

Department of Legislative Services
Maryland General Assembly
2023 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 649
Appropriations

(Delegate Wivell, *et al.*)

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 county reimbursing the State for the local share deposited. The bill establishes a subtraction modification from the State income tax for contributions to an eligible ESA, beginning in tax year 2023. **The bill takes effect July 1, 2023.**

Fiscal Summary

State Effect: General fund revenues decrease beginning as early as FY 2024 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 participating home-schooled students in public school enrollment counts, beginning in FY 2025. **This bill increases a mandated appropriation beginning in FY 2025.**

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 2025; 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 student” means a student 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; a home school program is not a qualifying school. 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 enrollment count. 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 2023, the federal poverty threshold for a family of four is \$30,000, making 500% of that level equal to \$150,000. 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 beginning in fiscal 2024 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 the ESA program have attended a public, charter, or home school for at least 100 days in the prior fiscal year. It takes effect July 1, 2023, which means the first year it impacts State (and local) education funding is fiscal 2025 because the fiscal 2025 formulas use the enrollment counts from the 2023-2024 school year. However, families may contribute to ESAs beginning in fiscal 2024, 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 2024 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) 2022-2023 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 2024.

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 children’s education. Although there are at least 44,000 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) counties 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 *per pupil funding* effect for local school systems is positive, even if total funding decreases.

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 2023, combined State and local per pupil funding ranges from \$15,377 in Carroll County to \$21,454 in Baltimore City, as shown in **Exhibit 1**. *For illustrative purposes only*, the exhibit shows the variation in the amounts of State and local per pupil payments that may 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. The per pupil funding levels are for fiscal 2023, so actual amounts in fiscal 2024 will vary somewhat. Moreover, these amounts represent the average per pupil expenditures based on the number of students eligible for different weighted payments based on their educational needs. Actual amounts paid will vary based on the specific programs for which each participating student qualifies. Thus, State and local contributions to eligible ESA accounts vary tremendously under the bill; without

information on the number of students from each jurisdiction that elect to participate, their family incomes, or their educational needs, a reliable estimate is not possible.

Exhibit 1
Estimated Payments to ESA Accounts
Fiscal 2024

	FY 2023		
	State and Local	50%	75%
	<u>Per Pupil Funding</u>	<u>ESA Payment</u>	<u>ESA Payment</u>
Allegany	\$17,545	\$8,772	\$13,159
Anne Arundel	16,707	8,353	12,530
Baltimore City	21,454	10,727	16,091
Baltimore	17,245	8,622	12,934
Calvert	17,124	8,562	12,843
Caroline	16,678	8,339	12,509
Carroll	15,377	7,688	11,532
Cecil	15,384	7,692	11,538
Charles	17,101	8,551	12,826
Dorchester	18,886	9,443	14,165
Frederick	15,730	7,865	11,798
Garrett	17,072	8,536	12,804
Harford	16,647	8,323	12,485
Howard	18,895	9,447	14,171
Kent	19,003	9,502	14,253
Montgomery	18,392	9,196	13,794
Prince George's	18,483	9,241	13,862
Queen Anne's	15,780	7,890	11,835
St. Mary's	15,505	7,753	11,629
Somerset	21,226	10,613	15,920
Talbot	16,327	8,164	12,245
Washington	16,058	8,029	12,043
Wicomico	17,218	8,609	12,913
Worcester	20,899	10,450	15,674

ESA: Education Savings Account

Note: This estimate is based on fiscal 2023 funding; actual fiscal 2024 amounts will vary somewhat.

Source: Department of Legislative Services

Due to the definition of “eligible student” a limited number of students may qualify. 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

MSDE incurs costs to manage the program and conduct annual audits of ESA accounts. As the bill requires MSDE to establish reasonable fees based on market rates, MSDE envisions covering these costs through a modest fee on ESA accounts, including costs associated with hiring a third-party administrator to manage the program and paying for the annual audits. 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, there is no net cost to MSDE for administrative expenses.

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 (reimburse the State for) ESA accounts instead of to local school systems.

Additional Information

Prior Introductions: Similar legislation has been introduced within the last three years. See HB 1156 of 2022 and HB 1113 of 2021.

Designated Cross File: None.

Information Source(s): Comptroller’s Office; Maryland State Department of Education; Department of Budget and Management; Baltimore City Public Schools; Anne Arundel County Public Schools; U.S. Department of Health and Human Services; Department of Legislative Services

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