aid calculation using a November 1 net taxable income drawdown date. Future year expenditure estimates reflect inflation and the estimated impact of increased State aid on teachers' retirement costs beginning in FY 2014. General fund expenditures for disparity grants could also increase, but that increase cannot be reliably estimated. Revenues are not affected.

(\$ in millions)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	0	39.6	42.0	48.9	52.7
Net Effect	\$0	(\$39.6)	(\$42.0)	(\$48.9)	(\$52.7)

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

Local Effect: Local school system revenues from direct State education aid increase by an estimated \$39.6 million in FY 2012. Approximately 19 school systems would receive additional aid in FY 2012, and no school systems would receive less funding. State aid from the disparity grants, which is allocated to county governments, could also increase beginning in FY 2012; however, disparity grants are capped at the FY 2010 levels.

Small Business Effect: None.

Analysis

Current Law: Disparity grants provide State aid to qualifying counties (and Baltimore City) that have less than 75% of the statewide per capita income wealth. Funding is determined through a formula that provides State aid to compensate for the local tax revenues that are not generated due to smaller income tax bases; however, funding levels for individual counties are capped at the amounts they received in fiscal 2010. The formula is based on income tax returns filed on or before August 15 of each year.

The majority of State education aid is distributed through formulas that allocate funding to the 24 local school systems inverse to local wealth per pupil. For the formulas, county (and Baltimore City) wealth includes net taxable income and the assessable property tax base. The net taxable income measure is based on returns filed on or before September 1 of each year.

The federal American Recovery and Reinvestment Act of 2009 (also referred to as the stimulus package) provided significant enhancements to federal education funding, including a new, one-time allocation of State Fiscal Stabilization Funds to be used in state fiscal 2010 and 2011. The majority of these funds were earmarked for education and could be used to support scheduled increases in state education aid formulas if the increases were enacted prior to October 1, 2008.

Background: Most people file their income tax returns each year by April 15, but federal and State laws allow for an automatic six-month extension of the filing deadline to October 15 for those who apply for the extension by April 15. An individual filing late must submit an estimated amount of taxes owed, but a county's net taxable income, as calculated by the Office of the Comptroller, only includes taxable income amounts for completed tax returns. Using data from income tax returns submitted by August 15 (as required for the disparity grants) or September 1 (education aid formulas) undercounts total net taxable income, since many returns are not submitted until the October 15 extension deadline.

In addition, the distribution of returns filed after August 15 or September 1 is not proportionate around the State. All counties have some residents who file their income tax returns late, but in general, wealthier individuals tend to file late more often. Thus, the distribution of county net taxable income changes from the August 15 and September 1 dates established in law to November 1, when nearly all returns have been filed. Using a later date provides a more complete representation of each county's wealth and tax capacity.

Exhibit 1
Tax Year 2008 Net Taxable Income by County
(\$ in Millions)

County	Returns Filed by			Share Filed After Nov. 1
	September 1	November 1	Increase	
Allegany	\$850	\$866	\$16	1.9%
Anne Arundel	12,196	13,439	1,243	9.2%
Baltimore City	6,787	7,382	595	8.1%
Baltimore	16,156	18,135	1,979	10.9%
Calvert	1,884	1,982	99	5.0%
Caroline	399	409	11	2.6%
Carroll	3,513	3,619	105	2.9%
Cecil	1,578	1,690	112	6.7%
Charles	2,664	2,780	116	4.2%
Dorchester	390	402	12	2.9%
Frederick	4,932	5,187	255	4.9%
Garrett	368	396	29	7.3%
Harford	4,882	5,102	221	4.3%
Howard	7,982	8,813	831	9.4%
Kent	318	345	27	7.9%
Montgomery	26,808	32,876	6,069	18.5%
Prince George's	12,242	12,724	482	3.8%
Queen Anne's	984	1,071	86	8.1%
St. Mary's	1,899	1,958	59	3.0%
Somerset	204	210	6	2.9%
Talbot	812	998	186	18.6%
Washington	2,171	2,248	77	3.4%
Wicomico	1,276	1,330	54	4.1%
Worcester	838	910	73	8.0%
Total	\$112,131	\$124,873	\$12,742	10.2%

Source: Comptroller's Office

The difference between tax year 2008 county net taxable income using a September 1, 2009 date and a November 1, 2009 date is shown in **Exhibit 1**. The chart shows that \$12.7 billion in taxable income (just over 10% of the total) was reported on returns filed

after September 1. However, the shares of taxable income reported after September 1 are very different around the State. Nearly one-fifth of county net taxable income was attributable to late filers in Montgomery (18.5%) and Talbot counties (18.6%), while 5% or less was attributable to late filers in 12 counties.

The State is using \$397 million in federal State Fiscal Stabilization Funds to support education aid formulas in fiscal 2010 and is anticipating the use of the remaining \$422 million in education stabilization funds for the same purpose in fiscal 2011.

State Expenditures:

Education Aid

General fund expenditures for direct State education aid increase by an estimated \$39.6 million in fiscal 2012 to pay counties the higher of the current law calculation using a September 1 net taxable income drawdown date or the recalculated amount using a November 1 calculation. The bill seems to establish the additional \$39.6 million as a discretionary amount that the Governor can choose to include in the budget in any amount up to the calculated figure. Any amount below the full funding level would be distributed proportionally to the counties that gain funding with the November 1 net taxable income date.

Future year general fund expenditure increases grow with inflation and projected changes in local wealth bases. By fiscal 2015, the additional spending for direct education aid could total an estimated \$48.0 million.

Increases in State education aid beginning in fiscal 2012 will also accelerate growth of teachers' retirement costs, which are paid by the State on behalf of local school systems. The majority of funding for local school systems supports personnel costs, so increasing State aid to school systems is likely to increase the number of new personnel hired by school systems or accelerate growth in the salaries of existing school staff. Either of these outcomes will increase the professional salary bases of local school systems and increase future retirement costs.

State payments for the teachers' retirement program are calculated using actual school system salary bases from the second prior fiscal year. Higher State aid levels beginning in fiscal 2012, therefore, will affect teachers' retirement payments beginning in fiscal 2014. The increases are estimated at \$4.1 million in fiscal 2014 and \$4.6 million in fiscal 2015.

Unless an additional federal stimulus plan is approved for fiscal 2012 or subsequent fiscal years, no federal funds will be available to support the additional spending proposed by the bill.

Disparity Grants

State aid under the disparity grants could also increase beginning in fiscal 2012. In fiscal 2011, calculating the formula using income tax returns filed by November 1 instead of August 15 would result in additional aid payments of \$24.4 million, which also represents the maximum increases qualifying counties can receive before achieving their capped grant levels. In future years, the impact of the change on State funding for disparity grants cannot be reliably estimated; however, funding will probably reach the maximum level of \$121.4 million in most years.

Administrative Costs

Under the bill, annual calculations of education aid will need to be done twice, once to reflect the current law September 1 net taxable income drawdown date and a second time to reflect the November 1 drawdown date. This will increase the workload for the Maryland State Department of Education and the Department of Budget and Management, the agencies responsible for computing the education aid formulas for inclusion in the annual State budget, and the Department of Legislative Services, which will have to determine the impact of any education aid adjustments proposed by the General Assembly under two different funding scenarios. It is believed, however, that the additional administrative work can be accomplished with existing personnel and resources.

Local Revenues: Revenues for local boards of education may increase by up to an estimated \$39.6 million in fiscal 2012 if full funding for the alternate calculation is provided. Approximately 19 local school systems will be eligible for additional State education aid. The additional amount is shown by local school system in **Exhibit 2**. Future year direct aid increases are estimated at \$42.0 million in fiscal 2013, \$44.8 million in fiscal 2014, and \$48.0 million in fiscal 2015.

In addition to increases in direct education State aid, State payments on behalf of local school systems for teachers' retirement will likely increase beginning in fiscal 2014. The increases are projected at \$4.1 million in fiscal 2014 and \$4.6 million in fiscal 2015.

State aid for counties (including Baltimore City) under the disparity grants may also increase beginning in fiscal 2012. Disparity grants are allocated to qualifying county governments, not the local boards of education. Any increases in State aid for local governments cannot be reliably estimated but could be significant for some jurisdictions.

Exhibit 2
Additional State Education Aid Provided Under HB 1214
Fiscal 2012
(\$ in Thousands)

<u>County</u>	<u>Bridge to Excellence Aid</u>			<u>HB 1214 Aid Difference from Sep 1 NTI</u>
	<u>Using Sep 1 NTI</u>	<u>Using Nov 1 NTI</u>	<u>HB 1214 (Higher of 2)</u>	
Allegany	\$77,129	\$78,163	\$78,163	\$1,034
Anne Arundel	287,480	290,230	290,230	2,750
Baltimore City	831,579	831,049	831,579	0
Baltimore	500,448	494,474	500,448	0
Calvert	83,178	84,231	84,231	1,053
Caroline	43,040	43,676	43,676	637
Carroll	137,711	139,834	139,834	2,122
Cecil	99,118	100,943	100,943	1,826
Charles	157,751	161,736	161,736	3,985
Dorchester	30,824	31,202	31,202	378
Frederick	213,989	215,970	215,970	1,981
Garrett	22,132	22,504	22,504	372
Harford	202,402	204,796	204,796	2,393
Howard	214,990	215,635	215,635	645
Kent	9,047	9,126	9,126	79
Montgomery	524,990	503,512	524,990	0
Prince George's	837,923	851,297	851,297	13,375
Queen Anne's	30,693	31,022	31,022	329
St. Mary's	94,290	95,652	95,652	1,362
Somerset	23,013	23,442	23,442	429
Talbot	10,766	10,766	10,766	0
Washington	151,246	154,188	154,188	2,942
Wicomico	116,798	118,746	118,746	1,948
Worcester	17,516	17,516	17,516	0
Total	\$4,718,052	\$4,729,712	\$4,757,694	\$39,642

NTI: Net taxable income
Source: Department of Legislative Services

Additional Information

Prior Introductions: HB 1094 of 2009 was withdrawn before a hearing was scheduled in the House Committee on Ways and Means.

Cross File: None.

Information Source(s): Department of Budget and Management, Maryland State Department of Education, Comptroller's Office, Maryland Association of Counties, Department of Legislative Services

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mlm/mwc

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