Department of Legislative Services

Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
Third Reader

Senate Bill 1112 (The President)(By Request - Departmental - Commerce)
Budget and Taxation Ways and Means

Income Tax - Aerospace, Electronics, or Defense Contract Tax Credit Program

This departmental bill creates a tax credit against the State income tax for a business that is certified by the Department of Commerce (DOC) as operating a qualifying aerospace, electronics, or defense contract (AEDC) tax credit project. DOC may award a maximum of $7.5 million in tax credits in each year to a business that is certified as meeting the requirements of the program.

The bill takes effect July 1, 2016, and terminates June 30, 2021.

Fiscal Summary

State Effect: General fund revenues decrease by $6.0 million annually in FY 2017 through 2021. Transportation Trust Fund (TTF) revenues decrease by $1.1 million annually and Higher Education Investment Fund (HEIF) revenues decrease by $0.5 million annually in FY 2017 through 2021. General fund expenditures increase by $32,000 in FY 2017 due to implementation costs at the Comptroller's Office.

($ in millions)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
GF Revenue	($6.0)	($6.0)	($6.0)	($6.0)	($6.0)
SF Revenue	($1.5)	($1.5)	($1.5)	($1.5)	($1.5)
Expenditure	0	0	0	0	0
Net Effect	($7.5)	($7.5)	($7.5)	($7.5)	($7.5)

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

Local Effect: Local highway user revenues distributed from the corporate income tax decrease by $105,100 annually in FY 2017 through 2021. Local expenditures are not affected.

Small Business Effect: The Department of Commerce has determined that this bill has a meaningful impact on small businesses (attached). The Department of Legislative Services concurs that the bill may have a meaningful impact, as discussed below.

Analysis

Bill Summary: DOC may certify a project as an AEDC tax credit project if the business entity that operates the project creates or retains at least 10,000 qualified positions and expends at least $25.0 million in qualifying expenditures during a credit year.

A qualified business operating an AEDC tax credit project that is certified by DOC can claim an income tax credit equal to $250 multiplied by the number of qualified employees employed during the credit year, subject to a maximum value of $2.5 million. If the amount of the credit exceeds the tax liability in the taxable year, the business can claim a refund in the amount of the excess. DOC may certify a business for up to three qualifying projects in a fiscal year and a maximum of $7.5 million in tax credits in the taxable year.

A qualified position (1) is full-time and of indefinite duration; (2) has an annual salary of at least $85,000, including benefits; (3) is located in the State; (4) is filled for at least 12 months; and (5) is newly created or retained as a result of the AEDC tax credit project. Qualified expenditures are capital expenditures that have been or will be expended by the qualified business and that DOC determines meets the requirements of the program.

A qualified business must apply to DOC and the application must include information with respect to the project on (1) a new contract executed by the business entity for the provision of goods or services in connection with the contract; (2) the number of qualified positions to be created or retained; and (3) a budget for the project that includes the amount of qualified expenditures that the applicant pledges to expend. DOC must certify a business as a qualified business entity within 60 days of receiving an application.

The Comptroller must recapture the credit if the business does not maintain a minimum number of specified jobs over certain time periods.

Current Law/Background: Businesses can generally deduct capital expenditures and employment costs, which typically lowers federal and State income tax liabilities. In addition, businesses may qualify for employment and investment tax credits such as the job creation, One Maryland, and enterprise zone tax credits.

The Governor's proposed fiscal 2017 budget includes a fiscal 2016 general fund deficiency appropriation of $20 million under the Economic Development Opportunities Program Fund (Sunny Day Fund). The described use of the deficiency appropriation is to "invest in aerospace and defense research" in the State and is intended to provide a retention incentive for Northrop Grumman's mission systems facility in Linthicum. Funds would be allocated in equal installments over four years and the company would be required to commit to a capital investment of at least $100 million and the retention of at least 10,000 employees within the State. The incentive does not anticipate the creation of any new jobs. According to DOC, the recipient would be held to the performance benchmarks for 10 years after the first disbursement of funds. Before any funds are allocated, the deficiency appropriation must be approved by the Legislative Policy Committee.

State Revenues: DOC may award to a qualified business entity up to three AEDC tax credit project designations in a fiscal year with a maximum credit value for each project of $2.5 million in a taxable year. Under the assumption that DOC awards the maximum annual amount of credits in tax years 2016 through 2020, general fund revenues will decrease by $6.0 million annually in fiscal 2017 through 2021. Over the same period, TTF revenues decrease by $1.1 million annually and HEIF revenues decrease by $450,000 annually.

State Expenditures: The Comptroller's Office reports that it will incur a one-time expenditure increase of $32,000 in fiscal 2017 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.

Small Business Impact: DOC advises that the bill will have a direct impact on capital spending and job creation among major contractors, but it may also lead to spillover effects and create positive impacts on small firms as well. The Department of Legislative Services notes that the primary beneficiary of the proposed tax credit, Northrop Grumman, is not a small business. Any benefit to small businesses from retaining the corporation's business activities or from indirect economic impacts must also consider the additional commitment of Sunny Day funds and the potential negative impacts on small businesses from reductions in State spending that may result from the proposed tax credit.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Department of Commerce, Governor's Office, Department of Legislative Services

Fiscal Note History: First Reader - March 14, 2016
md/jrb

Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510

ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: **Department of Economic Competitiveness and Commerce – Aerospace, Electronics, or Defense Contract Tax Credit Program**

BILL NUMBER: SB 1112

PREPARED BY: Mikra Krasniqi, Economist, Department of Commerce

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

___ WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND SMALL BUSINESS

OR

__X__ WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS

This bill creates a tax incentive that will have a direct impact in capital spending and job creation among major contractors, but it may also lead to spillover effects and create positive impact on small firms as well. The business value generated here is achieved through subcontracting. Major aerospace and defense entities routinely subcontract certain services to other firms, including small businesses that may or may not be directly related to aerospace and defense industry. In total, there were 2,252 defense subcontracts to 500 companies based in Maryland generating more than $1 billion in 2015. The share of these subcontractors equals 7.6% of prime contracts awarded to subcontractors. While not all of these subcontractors are small businesses, they include a broad array of products and services such as engineering services, building construction, supply and equipment manufacturers and distributors, computer programming, and repair services.

One such company is Worcester County-based, Hardwire Armor Systems, which was founded in 2000 and employed about 34 workers as of June 2015. *Hardwire* manufactures a variety of armor and protection ranging from Improvised Explosive Devices (IEDs) to E-glass panels to the Defense Logistics Agency during operations in Iraq.

Another similar small firm is ***Land Sea Air Autonomy*** based in Westminster, Carroll County. LSA Autonomy provides services to major defense contractors by fabricating and integrating a wide range of products in robotics, autonomous systems, and other response and surveillance solutions.

Mid Atlantic Data Systems is a small Information Technology services company in Gaithersburg and supplies ADP and IT services to defense contractors and received $908,195 as a subcontractor

in FY15. The amount of their contracts has grown significantly since 2011. Mid Atlantic has xx employees and has grown. ***Tag Engineering*** is a small manufacturer in Baltimore County that has supplied navigational instrument and storage device manufacturing services to defense prime contractors. Tag Engineering has 54 employees.
Avnet Systems is a small engineering services company in Baltimore that has provided electrical components to defense prime contractors. In FY15 the company received over $2 million in subcontracts.

These companies provide an example of small Maryland-based firms directly involved in aerospace and defense industries, but there are more firms that sell related products and services ranging from computer systems design to engineering services that operate in an extended network of suppliers, consultants, researchers, and service providers in these industries.