

Department of Legislative Services
2014 Session

FISCAL AND POLICY NOTE

Senate Bill 633

(Senator DeGrange, *et al.*)

Budget and Taxation

Maryland Education Credit

This bill creates a State income tax credit for 60% of the contributions made by a business or nonprofit organization to an eligible nonprofit organization that provides specified financial assistance to students at public or eligible nonpublic K-12 schools and pre-K programs. The amount of credits that the Department of Business and Economic Development (DBED) can award in each year cannot exceed the amount of money appropriated to a reserve fund established by the bill. The bill states that it is the intent of the General Assembly that the appropriation to the reserve fund may not exceed \$15 million in a fiscal year.

The bill takes effect July 1, 2014, and applies to tax year 2014 and beyond.

Fiscal Summary

State Effect: Potential significant general fund expenditure increase beginning in FY 2015. The amount of the expenditure increase depends on the amount of money, if any, appropriated to the reserve fund each year. If the credit is funded at \$15.0 million, general fund expenditures will increase by \$15.0 million annually. Administrative costs increase by \$179,300 in FY 2015 and by \$112,800 in FY 2019. Potential decrease in general fund expenditures for State education aid beginning in FY 2016.

(\$ in millions)	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	15.2	15.1	15.1	15.1	15.1
Net Effect	(\$15.2)	(\$15.1)	(\$15.1)	(\$15.1)	(\$15.1)

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

Local Effect: Local highway user revenues distributed from the Transportation Trust Fund will decrease as a result of credits claimed against the corporate income tax. Local income tax revenues increase beginning in FY 2015 due to the requirement that taxpayers add-back any amount of credit claimed. Local expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Bill Summary: The bill establishes a Maryland Education Tax Credit Reserve Fund. The total amount of initial tax credit certificates issued by DBED in each fiscal year cannot exceed the amount appropriated to the reserve fund in the State budget. The Governor may appropriate money to the reserve fund but the bill does not require an amount. The bill states that it is the intent of the General Assembly that any appropriation to the reserve fund may not exceed \$15 million. Any amount of money in the fund that is not expended in the fiscal year must be rolled over into the next fiscal year.

Credits can be claimed for monetary donations to student assistance organizations (SAOs). SAOs are nonprofit organizations that provide financial assistance to students attending eligible pre-K programs and K-12 schools. DBED can approve a maximum of 60% of the total amount appropriated to the reserve fund for donations to SAOs that provide financial assistance to students in eligible nonpublic programs and schools and 40% to SAOs that provide assistance to students in eligible public programs and schools. Qualified education expenses include elementary and secondary education expenses as defined in Section 530(B)(3)(5) of the Internal Revenue Code and include tuition and fees, academic tutoring, books and supplies, computer equipment or Internet access, transportation, special needs services, and required uniforms.

The value of the credit is equal to 60% of the eligible contribution, not to exceed \$200,000. Organizations claiming the credit are required to add back the amount of the contribution for which a credit is claimed to Maryland adjusted gross income or Maryland modified income.

SAOs seeking the tax credit must apply to DBED for each contribution it intends to make in the tax year; applications are approved on a first-come, first-served basis until the total cap for the year is reached. In order for a contribution to qualify for the tax credit, the contribution must be made to an organization approved by DBED. An eligible SAO must apply to DBED for approval in each year and submit other required information that verifies eligibility for the program.

DBED is required to (1) approve tax credit applications; (2) process SAO applications and publish an annual list of eligible SAOs; (3) adopt regulations to implement the bill; and (4) report specified information about the tax credit to the Governor and the General Assembly by January 10 of each year.

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

Background: According to the National Conference of State Legislatures, 13 states have established a tuition tax credit program as of July 1, 2013. These programs, also known as scholarship tax credit programs, allow individuals and corporations to allocate a portion of state taxes to private nonprofit school tuition organizations that issue scholarships to eligible students. The scholarship allows a student to choose among a list of private schools, and sometimes public schools outside of the district, approved by the school tuition organization. The scholarship is used to pay tuition, fees, and other related expenses. As a result, the state does not have to appropriate per pupil education funding for those students that receive scholarships. Of Maryland's surrounding states, Virginia and Pennsylvania offer similar tax credit programs.

State Fiscal Effect:

Appropriations to the Reserve Fund

The bill provides that the Governor may appropriate funds to the reserve fund but does not require an amount that should be appropriated. The bill does, however, state that it is the intent of the General Assembly that the amount appropriated to the fund not exceed \$15 million in a fiscal year. If the program is funded at this level, general fund expenditures will increase by \$15 million annually.

To the extent that the Governor provides less or no money to the reserve fund in any year, the increase in general fund expenditures will be less. However, there is no limit on the amount that can be appropriated to the reserve fund.

State Education Aid Impact

A portion of the credits that can be claimed are for contributions made to an eligible nonprofit organization that provides financial assistance to students at an eligible nonpublic K-12 school. To the extent that this financial assistance reduces public school enrollment beginning with the 2014-2015 school year, general fund expenditures for State education aid may decrease beginning in fiscal 2016. The actual amount of the decrease, if any, depends on the amount of credits that can be awarded in each fiscal year, the portion of credits that are for financial assistance for students attending nonpublic schools, and the amount of financial assistance that results in a public school student attending a nonpublic school.

Administrative Costs

General fund expenditures increase by \$179,300 in fiscal 2015 due to implementation costs at DBED and the Comptroller's Office, as described below.

DBED indicates it would need one administrator to implement and administer the program. General fund expenditures will increase by an estimated \$100,300 in fiscal 2015, which reflects the bill's July 1, 2014 effective date. This estimate includes a salary, fringe benefits, and ongoing operating expenses.

The Comptroller's Office reports that it will incur a one-time expenditure increase of \$79,000 in fiscal 2015 to add the credit to the personal and corporate income tax forms. This amount includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

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Salary and Fringe Benefits	\$95,330
Operating Expenses	<u>4,950</u>
DBED Expenditures	\$100,280
Comptroller Expenditures	<u>79,000</u>
Total FY 2015 Expenditures	\$179,280

Future year expenditures reflect a full salary with annual increases and employee turnover as well as annual increases in ongoing operating expenses.

Local Revenues: Local highway user revenues will decrease as a result of credits claimed against the corporate income tax. Local income tax revenues will increase due to the bill's add-back requirement. If \$15.0 million in credits are claimed in each year with 90% of this amount claimed against the corporate income tax, local income tax revenues may increase by \$46,500 annually and local highway user revenues will decrease by \$196,700 annually.

Additional Information

Prior Introductions: Similar legislation was introduced in the 2012 session. SB 844 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 1216, received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: HB 1262 (Delegate Mitchell, *et al.*) - Ways and Means.

Information Source(s): Department of Business and Economic Development, Maryland State Department of Education, Comptroller's Office, National Conference of State Legislatures, Department of Legislative Services

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