HB 849

Department of Legislative Services

Maryland General Assembly
2004 Session

FISCAL AND POLICY NOTE

House Bill 849 (Delegate Gordon, *et al.*)
Ways and Means

Tax Incentives and Benefits - Credits and Subtraction Modifications

This bill converts specified credits against the State income tax to subtraction modifications.

The bill takes effect July 1, 2004 and applies to tax year 2004 and beyond. The bill does not affect any credits claimed on or after July 1, 2004 if the taxpayer claiming the credit qualified for the credits before July 1, 2004.

Fiscal Summary

State Effect: General fund revenue increase of approximately $14.3 million and Transportation Trust Fund (TTF) revenue increase of approximately $866,644 in FY 2005, which reflects the impact of one-half tax year and estimated accelerated credits taken. Future year increases reflect an increasing amount of subtractions being claimed as well as future sunset provisions. Expenditure increase due to tax form changes by approximately $129,000 in FY 2005.

($ in millions)	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
GF Revenue	$14.3	$40.8	$44.8	$45.7	$45.1
SF Revenue	.9	2.3	2.7	2.6	2.0
SF Expenditure	.1	0	0	0	0
Net Effect	$15.0	$43.1	$47.5	$48.3	$47.0

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

Local Effect: Revenue increase of approximately $65,578 in FY 2005, $47,351 in FY 2006, $93,432 in FY 2007, and $35,735 in FY 2008. Revenue decrease of approximately $165,615 in FY 2009.

Small Business Effect: Minimal.

Analysis

Bill Summary: The bill converts the following income tax credits to subtraction modifications:

- **Enterprise Zone Credit:** Businesses located in a Maryland enterprise zone may be entitled to a tax credit for wages paid to newly hired employees. The local enterprise zone administrator must certify the business to qualify for the credit. The credits are based on the wages paid during the taxable year to each qualified employee.

- **Job Creation Tax Credit:** Businesses that expand or establish a facility in Maryland resulting in the creation of new positions in the State may be entitled to a tax credit. The amount of the tax credit is based on the number of positions created or on the wages paid to the new employees. The credit allowed depends on where in Maryland the facility is located. If the facility is located in a revitalization area, the credit is the lesser of $1,500 multiplied by the number of employees hired to fill the new positions, or 5% of the wages paid to employees hired to fill the new positions. If the facility is not located in a revitalization area, the credit is reduced to the lesser of $1,000 multiplied by the number of employees hired to fill the new positions, or 2.5% of the wages paid to employees hired to fill the new positions. Half of the amount of the allowable credit is claimed in the first year and the remaining half in the following taxable year. The total credit earned by any one company may not exceed $1 million for any credit year. If the credit is more than the tax liability, the unused credit may be carried forward for the next five tax years.

- **One Maryland Economic Development Credit:** Businesses that establish or expand a business facility in a priority funding area or as part of a project approved by the Board of Public Works, and that are located in a "distressed" Maryland county, may be entitled to a tax credit for costs related to the new or expanded facility. A "distressed" county has an average rate of unemployment that is 150% higher than the statewide average or an average per-capita personal income that is equal to or less than 67% of the statewide average. The credit for start-up costs is the lesser of 100% of eligible start-up costs (up to $500,000), less any credits taken in prior years, or $10,000 multiplied by the number of employees that have filled the newly created, qualified positions. The credit for project costs is the lesser of 100% of eligible project costs (up to $5 million), less any credits taken in prior years, or the State income tax liability for the taxable year from the project. No credit may be claimed against the insurance premium tax for the first year or for the next four years after the project is placed in service. If the credit is more than the tax liability, the unused credit may be carried forward for the next 14 tax years. At any time after the fourth tax year following the tax year in which the project is placed in service, but before the expiration of the fifteenth year, the business may apply the excess credit to nonproject-related taxable income. Excess unused credits may be refunded. If the majority of the positions created are paid at 250% or more of the minimum wage and the first notice of intent to seek certification is filed with the Department of Business and Economic Development as of July 1, 2002, the excess credit may be used against the tax on nonproject income or refunded two years earlier. For any tax year, the total of any refund claimed for the project cost credit and the amounts used against the taxpayer's nonproject Maryland tax liability for that credit may not exceed State and local taxes that must be withheld from the newly hired employees. For the start-up cost credit, the amount to be refunded may not exceed the State and local taxes required to be withheld from the newly hired employees.

- **Neighborhood Partnership Program:** Businesses that contribute cash or goods to approved projects operated by tax-exempt organizations (under Internal Revenue Code Section 501(c)(3)) are eligible for a tax credit of up to $125,000 per year. This credit is in addition to any charitable contribution deduction that is allowed for these contributions on both the State and federal income tax returns. The credit is 50% of the value of the donation, up to $125,000 per year. Total contributions eligible for the tax credits for all approved projects may not be more than $2 million per fiscal year. If the credit is more than the tax liability, the unused credit may be carried forward for the next five tax years.

- **Work-based Learning Program Credit:** Businesses that hire students as part of an approved work-based learning program in the State may be entitled to a tax credit for a portion of the wages paid to these individuals. The credit sunsets June 30, 2004. The credit is 15% of the wages paid to each student during the taxable year. Cumulative credits for all years cannot exceed $1,500 per student. If the credit is more than the tax liability, the unused credit may be carried forward for the next five tax years.

- **Commuter Tax Credit:** Maryland-based businesses that provide commuter benefits for employees may be entitled to a tax credit for a portion of the amounts paid during the taxable year. Commuter benefits include certain costs for an employee's travel to and from home and the workplace, a Guaranteed Ride Home program, or a parking "Cash-Out" program. The tax credit is 50% of the cost of providing the commuter benefits up to a maximum of $50 per month (based on a $100 employer contribution) for each employee. The credit may not exceed the Maryland tax due for a particular tax year. If the credit is more than the tax liability, the unused credit may not be carried forward to any other taxable year.

- **Tax Credit for Qualified Ex-felons:** A business entity may claim a tax credit for wages paid to a qualified ex-felon employee. For each taxable year, a credit is allowed in an amount equal to: (1) 30% of up to the first $6,000 of the wages paid to the qualified ex-felon employee during the first year of employment; and (2) 20% of up to the first $6,000 of the wages paid to the qualified ex-felon employee during the second year of employment. A tax-exempt organization may apply the credit against income tax due on unrelated business taxable income or for the payment to the Comptroller of taxes that the organization is required to withhold from the wages of employees. The credit sunsets December 31, 2004.

- **Maryland-Mined Coal Credit:** A co-generator, a public service company, or an electricity supplier that purchases coal mined in Maryland may be eligible for a tax credit. The credit is $3 per ton of Maryland-mined coal purchased during the taxable year. If the credit is more than the tax liability, the unused credit may not be carried forward to future taxable years.

- **Water Quality Improvement Credit:** A credit may be claimed for the additional commercial fertilizer costs necessary to convert agricultural production to a certified nutrient management plan. The credit allowed is equal to 50% of the certified additional commercial fertilizer costs necessary to convert agricultural production to a nutrient management plan. The credit may be claimed for up to three consecutive years, may not exceed $4,500 in any tax year, and may not be earned for any tax year beginning on or after January 1, 2009. If the credit is more than the tax liability, the unused credit may be carried forward for the next five tax years.

- **Employer-provided Long-term Care Credit:** Employers who provide long-term care insurance as part of an employee benefit package may claim a credit for costs incurred. The credit allowed is 5% of the costs. The total claimed for a taxable year for all employees may not exceed $5,000, or $100 per employee, whichever is less. If the credit is more than the tax liability, the unused credit may be carried forward for the next five tax years.

- **Long-term Care Insurance Credit:** Purchasers of a long-term care insurance contract for themselves or for certain members of their family may be eligible for a credit of up to $500 for each insured. The credit is 100% of the premium paid for each long-term care contract during the tax year. Each credit cannot exceed certain amounts based on the age of the insured. The maximum credit for 2002 is as follows: ages 40 or less – $240; ages 41 to 50 – $450; and ages 51 and over – $500.

- **Research and Development Credit:** Businesses that incur qualified research and development expenses in Maryland are entitled to a tax credit. The total credits for all businesses may not exceed $6 million per year. There are two types of research and development tax credits available to businesses. The *Basic Research and Development Credit* is equal to 3% of the Maryland qualified research and development expenses paid during the tax year, up to the Maryland base amount. The *Growth Research and Development Credit* is equal to 10% of the Maryland qualified research and development expenses paid during the year that exceed the Maryland base amount. The Maryland base amount is the average annual gross receipts of the business for the four preceding tax years multiplied by a fixed-base percentage. For most businesses, the fixed-base percentage is the percentage that Maryland research and development expenses for the preceding four tax years is of total gross receipts for those years. If the credit is more than the tax liability, the unused credit may be carried forward for the next 15 tax years.

- **Green Buildings Credit:** Businesses that construct or rehabilitate a building that conforms to specific standards intended to save energy and to mitigate environmental impact may take a credit for a portion of the cost. The total amount of credits certified for all taxpayers each year (calendar 2003 through 2011) is subject to certain limitations. Credits will be allowed for amounts spent on or after July 1, 2001. This credit will be available for tax years beginning after December 31, 2002. Allowable costs may not exceed in the aggregate: $120 per square foot for that portion of the building that is owner occupied, and $60 per square foot for that portion of the building that comprises the tenant space. The credit is the sum of four credit components. *Building credit component:* A percentage of the allowable costs paid by the owner or tenant to make some portion of the building "green." Each credit is limited by a dollar amount per square foot. For a whole building, 8% of the allowable costs paid for or incurred by the owner or tenant, as outlined: <u>base building</u> (areas not intended to be occupied) – 6% of the allowable costs; allowable costs may not exceed $120 per square foot; the maximum credit amount is $7.20 per square foot for the area that comprises the base building; <u>tenant space</u> – 6% of the allowable costs; allowable costs may not exceed $60 per square foot; the credit cannot be claimed by the owner if the owner occupies less than 10,000 square feet of the building or by the tenant if the tenant occupies less than 5,000 square feet; the maximum credit amount is $3.60 per square foot. *Fuel cell credit component:* 30% of the costs paid by the owner or tenant to purchase and install a fuel cell in a green whole building, base building, or tenant space. The credit cannot exceed $1,000 per kilowatt hour of capacity and is reduced by nontaxable government grants used to purchase and install the fuel cell. *Photovoltaic module credit component:* 25% (20% if building-integrated) of the cost paid by an owner or tenant to purchase and install a photovoltaic module in a green whole building, base building, or tenant space. The costs used to determine the credit amount cannot exceed $3 per watt of capacity, and are reduced by nontaxable government grants used to purchase and install the modules. The credit cannot be taken if the Clean Energy Incentive Credit has been claimed for the installation of the photovoltaic modules. *Wind turbine component:* 25% of the cost to purchase and install wind turbines that qualify as alternative energy sources and will serve a green whole building, base building, or tenant space. The total amount of credits approved for all taxpayers in each year is also subject to certain limitations. If the credit is more than the tax liability, the unused credit may be carried forward for the next 10 tax years.

- **Clean Energy Incentive Tax Credit:** Individuals who purchase and install solar water heating property or photovoltaic property may be entitled to income tax credits for property placed in service after June 30, 2000 and before January 1, 2005. There are separate calculations for each credit depending on the type of property purchased. For photovoltaic property, the credit equals the lesser of 15% of the total installed cost or $2,000 for each system; for solar water heating property, the credit equals the lesser of 15% of the total installed cost or $1,000 for each system.

- **Quality Teacher Incentive Credit:** Public school teachers who pay tuition during the tax year for graduate-level courses to maintain certification may be entitled to an income tax credit. An individual must be employed by a local board of education and be a classroom teacher in a public school, must hold a standard professional certificate or an advanced professional certificate, and must have completed one or more graduate-level courses with a grade of B or better. The courses taken must be required to maintain certification and the cost of the courses must exceed any amount reimbursed by the county. The credit is 100% of the unreimbursed amount of tuition paid, or $1,500, whichever is less. A credit of up to $1,500 is allowed for each individual. On a joint return, up to $3,000 is allowed if each spouse qualifies for the credit.

- **Preservation and Conservation Easements Credit:** Donors of a perpetual easement to the Maryland Environmental Trust or the Maryland Agricultural Land Preservation Foundation may be entitled to an income tax credit. An easement must preserve open space, natural resources, agriculture, forest land, watersheds, significant ecosystems, view sheds, or historic property. The credit is the difference between the value of the property before and after the donation, less any amounts received for the easement. For any taxable year, each owner is entitled to a credit equal to the lesser of $5,000 or the State income tax for that year. If the credit is more than the tax liability, any unused credit may be carried forward for up to 15 years, subject to $5,000 or State income tax limitations.

- **Aquaculture Oyster Float Credit:** A taxpayer who purchases an aquaculture oyster float on or after July 1, 2002 may be entitled to a credit of up to $500. An aquaculture oyster float is designed to grow oysters to help restore the oyster population in certain bodies of water.

- **Maryland Disability Employment Tax Credit:** Businesses that hire people with disabilities may be entitled to a tax credit for wages paid to the employees and for child care and transportation expenses paid on behalf of the employees. A person with a disability includes a veteran released from the armed forces for a service-related disability. The credit is allowed for the first two years of employment of the disabled individual for both the wages paid and the child care or transportation expenses paid on behalf of the employee. For the first year, 30% of the first $6,000 of wages paid for a maximum allowable credit of $1,800 (20% for employees hired before July 1, 2000) and up to $600 of expenses paid for child care and transportation expenses. For the second year, 20% of the first $6,000 of wages for a maximum allowable credit of $1,200 and up to $500 of expenses paid for child care and transportation expenses. If the credit is more than the tax liability, the unused credit may be carried forward for the next five tax years.

- **Employment Opportunity (Work, Not Welfare Credit):** Businesses that hire an individual who is receiving Family Investment Program entitlements may be entitled to a tax credit for wages paid to the employee and child care and transportation expenses paid on behalf of the employee. The credit is allowed for the first two years of employment of the individual for both the wages paid and the child care or transportation expenses paid on behalf of the employee. For the first year, 30% of the first $6,000 of wages paid for a maximum allowable credit of $1,800 (20% for employees hired before July 1, 2000) and up to $600 of expenses paid for child care and transportation expenses. For the second year, 20% of the first $6,000 of wages for a maximum allowable credit of $1,200 and up to $500 of expenses paid for child care and transportation expenses. If the employee has been a recipient of temporary cash assistance for any 18 months during the last 48 months and is employed by the business for a full year, the credit increases to 40% of the first $10,000 of wages paid to the employee. The credit for child care or transportation expenses may also be taken for the first and second years as shown above. If the credit is more than the tax liability, the unused credit may be carried forward for the next five tax years.

Finally, the bill repeals provisions of current law that authorize claiming the credits against the public service company franchise tax and the insurance premiums tax.

Background: Prior to 1995, with the exception of the Earned Income Credit, tax credits were not a significant feature of Maryland income tax policy. Other than the Earned Income Credit and the credits allowed for withholding and estimated tax payments and for income tax paid to another state, the only credits allowed were the Enterprise Zone Wage Credit and the Maryland-Mined Coal Credit. Since 1995, however, there has been considerable legislative activity regarding income tax credits, with over 30 new credits enacted as shown in **Exhibit 1**.

Exhibit 1
Tax Credits under the Maryland Income Tax

Primarily Individual Credits

Earned income credit (1987)
Neighborhood preservation (1996)
Heritage rehabilitation (1996)
Installment sales/other state (1997)
Refundable Earned Income Credit (1998)
Poverty level credit (1998)
Child/dependent care credit (1999)
Teacher advanced education (1999)
Long-term care premiums (2000)
Photovoltaic/solar property (2000)
Preservation/conservation easements (2001)
Arts & Entertainment District (2001)
Aquaculture oyster float (2002)

Primarily Business Credits

Enterprise Zone Wage (1982)
Maryland-mined coal (1987)
Work, not Welfare (1995)
Job Creation (1996)
Neighborhood Assistance (1997)
New/Expanded Business Premises (1997)
Telecommunications Utility Operating Real Property (1997)
Disabled employees (1998)
Employer-provided long-term care (1998)
Student work-based learning program (1998)
Commercial fertilizer costs (1998)
Employer-provided commuter benefits (1999)
One Maryland Economic Development (1999)
Electric Generating Utility Operating Real Property (1999)
Multijurisdictional Electric Company Headquarters (1999)
Qualified energy resources (2000)
Research and Development (2000)
Green building credits (2001)
Employment of Qualified Ex-felons (2002)

Source: Department of Legislative Services

State Revenues: General and special fund revenues increase by approximately $15.0 million in fiscal 2005. In fiscal 2005, only credits earned after July 1, 2004 are affected by the provisions of the bill, resulting in one-half tax year savings. In addition, it is estimated that 10% of the credits that would have been earned in the second half of tax year 2004 will be accelerated before July 1, 2004 in anticipation of lower benefits received by a taxpayer from a subtraction modification. Future fiscal year savings reflect annualization and estimated number of subtractions being claimed. Changing existing State income tax credits to subtraction modifications will reduce the State revenue loss associated with the tax credits. While State revenues will be reduced by the subtraction modifications, the overall effect will be a revenue savings. Income tax credits reduce State revenues in the amount of the credit claimed on tax returns. Subtraction modifications reduce State revenues by the tax rate multiplied by the amount of the subtraction claimed.

It is estimated that the total amount of earned tax credits for those referenced in the bill would total approximately $41.7 million in tax year 2004. **Appendix 1** shows the estimated amounts of income tax credits that will be earned for tax years 2003 through 2008.

Appendix 2 shows the estimated impact on State and local revenues of changing the income tax credits described above to subtraction modifications.

State Expenditures: The Comptroller's Office reports that in order to have both the credits allowed under existing law and subtraction modifications proposed by the bill on the tax year 2004 forms, it would incur a one-time expenditure increase of approximately $129,000 in fiscal 2005. This includes data processing changes to the SMART income tax return processing and imaging systems, and systems testing.

The Comptroller's Office also reports that it would incur a one-time expenditure increase of $265,800 in fiscal 2006 in order to eliminate the credits on the tax year 2005 form as proposed by the bill. Legislative Services advises that removal of the credits could be handled with existing resources and offset through the reduction in data verification requirements.

Local Revenues: Revenues increase by approximately $65,578 in fiscal 2005, $47,351 in fiscal 2006, $93,432 in fiscal 2007, and $35,735 in fiscal 2008. Revenue decrease of approximately $165,615 in fiscal 2009. Local revenues would increase as a result of credits no longer being claimed against the corporate income tax. Local revenues would decline as a result of subtraction modifications being taken against the personal and corporate income tax and flowing through to reduce local tax liability. Finally, local revenues would decline as a result of the Maryland-Mined Coal Credit no longer being claimed against the public service franchise tax but instead as a subtraction modification proposed under the bill.

Additional Information

Prior Introductions: HB 1084 of 2003, a similar bill, was not reported from the House Ways and Means Committee.

Cross File: None.

Information Source(s): State Department of Assessments and Taxation, Comptroller's Office, Department of Legislative Services

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Appendix 1
Estimated Income Tax Credits Claimed Under Current Law

	TY 2003	TY 2004	TY 2005	TY 2006	TY 2007	TY 2008
Enterprise Zone	$600000	$700000	$800000	$900000	$1000000	$1100000
Job Creation	1500000	1600000	1700000	1800000	950000	
One Maryland	1200000	1200000	1200000	1200000	1200000	1200000
Neighborhood Partnership Program	2000000	2000000	2000000	2000000	2000000	2000000
Work-Based Learning	60000	30000				
Commuter Benefits	250000	300000	350000	400000	450000	500000
Employers that Hire Ex-Felons	4000	4000	2000			
Maryland-Mined Coal	1300000	1444876	1502671	1562778	1625289	1690301
Water Quality	0	0	0	0	0	0
Employer-Provided Long-term Care Insurance	2200	2300	2400	2500	2600	2700
Employment Opportunity	400000	400000	400000	400000	400000	400000
Maryland Disability Employment	15000	15000	15000	15000	15000	15000
Businesses That Create New Jobs	0	0	0	0	0	0
Long-Term Care Insurance	6400000	7,400,000	8,300,000	9,100,000	9,800,000	10,400,000
Research and Development	1000000	2000000	3000000	4000000	2000000	0
Green Buildings	0	3000000	3000000	4000000	5000000	4000000
Clean Energy Incentives	100000	120000				
Quality Teacher Incentive	6,200,000	7,200,000	8,200,000	9,200,000	10,200,000	11,200,000
Conservation Easements	400000	420000	440000	460000	480000	500000
Neighborhood Stabilization	700000	700000	700000	700000	700000	700000
Oyster Floats	120000	120000	120000	120000	120000	120000
Maryland-Mined Coal PSF Tax	12,500,000	13,003,885	13,524,040	14,065,001	14,627,602	15,212,706
Total	**$34,751,200**	**$41,660,061**	**$45,256,111**	**$49,925,279**	**$50,570,491**	**$49,040,707**

Appendix 2
Impact on State and Local Revenues

	FY 2005**	FY 2006	FY 2007	FY 2008	FY 2009
Current Law*					
Personal	$18,670,750	$20,995,193	$23,339,636	$24,156,127	$24,872,602
PSF	13,003,885	13,524,040	14,065,001	14,627,602	15,212,706
Corporate	10,394,879	10,463,122	12,180,903	11,557,172	8,835,958
Total	**$42,069,514**	**$44,982,355**	**$49,585,540**	**$50,340,901**	**$48,921,266**
GF Loss	39,574,743	42,471,206	46,662,123	47,567,180	46,800,636
TTF Loss	2,494,771	2,511,149	2,923,417	2,773,721	2,120,630
Local TTF Loss	748,431	753,345	877,025	832,116	636,189
Personal	460,450	1,062,572	1,175,165	1,203,837	1,235,718
Corporate	382,235	795,349	918,398	852,877	657,852
Total	**$842,684**	**$1,857,921**	**$2,093,563**	**$2,056,714**	**$1,893,570**
GF Loss	750,948	1,667,037	1,873,147	1,852,024	1,735,686
TTF Loss	91,736	190,884	220,416	204,690	157,884
Local TTF Loss	$27,521	57,265	66,125	61,407	47,365
Local Income Tax Loss	281,117	648,728	717,469	734,974	754,438
Total Local Loss	**$308,637**	**705,994**	**783,593**	**796,381**	**801,804**
Total	**$15,985,122**	**$43,124,434**	**$47,491,977**	**$48,284,187**	**$47,027,696**
General Funds	14,275,793	40,804,168	44,788,976	45,715,156	45,064,951
Special Funds	866,644	2,320,266	2,703,001	2,569,031	1,962,745
Local	65,578	47,351	93,432	35,735	(165,615)

* Reflects current law tax year losses as illustrated in Appendix 1, adjusted required addition modifications.
** Reflects half-year savings realized by July 1, 2004 effective date and estimate that 10% of credits will be accelerated.