HB 1156

Department of Legislative Services

Maryland General Assembly
2022 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 1156 (Delegate Wivell, *et al.*)
Appropriations

Primary and Secondary Education - Education Savings Account Program - Established

This bill creates the Education Savings Account (ESA) program in the Maryland State Department of Education (MSDE) to provide grants to families to defray specified costs related to nonpublic schooling for eligible students. Participating students are included in the enrollment count used to calculate required State and local education aid for local school systems. The State must deposit specified portions of per pupil State and local education aid, depending on family income, in each participating student's account, with each local school system reimbursing the State for the local share deposited. The bill establishes a subtraction modification from State income tax for contributions to an eligible ESA, beginning in tax year 2022. **The bill takes effect July 1, 2022.**

Fiscal Summary

State Effect: General fund revenues decrease beginning as early as FY 2023 due to the subtraction modification for contributions to ESA accounts, but a reliable estimate is not feasible as discussed below. General fund expenditures increase, likely minimally, due to the inclusion of home-schooled students in public school enrollment counts, beginning in FY 2024; this is not reflected in the table below. General fund expenditures further increase beginning in FY 2023 to implement the ESA program (minimum administrative costs reflected below). **This bill increases a mandated appropriation beginning in FY 2024.**

(in dollars)	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
GF Revenue	(-)	(-)	(-)	(-)	(-)
GF Expenditure	$58,900	$68,800	$70,800	$72,700	$74,700
Net Effect	($-)	($-)	($-)	($-)	($-)

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

Local Effect: Local expenditures for public school aid increase, likely minimally, due to the inclusion of participating students who were previously home-schooled in enrollment counts beginning in FY 2024; revenues for local school systems increase commensurately. However, a portion of local per pupil revenues for public education is redirected to ESA accounts. **This bill imposes a mandate on a unit of local government.**

Small Business Effect: Potential Minimal.

Analysis

Bill Summary:

Eligible Students and Qualifying Schools

"Eligible students" means those eligible to enroll in a public school in Maryland and who attended a public, charter, or home school for at least 100 days in the immediately preceding fiscal year. It includes a student of an active-duty military member stationed in the State regardless of prior school attendance.

In order to qualify for an ESA grant, an eligible student's parent must sign an agreement with MSDE with specified provisions, including that participating children will take all assessments required by the State and that all funds provided by ESA will be used only for specified expenses.

The bill establishes educational, legal, and reporting requirements for "qualifying schools," which are defined as nonpublic schools that meet specified conditions. Resident school districts must provide a qualifying school or other specified providers with a complete copy of a student's record in compliance with federal law.

Contributions to Eligible Accounts

For students whose family income is less than or equal to 500% of the federal poverty level (FPL), the State must deposit into an ESA account, on a quarterly basis, 75% of the per pupil amount of State and local funds for each education program for which the student would be included in the resident school district. For students whose family income exceeds 500% of FPL, the contribution is 50% of per pupil education funding, also on a quarterly basis. Any funding deposited into an eligible student's ESA account must be deducted from the amount of State and local funds provided to the resident school district under the State's K-12 funding formulas. In 2021, the federal poverty threshold for a family of four was $27,479, making 500% of that level equal to $137,395. Actual thresholds used for the program will vary by the size of each participating family.

Any unused funds when the student achieves a high school diploma or is no longer enrolled in a qualifying school must be returned to the State.

Eligible Expenses

Parents of eligible students may use funds in the account only for the following expenses:

- tuition and fees at a qualifying school;
- textbooks or uniforms required by a qualifying school;
- private tutoring;
- the purchase of curriculum and instructional materials;
- tuition or fees for a nonpublic online learning program;
- fees for specified exams;
- education services from a licensed or accredited provider of services for students with special needs or disabilities;
- contracted education services provided at a public school;
- Internet service provider or online learning fees, if applicable; and
- any other expenses approved by MSDE.

Maryland State Department of Education Responsibilities

MSDE must qualify private financial management firms or similar entities to manage accounts and establish reasonable fees based on market rates. It may conduct or contract for the auditing of accounts, but at a minimum, a random sampling of accounts must be audited annually. MSDE must provide written notice to parents on eligible uses of funds, parental responsibilities, and duties of the department, and must develop regulations to implement the bill. MSDE may determine a parent to be ineligible based on misuse of funds.

Subtraction Modification

Parents of an eligible student may deposit additional funds to an account on a pre-tax basis. Any such contributions by a parent (but not by the program) are eligible for a subtraction modification in the calculation of Maryland adjusted gross income for the purpose of calculating State income tax payments.

Current Law:

State Aid to Education – Generally

The great majority of direct State aid to public schools (excluding teachers' retirement) is determined by funding formulas found in Title 5, Subtitle 2 of the Education Article. These funding formulas were originally set forth in the Bridge to Excellence in Public Schools Act (Chapter 288 of 2002); they were substantially altered and expanded by the Blueprint for Maryland's Future – Implementation (Chapter 36 of 2021). The formulas are in part based on three components. The first is a uniform base cost per pupil that is necessary to provide general education services to students in every school system. The second component involves adjustments for the additional costs associated with educating at-risk student populations, including special education students, students eligible for free and reduced-price meals, and English language learners. The third component is an adjustment that accounts for differences in the local costs of educational resources. Chapter 36 altered these formulas and established new formulas and programs to implement the final recommendations of the Commission on Innovation and Excellence in Education to provide a world-class education to Maryland students.

The majority of State education aid formulas also entail wealth equalization across counties, compensating for differences in local wealth by providing less aid per pupil to more wealthy counties and more aid per pupil to less wealthy counties. Although most State aid formulas are designed to have the State pay roughly one-half of program costs statewide, the State's share for the less wealthy counties is higher than 50%, and the State's share for more wealthy counties is lower than 50%.

Maryland 529 Plans

Qualified tuition plans, also known as 529 plans, are State programs that allow an individual to either prepay or contribute to an account established for paying a student's qualified education expenses at an eligible educational institution. The College Savings Plans of Maryland Board currently operates two qualified tuition plans: the Maryland Prepaid College Trust and the Maryland College Investment Plan. Chapter 548 of 2008 authorized the board to establish a third plan, the Maryland Broker-Dealer College Investment Plan, but the board has yet to do so.

The federal Tax Cuts and Jobs Act of 2017 (Public Law 115-97) was signed into law on December 22, 2017, and expands the permissible use of 529 plans by amending "qualified higher education expense" to include expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private, or religious school. An account holder can withdraw up to $10,000 in each year for expenses associated with enrollment at these schools.

A person may claim a subtraction modification for the advanced amount of tuition payments made to the Maryland Prepaid College Trust or amount contributed to the Maryland College Investment Plan. The subtraction modification claimed by a taxpayer may not exceed $2,500 for each contract purchased (Maryland Prepaid College Trust) or $2,500 per beneficiary (Maryland College Investment Plan). This limitation is increased to $5,000 for married individuals who file jointly. Any unused amount of the subtraction modification can be carried forward to future tax years until the full amount of the excess is used under the Maryland Prepaid College Trust and up to 10 tax years for contributions to the Maryland College Investment Plan. An investment plan account holder is not eligible for the subtraction modification for contributions to an investment account in any year in which the account holder receives funds under the State Contribution Program.

State Revenues: General fund revenues decrease due to the subtraction modification decreasing taxable income for some participating families, but a reliable estimate is not feasible. The number of participating families cannot be known in advance; moreover, it is not known what percentage of participating families will make their own tax-exempt contributions to ESAs in excess of contributions by the State and local school systems. As Maryland taxpayers can already claim a subtraction modification for contributions to 529 plans, which can also be used for eligible expenses related to nonpublic school enrollment, the number of families that also make contributions to ESAs may be limited. Families that wish to make contributions that exceed the caps on the subtraction modification for 529 plans are the most likely to also make contributions to ESAs so they can claim additional tax deductions.

State Expenditures: The bill requires that students who participate in ESAs have attended a public, charter, or home school for at least 100 days in the prior fiscal year. It takes effect July 1, 2022, which means the first year it impacts State (and local) education funding is fiscal 2024 because the fiscal 2024 formulas use the enrollment counts from the 2022-2023 school year. However, families may contribute to ESAs beginning in fiscal 2023, depending on when MSDE is able to get the program up and running.

State Education Funding

This analysis assumes that all students who participate in the ESA program in fiscal 2023 attended a public, charter, or home school for at least 100 days in the prior year and are included in the enrollment count for the (prior) 2021-2022 school year. With the exception of home-schooled students, this means that there is no change in State education aid for these students because they were counted in the prior year and are still counted in fiscal 2023.

However, participation in ESA is likely severely restricted by the bill's definition of "eligible student." Under the bill, a student may receive an ESA grant in a given year only if the student attended a public, charter, or home school for at least 100 days in the prior year. But to receive an ESA grant, the student must also agree to enroll in a nonpublic school. In short, participation in ESA one year disqualifies a student from participating the following year by virtue of being enrolled in a nonpublic school. It is possible that some students bounce in and out of public schools in order to qualify for ESA every other year, but more likely, parents choose not to participate if it means they have to pick up the full tuition cost of a private school after one year. This likely limits the fiscal effect on State aid formulas.

The bill's requirement that participating home-schooled students be (newly) included in student enrollment counts has the potential to increase general fund expenditures for education aid because home-schooled students are not otherwise included in enrollment counts, but the definition of "eligible student" also likely severely limits participation by home-schooled students. As with a student who previously attended a public school, a home-schooled student who enrolls in ESA must enroll in a nonpublic school (a home school is not a qualifying school), which renders that student ineligible to participate the following year. In all likelihood, most parents of home-schooled children elect not to enroll in the program if it means disrupting their child's education. Although there are at least 25,000 home-schooled students potentially eligible to be included in public school enrollment counts, the bill's definition of "eligible student" likely keeps the actual number of participating home-schooled students very low.

Education Savings Account Program

For participating students, the bill requires that (1) State contributions to eligible accounts be deducted from State education aid payments to local school systems and (2) local school systems reimburse the State for the local share of the contributions to eligible ESA accounts. Therefore, State and local funding for public schools *decreases* by the amount redirected to ESA accounts to offset expenditures for nonpublic schools. However, local school systems continue to receive either 25% or 50% of per pupil funding for students who are no longer enrolled (and for previously home-schooled students) because they are participating in ESA, so the net effect for local school systems is positive. It is assumed that there is no impact from local school systems reimbursing the State for the local share of the ESA contributions because the State will deduct the local share from the State aid that would otherwise have been distributed to the local school system, so no reimbursement is required.

A reliable estimate of the amount of State (and local) K-12 education funding that is redirected to ESA accounts is not feasible because it depends on at least four factors that cannot be known in advance: (1) the number of current public school students who elect to participate in the program; (2) the family income of the students who elect to participate; (3) the local school system in which each student is currently enrolled; and (4) whether the student qualifies for special services (*e.g.*, special education). Since the vast majority of students currently enrolled in nonpublic schools are not eligible to participate in ESA, current enrollment in nonpublic schools is not indicative or illustrative of the bill's potential effects.

Per pupil funding levels vary widely in the State. For fiscal 2021, combined State and local per pupil funding ranges from $14,264 in St. Mary's County to $19,202 in Worcester County, as shown in **Exhibit 1**. *For illustrative purposes only*, the exhibit shows the varying amounts of State and local per pupil payments that would be made to ESA accounts for each eligible student from families with incomes at or below 500% of FPL and those with incomes above that level. Thus, State and local contributions to eligible ESA accounts vary tremendously under the bill; without information on the number of students from each jurisdiction, or their family incomes, that elect to participate, a reliable estimate is not possible.

Exhibit 1
Estimated Payments to ESA Accounts
Fiscal 2023

	FY 2021 State and Local Per Pupil Funding	50% ESA Payment	75% ESA Payment
Allegany	$16,273	$8,136	$12,204
Anne Arundel	15,111	7,556	11,333
Baltimore City	16,707	8,354	12,531
Baltimore	15,754	7,877	11,816
Calvert	16,075	8,038	12,056
Caroline	15,721	7,861	11,791
Carroll	14,853	7,426	11,140
Cecil	14,891	7,446	11,168
Charles	16,076	8,038	12,057
Dorchester	16,379	8,190	12,284
Frederick	14,418	7,209	10,814
Garrett	15,623	7,812	11,717
Harford	14,706	7,353	11,030
Howard	17,224	8,612	12,918
Kent	17,612	8,806	13,209
Montgomery	17,276	8,638	12,957
Prince George's	17,188	8,594	12,891
Queen Anne's	14,611	7,306	10,959
St. Mary's	14,264	7,132	10,698
Somerset	18,516	9,258	13,887
Talbot	14,804	7,402	11,103
Washington	15,023	7,512	11,267
Wicomico	15,533	7,767	11,650
Worcester	19,202	9,601	14,401

ESA: Education Savings Account

Note: This estimate is based on fiscal 2021 funding; actual fiscal 2023 amounts would be based on fiscal 2022 funding.

Source: Department of Legislative Services

Due to the definition of "eligible student" a limited number of students may end up qualifying. If the definition were to change, or the interpretation of the definition were to allow students to remain eligible without returning to public school every other year, the number is likely significant. Assuming an average payment of about $10,000, the amount of public funds diverted to ESA accounts totals $1.0 million for every 100 students that participate.

Maryland State Department of Education Administrative Expenses

This estimate assumes very few students participate due to the definition of "eligible student" that limits participation as explained in greater detail above. However, it is assumed that at least a few students participate annually and that there are a significant number of inquiries about program participation.

Thus, general fund expenditures for MSDE increase by *at least* $58,935 in fiscal 2023, which accounts for a 90-day start-up delay from the bill's July 1, 2022 effective date. This estimate reflects the cost of hiring a fiscal specialist to manage the program, including developing regulations and application procedures, tracking contributions to the accounts and payments from the accounts, and ensuring compliance with statutory requirements, and to handle inquiries about eligibility for the program. It includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Position	1.0
Salary and Fringe Benefits	$51,592
Operating Expenses	7,343
Total FY 2023 MSDE Administrative Expenditures	**$58,935**

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

A more robust program with more eligible students may require additional administrative expenditures not reflected in this estimate.

The estimate does not include the cost of retaining a third party to administer the program or manage account assets, as it is assumed that any costs associated with third-party management is covered by an asset fee. This is consistent with the practice of Maryland's 529 plans and supplemental retirement plans, both of which use third-party program and asset managers that are reimbursed by fees based on a percentage of assets. Therefore, it is assumed that State funds are not used to retain a third-party manager.

Local Fiscal Effect: Local school system revenues increase by at least 25% of State and local per pupil funding for students who are no longer enrolled and for previously home-schooled students who participate in ESA. Local expenditures for public schools increase commensurately due to the addition of previously home-schooled students in the enrollment counts. The overall effect is expected to be minimal due to limited participation in ESA, as discussed above. A portion of local expenditures is redirected to ESA accounts instead of to local school systems.

Additional Information

Prior Introductions: HB 1113 of 2021, a similar bill, received a hearing in the House Appropriations Committee, but no further action was taken on the bill.

Designated Cross File: None.

Information Source(s): Caroline and Prince George's counties; Maryland Association of Counties; Comptroller's Office; Maryland State Department of Education; Department of Budget and Management; Baltimore City Public Schools; Prince George's County Public Schools; Department of Legislative Services

Fiscal Note History: First Reader - March 14, 2022
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