

Department of Legislative Services
 Maryland General Assembly
 2021 Session

FISCAL AND POLICY NOTE
 First Reader

House Bill 1113 (Delegate Wivell)
 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 or home schooling for eligible students. Eligible 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 eligible 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 2021. **The bill takes effect July 1, 2021.**

Fiscal Summary

State Effect: General fund revenues decrease beginning as early as FY 2022 due to the subtraction modification for contributions to ESA accounts, but a reliable estimate is not feasible as discussed below. General fund expenditures increase by approximately \$228.2 million in FY 2023 for State education aid due to the inclusion of home-schooled students in public school enrollment counts; out-years reflect anticipated growth in the number of home-schooled students and per pupil funding. General fund expenditures further increase beginning in FY 2022 to implement the ESA program. **This bill increases a mandated appropriation beginning in FY 2023.**

(\$ in millions)	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026
GF Revenue	(-)	(-)	(-)	(-)	(-)
GF Expenditure	\$0.37	\$228.62	\$240.05	\$252.04	\$264.64
Net Effect	(\$0.37)	(\$228.62)	(\$240.05)	(\$252.04)	(\$264.64)

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

Local Effect: Local expenditures for public school aid increase by approximately \$212.8 million beginning in fiscal 2023 due to the inclusion of home-schooled students in enrollment counts; 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: None.

Analysis

Bill Summary:

Eligible Students and Qualifying Schools

Eligible students are those 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 be eligible 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 (1) nonpublic schools that meet specified conditions and (2) home schools. 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, the State must deposit into an ESA account, on a quarterly basis, 25% 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 the federal poverty level, the contribution is 18.75% 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.

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.

MSDE 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 HB 1113/ Page 3

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 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 ESA have attended a public, charter, or home school for at least 100 days in the prior fiscal year. It takes effect July 1, 2021, which means the first year it impacts State (and local) education funding is fiscal 2023 because the fiscal 2023 formulas use the enrollment counts from the 2021-2022 school year. However, families may contribute to ESAs beginning in fiscal 2022, 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 2021-22 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. Further, these students can only participate in the ESA program for one year because the bill requires them to be enrolled in a public school for at least 100 days in the prior year in order to qualify for an ESA grant. Thus, if a student uses an ESA grant to pay tuition at a nonpublic school for more than 80 days in one school year, that student is not eligible to receive an ESA grant in the following year. These students may bounce in and out of the public school enrollments and ESA program in order to qualify, but parents are unlikely to want to move their children back and forth between schools so frequently that there is likely not a significant fiscal impact on State aid formulas.

However, home-schooled students are not currently included in enrollment counts. Therefore, the bill's requirement that home-schooled students be included in those counts increases general fund expenditures significantly. For the 2019-20 school year, MSDE

reports that there were approximately 27,750 students being home schooled. Assuming all families with home-schooled students choose to participate in the ESA program, and using the latest available data for enrollment (total home-schooled students has averaged around 27,400 annually in recent years) and per pupil funding amounts (for fiscal 2021), general fund expenditures increase by an estimated \$228.2 million in fiscal 2023, as shown in **Exhibit 1**. The number of students being home schooled in the current school year was not available in time for this analysis, but to the extent that it is substantially greater due to the COVID-19 pandemic and does not return to the previous average in fall 2021, State expenditures increase even more.

Unlike nonpublic school students, students who are home schooled may participate in consecutive years. Thus, out-year expenditures increase by at least 5% annually assuming the ESA program results in more home-schooled students each year and annual increases in per pupil funding.

Exhibit 1
Increase in State and Local Education Aid Due to Home-schooled Students

	FY 2021 Local Per Pupil Funding	FY 2021 State Per Pupil Funding	2019 Home-schooled Students	FY 2023 Local Aid	FY 2023 State Aid
Allegany	\$4,022	\$12,251	314	\$1,262,759	\$3,846,845
Anne Arundel	9,237	5,875	2,825	26,093,147	16,596,332
Baltimore City	3,816	12,891	1,445	5,514,156	18,628,145
Baltimore	7,949	7,805	3,765	29,928,069	29,387,270
Calvert	9,009	7,066	725	6,531,655	5,122,802
Caroline	2,929	12,792	373	1,092,485	4,771,464
Carroll	8,181	6,672	1,276	10,439,066	8,513,020
Cecil	6,071	8,820	961	5,834,354	8,476,051
Charles	7,517	8,559	1,072	8,058,718	9,174,899
Dorchester	4,517	11,862	185	835,622	2,194,521
Frederick	7,035	7,383	2,270	15,969,959	16,759,574
Garrett	8,069	7,554	172	1,387,928	1,299,230
Harford	7,577	7,129	808	6,122,463	5,760,188
Howard	11,018	6,206	1,318	14,521,926	8,179,581
Kent	10,710	6,903	82	878,181	566,006
Montgomery	11,160	6,116	2,914	32,520,425	17,823,001
Prince George's	6,382	10,806	3,177	20,275,691	34,329,780
Queen Anne's	8,511	6,100	349	2,970,396	2,128,960
St. Mary's	6,550	7,715	1,177	7,708,940	9,080,090
Somerset	3,828	14,689	208	796,155	3,055,240

	FY 2021 Local Per Pupil Funding	FY 2021 State Per Pupil Funding	2019 Home-schooled Students	FY 2023 Local Aid	FY 2023 State Aid
Talbot	10,164	4,640	194	1,971,839	900,104
Washington	4,881	10,142	1,199	5,852,836	12,159,768
Wicomico	3,290	12,243	671	2,207,311	8,215,386
Worcester	14,779	4,423	274	4,049,347	1,211,892
Total	\$7,977	\$8,395	27,754	\$212,823,427	\$228,180,148

Source: Maryland State Department of Education; Department of Legislative Services

ESA 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 and home schooling. However, local school systems continue to receive at least 75% of per pupil funding for students who are no longer enrolled (and for 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, current enrollment in nonpublic schools is not indicative or illustrative of the bill's potential effects.

Per pupil funding levels vary tremendously 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 2**. *For illustrative purposes only*, Exhibit 2 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

the federal poverty level and 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, but is likely significant. Assuming an average payment of about \$3,500, the amount of public funds diverted to ESA accounts totals \$3.5 million for every 1,000 students that participate.

Exhibit 2
Estimated Payments to ESA Accounts
FY 2023

	FY 2021 State and Local Per Pupil Funding	25% ESA Payment	18.75% ESA Payment
Allegany	\$16,273	\$4,068	\$3,051
Anne Arundel	15,111	3,778	2,833
Baltimore City	16,707	4,177	3,133
Baltimore	15,754	3,939	2,954
Calvert	16,075	4,019	3,014
Caroline	15,721	3,930	2,948
Carroll	14,853	3,713	2,785
Cecil	14,891	3,723	2,792
Charles	16,076	4,019	3,014
Dorchester	16,379	4,095	3,071
Frederick	14,418	3,605	2,703
Garrett	15,623	3,906	2,929
Harford	14,706	3,677	2,757
Howard	17,224	4,306	3,230
Kent	17,612	4,403	3,302
Montgomery	17,276	4,319	3,239
Prince George's	17,188	4,297	3,223
Queen Anne's	14,611	3,653	2,740
St. Mary's	14,264	3,566	2,675
Somerset	18,516	4,629	3,472
Talbot	14,804	3,701	2,776
Washington	15,023	3,756	2,817
Wicomico	15,533	3,883	2,912
Worcester	19,202	4,800	3,600

Source: Department of Legislative Services

MSDE Administrative Expenses

General fund expenditures for MSDE increase by \$374,041 in fiscal 2022, which accounts for a 90-day start-up delay from the bill’s July 1, 2021 effective date. This estimate reflects the cost of hiring a program manager, two program specialists, a fiscal services specialist, and an administrative officer 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. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	5.0
Salaries and Fringe Benefits	\$346,135
Operating Expenses	<u>27,906</u>
Total FY 2022 MSDE Expenditures	\$374,041

Future year expenditures reflect full salaries with annual increases and employee turnover and ongoing operating expenses.

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 (counties and Baltimore City) expenditures increase by approximately \$212.8 million in fiscal 2023 and increasing in future years as discussed above. Local school system revenues increase by at least 75% of State and local per pupil funding for students who are no longer enrolled and for home-schooled students because they are participating in ESA.

Additional Information

Prior Introductions: None.

Designated Cross File: None.

Information Source(s): Anne Arundel, Baltimore, Charles, Frederick, Montgomery, and Somerset counties; Comptroller's Office; Maryland State Department of Education; Department of Budget and Management; Baltimore City Public Schools; Baltimore County Public Schools; Montgomery County Public Schools; Prince George's County Public Schools; Department of Legislative Services

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