Department of Legislative Services

Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 738 (Senator Edwards, *et al.*)
Budget and Taxation

Economic Development - Maryland Economic Development Program and One Maryland Tax Credit

This bill establishes the Maryland Economic Development Program under which a qualified business located in a specified business or industrial park in the State is eligible for 10 years of property, income, and sales tax benefits. The bill also establishes the Rural Economic Development Program Infrastructure Fund to issue grants to 8 eligible counties for specific capital purposes; the Governor must appropriate $5.0 million annually in the operating or capital budget from fiscal 2018 through 2022 to the fund. The definition of "qualified distressed county" for purposes of the One Maryland Tax Credit Program is altered to permanently remove eligibility for counties which become ineligible for any period of time.

Fiscal Summary

State Effect: General and special fund revenues decrease significantly beginning in FY 2017 from tax incentives, most of which is anticipated to be from the general fund, and a relatively limited portion of which may be offset by the change to the One Maryland program. General obligation bond (GO) or general fund pay-as-you-go (PAYGO) expenditures increase by at least $5.0 million annually from FY 2018 through 2022; special fund revenues and expenditures increase correspondingly for the Department of Economic Competitiveness and Commerce (DOC). General fund expenditures for the Comptroller increase by $208,500 beginning in FY 2017. **This bill establishes a mandated appropriation beginning in FY 2018.**

($ in millions)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
GF Revenue	(-)	(-)	(-)	(-)	(-)
SF Revenue	(-)	$5.0	$5.0	$5.0	$5.0
GF Expenditure	$0.2	$0.3	$0.3	$0.3	$0.3
SF Expenditure	$0	$5.0	$5.0	$5.0	$5.0
PAYGO GF exp	$0	$5.0	$5.0	$5.0	$5.0
Net Effect	($0.2)	($5.3)	($5.3)	($5.3)	($5.3)

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

Local Effect: Local income tax revenues decrease by about 3% of the total net State subtraction modification claimed beginning in FY 2017. Local real and personal property tax revenues decrease beginning in FY 2018 from property tax exemptions taken by qualified businesses. Further, local highway user revenues potentially decrease beginning in FY 2017 from reduced corporate income tax (CIT) revenue, which may be partially offset by increased CIT revenue due to the change to the One Maryland program. Local revenues and expenditures increase to the extent a county receives an infrastructure grant under the program. **This bill imposes a mandate on a unit of local government**.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: The Maryland Economic Development Program is established to (1) encourage businesses to locate and expand in the State and (2) provide the rural counties of the State with a source of funding for the expansion of infrastructure necessary to encourage businesses to locate and expand in those counties.

Location and Expansion of Businesses in the State

DOC may certify a business as a qualified business if the business (1) applies to DOC; (2) meets any additional requirements established by DOC; and (3) provides evidence of an intention to expand a business in an industrial or business park in the State that was built with State or federal money *and* to hire at least 20 additional employees. A business may not be designated as a qualified business if the activities of the business are primarily retail.

For each of the 10 taxable years after a business is designated as a qualified business under the bill, the qualified business is entitled to the following tax incentives:

- the property tax exemption under § 7-245 of the Tax-Property Article;
- the income tax subtraction modification under §§ 23 10-207(cc) (corporate income) or 10-307(g)(5) (personal income) of the Tax-General Article; and
- the sales and use tax exemption under § 11-232 of the Tax-General Article.

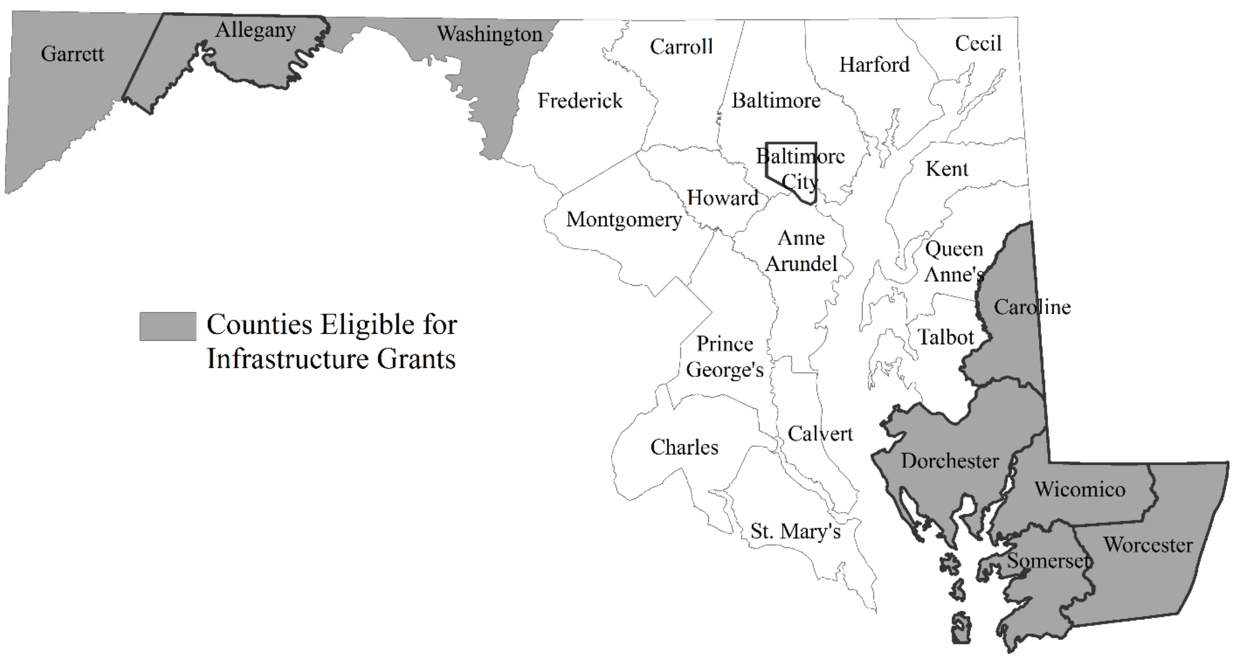
DOC may not designate a business as a qualified business under the bill after September 30, 2026. DOC must adopt regulations to implement these provisions of the bill.

Infrastructure Funding

The Rural Economic Development Program Infrastructure Fund is established as a special, nonlapsing fund to provide 8 rural counties of the State, as shown in **Exhibit 1**, with a source of funding for the expansion of infrastructure necessary to encourage businesses to locate and expand in those counties. The fund consists of (1) money appropriated in the State budget to the fund; (2) investment earnings of the fund; and (3) any other money from any other source accepted for the benefit of the fund.

For fiscal 2018 through 2022, the Governor must include in the annual operating or capital budget an appropriation to the fund of at least $5.0 million. Expenditures from the fund may be made only in accordance with the State budget.

Exhibit 1
Counties Eligible for Infrastructure Grants



Note: Bold outlines indicate eligibility for the One Maryland Tax Credit Program as a qualified distressed county.

Source: Department of Legislative Services

The fund may be used only for grants to eligible counties for the purchase of land or the construction of public buildings, water and sewer projects, or roads. Money expended from the fund for grants to counties is supplemental to and is not intended to take the place of funding that otherwise would be appropriated for infrastructure projects within a county. If a county sells an asset that benefits from a grant, the county must reimburse the fund in the amount of the grant received.

Tax Incentives for Qualified Businesses

A qualified business in the State is eligible for a subtraction modification for the personal income tax or CIT. In addition, property is not subject to property tax if the property is owned by a qualified business. Both the subtraction modification and the property tax exemption can be taken for up to the 10 taxable years following the designation of a business as a qualified business. Finally, the sales and use tax does not apply to a sale of building materials or capital equipment used as part of the certain activities of a qualified business.

One Maryland Program Eligibility Change

The definition of "qualified distressed county" for purposes of the One Maryland Tax Credit Program is altered to permanently remove eligibility for jurisdictions that become ineligible for any period of time. However, the definition change may not be construed to prohibit Baltimore City or Allegany, Caroline, Dorchester, Somerset, Washington, or Worcester counties from participating in the program until the jurisdiction fails to meet the definition of a qualified distressed county under current law. Exhibit 1 also shows the counties that currently qualify as One Maryland counties. The bill further specifies the intent of the General Assembly that the cost savings from this change offset the additional cost of the program enacted by the bill.

Current Law:

Qualified Distressed County

A project must be in a qualified distressed county and in a priority funding area to qualify for the One Maryland program. To qualify as a distressed county, a county must have:

- an average unemployment rate that exceeded the State's average during the preceding 24-month period by either 2 percentage points or 150%; or
- a per capita personal income that may not exceed 67% of the State's average during the preceding 24-month period.

A distressed county also includes any county that no longer meets the unemployment and personal income criteria but has met at least 1 of the criteria at some point in the preceding 24-month period. Counties can enter and exit the program based on these criteria.

Baltimore City and Allegany, Caroline, Dorchester, Somerset, Wicomico, and Worcester counties are currently considered qualified distressed counties. Caroline and Worcester counties are within the 24-month grace period of eligibility, which expires for both counties in 2016.

Background:

Economic Development Tax Incentives

Numerous federal, State, and local programs with a similar focus and objective to the program established under the bill are currently in place. Incentives that aim to increase employment or economic development within distressed areas or similar areas include the One Maryland economic development tax credit, enterprise zone tax credit, job creation tax credit, Base Realignment and Closure Revitalization and Incentive Zone Program, Brownfields tax credit, community investment tax credit, and sustainable communities tax credit.

One Maryland Economic Development Tax Credit

In response to concerns about the impacts of tax credits, Chapters 568 and 569 of 2012 established the Tax Credit Evaluation Act, a legislative process for evaluating certain tax credits. The evaluation process is conducted by a legislative evaluation committee. The committee was required to review and evaluate the One Maryland economic development tax credit by July 1, 2014. The final report on the credit was completed in August 2014 and can be found on the Department of Legislative Services' website.

Chapter 303 of 1999 established the One Maryland economic development tax credit, designed to assist in paying for both project expansion and start-up costs for certain businesses that add at least 25 qualified employees in distressed counties. The One Maryland tax credit is a high-value, low-utilization credit compared to other business tax credits. As of August 2014, DOC had certified a total of $197.4 million in One Maryland tax credits; however, only about one-third of this amount had been claimed at that time, thereby creating a large pipeline of unclaimed credits. Companies generally have 15 years to claim the entire amount of the credit; therefore, those projects will continue to decrease State revenues by up to $136 million through tax year 2025 (fiscal 2026). This revenue loss is before any revenue losses that will result from new projects going forward from that date.

State Aid for Transportation Infrastructure

In fiscal 2016, local governments are estimated to receive $169.3 million in State aid through highway user revenues and $25.0 million for special transportation grants. Local governments also are estimated to receive $7.2 million for special transit grants. State aid to local governments for transportation purposes increased by 37.4% between fiscal 2011 and 2016.

Business and Industrial Parks

DOC advises that the following business and industrial parks have been financed with State funds from the department's financing programs:

- Patuxent Business Park;
- Keyser's Ridge Business Park;
- Ridgely Technology Park;
- Denton Industrial Park;
- Federalsburg Industrial Park;
- Dorchester Tech Park;
- Barton Business Park;
- Westminster Tech Park;
- Warfield Commerce Center;
- East Baltimore Development Foundation for the Hopkins BioPark;
- University of Maryland Baltimore County Research Park;
- University of Maryland BioPark (Baltimore); and
- M Square Research Park at the University of Maryland (College Park).

The parks include vacant property owned by the county or the Maryland Economic Development Corporation. DOC advises that this list does not include buildings built with State funds within existing business and industrial parks and does not represent the entire universe of business and industrial parks that could qualify under this bill.

State Fiscal Effect: General and special fund revenues decrease *significantly* beginning in fiscal 2017 from tax incentives taken by qualified businesses, the majority of which is anticipated to be from the general fund, and a relatively limited portion of which may be offset by the change to the One Maryland program as discussed below. GO bond or general fund PAYGO expenditures increase by at least $5.0 million annually from fiscal 2018 through 2022. Special fund revenues and expenditures for DOC increase correspondingly to issue grants to eligible counties. General fund expenditures Comptroller administrative expenses increase by $208,489 beginning in fiscal 2017.

Location and Expansion of Businesses in the State and Infrastructure Funding

Demand for the program cannot be reliably estimated at this time. Even so, general fund revenues, Transportation Trust Fund (TTF) revenues, and Higher Education Investment Fund (HEIF) revenues decrease *significantly* beginning in fiscal 2017 from subtraction modifications and sales tax exemptions taken under the bill by qualified businesses. Special fund revenues for the Annuity Bond Fund decrease beginning in fiscal 2018 from real property tax exemptions taken under the bill by qualified businesses. The annual cost and the allocation of the revenue decreases cannot be reliably estimated at this time; however, given the revenue structure of the possible taxes to which the credit may apply, the majority of the revenue decrease is anticipated to be from the general fund.

GO bond or general fund PAYGO expenditures increase by at least $5.0 million annually from fiscal 2018 through 2022 from the mandated appropriation to the Rural Economic Development Program Infrastructure Fund. Special fund revenues and expenditures for DOC increase correspondingly as DOC issues grants under the program.

DOC advises that it can administer the fund using existing staff. It is assumed that general fund expenditures for the Comptroller increase by $208,489 in fiscal 2017, which accounts for the bill's October 1, 2016 effective date. This estimate reflects the cost of hiring three tax specialists to audit and review tax incentives taken by qualified businesses under the program established by the bill. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	3.0
Salaries and Fringe Benefits	$194,045
Other Operating Expenses	14,444
Total FY 2017 Comptroller Expenditures	**$208,489**

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

One Maryland Program Eligibility Change

Based on the historical tendency of counties to lose and regain their status as qualified distressed counties under the One Maryland program and that, therefore, one or more counties will eventually be permanently removed from the One Maryland program under the bill, general fund revenues increase, TTF revenues increase, and HEIF revenues increase, potentially as early as fiscal 2017, due to the change to the One Maryland program. The amount, however, cannot be reliably estimated. Two counties are currently in the two-year grace period of the program under current law – Wicomico (through April 2016) and Caroline (through November 2016).

Local Fiscal Effect: Local income tax revenues decrease by about 3% of the total net State subtraction modification claimed beginning in fiscal 2017. Local real and personal property tax revenues decrease beginning in fiscal 2018 from real and personal property tax exemptions taken by qualified businesses. Local highway user revenues potentially decrease beginning in fiscal 2017 from reduced CIT revenue, which may be partially offset by increased CIT revenue due to the change to the One Maryland program. Local revenues and expenditures increase to the extent a county receives an infrastructure grant under the program.

Small Business Effect: The bill provides qualified businesses with tax benefits for 10 years. The certification process requires a business to provide evidence of an intention to expand in an eligible business or industrial park in the State and to hire at least 20 additional employees. Conceivably, a small business could expand into the State, hire 20 additional employees, and still remain a small business. These small businesses would benefit from the tax incentives provided under the bill. It is unlikely, however, that all qualified businesses will be small businesses.

Additional Information

Prior Introductions: SB 196 of 2015, a similar bill, received a hearing in the Senate Budget Taxation Committee, but no further action was taken. Its cross file, HB 1089, received a hearing in the House Economic Matters Committee, but no further action was taken.

Cross File: None.

Information Source(s): Department of Commerce, Department of Budget and Management, State Department of Assessments and Taxation, Maryland Association of Counties, Department of Legislative Services

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min/rhh

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